CHALLENGES FOR RESPONSIBLE INVESTMENT IN THE RETIREMENT BENEFITS SECTOR OF KENYA

BY

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Abstract

Responsible investment (RI) is the investment strategy that incorporates environmental, social and governance (ESG) factors into the investment decision-making process (Hebb, Hawley, Hoepner, Neher, & Wood, 2015). RI has shifted from what was considered a niche market to become one of the fastest-growing areas of finance in many parts of the world (PRI, 2019b). However, a closer look at the development of RI and adoption rates in countries and regions reveals that RI is not commonly practised in sub-Sahara Africa (except for South Africa). This study explores the critical challenges for RI development in the retirement benefits sector of Kenya and, by engaging with a variety of key stakeholders, proposes how to overcome the identified challenges. It contributes to the literature on challenges for RI in a developing country by offering an in-depth case study of the retirement benefits sector.

My study employs qualitative methods to collect and analyse data collected from semi-structured interviews with 22 participants (asset managers, regulators and capital market experts, and a council member of the Association of Retirement Benefits Schemes of Kenya) as well as a collection of published documents by government agencies in Kenya. Also, I analysed 10 annual reports to assess the kind of ESG information that is disclosed by listed companies. My study explores, in particular, how actors in the retirement benefits sector conceptualise RI. It identifies the leading ESG factors in Kenya and draws on the business-case approach to RI to explore whether the participants consider those factors as material risk factors that present both risks and opportunities to the investment decision-making process. Further, my study identifies the specific barriers for RI development and proposes how to overcome them.

The findings show that participants define RI using several terminologies. This is consistent with the existing literature. My study finds that all participants consider corporate governance as a material risk factor that can impact the financial returns of a portfolio. However, most of the asset managers do not think that the environmental and social factors can present material risk factors to their investment decision-making process. Although over a third of the asset managers recognise that the environmental and social issues in Kenya present business opportunities to retirement benefits schemes, there is a shortage of well-structured assets in those areas. Further, this study identifies five specific barriers for RI development: diversification challenges; a lack of ESG data; a lack of demand/incentives; short-termism; and the demand for high financial returns and a lack of awareness and expert knowledge of RI

practices. My study recommends that the National Treasury of Kenya develops RI policy for the entire finance sector. In addition, the findings support a recommendation for the Capital Markets Authority and the Retirement Benefits Authority to embark on capacity building programmes to educate the actors in the finance sector on RI strategies and to create awareness of the impact of ESG on financial returns in the long run.

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Abbreviations

ARBS	Association of Retirement Benefits Schemes
CEO	Chief Executive Officer
CMA	Capital Markets Authority
EIRIS	Ethical Investment Research and Information Service
ESG	environmental, social and governance
EU	European Union
FTSE	Financial Times Stock Exchange
GDP	gross domestic product
GRI	Global Reporting Initiative
GSIA	Global Sustainable Investment Alliance
HDI	Human Development Index
KSh	Kenya Shillings
MSCI	Morgan Stanley Capital International
NGO	non-governmental organisation
OECD	Organisation for Economic Co-operation and Development
PLC	Public Limited Company
PRI	Principles for Responsible Investment
RBA	Retirement Benefits Authority
REITs	Real Estate Investment Trusts
RI	responsible investment
SIF	Sustainable Investment Forum
SRI	socially responsible investment
UN	United Nations
USA	United States of America
USAID	United States Agency for International Development

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Chapter 1. Introduction

Responsible investment (RI) is the investment strategy that incorporates environmental, social and governance (ESG) factors into the investment decision-making process (Hebb et al., 2015). RI began in the eighteenth century as a small movement of faith-based investors, but gained momentum in the mid-2000s to become one of the fastest-growing areas of finance in many parts of the world (Arjaliès, 2010; Derwall, Koedijk, & Ter Horst, 2011; Falcone, Morone, & Sica, 2018; Nilsson, Jansson, Isberg, & Nordvall, 2014; Nofsinger & Varma, 2014; Revelli, 2017; Sandberg & Nilsson, 2011; Sullivan & Mackenzie, 2006; Zarbafi, 2011).

The launch of the United Nations-supported Principles for Responsible Investment (PRI) initiative in 2005 (discussed in Chapter 3) has especially popularised the integration of ESG issues among institutional investors who are the dominant actors in the RI market (Gifford, 2010; Hebb et al., 2015; PRI, 2019b; Revelli, 2017; Sievänen, Rita, & Scholtens, 2013). By the end of 2019, the Principles had about 2,300 signatories, representing over USD 80 trillion worth of assets under management (PRI, 2019b). However, a closer look at the development of RI and adoption rates in countries and regions reveals that RI is not commonly practised in sub-Sahara Africa (except for South Africa). Most of the signatories are in Europe, USA, Australia, and New Zealand, while Africa and Latin America have fewer signatories (PRI, 2019a).

This study explores the critical challenges for RI development in the retirement benefits sector of Kenya and, by engaging a variety of key stakeholders, proposes how to overcome the identified challenges. I approach this study from the business case theory which contends that material ESG factors can add firm value and reduce risk (Hebb, 2011; Hebb et al., 2015). Proponents of the business case theory argue that material ESG issues are a source of information asymmetry in the financial markets (Hebb, 2011; Hebb et al., 2015; Richardson & Cragg, 2010). Hence, integrating material ESG issues in investment decision-making is understood to reflect comprehensive market information, leading to enhanced risk mitigation (Hebb et al., 2015; PRI, 2019b). Accordingly, I frame the ESG issues in Kenya as factors that can add firm value and reduce risk.

I use a case study approach to explore the critical challenges for RI development in the retirement benefits sector of Kenya. The case study strategy is appropriate for this study because it allows the research questions to be adequately answered. I adopt a qualitative approach in a constructivist and interpretive sense to collect and analyse data. Documents and semi-structured interviews are the main data sources and I triangulate across data sources to increase the validity and reliability of the research findings.

I begin by reviewing extant literature to gain a deeper understanding of RI and the common drivers and deterrents of the RI market in various parts of the world. The review of literature is also a way of theorising the research engagement to formulate the research questions. To understand the ESG context of Kenya, I review key websites of government agencies in Kenya, including Kenya Vision 2030 (the country's economic development blueprint) and the Kenya National Bureau of Statistics, as well as other relevant research documents that highlight ESG issues in Kenya. I also review legislative documents from the Government of Kenya, particularly the provisions of the Retirement Benefits Act (1997), the principal legislation governing the retirement benefits schemes in Kenya. For institutional investors to implement RI, they require ESG data to be disclosed by the issuers of securities for them to incorporate it in their analysis. To understand the ESG disclosure requirements, I review the ESG disclosure guidelines by the Companies Act (2015) and the *Code of Corporate Governance Practices for Issuers of Securities to the Public* (the Code) developed by the Capital Markets Authority (CMA) of Kenya (CMA, 2015a). Further, I analyse annual reports of 10 randomly selected listed companies to assess how companies comply with the requirements of the *Companies Act 2015* (KNY) and the Code.

Additionally, I explore the specific barriers for RI development from the industry actors' perspective. To do this, I conducted 22 semi-structured interviews with a variety of stakeholders, including asset managers, regulators, a capital market development specialist, an academic and a council member of the Association of Retirement Benefits Schemes (ARBS). I use an inductive analysis method to make sense of the data obtained from the interviews and draw on business case perspective to interpret the themes. The use of inductive analysis means that the notable patterns and themes of my participants' understanding of RI and their views on the critical challenges for RI emerge from the data without assuming in advance what the patterns and themes would be (Falcone et al., 2018; Guest, MacQueen, & Namey, 2012; Morse & Field, 1995; Patton, 2002).

1.1 Research motivation

My primary motivation for undertaking this study is to explore how RI, an investment strategy primarily practised in developed countries, can be implemented in a developing country like Kenya. While RI is not a new phenomenon, it has been marked by heterogeneity in terms of definition, strategy, terminology, and in the way that it is practised (discussed further in Chapter 3). However, the PRI popularised the current definition of RI which frames ESG issues from a risk and return perspective, placing a strong emphasis on the impact of material ESG issues on the financial performance of an investment. This strong financial orientation has made ESG integration convincing even for those institutional investors who had concerns about firm performance and breaching of fiduciary duty to maximise returns, i.e. they have been sold on the "business case" of RI (Giamporcaro & Pretorius, 2012; Hebb, 2011). While much attention has been paid in the RI literature to its implementation in developed country contexts, little research has been undertaken in the developing country contexts. Accordingly, responding to this gap in the literature, I wish to explore whether and how RI practices can be applied in Kenya – focusing on the retirement benefits sector as a case site. I focus on this sector because the shift towards RI can only occur if it is meaningful institutional investors such as retirement benefit schemes because of their large size and ability to influence corporations (Robert, Michael, & Adam, 2010).

My personal motivation for undertaking this study is that, as a Kenyan, I recognise the challenges presented by the prevailing ESG factors in Kenya and wish to explore the role that RI strategies can play in addressing the ESG issues in Kenya. Kenya has many ESG issues including high income inequality, a lack of employment, high rate of poverty, a lack of access to water, and a lack of access to adequate health care, pollution of air, water and soil, a culture of corruption which affects both public and private institutions and inadequate corporate governance. Since RI strategies are based on the idea that investment decisions can help facilitate the transformation of societies by redirecting capital to where it is needed the most (Eurosif, 2016), I wish to understand the role that RI strategies can play in addressing the ESG issues in Kenya. I regard my thesis as a contribution to my country. While ESG issues in developing countries are not homogeneous, the findings from this study may inform RI development efforts in countries that are similar to Kenya.

Moreover, the growth of RI has been accompanied by considerable academic interest (Ammann, Oesch, & Schmid, 2011; Capelle-Blancard & Monjon, 2012; Haigh & Hazelton, 2004; Hoepner & McMillan, 2009; Jeucken, 2010; Scholtens, 2006, 2010; Sjöström, 2008). Most of the studies in this area are conducted in developed countries, led by the USA and

Europe (Reverte, 2009). Many of the studies investigate whether the decision to invest or avoid a certain company significantly affects the share price of that company and thus generates a higher or a lower shareholder return (Zarbafi, 2011). This strand of studies assumes that the share price reflects the comprehensive information of the financial markets and that the company is driven by shareholder value maximisation. For example, event studies explore the effect of ESG-related announcements, such as the inclusion or exclusion of specific companies from the Dow Jones Sustainability Index or the enactment of corporate governance guidelines on a company’s share price (Curran & Moran, 2007; Picou & Rubach, 2006).

Another strand of studies elaborates on the relationship between a company’s social performance and its financial performance (Auer & Schuhmacher, 2016; Marc, Frank, & Sara, 2003; Margolis, Elfenbein, & Walsh, 2009; Ortas, Moneva, & Salvador, 2012; Renneboog, Ter Horst, & Zhang, 2008; Richardson & Cragg, 2010; Schröder, 2007). Other studies (Bauer, Derwall, & Otten, 2007; Bauer, Koedijk, & Otten, 2005; Bauer, Otten, & Rad, 2006; Bello, 2005; Kreander, Gray, Power, & Sinclair, 2005; Mill, 2006; Scholtens, 2005; Statman & Glushkov, 2009) compare the economic performance of social funds and conventional mutual funds resulting in varying conclusions. Findings from these studies vary significantly and cannot be generalised because of the heterogeneity of selected research methods and the short periods of investigation. Moreover, Zarbafi (2011) points out that most of the studies evaluate different strands of ESG factors, rendering it difficult to compare or draw conclusive remarks. On account of this, results are conflicting and to some extent inconclusive (Nielsen, 2014).

Furthermore, existing literature almost exclusively focuses on the financial consequences of accounting for ESG and research on the drivers or challenges for RI are limited (Sievänen et al., 2013). There is little, if any, research on actual or potential challenges to RI development in a developing country like Kenya. This research will bridge this gap, contributing to the literature on the critical challenges for RI development in a developing country setting.

Studies show that RI practices differ from one market to another, and even within the same market (Arjaliès, 2010; Bengtsson, 2008; Sakuma & Louche, 2008; Sandberg, Juravle, Hedesström, & Hamilton, 2009). One explanation for the variation is that ESG disclosure tends to vary across companies and countries (Ioannou & Serafeim, 2011; Reverte, 2009; van Duuren, Plantinga, & Scholtens, 2016). The inconsistency in the ESG information disclosure is partly because, unlike reporting of financial information, which is standardised, directors of companies are permitted to exercise their discretion on disclosure of non-financial information.

This discretion enables directors to decide how much to disclose (or not), which leads to inconsistency in the ESG information reported (Elzahar, Hussainey, Mazzi, & Tsalavoutas, 2015). Also, CEO power and other country-specific factors, such as politics and cultural practices, affect ESG disclosure practices (Baldini, Maso, Liberatore, Mazzi, & Terzani, 2018; Song & Thakor, 2006). Because of these differences in RI practices, RI should be understood from a country-specific context (Li, Gong, Zhang, & Koh, 2017). In response to this call, I use an in-depth case study approach to explore and learn more about the critical challenges for RI development in the context of Kenya.

1.2 Research questions

The central question addressed by this study is: what are the critical challenges for RI development in the retirement benefits sector of Kenya? To address this research question, I break it into the following four sub-questions:

1) How do the actors in the retirement benefits sector of Kenya conceptualise RI?
2) What are the main ESG issues in Kenya and do they present material risks or opportunities to the investment decision-making process?
3) What are the specific barriers for RI development in the Kenyan retirement benefits sector?
4) What role can a well-developed RI policy framework play in addressing the identified ESG issues in Kenya?

1.3 Thesis outline

The rest of this thesis is organised as follows. Chapter 2 presents an overview of the five major RI regions/countries in the world. These are Europe, USA, Canada, Australia/New Zealand, and Japan. For this study, I present the regions of Europe and Australia/New Zealand as single RI markets, while Japan, USA and Canada are presented as single countries. I also provide a snapshot of RI activities in selected Latin American countries and South Africa. Finally, I introduce Kenya and highlight the socio-political, economic, environmental and governance context of the country. I conclude the chapter by examining some of the national development policies that seek to address ESG issues in Kenya.

Chapter 3 reviews existing literature on RI development, briefly outlining its journey from religious roots to a more secularly informed movement that is regarded by many as a mainstream investment approach. I discuss the theoretical underpinning of RI and explain how my study benefits from the business case approach to RI for data collection and analysis. In addition, I review the rationale for common RI strategies, and conclude with a discussion of the major drivers and barriers to RI development.

Chapter 4 justifies the use of the qualitative methodology and methods to explore the challenges for RI development in the retirement benefits sector of Kenya. I outline the research process in detail, explaining the research methods used to collect and analyse data. I also introduce the selected case study, which is the retirement benefits sector of Kenya, and discuss the types of retirement benefits schemes, the registration procedures of the schemes and the key actors in the sector.

Chapters 5 and 6 present the results of my findings from the interviews and Chapter 7 presents the results of my analyses of annual reports of 10 companies that are listed on the Nairobi Securities Exchange.

Chapter 8 discusses the findings in relation to the literature and theories discussed in Chapter 3. Finally, Chapter 9 concludes the study, presenting the contributions and limitations of my study. It also provides suggestions for future research.

Chapter 2. The global RI markets

In this chapter, I provide an overview of the RI market in Europe, USA, Canada, Australia/New Zealand, and Japan. These are recognised as the five leading RI regions in terms of weighted RI assets (Global Sustainable Investment Alliance, 2018). These regions have identifiable RI markets that are supported by associations and forums that promote RI strategies in their respective regions. The associations and forums also conduct market studies that show the trends of RI growth in each region.

To provide a general view of RI growth in the rest of the world, I highlight RI activities in four Latin American countries. These are Brazil, Colombia, Chile, and Mexico. Closer to Kenya, I provide a more comprehensive review of RI market in South Africa. South Africa stands out because it is the country that has the largest RI market in Africa and the one that has the longest track record of RI among developing economies.

The last part of this chapter introduces Kenya, the field site of my research. I provide a short political history of Kenya and present an overview of the economy of Kenya. Further I discuss the main ESG issues in Kenya and conclude the chapter by examining the key national development policies and initiatives that address ESG issues in Kenya.

2.1 Overview

Some responsible investors consider ESG factors but they are not signatories to the PRI (Hebb et al., 2015). Many investors establish national and regional voluntary associations where they deliberate their strategies to advance RI practices in their countries and the neighbouring regions. These associations also research RI strategies and run certification programmes that provide investors with standardised and consistent information enabling them to compare and contrast the investment options that have been verified and certified as responsible.

Some associations are known as sustainable investment forums (SIFs). For example, the associations in the UK and USA are known as the UKSIF and the US SIF, respectively. Others are simply known as the Responsible Investment Association, for example, that of Canada. Moreover, some countries form regional associations. For example, Eurosif is a regional association of European member SIFs (Eurosif, 2018), and Australia and New Zealand are served by the Responsible Investment Association Australasia (Responsible Investment Association Australasia, 2019). AfricaSIF was established in 2010, but the website shows little activity since 2013 (AfricaSIF, 2019), while LatinSIF merged with the PRI in 2018 (PRI, 2018).

The Global Sustainable Investment Alliance is an international collaboration of membership-based SIFs and associations (Global Sustainable Investment Alliance, 2018). It collates results from the market studies of regional SIFs and associations to provide biennial reviews of the global RI market. The trend report of 2018 shows that there are five major RI markets in the world. These are Europe, USA, Japan, Canada and Australia/New Zealand (Global Sustainable Investment Alliance, 2018). As shown in Table 1, the total RI assets of the five regions amounted to USD 30.7 trillion in 2018, up from USD 18.2 trillion in 2014. The assets increased by 34 per cent from 2016 to 2018.

Table 1. A snapshot of the RI market in the five major markets, 2014–2018

Region	**2014** **USD billion**	**2016** **USD billion**	**2018** **USD billion**
Europe	$ 10,775	$ 12,040	$ 14,075
USA	$ 6,572	$ 8,723	$ 11,995
Canada	$ 729	$ 1,086	$ 1,699
Japan	$ 7	$ 474	$ 2,180
Australia/New Zealand	$ 148	$ 516	$ 734
Total	**$ 18,231**	**$ 22,839**	**$ 30,683**

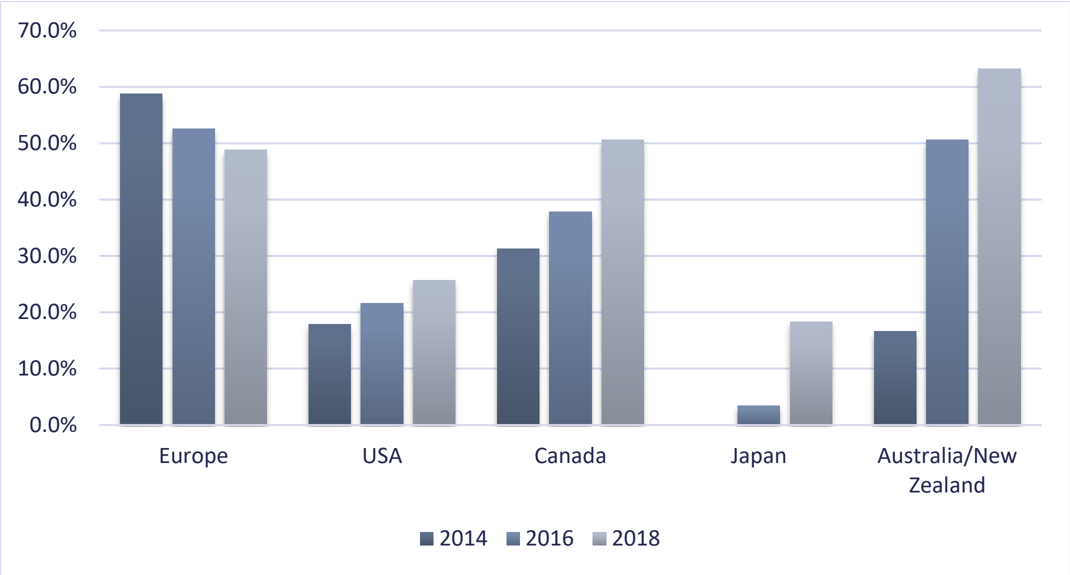
Source: Global Sustainable Investment Alliance (2016, 2018).

The table shows Europe consistently accounting for the largest portion of RI assets in the five regions in the four years. Japan has the largest growth of more than 400 per cent, while the USA assets grew at a slightly higher margin between 2016 and 2018 in comparison to the previous period. RI assets in Canada, Europe and Australia/New Zealand increased between 2016 and 2018, but at a slower pace than between 2014 and 2016 (Global Sustainable Investment Alliance, 2018).

Professionally managed assets are usually classified as either retail or institutional assets. The difference between the two classes of assets is that retail assets are personal assets of individual investors, while institutional assets belong to institutional asset owners such as pension schemes, foundations and insurers (Global Sustainable Investment Alliance, 2018). The RI market in the five regions is made up of both institutional and retail investors, with institutional investors accounting for 75 per cent in 2018 (Global Sustainable Investment Alliance, 2018).

Overall, the proportion of RI assets relative to the total managed assets shows growth in most of the surveyed regions, apart from Europe where the proportion seems to be declining steadily from 2014 to 2018 (Global Sustainable Investment Alliance, 2018). Figure 1 shows the percentage of RI assets in each region in comparison to the total managed assets, as at the beginning of 2018.

Figure 1. The proportion of RI assets relative to total managed assets in the five major markets, 2014–2018



Source: Global Sustainable Investment Alliance (2018).

As shown in Figure 1, RI assets make up over half of the total professionally managed assets in Canada and Australia/New Zealand. Although there is no data for Japan for 2014, the proportion of RI assets in Japan increased significantly from 3.4 per cent to 18.3 per cent in two years. Meanwhile, RI assets in the USA can be said to be growing steadily, but at a modest rate.

RI assets extend across a wide range of asset classes, such as public equities, debt instruments, private equity, venture capital and real estate property. More than half of RI assets in the USA, Europe, Canada and Japan were allocated to public equities in 2018 (Global Sustainable Investment Alliance, 2018). Fixed income, such as debt instruments, is the second-largest class of RI assets at 36 per cent. The rest is shared between real estate property, private equity and venture capital (Global Sustainable Investment Alliance, 2018).

Since the factors that motivate investors to engage with RI vary from country to country, the following sections provide snapshots of RI in each of the five regions, showing the major region-specific factors that drive RI.

2.1.1 Europe

Europe adopted a narrower definition of ESG integration in 2016 (Eurosif, 2016). Further, the European Commission realised that the lack of standard definitions and clear criteria for defining the RI process led to a situation where many assets in Europe were incorrectly branded as green. Thus, the European Commission tightened the definition of green assets in 2018 to avoid "greenwashing" and over-reporting of assets as RI (Eurosif, 2018). Greenwashing is the act of conveying misleading information that a company's practices or products are environmentally friendly when they are not (Magali & Vanessa Cuerel, 2011). Concerns about greenwashing are the top deterrent for investors interested in RI in Europe (Eurosif, 2018). As a result of the redefinition, some asset managers, especially in Germany and France, reported fewer assets as RI (Global Sustainable Investment Alliance, 2018).

Climate change and tobacco are the leading issues of concern for many European investors. Climate change seems to be driving legislation and increased interest in green bonds in the European Union (EU) member states (Eurosif, 2018). For example, in 2018, the European Commission published the Action Plan for Sustainable Finance, proposing changes in legislation to facilitate and incentivise green and climate-friendly investments (Eurosif, 2018). First, the Action Plan proposed a draft regulation to agree on an EU-wide definition for what is green and what is not. The regulation is also known as the "green finance taxonomy" and is supposed to provide clarity to those who want to invest in climate-friendly financial products and address the problem of greenwashing. Second, the Action Plan proposed improvement in the disclosure of how institutional investors integrate climate change in their investment decisions. The third and final proposal of the Action Plan was for investors to be given reliable tools to measure a financial product's carbon footprint (Eurosif, 2018).

The European Parliament adopted the proposals contained in the Action Plan and they are to be applied to all EU member countries as a single market (Eurosif, 2018). Henceforth, asset managers should use a common reporting standard to disclose how they integrate ESG factors (Eurosif, 2018; Global Sustainable Investment Alliance, 2018). However, it is unclear if the

UK will adopt the proposals contained in the Action Plan, since it has left the EU. In the meantime, the UK Treasury set up a domestic task force, the Green Finance Taskforce, that is supposed to mobilise investment in clean and sustainable growth in the UK (Eurosif, 2018).

Europe is the largest issuer of green bonds in the world (Eurosif, 2018). European issuers of green bonds are a mix between companies, financial institutions, and sovereigns. The Nordic countries and France have issued the highest number of green bonds in Europe. The first sovereign green bond in the world was issued in Europe by the Treasury of France in 2017 (Eurosif, 2018).

Overall, the European RI market is considered as a mature RI market with the necessary infrastructure and institutions to support it (Eurosif, 2018). Although institutional investors make up the majority of the RI market in Europe, an increase in demand in the retail sector is growing (Eurosif, 2018). The key drivers of demand for RI in Europe include legislation, a clearer definition of the fiduciary duty that includes ESG integration, pressure from non-governmental organisations (NGOs) and international initiatives such as the PRI. The factors that deter RI in Europe include performance concerns, a lack of viable products, a lack of expert advice and concerns about greenwashing of products (Eurosif, 2018).

2.1.2 USA

The RI market in the USA is composed of institutional asset owners (for example, public employee retirement plans), fund managers (for example, mutual funds and exchange-traded funds), alternative investing vehicles (for example, private equity and venture capital funds, hedge funds and property funds), community investing institutions (for example, community development banks and credit unions), and other commingled funds (Global Sustainable Investment Alliance, 2018; US SIF, 2018). More than three-quarters of total RI assets are managed on behalf of institutional investors, while a quarter is managed on behalf of retail investors (US SIF, 2018).

Client demand is the biggest motivator for ESG integration in the USA (US SIF, 2018). Other reasons include the desire to fulfil the client's mission statement, to pursue social or environmental benefits, to improve returns over time, to minimise risks, and to fulfil fiduciary duties (US SIF, 2018). Climate change is the top environmental factor considered by most managers in the USA (Global Sustainable Investment Alliance, 2018). Another prominent issue of concern for USA investors is investing in areas affected by conflict risk and abuse of human rights (Global Sustainable Investment Alliance, 2018). Conflict risk includes the risk of investing in countries affected by terrorism or where the ruling regime is repressive. Concern over conflict risk has led institutional investors to develop policies to address investing in conflict-affected regions (US SIF, 2018). The top governance issues for clients and managers are transparency and anti-corruption (US SIF, 2018). Board diversity, executive pay, disclosure of corporate political spending and lobbying are also important governance issues for the RI market (Global Sustainable Investment Alliance, 2018). In terms of product-specific restrictions, tobacco-related products and investments in weapons are the main products that are excluded by investors (US SIF, 2018).

2.1.3 Canada

Although institutional investors are by far the majority in the Canadian RI market, there is an increasing number of individual investors choosing to consider ESG integration (Responsible Investment Association Canada, 2019). The three top motivations for investment managers and asset owners to engage with RI are to minimise risk over time, to improve returns over time and to fulfil fiduciary duties (Responsible Investment Association Canada, 2019). A sense of responsibility to clients and generational transfer of wealth are also important drivers of RI in Canada. Research shows that millennial investors are more likely to demand ESG integration than the previous generation (Responsible Investment Association Canada, 2016).

Other drivers for RI growth in Canada include a steady growth of pension assets that are integrating RI, heightened awareness of the significance of ESG risks and opportunities, and increased engagement by investment managers with investee companies. Like in the other markets, climate change is the top environmental issue that institutional investors consider when making investment decisions. Corporate governance, specifically executive compensation, and gender diversity are also prominent RI issues in Canada (Responsible Investment Association Canada, 2019).

2.1.4 Australia and New Zealand

As demonstrated in Figure 1, RI assets now represent over 63 per cent of all professionally managed assets in Australia and New Zealand. While concern over the impact of ESG issues on financial performance is the key driver of RI growth in Australia, alignment to the mission statement is the key driver in New Zealand (Global Sustainable Investment Alliance, 2018).

Like the other regions, climate change is the key environmental issue in Australia and New Zealand. The top four ESG products that are frequently screened out by most funds are weapons, tobacco, gambling and alcohol (Responsible Investment Association Australasia, 2019). Modern slavery stands out as an important issue for investors in Australia and New Zealand. In 2019, the Australian Council of Superannuation Investors in conjunction with the Responsible Investment Association Australasia issued the modern slavery reporting guide for investors (Responsible Investment Association Australasia, 2019).

Stock exchanges in both Australia and New Zealand have revised their corporate governance guidelines for issuers to require the disclosure of material ESG factors. New Zealand's revised Corporate Governance Code is designed around eight principles that cover code of ethics, board composition and performance, board committees, reporting and disclosure, remuneration, risk management, auditors, and shareholder rights and relations (New Zealand Exchange, 2019). Principle 4 of New Zealand's Corporate Governance Code recommends that issuers provide non-financial disclosure annually, including ESG and economic sustainability factors and practices, detailing how operational non-financial targets are measured (New Zealand Exchange, 2019). Similarly, the revised *ASX Corporate Governance* guidelines require all listed companies to report any material exposure to ESG risks (Australian Securities Exchange, 2019). The guidelines in both countries operate on a "comply or explain" basis (discussed further in section 3.4.3.2).

Some other RI initiatives in Australia and New Zealand include the Australian Sustainable Finance Initiative, a collaboration of banks, superannuation funds, insurance companies, financial sector organisations and academia (Responsible Investment Association Australasia, 2019). The objective of the Sustainable Finance Initiative is to shape the Australian economy in a way that prioritises the well-being of Australians and provides social equity and environmental protection (Responsible Investment Association Australasia, 2019).

2.1.5 Japan

The rapid growth of RI assets in Japan is mainly due to a combination of increased disclosure of RI activities by institutional investors, and significant developments that promoted RI among investors (Global Sustainable Investment Alliance, 2018). The developments include the establishment of Japan's first Stewardship Code in 2014, followed by the Corporate Governance Code in 2015 (Japan Sustainable Investment Forum, 2016). To promote corporate governance in Japan, the Tokyo Stock Exchange incorporated the Corporate Governance Code into the listing rules for issuers of securities to the public (Japan Exchange Group, 2019). Listed companies should explain non-compliance with the principles of the Corporate Governance Code (Japan Exchange Group, 2019).

Some other initiatives that have had a large influence on sustainable investment in Japan include a project to improve competitiveness and incentives for sustainable growth by building favourable relationships between companies and investors and another projects to increase the visibility of the participation of women (Japan Sustainable Investment Forum, 2016). Additionally, in 2015, the Ministry of Economy, Trade and Industry established a health and productivity stock selection programme that was supposed to recognise one exemplar listed company per industry that is engaging in health and productivity management programmes. The programme aims to promote employee health from a management perspective (Japan Sustainable Investment Forum, 2016). Furthermore, the Japanese Government Pension Investment Fund became a PRI signatory in 2015 (Global Sustainable Investment Alliance, 2016).

Climate change is again the top environmental issue of concern in Japan. The other factors of concern include companies that contribute to manufacturing or sales of weapons, tobacco, or those that violate the United Nations Global Compact (Japan Sustainable Investment Forum, 2019).

As previously stated, the above five regions are leaders in the RI market. Climate change is the one issue that is common between all five countries. Tobacco and weapons also feature as an issue in several countries. The following section presents highlights of the RI market in four Latin American countries: Brazil, Colombia, Chile, and Mexico.

2.2 Latin America

The stock exchanges in Colombia, Brazil, Chile and Mexico are members of the Sustainable Stock Exchanges Initiative, which encourages member exchanges to create financial products that promote ESG issues (Vigeo Eiris & GovernArt, 2017).

Brazil has the highest number of PRI signatories in the Latin America region (PRI, 2019a). Also, Brazilian regulators proactively challenge pension funds to make ESG integration central to their decision-making process (Vigeo Eiris & GovernArt, 2017). For example, the Brazilian National Monetary Council requires pension funds to employ social and environmental criteria into their investment policy. In addition, the Brazilian Association of Capital Market Investors launched the *AMEC Stewardship Code* in 2016, intending to cultivate a stewardship culture and develop a benchmark for responsible engagement (Brazilian Association of Capital Market Investors, 2016). The Stewardship Code comprises seven principles, one of which is the incorporation of ESG factors into investment practices. Unlike many voluntary stewardship codes, the Brazilian one is mandatory, and the seven principles should be implemented in their entirety. The ultimate objective of the Stewardship Code is to provide a framework for institutional investors to create internal policies of RI, rather than providing a set of rules. For that reason, investors ought to prioritise the substance of the Stewardship Code over its form (Brazilian Association of Capital Market Investors, 2016).

The Brazil Stock Exchange has several exchange-traded funds that emphasise sustainability. The Exchange has launched a series of sustainability indices, such as the Special Corporate Governance Stock Index, the Corporate Sustainability Index, the Carbon Efficient Index, the Corporate Governance Trade Index, and the New Market Corporate Governance Equity Index (Vigeo Eiris & GovernArt, 2017).

In Colombia, the trade association of the financial sector launched the Green Protocol, whose primary aim is to foster sustainable development (Vigeo Eiris & GovernArt, 2017). The Green Protocol asks financial institutions to develop and design green products and services that take ESG factors into account (Vigeo Eiris & GovernArt, 2017). In this way, it has enabled the establishment of green financing opportunities for environmentally sustainable projects (Global Sustainable Investment Alliance, 2016).

In Chile, the Santiago Stock Exchange, in collaboration with the professional firm Ernst & Young, released some guidelines for responsible investment in 2017 (Vigeo Eiris & GovernArt, 2017). Some of the key objectives of the guidelines are to understand RI, to identify ESG risks and opportunities, to determine strategies and steps to invest responsibly, and to explore the potential of RI in Chile. The guidelines for responsible investment serve as a source of information regarding RI for both the public and investment professionals. Moreover, the Santiago Stock Exchange created the Dow Jones Sustainability Chile Index in 2015 (Vigeo Eiris & GovernArt, 2017).

In Mexico, the regulator of pension funds recommends that pension funds analyse and disclose whether an investee company is certified as a socially responsible company (Vigeo Eiris & GovernArt, 2017). Also, pension funds are required to disclose if their investment decision-making considers ESG issues (Hebb et al., 2015). The impetus for developing ESG strategies by the private pension funds in Mexico is mainly due to international pressure, and not necessarily because the pension fund administrators recognise ESG factors as value drivers (Global Sustainable Investment Alliance, 2016).

Interestingly, the Mexican branches of international organisations that are signatories to the PRI in their home countries have not signed the Principles in Mexico. For example, Santander HSBC has signed the Principles in Spain, but the Mexican branch is not a signatory (Hebb et al., 2015). However, many Mexican companies and NGOs have joined the United Nations Global Compact network since its launch in Mexico in 2005 (Hebb et al., 2015). Moreover, the Mexico Stock Exchange created the Sustainability Index in 2011 (Vigeo Eiris & GovernArt, 2017). Other RI institutions in Mexico include the National Banks Association, which coordinates the associated banks' social responsibility reports and actions, and mainly focusing on fostering philanthropic activities and measuring the banking sector's carbon footprint (Hebb et al., 2015).

Also, Mexico has several banks that are interested in ESG matters. For example, CiBanco Bank is a green bank that actively seeks to cultivate new sustainability banking practices (CiBanco Bank, 2019). CiBanco Bank gives preferential loans to businesses that demonstrate responsibility for the environment. The businesses that satisfy this criterion include those involved in renewable energy projects and green construction projects, and companies that are committed to reducing their carbon footprint (CiBanco Bank, 2019). For example, the bank grants better financing conditions to companies that have attained the international environmental management systems certification ISO 14000. Banorte Bank of Mexico and Banamex Bank are also interested in ESG issues. The two banks analyse the environmental and social impact of the projects they finance, assess the risk of climate change on certain investments and finance impact investments (Hebb et al., 2015). In addition, Banamex Bank actively promotes the development of renewable energy and uses renewable energy supplied by Enel Green Power to power its operations (Enel Green Power, 2019).

The above section shows the initiatives undertaken by the four Latin American countries to advance RI in the respective countries. While it is difficult to compare the initiatives that have been started by each of the four countries, it seems that Brazil and Mexico have each established more initiatives than Colombia or Chile. The following section discusses RI in South Africa, which, as previously stated, has the highest number of PRI signatories in sub-Sahara Africa (PRI, 2019b). It also has a long history of RI movement, stemming from the days of apartheid.

2.3 South Africa

South Africa is the second-largest economy in Africa with a gross domestic product (GDP) of USD 349.299 billion in 2017 (International Monetary Fund, 2017). South Africa is classified as a developing economy with an upper-middle-income level and a Human Development Index (HDI) value of 0.699 points in 2017 (World Bank, 2019). The population of South Africa was estimated to be 57.7 million people in 2018 (Statistics South Africa, 2018). The main economic sectors of South Africa are mining, transport, energy, manufacturing, tourism and agriculture (Hebb et al., 2015).

A unique aspect of South Africa's history is that it went through the repressive apartheid regime that left the country polarised along racial lines. International investors from the USA, Canada and Europe opposed to the apartheid regime protested and began a campaign to divest from South African operations in the 1970s and 1980s (De Cleene & Sonnenberg, 2004; Renneboog et al., 2008). In 1977, Rev. Leon Sullivan developed the Sullivan Principles, which were to become the Code of Conduct for USA companies operating in South Africa (Knoll, 2002). The same principles were re-launched in 1999 as the Global Sullivan Principles for Corporate Social Responsibility to encourage companies and organisations to uphold economic, social and political justice, including human rights and equal opportunities for all (Visser, Matten, Pohl, & Tolhurst, 2010). The divestment campaign ignited growth in the RI market and helped shape the discourse to include social issues such as the racial segregation and inequality that was widespread in South Africa at the time (Renneboog et al., 2008; Viviers & Els, 2017).

Another social aspect that stands out in South Africa is that it has the highest population of people living with HIV/AIDs in Africa (Avert, 2019). Estimates show that over 7.5 million South Africans were HIV-positive in 2018 (Statistics South Africa, 2018). The number of new infections was estimated to be 240,000 per year in 2018, which is a high rate of infection compared to other countries such as Kenya, which has about 42,000 yearly infections (Avert, 2019). HIV presents both direct challenges to investors, due to the higher cost of health care of employees, and indirect challenges, due to employees missing work because of poor health. Hebb et al. (2015) suggest that responsible investors can engage stakeholders, including governments, companies, and health workers, and promote dialogue on HIV/AIDS issues and initiatives.

South Africa has the largest RI market in Africa (International Finance Company, 2011). It also has the longest track record of RI among developing economies (Viviers & Els, 2017). The first RI fund in South Africa was launched in 1992 and, since then, 91 RI funds have been established, 16 of which have been discontinued over the same period (Viviers & Els, 2017). The publication of the four King reports on corporate governance in 1994, 2002, 2009 and 2016, the launch of the PRI, legislative changes, and the formulation of institutional investor guidelines such as the *Code for Responsible Investing in South Africa* (Institute of Directors in Southern Africa, 2011) have all influenced the development of the South African RI market (Viviers & Els, 2017). The first *King Report on Corporate Governance* (King I) of 1994 defined the expected standards of conduct for directors of listed companies, the banking sector and certain state-owned enterprises (Viviers & Els, 2017). King I also recommended an integrated approach to good governance that would benefit a broad range of stakeholders and defined guiding principles for addressing issues of board composition and the mandate of the boards (Viviers & Els, 2017).

The 2002 World Summit on Sustainable Development held in Johannesburg cast light on the need for sustainable business and investment practices globally. At the domestic level, the summit highlighted some specific areas that merited prioritising, such as corruption and chronic diseases like HIV/AIDS, malaria and tuberculosis (Viviers & Els, 2017). In the spirit of that summit, in 2002 the *King Report on Corporate Governance* (King II) was developed. This report included subjects such as sustainability, risk management and the structure and role of the board as part of the reporting requirements for listed companies (Viviers & Els, 2017). King II also proposed that companies be open to shareholder activism and emphasised the importance of assessing firm performance on sustainability aspects (Rademeyer & Holtzhausen, 2003). After the publication of King II, the Johannesburg Stock Exchange made it obligatory for listed companies to disclose the extent to which they complied with the report's recommendations.

In 2009, the King Code of Governance Principles and *the King Report on Governance for South Africa* (King III) were developed (Institute of Directors in Southern Africa, 2009). The King III report was introduced on the idea that the real purpose of corporate governance is that the sustainability of a company (that is, the ability of a company to continue to trade over the long term) is dependent on the sustainability of the economic, social and environmental context in which it operates (Natesan, 2020). The King III Code of Governance Principles applies to all entities (public, private, and non-profit), and the King III report recommends that all entities prepare integrated annual reports using the *Global Reporting Initiative (GRI) Standard*s on sustainability reporting (Global Reporting Initiative Standards, 2020). How these concepts find application is different for each company, and therefore the "apply or explain" regime was thought to be more appropriate (Natesan, 2020). The apply or explain regime encourages entities to adopt the principles and explain how they have been applied or were not applicable. It means that companies can decide that certain principles or practices are not appropriate for their businesses and explain why. As stated in the introduction of the King III report:

> It is the legal duty of directors to act in the best interests of the company. In following the "apply or explain" approach, the board of directors, in its collective decision-making, could conclude that to follow a recommendation would not, in the particular circumstances, be in the best interests of the company. The board could decide to apply the recommendation differently or apply another practice and still achieve the objective of the overarching corporate governance principles of fairness, accountability, responsibility, and transparency. Explaining how the principles and recommendations were applied, or if not applied, the reasons result in compliance. In reality, the ultimate compliance officer is not the company's compliance officer or a bureaucrat ensuring compliance with statutory provisions, but the stakeholders. (Institute of Directors in Southern Africa, 2009, p. 7)

To encourage institutional investors to comply with the PRI and King III Code of Governance Principles recommendations, the Institute of Directors in Southern Africa launched the *Code for Responsible Investing in South Africa* in 2011 (Institute of Directors in Southern Africa, 2011). Like the King III Code of Governance Principles, the Code for Responsible Investing in South Africa is built on the "apply or explain" basis and applies to both asset owners and their service providers, such as asset managers (Viviers & Els, 2017).

In 2016, South Africa developed the Code of Corporate Governance and the *King IV Report on Corporate Governance for South Africa* (King IV) (Institute of Directors in Southern Africa, 2016). According to Natesan (2020), the imperative to develop the King IV report was that non-profit organisations, private companies and entities in the public sector had experienced challenges in interpreting and adapting King III to their particular circumstance. The King IV report was therefore developed to make it more accessible to all types of entities across the sector. The King IV Code of Corporate Governance reduced the 75 principles contained in King III to 17 principles, one of which applies to institutional investors alone, while the rest can be applied by all organisations (Institute of Directors in Southern Africa, 2016).

The King IV Code of Corporate Governance was issued on the "apply and explain" approach, which is aimed at leading boards to look beyond compliance to the positive benefits, or outcomes, that each principle could deliver (Natesan, 2020). The governance outcomes in King IV are ethical culture, good performance, effective control and legitimacy (Institute of Directors in Southern Africa, 2016). The King IV Code of Corporate Governance assumes that entities are already applying the principles and requires an explanation as to how they achieved the application. The explanation should be in the form of a narrative account and should address the practices that have been implemented (Institute of Directors in Southern Africa, 2016). The requirement for detailed explanations encourages organisations to view corporate governance not as a tick-the-box act of compliance but as something that will yield positive outcomes if approached mindfully with due consideration of the organisation's circumstances (Institute of Directors in Southern Africa, 2016).

The Government Employees Pension Fund, the largest pension fund in South Africa, was one of the founding signatories of the PRI (Viviers & Els, 2017). The pension fund controls close to half of all the retirement savings in the country, granting it the power to potentially exert pressure on investee companies to reform their ESG policies and practices (Viviers & Els, 2017). Furthermore, Regulation 28 of the Pension Funds Act (1956) was amended in 2011 to require the trustees of local pension funds to develop an investment policy statement describing the fund's approach to trustee education, Broad-Based Black Economic Empowerment, and ESG issues (Viviers & Els, 2017). In addition, the amendment increased the proportion of investment into alternative investments such as hedge funds and private equities from 5 per cent to 15 per cent (Regulation 28 of the Pension Funds Act, 1956). The relevance of this development to the RI market is that private equity investments provide trustees with another potentially profitable avenue, besides listed securities, to explore ESG investments (Viviers & Els, 2017).

The initiatives discussed above demonstrate that South Africa has made strides in the development of RI market. However, the RI market can still be considered a fringe activity in South Africa's financial markets (Hebb et al. (2015). The primary barrier to RI uptake in South Africa is the perception among institutional investors that RI involves a financial sacrifice (Hebb et al., 2015).

In the following section, I introduce Kenya. First, I present a short political history of Kenya which sets the scene for understanding the genesis of some of social and governance issues in Kenya. Then, I present an overview of the economy of Kenya followed by a discussion of the main ESG factors in Kenya. Lastly, I examine the initiatives undertaken by both the Kenyan government and the CMA to address the prevailing ESG issues.

2.4 Kenya

Kenya is an East African country whose economy is the third-largest in sub-Sahara Africa after Nigeria and South Africa (Bloomberg, 2020). Nairobi is Kenya's capital city and the largest city, while the coastal city of Mombasa is the oldest city and the home to the chief port of Kenya. Kenya straddles the equator with a single time zone, and the country's climate varies from tropical along the coast, to temperate in the inland regions, to arid in the north and north-east (Government of Kenya, 2019).

There are two wet seasons in Kenya – the wettest season runs from March to May with another short rainy season between October and December. However, the weather patterns are changing, and the rainy seasons are no longer as predictable as they were some years ago (United Nations Development Programme, 2018b). Moreover, Kenya's geographic location makes it inherently prone to cyclical droughts and floods, which leave the livelihoods and economic activities vulnerable to climatic fluctuations (United Nations Development Programme, 2020). The unpredictable weather patterns especially affect food production, thereby threatening the food security of many Kenyan families that rely on food crop farming for sustenance.

Kenya derives its name from Mt Kenya, its highest mountain, and the second-highest mountain in Africa. Kenya is home to a wide variety of wildlife, including the "big five" game animals of Africa: lions, leopards, rhinoceros, elephants, and buffalo. A sizable land area of about 44,000 square kilometres is devoted to wildlife habitats, including 16 major reserves designated to national parks, game reserves and national reserves (Okello, Wishitemi, & Mwinzi, 2001). These features make Kenya an attractive tourist destination, especially for wildlife tourism. The tourism sector makes a valuable contribution to the economy as a foreign exchange earner (Okello, Manka, & D'Amour, 2008). It also creates about half a million jobs each year (Njoya & Seetaram, 2018). However, persistent droughts affect the animals' food supply.

The population of Kenya is estimated to be 47.8 million (Kenya National Bureau of Statistics, 2019). The population of Kenya is considered youthful, with about 72 per cent of the population aged below 35 years (Third Medium Term Plan, 2018). The people of Kenya are ethnically and linguistically diverse, with an estimated 42 different communities that are made up of Bantu, Nilotic and the Cushitic-speaking ethnic groups, as well as Arabs, Indians and Europeans (Government of Kenya, 2019). There are two official languages: English and Kiswahili (Constitution of Kenya, 2010). Most urban dwellers speak both languages with a varying degree of fluency, while those who live in rural areas speak mainly in their mother tongue.

Most Kenyans identify as Christians (83 per cent), followed by Muslims (15 per cent) and a small population who practise traditional African beliefs. Kenya has one of Africa's largest Hindu population, mostly of Indian origin (National Council for Population Development, 2017).

2.4.1 A short political history

2.4.1.1 Colonial politics

The political history of modern Kenya goes back to the Berlin Conference of 1884–1885, when European powers first subdivided East Africa into territories (Brennan, 2008). Until then, the Sultans of Zanzibar controlled much of the Swahili coast and trading routes extending further into the continent as far as the Democratic Republic of Congo. The British government founded the East Africa Protectorate in 1895 and soon opened the fertile highlands to white settlers. The East Africa Protectorate occupied roughly the same area as present-day Kenya, except for a 10-mile strip on the Kenyan coast that remained under the Sultan of Zanzibar. British powers leased the coastal strip from Zanzibar and established trading posts (Brennan, 2008).

The British colonial administration established a Legislative Council in 1907 to advise the Chief Minister on the running of the Protectorate (Parliament of Kenya, 2019). The first council was composed of both elected and appointed members. To increase their powers, the settlers lobbied to transform the Protectorate into a Crown Colony (Focus on Land in Africa, 2011). The transformation occurred in 1920, when Britain transformed the Protectorate into a British Crown Colony with the Governor representing the King. It was named the Kenya Colony and it did not include the 10-mile strip,[1] which remained a Protectorate under the Sultan of Zanzibar. The two territories – that is, the Colony and the Protectorate – were controlled as a single administrative unit "the Colony and Protectorate of Kenya" under an agreement between the United Kingdom and the Sultan dated 14 December 1895 (Brennan, 2008).

[1] Kenya Protectorate Order in Council, 1920, S.R.O. 1920 No. 2343 & S.I. Rev. VIII, 258, State Pp., Vol. 87, p. 968.

According to Hornsby (2013), the main impetus for British settlement in Kenya was to reach the wealthy Kingdom of Buganda. To do that, the British planned to build a railway from the Coast to Uganda, crossing through Kenya. The British government brought in many Indians to construct the railway, which began in the Port of Mombasa in 1895 and reached Kisumu on Lake Victoria in 1901 (Hornsby, 2013; Onyango, 2015). The Indians subsequently settled in Kenya. Once the railway was completed, many Europeans immigrated to the Kenya highlands, which were free from diseases, to farm and live an adventurous life (Hornsby, 2013).

The Governor at the time of the completion of the railway, Sir Charles Eliot, perceived Kenya as having an agricultural potential, and called the Kenya highlands the "white man's country" (Onyango, 2015, p. 185). He argued that the Protectorate should finance its administration costs, and for that reason new sources of revenue had to be established to meet the cost of maintaining the railway. He thus proposed a tax per household, or "hut tax" as it was called, and encouraged white settlers and merchants to immigrate to Kenya. He recommended that white Europeans be allowed to settle on the rich Kenya highlands to encourage Africans to develop their resources to the point of making the railway successful (Onyango, 2015). Therefore, the policy of white settlement began with the enactment of the Crown Land Ordinance of 1902, followed by the 1906 declaration by Lord Elgin, the Secretary of State for the Colonies, that land lying between Kiu and Fort Ternan should only be allocated to white settlers. Most of the land consisted of open savannah plains occupied by herds of game and land where the Maasai people grazed their cattle, and the rest was uninhabited or under forest (Fazan, 2014). This area became known as the White Highlands. The second wave of settlement took place between 1911 and 1913 and, with that, the Crown Land Ordinance of 1913 was enacted to allow for another settlement, this time in Limuru (Fazan, 2014).

By the time Kenya became a colony in 1920, the future policy and pattern for the development of Kenya were set in such a way that a dual policy existed where the development of the land reserved for European settlement was to progress alongside that of the development of African tribal lands. In 1921, the Secretary of State for the Colonies, Lord Milner, announced that the British government had decided that the existing practice regarding both initial granting of land and transfers must be maintained. His successor Winston Churchill maintained this position in 1922 when he stated that "we pledged by undertakings given in the past to reserve the highlands of East Africa exclusively for European settlers and do not intend to depart from that pledge" (Fazan, 2014, p. 150). The Kenya Land Commission of 1932–1933 determined the extent of the boundaries of the Highlands, and in 1934, the commission closed the frontier between the

White Highlands and the African Land units. By that time, the settlers controlled about a third of the total arable land and Africans were denied any form of rights in the White Highlands (Fazan, 2014).

It suffices to say that the setting aside of a specific area exclusively for European settlers was the cornerstone of white settlement in Kenya and has always been a controversial subject (Asaka, 2015; Fazan, 2014). By declaring all land to be Crown Land, the British took land rights from Africans and alienated land from customary systems, usually without compensation. The British established a tenure system that accorded recognition of land rights secured by individual freehold title. In contrast, the customary tenure was more complex, involving individual and group rights derived from kinship. Because the customary tenure did not lend itself to absolute individual ownership, most customary land was not registered (Focus on Land in Africa, 2011). After independence, the government established settlement schemes to facilitate the purchase and distribution of settler farms to landless Kenyans. However, many Kenyans could not afford to buy back the land and others could not see the justification of paying for land that was forcefully taken from them (Focus on Land in Africa, 2011). Thus, wealthy individuals bought land, while many others remained landless and without compensation for the colonial era and post-independence alienations (Focus on Land in Africa, 2011).

The issue of land rights in Kenya has remained contentious ever since, and it is still a source of socio-political conflicts as subsequent regimes have never fully addressed it. Almost all elections are marred by land conflicts, violence and population displacement (Focus on Land in Africa, 2011; Wa Gĩthĩnji & Holmquist, 2008).

For a long time, the white settlers denied political representation to Africans, Arabs, and Indians. In 1924, a white clergyman was appointed to represent African interests, while five Indians and one Arab were elected into the Legislative Council (Focus on Land in Africa, 2011). Thus, Africans were excluded from direct political participation until 1944, when the Governor nominated the first African member into the Council (Parliament of Kenya, 2019). The colonial office broadened the Legislative Council, and in 1954 Africans, Arabs and Indians were admitted to the Council by quotas on a representative basis. While Indians were first allowed to vote in 1956, Africans were allowed to vote in 1957 after acquiring voting rights based on wealth and education (Parliament of Kenya, 2019). The European population continued to grow, and, by the end of 1959, they formed about 1 per cent of Kenya's total population. Yet they had more than half the share of representation at the Legislative Council (Hornsby, 2013).

In 1942, as a reaction to their exclusion from political representation, members of some tribes took an oath of unity and secrecy to fight for freedom from British rule (Government of Kenya, 2019). These tribes collectively formed the Kenya Land and Freedom Armies, also known as the Mau Mau movement, under oath, and Kenya began its long road to national sovereignty (Wa Gĩthĩnji & Holmquist, 2008). The Mau Mau movement was declared an illegal society in 1950, and in 1952 the Governor of Kenya declared a state of emergency, which lasted until 1959 (Government of Kenya, 2019). Thousands of Kenyans were incarcerated in detention camps, and others were imprisoned during this period. Mzee Jomo Kenyatta (who later became the first President of the Republic of Kenya) and five other freedom fighters were imprisoned for seven years in April 1953 (Government of Kenya, 2019). The war officially ended in January 0f 1960 (Kariuki, 2015).

While the war was going on, Africans started demanding a constitutional conference and, in 1960, the Kenya Constitutional Conference started at Lancaster House in London (Kariuki, 2015). The Constitution, which was to become Kenya's first Constitution, was agreed upon in 1963, after a series of meetings at Lancaster House. The major focus of the constitution was a strong central government with a federal provision for regional governments, providing for citizenship, fundamental rights, and composition of the bicameral legislature, which continues today.

Although Kenyatta and his companions were due for release in April of 1959 after serving three-quarters of their prison sentence, the Governor applied for a restriction order, saying that violence would erupt if Kenyatta was released. He was thus detained in the remote area of Lodwar in Northern Kenya for a further two years until his release in 1961, while Kenya was still under British rule (Kariuki, 2015). Two years later, in 1963, Britain ceded sovereignty over the colony of Kenya and Kenyatta was elected the first Prime Minister of Kenya. At the same time, the Sultan of Zanzibar agreed to cede sovereignty over the 10-mile strip. However, the independence that Britain first granted Kenya was that of a dominion, based on a Westminster model of a constitution (Kariuki, 2015). Queen Elizabeth II remained the head of state until 1964, when Kenya became a republic within the Commonwealth, and Kenyatta became the first president of the Republic of Kenya.

2.4.1.2 Post-colonial politics

The political governance of post-colonial Kenya started as a multi-party system and has remained so for the most part. However, in 1969, the president banned and arrested the leader of an opposition party and Kenya became a “de facto” single-party state (Government of Kenya, 2019). President Kenyatta died in 1978 and Daniel arap Moi, who was his Vice President, became the President. He ruled Kenya for the next 24 years until 2002, and although he started by calling for democracy, he officially declared Kenya a one-party state in 1982, amending the Constitution accordingly. The multi-party democracy system was finally restored in 1992 after the Parliament annulled the one-party section of the Constitution in December 1991 (Government of Kenya, 2019).

Kenya reached a turning point in August of 2010 when a new Constitution was promulgated to replace that inherited from Britain in 1962 (Constitution of Kenya, 2010). The new Constitution reconfigured a balance of power, authority, resources, and responsibilities from the National government to a devolved government comprising 47 counties. Thus, the Republic of Kenya is now a unitary State divided into 47 counties.

The first elections under the devolved government took place in 2013, where Uhuru Kenyatta was elected as the President. The parliament of Kenya is a bicameral house consisting of the National Assembly and the Senate. According to the United States Agency for International Development (USAID), democracy has progressed, and political space has expanded within the first five years of the new devolved system. The progress is especially noticeable within the marginalised communities in Kenya (USAID, 2019).

Like many African countries, the colonial heritage that Kenya obtained at independence had a significant impact on the administrative features and development of the new republic (Carey, 2001). For instance, many scholars comment that tribalism or ethnic identity was a product of colonialism as a result of the divide and rule strategy that many colonial masters seemed to prefer (Atieno-Odhiambo, 2002; Carey, 2001; Chimhundu, 1992; Maina, 2017; Onyango, 2015; Ranger, 1985, 1993). As explained by Hornsby (2013), Kenya had a few ethnic political structures and no trans-ethnic political alliances before the imposition of colonial rule. Authority was personal and local, a function of age, lineage, wealth, leadership skills and other such factors. Societies were more egalitarian, and relationships were personal. The colonial master divided the country administratively into provinces, districts, divisions, locations, and so forth. The boundaries were drawn based on the needs of the white settlers and their understanding of the African ethnic groups. Whether one agrees with colonialism as the genesis of ethnic identity or not, it is evident that it became a crucial vehicle for mobilising voters as individual personalities and local groups, and regional and ethnic ties became increasingly important for gathering and representing the interests of the citizens.

In Kenya, the colonial policy had banned nationwide development of political alliances until 1960, and political organisations were only allowed at the district level. Hence, to facilitate general elections after the release of Kenyatta, two major political parties were hurriedly formed, the Kenya National African Union and the Kenya African Democratic Union. Owing to the circumstances, both parties were mostly loose alliances of district- and local-level political organisations (Barkan, 1987). The first political party represented the populous Kikuyu and Luo tribes, who made up about 60 per cent of the population, while the latter was a coalition of smaller ethnic groups that felt threatened by numerous and politically aggressive ethnic groups (Barkan, 1987; Kabiri, 2014).

Thus, scholars such as Carey (2001) and Maina (2017) argue that the effect of colonial policy was to encourage ethnically homogeneous political associations to emerge across the country. In Kenya, political parties continue to draw their political legitimacy and capital from their respective ethnic bases, and the behaviour of ethnic allegiance has largely remained amongst the voters and continues to be the most influential motivator during elections, regardless of where they reside. Presidents and parliamentarians are elected based on ethnicity, which has led to a situation where leaders channel national resources to their ethnic supporters to safeguard their political survival. In turn, this system of political patronage that is deeply entrenched within the fabric of Kenyan society (Jarso, 2010) has created a situation whereby supporters feel entitled to national resources from the candidates they helped put in government (Carey, 2001). Consequently, the politics of ethnicity has created inter-community competition, not only for positions in government but also for resources. This trend has created rampant corruption, tension between communities, marginalisation, disenfranchisement of entire communities and full-scale violence between communities (Maina, 2017).

Although ethnic tension escalates during the electioneering period, it is not limited to that period and Kenya has experienced several ethnic clashes since 1991 (Kabiri, 2014). Perhaps the best-known incident was the post-election violence that occurred after the 2007 general elections. The violence resulted in more than 1,000 deaths, a significant number of internally displaced persons and refugees, and destruction of private and government-owned properties (Schwartz, 2009). However, while scholars such as Chege (2010), together with the media and political leaders, portray ethnic diversity as the cause of the recurring ethnic conflicts, Kabiri (2014) demonstrates that ethnicity or tribalism per se is not at the core of Kenya's ethnic clashes. Instead, the author posits that the clashes reveal a political elite mode of negotiating state power at whatever cost, including using ethnic groups as collateral, while ignoring the critical class issues that matter to the people. She argues that when ethnicity appears in the Kenyan political arena, it is largely engineered because of institutional failure.

Speaking specifically about the 2007/2008 clashes, existing investigations by the Human Rights Watch (2008) dispute the ethnic origins of the conflict and show that they were inherently a political party affair. Academic scholars evaluating the clashes (Anderson & Lochery, 2008; Wa Gĩthĩnji & Holmquist, 2008) argue that the genesis is best understood not as a simple ethnic rivalry but as a complex issue with deep historical roots. They contend that the problem requires a combination of constitutional and economic policy changes to redress historical problems and address immediate issues of peace and justice. From an investment perspective, it has been demonstrated that conflicts decrease investment in the affected area (Mueller, 2013).

2.4.2 Overview of the economy

The recorded GDP for 2018 was approximately USD 89 billion (NZD 142.4 billion), representing a 6.3 per cent growth from 2017 (Kenya National Bureau of Statistics, 2019). In comparison, sub-Sahara Africa's GDP grew by 3 per cent in the same period, while that of the East African Community grew by 5.9 per cent (Kenya National Bureau of Statistics, 2019).

Agriculture is the most important contributor to the Kenyan GDP (27.8 per cent), with tea, coffee, and horticulture as some of the leading export earners. Other factors supporting the steady economic growth include a reasonably well-educated labour force (Hope, 2017), a port that serves as an entry point for goods destined for the Central and East Africa interior, abundant wildlife and a long coastline that attracts tourism, accelerated manufacturing activities, and sustained growth in the transportation and service sectors (Kenya National Bureau of Statistics, 2019).

Moreover, Kenya's strategic position as the economic, commercial and logistical hub of the East Africa region makes it one of the most attractive investment destinations in East and Central Africa (Financial Times, 2020). The country is one of the largest recipients of foreign direct investment in Africa (Santander Trade Markets, 2020). For instance, Kenya received USD 1.6 billion in foreign direct investment in 2018 – a 27 per cent increase from the previous year (United Nations Conference on Trade and Development, 2019). The majority of the foreign investors in Kenya come from the UK, Belgium, the Netherlands, China and South Africa (Santander Trade Markets, 2020). They mostly invest in the banking, information and communication technology, tourism, infrastructure and extractive industries (Santander Trade Markets, 2020). In more recent times, the information and communication technology sector has attracted more investment. For example, in 2018 Microsoft opened an African development centre in Kenya, while Cisco Systems (USA) and Standard Chartered Bank (UK) both opened innovation hubs (Financial Times, 2020).

One of Kenya's long-term development goals is to transition from a frontier economy to the Morgan Stanley Capital International (MSCI) emerging market status by the year 2023, and one requirement for the shift to occur is to raise the proportion of total investors as a percentage of the adult population from the current 19 per cent to at least 30 per cent (CMA, 2018). To this end, the CMA endeavours to create a conducive policy and regulatory environment that can help attract a broader set of investors, including international investors. As stated before, international investors, especially those from developed markets, are keen to ensure that capital market players enhance their policies around ESG factors (CMA, 2018). In this regard, the CMA is exploring the possibilities of introducing ESG reporting by first ascertaining the extent to which current and potential issuers have the capacity and appetite for extending the range of ESG reporting, and the extent to which the costs of complying with increased reporting standards are likely to be justified (CMA, 2018).

Governments play a vital role in creating enabling conditions for sustainable private sector investment. The Kenyan government has made several market reforms that improved the country's Ease of Doing Business Index from position 129 in 2013 to position 80 in 2017, out of 189 countries surveyed (Kenya Vision 2030, 2019). Kenya was also voted as the third most improved country globally in the Ease of Doing Business Survey for two consecutive years, placing the country on the way to achieving its target of being ranked among the top 50 countries on both the Ease of Doing Business and the Global Competitive Index (Kenya Vision 2030, 2019). The improved market reforms further enhance Kenya's attractiveness as an investment destination (Kenya Vision 2030, 2019).

Kenya's long-term economic development objectives are outlined in the country's development blueprint – Kenya Vision 2030. Kenya Vision 2030 was launched in 2008 to transform Kenya into a middle-income country by 2030 (Kenya Vision 2030, 2019). It is anchored on three pillars: the economic and macro pillar, the social pillar, and the political pillar. The economic and macro pillar aims to improve the prosperity of Kenyans through economic development programmes, while the social pillar seeks to build a just and cohesive society in a clean and secure environment. Finally, the political pillar aims to realise a democratic political system that is founded on issue-based politics, that respects the rule of law and protects the rights and freedoms of every individual in Kenya (Kenya Vision 2030, 2019).

Vision 2030 is implemented through a series of five-year medium-term plans, and it is currently in its third medium-term plan, which covers 2018–2022 (Third Medium Term Plan, 2018). The current plan tightly focuses on the government's priority areas, which aim to help accelerate the achievement of the vision of a just and cohesive society. The four government priority areas are also known as the "Big 4 Agenda" and consist of food security, affordable housing, manufacturing, and affordable health care for all. Specifically, the government's main objectives for this period are to raise the share of the manufacturing sector to 15 per cent of GDP; to ensure that all citizens enjoy food security and improved nutrition; to achieve universal health coverage; and to deliver at least 500 thousand affordable housing units by 2022 ((Third Medium Term Plan, 2018).

2.4.3 Environmental, social and governance context

The Kenyan economy is highly vulnerable to climatic variation due to its over-reliance on climate-sensitive sectors such as agriculture, water, energy generation, tourism and forestry (Kenya National Bureau of Statistics, 2019). The cycle of drought and floods leads to increased food insecurity, especially in the arid and semi-arid regions. For example, Kenya received a below-average amount of rainfall in 2016, and the effect of this insufficient rainfall was a severe drought in the arid and semi-arid regions, to the extent that 2.7 million people required relief food in 2017 (United Nations Development Programme (2018a). Before Kenya could recover from the effects of the drought, severe floods occurred in 2018, leaving 183 people dead, a further 332,000 people displaced, and crops destroyed in some regions (United Nations Development Programme, 2018a).

Regarding socio-economic development, Kenya has taken considerable steps to reduce poverty and improve quality of life for its citizens and, as a result, the social indicators have been improving consistently. For example, according to the United Nations Development Programme (2018a), Kenya's HDI improved from 0.468 in 1990 to 0.590 in 2017, as shown in Table 2. The index is a composite statistic that measures a country's overall achievement in three basic dimensions of human development: the health of the people, their access to knowledge and their standard of living. Health is measured by life expectancy, while knowledge is measured by both the expected years of schooling for children of school-entry age and the average number of years of education received in a lifetime by people aged 25 years and older. The standard of living is measured by the Gross National Income per capita expressed in constant 2011 international dollars converted using purchasing power parity conversion rates (United Nations Development Programme, 2018a).

Table 2. Kenya's HDI trends from 1990 to 2017

Year	**Life expectancy at birth**	**Expected years of schooling**	**Minimum years of schooling**	**Gross National Income per capita (2011 PPP, USD)**	**HDI value**
1990	57.5	9.1	3.7	$ 2,297	0.468
1995	53.9	8.7	4.5	$ 2,130	0.456
2000	51.8	8.4	5.3	$ 2,112	0.451
2005	55.8	9.4	5.8	$ 2,223	0.490
2010	62.9	10.7	6.1	$ 2,467	0.543
2015	66.7	11.7	6.3	$ 2,806	0.578
2016	67.0	11.9	6.4	$ 2,898	0.585
2017	67.3	12.1	6.5	$ 2,961	0.590

Source: United Nations Development Programme (2018a).

Although the HDI of 0.590 placed Kenya in the medium human development category, it is below the average of 0.645 for countries in the lower-middle-income category. However, it is above the average of 0.537 for countries in sub-Sahara Africa. A key criticism of the HDI is that it masks the inequality in the distribution of human development across the population in each country. However, that can be accounted for by discounting the average value of each dimension according to its level of inequality (United Nations Development Programme, 2018a). The resulting index is referred to as the inequality adjusted HDI, and the difference between the HDI and the adjusted HDI is the loss in human development because of inequality.

Kenya’s inequality adjusted HDI for 2017 was 0.434, down from the unadjusted measure of 0.590. The average adjusted measure for countries in sub-Sahara Africa is 0.372 (United Nations Development Programme, 2018a).

The overall national poverty rate reduced from 46.6 per cent in 2006 to 36.1 per cent in 2016 (Kenya National Bureau of Statistics, 2018). The biggest decline is attributed to progress in rural areas where poverty reduced from 50 per cent in 2006 to 38.8 per cent in 2016. The government’s fiscal strategy is to improve the welfare of citizens through enhanced pro-poor expenditures in health, education and social protection (Kenya National Bureau of Statistics, 2019). These pro-poor expenditure patterns have reduced inequality in Kenya, as shown by several inequality measures, such as the Gini index of 40.8 in 2015 down from 46.5 in 2005 (World Bank, 2020).

Despite the progress made in alleviating poverty and improving the overall quality of life for Kenyans, youth unemployment is still high. Overall, 17.8 million people were engaged in one form of employment or another in 2018 (Kenya National Bureau of Statistics, 2019). The problem is that 86.3 per cent of these people were engaged in the informal economy, which is characterised by small-scale activities requiring little capital investment and offering limited or no job security (Kenya National Bureau of Statistics, 2019). A comprehensive analysis of the state of the labour force shows that the rate of job creation is not keeping pace with the growth of the labour force (Third Medium Term Plan, 2018).

In addition to limited job opportunities, there are other structural issues like employers insisting on graduates having job-relevant skills and experience, the emergence of green jobs and the discovery of oil and gas, necessitating new work skills that are currently lacking. The government endeavours to address unemployment through the continued establishment of job-creating projects and initiating policies and institutions that will help redress the current problems in the labour market (Third Medium Term Plan, 2018).

Another major problem that post-colonial Kenya has struggled with is corruption, which has seen Kenya classified as one of the most corrupt states in the world by many commentators. In 2019, Kenya ranked position 137 out of 180 in the corruption perception index (Transparency International Limited, 2019) and position 95 out 141 in the Global Competitive Index (World Economic Forum, 2019). Although the competitive index is influenced by several factors, corruption is the most prominent issue in Kenya (Third Medium Term Plan, 2018). Corruption presents integrity risks that are real concerns for investors.

Like tribalism, several scholars (Apata, 2019; Mulinge & Lesetedi, 2002; Sahle, 2017) trace corruption in Africa to its colonial past, when the colonial master imposed a Western capitalist tradition and exploitative tendencies on Africans. Corruption persists in Kenya more than five decades after independence to the point of becoming a matter of concern both domestically and internationally due to its ability to undermine the economy. Corruption is deeply entrenched in Kenyans' way of life, pointing to the fact that something is wrong in the governance of the country. Some authors describe the problem as systemic, going beyond a few individuals to the structural and institutional levels (Hope, 2014; Mulinge & Lesetedi, 2002). Hope (2014) argues that corruption persists in Kenya mainly because there are people in power who benefit from it, and the current governance institutions lack the will and the capacity to stop them from doing so.

Corruption in Kenya manifests itself in various forms, ranging from petty bribery to grand-scale corruption. Petty corruption frequently involves instances where individuals must pay money to obtain public services. Companies also frequently encounter demand for bribes to "get things done", especially when dealing with the public procurement sector (GAN business anti-corruption portal, 2019). Corruption scandals have been the subject of debate both domestically and internationally, and hardly a day goes by without the media highlighting large corruption scandals involving the misappropriation of public funds. The sheer magnitude of the scandals and the attendant culture of impunity have led to a widespread lack of confidence in the Kenyan government to the extent that international donors have sought alternative methods of funding and implementing development assistance programmes (Hope, 2017).

Jarso (2010) documents some of the major scandals involving government officials since the early 1990s in detail. A significant proportion of the grand corruption scandals in Kenya involve public procurement and disposal of assets (Transparency International Kenya, 2014). To illustrate the economic loss due to corruption of public officials, the first major scandal, which is commonly known as the Goldenberg scandal, is said to have cost the country approximately 10 per cent of GDP (Jarso, 2010). The scandal began in 1991 with investigations lasting several years with no prosecution (Mnjama & Kemoni, 2009). It involved a company, Goldenberg International that exploited a government scheme that was aimed at revitalising Kenya's economy. The government, to encourage exporters to repatriate their hard currency earnings, established a scheme promising a 20 per cent premium on foreign currency deposited in the Central Bank of Kenya. Through this scheme, Goldenberg International supposedly earned compensation of about USD 850 million for processing gold and diamonds for export. The problem is that those minerals did not exist (Mnjama & Kemoni, 2009).

It appears that Goldenberg was a precursor to bigger and more threatening scandals, such as the Anglo Leasing scandal of the 2000s, which involved an array of contracts with non-existent entities for various fictitious security-related projects (Jarso, 2010). The media continues to expose more scandals involving government officials. In consequence, civil society groups and foreign diplomats have condemned corruption for its capacity to undermine Kenya's economic future. For example, in 2014, 18 chiefs of mission that represent Kenya's biggest multilateral partners issued a bold warning to the government that their failure to tackle corruption is "undermining Kenya's future" (18 envoys challenge Uhuru to act against corruption, 2014, April 12).

2.4.4 Key development policies and initiatives on ESG factors

The Kenyan government has made a high-level commitment to sustainable development, especially through the Constitution of Kenya, Kenya Vision 2030, and the medium-term plans. Regarding environmental protection, Article 42 of the Constitution of Kenya (2010) states that everyone has the right to a clean and healthy environment and to have the environment protected for present and future generations through legislation. The Article further states that companies or investors should assess environmental impacts before commencing any work. Also, the Article provides for the establishment of a specialised environmental court, which was established under the Environment and Land Court Act (2011). The environmental court is currently the only operational and constitutionally mandated environmental court in Africa (Soyapi, 2019).

The Kenyan government has taken a strong stance against climate change by ratifying the United Nations Framework Convention on Climate Change (CMA, 2018). Moreover, the government banned the use, manufacture and importation of all plastic bags for commercial and household packaging in 2017, and further banned the manufacture, importation, supply, distribution and use of non-woven polypropylene bags in 2019 (National Authority Management Authority, 2019). The National Environment Management Authority is the principal instrument of the government for implementing all policies relating to the environment. It is also tasked with general supervision and coordination over all matters relating to the environment. Moreover, both the CMA and the Nairobi Securities Exchange are signatories to the Marrakech Pledge – a coalition of African capital markets regulators and exchanges committed to acting collectively to foster green capital markets in Africa (Marrakech Pledge, 2016). The objective of the pledge is to enable an effective shift towards a low-carbon economy, while stimulating strong and sustainable growth in the region (Marrakech Pledge, 2016).

The development of a just and cohesive society enjoying equitable social development in a clean and secure environment, as expressed in Article 43 of the Constitution of Kenya (2010), is integral to Kenya Vision 2030 (International Finance Company, 2015). The Constitution of Kenya lays out the country's social development vision by stating:

> Every person has the right to the highest attainable standard of health, adequate housing, reasonable standards of sanitation, to be free from hunger, and to have adequate food of acceptable quality, to clean and safe water in adequate quantities, to social security and education (Article 43 of the Constitution of Kenya, 2010).

As previously stated, the government is focusing on four priority areas, three of which are concerned with social development, indicating the president's commitment to raising the social status of Kenyans. Figure 2 shows the flagship projects and programmes under the Big 4 Agenda, as articulated in the Third Medium Term Plan.

Figure 2. Environment, water, sanitation and regional development flagship projects and programmes under the Big 4 Agenda

Waste management and pollution control	Strengthening environmental governance
Rehabilitation and protection of the water towers	Land reclamation
Modernisation of meteorological services programme	Rehabilitation of urban rivers
Forest conservation and management	Promotion and piloting of green energy
The plastic bags initiative	Forestry research and development
Water resource management programme	Water harvesting and storage programme

Provision of water to poor, unserved areas, including informal settlements	Water research programme
Urban and rural water supply	Promotion of drip irrigation, greenhouses, and renewable energy
Irrigation and drainage infrastructure	
Irrigation water storage programme	An integrated regional development programme
Irrigation water management programme	Sewerage programme
Green technologies and innovations programme	Population, health, and environment programme
Wildlife conservation and management	Trans-boundary waters

Source: Third Medium Term Plan Third Medium Term Plan (2018).

Furthermore, the Third Medium Term Plan is aligned with African Union's Agenda 2063, which constitutes the strategic framework for the social and economic transformation of Africa by 2063 (African Union, 2013). Agenda 2063 aims to prioritise inclusive social and economic development, encourage continental and regional integration, and foster democratic governance, peace and security, among other goals (African Union, 2013).

Regarding governance, Kenya has enacted several pieces of legislation and established institutions to combat corruption, especially since the early 2000s (Kichwen, 2017). The legislation includes but is not limited to the *Anti-Corruption and Economic Crimes Act 2003* (KNY), the *Public Officer Ethics Act 2003* (KNY), the *Government Financial Management Act 2004* (KNY), the *Public Procurement and Disposal Act 2005* (KNY), the *Witness Protection Act 2006* (KNY), the *Fiscal Management Act 2009* (KNY), the *Public Finance Management Act 2019* (KNY) and the *Ethics and Anti-Corruption Commission Act 2011* (KNY) (Jarso, 2010; Transparency International Kenya, 2014).

Kenya has also ratified several regional and international arrangements on corruption, reflecting the resolve to fight it. For instance, Kenya is a party to the United Nations Convention Against Corruption (2003), whose object is to promote and strengthen measures to prevent and tackle corruption more efficiently and effectively (Jarso, 2010). Kenya is also party to the United Nations Conventions against Transnational Organized Crime and the Protocols Thereto (2000), whose purpose is to promote cooperation to prevent and combat transnational organised crime. At the continental level, Kenya is a party to the African Union (2003), whose goal is to promote and strengthen development in Africa by establishing the necessary conditions to encourage transparency and accountability in the management of public affairs (Jarso, 2010).

In tandem with the legal frameworks, several institutions dedicated to combating corruption have been established over time. The most recently established institution is the Ethics and Anti-Corruption Commission, which was set up in 2011, replacing the Kenya Anti-Corruption Commission of 2003 (Kichwen, 2017). The other institutions expected to play a critical role in the fight against graft include the office of the Public Procurement and Oversight Authority, as well as the office of the Attorney General and that of the Auditor General. In addition, there is an office of the Ombudsman, whose primary role is to receive all complaints relating to public officials (Transparency International Kenya, 2014).

The Companies Act (2015) encourages greater transparency, especially regarding the directors of a company. According to section 653 of the Companies Act (2015), the directors of a company should prepare a directors' report for each financial year in which the company is a parent company. Section 654 (1) provides that the directors' report should include the names of the persons who, at any time during the financial year, were directors of the company. If the directors of a company fail to comply with section 653 or 654, each director of the company who is in default commits an offence and on conviction is liable to a fine not exceeding KSh 500,000 (USD 5,000).

Further, section 655 (1) and (2) of the Companies Act (2015) provides that the directors' report should include a business review to inform the shareholders and assist them to assess how the directors have performed their duty. According to section 655 (3) (a), the business review should contain a fair review of the company's business, and a description of the principal risks and uncertainties facing the company. Further, section 655 (4) provides that directors of a listed company must specify in the business review (to the extent necessary for an understanding of the development, performance, or position of the company) a fair review of the following items:

a) The main trends and factors that are likely to affect the future development, performance, and position of the business of the company.
b) Information about environmental matters (including the impact of the business of the company on the environment); the employees of the company; and social and community issues, including information on any policies of the company in relation to those matters and the effectiveness of those policies.
c) Information about persons with whom the company has contractual or other arrangements that are essential to the business of the company (section 655 (4) of the Companies Act, 2015).

Section 655 (5) of the Companies Act (2015) provides that if the business review does not contain information of each kind mentioned in subsection (4) (b) and (c), the directors should specify in the review which of those kinds of information it does not contain. Further, section 655 (6) provides that, to the extent necessary for an understanding of the development, performance or position of the company's business, the business review should include an analysis using financial key performance indicators and, if appropriate, an analysis using other key performance indicators (including information relating to environmental matters and employee matters). According to section 655 (9) of the Companies Act (2015), if the directors of a company fail to comply with a requirement of section 655, each director of the company who is in default commits an offence and on conviction is liable to a fine not exceeding KSh 500,000 (USD 5,000). However, section 655 excludes small companies, that is, companies whose turnover in that year is not more than KSh 50 million (USD 500,000) and whose net assets, specified in its balance sheet as at the end of that year, are valued at not more than KSh 20 million (USD 200,000).

Another compulsory disclosure is that of the board members' remuneration policy. According to section 659 (1) and (2) of the Companies Act (2015), the board of directors of a quoted company should prepare a directors' remuneration report for each financial year of the company. If directors fail to prepare a directors' remuneration report for a financial year, each person who was a director of the company immediately before the deadline for lodging the company's financial statements and reports for the year and failed to take all reasonable steps to ensure that that subsection was complied with commits an offence and is liable on conviction to a fine not exceeding KSh 1 million (USD 10,000) or to imprisonment for a term not exceeding three years, or to both.

Moreover, the CMA has undertaken key initiatives to reform corporate governance in the last five years. For instance, in 2015 the CMA issued a Code replacing the 2002 Code (CMA, 2015a). The 2015 Code is to be applied by both listed and unlisted public companies in Kenya, with the purpose of providing the minimum standards required from shareholders, directors, CEOs and management of a listed company or an unlisted company that issues securities to the public. The objective is to promote high standards of conduct as well as ensure that they exercise their duties and responsibilities with clarity, assurance and effectiveness (CMA, 2015a).

The 2002 Code adopted a “comply or explain” approach (discussed further in section 3.4.3.2) that recommends that company directors comply with the principles of the Code or explain the reasons for their non-compliance if they do not comply. That means that if company directors fail to implement the recommended principles, they should explain why they have failed to. According to the Financial Reporting Council (UK) (2018), an alternative to complying with the provisions may be justified in certain circumstances, but the directors should provide an explanation and provide a rationale of the action the company is taking. However, the 2015 Code adopted the “apply or explain” approach (CMA, 2015a). As discussed in section 2.3, the apply or explain approach requires company directors to not only apply the principles of the Code, but also to provide a statement showing to what extent they complied with the principles.

The 2015 Code contains some mandatory provisions, which are the minimum standards that issuers must implement, and these are repeated in the listing rules for public issuers. For example, Principle 2.9 obliges the board to establish and approve remuneration policies for the board, including the directors’ fees (including the executive directors), attendance allowances and bonuses (CMA, 2015a). The remuneration policies should be aligned with the board’s strategies and disclosed in the annual report. Moreover, Principle 2.1.5 recommends that each board considers whether its size, diversity and demographics make it effective (CMA, 2015a). Diversity applies to academic qualifications, technical expertise, relevant industry knowledge, experience, nationality, age, race, and gender.

Principle 7.1 of the Code requires the board to promote timely and balanced disclosure of all material information concerning the company. In this case, material information is defined as any information that may affect the price of an issuer’s securities or influence investment decisions, including company policies on ESG and implementation thereof (CMA, 2015a). Principle 7.1.1 (h) requires disclosure of the directors' qualifications, the directors' other board memberships, the selection process, whether directors are regarded as independent and, if so, the criteria used to support their independence, and any other material information about the board members (CMA, 2015a). Further, Principle 2.5.1 recommends that board members should retire at the age of 70. However, members may vote to retain a board member who is over 70 years at an annual general meeting (CMA, 2015a). According to Principle 7.1.1 (j), the board must ensure that the company discloses its ESG policies in its annual report and website (CMA, 2015a).

The CMA issued the *Stewardship Code for Institutional Investors* in 2017 (CMA, 2017). The Stewardship Code is based on the comply or explain principle, and the primary intent is to encourage institutional investors to provide deliberate oversight of assets by engaging with listed companies. Institutional investors in Kenya include pension funds, private pension scheme providers, insurance companies, takaful (Sharia-compliant) operators, investment trusts and collective investment schemes.

Further, the CMA issued the *Guidelines for the Prevention of Money Laundering and Terrorist Financing in the Capital Markets* (CMA, 2015b). The guidelines state that the board of directors of a market intermediary is responsible for establishing appropriate policies and procedures for the detection and prevention of money laundering and terrorist financing, ensuring that the policies are effective (CMA, 2015b). The directors should also ensure that the market intermediaries comply with the *Proceeds of Crime and Anti-Money Laundering Act 2009* (KNY) and all other legal and regulatory requirements (CMA, 2015b). In addition to the CMA's guidelines, the Kenya Public Service Commission (2015) issued the *Code of Governance for State Corporations* based on comply or explain.

Other industry initiatives on ESG include the self-listing of the Nairobi Securities Exchange in 2014 and subsequently joining the United Nations' Sustainable Stock Exchanges Initiative in 2015 (Sustainable Stock Exchanges Initiative, 2015). The Sustainable Stock Exchanges Initiative encourages member exchanges to guide their capital markets on ESG reporting by issuing guidelines. The Nairobi Securities Exchange published guidelines for issuers of green bonds to the market in 2019, and revised the listing rules to provide for the green bonds (Nairobi Securities Exchange, 2019).

In support of the national development goals and priorities, the CMA strategic plan of 2018–2023 considered the domestic socio-economic priorities, including Kenya Vision 2030, the medium-term plans and the sustainable development goals when setting up its strategic priorities. Noting the government's emphasis on the Big 4 Agenda, the CMA strategically positions itself to support the government by facilitating responsive policy and regulatory framework for capital market development and facilitating the development of products and services that are linked to the four priority areas. These include and are not limited to the issuance of housing bonds, green and sukuk (Sharia-compliant) bonds, social impact bonds, such as water, and HIV bonds (CMA, 2018).

To summarise this section, Kenya has reached many milestones since independence and has made progress in many areas, while other areas such as governance are lagging. The ambitious desire to transition to MSCI emerging market status in the next few years will require greater levels of investment, among other things. Despite the progress made in improving the business environment and the government's commitment to improving the economy, Kenya faces many challenges of ESG nature. For that reason, Kenya's development largely depends on whether Kenya can address the social, environmental and governance challenges. The Kenyan government and the CMA seem determined to address the ESG issues through the enactment of laws, establishing institutions and providing guidelines on how to deal with ESG issues in Kenya.

2.4.5 Conclusion

In this chapter, I have provided an overview of the RI market in various regions of the world, highlighting the ESG factors that RI practitioners are concerned about especially in the five leading regions. Data from the five leading regions show that some factors that motivate investors to engage with RI are common in more than one region. For example, climate change is a common environmental factor that RI investors are concerned about in all the five regions. Also, tobacco related products are identified as important issues in Europe, USA, and Japan. However, the data also shows some differences. For instance, modern slavery stands out as important issue for investors in Australia and New Zealand while investing in areas of conflict stands out in USA. The differences reinforce the call to understand RI from a country specific context.

Moreover, I highlighted the RI initiatives in four Latin American countries. A striking difference between Brazil and Mexico is that the Brazilian regulators proactively challenge pension funds to integrate ESG issues while the drive for developing ESG strategies by the private pension funds in Mexico is mainly due to international pressure. That is an interesting insight considering that actors in the capital market of Kenya seem to be experiencing similar pressure from international investors to develop RI strategies.

Further, I have provided an overview of RI efforts in South Africa, showing the role that the repressive apartheid regime played in the development of RI market in South Africa. I documented the various initiatives that have been established by both the government and the Institute of Directors in Southern Africa to promote ESG integration. Finally, I introduced Kenya, showing the economic and ESG context that the retirement benefits sector operates in. While the section reveals the many competing needs facing Kenya, it also shows the government's initiatives to address them.

Chapter 3. Literature review

This chapter discusses selected theories and empirical studies that underpin RI. I begin with a brief institutional history of RI, tracing it from a niche market to a more mainstream investment approach. I then discuss the theoretical underpinning of RI, highlighting the relevant theory to this study and explaining how the study benefits from that theory. Next, I discuss the rationale for the common strategies used to implement RI and show how the strategies are used by the five leading regions discussed in Chapter 2. Considering my overarching research question, the last part of this chapter reviews the literature of drivers and barriers to RI in other markets.

3.1 Institutional background of RI

RI began in the eighteenth century as a movement of faith-based investors concerned about aligning their investment decisions with religious principles (Derwall et al., 2011; Entine, 2003; Louche, Arenas, Cranenburgh, & Cranenburgh, 2012). The first known consumer screens occurred when Quakers settled in North America and refused to invest in companies involved in weapons and slave trade, tobacco, or gambling (Entine, 2003; Louche et al., 2012; Renneboog et al., 2008). The founder of Methodism (1703–1791) taught that people should not engage in sinful trade or profit from harming others (Louche et al., 2012; Renneboog et al., 2008). In the 1920s, the Methodist Church in the UK refused to invest in alcohol- and tobacco-producing companies, weapons and gambling (Renneboog et al., 2008). The Pioneer Fund, the first mutual fund that screened assets on a religious basis was incorporated by a Boston-based ecclesiastical group in 1928 (Entine, 2003; Knoll, 2002). The teachings and interpretations of the Qur'an have also influenced the responsible investment movement. For instance, Islamic investors avoid investing in pork-producing companies, gambling or interest-seeking financial institutions (Edward & José, 1998).

The 1960s to the late 1980s mark the beginning of RI in the contemporary sense of the word, as RI was transformed from a faith-based movement to a movement that promoted the public's awareness of the social responsibility of companies (Louche et al., 2012). Social activism and protests of this period prompted the development of investment screening based on views other than religion (Entine, 2003; Louche et al., 2012). For example, the anti-Vietnam War and the civil rights movement of the USA made investors aware of the social consequences of their investments (Knoll, 2002; Louche & Lydenberg, 2006; Renneboog et al., 2008). The opposition to the Vietnam War started with university students calling for universities to shun military contractors from their portfolio, and subsequently expanded beyond universities

(Knoll, 2002). This led to the founding of the Pax World Funds in 1971 in the USA (Entine, 2003). In addition to alcohol and tobacco products, the fund avoided companies that were involved in the supply of arms for the war in Vietnam (Renneboog et al., 2008).

Further, a series of critical incidents that have rocked the corporate world since the 1980s with far-reaching ramifications of the loss of human life, environmental damage and financial losses have made investors more aware of potential negative consequences of industrial development (Renneboog et al., 2008). One example is the 1984 Bhopal (India) industrial disaster, where gas leaked in a pesticide plant, exposing people to a highly toxic substance resulting in large-scale loss of life. Another example is the Exxon Valdez disaster of 1989, where the oil tanker hit the Prince William Sounds in the Gulf of Alaska, spilling 11 million gallons of crude oil (Renneboog et al., 2008). The corporate response of the organisations involved in such events has on many occasions been found to be wanting, triggering protests from civil society groups against such behaviour and calling for a greater show of responsibility from businesses.

Environmental protection, human rights and labour relations became the focal point of the RI movement from the early 1990s and persisted through to the early 2000s (Louche et al., 2012; Renneboog et al., 2008). Ethical consumerism, where consumers pay a premium for products that are consistent with their values, became popular at this time. The RI industry experienced strong growth in Europe and the USA. During this period, social rating agencies and RI indexes emerged and grew rapidly. For example, the Dow Jones and Company launched the Dow Jones Sustainability Index in 1999 and the Financial Times Stock Exchange (FTSE) group launched the FTSE4Good Index in 2001 (Louche, 2004). Around this time, RI strategies began to change from the confrontational approach to a more professional approach, with strong growth in environmental and social concerns (Déjean, Gond, & Leca, 2004; Louche, 2004; Louche et al., 2012). Increasingly, institutional investors, especially pension funds, began to realise that ESG and ethical criteria should be included in the investment decision-making process. For example, the California Public Employees Retirement System in the USA has been actively promoting socially responsible behaviour within companies since the late 1990s, while the Dutch Pension Fund for Public Employees revised the code for prudent investment policy in 2000 to include the integration of environmental, social and ethical criteria in its investment process (Hebb et al., 2015; Renneboog et al., 2008). Regulatory changes regarding the disclosure of environmental, social and ethical information by pension funds and listed companies also contributed to the growth of RI in the 1990s and the early 2000s (Louche, 2004; Renneboog et al., 2008; Zarbafi, 2011). Renneboog et al. (2008) provide a summary of the regulatory initiatives taken mostly by European national governments in this regard. For example, in 2000 the UK amended the *Pensions Act 1995* (UK) after which pension funds must disclose the extent (if at all) to which they incorporate environmental, social and ethical issues in their investment decision-making process (Renneboog et al., 2008).

Many researchers believe that RI has now become a mainstream investment strategy that attracts a vast number of large institutional investors (Derwall et al., 2011; Giamporcaro & Pretorius, 2012; Gifford, 2010; Revelli, 2017; Sievänen et al., 2013). However, according to Sullivan and Mackenzie (2006), the main motivation for institutional investors to adopt RI strategies is the belief that markets are not perfect and investors with better information on ESG than others can trade on that information to their advantage. For that reason, the institutional investors shifted their engagement with RI from ethics-driven concerns to risk management and financial returns, sustainability, and eco-efficiency (Juravle & Lewis, 2008; Louche & Lydenberg, 2006; Zarbafi, 2011). The increasing acceptance by institutional investors was especially marked by the launch in 2006 of the six Principles for Responsible Investment. In 2005, the then United Nations Secretary-General invited institutional investors from several countries to reflect upon the increasing relevance of the ESG issues to investment decision practices (PRI, 2019b). A working group was formed under the auspices of the United Nations Global Compact and the United Nations Environment Programme Finance Initiative (UNEP-FI) (PRI, 2019b). The working group created the six principles and launched them at the New York Stock Exchange in April of 2006 (PRI, 2019b). The idea behind the formation of the PRI was to promote the integration of ESG factors into the mainstream investment decision-making process (Hebb et al., 2015). At the time of the formation of the PRI, asset owners and corporations identified ESG factors as extra-financial factors that impacted the firm but were not accounted for by the traditional financial analysis (Hebb et al., 2015). However, the founders of the PRI argued that ESG factors were material to a firm's value, both in the short and the long run (Hebb et al., 2015).

The principles, including the signatories' commitment, read as follows:

> As institutional investors, we have to act in the best long-term interests of our beneficiaries. In this fiduciary role, we believe that ESG issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time). We also recognise that applying these Principles may better align investors with broader objectives of society.

> Therefore, where consistent with our fiduciary responsibilities, we commit to the following:
>
> 1. We will incorporate ESG issues into investment analysis and decision-making processes.
> 2. We will be active owners and incorporate ESG issues into our ownership policies and practices.
> 3. We will seek appropriate disclosure on ESG issues by the entities in which we invest.
> 4. We will promote acceptance and implementation of the Principles within the investment industry.
> 5. We will work together to enhance our effectiveness in implementing the Principles.
> 6. We will each report on our activities and progress towards implementing the Principles. (PRI, 2019b)

Hebb et al. (2015) suggest that the development of the PRI was a strong indicator that RI's relevance has substantially increased within financial markets. Since the signatories commit to the principles, whose main focus is the integration of ESG factors into investment decision-making and ownership practices, the PRI initiative places a strong emphasis on the impact of material ESG issues on the financial performance of an investment as opposed to avoiding assets purely on ethical or moral grounds. In turn, the strong financial orientation has made ESG integration convincing even for those institutional investors who had concerns about firm performance and breaching of fiduciary duty to maximise returns (Giamporcaro & Pretorius, 2012; Hebb, 2011). The business case for RI is one of the biggest drivers of the RI market (Giamporcaro & Pretorius, 2012; Hebb et al., 2015; Juravle & Lewis, 2008; Louche & Lydenberg, 2006; Zarbafi, 2011).

As demonstrated, RI has a long history, and it has moved from a fringe to a mainstream investment strategy. However, the transition is mainly in developed countries. While developed countries are not homogeneous, they have many things in common, including relatively sophisticated capital markets that offer a wide array of financial products. The legal and regulatory frameworks in these markets are well established when compared to those of developing states. The following section discusses the theoretical and empirical underpinning of RI.

3.2 Theoretical underpinning of RI

ESG issues have traditionally been viewed as externalities of the firm and therefore not considered as something that can add to a firm's value (Hebb, 2008, 2011; UNEP-FI, 2008). The mentality that ESG integration detracts from corporations' goals of shareholder wealth maximisation (Friedman, 1970) seems to be gradually fading away. On the contrary, many investors are increasingly viewing ESG integration as a means of increasing shareholder profits (Porter & Kramer, 2006). This change in perspective is brought about by the realisation that material ESG factors can add firm value and reduce risk (Hebb, 2011; Hebb et al., 2015). This understanding is known as the "business case" for RI. Proponents of the business case for RI contend that investing responsibly is not simply a matter of considering ethics, but rather that financial gains, management of risk and corporate responsibility converge in the long run (Hill, Ainscough, Shank, & Manullang, 2007; Lydenberg, 2006). The advantage of considering ESG issues when making investment decisions is that it is possible to anticipate and mitigate long-term risks through raised ESG standards ((Hebb et al., 2015; UNEP, 2008).

Scholars contend that the theoretical underpinnings of business case for RI address the problems associated with the efficient market hypothesis (Malkiel & Fama, 1970) and modern portfolio theory (Markowitz, 1952) with their assumptions of a rational market (Hebb, 2011; Hebb et al., 2015). Proponents of the business case for RI argue that information asymmetries in the financial market are the norm and ESG factors contribute to that asymmetry (Hebb et al., 2015). Therefore, RI's theoretical framework is built on the recognition that ESG factors are a source of information asymmetry in financial markets (Clark & Hebb, 2005; Hebb, 2011; Hebb et al., 2015).

The efficient market theory was especially criticised post the global financial crisis as it became evident that financial markets are not as efficient as it was previously thought (Fox & Sklar, 2009; Taleb, 2008). Ambachtsheer (2009) suggests that the crisis was caused by the failure of financial sector governance mechanisms in both governments and the private sector. One way that the failures manifested themselves was in undisciplined and excessive risk-taking that was fuelled by the compensation schemes that favour short-term gains at the expense of long-term ones. Proponents of the RI business case contend that RI is not merely a matter of ethics, but rather the long-term convergence of financial gains, management of risk and corporate responsibility (Louche & Lydenberg, 2006).

ESG issues acquire significance mostly to the extent that they are perceived as financially material to an investment portfolio (UNEP-FI, 2004). The concept of materiality is rooted in financial accounting, and focuses on presenting a true and fair view of a company's financial information to support financial decision-making that serves the interests of investors as the primary stakeholder group (Puroila & Mäkelä, 2019). The International Accounting Standards Board defines material information as that which, in its omission, misstatement or obscuring in the financial reports, could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make based on those statements (International Accounting Standards Board, 2018).

In practice, the principle of materiality is commonly used in ESG disclosure. The GRI guidelines are the most popular framework for ESG disclosure (KPMG, 2017). However, implementing the concept of materiality varies widely between organisations (Moroney & Trotman, 2016). Although the GRI includes a comprehensive overview of the most material ESG issues in different sectors, it does not predefine the content that should be included in an ESG disclosure report (Global Reporting Initiative Standards, 2020). Instead, the GRI allows companies to decide which ESG topics are sufficiently important that it is essential to report on them. The GRI further recommends that companies should undertake a comprehensive analysis of the impact of their ESG issues, with an emphasis on stakeholder engagement, to be able to report on them (Global Reporting Initiative Standards, 2020; Puroila & Mäkelä, 2019). The ultimate responsibility of deciding what is material or not is left to each company. However, there is a great amount of discretion involved in determining what is material or not, which results in inconsistencies in the ESG information disclosed by companies (Lai, 2017; Puroila & Mäkelä, 2019).

Identifying and prioritising material ESG issues has been noted as one of the most complicated ESG-related decisions for senior managers of companies (Calabrese, Costa, Levialdi, & Menichini, 2016; Hsu, Lee, & Chao, 2013; Koehler & Hespenheide, 2012). The process is a complex one, because there is no unified understanding of what material information for the diverse groups of stakeholders of a company is (Eccles, 2015; Lai, 2017; Puroila & Mäkelä, 2019). Moreover, analysing the materiality of ESG issues should consider the reporting timescale, because the operational and financial aspects of corporations often have a significantly different timescale than their complex ESG issues (Puroila & Mäkelä, 2019). Further, like the materiality of any input in investment decision-making, the materiality of the ESG data should be related to investment valuation impacts (for example, through future earnings growth prospects, or potential impacts on balance sheet liabilities and risks) (Koehler & Hespenheide, 2012; PRI, 2016c). Yet, companies find it challenging to identify the most appropriate valuation model to assess the impact of ESG topics, as, quite often, the impact is hard to monetise (Flammer, 2013; Koehler & Hespenheide, 2012).

Despite the challenges associated with the materiality determination process, the proponents of the business case approach to RI suggest that what the market participants think is important or material is what will move the RI market (Hebb et al., 2015). Empirical research supporting the business case proposition are numerous. For example, several studies that focused on corporate governance found a strong correlation between firms' corporate governance and stock market returns (Ammann et al., 2011; Brown & Caylor, 2006; Cremers, Nair, & John, 2009; Gompers, Ishii, & Metrick, 2003; Jiraporn & Gleason, 2007). Value arises through companies' internal improvements in employee and product quality, or from the reduced cost of capital (Jo & Harjoto, 2011).

Environmental factors are probably the most researched of the three elements of ESG (Zuraida, 2015). Several studies reported a positive relationship between improved environmental performance and the value of the firm (Derwall, Guenster, Bauer, & Koedijk, 2005; Konar & Cohen, 2001; Yadav, Han, & Rho, 2016). Also, many studies investigating the effect of self-disclosure of environmental activities or third-party certifications and awards on stock prices of firms have reported a positive relationship (Aerts, Cormier, & Magnan, 2008; Amato & Amato, 2012; Clarkson, Fang, Li, & Richardson, 2013; Connors & Silva-Gao, 2008). Results from these studies provide evidence of a positive impact on stock values from favourable environmental recognition, leading to significant positive returns.

Other studies show that racial diversity adds value to organisational performance and contributes to a firm's competitive advantage (Jacobs, Singhal, & Subramanian, 2010; Richard, Murthi, & Ismail, 2007). Relatedly, firms that improve employee welfare have a lower cost of equity capital (El Ghoul, Guedhami, Kwok, & Mishra, 2011). The positive results from these studies prompt many investors to regard ESG integration as a means of driving shareholder profit (Carroll & Shabana, 2010; Hebb et al., 2015; Porter & Kramer, 2006).

On the contrary, neglecting ESG issues has been shown to result in company-specific risks. The risks can be due to corporate fines and settlements, which can have a significant financial impact on the entity. To illustrate the magnitude of the financial costs that firms can incur,

Table 3 shows the 10 largest corporate fines and settlements due to ESG issues in the period from 2009 to 2014. Collectively, the fines amount to USD 45.5 billion.

Table 3. The 10 largest corporate fines and settlements due to ESG issues, 2009–2014

Company and year	**Sector**	**Country**	**USD (million)**	**Cause**
Bank of America (2014)	Financial	USA	16,650	Financial fraud leading to and during the financial crisis.
JP Morgan (2013)	Financial	USA	13,000	Misleading investors about securities containing toxic mortgages.
BNP Paribas (2014)	Financial	France	8,970	Illegally processing financial transactions for countries subject to USA economic sanctions.
Citigroup (2014)	Financial	USA	7,000	Misleading investors about securities containing toxic mortgages.
Anadarko (2014)	Energy	USA	5,150	Fraudulent conveyance designed to evade environmental liabilities.
British Petroleum (2012)	Energy	UK	4,500	Felony manslaughter: 11 people killed; environmental crimes: oil spill in the Gulf of Mexico; obstruction:

				misstatement of the amount of oil being discharged into the gulf.
GlaxoSmithKline (2012)	Pharmaceuticals	UK	3,000	Unlawful promotion of certain prescription drugs; failure to report certain safety data to the FDA; false price reporting practices.
Credit Suisse (2014)	Financial	Switzerland	2,800	Helping USA taxpayers hide offshore accounts from the Inland Revenue Services.
Pfizer (2009)	Pharmaceuticals	USA	2,300	Misbranding a prohibited drug with the intent to defraud or mislead.
Johnson & Johnson (2013)	Pharmaceuticals	USA	2,200	Off-label marketing and kickbacks to doctors and pharmacists.

Source: Clark, Feiner, and Viehs (2015).

Estimates show that, by 2015, USA banks had paid out USD 100 billion in USA legal settlements alone since the start of the 2008/2009 financial crisis (Clark et al., 2015). The size of the fines illustrates why many institutional investors are concerned about their exposure to social and environmental risks.

A further criticism for the efficient market hypothesis is based on the idea that financial institutions have a pragmatic reason to be socially responsible from a self-interest perspective (Hawley & Williams, 2000). The authors suggest that major institutional investors have grown sufficiently large that they have earned the name “universal owners”. They argue that some institutional investors invest broadly in both the domestic and global economy, exposing them to a wider variety of risks from all the jurisdictions in which they operate. In that case, what may be negative externalities in one company on the portfolio may have a direct and costly impact on another holding (Clark et al., 2015; Hawley & Williams, 2000; Hawley & Williams, 2007; Hebb et al., 2015). For that reason, it is argued that the financial performance of such institutions largely depends on the performance of the financial markets as a whole, as opposed to the performance of the individual firms in which they hold a financial interest (Amalric, 2006; Hawley & Williams, 2007; Hoepner, Rezec, & Siegl, 2011; Kiernan, 2007; PRI, 2011). Furthermore, such institutions have both the power and a shared interest to try and improve on the economic as well as the ESG conditions of the economies to which their portfolio is linked. In doing so, they can help create stable economies that would, in turn, lead to higher financial returns for the investors (Hoepner et al., 2011).

Another theoretical underpinning derives from the principal–agent problem (Fama & Jensen, 1983; Jensen & Meckling, 1976; Shleifer & Vishny, 1997). Hebb et al. (2015) quoting Berle Jr. and Gardner (1934) observe that the struggle for corporate control between owners (principal) and managers (agent) has a long history in the legal, financial and economic literature. Given that RI encourages active share ownership and corporate engagement, it represents a shift of control away from firm managers and toward owners of corporations. RI supporters suggest that institutional owners should provide active and engaged oversight of corporations through corporate engagement and voting (Davis, Lukomnik, & Pitt-Watson, 2006; Monks, 2001).

There are other theories that help explain why firms engage in RI including the resource-based view of the firm, the stakeholder theory, and the shareholder engagement and activism (discussed in section 3.3 as one strategy used by practitioners to implement RI). The resource-based view of the firm argues that firms can gain a competitive advantage over their competitors if they can control resources and capabilities that are valuable, rare, not easily imitated by rivals, and not easily bought or sold on markets (that is, completely substituted) (Barney, 1991; Barney, Wright, & Ketchen, 2001). Resources include tangible assets such as physical and financial assets, and intangible assets such as employee knowledge, experience and skills, and the firm's reputation and brand name (Grant, 1991; Mathews, 2002). Barney (1991) suggests that resources gain value when they enable a firm to implement strategies that improve its efficiency or effectiveness. Hence, a firm is said to have a competitive advantage when it is implementing a value creating strategy not being implemented by a current or potential competitor (Barney, 1991).

Theorists with a resource-based view suggest that firms are more likely to gain a sustainable competitive advantage from intangible resources than from tangible resources (Barney, 1999; Carmeli & Tishler, 2004; Ray, Barney, & Muhanna, 2004). That is because intangible resources, such as reputation, knowledge assets, and long-term relationships with suppliers and customers take considerable time and effort to build, and are the result of complex social relationships and interactions over time (Ayuso, Roca, Arevalo, & Aravind, 2016). However, research shows that it is much more difficult to value intangible assets than tangible assets (Cosmulese, Grosu, & HLACIUC, 2017).

Proponents of the business case suggest that RI firms gain a competitive advantage over other firms because consideration of ESG issues results in enhanced risk assessment and management, better financial performance through product innovation, attraction of like-minded employees and improved corporate reputation (Barnett & Salomon, 2006; Clark et al., 2015; Scholtens, 2010). However, the resource-based theory is not suitable for my study because it does address the question that motivates this study: what are the critical challenges for RI development in the retirement benefits sector of Kenya? Moreover, my study focuses on institutional investors who are likely to possess more intangible assets than tangible assets. As previously stated, intangible assets are more difficult to value than tangible assets.

Also, critics argue that the two concepts fundamental to the resource-based view-resources and value- are indeterminate in nature (Kraaijenbrink, Spender, & Groen, 2010). According to Kraaijenbrink et al. (2010), the value of a resource is too indeterminate to provide for useful theory and the definition of resource is unworkable because the resource-based view does not differentiate between the resources that are inputs to the firm and the capabilities that enable the firm to utilise those resources to create a sustainable competitive advantage. So, the theory does not address fundamental differences in how different types of resources may contribute in a different manner to a firm’s sustainable competitive advantage.

The stakeholder theory argues that an organisation has many types of stakeholders with multiple expectations and sometimes conflicting expectations (Fernando & Lawrence, 2014). Broadly, a stakeholder can be defined as “any group or individual who can affect or is affected by the achievement of the organisation’s objectives” (Freeman, 1984, p. 46). The stakeholder perspective suggests that an organisation has financial, social, and environmental responsibilities to its stakeholders (Fernando & Lawrence, 2014).

The stakeholder theory is closely related to corporate social responsibility in that stakeholder theorists define appropriate and inappropriate corporate behaviour in terms of how corporations act towards their stakeholders (John, 2007). It describes what the corporation is, who its stakeholders are and contends that stakeholders have legitimate interests in corporate activities. Moreover, it recommends attitudes, structures, and practices that constitute stakeholder management and identifies the relationship between stakeholder management and the achievement of various corporate performance goals, such as profitability, stability, and growth (John, 2007). In that way, it is linked to RI because in RI, investors try to account to account for ESG issues in the investment process thereby accounting to different stakeholder interests, ranging from economic (such as institutional investors), organisational (such as labour unions), and societal (such as governments and NGOs) (Sievänen et al., 2013).

Like the resource-based theory, the stakeholder theory is not suited for my study because it does not address the central question of my research. Also, it has been criticised for not attending to the dilemmas that confront managers when the normative (managers ought to attend to stakeholders other than shareholders independent of financial gains) and instrumental (attend to stakeholders other than shareholders because there are economic gains) claims do not perfectly align (John, 2007; Margolis & Walsh, 2003).

I approach this study from a business case perspective, recognising that material ESG issues in Kenya can present both risks and opportunities to the retirement benefits schemes. The business case approach is the most appropriate approach for this study because my primary motivation is to understand how RI, an investment strategy that is mainly practised in developed countries can be implemented in a developing country like Kenya. Since the business case for RI is currently one of the biggest driving forces for RI market in the world, it is appropriate to study the challenges for RI development in the retirement benefits sector of Kenya from the business case perspective.

The business case approach allowed me to frame the ESG factors as factors that can present risks and returns. By so doing, it allowed the participants to discuss the critical challenges for RI from the risk and return perspective. Thus, it not only provided conceptual but also analytical direction that helped me address the central question for this study: what are the critical challenges for RI development in the retirement benefits sector of Kenya? I especially draw on the business case approach to develop the research questions and to formulate the interview questions that guide the data collection phase. Further, I use the business case lens to analysis the data, assessing the extent to which the actors in the retirement benefits sector recognise ESG factors as material factors. Recognising ESG factors as material factors is an important part of the business case approach because ESG issues acquire significance mostly to the extent that they are perceived as financially material to an investment portfolio (UNEP-FI, 2004). Analysing the data from the business case perspective allowed me to explore the participants conceptualisation of RI in terms of definition and the perception of ESG issues in Kenya. Doing so helped me understand the participants perception of ESG issues, and how that relates to the overall challenges for RI development in the retirement benefits sector of Kenya.

3.3 Implementing RI

RI practitioners use several strategies to integrate ESG issues in the decision-making process. Some approaches are used when identifying prospective investment opportunities, while others are used after the investment has been made. The strategies can be used in isolation or in combination to achieve the desired outcome. The main strategies are screening (to either include or exclude some assets), ESG integration, shareholder engagement and activism, sustainability-themed investing, and impact investing (Eurosif, 2018; Global Sustainable Investment Alliance, 2018; PRI, 2019b; Zarbafi, 2011). The following sections discuss the rationale for these strategies further.

3.3.1 Screening

The main objective of screening is to gather and process information to identify potential investment opportunities (Scholtens, 2006). Concerning RI, screening results in inclusion or exclusion of companies or industries, using ESG criteria as a filter. The principal screening strategies are negative/exclusionary, positive, best-in-class and norms-based screening.

3.3.1.1 Negative/exclusionary screening

This is the most popular strategy among institutional investors globally and the best-known approach amongst consumers (Global Sustainable Investment Alliance, 2016, 2018). As the name suggests, it implies the complete exclusion of companies from the investment portfolio based on ESG criteria or based on international standards or conventions (Eurosif, 2016). The idea goes back to when RI was guided and driven by religious organisations (Sparkes & Cowton, 2004; Viviers, Bosch, Smit, & Buijs, 2009). Through negative screening, investors can align their portfolio with a certain set of values that may originate from their beliefs or may reflect the interests of the consumers to limit potential reputational risk. The top exclusion criteria in Europe includes controversial weapons, tobacco, pornography, gambling and nuclear energy (Eurosif, 2018). Controversial weapons such as cluster munition and anti-personnel landmines are already banned by law in many European countries (Eurosif, 2016).

3.3.1.2 Positive screening

This is where investment managers proactively select projects because of their positive performance on ESG factors. Companies are included because of their superior performance in ESG areas, such as a reduction of greenhouse emissions or clear corporate governance policies (Zarbafi, 2011). Positive screening allows managers to customise desired outcomes by identifying companies whose ESG interests coincide with theirs (Lamore, Link, & Blackmond, 2006). However, it can result in some companies or sectors being excluded entirely if they do not match the criteria that fund managers are interested in (Vandekerckhove, Leys, & Van Braeckel, 2007). For that reason, investors desist from using this strategy, because it can result in reduced portfolio diversification (Zarbafi, 2011). Also, the assessment of "good" companies is harder than that of "bad" companies due to differing moral norms and standards (Zarbafi, 2011). Moreover, it can be more difficult to administer as it requires a thorough analysis of ESG issues, some of which are complex, such as diversity and health and safety of workers, necessitating examination of corporate policies and practices, information that is either not publicly available or in a format that is expensive or difficult to analyse (Viviers et al., 2009).

The whole process places a strain on resources and especially time, because the social aspect of ESG is also challenging to measure (Sparkes & Cowton, 2004). Furthermore, corporations, especially large ones, are involved in diverse activities such that they might perform better in some areas and not others, making it harder for investors to decide which aspects to give prominence (Knoll, 2002). These challenges have brought about a shift in the current industry practice from positive screening to best-in-class, which is viewed as less restrictive (Herringer, Firer, & Viviers, 2009; Zarbafi, 2011)

3.3.1.3 Best-in-class

As opposed to negative or positive selection, best-in-class does not require excluding whole sectors or industries, unless they are banned by the law (Eurosif, 2016; Vandekerckhove et al., 2007; Zarbafi, 2011). Instead, this approach aims at generating comparative criteria to compile an investment portfolio out of the best-in-class companies regarding ESG performance from every sector or industry (Vandekerckhove et al., 2007; Zarbafi, 2011). For example, an investment fund may have criteria that allow it to invest in the oil and gas sector but only in the best-in-class companies regarding ESG performance (Eurosif, 2016). Thus, best-in-class allows for evaluation of a more comprehensive array of companies, counteracting the diversification challenges associated with negative screening, while still allowing for ESG consideration in the investment decision-making process (Vandekerckhove et al., 2007; Zarbafi, 2011). According to Zarbafi (2011), the best-known best-in-class approach to managing RI is the Dow Jones Sustainability Index, which tracks the financial performance of companies assessed as industry leaders with regards to ESG issues.

One disadvantage of the best-in-class approach is that companies that may otherwise be deemed undesirable under negative screening criteria can make their way into this category, thus tainting the resulting portfolio morally (Sparkes & Cowton, 2004). Irrespective of this concern, best-in-class is the leading strategy in France (Eurosif, 2018; Global Sustainable Investment Alliance, 2018).

3.3.1.4 Norms-based screening

This is the screening of assets against the minimum standards of business practice based on international norms (Global Sustainable Investment Alliance, 2018). Such norms focus on areas such as environmental protection, human rights, labour standards and anti-corruption, and are set by international initiatives and guidelines such as the Organisation for Economic Co-operation and Development (OECD) *Guidelines for Multinational Enterprises*, the United Nations Global Compact, the International Labour Organization *Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy*, and the United Nations Children’s Fund (Eurosif, 2018). Investors have the option to use norms-based screening on its own or in conjunction with other strategies, such as engagement and exclusion. Norms-based screening is more popular in Europe than the USA, Canada, or Australia/New Zealand (Global Sustainable Investment Alliance, 2018). The most common norms-based screening in Europe is the United Nations Global Compact, followed by the International Labour Organization and the OECD *Guidelines for Multinational Enterprises* (Eurosif, 2018; Global Sustainable Investment Alliance, 2018).

3.3.2 ESG integration

ESG integration is the investment approach that explicitly integrates ESG factors into traditional financial analysis. The traditional financial analysis involves strategies such as financial forecasting (such as revenue, operating cost, asset book value and capital expenditure) or company valuation models (such as the dividend discount model, the discounted cash flow and the adjusted present value model) (PRI, 2016c). ESG factors can be integrated into the traditional strategies to adjust for the expected impact of material ESG factors. The purpose of this enhanced analysis is to derive an optimal portfolio based on integrating ESG factors into the calculation of alpha (Zarbafi, 2011). In this case, alpha is the excess return on a portfolio relative to the return of the benchmark index (Zarbafi, 2011).

The first step of integrating ESG factors involves gathering relevant ESG information from sources such as company reports and third-party investment research institutions and identifying the material factors affecting the company (PRI, 2016c). This step can involve screening to identify a qualifying investment universe by excluding companies with the weakest ESG performance based on ESG scores from ESG research providers. The next step is to identify the most promising companies from within the identified universe both in terms of traditional valuation and from an ESG perspective. The other step is to identify the material ESG factors for each sector and perform quantitative analysis of the factors to assess their impact on securities, adjusting the financial forecasts or valuation models appropriately (PRI, 2016c). The investor can then decide whether to invest (or increase weighting), hold (or maintain weighting) or sell (or decrease weighting) (PRI, 2016c). The ESG analysis process can be done internally by asset managers or externally by a specialised research firm or ESG rating agency that supply the information to the asset manager (Sullivan & Mackenzie, 2006; Zarbafi, 2011).

The objective of the enhanced analysis of ESG issues is to shift the traditional financial analysis from the short-term financial assessment, such as quarterly earnings, towards long-term stock valuation regarding ESG performance (Barton & Wiseman, 2014; Hebb et al., 2015; Kay, 2012; Zarbafi, 2011). Unlike screening, ESG analysis represents a more holistic approach than pure screening based on ethics. ESG analysis is based on the investment belief that ESG integration ensures a more efficient allocation of capital, thereby improving overall market returns (Zarbafi, 2011). As stated before, integrating ESG factors into the traditional financial analysis implies an underlying belief in market imperfections, as investors with better ESG than others can trade on that information to their advantage (Sullivan & Mackenzie, 2006; Zarbafi, 2011).

ESG integration is the second most popular strategy globally and the leading strategy in the USA, Canada and Australia/New Zealand (Global Sustainable Investment Alliance, 2018). Many EU investors view ESG integration as an easy way to embed sustainability matters into the asset selection process (Eurosif, 2018). However, it is difficult to apply this strategy because currently there is no standard formula stating how to integrate ESG issues effectively. Thus, EU investors suggest that the EU should establish a method that clarifies the parameters governing the integration of ESG factors (Eurosif, 2018).

3.3.3 Impact investment strategy

Impact investing is where investors aim to solve some specific social or environmental problems such as a lack of proper housing or inadequate community infrastructure through investment decisions (Hebb, 2011; Louche & Hebb, 2014). This style of investing focuses on the financing of alternative economies and projects that would not usually be funded by regular market forces (Vandekerckhove et al., 2007). It seeks to address capital gaps by investing directly in the real economy to generate socially desirable outcomes, while at the same time gaining competitive financial returns (Viviers et al., 2009). The Global Impact Investing Network is a non-profit organisation whose objective is to promote impact investing through research. Its 2017 survey observes that impact investing is gaining popularity globally (Global Impact Investing Network, 2017).

The African Investing for Impact Barometer (2017) determined that impact investing is the most promising RI strategy in East Africa. As the financial and capital centre of East Africa, Kenya has the highest concentration of the number of impact investors in comparison to the neighbouring countries, and it also receives a significantly higher amount of impact capital (Saltuk, El Idrissi, Bouri, Mudaliar, & Schiff, 2015). The key impact investors in Kenya, in terms of the capital committed, are development finance institutions such as the African Development Bank. They invest directly in financial services and the energy sector (Saltuk et al., 2015). Other impact investors include private foundations (for example, the Bill and Melinda Gates Foundation), high net worth individuals, and institutional investors (for example, the Equity Bank of Kenya) (United Nations Development Programme Africa, 2015). Impact investing fills an important gap in the market by providing capital to start-ups and businesses that are in the early stages. Commercial banks are usually reluctant to lend to start-ups, and when they do, they require high collateral ratios that small-scale borrowers are unable to meet (Saltuk et al., 2015).

3.3.4 Sustainability-themed investing

Sustainability-themed investing is defined as investment in assets that are specifically related to sustainability, such as education, renewable energy and sustainable agriculture, among others (Global Sustainable Investment Alliance, 2018). Sustainability-themed or themed investing is sometimes classified as impact investing or cause-based investing (Hebb, 2011; Louche & Hebb, 2014). Sustainability-themed investing is especially popular with investors concerned about the long-term impact of climate change. They invest in assets aligned with renewable energy and energy efficiency. While sustainability-themed investing is one of the least popular strategies, it is gaining traction, especially in the USA (Global Sustainable Investment Alliance, 2018).

3.3.5 Shareholder engagement and activism

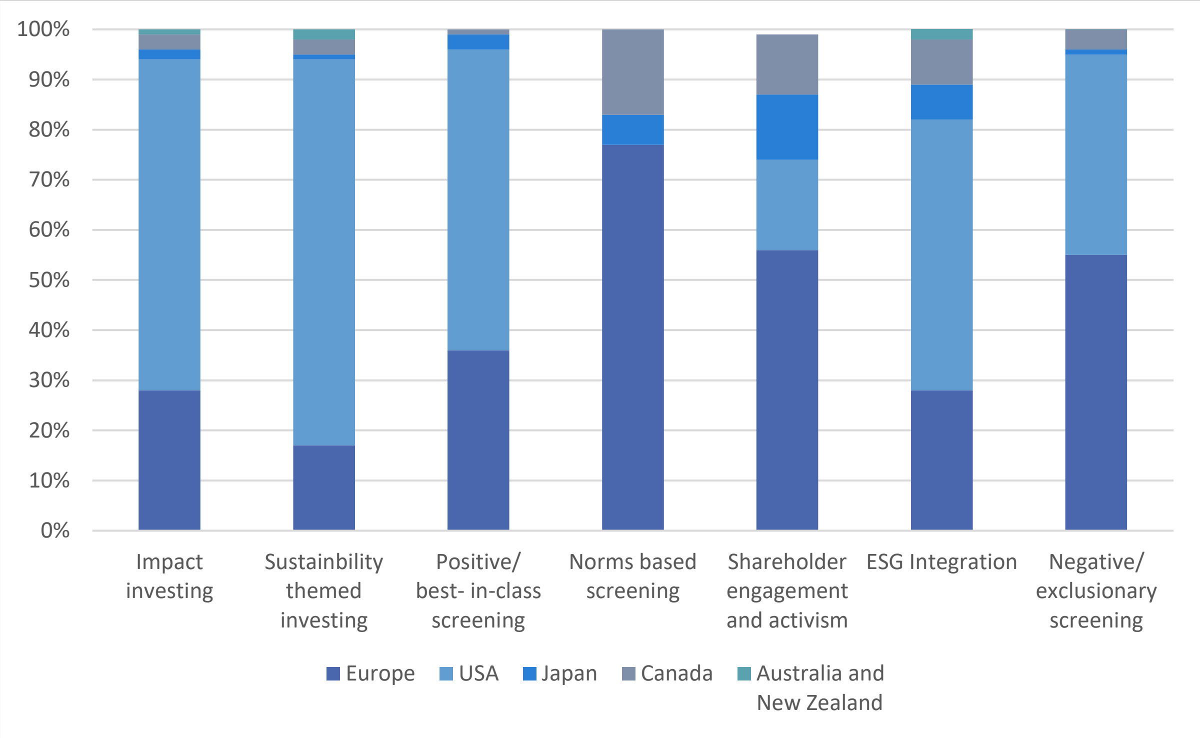
Shareholder engagement and activism are also known as shareholder or investor advocacy (Schueth, 2003; Smith, 2005), engagement (Vandekerckhove et al., 2007), engagement and activism (Zarbafi, 2011), engagement and voting (Eurosif, 2018), corporate engagement and shareholder action (Global Sustainable Investment Alliance, 2018), and active ownership and engagement (PRI, 2019b). The underlying objective of shareholder engagement and activism is to offer a mechanism for shareholders to engage with investee companies after the investment is made, to bring about company behaviour change on ESG issues through dialogue (David, Bloom, & Hillman, 2007; Zarbafi, 2011). Research shows that institutional shareholders can influence corporate governance of investee companies because they usually (but not always) have large blocks of shares and therefore the directors are likely to respond to their demands (O' Rourke, 2003; Richardson & Cragg, 2010). Moreover, it may be argued that institutional shareholders have a fiduciary duty to ensure that investment decisions are made in the best interest of the beneficiaries (Fairshare Educational Foundation, 2011). That duty might involve taking a significant role in monitoring the performance of the investee company, ensuring that the company is well run to ensure dividends and growth in the value of their investment.

Zarbafi (2011) differentiates shareholder engagement from shareholder activism and states that activism involves the use of formal rights available to ordinary shareholders while engagement involves the use of an informal approach to try and bring corporate behaviour change through dialogue. Accordingly, corporate engagement is characterised by the use of dialogue between investors and corporate management to raise concerns about ESG risks (Zarbafi, 2011). This soft approach includes activities such as personal communication, face-to-face meetings with managers, writing letters, conducting industry surveys, and discussing the results with corporate management (Hebb et al., 2015; Zarbafi, 2011). Shareholder activism is where investors exercise their formal rights, and they can do this using several avenues. For example, they can file a resolution to express concern about how the company handles ESG risks. The resolution can be presented to the annual general meeting where it can be voted on. Alternatively, shareholders can engage in a public campaign to raise awareness of corporate misbehaviour. Finally, if all strategies fail to achieve the desired results, the investor can divest from the organisation (Zarbafi, 2011).

Shareholder engagement and activism is the third most popular strategy globally and the dominant strategy in Japan and the UK (Global Sustainable Investment Alliance, 2018). Climate change and tobacco are among the top issues of engagement in Europe (Eurosif, 2018). Also, many European institutional and retail investors express the desire to divest from fossil fuel while simultaneously increasing their investment in industries dealing with renewable energy and energy efficiency (Eurosif, 2018).

In summary, negative or the exclusionary screening of assets, the oldest strategy, is still the most prevalent strategy globally, followed by ESG integration and shareholder engagement and activism (Global Sustainable Investment Alliance, 2018). Negative screening is most common in Europe while ESG integration is the dominant strategy in the USA, Canada, Australia/New Zealand. Shareholder engagement and activism is the preferred strategy in Japan and the second-largest strategy in Europe. Figure 3 shows the share of each of the strategies between the five regions in 2018.

Figure 3. Regional shares in the use of RI strategies in 2018



Source: Global Sustainable Investment Alliance (2018).

3.4 Drivers and enablers

RI drivers differ from country to country and from region to region. For example, the drivers of RI in South Africa are different from the drivers of RI in Norway. Often, RI adoption originates from either an earlier history that created a path dependence, leading investors toward RI or, where such a tradition does not exist, governments create regulatory regimes that encourage or require ESG factors to be taken into consideration in investment decision-making (Hebb et al., 2015). For example, the USA has a strong social movement that has shaped RI activities in that country, while the Scandinavian countries were the first to introduce regulatory frameworks and ESG standards (Hebb et al., 2015). This section discusses some key drivers of RI as reported in both academic and practitioners' literature.

3.4.1 Clients demand

Many studies (Banerjee, 2010; Eurosif, 2016; Global Sustainable Investment Alliance, 2016; Hellsten & Mallin, 2006; Schueth, 2003; Sievänen et al., 2013; Sparkes & Cowton, 2004; Zarbafi, 2011) attribute the mainstreaming of RI to clients' demand that corporations adhere to global norms on environmental protection, human rights, labour standards and anti-corruption. For instance, in 2016, 85 per cent of the asset managers in the USA stated that they incorporate

ESG issues in their decision-making processes due to client demand (Global Sustainable Investment Alliance, 2016).

Both academic and practitioner literature suggest that clients are more concerned about environmental and governance factors, while social issues lag. One reason that social issues are researched less is that they are difficult to define, as they are multiple and often change. Another reason is that it is difficult to quantify the financial impact of some social factors, such as the impact of a project on communities (Hebb et al., 2015).

One reason environmental factors are perhaps the most studied element of ESG is the increased pressure on companies by regulators and the wider society to be more concerned about the long-term impact of their actions on the natural environment (Filbeck & Gorman, 2004; Zarbafi, 2011; Zuraida, 2015). Another likely explanation is that environmental data is more quantifiable than social data (Eccles, Serafeim, and Krzus (2011). The literature on environmental accounting tends to focus on one of the following three areas: the value relevance of environmental information; the determinants of environmental disclosure; and the relationship of environmental disclosure to company performance (Clarkson, Richardson, & Vasvari, 2008; Zuraida, 2015).

Concern over the effects of climate change is the environmental factor that has received the most attention from NGOs, investors, academics, and governments (Global Sustainable Investment Alliance, 2016, 2018; Zarbafi, 2011). Climate change is a long-term alteration in temperature and weather patterns (National Geographic, 2020). To address the challenges related to climate change, world leaders agreed in Paris in 2015 to work towards limiting the global rise in temperature to two degrees Celsius by 2050 (United Nations Framework Convention on Climate Change, 2015). Investors are specifically concerned about how climate change risk affects their portfolio (Solomon, Solomon, Norton, & Joseph, 2011). Examples of climate risk implications for investors include the physical risk to assets due to extreme weather events, such as flooding, fire, and storms (Ciscar et al., 2011; Task Force on Climate-Related Financial Disclosures, 2017), which can result in losses for insurance companies and real estate owners. Another implication for investors is assets becoming stranded, that is, suffering from unanticipated or premature write-downs, or loss of value as a result of being overexposed to environment-related risks (Caldecott, Tilbury, & Carey, 2014). The loss in value may be due to future regulation, policies or changing consumer attitudes – for example, thermal coal assets could decline in value if carbon taxes are imposed or if there is a higher price for carbon emissions (Nielsen, 2014). Thus, corporations that have a significant amount of investment in fossil fuel face valuation risk in the future if such assets cease being used due to changes in legislation (Nielsen, 2014). This has caused some companies, such as the French energy firm Total, to withdraw from coal mining and marketing coal (Total, 2015).

The heightened climate risk concern is driving interest in green finance and bonds aligned to climate change (Eurosif, 2018; Global Sustainable Investment Alliance, 2018). The movement towards climate-aligned assets seems to be changing the portfolio composition of RI funds globally. For example, total European RI equity assets declined by 20 per cent in 2016, which corresponded with an increase in green bonds from 40 per cent to 64 per cent compared with 2014 (Eurosif, 2016). Similarly, sustainability-themed investing and impact investing in Europe grew substantially from 2014 to 2016 due to demand from clients for opportunities in renewable energy and energy efficiency (Eurosif, 2016). In the USA, shareholders concerned about the effects of climate change filed 93 resolutions in 2016, and negotiated with selected companies to reduce their greenhouse gas emissions or disclose their plans around climate change (Global Sustainable Investment Alliance, 2016).

The 2008/2009 financial crisis is another issue that has led to increased demand for ESG integration (Arjaliès, 2010; Eurosif, 2016; Hebb et al., 2015; Revelli, 2017; Richardson, 2013; Sievänen et al., 2013). The crisis brought to the fore the dangers of short-termism (Barton & Wiseman, 2014; Hebb et al., 2015; Kay, 2012), which refers to a disproportionate focus on short-term results at the expense of long-term interests (Chartered Financial Analyst Institute, 2020). The crisis revealed that an excessive focus on short-term performance may distract attention from large, underlying longer-term risks and threats, to the detriment of the investor (Waitzer, 2009).

Since the crisis, demand has increased from both consumers and investors for greater transparency, accountability, responsibility, and democracy from the markets (Banerjee, 2010; Sievänen et al., 2013). At the same time, asset managers are increasingly looking to ESG integration to restore legitimacy following the negative image that was created by the finance professionals during the financial meltdown. Thus, like a domino effect, the financial crisis catalysed change; it not only renewed interest in RI among investors and other commentators, it also stimulated further discussions about the potential for a more socially and environmentally responsible global financial market (Richardson, 2013).

3.4.2 To fulfil the fiduciary duty

Institutional investors, such as pension funds, are financial intermediaries whose role in the economy is to act on behalf of beneficiaries who invest their savings in those institutions (Zarbafi, 2011). In many countries, the law imposes a fiduciary obligation on institutional investors to act in the best interest of the beneficiaries (Hoepner et al., 2011; Zarbafi, 2011). The best interest of the beneficiaries is often interpreted to mean the best financial interest (Fairshare Educational Foundation, 2011; Sullivan & Mackenzie, 2006; Thornton & Fleming, 2011). With the surge of interest in ESG integration, a debate emerged on whether ESG integration is compatible with the fiduciary duty of pension funds (Hoepner et al., 2011; Woods & Urwin, 2010). In common law countries, the question centres on two elements of the fiduciary duty. These are the duty to exercise loyalty and the duty to act prudently (Woods & Urwin, 2010). The duty of loyalty requires trustees to act in the best interest of the beneficiary, while the duty of prudence requires trustees to exercise prudence, skills, care and diligence in managing trust funds for beneficiaries (Woods & Urwin, 2010). Under both USA and UK law, the modern portfolio theory is the accepted approach to prudent management of trust funds (Fairshare Educational Foundation, 2011; Hawley, Johnson, & Waitzer, 2011; Woods & Urwin, 2010).

Institutional investors show reluctance to engage in RI strategies such as negative screening because they do not want to breach the fiduciary duty obligations to act loyally and prudently. They argue that such strategies may lower the returns of the fund because they reduce the chances for portfolio diversification (Sullivan & Mackenzie, 2006; Thornton & Fleming, 2011; Zarbafi, 2011). Because they do not see the relationship between ESG integration and the fiduciary duty clearly, they do not consider it necessary to consider ESG integration in their investment decision-making (Zarbafi, 2011). In this case, the fiduciary duty to invest per the modern portfolio theory is viewed as a barrier to ESG integration.

Several countries and institutions have tried to clarify the circumstances under which ESG integration is legally permissible. The UNEP-FI commissioned a law firm, Freshfields Bruckhaus Deringer, to research and publish a report on whether ESG integration into the investment process by institutional investors is contrary to fiduciary duty (UNEP-FI, 2005). The report concluded:

> It is not a breach of fiduciary duties per se to have regard to ESG considerations while pursuing the purposes of the trust. Rather, in our opinion, it may be a breach of fiduciary duties to fail to take account of ESG considerations that are relevant

> and to give them appropriate weight, bearing in mind that some important economic analysts and leading financial institutions are satisfied that a strong link between good ESG performance and good financial performance exists. (UNEP-FI, 2005, p. 100)

Following the clarification by Freshfields' report that ESG integration does not necessarily result in a breach of fiduciary duty, countries such as Australia, France, Germany and the UK have made regulatory changes regarding fiduciary duties concerning ESG integration (Hoepner et al., 2011). Other countries introduced stewardship codes requiring institutional investors to consider ESG issues when making investment decisions (Hoepner et al., 2011; PRI, 2015). Thus, many institutional investors have come to regard ESG integration as part of their fiduciary duty, and the desire to fulfil that duty is one of the key drivers of the RI market in Europe, Canada and the USA (Eurosif, 2016; Responsible Investment Association Canada, 2019; US SIF, 2018).

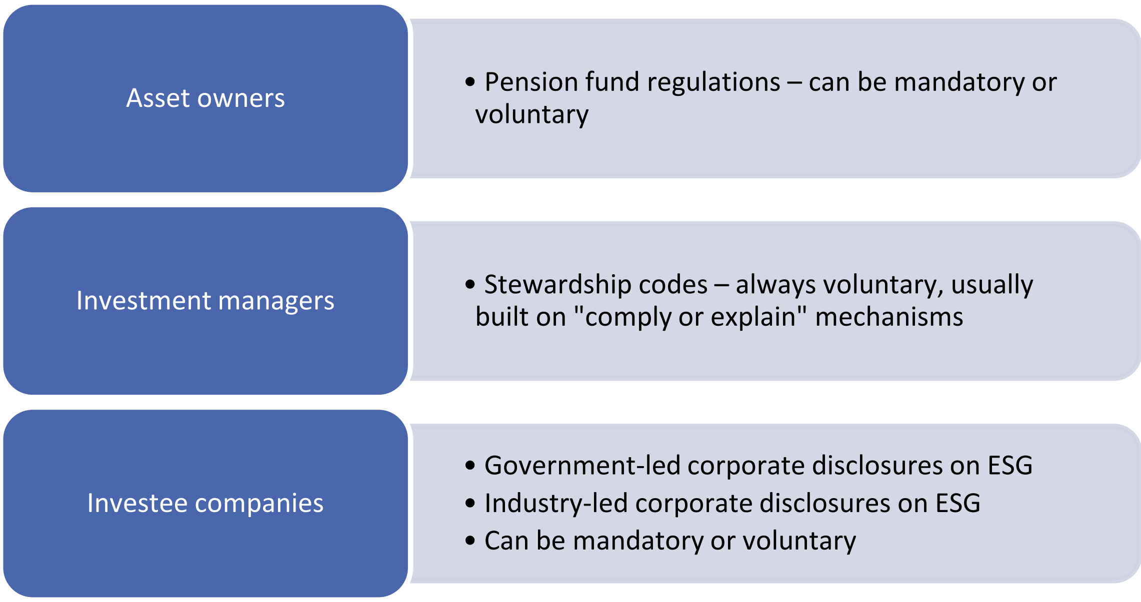
3.4.3 Policy changes and regulatory reforms

Policy changes and regulation regarding disclosure of ESG information by pension funds and listed companies have contributed to the growth of the RI market (Eurosif, 2016; PRI, 2016a; Renneboog et al., 2008). RI-related policies have considerably increased since the mid-1990s, with a particular surge since the global financial crisis (PRI, 2019b). Europe has formulated the most policies and passed the most regulations about RI to date (PRI, 2016a). Some policies and regulations are made at the EU level, while others are made at the individual country level.

For example, in 2016, the European Commission revised the *Institution for Occupational Retirement Provision Directive*, which covers all occupational pension schemes in the EU. One proposal of the revised directive requires member states to disclose where ESG factors are considered in investment decisions and to explain how they form part of their risk management system (European Commission, 2016). At a national level, France enacted the French Energy Transition for Green Growth Law (2015). Article 173 of the *French Energy Transition for Green Growth Law (2015)* asks institutional investors to disclose how they account for ESG criteria, with specific mention of climate change, in their investment policies. The law also asks them to explain the measures they have put in place to help transition to low-carbon energy and other environmental objectives. Moreover, several European countries have enforced laws prohibiting investment in cluster munitions and anti-personnel landmines (Eurosif, 2016). Although some countries (for example, UK, France, and Norway) view the issue as part of the international conventions to the cluster munition to which they adhere, others, including Spain, Belgium, Italy, Netherlands, Luxembourg, Switzerland and Ireland, passed specific legislation to ban investment in cluster munitions and anti-personnel landmines. Further, some countries, such as France, Finland, Poland and Spain, restrict all forms of weapons (Eurosif, 2016).

Research shows that there is a strong correlation between RI regulation and better ESG risk management (PRI, 2016a). However, there is scepticism over the effectiveness of policies due to weakness in policy design, poor monitoring and a lack of consistency between various government departments and industry regulators (PRI, 2016a). Broadly speaking, existing policies can be classified into three categories depending on the part of the investment chain they relate to. As shown in Figure 4, these are investor regulations (such as pension fund regulations) that relate to asset owners, industry-led stewardship codes that relate to investment managers, and corporate disclosure policies that relate to investee companies (PRI, 2016a).

Figure 4. Categories of RI regulations



Source: PRI (2016a).

3.4.3.1 Asset owners – pension fund regulations

Asset owners' regulations usually focus on ESG integration in investment decision-making processes (PRI, 2016a). The regulations place ESG issues on the agenda for trustees to consider when formulating the fund's investment strategies and when making internal investment guidelines. The regulations can be mandatory or voluntary. If voluntary, they can be codified into stewardship codes or other guidelines for making investment decisions, as appropriate (PRI, 2016a).

Mandatory asset owners' regulations can require the disclosure of ESG information through the statement of investment principles, or equivalent (PRI, 2016a). For example, section 78 (3) of regulation 909 of Ontario's *Pension Benefits Act 1990* (RSO) requires pension funds in Ontario to disclose in their investment policies whether ESG factors are incorporated into the investment policies and procedures, and to explain how those factors are incorporated (Regulation 909 of Pension Benefits Act, 1990). By setting mandates, asset owners control the incentive structure of the asset managers because of the commitments made. This kind of regulation obligates asset managers to implement investment beliefs and relevant investment policies, which, when fully and effectively implemented, should create a multiplier effect across the investment market (PRI, 2016b).

3.4.3.2 Investment managers – stewardship codes

Stewardship codes govern the interaction between investors and investee companies to promote long-term value creation strategies. The UK was the first to develop stewardship codes in 2012 on a "comply or explain" basis, and most of the stewardship codes follow the UK's model (Galander, Walgenbach, & Rost, 2015). The UK built on a long tradition of industry-led initiatives to promote engagement and voting on particular aspects of corporate governance (PRI, 2016a).

The comply or explain principle originated in the UK with the *Report of the Committee on the Financial Aspects of Corporate Governance* (commonly known as the Cadbury Report) (Committee on the financial aspects of corporate governance, 1992). The principle takes into consideration that it is not possible to adopt a one-size-fits-all approach to corporate governance codes, because companies that are subject to the codes differ in terms of size, structure and organisation (Macneil & Li, 2006). The essence of the comply or explain principle is that compliance with the code of governance is not mandatory but disclosing of non-compliance is mandatory (Financial Reporting Council, 2012; Keay, 2014; Macneil & Li, 2006). The comply or explain principle makes the board accountable for what has been done and what has not been done. Where the boards are confident that their existing arrangements ensure accountability and support board effectiveness, they are at liberty not to comply with the provisions of the code, provided they explain their reason for non-compliance (Keay, 2014).

Comply or explain principles are built on the assumption that the market, and not the regulatory authorities, will monitor compliance with the code of governance. The market can either penalise non-compliance through lowering share prices or accept that non-compliance is justified in the given circumstances (Anand, 2005; Keay, 2014; Macneil & Li, 2006). The principle assumes that companies have the incentive to comply because compliance is likely to be reflected in a company's share price (Macneil & Li, 2006). The drawback of leaving the market to evaluate a company's compliance with the code is that the market may not be concerned about compliance and that there is no credible sanction to non-compliance (Macneil & Li, 2006).

The comply or explain principle allows shareholders and other relevant stakeholders to evaluate whether non-compliance is justified given the company's circumstances (Keay, 2014; Macneil & Li, 2006). If shareholders are dissatisfied with the board's performance on corporate governance obligations, they can divest themselves of their shares, exert pressure on the board for a change, or exercise their voting rights (Keay, 2014). Moreover, where the provisions of the code are enshrined in the company's articles of association, shareholders can sue the directors for breach of their duties. However, many of these options may not be practical, as the shareholding may be either too small to warrant taking on a monitoring role, or too large to dispose of a significant proportion of shares, which could lead to a substantial loss that the shareholder may not be willing to incur (Keay, 2014).

In general, enforcing voluntary codes is problematic (Berglöf & Claessens, 2006; Cankar, 2005; Keay, 2014). Enforcement is especially problematic in developing and transitioning economies, because the corporate environment in such economies tends to be characterised by a weak culture of compliance and the market control systems are not sufficiently developed to support compliance with self-regulatory norms (Berglöf & Claessens, 2006; Cankar, 2005; Munisi & Randøy, 2013). Berglöf and Claessens (2006) argue that enforcement is the key to creating an effective business environment and good corporate governance in developing and transitioning economies. It is more important than increasing the number of regulations and voluntary codes.

Evidence suggests that stewardship codes increase the dialogue between the investors and investee companies (PRI, 2016a). But the effectiveness of the stewardship codes to manage companies' ESG risk increases where there is asset owners' regulation.

3.4.3.3 Investee companies – corporate disclosure guidelines

Corporate disclosure requirements on ESG issues assist investors to access data on ESG risk and opportunities. Investors require this information for them to integrate ESG into their investment strategies (PRI, 2016a). Corporate disclosure regulations are the most common initiatives (in comparison to stewardship and pension fund regulation), and although they tend to be mainly voluntary, they play a major role in raising awareness of ESG issues within an organisation and can result in better management practices – because, as the saying goes, what gets reported gets managed (PRI, 2016a).

Corporate reporting guidelines can be issued by governments, stock exchanges or by industry associations (PRI, 2016a). They may be mandatory or voluntary. Research suggests that countries with government-led mandatory disclosure guidelines score highly on ESG standards, suggesting that formal enforcement mechanisms strengthen the implementation PRI (2016a). The research further suggests that integrating ESG disclosure requirements into listing rules may strengthen their implementation because that is the primary enforcement available to exchanges. In contrast, voluntary disclosure requirements are not as effective as those that are mandatory, but they are useful as a stepping stone to other more comprehensive frameworks (PRI, 2016a).

Overall, companies located in countries with government-led mandatory ESG disclosure requirements show better risk management practices than those in countries with voluntary requirements alone (PRI, 2016a). It is worth noting that no emerging market has all three types of regulations, that is, those for asset owners, investment managers and investee companies (PRI, 2016a).

3.4.4 ESG rating agencies and RI indices

Availability of ESG information on international databases has made it relatively easy for investment managers to incorporate ESG issues into investment decisions (Novethic research, 2014). ESG rating agencies assess the ESG performance of a company or a country and award a rating. Company analysis covers multiple criteria, such as work-related accidents, energy consumption, greenhouse gas emissions and standards (for example, the International Labour Organization conventions and the United Nations Global Compact's principles). Also, they offer other services and products, such as controversy alerts and engagement services. The rating enables asset managers to compare company or country performance on ESG and choose according to their investment policy (Novethic research, 2014).

ESG rating agencies have been established since the late 1990s (Novethic research, 2014). The major research providers providing full ESG ratings include Vigeo Eiris (Ethical Investment Research and Information Service) (United Kingdom/France), oekom (Germany), Sustainalytics (Netherlands), Inrate (Switzerland), EthiFinance (France) and the MSCI ESG Research (USA) (Novethic research, 2014). Moreover, traditional data providers like Thomson Reuters and Bloomberg also offer ESG data, either on their own or through partnering with specialised research agencies (Novethic research, 2014). Furthermore, other smaller agencies offer specialised products, for example, Trucost (UK) measures companies' environmental impacts, while EthiFinance (France) produces ESG ratings on both listed and unlisted small- and mid-cap companies (Novethic research, 2014).

ESG analysis is primarily based on publicly available data reported by companies, NGOs, governmental organisations, and trade unions. Rating agencies also use specific questionnaires, telephone calls and face-to-face contact to gather relevant information. These analyses are used to determine a rating for each ESG criterion and an overall rating for each company, which can be used to compare companies' performance (Novethic research, 2014). Each agency develops its own methodology, as there is no common framework for ESG rating. However, most agencies use the same base of international standards to establish appropriate rating criteria (Novethic research, 2014). Table 4 illustrates the products and services offered by EIRIS Ltd, a UK-based rating agency.

Table 4. EIRIS Ltd products and services

EIRIS Global Platform	Provides access to detailed ESG assessments of more than 3,300 companies listed in the main stock market indices on over 110 different ESG areas. It can be customised to suit specific investment approaches.
EIRIS Global Screening Service	Used to follow controversial activities of over 5,500 firms in developed and emerging markets regarding selected ethical indicators, such as tobacco, arms, or alcohol production. The service provides a variety of screening thresholds.
EIRIS Emerging markets services	Provides access to ESG assessments of 300 of the largest capitalisations in emerging countries. It also provides sector-

	based and norm-based screening for 800 companies. This service is developed in part through the EIRIS network of partners in those countries.
Convention Watch	Provides norm-based (human rights, labour rights, corruption, etc.) analysis of allegations made in the press or by NGOs and classifies them based on their seriousness and the reliability of the source. In the event of an evidenced violation, a dialogue is engaged with the company. The company’s response is rated based on its relevance. Reports are updated every three months. This covers 3,700 companies, of which 700 are in emerging countries.
Climate Change Toolkit	Used to analyse companies in terms of their climate change risks and opportunities. A portfolio can be compared to any other benchmark.
PRI Toolkit	Aids financial institutions in complying with the PRI.
Global Sustainability Rating	Rates companies from A to E, giving EIRIS Ltd global assessment of companies’ performance through the analysis of their mitigation of ESG risks.
Country Sustainability Ratings	ESG rating tool covering more than 75 countries.
Global News Service	Monitors companies affected by ESG controversies and breaches of international norms. This system covers emerging and developed countries and provides a three-level risk assessment of the news.
Global Controversial Weapons Watch	Identifies manufacturers of controversial weapons, covering 13,000 companies. Information is updated every three months.

Global Engagement Service	Assists investors in their theme-based engagement or controversy-led engagement approach.
Global Voting Service	Supports investors in integrating ESG considerations into their voting policy, implemented by providing voting recommendations on specific resolutions and introducing reporting on voting and engagement.
EIRIS Conflict Risk Network	Supports investors in analysing risks of companies involved in Sudan and Myanmar.
Global Fund Report Card	Provides a comparative analysis of funds' ESG performance.

Source: Novethic research (2014).

The ESG disclosure scores calculated by rating agencies not only reflect a growing market interest in the degree of a company's transparency about ESG performance, but also show increased use of ESG scores by investors (Eccles et al., 2011). Unlike financial rating agencies, ESG rating agencies are paid by investors. Research shows that responsible investors are not the only ones that find ESG information useful, but conventional investors also use ESG information to assess risk (Amel-Zadeh & Serafeim, 2018; van Duuren et al., 2016). A study by Amel-Zadeh and Serafeim (2018) used survey data from mainstream investors and found that 82 per cent of the investors used ESG information. According to the study, mainstream investors integrate ESG information mostly because it is financially material to investment performance. Other factors are client demand for ESG integration, product strategy and ethical considerations (Amel-Zadeh & Serafeim, 2018).

ESG rating agencies also establish RI indices using their ESG analysis methodology to select issuers that are included in the index (Novethic research, 2014). ESG rating agencies often use a provider of traditional indices to create a socially responsible investment index. The indices can be used as a basis to compare the performance of RI funds or even to build RI index funds. ESG indices especially enable investors to practice an exclusion policy (Novethic research, 2014). Although not all indices are established by rating agencies, a significant number of them are developed by ESG rating agencies.

Although not all countries have rating agencies and RI indices, those that do have greater awareness and acceptance of RI concepts. For example, the number of Brazilian retail assets under management grew significantly after the establishment of the Brazilian Corporate Sustainability Index in 2015 (Ortas et al., 2012). RI indices play an important role in influencing the ESG strategies of companies that are willing to be included in such indices (Novethic research, 2014). The indices highlight a positive assessment of the companies' sustainable development policies, which in turn boost their reputation (Novethic research, 2014).

3.5 Deterrent for the growth of the RI market

As the drivers of RI, the factors that hinder RI development are not homogeneous. They depend on the cultural context, the market setup, the size of the market and other such factors. The following sections discuss five dominant factors that deter the development of the RI market. These are performance concerns; increased administration cost; a lack of expert knowledge and a shortage of viable products; short-termism; and ambiguity in RI definition and practice.

3.5.1 Performance concerns

The most significant disincentive to RI strategies is investors' concern over RI fund performance. As stated before, the issue has generated considerable interest among scholars, resulting in numerous empirical studies. Although many studies have shown that ESG integration can add firm value, the perception that RI leads to fewer returns persists (PRI, 2016b). For instance, performance concern has been one of the top deterrents to RI growth in Europe (Eurosif, 2018).

A key argument put forward by opponents is that the RI market forms a small subset of the total investments that make up the market portfolio. Thus, from a modern portfolio theory perspective (Markowitz, 1952), concentrating on smaller portfolios reduces diversification opportunities (Bauer et al., 2007; Knoll, 2002; Lee, Humphrey, Benson, & Ahn, 2010; Revelli & Viviani, 2015). This leads to a reduction in risk-adjusted returns and an increase in firm-specific risks. As a result of higher firm-specific risks, equity investors are likely to demand a risk premium as compensation if they perceive that they are assuming the extra risk (Fama &

French, 1997). The result is a higher cost of capital, which ultimately leads to lower firm value (Hong & Kacperczyk, 2009; Viviers et al., 2009).

Several studies counter the reduced diversification argument. For example, Bello (2005) found that both RI and conventional funds exhibit similar diversification characteristics and there is no significant difference in performance between RI and conventional funds. Another study found that, in some instances, specialised funds improve risk-adjusted fund returns, thereby reducing the severity of possible costs associated with reduced diversification (Gil-Bazo, Ruiz-Verdú, & Santos, 2010). Moreover, an investigation of Canadian companies found that responsible companies tend to show less diversifiable risk than companies that do not integrate ESG factors in their risk assessment (Boutin-Dufresne & Savaria, 2004). Further, some scholars argue that in the presence of incomplete information (like that presented by ESG factors), a perfectly diversified portfolio is no longer efficient (Merton, 1987; Revelli & Viviani, 2015). On the contrary, if RI investors possess information that conventional investors do not have, they can obtain higher returns even if they appear to be under-diversified (Revelli & Viviani, 2015).

3.5.2 Increased administration costs

The process of screening and monitoring the non-financial performance of a company has been shown to increase administration expenses, which ultimately lower expected returns (Laurel, 2011). The cost to determine which stock to include in the RI portfolio tends to be higher because ESG reporting is not as stringent as economic reporting, which relies on the highly formalised accounting system (Revelli & Viviani, 2015).

Additionally, RI funds are said to exhibit higher management expense ratios when compared to conventional models with similar investment portfolios (Bauer et al., 2005; Gold & Ali, 2002). The costs may include higher investment management fees charged by asset managers with superior asset selection skills as compensation for the ability to generate over and above the expected returns or fees paid to external service providers such as index vendors and RI research providers. Further, RI product certification may not be free. For instance, members of the Responsible Investment Association Australasia pay AUD 150 per certified product, capped at AUD 1,000 per year per member (Responsible Investment Association Australasia, 2019).

The added costs of incorporating ESG information and the subsequent costs to actively manage the portfolio sometimes outweigh the benefits to be gained from such investment (Hassel, Nilsson, & Nyquist, 2005). Even where asset owners can analyse ESG issues, they are concerned that the cost will outweigh the investment benefits that accrue (PRI, 2016b).

3.5.3 A lack of expert knowledge and a shortage of viable RI product

Research shows that both asset owners and asset managers often lack expert knowledge on RI, which in turn affects the array of RI assets offered to the clients (Eurosif, 2018; Moret, 2020; PRI, 2016b). The lack of expert knowledge by asset owners limits their ability to engage with asset managers to encourage them to offer RI-related products. While they expect asset managers to have core competencies that enable them to invest their assets in a manner that adds value, asset managers often lack the full range of RI-related skills and competencies (PRI, 2016b). The lack of clear indication from asset owners that they would like RI products or that they expect asset managers to have RI capabilities means that asset managers have little incentive to develop such products or acquire RI skills (PRI, 2016b).

A lack of expertise among asset managers and investment analysts emerged as one of the obstacles to RI development in South Africa (Viviers et al., 2009). Similarly, a lack of qualified advice or expertise was one of the top deterrents to RI in Europe (Eurosif, 2016, 2018). To some extent, the lack of expertise hampers European asset managers' ability to offer the right products to clients. For example, in France, commercial banks and insurance companies are starting to offer RI products, but in-house advisors lack training on most RI products (Eurosif, 2018).

3.5.4 Short-termism

Short-termism is defined as "the excessive focus of some corporate leaders, investors, and analysts on short-term, quarterly earnings and a lack of attention to the strategy, fundamentals, and conventional approaches to long-term value creation" (Chartered Financial Institute, 2006, p. 5). Research shows that most managers, including those who manage pension capital, are incentivised to "outperform" in less than a year, and in many cases shorter periods (Barton & Wiseman, 2014; Hebb, 2011; Hebb et al., 2015; Johnson & de Graaf, 2009; Kay, 2012). A 2013 study conducted on behalf of McKinsey and Company and the Canada Pension Plan Investment Board found that nearly 80 per cent of 1,000 surveyed senior corporate managers and board members felt the pressure to deliver financial returns in two years or less (Bailey, Berube, Godsall, & Kehoe, 2014). The study also found that more than 80 per cent of the managers believe that using a longer-term horizon to make business decisions would positively affect corporate performance in several ways, including strengthening longer-term financial returns and increasing innovation (Bailey et al., 2014). Thus, the pressure to deliver financial returns in a short time is against their conviction.

A similar survey of more than 400 financial executives found that the majority of the surveyed managers would avoid initiating a positive net present value project if it meant falling short of the current quarter's consensus earnings (Graham, Harvey, & Rajgopal, 2006). A further 80 per cent of the respondents indicated that they would decrease discretionary spending on areas such as research and development, advertising, maintenance and hiring in order to meet short-term earnings (Graham et al., 2006).

The problem with short-termism is that it creates a misalignment of interest between asset owners, especially retirement funds, which require a long-term view, and asset managers, whose compensation system is tied to short-term financial results (Chartered Financial Analyst Institute, 2020; Hebb et al., 2015; Johnson & de Graaf, 2009; Kay, 2012). According to the 2012 Kay Review of UK equity markets, the misalignment of incentives creates several problems, as the interests of beneficiaries are in long-term absolute performance, while asset managers' concerns and the basis on which they are monitored by many asset holders is short-term relative performance (Kay, 2012). Because of this conflict of interest, asset owners can incur losses due to portfolio turnover, which can increase transaction costs thereby reducing investors' returns (Chartered Financial Analyst Institute, 2020).

Hebb (2011) observes that conventional pension fund investment strategies usually fail to sufficiently take ESG issues into account in making investment decisions. These strategies have significant limitations because they do not align sufficiently with the long-term investment principles to which pension funds are suited (Sethi, 2005). Moreover, the emphasis on short-term results calls into question whether or not trustees are adequately addressing the need to both generate current income for the current retirees and create value for the younger active members who will retire in years to come (Hebb et al., 2015; Johnson & de Graaf, 2009). The excessive focus on short-term investment horizons, use of short-term benchmarks and evaluation of portfolio managers based on short-term results, as well as a lack of attention to the risks associated with potential long-term value destruction should ring fiduciary alarms for pension funds that are managing assets to meet liabilities over several generations (Johnson & de Graaf, 2009).

Academic and professional institutions view short-termism as one of the most severe impediments to the growth of RI (Barton & Wiseman, 2014; Chartered Financial Institute, 2006; Guyatt, 2006; Juravle & Lewis, 2008; PRI, 2016b). In the process of looking for a solution, academic and professional panels have enumerated several methods that may help to mitigate short-termism in the financial markets (Aspen Institute, 2009; Chartered Financial Institute, 2006; Kay, 2012). The recommendations revolve around aligning the interests of asset owners and asset managers such that the incentive structure rewards performance over a longer timeframe (Hebb, 2011; Hebb et al., 2015). For example, Johnson and de Graaf (2009) suggest that trustees should adopt fund governance practices that improve investment performance, and expand risk identification and management practices to consider ESG factors that may not be reflected on the standard financial statements. Accordingly, trustees should develop a fee structure that reflects the value received by the fund from the services of the asset managers (Johnson & de Graaf, 2009). Also, the contract mandate should align timeframes through fees and pay structures and ensure that ESG issues are fully integrated into investment decision-making (PRI, 2016b).

3.5.5 Ambiguity

Despite RI's longevity, it lacks a standard definition. The RI market is heterogeneous in terms of definition, strategy, terminology, and in the way it is practised (Sandberg et al., 2009). A diverse range of labels is used to describe the same activity and, in some instances, the same labels are used for different activities (Zarbafi, 2011). Academic literature suggests that socially responsible investment (SRI) is the most used term (Bello, 2005; Derwall et al., 2005; Eccles et al., 2011; Haigh & Hazelton, 2004; Juravle & Lewis, 2008; Kinder, 2005; Renneboog et al., 2008; Sparkes & Cowton, 2004; Vandekerckhove et al., 2007). The other terms used to describe investing practice that integrates non-financial information include ethical investing (Sparkes, 2001), green investing (Heinkel, Kraus, & Zechner, 2001), the triple bottom line (Rubinstein, 2003), value-based investing (Fehrenbacher, 2001), sustainability-themed investing ((Ielasi, Rossolini, & Limberti, 2018), and ESG integration (Hanson, 2013; Kevin, 2013; van Duuren et al., 2016).

Many scholars observe that RI lacks semantic clarity and call for closer scrutiny of the meaning of key RI concepts and strategies (Berry & Junkus, 2013; Sandberg et al., 2009; van Duuren et al., 2016). The terms used to define RI are subject to different interpretation by different users. For example, even though SRI is the most commonly used term, the constitution of the terminology is itself debatable (Michelson, Wailes, Van Der Laan, & Frost, 2004). There is no consensus of the exact meaning of SRI for investors (Berry & Junkus, 2013; van Duuren et al., 2016).

While some authors suggest that ethical investing is the older term for SRI (Sparkes & Cowton, 2004), others observe that the two terms are used interchangeably (Harte, Lewis, & Owen, 1991; Mackenzie & Lewis, 1999; Michelson et al., 2004; Schäfer, 2004; Sparkes, 2001). Even where attempts have been made to define ethical investment or SRI, questions remain of whose ethics or what actions/assets are socially acceptable (Sparkes, 2001). For instance, Button (1988) defines SRI as investing in assets that not only yield a financial return but do not support areas of business of which the investor disapproves, such as arms, tobacco, alcohol, apartheid, violation of human rights, to name a few. The difficulty lies in determining exactly what is socially acceptable, as some people feel strongly about tobacco, while others feel strongly about arms, or favour diversity at the workplace, and so on (Sparkes, 2001). Moreover, other terminologies also differ – for example, negative and positive screening are also known as avoidance and supportive strategies, respectively (Sandberg & Nilsson, 2011). In general, RI means different things in different markets, and can even mean different things within the same market (Sandberg et al., 2009).

The strategic dimension of heterogeneity is concerned with how ESG factors are incorporated into investment decisions (Sandberg et al., 2009). As established, there are numerous RI strategies, some more popular than others and some more popular in certain regions. Finally, the practical dimension of heterogeneity is where strategies are translated into the criteria for investment decision-making by investors (Sandberg et al., 2009). Although the PRI encourages investors to incorporate ESG issues through the PRI, one institution's formulation of negative screens may differ from another's. For example, one institution may decide to avoid investing in manufacturers and distributors of arms, while another may decide to avoid firms that have significant turnover from the sale of armament (Sandberg et al., 2009). Since the activities involved in each strategy are fundamentally different, the composition of RI portfolios will consequently be different.

While the factors that account for heterogeneity are not clear cut, they include the cultural and ideological differences between different regions, differences in norms and values between various RI stakeholders, and the market setting (Sandberg et al., 2009). For instance, the term "ethical investing" is more popular in the UK than in the USA, where the term SRI is more popular (Sandberg et al., 2009). Sparkes (1995) suggests that ethical investment is more popular in the UK because the Methodist Church and the Quakers were influential in the introduction of the first UK ethical unit trust and the forming of EIRIS, the first SRI screening agency in the early 1980s. Since the screens were designed to exclude companies that operated in areas that the church deemed inappropriate on moral grounds, it explains why ethical investment became the term used in the UK (Sandberg et al., 2009). Since the USA's movement originated in the 1970s, and its vocabulary and concerns originated from issues of fairness and justice, which were the main causes of protests against the corporate practices and government policies of that time, SRI became the USA's dominant term (Louche & Lydenberg, 2006). The protests revolved around issues such as the Vietnam War, and fair treatment of minorities in the workplace and in society, which in turn drew from the civil rights movement of the 1960s, and the gay rights and feminist movements of the 1970s and 1980s (Louche & Lydenberg, 2006; Sandberg et al., 2009).

The difference in ideologies, norms and values among the various actors contributes to the heterogeneity, because the actors – the RI stakeholders – have different perspectives on RI. The stakeholders include asset managers, financial analysts, institutional investors, consultants, trustees, companies, regulators, the public and the media (Sandberg et al., 2009). The definition of RI could depend on the role and objectives of these stakeholders.

The term RI has become mainstream in its usage since the founding of the PRI in 2006 (Hebb et al., 2015). Although the PRI brought some level of standardisation through its six principles, whose central focus is the integration of material ESG factors into mainstream investment decision-making and ownership practices (Hebb, 2011), it is difficult to establish categories for ESG integration (Eurosif, 2016). Moreover, RI practitioners express scepticism whether a standardised system of classification will ever be achieved or whether it is indeed necessary. One reason that the actors in the RI field may resist unification of the plethora of definitions is that the RI market calls for new product development that opens up new investment opportunities for investors concerned about ESG (Sandberg et al., 2009). The creation of new products presents an opportunity for market segmentation, which would necessitate the players to have a strong identity to differentiate themselves from the others (O'Rourke, 2003). All in all, both academicians and practitioners agree that heterogeneity confuses both the investors and the public (Eurosif, 2016; Sandberg et al., 2009; Sparkes & Cowton, 2004; Sullivan & Mackenzie, 2006). Some writers see heterogeneity as detrimental to the success of RI (Hebb et al., 2015; Herringer et al., 2009; Sethi, 2005; Sparkes, 2002; Viederman, 2004).

3.6 Literature summary

This chapter has shown how RI began as a fringe movement to a mainstream investment strategy in many parts of the world. It shows how RI started as a practical movement built by practitioners concerned about aligning their investment practices with their religious beliefs, to a movement that has gained acceptance by mainstream investors. It has also gained theoretical support from scholars. As evidenced, the RI market is heterogeneous on many fronts, including in strategies, drivers, deterrents, and language used. The diversity strengthens the call for a customisation of RI studies to a country-specific context (Li et al., 2017). The following chapter discusses the research methodology for this study.

Chapter 4. Research methodology and methods

In this chapter, I demonstrate how and why the research methodology and methods used are appropriate for this study. I first introduce the research objectives and research questions that I developed after reviewing the existing literature. I then discuss the validity and reliability of the research methodology, followed by a discussion of the suitability of the research methods. I also justify why a case study approach is suitable for my study. Further, I provide an overview of the selected case study, which is the retirement benefits sector of Kenya, and discuss the data collection procedures, thematic data analysis procedures, as well as ethical issues concerned with this study.

4.1 Research objective and questions

The purpose of this study is to examine the critical challenges for RI development in the retirement benefits sector of Kenya. I start by exploring how the actors who operate within this sector conceptualise RI. As discussed in Chapter 3, RI is defined using multiple terminologies, which confuses the market. While the lack of a standard definition can cause confusion that could hinder the growth of the RI market, it could also mean that markets are more advanced in RI practices than is commonly known, as they may be using uncommon terminologies (Hebb et al., 2015). The objective of my first research question is to explore how the actors in the retirement benefits sector of Kenya conceptualise RI and to explore if they define RI in a significantly different manner than is already documented in the literature:

How do the actors in the retirement benefits sector of Kenya conceptualise RI?

The business case approach to RI discussed in Chapter 3 is built on the understanding that material ESG issues are a source of information asymmetry and can pose risks to financial markets. Because different countries, industries and sectors have their unique set of material ESG factors, investors interested in ESG integration should first identify the material ESG issues present in their investment environment before deciding how those factors impact on their investment decisions (Clark et al., 2015). The objective of my second research question is first to identify the main ESG issues in Kenya and then to assess the participants' perceptions of the identified ESG issues regarding their investment decision-making processes:

What are the main ESG issues in Kenya and do they present material risks or opportunities to the investment decision-making process?

Contextualisation is an important element of my study, as countries are not homogeneous. While Chapter 3 discusses several factors that hinder RI development, each country has a specific culture, history, market setting and market size that require an understanding of RI from a country-specific perspective (Hebb et al., 2015; Li et al., 2017). The objective of my third research question is to explore the specific barriers for RI development in the retirement benefits sector of Kenya:

What are the specific barriers for RI development in the Kenyan retirement benefits sector?

Policy frameworks can enable investors to allocate capital towards well-governed companies, improving investment performance and raising environmental and social standards (PRI, 2016a). As discussed in Chapters 2 and 3, many countries have formulated RI policies and regulations regarding disclosure of ESG information by pension funds and listed companies. Kenya has developed laws and other initiatives, such as the various codes and guidelines aimed at improving ESG disclosure by the listed companies. But there is no policy specific to ESG disclosure by the retirement benefits schemes, and there is no policy on ESG covering the entire finance sector. My fourth and final research question explores the participants' views regarding ESG policy:

What role can a well-developed RI policy framework play in addressing the identified ESG issues in Kenya?

I use qualitative research methodology and methods to collect and analyse empirical data. In the next section, I discuss the methodology and methods I used to collect and analyse data.

4.2 Research methodology

This exploratory research uses a qualitative research design to gather and analyse information regarding RI development in Kenya. Studies show that it is more effective to use exploratory research, vivid description and case analysis to understand a complex phenomenon where well-developed theories are absent (Birkinshaw, Yoko, & Tung, 2011; Singh, 2007). RI theories in Kenya are underdeveloped because the topic is relatively new in the country.

A qualitative approach in a constructivist and interpretive sense is deemed appropriate for this research because it promotes multiple perspectives with which to understand research issues. As explained by Mason (2017), qualitative researchers usually choose methods that allow different world views to be represented. Constructivism rejects the notion that there is a single reality or truth that can be measured using reliable and valid tools to know and measure that truth. Instead, constructivists posit there is no single truth, but rather, individuals gradually build their truth and create their reality of the world through experience and maturation (Willis, 2007).

Qualitative researchers admit subjectivity and emphasise the socially constructed nature of reality. The researchers believe that people make their interpretations of reality to discover the underlying meaning of events and activities (Willis, 2007). Consequently, the researcher tries to understand how social experience is created and interpreted (Fontana & Frey, 2005). As opposed to post-positivism and critical theory,

> interpretivism looks for an understanding of a particular context. Interpretivists believe an understanding of the context in which any form of research is conducted is critical to the interpretation of the data gathered. (Fontana & Frey, 2005, p. 99)

In conformity with the theoretical framings and ontological assumptions, my study did not take the view that there is only one objective reality that is capable of being accurately known through some appropriate methods of inquiry. Rather, my study took the view expressed by Crotty (1998), that meaning is constructed when we consciously engage with the world and the objects in the world. Consequently, research into what constitutes ESG issues in Kenya and the challenges for RI development in the retirement benefits sector of Kenya necessarily followed a constructionist's paradigm, which takes the perspective that knowledge and all meaningful reality is constructed by the participants involved in the construction of reality. It is necessary to adopt this stance, since RI is seen as a socially constructed notion that has a different meaning to different people, as evidenced by the heterogeneity of RI, spanning across four levels: definitional, terminological, strategic and practical (Sandberg et al., 2009).

Qualitative methodology is appropriate for this research because it provides flexibility for researchers to explore and understand the complexities of social issues (Fontana & Frey, 2005). For this study, it addresses RI in the complex context of a developing country with many competing needs, and the social and economic impact of ESG factors is not well understood or fully appreciated by actors in the Kenyan financial sector. This study attempts to understand these issues and bring them to the surface with the hope of promoting a culture of responsible investing in Kenya.

Further, this approach accommodates varied and adaptable methods that allow for the "generation of data that are sensitive to the social context of each case, thus allowing for exploration of emergent issues" (Ormston, Spencer, Barnard, & Snape, 2014, p. 4). This perspective is suitable for this research, since the primary objectives under consideration, that is, the definition and challenges facing the RI industry, are subjectively constructed notions that derive their meaning from the context in which they are applied.

Moreover, it enables interpretation of results to be made through descriptions, analysing themes and categories, and drawing conclusions about personal and theoretical meaning in a way that can be understood in the particular context (Bryman, 2015; Robson & McCartan, 2016). Following Bansal (2011); Tsui (2006) and Ormston et al. (2014), contextualisation allows this study to develop theories that are specific to the Kenyan context while testing existing global theories and elucidating any new phenomena by bringing to surface contextual nuances.

4.3 Research methods

Qualitative researchers may choose to use a multi-method approach to provide triangulation of the data, thus allowing for a greater understanding of the phenomenon (Fontana & Frey, 2005). The purpose of triangulation is to provide convergence of evidence that breeds credibility (Bowen, 2009) and increases the validity of the research through confirmation across the various data collection methods (Fontana & Frey, 2005). Triangulation is not limited to multiple data collection methods; it can include multiple theories, multiple researchers, multiple methodologies or a combination of these research activities (Denzin, 1978). It is common practice for qualitative researchers to use at least two different data sources and methods because the weaknesses of one method can be compensated by the strengths of the other, further increasing the credibility of findings through cross-checking (Patton, 2002). For this research, I triangulate across data source.

4.3.1 Case study approach

Case study methods are commonly used in qualitative research. Case studies "allow researchers to systematically gather enough information about a person, a social setting, event or a group to permit the researcher to effectively understand how it operates or functions" (Berg, 2012, p. 225). According to Leedy and Ormrod (2005), case studies are suitable where the research is striving to learn more about a situation that is little known or poorly understood, which is the case of RI in Kenya.

A case study is a methodological approach that encompasses many data-gathering procedures resulting in rich, detailed and in-depth information (Berg, 2012). The idea of a case study is that a real-life situation must be examined from various angles using numerous methods of data collection to obtain a clear picture of the phenomenon (Sekaran & Bougie, 2016). Because of its holistic nature, it allows researchers to understand issues in a specific social context, and it can be carried out without extended prearranged detailed plans (Willis, 2007). Another reason why researchers may choose a case study approach is that “case studies can pave the way for discoveries, serving as a breeding ground for insights and even hypotheses that may be pursued in subsequent studies” (Berg, 2012, p. 231).

Given the exploratory nature of this work, these features are important because, in the absence of prior research on RI within the retirement benefits sector of Kenya, rich and comprehensive data needs to be gathered. As discussed elsewhere, contextualisation is important for this study and the case study approach helped situate issues within their social, cultural, historical, and political context.

4.3.2 Case selection

The case study focuses on the retirement benefits sector of Kenya, which is the third-largest sector in the wider finance sector of Kenya after the banking sector and the capital markets (Murai & Kirima, 2015). Specifically, the research centres on the asset managers who are licensed by the Retirement Benefits Authority (RBA) to manage the retirement benefits schemes in Kenya. While the trustees have the ultimate responsibility of ensuring that the retirement funds are invested prudently for the benefit of the beneficiaries, the Retirement Benefits Act (1997) requires the trustees to delegate certain functions to professional service providers such as administrators, custodians and professional asset managers, while maintaining responsibility and oversight to the service providers. I chose to interview the asset managers, because they are the ones who evaluate the risks and returns of the assets before making the investment decisions (guided by the prudent investment policy statement) on behalf of the trustees.

Section 2 of the *Retirement Benefits Act 1997* (KNY) interprets a “manager” to mean a company whose business includes undertaking the management of the funds and other assets of a scheme fund for purposes of investment; providing consultancy services on the investment of scheme funds; or reporting or disseminating information concerning the assets available for investment of scheme funds. Although I refer to some interview participants as asset managers (abbreviated as “AM” in the analysis chapters), they are the employees of the asset management companies that participated in my study. Most of them are CEOs, general managers, or senior investment managers of their companies. I discuss the retirement benefits sector in detail in the following sections.

4.3.3 The retirement benefits sector of Kenya

The *Retirement Benefits Act 1997* (KNY) is the main statute governing the retirement benefits schemes in Kenya, and the RBA is the primary regulatory authority of the sector. According to section 5 of the Retirement Benefits Act (1997), the primary functions of the RBA are to regulate and supervise the establishment and management of retirement benefits schemes; to protect the interests of members and sponsors; and to promote the development of the retirement benefits sector. Another function of the RBA is to advise the Minister of Finance on the national policy to be followed regarding retirement benefits schemes and to implement all government policies about the retirement benefits sector. Further, the RBA should approve the trustees’ remuneration approved by members during the annual general meeting after every three years, and perform other functions conferred on it by the Retirement Benefits Act (1997) or by any other written law.

4.3.3.1 Registration of retirement benefits schemes and service providers

Section 24 of the *Retirement Benefits Act 1997* (KNY) provides that a scheme must be established under an irrevocable trust, and schemes must establish rules stipulating how they will be managed. The rules must provide for the appointment, term, removal from office, powers, and remuneration of trustees. Section 22 of the *Retirement Benefits Act 1997* (KNY) requires any person intending to establish a retirement benefits scheme or to act as a manager, custodian, or administrator to be registered with the RBA and obtain a certificate of registration before establishing the scheme or commencing the performance of any of the functions of a manager, custodian or administrator. The managers, custodians and corporate administrators must also be registered with the *Companies Act 2015* (KNY). However, section 22 (2A) of the Retirement Benefits Act (1997) states that the requirement for registration does not apply to administrators who are natural persons.

4.3.3.1.1 The trustee

Section 2 of the Retirement Benefits Act (1997) states that a trustee can be an individual or a trust corporation. According to this section, a trust corporation is a company incorporated under the *Companies Act 2015* (KNY), having a subscribed capital of not less than KSh 10 million

(USD 100,000) and which is empowered (by or under any written law, its charter, memorandum of association, deed of settlement or other instrument constituting it or defining its powers) to undertake trusts (Retirement Benefits Act, 1997).

According to section 26 (2) of the Retirement Benefits Act (1997), a person cannot be registered as a trustee if such a person has been sentenced to imprisonment by a court of competent jurisdiction for six months or more or is declared bankrupt by a court of law. Also, a person cannot be registered if he or she was previously involved in the management or administration of a scheme that was deregistered for any failure on the part of the management. Further, a person cannot be registered if he or she is disqualified from holding the office of a trustee under any other written law, or where the RBA deems his or her holding the office of a trustee as being detrimental to the scheme, or if the person does not comply with the guidelines or practice notes issued by the RBA. Notwithstanding the provisions of section 26 (2), section 26 (3) of the Retirement Benefits Act (1997) provides that the appointment of any person as a trustee is subject to the approval of the RBA.

According to paragraph 19 of the *Retirement Benefits (Good Governance Practices) Guidelines 2018* (KNY), the board of trustees should have a broad mix of skills and competencies and include at least one trustee who is a professional qualified in any matter related with finance as may be recognised by a relevant industry body. The composition of the board of trustees should consider gender balance and the age and experience of trustees. Further, the tenures of trustees should be staggered so that not more than one-third of the trustees will simultaneously retire.

The trustee has the ultimate responsibility to ensure that the scheme is administered following the provisions of the *Act*, other relevant regulations, and scheme rules (Retirement Benefits Act, 1997). Paragraphs 47 and 48 (a) of the Retirement Benefits (Good Governance Practices) Guidelines (2018) provide that the trustees should establish and maintain a formal and transparent strategy for engaging with key stakeholders in the decisions and management of the scheme. The trustees should conduct regular reviews of who the scheme's key stakeholders are and determine how to meet their needs. Specific to ESG concerns, paragraph 51 (2–4) of the Retirement Benefits (Good Governance Practices) Guidelines (2018) states that the trustees should oversee and monitor the scheme's workplace and economic behaviour, and ESG matters related to the activities of the scheme. Moreover, paragraph 51 (3) encourages (but does not mandate) the trustees to adopt socially responsible investing by considering the financial returns of investment and social or environmental benefits of investment for the members and the community in which the scheme invests. Where the board of trustees adopts socially responsible investing, the board should disclose how the investing will be managed, the monitoring measures it has established and how corporate citizenship outcomes will be managed.

Although paragraph 23 of the Retirement Benefits (Good Governance Practices) Guidelines (2018) states that the sponsor of a scheme must ensure that the trustees undergo a well-structured induction process regarding the role and responsibilities of a trustee in the scheme, the guidelines do not mention the need for trustees to be inducted on ESG matters.

4.3.3.1.2 The administrator

According to section 2 of the Retirement Benefits Act (1997), an administrator means a person appointed by the trustee under a written instrument to manage the administrative affairs of the scheme. Paragraph 35 of the Retirement Benefits (Good Governance Practices) Guidelines (2018) provides that schemes must appoint an internal or external administrator. According to section 25B of the Retirement Benefits Act (1997), the external administrator must be a limited liability company incorporated under the *Companies Act 2015* (KNY), whose liability is limited by shares and whose main objective is to render administrative services to schemes. Also, it must never have been an administrator of any scheme fund that has been either deregistered, wound up or placed under an interim administrator due to any fault, either full or partial, of the administrator. Further, the company must have on its board of directors and top management persons who are academically and professionally qualified in matters relating to the administration of schemes, insurance, law, accounting, actuarial science, economics, banking, finance, or investment of scheme funds.

Paragraph 27 of the Retirement Benefits (Good Governance Practices) Guidelines (2018) provides that the trustee may appoint a trust secretary from the staff of the administrator of the scheme. Where a board of trustees intends to appoint a trust secretary, the scheme rules should set out the terms and conditions of appointment and the remuneration, if any, of the trust secretary. According to part 3 of paragraph 27, the role of the trust secretary includes, but is not limited to: providing guidance to the board of trustees on the trustees' duties and responsibilities and matters of governance; ensuring the timely preparation and circulation of papers and minutes of the board of trustees; and ensuring that the trustees are aware of the relevant laws relating to the scheme. Further, part 5 of the same paragraph states that a trust secretary should preferably be a lawyer or possess a law qualification or be a certified public secretary, and he or she should attend all the meetings of the board of trustees.

4.3.3.1.3 The manager

According to regulation 9 of the Retirement Benefits (Transitional) Regulations (2000), schemes must engage the services of a manager and a custodian under written instruments and submit to the RBA duly signed copies of such instruments. Also, schemes must submit certificates signed by the appointed managers and custodians certifying that the manager has commenced management of scheme funds and the custodian has received custody of scheme funds. Regulation 5 (1) of the Retirement Benefits (Managers And Custodians) Regulations (2000) provides that the trustees must appoint a manager of a scheme fund, and the terms and conditions of service are determined by the trustees in the instrument of appointment or otherwise in writing from time to time. However, regulation 5 (1) (a) provides that regulation 5 (1) does not apply to schemes that have invested all the funds in guaranteed funds. According to regulation 5 (1) (b), the approved issuer of the scheme whose funds are in a guaranteed fund must submit quarterly investment reports to the RBA.

Regulation 5 (2) of the Retirement Benefits (Managers And Custodians) Regulations (2000) provides that a manager must have all the powers necessary for the performance of his functions, including advising the scheme on the available asset classes for investment, assisting the scheme to formulate a prudent investment policy, investing capital, and reinvesting any income of the scheme fund that is not required by the trustees for any immediate payments. According to regulation 5 (5) of the Retirement Benefits (Managers And Custodians) Regulations (2000), the manager must submit to the RBA after 30 days of his or her appointment, and subsequently, within 30 days after every quarter, a valuation of the scheme fund and all the investments representing the scheme, including details of the cost of such investments and their estimated yields. Also, the manager must submit a report reviewing the investment activity and performance of the investment portfolios comprising the scheme fund since the last report date and containing the manager's proposals for the investment of the scheme fund during the following period as recommended by the RBA.

Section 25 of the Retirement Benefits Act (1997) provides that a company cannot be registered with the RBA as a manager unless it is a limited liability company incorporated under the *Companies Act 2015* (KNY), whose liability is limited by shares and whose main objective is to manage scheme funds. Further, the manager must never have been involved in the management of the scheme fund of any scheme that was deregistered due to any failure on the part of the management. According to regulation 4 of the Retirement Benefits (Managers And Custodians) Regulations (2000), the minimum paid-up share capital of a manager, including unimpaired reserves, must be KSh 10 million (USD 100,000), or as may be prescribed from time to time. The same regulation provides that a manager must at all times have in its top management, including the board of directors, persons who are academically and professionally qualified in matters relating to either banking, insurance, law, accounting, actuarial science, finance, economics or investment of scheme funds. There were 21 managers at the time I conducted the research and 15 of them participated in my study.

4.3.3.1.4 The custodian

Regulation 8 of the Retirement Benefits (Managers And Custodians) Regulations (2000) provides that the trustee of a scheme must appoint a custodian. The trustee must, in the instrument of appointment or otherwise in writing from time to time, determine the terms and conditions of service of the custodian. According to regulation 8 (d), the custodian is responsible for keeping the necessary records to give a complete record of the entire scheme fund investment portfolio held by the custodian and the transactions carried out by the custodian on behalf of the scheme. Further, regulation 8 (dd) provides that the custodian must submit to the scheme, at least quarterly from the date of commencement of the financial year of the scheme, a valuation of the scheme fund and all investments representing the respective fund, including details of the cost of such investments and their estimated yields. Moreover, the custodian must submit a report reviewing the investment activity and performance of the investment portfolios of the scheme fund for the period following the date of the last report. According to regulation 8 (dd) (ii) of the Retirement Benefits (Managers And Custodians) Regulations (2000), the review should contain the manager’s proposals for the investment of the scheme fund for the forthcoming period.

Section 25A of the Retirement Benefits Act (1997) provides that a custodian must be a limited liability company incorporated under the *Companies Act 2015* (KNY), whose main function is to perform the functions of a custodian. The same section provides that a custodian must never have been a custodian of any scheme fund that was deregistered due to any fault, either full or partial, of the custodian, and must have the professional capacity and adequate operational systems to perform the functions of a custodian.

According to section 27 of the *Retirement Benefits Act 1997* (KNY), the RBA may refuse to register any scheme, manager, custodian, or administrator if the applicant does not meet the above requirements for registration or if the information contained in the application is materially false or untrue.

4.3.3.2 Types of retirement benefits schemes

Retirement benefits schemes in Kenya take either the form of a defined benefit or defined contribution scheme. Defined contributions schemes are where an employer, employee or both make regular contributions to a scheme (RBA, 2020). The contributions are set either as a percentage of the employee's pay or a fixed amount. The value of the member's retirement benefits is equal to the contributions (net of expenses) accumulated in an individual account with investment return and any surpluses or deficits as determined by the trustees of the scheme; benefits depend on the amount contributed and the performance of the investment. The RBA may require a defined contribution scheme to be reviewed by an actuary from time to time (*Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations 2000* (KNY)).

A defined benefit scheme is where an employer promises to pay on retirement a predetermined amount using a formula based on the employee's earnings history, tenure of service and age. Since the amount of the benefit is determined in advance, the member contributes a fixed amount, and the employer meets the balance of the promised amount if there if a shortfall (RBA, 2020). Thus, this scheme is often treated as a liability by employers. Regulation 31 of the Retirement Benefits Authority (2000) provides that an actuary must value a defined benefit scheme at least once in every three years from the date of registration, and submit a copy of the valuation report to the RBA and its sponsor within five months from the end of the financial year. In the case of a pension scheme, the actuary must provide for annual pension increases and determine a rate of increase of the pension, which will apply until the next valuation.

There are five main categories of retirement benefits schemes in Kenya. These are state pensions (statutory), managed by the National Social Security Fund (NSSF), occupational retirement benefits schemes, public service pension schemes, individual pension schemes and umbrella pension schemes (RBA, 2020). The NSSF is a mandatory state pension scheme whose main objective is to provide basic social security to employees of both formal and informal sectors upon retirement (Kenya National Bureau of Statistics, 2019). The NSSF is mandatory for all persons aged between 18 and 65 years who are subject to the *Employment Act 2007*

(KNY). According to section 3 of the *Employment Act 2007* (KNY), the *Act* applies to all employees employed by an employer under a contract of service. It does not apply to the armed forces, the Kenya Police, the Kenya Prisons Service, the Administration Police Force, the National Youth Service, or an employer and the employer's dependants where the dependants are the only employees in a family undertaking.

The statutory contributions to NSSF are fixed at 12 per cent of the employee's pay, split equally between the employer and the employee (*National Social Security Fund Act 2013* (KNY)). As detailed in section 20 of the *National Social Security Fund Act 2013* (KNY), an employer can, under certain circumstances, opt to pay pension contributions in respect of employees in another approved scheme, so long as the scheme is approved by the RBA. Also, the *National Social Security Fund Act 2013* (KNY) established a provident fund, which is voluntary for every Kenyan, including those who are self-employed or retired. According to section 67 of the *National Social Security Fund Act (2013)* (KNY), contributions to the provident fund form part of tax-deductible expenses in the computation of tax payable by the person, or by the employee as the case may be.

Occupational retirement benefits schemes are schemes established by employers for the benefit of employees (*Retirement Benefits Act 1997* (KNY)). Occupational retirement benefits schemes can be either defined benefit or defined contribution schemes. Regulation 8 of the Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations (2000) provides that an occupational retirement benefits scheme can appoint natural persons or corporate trustees. Where they appoint natural persons, they must have a certain number of trustees. Where trustees are natural persons, regulation 8 (1) (c) of the Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations (2000) provides that defined contribution schemes must have between four and nine trustees, and the number of trustees should not be less than a half of the board of trustees unless where the scheme has appointed a corporate trustee. Defined benefit schemes must have between three and nine trustees, and the number of trustees nominated by members must not be less than one-third of the board of trustees. Further, a scheme or a corporate trust should have in the board of trustees at least one member who has been vetted by the RBA to provide trust services.

According to regulation 2 of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations (2017), an umbrella scheme is a retirement benefits scheme with members employed by several employers, into which employee's and employer's contributions are paid.

Umbrella schemes are set up to pool small- to medium-sized companies that may not find it financially viable to set up their retirement benefits schemes. Regulation 5 (2) of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations (2017) provides that the sponsor of an umbrella scheme must be a company, cooperative, partnership, association, society, or any other legal entity as may be appropriate. According to regulation 8 of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations (2017), an umbrella scheme may be established for employers who have commercial or professional relationships with each other, such as employers within the same industry, trade, profession, group or association, or a county government. They can also be established for employers who do not have any commercial or professional relationship with each other. Umbrella schemes provide a cost-effective way for employers to provide retirement benefits to employees. There are 30 registered umbrella schemes in Kenya (RBA, 2020).

Regulation 5 (1) of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations (2017) states that the entity establishing an umbrella scheme must at all times have in its board of directors and top management at least four persons who are academically and professionally qualified in matters relating to either administration of schemes, insurance, law, accounting, actuarial science, economics, banking, finance, or investment of scheme funds. Also, the entity establishing a scheme must have a person possessing at least five years' experience in the administration of retirement benefits schemes.

Like the occupational retirement benefits schemes, regulation 12 of the *Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations 2017* (KNY) provides that umbrella schemes can appoint natural persons or corporate trustees. Regulation 12 (2) of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations (2017) provides that where the scheme does not appoint a trust corporation, the sponsor of a scheme must appoint nine trustees, five of whom must be nominated by participating employers from amongst members of the management committee, and four must be nominated by the sponsor, of whom two shall not be employees, directors or have any business relationship with the sponsor.

Individual retirement benefits schemes are schemes for the benefit of individual beneficiaries, such as self-employed people, those who wish to make an additional voluntary contribution, and those whose employers have not established pension schemes for them. According to regulation 9 (3) of the Retirement Benefits Authority (2000), the trustee of an individual retirement benefits scheme must be a trust corporation appointed under a deed and it must have at least one director vetted by the RBA. The difference between the individual schemes and the NSSF provident fund discussed above is that the benefits from the provident fund are paid in a lump sum, while the benefits from the individual retirement benefits scheme are treated as ordinary pension income. Currently, there are 34 individual pension schemes in Kenya (RBA, 2020).

The civil servants' pension schemes are established under the *Public Service Superannuation Scheme Act 2012* (KNY). Section 6 of the *Public Service Superannuation Scheme Act 2012* (KNY) provides that civil servants who are employed on a permanent and pensionable basis contribute to the scheme at the rate of 7.5 per cent of monthly pensionable emoluments before tax, and the government contributes at the rate of 15 per cent of each member's monthly pensionable emoluments before tax. Before 2012, the civil service pension was non-contributory and non-funded, which placed a considerable financial strain on the government.

There are some tax benefits associated with savings for retirement through the registered schemes. According to section 8 (5 a–c) of the *Income Tax Act 1973* (KNY), the first KSh 600,000 (USD 6,000) lump sums paid out by a registered pension or an individual retirement scheme are tax-exempt. Also, where a person withdraws from a pension/provident fund or individual retirement scheme, the first KSh 600,000 (USD 6,000), or the first KSh 60,000 (USD 600) per full year of pensionable service with that employer, is tax-exempt. However, where the employee had previously received a lump sum payment from that same employer, the date of pensionable service starts after receipt of that lump sum.

Moreover, when ascertaining the total income of an employee, section 22A of the *Income Tax Act 1973* (KNY) provides that the lesser of: the contribution made to registered pension/provident funds or individual retirement funds in a year; or 30 per cent of the employee's pensionable income in a year; or KSh 240,000 (USD 2,400) (or KSh 20,500 (USD 205) per month where contributions are made in respect of a part-year of service of a member) is tax-exempt. Also, section 20 of the *Income Tax Act 1973* (KNY) states that all income earned from the investment is tax-exempt, as it is deemed to have been taxed.

4.3.3.3 Investment policy

Section 37 of the Retirement Benefits Act (1997) provides that a scheme must prepare and submit to the RBA a prudent investment policy statement on the investment of the funds of the scheme to maintain the capital funds of the scheme and generally to secure market rates of return on such investment. Regulation 37 of the Retirement Benefits (Occupational Retirement

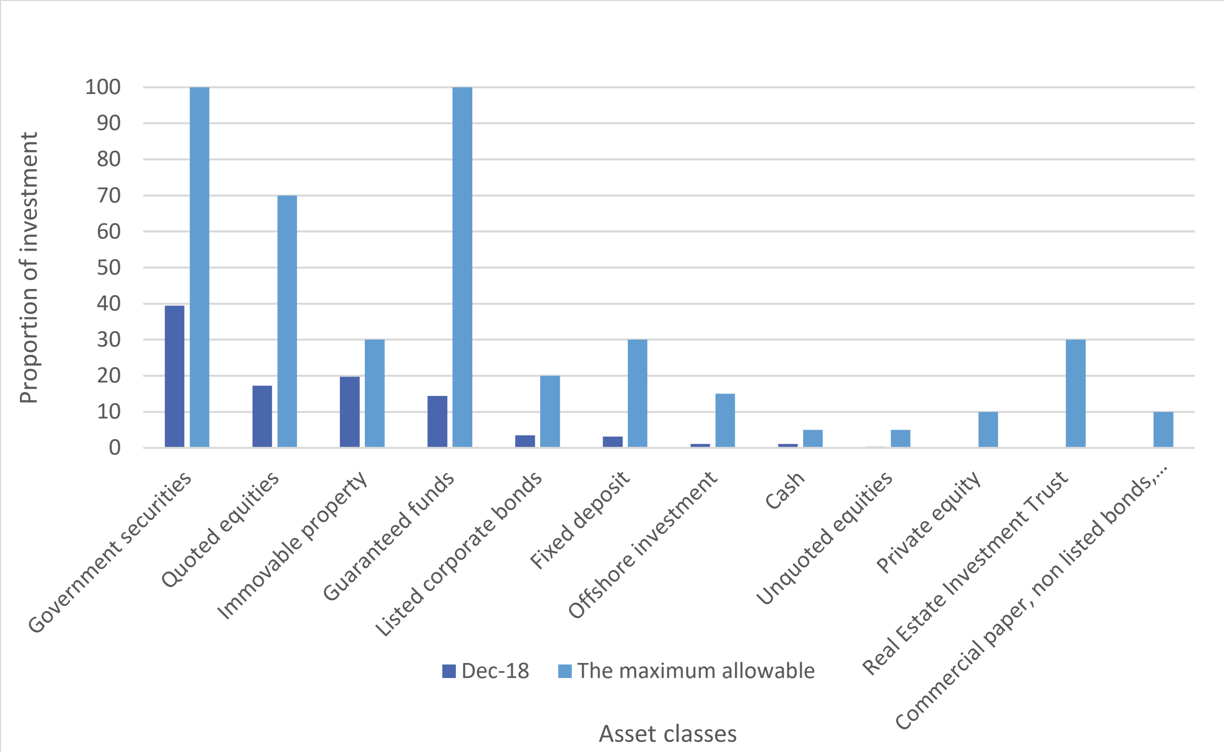
Benefits Schemes) Regulations (2000), regulation 30 of the Retirement Benefits Authority (2000) and regulation 44 of the Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations (2017) state that the investment policy should be revised after three years. The prudent investment policy statement of each type of scheme should identify the principles governing decisions on investments for the scheme fund. It must cover the policy of the scheme on (a) the categories of investments to be held; (b) risk; (c) the realisation of investments; (d) other matters that may be prescribed from time to time by the RBA. According to these regulations, schemes must obtain written advice from either a registered Chartered Financial Analyst, an actuary, an investment advisor, or a manager registered under the CMA when writing and revising the investment policy statement. However, the advisor of each should not be the scheme manager, nor can the advisor be related to an employee of the scheme. Moreover, schemes must consider the latest actuarial report when determining the principles governing decisions on investments.

According to section 38 (1) (b) of the (Retirement Benefits Act, 1997), schemes can only invest per the guidelines prescribed in Table G of the Retirement Benefits Act (Forms and Fees) (Amendment) Regulations (2016). The investment guidelines permit a wide range of asset allocation across various categories including alternative asset classes such as Real Estate Investment Trusts (REITs), private equity and venture capital, collective investment schemes, asset-backed securities, and green bonds. Regulation 18A of the Retirement Benefits Act (Forms and Fees) (Amendment) Regulations (2016) provides that schemes cannot invest more than 15 per cent of the schemes' funds in a single issue of securities in any asset class. Also, schemes must not invest more than 15 per cent of the total available securities issued by a single issuer. This provision does not apply to government securities, and schemes can invest up to 100 per cent of their funds in government securities (Retirement Benefits Act (Forms and Fees) (Amendment) Regulations, 2016).

4.3.3.4 Asset allocation

Government bonds consistently account for the largest share of the total assets followed by immovable property and quoted equities. For example, in December 2018, government bonds accounted for 39.41 per cent, followed by immovable property at 19.7 per cent and quoted equities in third place at 17.27 per cent. Figure 5 shows how the schemes invested in the various asset classes in December 2018.

Figure 5. Industry investment portfolio vs the statutory maximum, December 2018



Source: Compiled from the retirement benefits industry report for December 2018 (RBA, 2018) and the amended Table G of the *Retirement Benefits Act (Forms and Fees) (Amendment) Regulations (2016)*.

Some asset classes, such as private equity, REITs and derivatives, are relatively new to the market, having been introduced in 2016 (RBA, 2018). However, even though the legal framework allows for the issuance of these assets, there are few or none in the market, for instance, there was no derivative asset in the market in 2018 (RBA, 2018).

Schemes invest a higher proportion of the funds in government securities for several reasons. First, there is no limit to how much they can invest in government securities and, second, there are more government securities than other asset classes (Nairobi Securities Exchange, 2020b). For example, there are currently more than 170 government securities (including treasury bills, government bonds, infrastructure bonds and government international bonds), while there are only 65 listed companies, five of which are currently suspended from trading on the Nairobi Securities Exchange (Nairobi Securities Exchange, 2020a). Two of the suspended companies have been placed under administration, one is under receivership and one is suspended to allow for corporate restructure and government buy-out. The last one has been acquired by another company (Nairobi Securities Exchange, 2020a). A third reason that schemes invest in government securities more than other assets is that the government encourages retirement benefits schemes to invest in government bonds to boost infrastructure (International Finance Company, 2015).

4.3.4 Document analysis

Document analysis occurs throughout this research because, as Yin (2013) advises, it is prudent to corroborate interview data with information from other sources to mitigate the issue of interview bias. Analysing documents is especially applicable to qualitative case studies as a research method (Bowen, 2009). Whether documents and records are in print or electronic form, they serve a variety of purposes in a study and this study benefited from five specific functions of documents, that are summarised by Bowen (2009):

- Documents provided background information and historical insights, which helped contextualise the retirement benefits sector.
- Documents provided information used to generate interview questions.
- Documents supplemented the interviews.
- Documents offered a means of tracking change and development by, for example, comparing various versions or editions of a document to identify the change.
- Document analysis helped verify findings and corroborate evidence from other sources such as interviews, by acting as a reference point for both pre- and post-interview stages.

Merriam (1988, p. 118) suggests that there is no limit to what types of documents a researcher can use to “uncover meaning, develop understanding and discover insights relevant to the research problem”. Interrogating documents provides a glimpse of the history of RI, tracing it to the most current trends and strategies that are available to investors, while simultaneously gauging the size of the RI market in the world. This process situates the present-day events within a historical and contemporary context (Chung & Zhang, 2011).

4.3.5 Interviews

Use of qualitative interviewing as a research method is widespread in social sciences (Alvesson & Deetz, 2000; Ammann et al., 2011; King, Horrocks, & Brooks, 2018; Landsheer & Boeije, 2010). Use of interviews allows researchers to learn about social life through the perspectives, experience, and language of those living it (Landsheer & Boeije, 2010). This approach is consistent with the epistemological stance of a constructionist paradigm, whereby knowledge is constructed by both the researcher and participants as they engage with the phenomena they are interpreting (Crotty, 1998; Gubrium & Holstein, 2002).

To assimilate the views and voices of the participants, I conducted face-to-face, semi-structured interviews between July and October 2018, and one more interview via Zoom in October 2020. Semi-structured interviews provide flexibility and active engagement between the interviewer and the interviewee (Fontana & Frey, 2005). The active engagement is of paramount importance, because “both parties to the interview are necessarily and unavoidably active and each is involved in the meaning-making work” (Holstein & Gubrium, 1995, p. 5). Holstein and Gubrium (1995) further state that respondents are not repositories of knowledge that can be merely transported through their replies, but it is communicated and assembled in the active interview encounter.

The flexibility afforded by semi-structured interviews proved to be invaluable, presenting me with the chance to explore in detail the expressed viewpoints by asking follow-on questions. I also modified questions and clarified interviewees’ meaning by repeating their statements, allowing interviewees the opportunity to elaborate, correct or revise their account (Chung & Zhang, 2011). My research found the ability to foster discussions and ask questions to clarify statements to be of great value, further strengthening research findings. Moreover, I formulated the interview questions in words familiar to the people being interviewed, rendering them easy to understand (Berg, 2012). Responses revealed participants’ differing opinions and levels of understanding of the issue.

I asked asset managers the same set of questions, allowing enough flexibility for the participants to opt not to answer any or some of the questions or to take as much time as they wished to discuss a particular question that they deemed weighty. I also modified the interview questions for the other participants and tailored them to the professional specialisation of each. For example, I asked the academic and the capital market development specialist questions that pertained to their expertise. The interview process provided unique insights into the Kenyan investment environment that are not evident from document analysis alone.

Sanders (1982) recommends interviews are audibly recorded and transcribed afterwards. In that way, the interviewer can probe in-depth by extending the line of enquiry without the distraction of taking notes. The author explains that audio recording ensures that what is transcribed and analysed is the participant’s exact words. When it comes to the interviewing process, the quality of interviews is more important than quantity. For that reason, “it is better to ask fewer questions and probe them in-depth than to ask more questions assuming that more questions will yield more data" (Sanders, 1982, p. 356). For this research, all participants consented to recorded interviews. I used a set of 12 questions to guide the interview process with the asset managers, while I used a variety of questions with the other participants, customising them accordingly. Details of the interview process are provided later in this chapter. In the following section, I discuss how I used these methods, what data I collected and from where, and the difficulties that I encountered during fieldwork.

4.4 Data collection methods

Data collection comprised document analysis and semi-structured interviews. The two sources yielded rich data that revealed the complexities of RI in Kenya. I then analysed the data to explore the challenges for RI development and the potential contributions of RI towards the improvement of the identified ESG issues. I discuss the data collection methods in detail in the following sections.

4.4.1 How I conducted the interviews

Before travelling to Kenya, I prepared the participants' information sheet (Appendix 1), participants' consent form (Appendix 2) and interview questions (Appendix 3), and they were approved by the Human Ethics Committee of Victoria University of Wellington, reference No. 0000025797 (Appendix 4). My study needed to inform and obtain permission from the CEO of the Retirement Benefits Authority (RBA) to interview the asset managers. That is the normal procedure when researching government organisations in Kenya. I wrote the letter that was also approved by the Human Ethics Committee and obtained permission from the CEO (Appendix 5). I also obtained a research permit from the National Commission for Science, Technology and Innovation of Kenya (Appendix 6), which is a requirement for anyone wanting to research in Kenya.

Networking plays a major role when conducting business in Kenya, because Kenyan's are more likely to be receptive to someone if the person is referred to them by an acquaintance. Conducting this research was no different, as I networked extensively to gain access to interview participants. I began by contacting (via email) the then head of the PRI in Africa and the Middle East, who was based in South Africa. Although he has since left the organisation, he was instrumental in introducing me to key people in Nairobi and South Africa who helped me navigate the interviewing process and eventually build a network of participants in Nairobi. I interviewed him via Skype before leaving for Kenya, but I did not analyse his interview because he had left the PRI, and he is out of the scope of this study. Nevertheless, his interview was insightful and helped me gain a better understanding of RI in Africa. He also gave me useful tips on how to approach asset managers in Nairobi for interviews on RI. This information was especially valuable when I needed to persuade asset managers to agree to an interview.

Once in Kenya, I continued networking through phone calls and meeting for coffee and lunches with my initial contacts. I obtained an updated list of all the 21 licensed managers at the time, complete with their physical and postal addresses. Because business in Kenya is often operated based on who you know, I needed someone to introduce me to the asset managers, otherwise, they were unlikely to grant interviews to me. The RBA staff could not introduce me to the asset managers because as the regulator they expressed interested in my findings, as RI is currently being discussed within the financial sector of Kenya. They were concerned that by providing introductions they would undermine my independence, which was crucial if the asset managers were to participate with total freedom and give impartial responses. For that reason, the RBA staff thought it best that I was not only independent, but I also appeared to be independent. I was in full agreement with their position since my study is independent and privately funded. But I still needed to connect with potential participants.

That connection came through the chairman of the Fund Managers Association, a voluntary initiative of the fund managers. I was introduced to the chairman by one of the employees of the RBA. The chairman, in turn, introduced me to all the members via email and I followed up from there. I made several follow-up emails (Appendix 7) and phone calls to secure interview appointments, making sure to attach to each email the consent form, the interview questions and the participants' information sheet so that the managers could familiarise themselves with the documents before consenting to interviews. The reality is that most of them appeared not to look at any of those forms beforehand, and I had to introduce myself and explain the object of my study to the ones who consented to the interview before commencing the interviewing.

The asset managers' world in Kenya is highly competitive, where staff often work long hours each day. That made securing interviews difficult and required sending out several emails followed by telephone calls several times a day. I met with each interviewee only once, on the day of the interview, which seems to be the norm according to DiCicco-Bloom and Crabtree (2006).

All interviews took place at the interviewees' workplaces, and all offices are in Nairobi, the capital city of Kenya. The interviewees explicitly requested that the interviews be held at their respective workplaces. In most cases, we sat in the boardrooms or other smaller meeting rooms. Upon meeting each participant, I took the first few minutes to introduce my research objectives and myself. I supplied the participants with a hard copy of the consent form and the participants' information sheet, and verbally reviewed the content with the interviewee, clearly explaining the confidential nature of the research and requesting permission to audio record the interview and for participants to sign the consent form at the end of the interview. All the participants consented to both.

During the interview, I introduced the questions by asking preliminary questions, which were not directly related to the research questions but were meant to establish a rapport and build trust (Qu & Dumay, 2011). I endeavoured to engage actively throughout the interview by asking questions or answering their questions. I attempted to maintain rapport, even sharing many light moments when talking about unique issues that seem to only happen in Kenya or when laughing about the absurdity of the state of corruption in the country. These moments put both the asset managers and me at ease, enabling a smooth and free flow of discussion. I digitally recorded all interviews and obtained signed consent forms at the end of each interview or as scanned copies via email.

a) What was collected?

The initial plan was to interview the five large asset managers who control more than 75 per cent of the market in dollar terms. However, following the university research committee's recommendations after my proposal presentation, I expanded the interview base to include all the asset managers who would consent to an interview. I interviewed 22 participants, drawn from asset managers, regulators, academia, staff from Financial Sector Deepening Africa, a senior manager from the Kenya Green Bond Programme and a council member of the ARBS. Interviews lasted from 15 minutes to 2 hours, with 1 hour as the average. I deliberately designed two interviews to last for 15 minutes because the participants were not directly linked to the retirement benefits sector, but their contribution helped sharpen my understanding of the debate. One was an academic and the other one was the senior manager from the Kenya Green Bond Programme. For all the others, the duration of interviews depended on the interviewee's time and willingness to talk. Table 5 shows the professional details of the participants.

Table 5. Professional details of participants

Sector	Number of participants
Asset managers	15
Regulators	3
Financial Sector Deepening Africa	1
Academic	1
Kenya Green Bonds Programme	1
Association of Retirement Benefits Schemes	1
Total	**22**

Interviewing participants from different professions ensured that I got diverse views because each category of participants play a different role in the market. For example, the primary role of the regulators is that of safeguarding the schemes funds while the asset managers are at the forefront of analysing investment opportunities before deploying capital. Thus, the views from the participants of each category of professionals are likely to differ because they are informed by their personal experience of interacting with the market. I recognise that the diversity of views from the asset managers may be limited because they belong to the same profession and they work in the same market. However, the participants are drawn from entities that are not identical or homogenous but rather they have distinctive characteristics which may help shape their views on RI. To increase the diversity of views from the asset managers, I interviewed all the 15 the asset managers (out of 22) who were willing to participate in my study.

b) Difficulties encountered

Some participants appeared apprehensive and sceptical at the beginning of an interview, which is understandable given the topic of the research. The apprehension came through in the way some quickly pre-empted the discussion by explaining why RI cannot work in Kenya since it has been proven not to work elsewhere and it is the government's work to fix social problems, not private investors. But I reassured them that, first, this research is exploratory and, second, the interview is a necessary part of my PhD. I then reaffirmed the voluntary nature of the interview and that they can opt-out of any question or walk out at any time during the interview.

In some instances, the scepticism delayed interview meetings. I persisted by making telephone calls to explain my research. It appears to me that some participants were suspicious of the motives of my research, or maybe they were cautious with information, as can be expected of an industry that deals with confidential information. Some would ask me to identify myself fully and explain my position at Victoria University of Wellington. One asked me if I hold a teaching position. I overcame this difficulty by fully explaining my research interest and stressing that my research is totally independent and privately funded by me, and that I am not a lecturer at the university. This aspect seemed to earn their trust and consent to interviews. I also constantly issued gentle reminders via emails and phone calls.

Again, even if the sector is growing, it is still quite small and highly competitive, creating an atmosphere of mistrust among asset managers who compete for the same clients. On that ground and even though the questions were not intrusive, some interviewees initially appeared anxious at providing information during the interviews. In other instances, some hesitated to allow me to record the interviews. I reassured them that research was confidential, and nothing will end up in the thesis that will directly identify them. Second, I explained that I would send back their interview transcripts and ask them to modify anything with which they were not comfortable. I also gave them time to read the questions immediately before the interview and, in that way, they could see that there is nothing intrusive. They all agreed to record after that reassurance.

During the interviews, some participants took too long on one question, especially the first question that asked them to introduce themselves briefly. It seems some regarded this is an opportunity to market their services to me, going into great details about what sets them apart from the others. As much as it is prudent to allow interviewees to spend more time on certain issues (Landsheer & Boeije, 2010), some interviewees provided too many irrelevant details. I found it necessary to keep reminding them of the main question. Others provided very brief responses despite my prompts to speak more about issues that I deemed important. Overall, the interviewees were supportive and patient.

4.4.2 How the documents were collected

I downloaded most documents from the internet. I endeavoured to source the most current version and edition of the printed documents. I collected other documents, such as the strategic plans and the latest industry reports from the retirement benefits sector during interviews.

a) What was collected?

I collected reports from associations such as the Global Sustainable Investment Alliance, Eurosif and other similar types of associations, the World Bank, and other agencies of the United Nations; legislative documents from the Government of Kenya; regulatory guidelines and other industry reports from the RBA and the CMA; and annual reports from 10 randomly selected listed companies in Kenya. I obtained these documents from the internet.

b) Difficulties encountered

It was difficult to find relevant documents and reports on RI that are specific to Kenya, or even Africa for that matter. This is likely to be because RI is still a relatively new phenomenon in Kenya, and there is hardly any academic research on RI focusing on Kenya.

4.5 Methods of data analysis

There are many approaches to analysing qualitative data, including thematic analysis, grounded theory, discourse analysis, narrative analysis, and semiotic analysis (Bryman, 2008; Denzin & Lincoln, 2011; Jeucken, 2010). I used thematic analysis to identify important patterns from both the documents and interview data.

4.5.1 Analysing interviews

Thematic analysis is a widely used method of analysing open-ended questions such as those used in this research (Boyatzis, 1998). The thematic analysis focuses on identifying notable patterns that emerge from the data, identifying common threads that extend throughout the entire data while pointing out any differences that occur (Guest et al., 2012; King et al., 2018; Morse & Field, 1995). The process involves careful reading and re-reading of the data (Rice & Ezzy, 1999) to "recognise patterns within the data where emerging themes become categories for data analysis" (Fereday & Muir-Cochrane, 2006, p. 82).

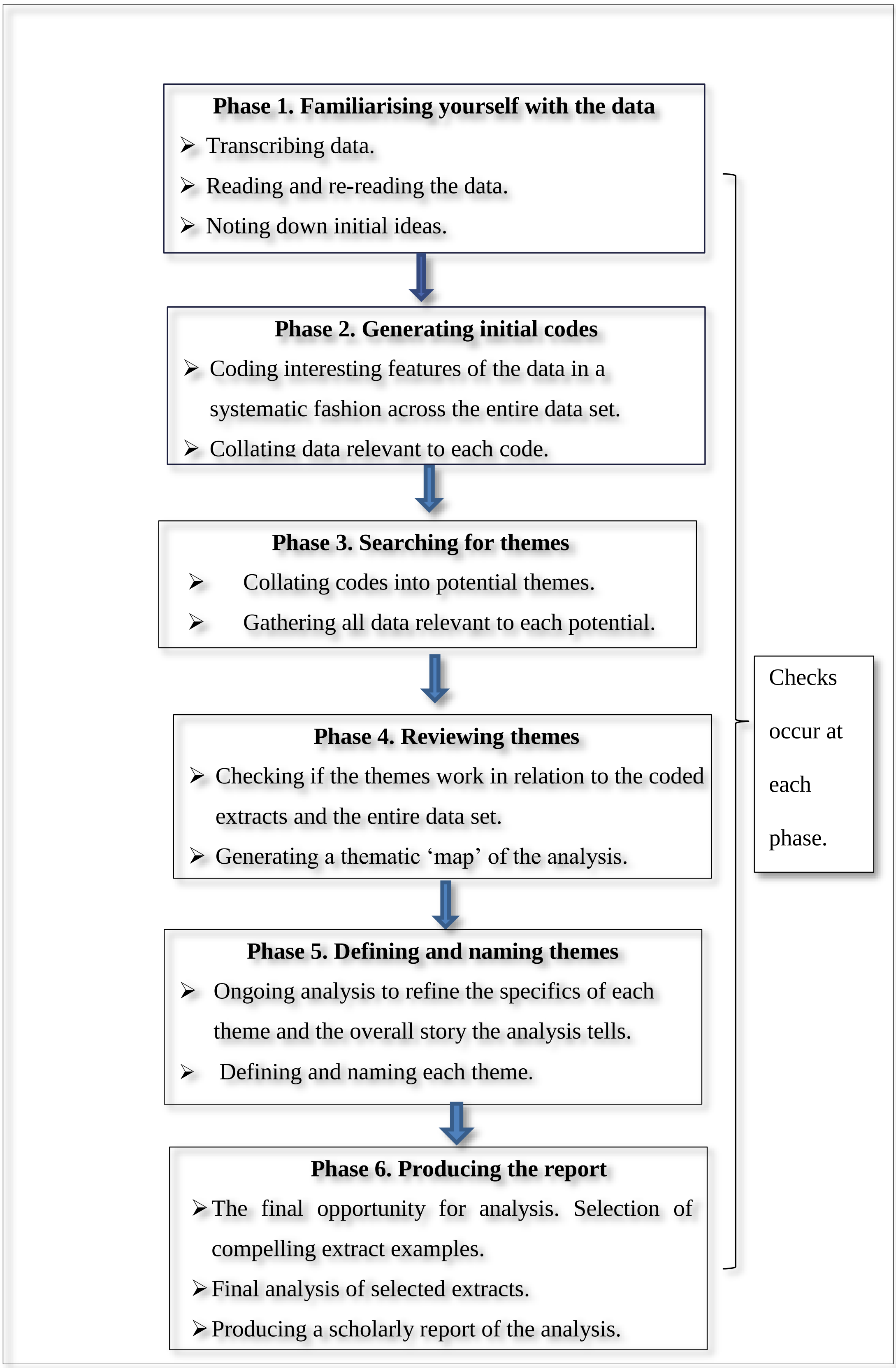
This back-and-forth process of reading and re-reading enables researchers to further familiarise themselves with the data, a necessary aspect of identifying important themes with which to describe the social phenomenon (Braun & Clarke, 2006; Fereday & Muir-Cochrane, 2006). Reading the data attentively is important, because

> themes are usually quite abstract and therefore difficult to identify. Also, themes do not immediately stand out of the interview but may be more apparent if researchers step back and consider what the participants are trying to tell them. Themes are often concepts indicated by the data rather than concrete entities directly described by the participants and once identified they appear to be significant concepts that link substantial portions of the interviews together. (Morse & Field, 1995, pp. 139-140)

One advantage of using thematic analysis is its flexibility, enabling a rich and detailed yet complex account of data (Braun & Clarke, 2006). Braun and Clarke (2006) explain that thematic analysis derives its flexibility from its independence from any theory or epistemology, and hence can be applied across a wide range of theoretical and epistemological approaches, making it compatible with both realist and constructionist paradigms. For all its advantages, flexibility is something of a double-edged sword in that a lack of clear and concise guidelines expose it to the “anything goes” critique of qualitative research, as succinctly described by Antaki, Billig, Edwards, and Potter (2003). Therefore, researchers need to make their epistemological and other assumptions explicit about mitigating this drawback (Holloway & Todres, 2003). Similar sentiments were expressed by Attride-Stirling (2001), who emphasised the need for qualitative researchers to document and include in their report their process and practice of method by explaining what they are doing, why they are doing it and how they did their analysis. I provide a step-by-step description of how I analysed interviews later in this chapter.

There are two primary ways in which patterns or themes can be observed within the data. These ways are inductive or data-driven (Boyatzis, 1998; Braun & Clarke, 2006; Hayes, 2000), and deductive or theory-driven (Crabtree & Miller, 1992). This research employed a data-driven inductive approach where notable themes and patterns of my participants’ responses emerged from the data without a prior assumption of what those patterns would be (Patton, 2002). The inductive process starts when the researcher starts noticing meaningful patterns and issues of importance in the data, which could be as early as during the data collection phase (Braun & Clarke, 2006). Figure 6 shows the analytic strategy that I used to systematically analyse the interview data.

Figure 6. Phases of thematic analysis



Source: Adapted from Braun and Clarke (2006, p. 87).

a) Phase 1. Familiarising yourself with the data

The main goal of this phase is to become familiar with data. Researchers immerse themselves in the data to the point that they are familiar with the length and breadth of the content (Braun & Clarke, 2006). Transcription, though extraordinarily time-consuming and at times boring can be an excellent way of getting familiar with audio-recorded data (Bloomberg, 2008). Some authors suggest that the transcription phase should be seen as a "key phase in data analysis within qualitative interpretative methodology" (Bird, 2005, p. 226). Another suggestion is that transcription should be recognised as an interpretative act where meanings are created, and not simply a mechanical method of putting verbal words into a paper (Lapadat & Lindsay, 1999).

I transcribed all the audio data collected during interviews into written form for closer study. Transcribing the interviews allowed me to listen to the responses once more quietly and reflectively, reinforcing my comprehension of the story told by the interviewees. Further, wherever possible, I transcribed the audio recordings on the same day of the interview meaning that the discussions were still fresh on my mind, and I could easily follow through. I played the recording several times for accuracy as recommended by Braun and Clarke (2006). Although there is no one set of guidelines to follow when transcribing, I attempted to be as "rigorous and thoroughly orthographic" (Braun & Clarke, 2006, p. 88) as I could to provide a verbatim account of all verbal communication, thus remaining true to the original nature of the information as much as possible.

In keeping with the Human Ethics Committee's requirements, I sent the transcribed version of the interview to the person interviewed, offering the interviewee an opportunity to alter his or her comments. I took the opportunity to seek clarification on points that were either not audible enough from the recording or responses that were not clear to me at first. The final product of this phase was pages of Microsoft Word documents that were ready for analysis. I read and re-read each text, re-confirming with the audio recording where necessary. In the process, some ideas and concepts emerged, which I later used in the coding phase.

To preserve the identity of the interviewees, I reviewed all the transcripts again, this time assigning pseudonyms to the participants to disguise their identity. I maintained a password-protected file, containing a key that matches pseudonyms with participants' names. The file is available to my faculty supervisors and me. I kept the key if I needed further clarification during the coding and analysis phase. Further, I redacted any identifying information (for example, names of participants and other individuals' names, and the location of their companies) from the data. I will maintain the data set, representing the aggregated responses of the participants, in a password-protected file for at least five years after the completion of this study. I will not report any information that can identify participants in this dissertation, nor will I do so in future conference presentations or scholarly or professional publications.

b) Phase 2. Generating initial codes

Again, this iterative process took several steps. The first step was to organise the data into a manageable classification form as the first step of analysis (Patton, 2002). To this end, I formatted the transcripts, formatting the main interview questions into heading one, sub-questions into heading two, and all participants' responses into body style. Next, I used the computer-assisted qualitative data management software NVivo 12 to manage data. In NVivo, I imported data originating from the asset managers' transcripts and grouped it according to question numbers, such that all responses to each question were grouped. I organised only the asset managers' responses in this way because I had asked all the asset managers similar questions (even if not all questions were answered). I then imported data from the other participants. I did not categorise their responses, because I had asked them a variety of questions depending on their specialisation.

I started generating themes inductively by identifying features of the data that appeared important and notable. Some qualitative researchers refer to this process of recognising (seeing) an important moment and encoding it (seeing it as something) as "sensing themes" (Boyatzis, 1998; Fereday & Muir-Cochrane, 2006; Smith, 2003). Code is defined as "the most basic element of the raw data that can be assessed in a meaningful way regarding the phenomenon" (Boyatzis, 1998, p. 63). Good code is one that captures the qualitative richness of the phenomenon.

I coded the ideas by tagging selections of text within the data item and dropping them into nodes. In NVivo, the word node refers to a basket or a container that lets the researcher gather related material in one place so that he or she can begin looking for emerging ideas. Following Braun and Clarke (2006), I systematically and repeatedly read through each transcript, giving equal attention to each data item and identifying any aspects that may form a repeated pattern in the full data set. By doing so, I deepened my appreciation of the participants' perspective of the topic and redefined additional codes in the processes (King et al., 2018).

A frequent criticism of coding is that context is lost in the process (Braun & Clarke, 2006; Bryman, 2016). To mitigate this problem, I coded extracts of data inclusively by capturing the surrounding words to preserve context. In addition to coding for as many themes as possible, I also coded extracts of data in as many themes as they fit into. I coded extracts of data that did not occur frequently but which captured meaningful qualitative data independently because the prevalence of a theme does not necessarily mean the theme itself is more crucial (Braun & Clarke, 2006).

This phase resulted in numerous codes that appeared disconnected. At this point I was feeling overwhelmed by the codes because there seemed to be no sequence whatsoever and, as rightly observed by Braun and Clarke (2006), there is no data set without contradictions and this was no exception. Similarities and differences were beginning to emerge at this point, indicating areas of consensus to responses to interview questions and areas of potential conflicts. Creating and maintaining accounts that departed from the dominant story and taking note of the tension in the data helped keep the coding phase on track.

c) Phase 3. Searching for themes

Miles and Huberman (1994) consider the process of coding as part of data analysis because, at that stage, the researcher organises the data into meaningful groups. As the data analysis phase is an iterative and reflective process, I redefined the codes in each node by reviewing them back and forth, un-coding data items from some nodes and placing them in more appropriate nodes from whence repeated patterns began to emerge the more the codes were refined.

While focusing on the broader level of themes rather than codes (Braun & Clarke, 2006), I clustered descriptive codes that shared similar meaning to create interpretive codes that captured the meaning offered by the text (King, 2010). Where possible, I clustered themes around the research questions but allowed flexibility such that codes were freely clustered according to what emerged from the data. I utilised the visualisation features offered by NVivo, such as using word frequency to generate a word cloud, depicting the most occurring word during the interviews. I provide an example of a word cloud in Figure 7, which shows the 100 most frequently occurring words in the whole data set. The bigger the word, the more frequently it occurs, and, in this case, governance was the most used word.

A word cloud by itself gives a pictorial representation of what is going on with the data, but it does not convey much information. Performing a word search and extracting a treemap, which shows the immediate words before and after a target word, provides the surrounding context under which a word is used in the interviews. All these tools helped me to identify and collate themes. I maintained a short description of the themes in NVivo, containing brief notes of what each node was to capture. These notes acted as a reminder and guiding posts, keeping the analysis on course. However, I frequently revised them as the coding progressed to reflect changes.

Figure 7. The 100 most frequently occurring words in the whole data set

At this point, I started considering the relationship between codes and between different levels of themes, that is, the main themes and sub-themes and the interrelationship between all of them. At the end of this phase, some initial codes went on to form candidate themes, while others formed sub-themes. Still, some codes did not seem to belong to any of the established themes, so I created a theme called “other”. Again, the significance of themes became clearer after constant revision of codes within nodes and using visualisation features such as a hierarchy chart of codes in a node, which visually displays the proportionate area occupied by a certain code in a node.

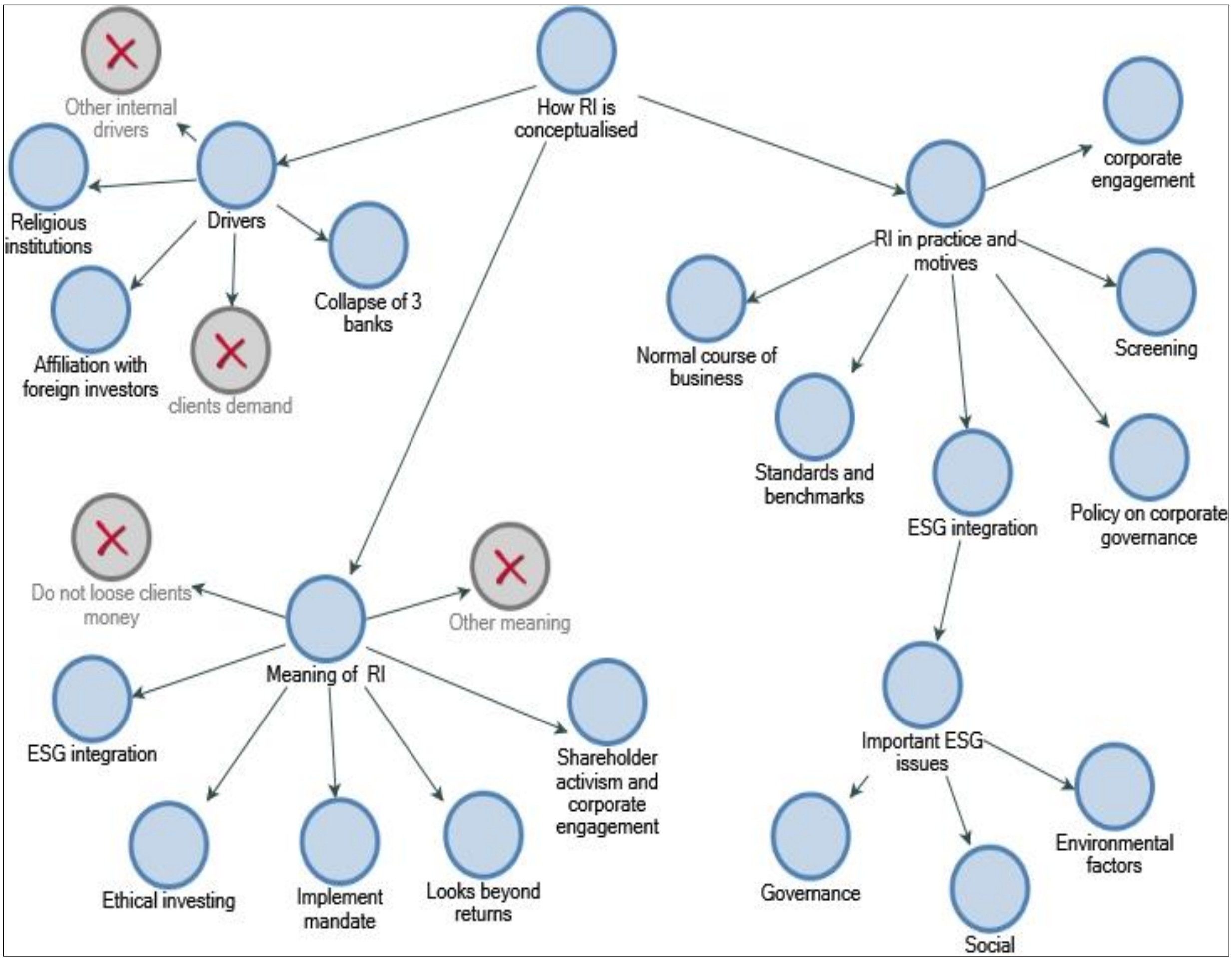
d) Phase 4. Reviewing themes

This phase involves the further refinement of candidate themes that were generated in the previous step. At this stage, data within a theme should fit together meaningfully and there should be clear and identifiable boundaries between themes (Braun & Clarke, 2006). I reviewed the themes at the level of coded data extracts by examining each theme and evaluating if they form a coherent pattern. Use of thematic maps, like the one shown in Figure 8, helped me to visualise the relationships between themes and sub-themes. The map represents the coding process of participants describing how they conceptualise RI.

On the occasion that some extracts did not appear to fit in a theme, I either removed them (see themes marked with an "X" on the map), encoded them elsewhere, or created new themes to accommodate them. Other nodes contained very diverse data, so I distributed them to more appropriate nodes. Moreover, to improve coherence, I merged some nodes to form one theme while I broke others down into two separate themes. Nevertheless, as mentioned earlier, some infrequently occurring data extracts went on to form candidate themes, because they contained exceptionally important information that added unique insight to the analysis.

Further, I evaluated each theme against the entire data set to see whether the themes accurately reflect the meaning contained in the whole data set (Braun & Clarke, 2006). For example, I removed the sub-theme "drivers" (shown in Figure 8) from the main theme "how RI is conceptualised" to form its own main theme.

Figure 8. Thematic map of coding



The whole process involves reading through all the data files and creating or deleting additional codes as needed. This re-coding procedure can be equated to editing written work, and caution is required as it could go on ad infinitum to the point where it does not add more value (Braun & Clarke, 2006). It is therefore advisable to stop when more coding only fine-tunes an already existing and fitting coding framework. I stopped coding when the thematic maps appeared as an accurate representation of my theoretical and analytic approach. At this point, I had a good idea of what story my data was telling.

e) Phase 5. Defining and naming themes

The next step after establishing satisfactory themes is to define and name them. The researcher does this by identifying the essence of each theme and the information captured. The goal is to establish what is important in each theme and why it is important in relation to the research questions and the overall story (Braun & Clarke, 2006). The outcome of this stage was five main themes with several sub-themes.

f) Phase 6. Producing the report

I chose the traditional method of separating the findings from the discussion chapters to write up the research findings. I reported key findings of the study in two chapters using verbatim quotes to illustrate the findings.

4.5.2 Analysing documents

I began by identifying relevant documents and filing them in file folders according to their content for easy access. I analysed documents by first skimming through, searching for pertinent information that was relevant to the research question, simultaneously bookmarking or highlighting the relevant text passages for closer examination afterwards (Corbin & Strauss, 2008). I then read the selected texts thoroughly, thematically coding data to uncover patterns pertinent to RI development in various parts of the world. The codes generated from document analysis served to integrate data gathered by interview (Bowen, 2009). The information helped me to formulate my research and interview questions and acted as pre- and post-interview cross-check data.

I analysed annual reports by identifying how the listed companies comply with the provisions of the *Companies Act 2015* (KNY) and the Code (CMA, 2015a) regarding ESG disclosure practices. I entered all documents in the EndNote X8 referencing programme, which was very useful for citations when writing the thesis. I strove to represent the research material fairly and to sensitively select and analyse the data from the documents, as suggested by Bowen (2009).

4.5.3 Issues in data analysis

I transcribed most of the interviews while in Nairobi so that I could obtain confirmation or clarification while in proximity with the participants; it was going to be much harder and more costly to communicate via email or phone calls once back in New Zealand. Although I was time constrained, this situation enhanced the data collection and analysis process, allowing me to familiarise myself with the interview data quickly.

4.6 Conclusion

I have provided an overview of the research design and methods used to collect and analyse data. I have justified the relevance of the applied methods and their usefulness for this study. Further, I have demonstrated the important role played by extensive networking to gain access to the participants in Nairobi. I doubt that my study would have been successful without networking widely. I present the results from this process in Chapters 5 and 6, and further discuss them in Chapter 8.

Chapter 5. Conceptualising RI in the retirement benefits sector of Kenya

In this chapter, I discuss the way actors working in the Kenyan retirement benefits sector conceptualise RI. Since RI involves the integration of material ESG issues into the investment decision-making process, I use the word conceptualisation to mean two things. First, I use it to mean the terminologies used to define RI by the actors of the retirement benefits sector. Second, I use conceptualisation to capture participants' perception of the materiality of ESG issues regarding investment decision-making. This chapter addresses my first and second research questions, which are:

1. How do the actors in the retirement benefits sector of Kenya conceptualise RI?
2. What are the main ESG issues in Kenya and do they present material risks or opportunities to the investment decision-making process?

5.1 Use of different terminologies

During the interviews, I did not provide participants with guidance or suggestions, but rather allowed them to define and describe their understanding of RI. The main terminologies used by participants are ethical investment; ESG integration; implementing the mandate; and looking beyond returns. The following sections summarise these descriptions, including the proportions of participants who discussed RI in similar terminologies. I first present the definitions, followed by a brief explanation of how I collated participants' responses under one theme. I also provide examples of the participants' responses that best represent the description of each definition.

5.1.1 ESG integration

This theme includes anyone who defines RI in terms of ESG integration, even if the participant does not apply that criterion in practice. Less than half of the asset managers and one regulator (AM4, AM5, AM6, AM11, AM13, AM14 and Regulator 3) define RI as the consideration of ESG factors in the investment decision-making process. One asset manager expresses it in this way:

> Broadly, my understanding of RI is an approach that seeks to incorporate ESG factors in the investment process to achieve sustainable long-term returns. (AM11)

The asset managers who define RI to mean ESG integration seem to view ESG integration as synonymous with screening to exclude or include some assets, or as sustainability-themed investing. For example, AM4 says that he integrates the "whole ESG package", because that is what the clients want. But he also states that "we call it screening. For instance, we have clients who request that we do not invest in tobacco, beer, manufacture of weapons, anti-corruption policies, and child trafficking". This comment appears to imply negative screening to exclude companies that are involved in areas that the clients do not want. On the other hand, AM13 seems to be describing sustainability-themed investing when he states that his firm is "increasingly allocating capital to new areas, many of which are based on harnessing natural resources" (AM13). He states that he prioritises renewable energy projects because his firm is keen on environmental impact. As discussed in Chapter 3, screening is often the first step of ESG integration, followed by a quantitative analysis of the identified material ESG factors to determine their impact on securities and adjust the valuation models to reflect that impact.

But AM5's definition of RI is markedly different from those of everyone else because he includes shareholder activism in his definition – the only one to do so out of all the participants. He states that although the "typical thing is the ESG consideration ... I think about shareholder activism. Once you invest in a company, are you actively pushing for reforms where things are not going well" (AM5). He notes that his parent company is based in South Africa and has used shareholder activism as a strategy in the South African market successfully, but his company does not apply it in Kenya. He explains that his company is relatively new to the Kenyan market and it does not have a significant stake in any one company to be able to use that strategy, "because it is important to have a significant stake for these strategies to be effective" (AM5).

5.1.2 Implement the mandate

This theme includes any participant who defines RI to mean the strict implementation of the mandate given to them by the trustees of the retirement schemes. Two asset managers (AM8 and AM12) define RI in this way. The two asset managers indicate their awareness of other definitions of RI such as ESG integration, but they appear to imply that those definitions are currently not in operation in Kenya. Instead, they define RI as taking due diligence and professionalism and investing according to what they have agreed with the clients. I provide here an example of a response from one asset manager:

> I speak like an investment professional, where responsible investment is purely perceived to mean investing that does not harm or destroy human life and the

> environment. But in practice, responsible investing is implementing the mandate, i.e., the investment policy statement to the letter. (AM8)

The above participant observes that the retirement benefits sector is highly regulated, such that it is nearly impossible to execute an irresponsible investment because an "irresponsible investment means an investment that is harmful to the environment or is in breach of the mandate" (AM8). He also states that asset managers can be perceived to be irresponsible when they invest in institutions that then collapse or when they invest in assets that do not deliver the expected returns. For him, the strict regulations exclude the opportunities for irresponsible investment as evidenced by the following comment: "I sit in the fund managers' council and we see it [is] almost impossible to invest irresponsibly" (AM8).

Similarly, AM12 states that "RI means taking due care and professionalism to invest for clients as per what you have agreed with them". This asset manager explains that RI means mitigating risks that may come with investing in certain assets or companies to ensure that clients do not lose money. According to AM12, asset managers look at the risk, liquidity and returns of an asset before making investment decisions. They mitigate the risks that can arise from any of those factors.

5.1.3 Ethical investing

This theme represents the participants who define RI to mean an investment that does not harm society or seeks to create some social good. Six participants (AM1, AM2, AM3, AM7, AM15, and the council member of the ARBS) define RI in this manner. These participants' definitions of ethical investment vary but tend towards investing in instruments or institutions that promote ethical practices, produce ethical products and services, or promote some social good. One asset manager explains his view of RI in this way:

> I think what comes to mind is, first, where am I investing, am I investing in things that are not ethical, things that probably if it was my own money I won't invest in or things that my company does not believe in. And, in some way, what sort of impact am I having on the people. Not just to make money. (AM3)

The above interviewee (AM3) narrates an example of a time that his firm had made an investment through a private equity firm and then realised that the private equity firm was producing and selling cheap liquor of substandard quality, prompting the investor to cease dealing with the entity based on unethical business practice.

The council member of the ARBS defines RI to mean an investment that "does not do more harm than good" or "investing in socially acceptable areas". The council member is an administrator of a pension scheme of one of the largest banks in Kenya. She notes that a few clients ask that the scheme does not invest in certain companies such as East African Breweries Limited, because it manufactures alcoholic drinks, and they are opposed to alcohol consumption. But she states that "given the limited number of blue-chip companies listed on the Nairobi Securities Exchange and the fact that East African Breweries Limited is one of the best-performing companies, the option not to invest may not be feasible".

5.1.4 Looking beyond returns

This theme represents participants who define RI to mean an investment that looks beyond immediate returns to create an impact. A total of seven participants (AM3, AM4, AM11, AM15, Regulator 2, Regulator 3, and the capital market development specialist) define RI in this way. For example, one asset manager defines RI to mean

> thinking beyond returns, because the return is one year, but what more can you say you have done beyond creating handsome returns? This is where we talk about impact, what impact am I having on the society. (AM4)

AM4 narrates how his firm had invested in a construction project to build a shopping mall in a downtown part of Nairobi. The construction phase, which lasted approximately two years, employed more than 10,000 people with the estimation that the new shopping mall will employ a similar number of people. The participant notes that the "project comes as both commercial and impact because investors are commercially oriented but the project itself has achieved more than just delivery of returns" (AM4). He observes that the value of the adjacent land increased significantly during those two years and the neighbourhood had prospered due to increased employment. Both AM4 and AM11 especially state that they prioritise investment opportunities that make a social impact when selecting between two choices with similar returns.

The capital market development specialist and the two regulators, while not involved in active investment decisions, express the view that RI ought to bring about positive transformation to people, the planet and profit. Regulator 3 defines RI to mean looking beyond immediate returns to think about long-term sustainability, and provides a mango tree analogy to express his view:

> When you plant a mango tree, you are interested in the mango, not the tree, but you must look after the tree. From the financial perspective, when you invest in an area, you are interested in the returns, but you must look at the externalities. That is why we talk of the environment, the social responsibilities and other factors that are more useful to you other than just the mangoes. (Regulator 3)

Both Regulator 2 and the capital market development specialist express that investment decisions should take a long-term view regarding the environment so that they do not harm the environment at the expense of future generations. According to the capital market development specialist, retirement benefits schemes can invest in products such as green bonds, which are intended to support climate-related and other environmental projects.

Overall, it is worth noting that four asset managers (AM4, AM5, AM7 and AM13) have international affiliations either with their clients or through the ownership structure of their firms. These asset managers explain that their clients and parent companies ask for ESG integration because they are familiar with the concept from their home countries, and they push for it in Kenya. For instance, one asset manager states that he primarily invests on behalf of foreign investors and comments that "foreign investors are quite well educated on RI and we have seen a big push from them to pursue RI more. I am yet to see a request from a local investor" (AM4).

Both AM5 and AM13 are employed by subsidiaries of firms that are based in South Africa and the parent companies are signatories to the PRI. AM13 states that his parent company is pushing the ESG policy throughout all their subsidiaries. He explains:

> We have subscribed to the PRI, through the parent company in South Africa. So, the standard gets rolled out, although the rolling out does not happen immediately. It takes a bit of time to integrate the standards in the way that we want them to work. However, there is a push towards that for all our offices. (AM13)

AM7 states that his firm is being persuaded to integrate ESG factors in investment processes by an international organisation that recently bought a significant number of shares in his firm. The international organisation is a leading supporter of RI and it is urging AM7's firm to consider ESG factors conscientiously. He acknowledges the push by saying:

> I think we are most certainly swayed. Perhaps we do not give it enough attention, but now we have been made to think more on ESG, document our thoughts around

> ESG, outline the practices that matter to us in as much as ESG is concerned, and we have been forced to align with ESG best practice. (AM7)

However, he states that "as far as investment management is concerned, it is not an explicit policy and we will not have an RI fund, but we will only have it as an overlay". Further, he adds that "we do not see commercial value in having ESG integration", which seems to indicate that they are not integrating ESG issues voluntarily.

Overlaps occur where asset managers use different terminologies to define RI. For instance, AM3 uses two terminologies to define RI, that is, an ethical investment and looking beyond returns. Also, both AM4 and AM11 define RI in terms of ESG integration and looking beyond returns. Thus, there are no clear boundaries and participants move from one definition to another with ease.

Some interviewees seem uncertain of what RI means to them, which is evident in the way they use contrasting statements. For instance, AM7 defines RI in this way, "it is something that I understand. I look at it as more of an investment style, something that you can overlay on top of an investment strategy". Shortly after he seems to contradict his statement by saying, "in our view, we do not look at responsible investment as something of an investment style, but we assess those factors in our commercial investment because it is the right thing to do". Such confusing statements are not rare, and, in the end, I wonder what some asset managers mean.

In the following section, I discuss the main ESG issues in Kenya as identified by participants.

5.2 The main ESG issues in Kenya

The environmental element of ESG refers to factors such as climate change, sustainable land use, consumption of water, and production and use of plastics. The social element refers to issues such as human rights and labour standards, conflict-affected zones, and employee relations. Corporate governance includes issues such as bribery, corruption, executive pay, the nomination of directors, shareholder rights and transparency (Clark et al., 2015).

For this research, I ask participants to identify what according to them are the leading ESG factors in Kenya. I also ask if they view the identified ESG factors as material factors that can present both risks and opportunities to their firms' financial stability in the long term. The next section discusses the issues raised in each of the ESG categories.

5.2.1 Environmental factors

Participants identify several environmental issues, ranging from the pollution of air, water and soil (AM1, AM5, AM6, AM9, AM14, AM15, Regulator 1, Regulator 2 and Regulator 3), deforestation (AM1, AM8 and Regulator 1), inappropriate garbage disposal systems (AM3, AM5, AM8, AM14 and AM15), drought and the effects of climate change (AM11, AM13, AM14 and the green bonds consultant), building on riparian reserve (AM1, AM10, AM12 and AM14), and unsustainable farming practices that erode soil fertility (Regulator 1).

Some participants, such as AM6, AM9, AM5 and Regulator 3, associate the excessive air pollution in Kenyan cities to "matatus[2] spewing out carbon monoxide in large quantities" (AM9), and express the opinion that quality controls are either lacking or, where they exist, the government is not enforcing them. For example, AM5 states that "there is zero quality control in terms of the cars that are driven around Nairobi and the quality of fuel is also a concern".

Kenya banned single-use plastic bags in 2017 (National Environment Management Authority, 2017). According to participants, the ban has created a difference in the cities. However, the same cannot be said of garbage collection and disposal, because as both AM5 and AM3 observe the general garbage disposal system in Kenya does not operate efficiently. Also, the industrial waste produced by companies is not properly disposed of, as AM3 explains:

> You go to the industrial area and find companies making millions of shillings, but they channel their waste to the river. When I look at that as an investor, I think if I invested in such a company, I would like to change how waste is disposed of. (AM3)

Four participants (AM11, AM13, AM14 and the green bonds consultant) especially state that climate change is a significant environmental problem, and that Kenya experiences the consequences of climate change, particularly through altered weather patterns affecting agricultural production. For example, AM14 states that climate change is

> something we can see. There is evidence, although some people argue that it does not exist. Currently, there is flooding in Nairobi and we come from one extreme to the other, that is, from extreme drought to flooding. (AM14)

While AM14 does not express a specific opinion on the effect of climate change on investment decision-making processes, he views environmental and social factors are "farfetched" and

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[2] Privately owned minibuses that are used for public transport in Kenya.

asset managers are “not yet at that point where we would have those constraints” (AM14). On the contrary, AM11 expresses the opinion that the change in weather patterns due to climate change “directly impacts on our economy and affects our social well-being”, because Kenya is “still an agrarian economy and approximately 30 per cent of our GDP is derived from agriculture, which in turn depends on [sufficient] rainfall, and when we have a long dry spell, we see it in our GDP” (AM11). For that reason, AM11 treats agricultural companies as trading assets. He explains:

> When I am investing for pensions, which take a longer-term view, we find that investing in agriculture companies (tea and coffee), we tend to be very cautious and we do not invest long-term because, although they make good returns, they are quite seasonal. We tend to look at the seasonality, and it will be more of a trading asset. (AM11)

Another asset manager expresses the opinion that he is “not particularly convinced that we have too much carbon emission going into the atmosphere” (AM2). He also wonders if Kenya’s carbon emission is accurately quantified. But the green bonds consultant states that in a developing country context, climate change should not be viewed from a carbon emission perspective, but via adaptation and mitigation. AM13 suggests that climate change is currently not fully grasped by asset managers in Kenya, “because it is all so in the future and it is not a pin that is pricking us today”.

Although AM11 and AM14 associates flooding in Nairobi to effects of climate change, environmentalists suggest that building on riparian reserves and encroachment of waterways in Nairobi exacerbates the problem, with detrimental effects such as deaths due to flash floods. A leading local newspaper quotes one Mr Omesa, an environmental scientist and campaign assistant at Greenpeace Africa, who explains that the riparian reserves “act as a safety valve in the watershed because they slow water flows, reduce the size of the flood further downstream and the destructive power of fast-flowing water” (Mugo, 2018). When people build on the riparian reserves and encroach waterways, the water speed can double, which can then lead to greater erosion.

By way of context, there were ongoing demolitions of buildings built on riparian and road reserves when I was conducting the fieldwork (Ndiso, J., & Fick, M. (2018, August 18). The government sanctioned the demolitions, which included well-established businesses such as a supermarket and a shopping mall, because they were built either on road reserves or riparian land. According to Article 62 of the Constitution of Kenya (2010), riparian land is public land. Hence, the current government argues that the land was allocated illegally, and planning permits were also granted illegally by officials serving in previous regimes. One asset manager expressed the opinion that investing in companies or projects that have acquired public land illegally is an important issue for asset managers to consider when making an investment decision in Kenya, because it can have serious financial repercussions in the future:

> That is a big risk, because, for instance, insurance companies invest in long-term assets and property funds come into play. If, let us say, I have invested into [a] property fund, I have exposed my clients to a property fund that [has been built] on riparian land and now it is demolished, of course, you lose money. I will be asked why I did not do my due diligence. It would come back to bite me. (AM12)

5.2.2 Social factors

Kenya has a host of social problems that again cross the line between various categories. The ones that feature prominently in this study are high levels of unemployment (AM3, AM7, AM11, AM14, AM15, Regulator 1 and Regulator 3), a lack of access to affordable education and health care (AM1, AM6, AM7, AM11, Regulator 1 and Regulator 3), a lack of affordable housing (AM2, AM1, AM6, AM8, Regulator 1 and Regulator 3), a lack of safe drinking water and poor sanitation (AM2, AM8, AM11 and Regulator 1), poverty (AM10, AM15 and Regulator 1), alcoholism (AM2 and Regulator 2), use of illicit drugs (AM2 and AM3), and corruption (AM7 and AM12). The use of pornography is identified as a time bomb waiting to explode, especially with increased access to the internet via mobile phones (AM2), while betting is a big social problem, especially among the youth (AM6).

The level of unemployment and underemployment, especially among the youth, is what AM7 describes as a "massive issue". Although Regulator 3 suggests that Kenyans need to "shift their mentality from thinking about employment in terms of white-collar jobs", both AM1 and AM7 suggest that the mentality is not the biggest challenge, but sources of money to start a business are the problem. AM7 notes that many young people in Kenya have very good business ideas "but lack access to capital because there are few providers of start-up capital, making it difficult for them to implement their ideas, and bank financing is notoriously difficult to access" (AM7).

Alcoholism and the use of illicit drugs, especially among the youth, "are other major problems that have done a lot of harm in our society" (Regulator 2). Both AM1 and AM3 wonder if there is a link between rising alcoholism and use of illicit drugs among the youth to high youth unemployment. Whether one causes the other, it seems that both are challenging problems to address in Kenya because the rate of job creation is not keeping pace with the labour force. The following narrative shows how one county governor sought to address alcoholism by employing youth, but soon ran out of funds:

> Kiambu County has a huge alcoholism problem, and the Governor has come up with an ambitious plan to employ all those that are jobless because they supposedly drink because they are jobless. The strategy has proven to be very expensive, and it has drained the county. Many people are questioning the sustainability of such an initiative. Where does he get the work from and when there is no money, does that mean they go back to drinking? (AM1)

Unemployment leads to other problems, like a lack of health care, education and affordable housing, the offshoot of which is abject poverty (AM3 and AM15). Although Kenya has started addressing the issue of affordable education, access to affordable health care remains a major challenge for most Kenyans (AM7). People living outside of the major cities especially have a bigger problem accessing proper health care because most of the referral hospitals that are properly equipped are in the major cities (AM11 and AM7).

The identified social issues align with those officially identified by the Government of Kenya through the Kenya Vision 2030 initiative (Kenya Vision 2030, 2019). As discussed in Chapter 2, the current government is committed to improving social issues such as housing through the Big 4 Agenda (Government of Kenya, 2018).

5.2.3 Governance factors

Governance elicits the most reaction from all respondents, and they agree that corporate governance is the biggest challenge for investors. The corporate governance issues that featured prominently in this study are corruption (AM1, AM2, AM3, AM4, AM5, AM6, AM7, AM9, AM10, AM12, AM14, AM15, Regulator 1, Regulator 2, and Regulator 3), dishonesty and a lack of integrity (AM7, AM9, AM11 and AM13), a lack of accountability (AM1 and AM13), a lack of transparency (AM2, AM5, AM6 and Regulator 3), and a lack of functional boards (AM3, AM10 and AM13). Most of the participants agree that corruption is a serious issue of concern for investors in Kenya, and it occurs in both the private and public sector, albeit at different magnitudes. One asset manager expressed the opinion that even though Kenya has some of the best anti-corruption laws, “we are still talking big about corruption in this country, in both the private and public sectors” (AM3).

According to the participants, corruption in Kenya takes many forms, such as bribery, theft, fraud, and embezzlement (AM2, AM12, AM14, AM15 and Regulator 1):

> Bribery of officials where money changes hands, white-collar theft of funds that is so blatant just like theft, mismanagement of companies for your benefit e.g. [names redacted]. (AM14)

According to AM14, corruption is particularly worse in organisations where the government is involved, such as in appointing directors. AM2 states that fraud stands out as a corruption issue and expresses the opinion that even if a fraud is committed by government officials, it is likely to circulate in the private sector where asset managers invest, such as through the banks. For example, the Central Bank of Kenya fined some banks in 2018 for having been complicit in a 2015 corruption scandal commonly known as the National Youth Service scandal (Central Bank of Kenya, 2018).[3]

A lack of transparency is another corporate governance problem mentioned by the participants. According to Regulator 3, a lack of transparency is a serious corporate governance issue in Kenya, and the CMA is working to rectify the problem. He reflects on the extent of lack of transparency:

> We want to focus on this area. When investors do not know the names of the CEO or chairman of the companies they have invested in, or they do not know when annual general meetings are held, or other such vital information … (Regulator 3)

The lack of transparency affects asset managers' ability to make investment decisions with confidence that they have adequate information to fully gauge how the companies operate. For that reason, AM2 states that his firm

> chose to invest singularly in companies that are transparent as far as corporate governance is concerned because without that we do not know what we are getting ourselves into and we would be hard-pressed to defend ourselves should a failure occur. Transparency with its linkage with fraud or lack thereof is our focus as investors. (AM2)

[3] The National Youth Service scandal was a 2015 corruption scandal involving the Ministry of Devolution and Planning, where Ksh 791 million (USD 7.6 million) was stolen (Mbae, 2015).

However, the exclusion of companies that do not provide such information reduces AM2's investment opportunities, as he states, "we end up being quite concentrated, because we have a very limited portfolio of what we can invest in, out of no fault of our own" (AM2).

Asset managers raise several issues regarding boards, including: a lack of functional boards, such that decisions are made by a single individual who lacks checks and balances; board members not possessing the right skills because they are not selected on merit; the CEO's power and length of tenure; and the influence of the board over the senior management. One asset manager expresses the problem in this way:

> They do not want to have boards, or they have boards that are not functional. We also have the issue of recycling the same people sitting on several boards. That would not be a problem if we had some people whose profession is to be professional non-executive directors in Kenya, but that is not the case. We have people in their 80s, and they are still sitting on several boards. That is why we struggle. I attended a course in corporate governance, and one person from a parastatal organisation said board members show up even when there is no board meeting, and they still want to be paid. (AM3)

On the issue of board qualifications, or lack thereof, AM11 expresses the opinion that troubled companies often lack strong independent boards, or they have board members whose skills do not match the industry. That becomes a problem where boards are not adequately equipped to execute their role, which involves steering the company in the right direction. He illustrates this point in this way, "when you run a cement company you need people with a bit of background knowledge about cement manufacturing such that when the management is taking certain risks, the board can say or know the downsides of the risks" (AM11).

Both AM4 and AM12 express the opinion that poor corporate governance practices lead to environmental and social problems (AM4 and AM12). For that reason, they suggest that addressing corporate governance practices will result in better environmental and social practices.

The above ESG issues are the main issues that recur throughout the interviews. I asked participants if they view those factors as material factors and whether they consider them important when making investment decisions, either as risks or opportunities to their earnings potential. They have varying views, which I will now discuss in the following section.

5.3 Are the identified ESG factors material factors that can present risks and opportunities to your company?

In this section, I discuss the participants' perceptions of the factors identified in the preceding section. Specifically, I explore whether the asset managers consider any of the above issues to be material factors that present both risks and opportunities to the financial stability of investment portfolios in the long term.

5.3.1 Material ESG issues that present risks to the investment decision-making process

All participants state that corporate governance is the main factor that presents an investment risk, and it is the one about which they are most concerned. Most of the asset managers state that they consider corporate governance issues when making investment decisions, but not environmental and social factors. For example, AM6 states that governance is "the big problem when it comes to investment. We look at governance and not the other two". Another asset manager states that "governance is the one issue that affects our investment decision, and if there are any red flags we are not going to go on with that investment" (AM13). One asset manager expresses it this way, providing examples of listed companies that are especially affected by weak corporate governance structures:

> Governance: That is the big one from an investment perspective. Serious concerns are coming out in terms of corporate governance, e.g., the banks that went down recently, big, leading chain supermarkets [names redacted] coming down, cement manufacturing companies like [name redacted] and [name redacted], which is under administration, and all these problems are tied to governance. These are big, listed companies that fund managers should be comfortable to allocate capital to, but now they are not that comfortable. (AM11)

By way of context, the banking sector suffered shocks between 2015 and 2016 after three banks collapsed, due to, among other factors, insider lending, weak corporate governance practices, weak regulatory and supervisory systems, poor risk management, lack of internal controls and conflicts of interest (Gathaiya, 2017). The banks that collapsed were the Dubai Bank Kenya, Imperial Bank Limited and Chase Bank Kenya (Central Bank of Kenya, 2017). The Central Bank of Kenya placed Dubai Bank Kenya Limited into liquidation in August 2015 due to capital deficiencies and liquidity. The Imperial Bank Limited was placed into receivership in October 2015 due to unsound and unsafe business conditions and practices. Chase Bank Kenya

Limited was placed into receivership in April 2016 due to a failure to meet the statutory banking ratios, and its under-reported insider loans (Central Bank of Kenya, 2017).

Some asset managers who manage the NSSF funds had invested in the three banks that ceased trading in 2015 and 2016. The Auditor-General recommended that four asset managers, who collectively lost approximately USD 1 million in corporate bonds and fixed deposits in two banks, have their contracts revoked by the trustees ("Ouko", 2018). The Auditor-General argued that the NSSF did not receive value for the consultancy fees it paid to the asset managers. Even if the ultimate liability rests with the trustees, asset managers are looking at this development from the Auditor General as a sign of difficult times ahead, as explained by one asset manager:

> In future, this is showing that fund managers will be required to demonstrate how they will not lose the money. This is not fool proof, but generally, governance needs to be elevated. (AM11)

The effects of weak corporate governance practices such as corruption can impact on the actors of the retirement benefits sector considerably because the trustees risk being sued, jailed or fined if found guilty of serious misconduct about the management of schemes, and the asset managers risk damaging their reputation and incurring economic losses if they lose their contracts. While the trustees have trustee's liability insurance that covers them in the event of litigation, asset managers rely on their due diligence, which is often hampered by a lack of transparency and integrity on the side of the companies.

In contrast to corporate governance, more than half of the asset managers (AM2, AM6, AM7, AM8, AM9, AM12, AM14 and AM15) express the view that environmental and social factors do not present a material risk to their investment decisions. For example, AM2 states that "we do not think these two pose an immediate risk", and further states that they "are not on our radar". Similarly, AM14 states that environmental and social factors "would not affect" investment decisions, and AM6 states that "environmental and social factors do not really come in unless they are flagged in the media, and then they catch our attention because if they are in the media there will be a negative perception to it". AM11 states that "in the ranking of concerns, the environment is not that high up in the mind of Kenyan unless there is direct damage to the people". AM9 states that, overall, ESG consideration "is not that big a thing in Kenya", and suggests that the issues will probably become material "in another hundred years".

Moreover, the council member of the ARBS expresses the view that ESG issues are currently not prioritised by the retirement benefits schemes, because schemes are primarily looking for financial returns and ESG factors do not add value to schemes' investment portfolios. She explains in this way:

> ESG issues in Kenya are currently not given priority when making investment decisions. The most important factor is the financial performance of the company. Consideration of ESG issues does not add value to a scheme's investment portfolio because we do not think that those issues will impact the bottom line when it comes to the investment decision-making process. (Council member of the ARBS)

Although the above participant is expressing her view, her opinion is important given that she is an administrator of a pension scheme.

Another notable pattern is that more than half of the asset managers (AM6, AM7, AM8, AM9, AM10, AM12, AM14 and AM15) express the view that environmental and social issues are the government's problems to fix and not the responsibility of the private sector. For example, AM9 states that he does not think that "the private sector can or should take a lead on ESG issues". Although some asset managers state that they engage in corporate social responsibility activities as a means of giving back to society, the general perception is that solving social problems is primarily the government's responsibility and not that of private investors. For example, the asset managers occasionally come together to give back to the community under the Fund Managers Association. On one such occasion, the fund managers donated KSh 1 million (USD 10,000) worth of books to primary schools and repainted classrooms. But AM9 does not think asset managers should be engaging in such activities, because that is not their job. He states that asset managers "are trying to do good, but this is something the government should never have let happen. The government should do what they are supposed to do".

Another asset manager states that his firm has a foundation that focuses on empowering the youth by sponsoring music and sports events. However, he comments that "the question arises of whether we are supposed to be trying to make people rich or dealing with some of these societal issues" (AM7). Similarly, AM8 states that "there is a conflict of whether you want to get a high return, or you want to impress society?".

Some asset managers (AM6, AM5, AM9 and AM11) especially note that the existing environmental and social laws should be enforced, and new ones enacted, to protect the environment and the society. These asset managers express the opinion that some environmental and social issues in Kenya are due to laxity in the implementation of existing laws and regulations. For example, both AM6 and AM9 state that the air pollution experienced in the major cities is because carbon emission controls are not enforced. AM11 reflected about a poisonous lead disposal case in Mombasa, whereby a lead-acid battery recycling plant was violating the Kenyan environment and human rights law by emitting fumes, dust and effluent laden with lead particles. The process contaminated water, soil, and air with toxic levels of lead, affecting the health of workers and neighbours to the point of causing deaths. Although the plant has since closed, the toxins continue to affect the lives of former workers and neighbours. Both AM6 and AM11 express the opinion that existing environmental laws need to be made stricter and enforced with stricter consequences, such as with fines applied in such a way as to make it difficult to circumvent or break the law.

5.3.2 ESG issues that present opportunities to the investment decision-making process

Five asset managers (AM1, AM3, AM10, AM11 and AM15) express the view that being mindful of ESG issues can improve the reputation of their firms and give them a competitive advantage for being known as responsible asset managers. For example, AM1 explains that when the banks collapsed, the shareholders of his firm compensated the beneficiaries who lost their money, and that improved their reputation as a credible asset manager who cares about the beneficiaries. Both AM10 and AM11 state that they could see a future where asset managers will position themselves as responsible investors and use that as a unique selling point. According to AM10, asset managers are already moving towards specialisation to position themselves as experts in a certain asset class. Thus, he says, they can position themselves as responsible equity investors and, in that way, stand out such that clients seek them as specialists.

On the contrary, six asset managers (AM2, AM5, AM7, AM8, AM9 and AM12) state that they do not see any benefit in positioning themselves as responsible investors. For example, AM2 states that “I will be very forthright and say that positioning ourselves as responsible investors will not give us any value, because this is a very return driven market”. AM8 even suggests that “there is a risk that pension funds appear to be socially responsible and deliver suboptimal returns”. AM5 suggests that “there is still a low level of that kind of knowledge” in the retirement benefits sector of Kenya for RI to be a significant edge right now. He expresses:

> It would be good for people to say we have ESG considerations but to lead with that as the competitive advantage it might not be a winning strategy, just because of where we are in the market right now. (AM5)

Six asset managers (AM6, AM10, AM11, AM14, AM7 and AM8) state that ESG presents business opportunities either now or in the future in the sense that they can invest in areas that solve a certain environmental or social problem. RI branded products would be targeted towards increasing access to electricity, education, creating employment or increasing affordable housing. For instance, AM10 perceives an opportunity to invest in renewable energy to increase the level of electricity utilisation in Kenya. He explains:

> If you look at the level of electricity utilisation, we talk of 30 per cent of households in Kenya being connected to electricity. There is still growth potential, and all we need is to bring cheap renewable energy like solar. (AM10)

He argues that access to electricity would create employment opportunities for many people, especially youth. But currently, many Kenyans, especially those in rural areas, do not have access to electricity, and, furthermore, electricity is quite expensive for many Kenyans. He suggests that if cheaper and renewable energy like solar were available, asset managers would be willing to invest in such projects.

Moreover, six asset managers (AM1, AM4, AM8, AM11, AM10 and AM14) state that they would prioritise investment in a project that creates a positive social impact over one that does not, so long as the asset is delivering an acceptable return. For example, AM11 demonstrates a time that he chose to invest in a product because it had a positive social impact and it delivered acceptable returns. He explains:

> East African Breweries Limited was manufacturing affordable beer, and they had an expansive programme with farmers to grow sorghum (raw material for the beer). The breweries had a lot of incentive recruiting farmers from Mt Kenya region and other regions, which had a big impact both on the farmers and affordability, replacing the illicit brews that are the source of the alcoholism problem in Kenya. The beer was much better quality than what the farmers would have made with the same sorghum (an illicit brew called busaa), and because the low-cost beer (Senator) performed very well in the industry, the farmers were selling sorghum in large qualities and making money and we saw a lot of value in that. We also saw a

> lot of social impacts because a better quality and affordability beer replaced illicit brews, which are the biggest problems. Unfortunately, the government kicked in with taxes and the beer stopped being affordable. We, therefore, took the reverse view because it stopped having the social impact and the returns went down, so we pulled out. (AM11)

However, many of the asset managers who state that they would prioritise investing in projects that create a positive social impact also state that such opportunities are few; such projects are not adequately regulated in a way that inspires confidence for asset managers to invest retirement benefits funds. For example, AM8 observes that Kenya has a large textile industry that employs a significant number of people, and he suggests that he would be willing to invest in such a sector because it creates employment for many people. But it would need to be properly regulated, which is currently not the case.

Regulator 1 agrees that there is a shortage of viable instruments for the retirement benefits schemes to invest. He notes that, in line with the Big 4 Agenda, the regulatory authority revised the investment guidelines allowing retirement benefits schemes to invest in new categories, such as REITs and private equity. But there was only one REIT in the market in 2018. He explains:

> You know you can only invest in what is in the market. For example, the guidelines allow investing in REITs, which is a good class for investing in housing, which is a part of the Big 4 Agendas. But though we have given a very generous allowance, we have only one in the market. (Regulator 1)

5.4 How do the identified ESG issues affect decision-making?

All asset managers state that they integrate corporate governance in their investment decision-making process, especially since the collapse of the three banks in 2015 and 2016. According to the asset managers, the failure of the three banks in relatively quick succession acted as a trigger point, prompting asset managers to evaluate their policies and procedures. Thus, all asset managers state that they have brought in additional measures and tightened existing ones to assess the corporate governance of investees, with the effect of lengthening their due diligence process. The following quote is from one asset manager explaining how governance problems affect asset managers' work in the wake of the collapse of the banks. He says:

> They affect our decisions big time because it means we must be very careful and spend more time interrogating our investment process to ensure that we invest our clients' money in profitable ventures. For example, before the collapse of banks, our investment process in determining the banks that we place an investment with was very quantitative. The criteria that we followed was the CAMEL ratio, which is a methodology that is used to assess the status and the quality of a bank you want to invest in. CAMEL stands for capital adequacy, asset quality, management quality of that institution, earnings, and the liquidity of the bank. We had always used CAMEL, whereby you put the data in a spreadsheet, come up with the ranking, and you can make your decision based on the rankings. However, following the collapse of the Chase Bank in 2016, we now do things differently. Now we rely on 60 per cent quantitative analysis and 40 per cent qualitative. Qualitative analysis is a very subjective process that has made our work harder in terms of determining the key investment decision. (AM1)

Yet, over half of the asset managers (AM1, AM2, AM6, AM7, AM8, AM9, AM10, AM11, AM14 and AM15) state that they do not have a formal or documented policy on how to assess governance. They express that it is challenging to assess the impact of corporate governance issues on investment decisions, as corporate governance issues are subjective. For instance, AM14 states that the investment committee of his firm sits to decide which opportunity has greater weight "depending on what each person in the room thinks" (AM14). According to AM14, the process of evaluating corporate governance is very subjective and its impact on investment is the hardest to measure, because "it is more of the person sitting on the board". He explains that asset managers "have started looking at corporate governance issues more keenly although very subjectively, you just feel that you do not trust this guy" (AM14).

AM9 states that analysis of corporate governance issues "is very difficult, because they put [out] financial reports that look just fine". He adds that his board of directors has asked him to be vigilant and provide any information about the investee companies that may indicate problems. He explains:

> The biggest [issue] is governance. Our board of directors has asked us, in addition to doing a quarterly review of all the banks we invest in on behalf of our clients, to provide a sort of background rumour or anything that does not smell right. (AM9)

Like AM9, AM12 states that her firm relies on hearsay, trend observations such as the resignation of key personnel, unexplained loss, or decline in profitability. But her firm also realises that such information may not be true and is prone to bias, which can result in loss of investment opportunities if they perceive certain investments to be risky when they are not. Both AM1 and AM12 especially state that they are putting together a framework with which to evaluate corporate governance issues more systematically. But they state that it will still be a subjective analysis and the challenge remains of how to incorporate the information in the risk metrics.

5.4.1 The current practice

More than half of the asset managers who participated in this study (AM2, AM4, AM5, AM9, AM10, AM11, AM12, AM13 and AM14) say that they predominantly rely on negative screening to exclude companies with whose performance they are not satisfied. Even though some asset managers engage the board and senior managers of investee companies to interrogate their plans, they say that the most common strategy is to stay away from such companies or sell if they had bought the securities. One asset manager explains that "currently, fund managers are quite passive in their approach, and if they are concerned about practices of a particular company, they will simply not invest, or if they already have investment, they just sell and get out" (AM14).

Less than half of the asset managers (AM1, AM2, AM3, AM11, AM12 and AM13) state that they engage the investee companies. Three of these asset managers (AM1, AM2 and AM12) mainly engage on matters of financial performance and corporate governance matters and not on environmental and social issues. For example, AM1 states that his company does corporate engagement whereby their "research team meets with the boards and interrogates them about their future plans". He also states that his investment decisions have always been based on "factors such as financial returns, profitability and managements" (AM1). He further states that he considers factors such as a company's market share in the industry when making investment decisions, and corporate governance forms part of his evaluation criteria.

AM2 states that his company engages with the management of investee companies, but he does not think the company has ever been successful in effecting change. He explains, "we have never really been able to influence the investees to change, so we pull out, if we were in, or choose not to invest" (AM2).

The other three asset managers (AM3, AM11 and AM13) engage the investee companies on matters other than financial performance and corporate governance. For example, AM11 states that his firm does not actively engage with the companies unless “they are manufacturing companies where there are illegal practices, especially how employees are treated, which is a big thing here”. He states that “if they are not following the law in those issues, we stay away from such a company on moral grounds, regardless of the returns” (AM11). Both AM3 and AM13 state that they take a more proactive approach when investing in private equity firms, because ESG matters are important to such firms. AM3 states that his company has an ESG officer whose work is to evaluate private equity firms’ performance on ESG. Also, he or another senior analyst attends board meetings of private equity firms to express their concerns. He explains:

> What we tend to do is to take a seat at the board of [the] investee company, but if we do not have expertise in a certain field, we look for an expert to represent us in the board, and one of the things we push for is good corporate governance, because if that is not fixed, you will have a big problem when trying to exit private equity. (AM3)

Similarly, AM13 states that his company demands to understand the ESG practices of private equity firms. They check whether the private equity firm has “an individual within their entity whose work is to drive ESG agenda”, and check whether that person occupies a senior position, “because part of private equity compliance is to comply with ESG-related matters” (AM13). According to AM13, the person in charge of ensuring ESG compliance at the private equity firm should have the authority to reject an investment purely on ESG matters.

5.5 Conclusion

In this chapter, I have explored how the actors in the retirement benefits sector of Kenya conceptualise RI, both in terms of definitions and the perception of identified ESG issues in Kenya concerning the investment decision-making process. As discussed, the participants use different terminologies to define RI, and some use more than one terminology. Also, it is evident from the above excerpts that the participants have mixed views about the materiality and impact of the environmental and social factors, but all of them agree that corporate governance issues are material risk factors that influence their decision-making process. As established in Chapter 3, RI’s theoretical framework is built on the recognition that ESG factors are a source of information asymmetry in the financial markets, and investors should identify the material ESG factors that can impact on the value of their investment. Based on this understanding, it can be inferred from the excerpts and the discussion in this chapter that regarding the environmental and social issues as immaterial factors can pose a challenge to the development of RI in the sector. I will discuss these findings further in Chapter 8, relating them to the existing literature on the challenges for RI development. The following chapter discusses the structural challenges for RI development in the retirement benefits sector of Kenya, and comments on the role that an RI framework can play to address the above ESG issues.

Chapter 6. Specific barriers for RI development and the role that RI can play to address the identified ESG issues

As I alluded to in the concluding section of Chapter 5, the way the actors conceptualise RI, especially their views of environmental and social issues as immaterial factors regarding investment decision-making, can deter the development of RI in the sector. In this chapter, I discuss the key structural challenges for RI development as they emerged from the discussions with the participants. I also present participants' views of the role that RI can play in addressing some of the identified ESG factors. I conclude the chapter by making two recommendations that will facilitate the development of RI in the sector. This chapter addresses my third and fourth research questions:

3. What are the specific barriers for RI development in the Kenyan retirement benefits sector?
4. What role can a well-developed RI policy framework play in addressing the identified ESG issues in Kenya?

6.1 What are the specific barriers for RI development in the Kenyan retirement benefits sector?

Five specific barriers emerge from the discussions with the participants of this study. These are: diversification challenges; a lack of quality ESG information; a lack of demand/incentives; short-termism and the demand for high financial returns; and a lack of awareness and expert knowledge. These barriers appear to be more structural in nature, implying that overcoming them will most likely require the coordination of the entire finance sector, as opposed to each subsector trying to overcome them alone. What follows is a discussion of these barriers, including the proportion of the participants who identified the challenges.

6.1.1 Diversification challenges

More than half of the participants (AM1, AM2, AM4, AM7, AM8, AM9, AM10, AM13, AM14, the three regulators, the capital market development specialist, and the council member of the ARBS) observe that the capital market of Kenya is small and lacks many products. The asset managers and the council member of the ARBS especially express concern that RI would lead to diversification challenges, because they are already faced with a shortage of investment opportunities. The shortage is especially felt in the equity market because, as established in Chapter 4, there are only 65 listed companies, five of which are currently suspended from trading on the Nairobi Securities Exchange. Both AM1 and AM8 state that they have been asset managers in Kenya for about 20 years, and they observe that the number of listed companies has not been growing at the same rate as the demand for investment opportunities. For that reason, AM1 expresses the opinion that, from the outset, implementing RI would be challenging because already there are few investment opportunities. He explains:

> In Kenya, as much as there are all those clear guidelines about where you cannot invest, there are very limited investment opportunities and that is one of the biggest challenges that we face in the implementation of ESG because there are very few companies to invest in. (AM1)

The capital market development specialist describes the Kenyan capital market as nascent, because it lacks a variety of products that are otherwise found in more sophisticated capital markets. He expresses that, in comparison to developed markets, Kenya has barely scratched the surface as far as products are concerned. He explains:

> One of the problems is that we have a shortage of products. We have plain vanilla products in this market and even with the plain vanilla products, we have barely scratched the surface of what vanilla products we can offer. For example, green, social impact and development bonds are vanilla bonds. We do not have these products, and we do not even have derivatives in Kenya. We have the legal framework for derivatives in place but no products yet. That is how nascent our capital market is. (Capital market development specialist)

Because of the shortage of equity investment opportunities to meet demand, some asset managers (AM4, AM8, AM13 and AM14) state that they are competing for the same limited investment opportunities, resulting in concentration in some sectors. Also, some asset managers state that they are forced to invest in the same companies, even if they are not satisfied with the performance of the companies. For instance, AM8 states that "a lot of pension funds have heavily invested in the listed companies in Kenya for lack of a choice", while AM14 states that "investment analysts are stuck with the same investments, even if they have corporate governance issues". When the desired returns are factored in, several asset managers and the council member of the ARBS express that issues such as ESG are relegated, while financial returns take precedence. AM14 explains:

> The more we get starved of options, the less we tend to look at some of these things, and financial returns become more important, because our clients just do not care how we make money. The question of we got fewer returns because you were investing in responsible companies will not fly with the clients. (AM14)

The size of the capital market prompts AM2 to express the view that "our market is too small to encourage thinking of ESG framework". He further states that the capital market would have to expand and have more listings, because otherwise "we defeat one of the key purposes of investment, which is diversification". Both AM1 and AM4 observe that even the clients who ask for the exclusion of some assets (mostly tobacco and alcohol) do not put a lot of pressure on them, because of the realisation that investment opportunities are limited. For instance, AM4 states that "there is a lot more money than the available assets", so when clients request the exclusion of tobacco and alcohol from a portfolio, it leaves limited options, especially considering that two of the best-performing companies produce tobacco and alcohol. He concludes by saying that "these are some of the challenges for RI, even from a foreign investors' perspective. The force with which they enforce RI here is not with the same gusto as in the developed countries" (AM4).

The shortage of investment assets especially affects Islamic and other faith-based investors because they mostly prefer to exclude alcohol and tobacco – and banks, for Muslims – from their investment portfolios (AM2, AM4 and the capital market development specialist). A strategy that excludes commercial banks in Kenya leaves fewer investment options, especially when the desired returns are factored in, because commercial banks represent nearly 20 per cent of the listed companies. One asset manager explains the shortage as follows:

> I am in the middle of screening all the equity assets available at the Nairobi Securities Exchange, and it turns out that, from both returns and Sharia-compliant perspective, there are only four assets available. That just highlights the importance of trying to develop some sort of pure products to avail to that section of the investment community. (AM2)

He explains that there are a few other assets that meet the desired returns criteria, but they are not Sharia-compliant. Research by the International Monetary Fund shows that the market share of Islamic banking assets in Kenya is below 2 per cent of banking sector assets (International Monetary Fund, 2017). The research observes that the demand for Islamic services in Kenya is expected to remain strong, especially with Kenya positioning itself as a hub for Islamic services in the East African region. However, the International Monetary Fund warned Kenya of Islamic banking regulation loopholes (International Monetary Fund, 2017). Specifically, the International Monetary Fund observed that "the legal framework exhibits some gaps and prudential frameworks have not been adapted to the specificities of Islamic banks. Also, there are gaps in the Sharia governance framework, consumer protection framework, liquidity management, resolution, and safety nets" (International Monetary Fund, 2017, p. 39). The capital market development specialist commented along similar lines, stating that there has been a lack of a regulatory framework to anchor Islamic finance products, which has been one of the causes of the shortage of Sharia-compliant products. But the CMA in partnership with Financial Sector Deepening Africa is working to create a regulatory framework for Islamic capital markets in Kenya, and to develop a separate policy, legislative and regulatory framework for Islamic products and services (CMA, 2018).

As established in Chapter 4, the RBA allows retirement benefits schemes to invest in 12 different asset classes, outlined in Table G of the Retirement Benefits Act (Forms and Fees) (Amendment) Regulations (2016). For instance, schemes can invest up to 15 per cent of their funds in offshore investments. But by the end of 2018, schemes invested less than 2 per cent of their funds in offshore assets (RBA, 2018). AM1 expresses the opinion that "offshore investments have added risks, such as currency risk", while AM9 states that "most Kenyan trustees do not want anything offshore". According to AM10, investing in different currencies would necessitate having a currency hedge, which asset managers do not.

Private equity is another asset class that would allow schemes to diversify and invest while investing in areas that take ESG issues seriously. Although the RBA allows schemes to invest up to 10 per cent of their funds in private equity, less than 1 per cent of schemes' funds was invested in this asset class by the end of 2018 (Njoya & Seetaram, 2018). Regulator 1 suggests that the slow uptake of this asset class by the asset managers is

> a matter of private equity being new in the market, and no one wants to invest in something without first seeing a track record of performance. Most of the private equity funds have just finished the first cycle, and they are now in the second round of fundraising whereby we have seen pension funds putting some money in. Now we see a lot of interest in this second cycle. (Regulator 1)

But AM3, who is more experienced in private equity and alternative assets such as property development, seems to think there are other reasons holding asset managers back from investing in these asset classes. For example, asset managers are normally appointed by trustees on a three-year contract, following a tendering process. But AM3 states that private equity projects take between five and seven years to mature, and property development takes an average of three years. Thus, he argues that asset managers will not have achieved much growth within three years, which can reduce their chances of winning a tender during the next round. He notes that this is one reason asset managers have not invested in those asset classes and instead choose fixed income securities. Moreover, he expresses the opinion that many trustees do not fully understand some asset classes. He explains:

> With trustees, you even show them a high enough internal rate of return, but they argue that that is in the future. The other thing is when it comes to alternative assets, trustees do not fully understand some assets, e.g., property development for sale. In my view, there is a lack of understanding of private equity from trustees, which becomes quite difficult. (AM3)

Moreover, a survey by the World Bank shows that pension schemes in Kenya are reluctant to invest in private equity due to structural and cultural impediments, including a lack of knowledge about the asset class and a lack of incentives to take the risk (World Bank, 2018). The survey also found that pension schemes are not prepared to pay the high fees charged by alternative investment managers (World Bank, 2018).

Furthermore, schemes can invest up to 20 per cent of their funds in corporate bonds and up to 10 per cent in any other assets. But, data from the Nairobi Securities Exchange (2020b) shows that there are not many corporate bonds in the market and, according to AM12, many asset managers lost trust in corporate bonds since the collapse of the three banks in 2015 and 2016, because one bank had issued a corporate bond that it was not able to honour.

Even though the CMA acknowledges the shortage of investment opportunities, it has not been able to attract new issuers. According to Regulator 3, the CMA is encountering two key challenges in its attempts to attract issuers. The first challenge is the general perception that the listing rules are too stringent for most companies, and even the listed companies "are feeling like it is an onerous task just to be an issuer" (Regulator 3). The CMA is investigating whether the perception that listing requirements are too stringent is justified. Based on the results of the investigation, the CMA will adjust the listing rules to strike a balance to ensure the listing requirements are stringent enough to safeguard shareholders assets, while at the same time not deterring new entrants to the capital markets. The second challenge is that potential issuers are questioning the methodology used to value shares before an initial public offering because, in some instances, the share price drops significantly soon after. Regulator 3 suggests that the drop in share price after the initial public offering can deter potential issuers. The CMA is working to find a solution to these two key challenges.

6.1.2 A lack of quality ESG information

About half of the participants (AM1, AM2, AM3, AM6, AM8, AM9, AM11, AM12, AM15, the academic and Regulator 3) state that the information provided by companies is either insufficient, untimely, or unreliable. Some asset managers (AM1, AM6 and AM14) state that they have observed improvements in the quantity of ESG information disclosed by listed companies, especially since the development of the Code in 2015 (CMA, 2015a). However, they say the disclosure is not consistent between companies, and some provide information that is of better quality for investment decision-making than others. I will discuss the quality of ESG data disclosed by the listed companies further in Chapter 7.

Moreover, some asset managers (AM1, AM2, AM6, AM9, AM11, AM13 and AM15) express dissatisfaction with the reliability of the information provided by some companies. For example, AM1 states that the requirement for listed companies to disclose corporate governance factors is "a good thing because it makes the companies more accountable to the wider stakeholders". However, he questions the reliability of the information provided by some listed companies, such as the banks that collapsed. He had used the published financial statements of one of the banks to make an investment decision, but five days later the bank published restated financial statements revealing a significant amount of insider lending. The restatement triggered the collapse of the bank, as customers panicked and rushed to withdraw their money. Thus, he asks:

> If a financial institution is going to restate their financial statements, that tells you that you can no longer rely on their financial statements alone to assess the suitability of such institutions for investment. (AM1)

AM15 expresses similar sentiments, saying that "you might have data, but you might not know if it is clean data. For instance, we used data from the banks that went down". He adds that his company has realised it must "add an extra level of checks and balances", which prolongs their time to analyse companies. It seems the reliability of information is challenging to many asset managers. AM2 states he is "never really sure when it comes to monitoring and ascertaining the [genuineness] of information”. For that reason, he observes that, for him, monitoring companies’ performance is the most challenging issue.

AM6 states that “the biggest problem is getting information about the board members, we get scanty information, e.g., where they have worked before, but you will not find any detrimental information readily”. He states that “a lack of information is the biggest hindrance, because as much as we work closely with senior managers, they will tell you what they want to tell you”. He further states that “investee companies will give you audience and information, but there is no validation of that information”. Like AM1, he observes that companies are complying with CMA’s requirements and are disclosing more information, but he questions the reliability of that information. He explains:

> Yes, they are complying with the requirements of the financial statement, but when it comes to the board, that is where the problem is. Again, they must report regularly on the governance, but how accurate are the audited reports? We have found instances where auditors have been complicit in some cases. (AM6)

As established, asset managers invest in a wide cross-section of assets, including unlisted companies and even family-owned businesses. Asset managers such as AM8 state that it is challenging to invest in unlisted companies due to a lack of reliable data for investment decision-making. He comments that unlisted companies provide information “to the extent that they are willing to give it, the extent that the owner wants to give it to you”. He comments that the lack of good quality data in unlisted companies is one reason that asset managers invest more in listed companies and less in other types of companies.

AM11 expresses the opinion that “corporate governance needs to be elevated, because asset managers still must look at many variables and they cannot be expected to come and prove that financial statements are correct, because that responsibility is for the auditors”. Like AM6, he questions the work of the auditors:

> The issue of auditors comes up because when you see the same audit company being mentioned severally it raises eyebrows. These are big private audit firms like the big four, which are meant to be the gatekeepers in the first place, but it appears that the government Auditor General is doing a better job than some of them, which are not the norm in Kenya. (AM11)

AM3 states that he obtains better quality ESG information when investing in private equity firms than when investing in listed companies. He observes that private equity investors have much better access to timely information because it is possible to attend the board meetings of private equity firms and obtain first-hand information about ESG performance, whereas it is not the norm to attend the board meetings of listed companies.

Related to the lack of sufficient and reliable ESG information is the lack of ESG rating agencies in Kenya. As discussed in Chapter 3, the process of integrating ESG factors into the investment decision-making process involves quantitative analysis of the impact of material ESG issues on securities. While the process can be done in-house by asset managers, it is often done by ESG rating agencies that have specialised in analysing and scoring industries based on their ESG performance (Zarbafi, 2011). The rating agencies assess the ESG performance of a company or a country and award a rating. But Kenya does not have a domestic ESG rating agency, so Kenyan asset managers would have to consult with international rating agencies if they wanted to get the ESG rating of Kenyan companies. Regulator 1 explains the situation:

> One of the challenges is verification, which is a challenge in every country. In developed countries, they have the certification bodies that audit companies and certify that they are ESG-compliant or something like that. Here, we do not have such bodies, and if we wanted to, we would have to call someone from Europe. We do not have a local base, so even if we told pension schemes to invest in companies that have such-and-such a certification, there is none. So, on our side, we cannot move ahead when the rest of the market is not there. So, there is no need for us saying you can only invest in a firm that meets these standards when we do not have a means of verifying that. And we are not the ones who would verify; it would have to be done by some other institution. So, for now, we cannot make that a requirement, but over time that will come. (Regulator 1)

Even if some rating agencies cover African countries, investors acquire ESG rating information at a fee (Novethic, 2014). The cost of buying the information can be a hindrance for asset managers in the retirement benefits sector of Kenya, especially if they cannot recover the cost of such information by raising management fees.

6.1.3 Short-termism and the demand for high financial returns

Several asset managers (AM2, AM3, AM5, AM6, AM8, AM4, AM15 and AM10) express the view that trustees demand that asset managers deliver high returns at every quarter, almost at the expense of everything else. The pressure to deliver high returns at each quarter reduces the asset managers' incentive to think long term. AM5 articulates his point in this way:

> Trustees have a very short-term mindset; they think in quarters, which conflicts with a pensioner's horizon, which is long term. The life of a fund should be infinite, which has a big bearing in investment positioning. You see, if the market has been down to 25 per cent for the last six months, I think it is a great time to buy stock and the market could further fall before recovering, but because of the pressure from trustees, I may not be able to implement the long-term philosophy. I think that is a big problem. (AM5)

To clarify, the requirement for asset managers to submit a quarterly valuation of the scheme fund and all the investments representing the scheme, including details of the cost of such investments and their estimated yield to the trustee, is a requirement of the Retirement Benefits (Managers And Custodians) Regulations (2000). So, while the managers report to the trustees, the frequency is set up by law and it is not an initiative of the trustees.

One asset manager shows some degree of frustration with the demand for returns at the expense of everything else and states:

> What clients are looking for, and this is not something I support, is returns at almost any cost, and matters to do with ESG sit at the back burner. It gets on my nerves about how clients are focused on returns to the detriment of everything else. (AM2)

Also, AM15 states that "quite frankly, people look at returns more than anything else", and AM14 states that "clients are primarily concerned about returns and they do not care where we invest". Several asset managers state that the trustees judge them solely by the returns they deliver, such that even when it comes to selecting the asset managers, they choose the one who delivered the highest returns for the scheme. But AM3, AM5 and AM8 argue that the asset manager who delivers the highest returns may also deliver the highest risk (AM8). They argue that trustees should broaden their assessment criteria to encompass other strengths of the asset managers, such as their ability to assess the risk due to ESG factors.

The recruitment process for asset managers is governed by the Public Procurement and Asset Disposal Act (2015), which requires that tenders be awarded to the tenderer who submitted the lowest evaluated responsive tender. According to the asset managers, trustees rank tenderers on the grounds of fees alone, and overlook section 60 (3) of the Public Procurement and Asset

Disposal Act (2015), which allows the tender to specify technical details that may include socio-economic impacts and environmental friendliness. Section 79 defines a responsive tender as one that meets the technical requirements, and section 83 requires taking the lowest cost responsive tender (subject to due diligence). So, while the lowest tender should be taken, social, economic, and environmental factors can be included as technical requirements. But, schemes do not specifically ask for the integration of environmental and social factors in investment decision-making, and the Retirement Benefits Act (1997) does not require that either. Hence, trustees assess asset managers primarily based on the fees they charge and the returns they deliver. Asset managers argue that this is “a very simplistic analysis” (AM5) and the trustees “need to understand that there are many ways to assess the fund managers’ performance” over and above the fees and the returns (AM3).

According to AM5, this system of basing everything on cost has a major implication for the development of the retirement benefits sector. One implication is the inability for asset managers to raise fees to reflect any work undertaken over and above the ordinary financial analysis of the investment. For example, asset managers have increased corporate governance checks with the effect of increased administration costs and lengthening of the due diligence period (AM1, AM10, AM11, AM12, AM13, AM14, AM15, AM2, AM6, AM7 and AM9). Consequently, both AM1 and AM5 state that they would like to raise their fees to cover the added costs. But they have not been successful, “because Kenya is a very competitive market and increasing the fee would mean that we lose clients” (AM1).

6.1.4 A lack of demand/incentives

Clients demand for RI has been one of the biggest driving forces for ESG integration in many parts of the world. That does not seem to be the case in Kenya because, as stated earlier, domestic clients, who are the majority, do not ask for RI as much as foreign clients do. Six asset managers (AM4, AM6, AM9, AM14 and AM15) state that, in their experience, domestic clients are not interested in ESG matters. For example, one asset manager states:

> I am yet to come across clients, even from pension schemes, who are even concerned about these issues because such issues would come up in policy investment statements, which give restrictions of where you can or cannot invest. (AM14)

As discussed in section 6.1.1, a small number of retirement schemes of faith-based organisations and foreign investors request that asset managers avoid investing in products such as alcohol and tobacco. But as AM2 and AM10 observe, retirement schemes of religious organisations are the minority, and even they do not put much pressure on asset managers to avoid those products because they do not want to compromise on returns.

Moreover, the regulators do not require asset managers to integrate ESG factors in their investment. As expressed by AM8, “RI is not a regulatory requirement and it is not on top of our priorities either”. Hence, without demand from either the clients or the regulators, it seems asset managers lack the incentive to consider ESG issues in their investment decision-making processes. Further, there seems to be a general perception that RI automatically leads to suboptimal returns. About half of the asset managers (AM2, AM6, AM7, AM8, AM9, AM10 and AM14) suggest that RI automatically leads to lower returns. For instance, AM9 states, “I do not know where you could invest money in companies that flaunt ESG in such a scale and make a profit”. AM2 states that “here people still interpret ESG to mean fewer returns”, and AM3 expresses the opinion that the main challenge for RI development in the retirement benefits sector is the perception that RI automatically leads to fewer returns.

Both AM1 and AM13 observe that the lack of push from the clients and regulators, and the perception that RI leads to suboptimal returns, gives asset managers no desire to change the status quo. As explained by AM13:

> Status quo, we have accepted that this is how we do things. There is also no requirement to do it and you have not been doing it, there is no incentive because complying with ESG comes at a cost, including the opportunity cost. These costs affect our bottom line. (AM13)

6.1.5 A lack of awareness and expert knowledge of RI practices

About half of the asset managers (AM1, AM3, AM4, AM10, AM11, AM14 and AM15) state that there is a general lack of awareness of RI and a lack of expert knowledge of how to integrate ESG issues in investment decision-making. From the outset, three asset managers (AM1, AM6 and AM9) state that they do not actively think about the impact of ESG on society when they make investment decisions. For example, AM6 states, “before you came in, this was not something that I was thinking about as something I would consider, because we are judged on returns”. But he seems to change his mind as the interview progresses, stating that “in the long term and going forward, I think it is something we need to take on board” (AM6).

Similarly, AM1 and AM9 say that asset managers do not consciously see the link between their investment decisions and the outcomes of those decisions. AM1 explains the lack of awareness:

> That direct linkage between investment decisions and the outcome in the wider society is non-existent. We do not look at it in that way and [in] very rare cases will you see the relationship between your investment decision and the wider society. (AM1)

In the same way, AM9 states that he is not always conscious of the impact of ESG issues when he is making investment decisions, even though some companies are known to offend the environment. He explains:

> When you are investing in [name redacted] or [name redacted], you are not actively thinking of the environmental impact, but perhaps we should because if you go to Mombasa, [name redacted] is the biggest seller of those [name redacted], which cause massive noise and air pollution. (AM9)

Both AM1 and AM2 state ESG integration is challenging to them because they lack expert knowledge of how to engage with the qualitative information that is disclosed by companies. Specifically, they do not know how to quantify the ESG data so that they can use it to adjust the traditional valuation models. AM1 explains the problem:

> How do I quantify ESG? When making [an] investment decision I come up with an investment criterion, and because investment assessment is a fairly mathematical process where numbers matter, how do I capture that aspect of ESG and say this is what it reflects in my model of investment. Quantifying is the problem. (AM1)

This lack of expert knowledge on how to quantify ESG information is closely related to the lack of ESG rating agencies previously discussed, because ESG rating enables asset managers to compare company or country performance on ESG and choose accordingly. However, the asset manager would still require knowledge of how to quantitatively analyse any material ESG factors that impact on the selected securities to assess their impact on securities and to adjust the financial forecasts or valuation models appropriately.

Eight asset managers (AM1, AM6, AM8, AM10, AM11, AM13, AM14 and AM15) identify the need for training on RI, and state that they have not had many opportunities for such training. Apart from AM13, whose firm receives training from the parent company in South Africa, the rest have not. For instance, AM10 states that he had attended only two seminars on RI. But some asset managers, such as AM11, express the view that there are no RI experts in Kenya who have experience in interacting with RI. So even if they want to attend such training, there are no training opportunities because there are no trainers. Another asset manager explains the lack of training opportunities:

> In the first place, who is the trainer on ESG? I have not seen any course on ESG, and if it is there, it is probably available only to the senior-most officers, [which] should not be the case because investment analysts are supposed to analyse financials and all these other factors and come up with recommendations. (AM14)

From an academic perspective, the academic from one of the leading universities explains that the curriculum for master's degrees at his university touches on sustainability matters, but not from an investment perspective. Thus, none of the course covers RI or ESG integration. He has the following comments on professional courses:

> From a professional point of view, the Chartered Financial Analyst curriculum does not emphasise RI as such, but it mentions investing in companies that are socially and environmentally responsible as one investment style or strategy. But, if you want to know what socially and environmentally responsible investment is, you need a different training or curriculum. (Academic)

The CMA is the primary regulatory authority for asset managers, and arguably the one that should be organising training opportunities. Even though the CMA recognises the need for a more effective education system within the capital market, Regulator 3 states that there are no immediate plans for training asset managers. At the same time, none of the asset managers has set aside a budget specifically for RI training because it is a new concept that is yet to take hold in Kenya (AM6, AM8 and AM11). But as AM8 explains, demand for training is driven by the skill set needs of what customers expect and what services and products are offered by the market. Currently, the demand for RI products and services in Kenya is minimal, and not enough to warrant asset managers sending staff for RI training overseas. (AM8).

Some participants (AM3, AM4, AM10, AM11 and the council member of the ARBS) state that the trustees are not conversant with the RI concept. For example, AM11 states that he pays attention to ESG factors when making investment decisions, but wonders, "if I put ESG on the financial analysis framework, will the trustees know what that is?". Also, AM4 states, "there is not much awareness on RI, we need to explain to trustees what that is" (AM4). The RBA, the primary regulator for the trustees, requires the trustees to under a certification programme called the Trustee Development Programme of Kenya, which is an examinable course for all aspiring trustees. According to Regulator 1, the RBA is in the process of reviewing the curriculum to introduce RI and sustainability matters:

> The course has been there for a long time, but the initial curriculum did not have much on sustainability or RI. However, we are right in the middle of [a] curriculum review, and we are bringing these issues on board, so, by the end of this year, the new curriculum will have RI and sustainability issues. (Regulator 1)

The Trustee Development Programme is delivered by the College of Insurance and run by the Association of Retirement Benefits Schemes (Association of Retirement Benefits Scheme, 2020). The course outline of the current programme, as published on the website of the College of Insurance, covers topics such as trustees and governance; retirement schemes investing and funding; contracts and sourcing; and administration and oversight (College of Insurance, 2020). The current course outline does not indicate any RI modules. The RBA in conjunction with the ARBS and the College of Insurance is currently revising the curriculum (Association of Retirement Benefits Schemes, 2020). While the trustees can learn about RI from other seminars and workshops, the official training avenue does not seem to cover RI strategies or other aspects of RI.

In conclusion, each of the specific barriers discussed by the participants shows the challenges for RI development in the retirement benefits sector of Kenya. It seems reasonable to say overcoming the above barriers requires the concerted efforts of the government, regulators, educators, and all industry participants. Although the challenges appear complex with no easy solution, asset managers and regulators seem to exude a confidence that such challenges can be overcome with time.

6.2 What role can a well-developed RI policy framework play in addressing the identified ESG issues in Kenya?

More than two-thirds of the participants (AM1, AM2, AM3, AM4, AM5, AM7, AM8, AM9, AM10, AM11, AM12, AM13, AM14, AM15, Regulator 1 and Regulator 3) respond that RI can play a role in improving ESG standards in Kenya. For example, AM3 starts by saying “that is a straight answer, yes, it would”, and adds that “these are the things that people will start talking about in the next few years, so we should start now and start doing them early”. Similarly, AM4 states that “we should not make the same mistakes as others have made. I believe the time to embrace responsible investing is now, not later”.

The participants discuss how they perceive RI in Kenya and suggest a variety of ways in which it can benefit the financial sector in general. For example, AM11 states that he can “see a role of RI in terms of influencing and, more so, rewarding good behaviour” in companies. Similarly, AM10 states that RI can play an “enormous role in standardising ESG matters, because that is what is lacking in this country”. AM13 expresses that RI would provide asset managers with a reference point to assess investees’ performance on ESG before deploying capital.

Regulator 1 states that RI can play a role in ensuring the stability of the retirement benefits sector, because there is “definitely a connection between ESG factors and the long-term financial stability of the sector”. He expresses the opinion that “eventually, all investments will have to be responsible, because if they are not, we will destroy the world and then there will be nowhere to invest; all investments will have to be sustainable”. He comments that it may take some time for the retirement benefits sector to develop an RI policy framework, but it will have benefits for the sector.

As established, one of the conditions of attaining MSCI emerging market status is to raise the proportion of total investors as a percentage of the adult population from the current 19 per cent to at least 30 per cent. The CMA is keen to attract both domestic and international investors, and the international investors are asking for an ESG framework. Regulator 3 explains:

> From some of the discussions that we are having from the developed markets, ESG has been popping up frequently. So, we are trying to attract as many investors as possible, but they are telling us to have a clear ESG framework. (Regulator 3)

Considering this requirement, some asset managers (AM1 and AM4) realise that the development of the RI market may be inevitable if Kenya wants to remain attractive as an investment destination. The realisation prompts one to comment that “if we are not addressing these issues, which are globally recognised as important factors, then we are not helping ourselves" (AM1). However, six participants (AM9, AM12, AM14, Regulator 1, Regulator 2, and Regulator 3) express the view that the retirement benefits sector is not quite ready for RI. The three regulators express that the development of a policy framework will be gradual work, starting with disclosure of ESG information by the issuers of securities.

6.3 The way forward

Because Kenya does not have guidelines on how to implement RI, I asked the participants to suggest how the identified challenges can be overcome to enable successful development of an RI market in the retirement benefits sector of Kenya. The participants propose policy development and capacity building, which I will now discuss.

6.3.1 Policy on RI

Most of the participants (AM1, AM2, AM4, AM6, AM8, AM11, AM12, AM13, AM14, AM15, the capital market development specialist, Regulator 1, and Regulator 2) discuss the need for a policy on RI in the wider finance sector of Kenya. The finance sector comprises the banking sector, the capital markets, the retirement benefits sector, the insurance sector and the savings and credit cooperative societies. Each of the five sectors has its apex regulator, and the National Treasury of Kenya monitors all the sectors. The participants state that the five subsectors do not have a coordinated approach to RI. Thus, they suggest that there is merit in having a policy for the entire finance sector so that the actors can have a common framework. For that reason, most of the participants, including the regulators, suggest that the National Treasury should develop the policy guidelines to be enforced by the individual subsectors. In that way, the policy is likely to have buy-in from all the actors, as articulated by one asset manager:

> It must come from the regulators to the players because one of the fastest ways to get players in this market to act is for the regulators to push it and give an ultimatum. If a good framework is drafted in the same way that the RBA came and put an order in the otherwise chaotic market, I believe yes it can work. If an initiative like this comes from the national government and it is passed on, then we would have to play our part. (AM5)

Another suggestion is for RI policy to be developed and embedded in the medium-term plans. One regulator thinks that RI policy can be successfully implemented and monitored if it is embedded in the medium-term plans, because they are reviewed every five years. He explains:

> For example, we have just done our [Third] Medium Term Plan in the financial sector. If we have the RI policy framework embedded in the medium-term plans, it can play a major role because, with the medium-term plans, every entity has a specific role. If we can have the RI policy under the medium-term plans, we can say clearly to the National Treasury that it is now their mandate. It can do us proud. (Regulator 3)

Concerning the implementation of RI policy, participants' opinions are divided between those who want the government to intervene and regulate RI or at least some aspects of it, and those who want industry-led initiatives. I present these arguments in the following sections.

6.3.1.1 Government-led regulation

About half of the participants (AM1, AM2, AM4, AM6, AM11, AM13, AM15, AM12, Regulator 1 and Regulator 2) advocate for some form of ESG regulation. Some propose a regulation for all registered companies, others for all listed companies, and some for targeting the asset managers.

For example, one asset manager seems to advocate for mandatory ESG regulation for asset managers, because he does not think that asset managers "have enough motivation at the industry level to lead a non-profit agenda" (AM4). For that reason, he thinks "the best way to approach this is from a regulatory perspective, so that it forces people to convert it into commercialised ideas". The way he sees it, everybody recognises that ESG factors are important, but the degree of implementation varies. However, he stresses that "these matters cannot be driven from micro-level, but they have to be pushed from the macro-level" (AM4). At the same time, he notes that even though regulation is key, it must be used sparingly because "there must be a balance such that there is no over-regulation". He concludes by acknowledging the difficulty in striking such a balance. (AM4).

Another asset manager expresses the opinion that even though education would contribute to increased awareness and create a thriving environment for RI, it would be better to combine that with regulation to increase chances for compliance:

> To my mind, if we had regulations, in whatever form they took, that require us to participate to some extent as far as that is concerned, that would be good. But where there is a lack of will, even if you know something, then you may not be inclined to participate. But if there are regulations, then you abide. (AM2)

There is an emphasis on governance over environmental and social issues, and one asset manager especially states that "regulation on corporate governance is urgently required" (AM11). He expresses that "on issues of corporate governance we now need a very serious regulation", and states, "the regulators need to make the corporate governance regulation mandatory, not voluntary for listed companies" (AM11). He further notes that the Code (CMA, 2015a) ought to be more rigorously enforced, because some companies that are experiencing difficulties are probably voluntarily compliant with the Code.

The regulators are not opposed to the idea of regulation, but they express the opinion that they want ESG integration to be implemented gradually. One regulator explains his preferred approach:

> [Regulation] will come, we will get there, but we are starting with disclosure then legislation. I think that is what most jurisdictions have done; I do not think any jurisdiction has gone straight to legislation; it has been gradual. (Regulator 1)

Another regulator thinks that Kenya should expect to see ESG regulations in the next five to ten years (Regulator 2). He expresses the opinion that RI should be introduced gradually so that people can buy into the concept first before making ESG integration mandatory. Additionally, he notes Kenya is still a developing country and expresses the opinion that "some investments are not very green but [we] still have to do them. For example, the Standard Gauge Railway had to pass through a national park, but it was a necessary investment, and that was the best route" (Regulator 2).

Another asset manager makes similar comments that some investments are necessary for Kenya even if they are not "green" (AM4). For example, he comments about the need to increase both accessibility and affordability of electricity in the country and expresses the opinion that coal can be a good alternative to both hydro and geothermal power sources in Kenya. However, he notes that "there has been a hullaballoo about [coal] globally" (AM4), with a good number of people asking why Kenya is using coal when other countries are actively limiting their use of it. While he notes that there are good merits in engaging in such a conversation, he proposes that Kenya should press on with coal production and justifies his position:

> The president of the African Development Bank wrote an article making a good argument as to why Africa should be allowed to use coal, and he has a very valid point. If you look at who is fighting us from using coal, it is investors in the US and Europe. (AM4)

Indeed, the President of the African Development Bank said that Africa must develop its energy sector with what it has, and that includes both renewable and non-renewable sources such as coal (IEA Clean Coal Centre, 2018). The asset manager makes his point that with the constant dry spells, "the hydro-based power has maximised, we have no more water resources to produce that kind of stable power, and the geothermal is taking the time" (AM4). Like Regulator 2, he acknowledges that Africa has a long way to go economically and says that "it is not to say that Africa is not aware of these issues, but it is just where it is. We need to put context amid this debate, and we need to reconcile the fact that we are in a poor country" (AM4).

6.3.1.2 Industry-led

More than a third of the participants (AM10, AM14, AM3, AM5, AM7, AM8, AM9 and Regulator 3) suggest that RI would be most effective if it is voluntary, as opposed to making it a mandatory requirement. For instance, AM8 states that "we [asset managers in Kenya] would be open to an RI discussion and see how we can implement it in our context". Another one states that "it is a complicated ecosystem and I do not think regulation will solve all problems" (AM5). AM3 states that he does not emphasise regulation because he thinks RI should be industry driven. The way he sees it, the actors in the retirement benefits sector should be able to decide how they want RI to be implemented in the sector. He explains:

> When we sit down as an industry and say this is what we should be doing, I think that should work. It should be more of education at the industry level, the people who are implementing it. It should be at the firm level and the industry-wide level. (AM3)

According to Regulator 3, the CMA prefers the finance sector to produce RI guidelines and engage the market before the regulator can make it mandatory. He suggests that self-regulating organisations such as the Nairobi Securities Exchange should drive the ESG agenda, because "as a regulator, we do not want to be seen as if we are imposing it ourselves" (Regulator 3). He explains that listed companies are already complaining about the listing requirements, and wonders what will happen when they ask them to incorporate ESG factors (Regulator 3).

Several asset managers suggest that they can come together through the Fund Managers Association and develop their guidelines. Most of the proposals appear to narrow down to addressing corporate governance specifically. For example, AM2 states that "if we decided to launch a framework, corporate governance would be our starting point". AM14 states that asset managers often have a shareholding in the same institutions such that they collectively have a lot of money invested in the same institution. Thus, if the institution is in trouble, all suffer the consequences, as happened with the banks. For that reason, he proposes that asset managers can identify the risks to which they are exposed by investing in certain companies, and jointly address them under the Fund Managers Association. He expresses:

> Individually we may have a small shareholding, but if we come together and collectively decided that we constitute this percentage of the company, we may be in a position to influence change. (AM14)

For example, AM3 suggests the generation of guidelines like the PRI, where investors voluntarily sign up to some principles or code of conduct (AM3). But AM5, whose firm is a signatory to the PRI through its parent company, suggests that it is better to encourage asset managers to sign up to the PRI instead of developing domestic principles. From his perspective:

> It could lead to a better outcome in the long run. Especially if you get a sizable number that follows this strategy and can deliver good returns, not just investment returns but good social, environmental and governance returns. I think there is no incentive in the legislation route. (AM5)

In conclusion, it seems that most of the participants support ESG regulation either by the government or by the industry. However, the majority lean towards strict regulation on corporate governance practices, with a few calling for regulation on environmental and social issues. However, the regulators do not seem keen to introduce ESG regulation other than what is already required by the law and the various guidelines, discussed in Chapter 4.

6.3.2 Capacity building

Most of the participants (the academic, AM1, AM13, AM14, AM15, AM2, AM3, AM4, AM6, AM8, the capital market development specialist, the green bonds consultant and the three regulators) call for capacity building within the finance sector. As discussed in section 6.1.5, about half of the participants state that there is a general lack of awareness about RI, and that there is a lack of expert knowledge of how to integrate ESG issues into the investment decision-making process.

Most of the participants recommend raising awareness through training programmes such as workshops and seminars, and by including RI strategies in the tertiary education curriculum. According to the capital market development specialist, capacity building initiatives should encompass lawmakers, enabling them to draft laws that support the necessary legal and regulatory framework that supports RI development.

Further, some asset managers propose that the CMA, the primary regulator of asset managers, orchestrates continuous investor education and makes it available to everyone in the industry. One asset manager states that the CMA could more effectively communicate existing resources and guidelines. For example, he states that the CMA introduced the *Stewardship Code for Institutional Investors,* (CMA, 2017), but few people know about it. He explains:

> [CMA] have started by introducing the Stewardship Code, but they need to move the [Stewardship] Code from theory to practice. Continuous investor education, which is a mandate of the CMA needs to continue and to be widely available to everyone in the whole industry. Only two of us may know about the Stewardship Code in the whole company. More industry sensitisation by CMA would be helpful (AM14).

6.4 Conclusion

Although the above barriers seem similar to those found in other parts of the world, such as Europe, overcoming them requires customised solutions that consider the social, cultural and regulatory infrastructure of Kenya. As I have alluded to in the concluding section of Chapter 5, the failure to recognise the environmental and social factors as material risk factors can be itself a challenge to RI development. That is because the factors gain importance if they are perceived to be financially material.

The two strategies that emerged as effective in addressing the challenges are capacity building and the development of a common RI policy for the entire finance sector that is enforced by each apex regulator. I will address these challenges and the proposed solutions further in

Chapter 8. In the following chapter, I will analyse annual reports to corroborate the information supplied by the participants about the lack of sufficient ESG information.

Chapter 7. Analysing selected annual reports

Following the analysis of interview data in Chapters 5 and 6, I found it necessary to analyse a sample of annual reports of the listed companies to verify the participants' claim that they lack sufficient ESG data. I randomly selected annual reports of 10 listed companies to verify the extent to which they comply with the ESG disclosure requirements as provided for by the Companies Act (2015) and the Code (CMA (2015a). By random selection, I mean I used no specific predetermined criteria to select the companies whose annual reports I reviewed. I discussed the ESG disclosure requirements of the Companies Act (2015) and the mandatory provisions of the Code in Chapter 2.

The 2017 annual reports are appropriate for this analysis, as I conducted most of the interviews in 2018. Also, the listed companies had one year to comply with the mandatory provisions of the Code from when it was issued (CMA (2015a). For that reason, I assumed that most of the listed companies would not have fully implemented the provisions in 2016. I view compliance with the provisions of the Companies Act (2015) and the mandatory provisions of the Code as meeting the minimum required standards of ESG disclosure.

7.1 Absa Bank Kenya PLC

Absa Bank Kenya is a subsidiary of Absa Group Limited, a South African-based financial services group. It was formerly known as Barclays Bank, and the integrated report of 2017 is in the name of Barclays Bank (Absa Bank Kenya PLC, 2017). KPMG audited the consolidated and separate financial statements for the year ended 31 December 2017.

Information about the board of directors

The directors' report discloses the name, age, professional qualifications and short professional history of each board member, and states the gender ratio at the board level is 50:50 (Absa Bank Kenya PLC, 2017, p. 98). The directors' report complies with the requirements of section 654 (1) of the Companies Act (2015) and Principle 7.1.1 (h) of the Code (CMA (2015a). Further, the directors' remuneration report discloses the remuneration elements of both the executive and non-executive directors, and shows the fees paid to each director in the 2017 financial year (Absa Bank Kenya PLC, 2017, p. 86). The directors' remuneration report complies with section 659 of the Companies Act (2015) and Principle 2.9 of the Code (CMA (2015a) regarding the disclosure board remuneration policy.

Information about environmental and social issues

The business review does not comply with the requirements of section 655 (4) (b) of the Companies Act (2015), because it does not contain information about environmental matters, the employees of the company, or social and community issues. However, the integrated report discloses most of this information in other sections. For example, the total number of employees, the gender ratio of male to female, information about training arrangements and the amount of money spent on staff training and development programmes are disclosed in the highlights section (Absa Bank Kenya PLC, 2017, p. 59). The report also discloses the type of community initiatives in which the company is involved, and the amount of money spent on community initiatives. For example, the bank launched a three-year scholarship programme in 2017 to provide bright but needy university students with an opportunity to complete their education, by catering for tuition, accommodation, upkeep money and a laptop (Absa Bank Kenya PLC, 2017, p. 72).

Although the integrated report does not disclose how the business impacts the environment, it states that the company is minimising the environmental footprint of its operations and embedding environmental principles in its financing services (Absa Bank Kenya PLC, 2017, p. 30). While it does not state how the business is minimising its environmental footprint, it discloses how much money was saved in 2016 on electricity, paper, and water costs.

Overall, Absa Bank Kenya PLC's integrated report provides most of the minimum required information on ESG according to the provisions of the Companies Act (2015) and the recommendations of the Code (CMA (2015a). But it does not provide the information in the prescribed format and the information is disclosed in various sections of the report, making it harder and more time consuming to analyse.

7.2 Kenya Power and Lighting Company PLC

The Auditor General audited the financial statements for the period ended 30 June 2017.

Information about the board of directors

The directors' report discloses the name, age, professional qualifications, and professional history of each board member. Thus, it complies with the provisions of section 654 (1) of the Companies Act (2015) and Principle 7.1.1 (h) of the Code (CMA (2015a). Further, the director's remuneration report discloses the remuneration elements for both the executive and non-executive directors, and discloses the fees and remuneration paid to individual directors for the years ended 30 June 2016 and 2017 (Kenya Power and Lighting Company PLC, 2017, p. 101). The directors' remuneration report complies with section 659 of the Companies Act (2015) and Principle 2.9 of the Code (CMA (2015a).

Information about environmental and social issues

The business review does not comply with the requirements of section 655 (4) (b) of the Companies Act (2015), because it does not contain information about environmental matters, the employees of the company, or social and community issues. However, some of this information is disclosed in other sections of the annual report. For example, the total number of employees and the gender ratio of male to female is disclosed in the statistical data section in the appendix, while information about the staff to customer ratio is published earlier in the report.

The impact of the business on the environment is not disclosed anywhere in the annual report. However, the company states that it is working to adopt a sustainable reporting framework following the GRI guidelines (Global Reporting Initiative Standards, 2020), and has identified the material economic, environmental, and social issues that will be considered in the sustainability framework. The identified environmental issues include environmental emissions from generation plants; infrastructure impact on flora and fauna; network aesthetics/visual impact; and contribution to climate change. The social issues include access to and affordability of electricity; employee and public safety/health; corporate social investment; employee development; employee practices/ethics; consistency with community goals and values; and stakeholder engagement (Kenya Power and Lighting Company PLC, 2017, p. 96). The company also has a corporate social investment report that states:

> We understand that a strategic, successful, and holistic approach to corporate social investment will eventually enhance our corporate reputation, promote a positive image of the company as an ideal corporate citizen, and provide an enduring opportunity for us to keep our employees engaged – all important ingredients for improved performance and our ability to attract and retain talent. According to this understanding of the significance of corporate social investment, we have a policy that aims at guiding our social investment initiatives towards success. Through this policy, the Company dedicates 1% of its after-tax profits towards corporate social

> investment programmes and activities. (Kenya Power and Lighting Company PLC, 2017, p. 92)

The corporate social investment programmes prioritise education, protecting the environment, promoting health and supporting sports (Kenya Power and Lighting Company PLC, 2017). The report details the activities that the company has undertaken in respect of these priority areas (p. 94).

Overall, the Kenya Power and Lighting Company PLC's annual report provides most of the minimum required ESG information, but it does not disclose it in the format prescribed by the Companies Act (2015).

7.3 Kenya Airways PLC

KPMG audited the financial statements for the year ended 31 March 2017.

Information about the board of directors

The directors' report discloses the name, age, and professional profile of both executive and non-executive board members (Kenya Airways PLC, 2017, pp. 9-12). It complies with the provisions of section 654 (1) of the Companies Act (2015) and Principle 7.1.1 (h) of the Code (CMA (2015a). Moreover, the directors' remuneration report identifies the remuneration elements of the executive directors to comprise a base salary, pension and other benefits designed to recognise the skills and experience of executive directors (Kenya Airways PLC, 2017, p. 76). While it complies with section 659 of the Companies Act (2015) and Principle 2.9 of the Code (CMA (2015a), it does not disclose the nature of the other benefits received by executive directors. Further, the remuneration report states that non-executive directors receive fees as well as sitting allowances for board and committee meetings, but it does not disclose how much they are paid per meeting. Also, the remuneration report does not disclose the fee received by each member. Instead, it discloses the aggregate emoluments paid to all the executive and non-executive directors.

Information about environmental and social issues

The business review does not comply with the requirements of section 655 (4) (b) of the Companies Act (2015), because it does not contain information about environmental matters, the employees of the company, or social and community issues (Kenya Airways PLC, 2017, pp. 72-75). However, some of the information is disclosed in other parts of the annual report. For example, the Chairman's statement states:

> On matters relating to the environment, the debate over global Market-Based Measures to mitigate carbon dioxide gas emissions from international aviation continues to be of interest. The EU Emission Trading System scheme as proposed by the EU was deferred by international aviation as they wait for the International Civil Aviation Organisation to come up with a universal scheme. Kenya Airways through the Kenya Civil Aviation Authority and Kenya's International Civil Aviation Organisation office in Montreal continues to participate in such discussions to ensure that its interests are adequately protected under such a scheme and is fully supportive of market-based measures as proposed by International Air Transport Association. (Kenya Airways PLC, 2017, p. 29)

The CEO's statement discloses the total number of employees and provides details of employees' training and development programmes for the year ended 31 March 2017 (Kenya Airways PLC, 2017, pp. 38–50). It does not provide details of gender balance. The annual report discloses that there is a case filed in the Supreme Court by the Aviation and Airport Services Workers Union over redundancies that had been effected in the 2012/2013 financial year under the staff rationalisation programme, and is still pending determination. Kenya Airways appealed the court case in 2014, but the court of appeal ruled that Kenya Airways was justified in declaring redundancies but failed to meet statutory procedural fairness (Kenya Airways PLC, 2017, p. 158).

The business review provides a comprehensive overview of the business and identifies the factors that are likely to affect the future development, performance, and position of the business of the company. The directors disclose that there is material uncertainty that may cast significant doubt about the company's ability to continue as a going concern (Kenya Airways PLC, 2017, p. 77). The annual report discloses that the company has been making net losses after tax for three consecutive financial years since the year ended 31 March 2015 (Kenya Airways PLC, 2017, p. 4). The business review highlights the actions taken by the directors to turn around the group's financial performance. The actions include commissioning Deloitte and Touche to conduct a forensic audit to investigate the key causes of the steep financial decline; strengthening the risk management environment, including controls and consequence management; and board and management changes (Kenya Airways PLC, 2017, p. 73).

Overall, Kenya Airways PLC's annual report provides most of the minimum required ESG information, but does not disclose it in the format prescribed by the Companies Act (2015).

7.4 Kakuzi PLC

Kakuzi PLC is a subsidiary of Camellia Public Limited Company, which is incorporated in England, and it is listed on both the Nairobi Securities Exchange and the London Stock Exchange (Kakuzi PLC, 2017). Deloitte and Touche audited the consolidated financial statements for the year ended 31 December 2017.

Information about the board of directors

The directors' report does not comply with the provisions in section 654 (1) of the Companies Act (2015), because it does not disclose the names of the directors (Kakuzi PLC, 2017, pp. 8-9). However, the names of the directors are disclosed on page 3 of the annual report (Kakuzi PLC, 2017). The annual report does not disclose the professional qualifications or skills of the board members as recommended by Principle 7.1.1 (h) of the Code (CMA (2015a). But those details are published on the company's website.

The directors' remuneration report discloses the amount of fees and benefits in kind paid to each non-executive director who was in office in 2017 (Kakuzi PLC, 2017, p. 14). While it complies with section 659 of the Companies Act (2015), it does not disclose the details of what constitutes the benefits in kind, and it does not disclose the amount paid to the executive directors. Also, the remuneration report does not identify the elements of remuneration of both the executive and non-executive directors as required by Principle 2.9 of the Code (CMA (2015a).

Information about environmental and social issues

The business review does not comply with the requirements of section 655 (4) (b) of the Companies Act (2015), because it does not contain information about environmental matters, the employees of the company, or social and community issues. However, the average number of employees during the year ended 31 December 2017 is disclosed in the notes to the consolidated and company financial statements section (Kakuzi PLC, 2017, p. 52). There is no further analysis regarding employees, such as gender balance or the details of the staff training budget.

Regarding the community, the Chairman's report mentions that, in 2017, the company supported many local community projects, which include education, water, sanitation and community road upgrades (Kakuzi PLC, 2017, pp. 5-7). The annual report does not disclose how the business impacts on the environment. However, the Chairman's statement states that Kakuzi PLC is working with the Carbon Trust to reduce its carbon footprint.

The business review identifies principal risks and uncertainties that could impact the group's operations:

a) Climate change: the level of rainfall affecting crop yields and, in extreme cases, crop viability.
b) Price volatility: changes in market prices impacting profitability each season.
c) Currency fluctuation: profit volatility arising from sales denominated in foreign currency.
d) Cost of labour: increased cost of production and lower profitability (Kakuzi PLC, 2017, p. 8).

Overall, Kakuzi PLC's annual report complies with the requirements of the Companies Act (2015), but it does not disclose it in the prescribed format. It does not comply with the mandatory requirements of the Code (CMA (2015a). Even though the remuneration report discloses the fees paid to non-executive directors, it lacks transparency because it does not identify the basis for the payment of the fees.

7.5 Safaricom PLC

PricewaterhouseCoopers audited the financial statements for the year ended 31 March 2017.

Information about the board of directors

The directors' report discloses the directors' names and nationalities, and the gender ratio of male to female at the board level (Safaricom PLC, 2017, p. 88). It complies with the provisions of section 654 (1) of the Companies Act (2015). The annual report does not disclose the professional qualifications and skills of the board members as required by Principle 7.1.1 (h) of the Code (CMA (2015a). However, those details are disclosed on the company's website.

There is no director's remuneration report as required by section 659 of the Companies Act (2015) and Principle 2.9 of the Code (CMA (2015a). The only element of remuneration disclosed in the annual report is that the non-executive directors are paid a sitting allowance for every meeting attended (Safaricom PLC, 2017, p. 77). The annual report does not disclose the amount paid to the executive directors. While the aggregate amount of fees and other emoluments paid to directors is published in the notes to the accounts section, it does not show how much each member is paid (Safaricom PLC, 2017, p. 131).

Information about environmental and social issues

The directors' report does not include a business review as required by section 655 of the Companies Act (2015), and there is no explanation why the business review is not included in the directors' report. However, the Chairman's statement contains an overview of the business and highlights the key factors that influence Safaricom's operations (Safaricom PLC, 2017, pp. 14-15). Further, the CEO and the Chief Financial Officer provide a business overview (Safaricom PLC, 2017, pp. 18-23).

Although the annual report does not disclose how the business impacts on the environment, it identifies the company's material sustainability matters in the following statement:

> Our sustainability material matters are the most important environmental, social, economic and governance risks and opportunities for our organisation and stakeholders. Our four material matters are; network quality, innovation, governance risk and regulation and environmental responsibility. (Safaricom PLC, 2017, p. 37)

The company discloses its carbon emission statistics and states that it is committed to becoming a net-zero-carbon-emitting company by 2050, improving on its energy consumption, and using environmentally friendly packaging (Safaricom PLC, 2017, p. 37).

The annual report discloses detailed information about employees in various sections. For example, it discloses the total number of employees, provides a comparative gender ratio of the entire workforce and the senior managers between 2016 and 2017, and the percentage of employees who live with disabilities (Safaricom PLC, 2017, pp. 38-41). It also provides further details, such as the number of fatalities in 2017 involving employees, contractors and third parties, the number of employees dismissed for fraud, and the percentage of employees trained on ethics, anti-corruption, and sign language.

Regarding social issues, the annual report contains a corporate social investment statement:

> We recognize that corporate social investment issues are of increasing importance to our stakeholders and are fundamental to the continued success of the business. Thus, we have a corporate social investment policy that ensures we responsibly operate our business at all times for the benefit of our customers, staff, suppliers, and the wider community. We exercise corporate social investment by partnering with and investing in communities to find sustainable solutions. (Safaricom PLC, 2017, p. 77)

Moreover, the annual report discloses a detailed analysis of the company's social initiatives and programmes that are implemented through the Safaricom and M-PESA foundations (Safaricom PLC, 2017, pp. 42-49). For example, the M-PESA Foundation established the M-PESA Foundation Academy in 2016. The Academy provides secondary school-level education and admits gifted but economically challenged students from all over Kenya on full scholarship.

Overall, Safaricom PLC's annual report discloses the most details and provides the most analysis of financial and non-financial information. However, it does not provide the information in the format prescribed by the Companies Act (2015), and it omits the business review and the directors' remuneration report. Thus, it does not comply with the requirements of the Companies Act (2015) on those aspects.

7.6 Liberty Kenya Holdings PLC

Liberty Kenya Holdings PLC is controlled by Liberty Holdings Limited in the Republic of South Africa; the ultimate parent of Liberty Holdings Limited is Standard Bank Group Limited, which is incorporated in South Africa (Liberty Kenya Holding PLC, 2017). KPMG audited the financial statements for the year ended 31 December 2017.

Information about the board of directors

The directors' report does not comply with the requirements of section 654 (1) of the Companies Act (2015), because it does not disclose the names of board members. However, the names of the directors who were in office in 2017 are published on page 3 of the annual report (Liberty Kenya Holding PLC, 2017, p. 15). Other details, such as the age, professional profile and qualifications of the board members and senior managers are disclosed in the corporate governance report (Liberty Kenya Holding PLC, 2017, pp. 24-25). Thus, the annual report complies with Principle 7.1.1 (h) of the Code (CMA (2015a).

The directors' remuneration report stipulates the remuneration elements for both executive and non-executive directors. There is only one executive director and he has a service agreement with the company. The fees and other emoluments paid to each director (executive and non-executive) for the year 2017 are disclosed (Liberty Kenya Holdings PLC, 2017, p. 20). The remuneration report complies with the provisions of section 659 of the Companies Act (2015) and Principle 2.9 of the Code (CMA, 2015a).

Information about environmental and social issues

The business review partially complies with the requirements of section 655 (4) (b) of the Companies Act (2015). It provides a review of the company's business and states the number and the gender balance of the employees at the end of the financial year (Liberty Kenya Holding PLC, 2017, p. 15). However, the business review does not contain information on the environment and the community. The Chairman's statement states that there is a social responsibility programme anchored on education and health, as part of the wider Liberty Group Policy (Liberty Kenya Holding PLC, 2017).

Overall, Liberty Kenya Holdings PLC's annual report provides most of the minimum required ESG information, but it does not disclose it in the format prescribed by the Companies Act (2015).

7.7 Athi River Mining PLC

Deloitte and Touche audited the financial statements for the year ended 31 December 2017.

Information about the board of directors

The directors' report discloses the names of the executive and non-executive board members and their professional qualifications and professional history (Athi River Mining PLC, 2017, p. 5). It complies with section 654 (1) of the Companies Act (2015) and Principle 7.1.1 (h) of the Code (CMA (2015a). Moreover, the director's remuneration report clearly states the remuneration elements of both the executive and the non-executive directors and discloses the amount of fees and emoluments paid to each director (Athi River Mining PLC, 2017, p. 17). It complies with the provisions of section 659 of the Companies Act (2015) and Principle 2.9 of the Code (CMA (2015a).

Information about environmental and social issues

The directors' report contains a business review that complies with the requirements of section 655 (4) (b) of the Companies Act (2015). The business review discloses that the group made net losses in the 2016 and 2017 financial years, and the company's cash flow was strained throughout the year by a high debt burden (Athi River Mining PLC, 2017, pp. 8-11). The business review discloses the total number of employees and provides further details, such as how many employees hold casual contracts and how many are permanent employees. The business review does not disclose how the business impacts on the environment. But it states:

> The Company places a strong emphasis on its environment, health and safety programmes and is improving standards in areas such as energy efficiency, health and safety and its engagement with local communities, in particular supporting the company's excellent provision of health, education and environmental services to local communities through the Rhino Cement Foundation. (Athi River Mining PLC, 2017, p. 2)

Overall, Athi River Mining PLC's annual report provides all the minimum required information on ESG and in the format prescribed by the Companies Act (2015).

7.8 Car and General (Kenya) PLC

Deloitte and Touche audited the financial statements for the year ended 30 September 2017.

Information about the board of directors

The directors' report identifies the names of the board members, but no other information such as professional qualifications, skills, gender, or age. Thus, it complies with the requirements of section 654 (1) of the Companies Act (2015), but it does not comply with Principle 7.1.1 (h) of the Code (CMA (2015a). The director's remuneration report identifies the remuneration elements of both non-executive and executive directors, and discloses the fees and other emoluments paid to each director for the year ended 30 September 2017 (Car and General (Kenya) PLC, 2017, p. 14). It complies with the provisions of section 659 of the Companies Act (2015) and Principle 2.9 of the Code (CMA (2015a).

Information about environmental and social issues

The directors' report contains a business review that complies with the provisions of section 655 of the Companies Act (2015). The review identifies several factors affecting business performance, such as weak economic growth, declining disposable incomes, drought across the region and a prolonged election in Kenya in 2017 (Car and General (Kenya) PLC, 2017, p. 12). The review states the number of employees that worked at the company in 2017, but it does not provide further details about them. Regarding the community, the review states that the group supports the eye clinic and water security programmes and is now embarking on an education programme. While the business review does not state how the business impacts on the environment, it states:

> The company continues to be conscious of environmental aspects and operates accordingly and is in compliance with all fuel emission standards and best practice safety processes. Safety is paramount in our operations and we strive to provide a safe working environment for our staff and all other stakeholders. (Car and General (Kenya) PLC, 2017, p. 12)

Overall, the Car and General (Kenya) PLC's annual report provides mandatory information in the manner prescribed by the Companies Act (2015). It does not fully comply with mandatory provisions of the Code (CMA (2015a).

7.9 Carbacid Investment PLC

Deloitte and Touche audited the financial statements for the year ended 31 July 2017.

Information about the board of directors

The directors' report discloses the names of five non-executive board members, but no further information about their qualifications or professional profile is provided. Thus it complies with section 654 (1) of the Companies Act (2015), but does not comply with Principle 7.1.1 (h) of the Code (CMA (2015a).

The directors' remuneration report states that the report is prepared following the provisions of the Code and the requirements of the Companies Act (2015) (Carbacid Investment PLC, 2017, p. 9). But it does not disclose the company's remuneration policy or the elements as required by Principle 2.9 of the Code (CMA (2015a). Instead, Carbacid Investment PLC's remuneration report states:

> The company's policy is to fairly remunerate directors for the role and responsibilities that they undertake for the group and company. The remuneration is determined by the board nomination, remuneration and governance committee by reference to market forces. The remuneration is subject to approval by the

> shareholders at the Annual General Meetings. (Carbacid Investment PLC, 2017, p. 9)

The remuneration report also states that directors have been issued with formal letters of appointment setting out terms and conditions. Although the total emoluments paid to each director for the year ended 31 July 2017 are disclosed, the elements of the remuneration, such as fees and sitting allowances, are not disclosed.

Information about environmental and social issues

The directors' report contains a business review section that complies with section 655 of the Companies Act (2015). It discloses the number of employees and provides a simple analysis of the number of employees working in various departments (Carbacid Investment PLC, 2017, p. 10). The review does not state how its business impacts on the environment, but it states:

> The group continues to be conscious of environmental aspects and operates accordingly and is in compliance with the National Environmental Management Authority requirements. Safety is paramount in our operations and we strive to provide a conducive working environment for our staff and all other stakeholders. (Carbacid Investment PLC, 2017, p. 10)

Regarding social and community issues, the business review states that the "company supports school fees and university fees initiatives for eligible, talented students from the localities in which we have manufacturing operations" (Carbacid Investment PLC, 2017, p. 11).

Overall, Carbacid Investment PLC's annual report provides mandatory information in the manner prescribed by the Companies Act (2015). It does not comply with the mandatory requirements of the Code (CMA (2015a).

7.10 Mumias Sugar Company Limited

RSM Eastern Africa audited the financial statements for the year ended 30 June 2017.

Information about the board of directors

The directors' report discloses the names of board members and provides details of their professional qualifications and professional profile (Mumias Sugar Company Limited, 2017, pp. 30-31). It complies with section 654 of the Companies Act (2015) and Principle 7.1.1 (h) of the Code (CMA (2015a). Moreover, the director's remuneration report discloses the remuneration elements of non-executive directors and discloses the amount of fees and allowances paid during the year. But it excludes both the remuneration policy for the executive directors and the value of the executive directors' pay (Mumias Sugar Company Limited, 2017, pp. 32–33). Thus, it complies with the provisions of section 659 of the Companies Act (2015), but does not comply fully with Principle 2.9 of the Code (CMA (2015a).

Information about environmental and social issues

The business review does not comply with the requirements of section 655 (4) (b) of the Companies Act (2015), because it does not contain information about environmental matters, the employees of the company, or social and community issues (Mumias Sugar Company Limited, 2017, pp. 30-31). However, the Chairman states that the company

> takes cognizance of the fact that by managing and improving the social, environmental, and economic impacts of its day-to-day operations, there is an opportunity to increase public confidence and satisfaction. This is done by preventing or reducing the negative impact on the environment while improving the quality of services and production efficiency and effectiveness. (Mumias Sugar Company Limited, 2017, pp. 12-13)

The business review does not disclose how the business impacts on the environment. The only information about the environment is mentioned in the CEO's statement, which states that "liquid and solid waste management processes were in place throughout the year and any wayward parameters received appropriate attention" (Mumias Sugar Company Limited, 2017, p. 22). Regarding social initiatives, the CEO states that the company's corporate social responsibility initiatives include medical camps in collaboration with the Ministry of Public Health & Sanitation on polio campaigns, distributing mosquito nets, and conducting eye clinics, among others (Mumias Sugar Company Limited, 2017, p. 20). The annual report does not publish the number of employees or gender balance.

Overall, Mumias Sugar Company Limited's annual report provides most of the minimum required ESG information, but it does not disclose it in the format prescribed by the Companies Act (2015). It does not fully comply with the mandatory provisions of the Code (CMA (2015a).

The surveyed companies have complied with most of the requirements of the Companies Act (2015) regarding disclosure of ESG information. However, none but Athi River Mining PLC provides the information in the format prescribed by the Companies Act (2015). Table 6 shows how the 10 companies comply with the three sections of the Companies Act (2015) and the two mandatory provisions of the Code (CMA (2015a).

Table 6. Summarising companies' compliance with the provisions of the Companies Act (2015) and the mandatory provisions of the Code (CMA, 2015a)

Company	**Complies with section 651 (1) of the *Companies Act 2015***	**Complies with section 655 (1)– (4) of the *Companies Act 2015***	**Complies with section 659 (1)– (2) of the *Companies Act 2015***	**Complies with Principle 2.9 of the Code**	**Complies with Principle 7.1.1 (h) of the Code**
Absa Bank PLC	Fully	Partially	Fully	Fully	Fully
Kenya Power and Lighting Company PLC	Fully	Partially	Fully	Fully	Fully
Kenya Airways PLC	Fully	Partially	Fully	Fully	Fully
Kakuzi PLC	No	Partially	Fully	No	No
Safaricom PLC	Fully	No	No	No	No
Liberty Kenya Holdings PLC	No	Partially	Fully	Fully	Fully
Athi River Mining PLC	Fully	Fully	Fully	Fully	Fully
Carbacid Investment PLC	Fully	Fully	Partially	No	No
Car and General (Kenya) PLC	Fully	Fully	Fully	Fully	No
Mumias Sugar Company Ltd	Fully	Partially	Fully	Partially	Fully

Only three out of the ten companies comply with section 655 (4) (b) of the Companies Act (2015), which requires disclosure of environmental and social issues in the business review section. The other six companies disclose the information in other parts of the annual report, which makes it hard to navigate and extract the relevant information, and there is no consistency in the quantity of the information disclosed by the companies. Taking the information about employees as an example, Absa Bank PLC discloses that information in the highlights section, Kenya Power and Lighting Company PLC in the appendix, Kenya Airways PLC in the CEO’s statement, Kakuzi PLC in the notes to the consolidated and company financial statements section, and Safaricom PLC in various parts of the annual report. Mumias Sugar Company Limited does not disclose the number of employees anywhere in the annual report.

Also, there is no consistency in the information disclosed. Taking the same example of information about employees, nine companies disclose the total number of employees, while four add details of gender balance, and three provide details about training and development. Interestingly, Safaricom PLC does not have a business review section as required by section 655 of the Companies Act (2015). Yet it is the only company that contains a detailed analysis of information relating to environmental and employee matters using other key performance indicators, as recommended in section 655 (6) of the Companies Act (2015).

Moreover, the depth of the ESG information disclosed does not seem sufficient to assist asset managers to assess the impact of the ESG issues on asset valuation. For example, none of the surveyed companies, including the cement manufacturing company, provide a report on the impact of the business of the company on the environment. Also, while nine out of the ten companies comply with section 654 (1) of the Companies Act (2015), which requires the directors’ report to disclose the names of the persons who were members of the board, four out of the ten companies do not disclose the qualification and professional skills of the board members as required by Principle 7.1.1 (h) of the Code (CMA (2015a).

Chapter 8. Discussion

The purpose of this study is to explore the critical challenges for RI development in the retirement benefits sector of Kenya. This question is broken down to the following four sub-questions:

1) How do the actors in the retirement benefits sector of Kenya conceptualise RI?
2) What are the main ESG issues in Kenya and do they present material risks or opportunities to the investment decision-making process?
3) What are the specific barriers for RI development in the Kenyan retirement benefits sector?
4) What role can a well-developed RI policy framework play in addressing the identified ESG issues in Kenya?

Answers to these questions will be discussed in this chapter as they relate to the literature and theories described in Chapter 3. I will begin by providing an overview of the key findings of this study, followed by a discussion of how the literature and theories described in Chapter 3 explain the conceptualisation of RI and the challenges for RI development in Kenya.

8.1 Overview of the findings

This study found that participants define RI using different terminologies; this practice is consistent with the international literature discussed in Chapter 3. Also, the study found that all participants view weak corporate governance practices as material risk factors that impact on the investment decision-making process. But participants' opinion on the materiality of environmental and social issues regarding the investment decision-making process is divided, with most of the asset managers expressing the view that these two factors are not material risk factors that can affect the investment decision-making process. However, over a third of the asset managers state that the prevailing environmental and social issues present business opportunities to retirement benefits schemes, and a similar number of asset managers state that they would prioritise investing in projects that address environmental and social issues.

This study also found that the most prevalent strategy is the exclusion of assets that do not satisfy the asset manager's expectations in terms of financial performance and where corporate governance practices are weak. That means they do not invest in certain assets or, if they have already invested, they sell their stake in such a company. A few of the asset managers state that they engage the managers and the board members of the investee companies on financial performance concerns or corporate governance practices.

The key challenges for RI development in the retirement benefits sector of Kenya, as identified by the participants of this study and from the document analysis, are diversification challenges; a lack of quality ESG information; a lack of demand for RI from both clients and regulators; short-termism; and a lack of awareness and expert knowledge of RI by the actors in the sector.

This study puts forward two recommendations that would help overcome some of the identified challenges and facilitate the development of the RI market. These are the development of an RI policy framework and capacity building. This study proposes that the National Treasury of Kenya, the highest and the common regulator of all the subsectors, develops an RI policy framework to serve as best practice guidelines for the wider finance sector of Kenya. Although opinion is divided on whether to mandate ESG integration, most of the participants express the opinion that some form of ESG regulation is necessary, especially on corporate governance practices. The second proposal is for capacity building, to enable the actors to acquire and retain skills and knowledge to engage with RI effectively. The remainder of this chapter addresses each of the research questions, incorporating the data, theories, and existing literature.

8.2 Use of different terminologies

Regarding my first research question, this study found that RI means different things to the various actors operating in the retirement benefits sector of Kenya. Broadly, the participants defined RI using a range of terminologies: ethical investment; looking beyond returns; ESG integration; and implementing the mandate that was agreed with the client. The use of different terminologies is consistent with the literature discussed in Chapter 3. The terms “ethical investment”, “ESG integration” and “investment that looks beyond immediate returns” have been extensively used by both academicians and practitioners. Defining RI in terms of strict implementation of the mandate, as it was used by two participants of this study, appears different. The rest of this section discusses these terms in relation to the existing literature.

8.2.1 Looking beyond returns

This study found that the investment ideas and practices portrayed by the participants who used this term echo those of many investors who are actively involved in impact investing. Impact investors combine commercial objectives and desire to solve certain problems in society (Louche & Hebb, 2014). These participants of this study indicate that they view RI as an investment style that seeks to achieve satisfactory financial returns while bringing benefits to society. It was common to hear them talk of the number of lives they have touched with their investment decisions, or the benefits they have brought to the communities where they have invested. For example, there is the asset manager who describes an investment project in terms of commercial gains and the extra benefits brought to society in the name of employment creation and raising the value of adjacent land, albeit speculatively. Another example is the asset manager who states that he prioritises investments that are likely to have a positive social impact, as demonstrated by his investment in better quality affordable beer, whose manufacturing process benefited the sorghum growers and the targeted beer consumers (those who cannot afford to buy regular beer).

8.2.2 Strict implementation of the mandate

While only two asset managers define RI in terms of strict implementation of the mandate, both strongly express the opinion that the most appropriate definition of RI is to execute the contract that is agreed between them and the client, and not to lose the client's money. Their view is that pension schemes come with an investment policy statement, which details a client's needs, and an asset manager's responsibility is to execute that policy, carrying out due diligence to minimise risks. They perceive the industry to be heavily regulated, leaving no room for irresponsible behaviour because, to them, irresponsibility is shown when asset managers invest in underperforming assets or when the investee company collapses after capital has been deployed, as happened with the three banks in 2015 and 2016. Consistent with their views, they avoid certain companies if they perceive those companies to present financial or corporate governance risks as part of their due diligence process. But they do not omit entire sectors or companies purely due to ESG concerns.

This literal definition of RI raises the question of whether a change of language would have a positive impact on the development of RI in the retirement benefits sector of Kenya. Since the two asset managers are willing to implement the contractual obligations expressed in the mandate to the letter, it seems plausible to suggest that they would integrate ESG issues in their investment decision-making process if such a requirement were clearly expressed in a prudent investment policy statement. After all, Hebb (2011) observes that mainstream investors such as pension schemes view the terms social, ethical, and even responsible as suspicious. Even if mainstream investors routinely engage in the positive screening of good companies and the negative screening of bad companies for financial reasons, the same strategies become suspicious when financially tangible ESG factors are used as the bases of screening (Hebb, 2011).

8.2.3 ESG integration

As stated in Chapter 5, three out of the six asset managers who choose this term have international affiliations, either through their clients or ownership structure. According to these asset managers, the international clients and owners are familiar with ESG integration from their countries of origin, and they push for it in Kenya. As previously stated, the CMA (2018) confirmed that international investors from developed markets are seeking to ensure that ESG policies are enhanced before they invest in Kenya. This behaviour of international investors driving RI in an emerging market has also been observed in Mexico (Global Sustainable Investment Alliance, 2016).

In practice, this study found that the asset managers who define RI to mean ESG integration mainly exclude the companies that do not meet their financial or corporate governance requirements. From the asset managers' narrative, it appears that their process does not extend to the enhanced quantitative analysis of material ESG factors to assess the degree of impact of each ESG factor on the portfolio. For example, the parent company of AM13 is a PRI signatory in South Africa. Although he defines RI to mean ESG integration, he says that his firm's strategy is to allocate more capital to sectors that produce clean energy and renewable energy. As established in Chapter 3, screening to filter assets is often the first stage of ESG integration, followed by further analysis to determine the impact of the identified ESG factors on the asset's valuation model (PRI, 2016c).

8.2.4 Ethical investing

Ethical investing, as typically used by the participants of this study, seems to be closely linked to avoidance of certain companies, because they are involved in unethical operations in one way or another. The decision to avoid these entities primarily comes from the moral conviction of the asset manager or the clients that the products or business processes are harmful to society. It is in this same manner that religious beliefs informed the ethical movement of yesteryear in the UK.

To summarise this section, the use of different terminologies by the participants of this study reflects their difference in ideologies and values, revealing their different perspectives on RI. While it is a common phenomenon within RI markets, some authors see it as ambiguous and consider it a hindrance to the growth of RI (Sethi, 2005; Sparkes, 2002; Viederman, 2004). Other scholars (Sandberg et al., 2009) see it as necessary to retaining nuances, and Eurosif (Eurosif, 2016) wonders if standardisation is possible or even necessary. On a positive note, the lack of a standard definition in the retirement benefits sector of Kenya can allow asset managers to develop and customise RI-branded portfolios according to how they understand RI, granting them an opportunity to differentiate themselves in the market by their product offering. For example, the asset managers who define RI to mean ethical investing can develop ethical branded portfolios. As discussed in Chapter 3, the question of whose ethics or what actions/assets are ethical and which ones are not would present the first obstacle to this approach. However, it is possible to customise a portfolio that excludes the products that are most requested by clients for exclusion, such as tobacco and alcohol. I note that there is already an international initiative to develop tobacco-free portfolios to eliminate tobacco from investment portfolios around the globe (Tobacco Free Portfolios, 2020). But schemes would have to clarify the products that they want to be excluded in their prudent investment policy statements for the asset managers to execute it.

On a negative note, the use of multiple terminologies to define RI can confuse clients regarding what strategies to use and which criteria are material. Also, a lack of a standard definition can lead to greenwashing, whereby portfolios are incorrectly branded as RI. As discussed in Chapter 2, greenwashing was becoming a major concern for many investors in Europe, prompting the European Commission to propose the Action Plan for Sustainable Finance, an EU-wide regulation to agree on definitions for what is green and what is not (Eurosif, 2018). In line with existing literature, I argue that developing RI in the retirement benefits sector of Kenya is unlikely to succeed if it is not supported by the collective beliefs, that is, the shared interpretations, that guide investors' actions and decisions (Dumas & Louche, 2016; Jemel-Fornetty, Louche, & Bourghelle, 2011). The study by Dumas and Louche (2016) argues that RI is likely to succeed in a market where there is a shared interpretation of three areas. These are: what is RI; why do RI; and how to do RI. A directive in the retirement benefits sector of Kenya, like that developed by the EU, can provide clarity to the actors as to what constitutes RI from the retirement benefits schemes' perspective, and can act as a starting point for RI discussions in the sector. It would probably prompt the actors to confront the issue of recognising the materiality of the identified ESG factors regarding the investment decision-making process.

8.3 The main ESG issues in Kenya

Considering my second research question, my study sought to identify the key ESG issues in Kenya and to determine if those issues present material risk or opportunities to the investment decision-making process. Table 7 summarises the key ESG issues in Kenya, both from the study participants' point of view and from the document review described in Chapter 3.

Table 7. Summary of key ESG issues in Kenya

Environmental	Social	Governance
• Variable weather patterns that affect food security • Pollution of air, water and soil • Deforestation • Unsustainable farming practices that degrade the soil	• Poverty • High youth unemployment • A lack of affordable housing, access to education and health care • Alcoholism and illicit use of recreational drugs • Ethnic tension that leads to crisis • Politics of ethnicity • Inequality, both income and gender	• Corruption, including bribery, theft, fraud and embezzlement • Dishonesty and a lack of integrity • A lack of accountability • A lack of functional boards, including a lack of diversity in skills and age • A lack of transparency

Source: Author.

While the above factors were identified as the main ESG issues in Kenya, this study shows that they do not carry equal weight when it comes to the investment decision-making process. In the following sections, I discuss the participants' perception of the identified ESG issues in reference to risks and opportunities to their investment decision-making process.

8.3.1 Material ESG issues that present risks to the investment decision-making process

Based on the findings of this study, all participants regard weak corporate governance practices as material factors that present risks to the investment decision-making process. However, opinion is divided about the materiality of social and environmental factors as risk factors to the investment decision-making process. More than half of the asset managers explicitly state that environmental and social issues do not present a material risk to their investment decisions, while a similar proportion expresses the view that environmental and social issues are the government's problems to fix.

The finding that weak corporate governance is regarded as a material risk factor by all the participants of this study is not surprising, for two reasons. The first reason is that losses due to weak corporate governance failures are frequent in Kenya. For example, the collapse of the three banks in 2015 and 2016, as discussed in Chapter 5, are not the first bank or corporate failures in Kenya due to inadequate governance arrangements, alongside other factors. A study by Kithinji and Waweru (2007) shows how Kenya experienced an extended banking crisis in different periods. For example, 37 banks failed between 1986 and 1998, and a further six banks failed between 2000 and 2006 (Kithinji & Waweru, 2007). Even though the failure of each bank was a combination of various factors, poor corporate governance practices, such as high insider lending, were a common problem in all the banks (Gathaiya, 2017; Kiemo, Olweny, Muturi, & Mwangi, 2019; Kithinji & Waweru, 2007; United Nations Conference on Trade and Development, 1998). Many other private companies and state-owned organisations failed, such as Kenya Corporative Creameries, National Housing Corporation, and the Kenya National Assurance Company, primarily due to failure of corporate governance (Musikali, 2008).

The second reason that corporate governance is perceived by all actors as a material risk factor is that it is relatively easy to monetise the value of the loss of an investment when an investee company collapses or when the share price drops due to loss of reputation. If an asset manager's contract is revoked by the trustees for investing in a company that then collapses, the asset manager can easily determine the material impact of the loss of the contract on his financial performance. Furthermore, the participants of this study identified corruption as a major corporate governance issue and corruption scandals are usually monetised, rendering it easy to determine the materiality of such issues.

However, the finding that more than half of the asset managers perceive environmental and social factors as immaterial, and too remote to affect their investment decisions, raises the question of how the asset managers determine the immateriality of those factors regarding investment decisions. As demonstrated in Chapter 3, companies that damage the environment can suffer from significant financial consequences, in the same way that companies suffer from the effects of weak corporate governance practices. The case of British Petroleum's Deepwater Horizon oil spill of 2010 is a good example of the financial damage companies and their investors are faced with as a result of poor environmental controls. British Petroleum incurred a USD 4,500 million fine, and its share price lost 50 per cent between 20 April 2010 and 29 June 2010 as the disaster unfolded (Clark et al., 2015).

Moreover, the view expressed by over half of the asset managers that environmental and social issues in Kenya are the government's responsibility to solve overlooks the fact that environmental disasters such as the one discussed above can happen even in Kenya, with serious financial and reputational consequences for investors. The view expressed by these participants is not new, as there is existing literature that suggests that the government should play a pivotal role in protecting the environment and providing public goods and services (Blowfield & Frynas, 2005; Boddewyn & Doh, 2011; Mansbridge, 2014; Newell & Frynas, 2007). However, the implementation of environmental protection policies relies on public support, and incorporated companies are part of the public (Kulin & Johansson Sevä, 2019).

I argue that it is in the asset managers' best interest to undertake a comprehensive analysis of the environmental and social factors present in the market and evaluate their impact on their investment decision-making process. As stated before, the materiality of ESG factors should be related to investment valuation impacts. Therefore, asset managers should identify the material ESG factors of each company in terms of creating value for retirement benefits schemes over the long term, bearing in mind that materiality of ESG factors differs substantially from one sector to another (Eccles, Krzus, Rogers, & Serafeim, 2012). For example, resource-intensive industries such as mining are exposed to different environmental and social factors than the commercial real estate sector (Clark et al., 2015).

In practical terms, asset managers can begin by examining concerns expressed directly by customers and other stakeholders. They can also take into account the expectations expressed in international standards and agreements with which organisations are expected to comply (Global Reporting Initiative Standards, 2020). For example, if an asset manager determines that compliance with environmental laws is a material factor for the construction and allied sector of Kenya, he or she can anticipate the worst-case scenario of a construction company that fails to comply with the law. For illustration purposes, an offence relating to an environmental impact assessment in Kenya can attract criminal sanctions, such as a two-year imprisonment or a fine of KSh 2 million (USD 20,000), or a combination of both (Envrionment Management and Co-ordination Act, 1999). The asset manager can factor the impact of the KSh 2 million on retained earnings to assess the potential impact of the environmental breach on the value of shares.

8.3.2 ESG issues that present opportunities to the investment decision-making process

In line with my second research question, this study found that a third of the asset managers express the opinion that being mindful of ESG issues can grant them a competitive edge for being known as a responsible asset manager. This finding is consistent with studies that suggest that integrating ESG issues can provide a company with competitive advantages over their peers (Clark et al., 2015; Jacobs et al., 2010; Porter & Kramer, 2006; Richard et al., 2007). For example, a 2013 study by Accenture surveying 1,000 CEOs from various industries showed that 80 per cent of the surveyed CEOs view sustainability issues (such as the environment, human rights, labour standards and anti-corruption) as a means to gain a competitive advantage over their peers (Accenture, 2013). Furthermore, the study found that 81 per cent of the CEOs view the reputation of their companies concerning sustainability performance as important for their consumers' purchasing decisions. Other studies show that institutions that are mindful of ESG issues, particularly the issues that affect communities, consumers, suppliers and employees, gain a positive public image that can lead to competitive advantages (Clark et al., 2015; Edmans, 2012; Kurucz, Colbert, & Wheeler, 2008). For example, Edmans (2012) found that a satisfying workplace can foster job security, ensuring employees do not leave the company. The positive image can also provide insurance-like benefits, because stakeholders are likely to temper negative judgements in case the company has an adverse ESG event (Godfrey, Merrill, & Hansen, 2009).

In contrast to the asset managers who view ESG as a source of competitive advantage, slightly more than a third of the asset managers who participated in my study do not see any value in positioning themselves as responsible investors. The latter group of asset managers seem sceptical that being known as responsible asset managers adds any value to their image. The perception that ESG integration does not add value to investment decision-making is not unique to Kenyan asset managers. A PRI (2016b) study identified this perception as one of the main factors that hinder asset owners from adopting RI strategies. The study suggests that asset owners should build their internal evidence base by integrating ESG issues and learning from experience how integration contributes to investment performance (PRI, 2016b).

Further, slightly more than a third of the asset managers recognise that environmental and social issues present business opportunities, while a similar number of states that they would prioritise investment in projects solving environmental and social problems. These asset managers suggest that they would engage in sustainability-themed investing or impact investing if the assets are structured in a way that attracts the asset managers in terms of the returns they deliver and the corporate governance arrangements. As discussed in Chapter 6, retirement benefits schemes in Kenya lack opportunities for investing in such areas, because there is a limited number of viable investment options in those areas that provide adequate financial returns and are well structured to inspire confidence in retirement benefits schemes to invest. However, a 2015 study of impact investing in Africa by the United Nations Development Programme demonstrates that the problem is not experienced in Kenya alone. The study found that the most practical challenge for impact investors in Africa is that there is a limited number of viable investment options that can provide adequate financial returns and demonstrate sufficient track record and capacity development to align with the risk appetite of investors (United Nations Development Programme, 2015). Furthermore, the Global Impact Investing Network (2015) found this to be a common problem worldwide, not only in Africa.

8.4 Specific barriers for RI development in the retirement benefits sector of Kenya

Considering my third research question, I discussed the specific barriers for RI development in the retirement benefits sector in Chapter 6. In this section, I provide a summary of the challenges and relate the findings to existing literature.

8.4.1 Diversification challenges

This study found the concern for the loss of diversification is a major concern for most of the participants, including the regulators, the capital market development specialist, and the council member of the ARBS. The participants observe that the capital market and the equity market in particular are already too small to satisfy the investment demands of both domestic and international investors. Also, the market lacks many basic financial instruments, like swaps, futures and a variety of debt instruments that are found in mature capital markets.

According to the participants, the market shrinks further when sound financial performance and corporate governance practices are factored in. For these reasons, participants of this study responded that ESG consideration would be difficult because it would introduce another layer of screening in an already strained market. It is already difficult to satisfy faith-based investors, especially Muslims because Sharia-compliant assets necessitate omitting all commercial banks, together with tobacco- and alcohol-producing companies.

Arguably, the size of the Nairobi Securities Exchange (in terms of listings) is small compared to the growing population and growing middle class with more disposable income than can be invested. As some participants observe, the average number of listed companies has not changed much over a considerable length of time. For illustration purposes, there are currently 65 listed companies on the Nairobi Securities Exchange, compared to 66 listed companies in

1968 (Nairobi Securities Exchange, 2020b). The total population of Kenya has grown almost five-fold, from 10.5 million to 51.3 million people, in the same period (World Bank, 2019a). Even though this is a simplistic analysis and noting that the growth of population does not necessarily indicate growth in the demand for equity securities, it shows the number of listed companies on the Nairobi Securities Exchange has not increased at the same pace as the population. Furthermore, Kenya's middle class is estimated to have increased by 46 per cent between 2009 and 2015 (Institute of Economic Affairs, 2015). In this case, the middle class is composed of people earning a monthly income of KSh 49,656 to KSh 67,380 (USD 496.56 to USD 673.80) in 2009, and Ksh 76,392 to KSh 102,429 (USD 763.92 to USD1,024.29) in 2015 ((Institute of Economic Affairs, 2015).The rise of the middle class is likely to lead to increased demand for investment opportunities as more people have a higher disposable income that can be invested in equity or debt instruments.

Another aspect worth considering is that the Nairobi Securities Exchange is highly concentrated, with five companies consistently accounting for more than 75 per cent of the total market capitalisation in two consecutive quarters in 2020 (CMA, 2020). The trend was the same in 2019, where the five companies accounted for more than 70 per cent of market capitalisation (CMA, 2019). While research shows that stock markets in emerging markets tend to be small and concentrated (Pereiro, 2006), there is the danger that if anything happens to those five companies, it could affect the whole market.

While the statistics of the Nairobi Securities Exchange seem discouraging, there are various ways to achieve diversification besides investing in different listed companies. Diversification can be achieved through investing in various asset classes, different industries, different countries, different currencies, and securities that have different maturity periods. Retirement benefits schemes in Kenya have the right to invest or increase asset weighting in other asset classes that are allowed by the RBA, such as guaranteed funds, private equity, and corporate bonds, alongside others. As discussed in Chapter 4, the current asset allocation on all the asset classes is below the maximum allowable percentage. Increasing weighting in other asset classes in addition to equity assets would reduce the concentration in the listed companies and increase diversification.

Understandably, retirement benefits schemes in Kenya may be reluctant to invest in unfamiliar asset classes, such as REITs or private equity firms that invest in small- and medium-sized enterprises or family-owned businesses, given their size and ownership structure. As confirmed in my interview with the council member of the ARBS, “pension schemes in Kenya are quite risk-averse and they want layers of guarantee before they can invest in the newer asset classes such as the private equity”. However, private equity market of Kenya is dominated by direct foreign investors, high-net-worth individuals and foreign institutional investors who introduced stringent ESG requirements for any entity that needs to raise private equity (World Bank, 2018). Thus, retirement benefits schemes would benefit from investing in such ventures that display higher ESG standards. Also, the asset managers who define RI as an investment that looks beyond returns can invest in thematic private equity funds, that is, funds that focus on certain areas such as small- and medium-sized enterprises, agriculture, or housing. As an example, in 2015 the Central Bank of Kenya pension scheme invested in a private equity fund that focuses on small- and medium-sized enterprises (World Bank, 2018).

One factor that can deter the retirement benefits sector of Kenya from investing in private equity funds is that they are currently unregulated (World Bank, 2018). However, the Treasury Cabinet Secretary has recently proposed an amendment to the Capital Markets Act (2000) to make private equity firms and venture capitalists that mobilise resources from public funds, particularly pension schemes, subject to CMA regulation (Government of Kenya, 2020). The regulatory reform will bring Kenya in line with other countries such as the USA and EU member states, which both increased oversight over private equity funds after the global financial crisis (World Bank, 2018).

Moreover, I argue that both asset managers and the schemes they represent should put the recommendations of the *Stewardship Code of Institutional Investors* (CMA, 2017) into practice by actively engaging in dialogues with the corporate management of both listed and unlisted companies that are not performing satisfactorily from a financial and ESG perspective. I argue that the schemes have the financial power and interest to influence change in these companies, especially the listed companies, thus concurrently increasing their investment opportunities and raising ESG standards. In line with the “universal owners” theory of Hawley and Williams (2007), it seems the retirement benefits schemes in Kenya have a pragmatic reason to engage with investee companies on ESG matters from a self-interest perspective. Doing so is especially likely to improve corporate governance performance of the companies, thereby expanding the schemes’ investment universe. I argue that corporate engagement is a better strategy to overcoming the diversification challenge than avoiding companies, because avoidance only serves to shrink the market further and reduce diversification even more. Moreover, I discussed in Chapter 3 how a complete diversification may not be the best strategy in the presence of information asymmetry caused by ESG issues.

As evidenced by the discussion in Chapter 6, some asset managers who are members of the Fund Managers Association express willingness to collaborate on issues of corporate governance. My study proposes that asset managers extend the discussion to include social and environmental factors as material risk factors for an investment decision.

8.4.2 A lack of ESG data

Based on the findings of this study, the ESG information disclosed by listed companies is improving, both in quantity and quality. The improvement is attributed to the Code (CMA, 2015a) and the Companies Act (2015), because they both require companies to disclose certain ESG information in their annual reports. However, the sample analysis of the annual reports of 10 companies in Chapter 7 shows varying degrees of compliance between companies, resulting in great inconsistencies in the mandatory ESG information disclosed. Also, the information is disclosed in a qualitative format that is not readily integrated by asset managers into their traditional financial analysis, which is oftentimes quantitative. The inconsistency in the kind of ESG information disclosed and the format in which it is disclosed makes it difficult for the asset managers to determine the materiality of the information. As discussed in Chapter 3, the determination of materiality of ESG data is one of the most complicated ESG-related issues encountered by RI practitioners, which is one of the reasons investors rely on ESG rating agencies to supply ESG scores for the companies and countries in which they want to invest. As established, Kenya does not yet have an ESG rating agency that can provide ESG scores.

Another finding is that the lack of disclosure of ESG information is closely related to a perception that the disclosed information is not reliable for informed decision-making. It seems there is considerable lack of trust between asset managers and the corporate management and boards of investee companies, such that asset managers are not confident that the information supplied by the companies is reliable for investment decision-making. Given that investors rely on audited financial statements to make investment decisions, the general-purpose financial statements must contain reliable and useful information for decision-making. Ideally, investors should have confidence using the financial statements of listed companies in Kenya to make investment decisions, because the statements are prepared following the *International Financial Reporting Standards* (International Financial Reporting Standards, 2020). Also, the 10 surveyed annual reports were audited by either the Auditor General or one of the big four auditing firms (with the exception of Mumias Sugar Company Limited, whose financial statements were audited by a different auditor). But this study found that half of the asset managers express a lack of trust in the information contained in the financial statements and even the subsequent information they obtain during management meetings.

Given that corruption is perceived as the key corporate governance challenge for asset managers, they express that the annual reports do not disclose detrimental information that could signal the occurrence of corruption deals or dishonesty on the part of the directors, and such information usually comes to light too late for investors to reverse an investment decision. For example, Kenya Airways PLC's annual report complies with the *Companies Act 2015* (KNY) regarding the disclosure of the names of the board of directors, and the audited financial statements disclose that Kenya Airways has made losses for several years, explaining that the losses are due to a bad business environment. But, according to local media, the director of criminal investigations has launched an investigation into how Kenya Airways lost billions of shillings. The lines of inquiry range from investigating the person who was the CEO from 2003 to 2014, to unprocedural procurement and tender processes (Business Today, 2019; The East African, 2016; Uzalendo News, 2019). As the asset managers have identified, information about the corruption of board members or senior managers is not published in the annual reports.

Research shows that a lack of transparency in financial reporting leads to a loss of investors' trust, which in turn leads to the reluctance of investors to invest (Chartered Financial Analyst Institute, 2013). Increased disclosure of ESG information may drive transparency, reduce information asymmetry, and help companies regain public trust, including investors (Barth, Konchitchki, & Landsman, 2013; Chartered Financial Analyst Institute, 2013; Ioannou & Serafeim, 2011; Koehler & Hespenheide, 2012). My study suggests that the regulatory authorities enforce the disclosure requirements to increase and improve on the quality of both financial and ESG information disclosed to increase transparency. In the meantime, asset managers can assess how companies comply with existing ESG laws, regulations, and industry standards to uncover any material omissions or misdemeanours.

Also, the media usually reports company failures or near misses that can trigger asset managers to extend their enquiry regarding ESG performance and adjust their investment decisions accordingly. For example, Kakuzi PLC has been in the media for human rights abuses for several years, and it was investigated by human rights activists for violation of human rights

(Waithera, 2019). There are cases of individuals being beaten by Kakuzi PLC's staff, including journalists beaten by security guards while covering protests by secondary school students against the decision by the company to take 45 acres of the school's land (Waithera, 2019). Kakuzi PLC's parent company has been sued in the UK over human rights abuses, including assault and sexual misconduct by employees ("Kakuzi sued", 2020). Consequently, two UK supermarkets have stopped buying avocadoes from Kakuzi PLC, pending investigations (Muthoni, 2020). To reiterate, asset managers can use the information disclosed by the media to actively engage the investee companies on such matters.

8.4.3 A lack of demand/incentives from the clients and regulatory authorities

Contrary to the literature that shows client demand as one of the leading causes for ESG integration in other parts of the world, this study found that only a small fraction of domestic clients in Kenya request RI. The small fraction, which is composed of schemes of mainly faith-based organisations and international investors, does not demand ESG integration with as much force as can be seen in other parts of the word because they do not want to compromise on returns. The study also found that the Retirement Benefits Act (1997), the principal legislation governing the administration of the retirement benefits schemes, and related regulations do not oblige retirement schemes to integrate ESG matters. Hence, the asset managers state that they do not have incentives to pursue RI. At the admission of two asset managers, they have maintained the status quo.

As discussed in Chapter 4, asset managers are guided by the prudent investment policy statement that each scheme must prepare, following the provision of the (Retirement Benefits Act, 1997). As is evident from the law, consideration of ESG issues is not an issue that the prudent investment policy statement of each scheme must cover. As I mentioned in Chapter 4, the Retirement Benefits (Good Governance Practices) Guidelines (2018) encourages schemes to adopt socially responsible investing. But it does not elaborate on what constitutes socially responsible investing. Moreover, the perception expressed by most of the asset managers and the council member of the ARBS that environmental and social factors are not material factors that present risks to investors provides no incentive to the asset managers to consider these factors. In line with the observation made by the PRI (2016a), I argue that additional incentives in the form of regulation are necessary, because client demand is not strong in the retirement benefits sector.

As discussed in Chapter 3, policy changes and regulatory reforms have played an important role in encouraging ESG integration by pension schemes. Most of the pension funds regulations relate to the mandatory disclosure of the extent to which pension funds incorporate ESG issues in their investment decision-making process. However, some regulations direct pension funds to avoid investing in certain areas, and others suggest the inclusion of RI policies in the investment policy statement. For example, the Government of Norway issued guidelines requiring pension funds to exclude companies that produce weapons whose normal use violates fundamental humanitarian principles, companies that produce alcohol or tobacco, companies that sell military equipment to specific countries, and companies that risk contributing to serious or systematic human rights violations, alongside others (PRI, 2020). In another example, the revised Regulation 28 of the Pension Funds Act (1956) of South Africa states that prudent investing should consider any factor, including factors of ESG character, that may materially affect the sustainable long-term performance of a fund's assets. Also, the *National Pension Act 1986* (KOR) of Korea obligates the National Pension Scheme to consider ESG issues and declare the extent to which they have been taken into account (PRI, 2016a).

My study proposes an amendment to the various sections of the Retirement Benefits Act (1997) and related regulations that stipulate the requirement of the prudent investment policy statement of each scheme to include ESG integration as part of risk management. These are section 37 of the (Retirement Benefits Act, 1997), section 37 of the (Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations, 2000), section 30 of the (Retirement Benefits Authority, 2000), and section 44 of the (Retirement Benefits (Umbrella Retirement Benefits Schemes) Regulations, 2017). I argue that tying material ESG issues to the prudent management of schemes funds would incentivise the retirement benefits schemes to consider ESG factors in their risk assessment.

Following the recommendation by the PRI (2016b), retirement benefits schemes in Kenya should ensure that the prudent investment policy statement defines investment goals using financial measures, such as liquidity requirements and a risk-adjusted return target. The prudent investment policy statement should be informed by each scheme's approach to risk management, including ESG-related risks and time horizons. Then, the schemes should develop a formal statement of investment beliefs, focusing on the issues that are the most important drivers of investment decisions, including issues of an ESG nature (PRI, 2016b). The trustees can then clearly state the expectations of the scheme in terms of ESG analysis and integration in the terms and conditions of service contained in the instrument of appointing asset managers. In that way, the trustees put the ESG agenda in the hands of the asset managers.

8.4.4 Short-termism and demand for high financial returns

This study found that asset managers are monitored quarterly, and they express concern that the trustees expect them to deliver high financial returns almost at the expense of anything else. As established in Chapter 4, the Retirement Benefits (Occupational Retirement Benefits Schemes) Regulations (2000) provides that asset managers submit a valuation of the scheme fund and all the investments representing the scheme, including details of the cost of such investments and their estimated yields, to the trustees at least quarterly from the date of commencement of the financial year of the scheme. This finding aligns with the literature discussed in Chapter 3, which identifies the quarterly (short-term) performance monitoring of asset managers as one of the causes of short-termism, which is one of the impediments to the growth of RI. As discussed in Chapter 3, short-term performance benchmarks put pressure on asset managers to deliver financial returns to the extent that they forego investing in profitable ventures if they are outside of the current earnings period (Graham et al., 2006). Research shows that an institutional investor that measures fund managers' performance against their benchmarks quarterly is likely to create an environment where short-term results matter and competitive thinking is encouraged (Zarbafi, 2011). Such investors are less likely to engage with investee companies because engagement is a time consuming and costly process.

Further, this study established that asset managers' performance is currently appraised solely on the return on investment, which they say is too simplistic and does not encourage them to think of other ways of investing. Moreover, asset managers are selected through a tendering process and, as they say, the trustees select the asset managers who charge the lowest fees and have delivered the highest returns in the past. As discussed in Chapter 6, the trustees are required to award the tender to the tenderer who submitted the lowest evaluated responsive tender (Public Procurement and Asset Disposal Act, 2015). Since ESG integration is not required by law, it seems logical that the trustees appraise the asset manager based on what they expect them to deliver, and ESG integration is not one of them.

It seems that the best way to meet the asset managers' expectations in terms of skills recognition during performance appraisal is to have the schemes clearly stating their expectations regarding ESG analysis and integration in their prudent investment policy statement and communicate their expectation in the instrument used to appoint the asset managers. Where schemes expect

ESG integration, the asset managers' selection, appointment/reappointment and performance appraisal can be aligned with the expectations of the schemes (PRI, 2016b). Further, the asset managers' contract and fee structure can be aligned with the expectations of the scheme (Johnson & de Graaf, 2009; Kay, 2012; PRI, 2016b).

This study also found that asset managers are appointed by the trustees on a three-year renewable contract. Although research shows that it is common to appoint external asset managers on a three-year contract, internally managed funds have a higher commitment to RI strategies than those managed by external managers (Brammer, Cox, & Millington, 2003). The reason is external asset managers appointed on a three-year contract are usually compensated on short-term performance benchmarks, while internal managers are paid employees who work under longer mandates and receive fixed salaries (Brammer et al., 2003). The longer mandates and stable compensation schemes in the form of fixed salaries create an environment where a stronger commitment to RI is more likely, because it makes more sense to the members of the organisation (Zarbafi, 2011). However, section 9 of the Retirement Benefits (Transitional) Regulations (2000) requires schemes (apart from the schemes that have invested all their funds in guaranteed funds) to appoint external asset managers. In that case, my study suggests that the retirement benefits schemes should develop in-house RI teams that engage in ongoing analysis and research on issues that cause concern and highlight the trends and emerging risks or opportunities that are specific to the company. This information can be used to inform the trustees, who can then amend the prudent investment policy statement accordingly.

Moreover, this study found that the three-year contract is too short for some assets to have matured. For example, private equity projects, and other alternative assets such as property development, take longer than three years to mature. Even though the contract is renewable, there is no guarantee that the asset manager's contract will be renewed, because they go through a tendering process after each tenure. The length of the mandate can discourage an asset manager from investing in such ventures because of the misalignment.

8.4.5 A lack of awareness and expert knowledge of RI practices

The participants of this study revealed that there is a lack of awareness of the potential benefits of RI and a lack of expert knowledge on how to integrate ESG issues in the investment decision-making process. The lack of awareness spreads across the asset managers and the trustees of the retirement benefits schemes. As established, the current curriculum for the Trustee Development Programme of Kenya does not include elements of RI (Association of

Retirement Benefits Scheme, 2020). This study found that the trustees require RI education so that they can drive the demand for RI through the prudent investment policy statements.

As evidenced in the discussion in Chapter 6, some asset managers admit that they are not always conscious of the implications of their investment decisions on the wider society, and others do not view environmental and social factors as material risk factors that can present risks to investments. Still, some tend to equate RI to suboptimal returns, which shows a gap in knowledge of the risks due to ESG factors in the long run. Thus, contrary to the literature, the growing awareness in other markets that financial performance is closely linked to ESG indicators does not seem to have occurred in Kenya. This study found that there is a need for training on how ESG factors can be a source of information asymmetry in the financial markets.

Further, some asset managers identify that they do not have expert knowledge on how to integrate ESG issues into the traditional valuation models, because they do not know how to quantify the ESG information that is disclosed by companies. These asset managers require technical training on ESG analysis to enable them to adopt RI practices.

This finding is consistent with the literature, which identifies a lack of expert knowledge on ESG issues as one of the main challenges for RI development (Eurosif, 2016, 2018; Johnson & de Graaf, 2009; PRI, 2016b). According to the PRI (2016b), many trustees lack the capacity and the expertise to influence the products being offered by investment managers. For that reason, they do not proactively engage with investment managers to encourage them to offer a wider range of ESG-related products. In turn, the absence of clear signals from the trustees to the asset managers that they would be interested in RI products means that asset managers have limited incentive to develop such products (PRI, 2016b).

My study recognises that the CMA and the RBA have the ultimate responsibility of providing investor education to both asset managers and trustees. But I invite the Kenyan institutions of higher learning to partner with these two regulatory authorities to develop training programmes aimed at providing continuous RI education to all actors involved in the investment decision-making chain. The training opportunities should extend to the lawmakers, because they are the ones tasked with the responsibility of developing a legal and regulatory framework that supports the introduction of RI-related instruments, such as social bonds, green bonds and Sharia-compliant instruments. Moreover, given that RI represents a cultural change, my study suggests that it is meritorious to gradually introduce RI subjects to business schools.

In conclusion, it seems that overcoming the challenges for RI development in Kenya will require strategic thinking and a collaborative approach from various stakeholder groups including the government, the regulatory authorities, and the issuers of securities. Despite the identified challenges, this study found that an RI policy framework can play the role of standardising how actors engage with ESG issues. The policy framework would introduce best practice procedures, which are currently lacking in the wider finance sector. Also, RI policy would enable the CMA to meet the conditions necessary for transitioning to MSCI emerging market status by 2023. I will discuss the role that an RI policy framework can play in the following section.

8.5 What role can an RI policy framework play in addressing some of the ESG issues in Kenya?

In line with my fourth research question, this study found that an RI policy framework can play the role of standardising the actors' approach to ESG matters. A policy framework would provide the actors with a reference point, acting as a benchmark of best practice. This finding is consistent with the literature, which recommends the development of sector-wide best practice standards (Johnson & de Graaf, 2009; PRI, 2016a). Even from a conventional fund governance perspective, regulatory authorities should convene a market-specific best practice committee to develop and maintain general standards aimed at improving the governance practices of pension funds (Johnson & de Graaf, 2009).

Similarly, my study found that an RI policy framework for the wider finance sector is necessary to provide a benchmark of best practice regarding RI within the finance market. While this study focuses on the retirement benefits sector, the current regulatory structure reveals that retirement benefits schemes invest in companies that are under various regulatory regimes. As established in Chapter 2, there are several guidelines relating to ESG issues in Kenya. However, there are currently no best practice guidelines on ESG standards that can serve as a guide for all the actors in the retirement benefits sector of Kenya. Research by the PRI (2016a) found that most ESG policies in the world are industry-led, and many lack coherence and are not aligned with wider policy frameworks. The lack of coherence may lead to a lack of support, whereby the policies can be undermined when other pressures take precedence. According to Johnson and de Graaf (2009), a sector-wide best practice standards, which can be used in combination with the "comply or explain" reporting approach, provides the trustees and asset managers with a practical guide.

Given the current regulatory structure, this study anticipates that an RI policy framework is likely to be most effective if it is developed by the National Treasury and communicated to all the regulatory authorities for enforcement. In that way, the actors in the wider finance sector have a reference point and a guide of what is the minimum standard expected regarding ESG integration. Such an overarching approach has been applied in Japan through Japanese Financial Services, an integrated regulator that supervises several regulatory authorities and oversees the adoption of the Principles for Responsible Institutional Investors, which encompasses stewardship and ESG integration (PRI, 2016a).

Also, Eurosif offers an example of best practice guidelines in the EU region (Eurosif, 2018). For instance, Eurosif defines what sustainable and responsible investing means in the EU market and defines the strategies that EU investors can use to engage with sustainable and responsible investing (Eurosif, 2018). Moreover, Eurosif developed the first European framework for sustainable investment products, calling for the European Commission to prepare an analysis of minimum sustainable and responsible investment standards to be respected by manufacturers, targeting all funds as a way to guarantee a harmonious, coherent and transparent market (Eurosif, 2018).

This study also found that an RI policy framework would indirectly enable the CMA to meet the conditions necessary to attain MSCI emerging market status by 2023 (CMA, 2018). As I mentioned in Chapter 1, Kenya needs to increase its proportion of investment to adult population to 30 per cent, from the current 19 per cent. The CMA is attempting to attract international investors, who in turn ask for ESG policies to be developed.

Chapter 9. Conclusion

RI is a rapidly growing movement to the extent that it is now considered as a mainstream investment strategy in regions such as Europe, the USA, and Australia and New Zealand. While it is not commonly practised in Kenya, there is a push from international investors for RI to be established in Kenya. This study explored the challenges for RI development in Kenya. A case study approach involving document analysis, semi-structured interviews and thematic analysis of interview data was undertaken to examine the research questions. This final chapter provides concluding comments.

The rest of this chapter is organised as follows. The first section reviews the empirical findings from Chapters 5, 6 and 7 in light of the research questions first posited in Chapter 1. The next section highlights the challenges for RI development from a developing country perspective, where the financial market's infrastructure is not as sophisticated as what might be found in developed countries. This is followed by the contribution of my study and its implications for RI development in Kenya. A brief discussion of the limitations of this research and suggestions for future research are then presented, followed by concluding remarks.

9.1 Findings – review and discussion

As outlined in Chapter 1, the overall objective of this research is to explore the critical challenges for RI development in Kenya. This objective was examined in a series of four sub-questions: (1) How do the actors in the retirement benefits sector of Kenya conceptualise RI?; (2) What are the main ESG issues in Kenya and do they present material risks or opportunities to the investment decision-making process?; (3) What are the specific barriers for RI development in the Kenyan retirement benefits sector?; and (4) What role can a well-developed RI policy framework play in addressing the identified ESG issues in Kenya?

Regarding the first research question, I used semi-structured interviews and analysed them, following the methodology described in Chapter 4, to explore how the actors in the retirement benefits sector of Kenya define RI. The research findings in Chapter 5 and the discussion in Chapter 8 show that the actors in the retirement benefits sector of Kenya use different terminologies to define RI. The terminologies used are ethical investment; consideration of ESG issues; implementing the mandate; and looking beyond returns. Overlaps occurred in some instances where the participants used more than one terminology to define RI. This study shows that participants' use of different terminologies to define RI can have both positive and negative impacts on the development of the RI market in the retirement benefits sector of Kenya. The lack of a standard definition can inspire RI product innovation and enable differentiation. At the same time, it is confusing and can impede actors' understanding of RI, thereby acting as a deterrent to the development of the RI market.

To answer the second question and to generally understand the Kenyan ESG context, I reviewed documents from the Kenyan government institutions such as Kenya Vision 2030 and the Kenya National Bureau of Statistics, as well as reviewing documents from the World Bank and other agencies of the United Nations. Also, I asked the participants to identify the main ESG issues in Kenya and state if there are material risk factors that can present risks and opportunities to the investment decision-making process. As discussed in Chapters 2, 5 and 6, top environmental issues include variable weather patterns that affect food security; pollution of air, water, and soil; deforestation; and unsustainable farming practices that degrade the soil. The most frequently mentioned social issues are high levels of unemployment; a lack of access to affordable education, health care and housing; poverty; a lack of safe drinking water; and poor sanitation. Finally, corporate governance issues that elicited the most reaction from the participants include corruption (bribery, theft, fraud, and embezzlement); dishonesty and a lack of integrity; a lack of accountability; a lack of functional boards; a lack of diversity in boards in terms of skills and age; and a lack of transparency.

This study found that most of the asset managers interviewed do not regard the environmental and social factors as material factors that can impact on their financial returns. This is contrary to the literature reviewed in Chapters 2 and 3 that shows environmental factors, particularly concern over the effect of climate change as material factors that have received the most attention from practitioners, governments, NGO's, and academics. As discussed in Chapter 2, climate change is the key environmental issue of concern in Europe, USA, Australia and New Zealand, Canada, and Japan. It is driving regulation and interest in green bonds in Europe.

The fact that the participants of this study do not regard environmental and social issues as material factors raise the question of whether the participants would regard these issues as material factors if there was a domestic ESG rating agency in Kenya that provides ESG ratings of the corporations in Kenya. While I believe that there will always be a certain amount of subjectivity and morality involved in deciding what is material and what is not, the participants of this study seem to have adopted the view that those issues do not matter. Thus, I wonder if the services of ESG rating agencies would increase the visibility of these factors and inject some level of objectivity when identifying and measuring ESG data in the form of a rating.

However, some participants recognise that environmental and social issues present business opportunities, and some say they would prioritise investing in assets that are aimed at solving social and environmental issues. But there are limited opportunities for investing in such areas because there are few well-structured assets that can inspire confidence for retirement benefits schemes to invest. As established in Chapter 4, the prudent investment policy described in section 37 of the Retirement Benefits Act (1997) requires fund investment to be invested in a way that schemes maintain their capital funds and generally secure market rates of return on investment.

Another notable finding of this study is that all participants regard issues of corporate governance nature as material factors that present an investment risk, and it is the one factor that they are most concerned about. Most of the asset managers state that they consider corporate governance issues when making investment decisions, but not environmental and social factors. They mostly avoid investing in companies that have inadequate corporate governance structures. The finding that corporate governance is a serious problem for the actors in the retirement benefits sector of Kenya is not surprising given the overall culture of corruption in the country. However, the fact that asset managers consider corporate governance issues as material risk factors and incorporate them in their investment decision making process supports the business case proposition that material ESG factors can add risk to investment portfolios. Secondly, it supports the suggestion that what the market participants think is important or material is what will move the RI market (Hebb et al., 2015). The participants of this study demonstrate this notion in the way that they have started avoiding (negative screening) assets that do not meet their corporate governance standards.

In addressing the third research question, I reviewed the legislation and the related regulations governing the retirement benefits sector of Kenya for an understanding of what the law permits or expects from the sector in terms of RI. Since the schemes invest in registered companies, I reviewed the sections of the (Companies Act, 2015) and guidelines from the CMA that relate to ESG disclosure requirements. Moreover, I asked the interview participants to identify the specific barriers for RI development in the retirement benefits sector of Kenya. The thematic analysis of interview data revealed that there are five specific barriers for RI development in the retirement benefits sector of Kenya. The specific barriers which are discussed in Chapter

6, are concerns over loss of diversification; a lack of ESG data; a lack of demand/incentives from the clients and regulators; short-termism and demand for high financial returns; and a lack of awareness and expert knowledge of RI.

As I have reflected in Chapter 8, the five specific barriers show that implementing RI in an underdeveloped capital market like the Kenyan market is likely to face many complex challenges that are interlinked. The concern over the loss of diversification is one of the major concerns for most of the participants of this study and it is compounded by the extent of corporate governance problems, shrinking the market further. Although concern over loss of diversification is noted in literature as one of the hindrances for RI development in developed countries, the small size of the capital market of Kenya paints a picture of a capital market that is already concentrated. Moreover, the current lack of regulation on private equity funds and venture capital funds does not inspire confidence in retirement benefits schemes to invest in such funds.

Further, the lack of reliable ESG data is equally significant because investment analysts require reliable data to integrate ESG information in investment decision making process. These challenges are further compounded by the lack of awareness and expert knowledge which in turn results in a lack of demand for ESG integration from clients. The fact that the regulatory authorities do not require ESG integration coupled with a lack of demand from clients create little to no incentive for the retirement benefit schemes to integrate ESG issues in their investment decision making processes. While not insurmountable, it seems the identified barriers require systematic and coordinated approach from the government and the actors in the retirement benefits sector.

The last research question explores the role that a well-developed RI policy framework plays in addressing the identified ESG issues in Kenya. First, given that Kenya aspires to move from a frontier economy to MSCI emerging market status by 2023 and must therefore increase the proportion of investment to adult population from the current 19 per cent to 30 per cent, and the CMA efforts to attract international investors are met with a demand for RI policies in the financial market by international investors, developing an RI policy framework would fulfil this requirement and attract more investment to the market. Second, as discussed in Chapters 6 and 8, the RI policy framework would act as a best practice benchmark for actors in the retirement benefits sector. The RI policy framework would complement the existing disclosure guidelines that have been provided by the CMA and the RBA.

However, given that the business case depends on the identification and recognition of ESG issues as material risk factors that can influence the financial performance of an investment, implementing RI policy that is based on the business case perspective will require capacity building to raise awareness about the materiality of ESG issues. I emphasise the environmental and social issues that are currently not perceived as material risk factors. Otherwise, the applicability of the business case is likely to be problematic if the actors continue to perceive these factors as immaterial. Also, identifying, and prioritising material ESG issues is noted as one of the most complicated ESG related decision for managers. Despite the drawbacks, the business case allowed the participants to discuss these issues, bringing them to the fore. While the business case may not address all the ESG issues instantaneously, it is the least that the actors can start with as the debate about how to raise the ESG standards continue.

9.2 Contributions to the empirical body of literature

This study contributes to the literature on the challenges for RI development and practice. Existing literature shows that RI should be understood from a country-specific perspective, because different countries have their own unique set of ESG and other factors, due to political and cultural practices that are unique to each country (Li et al., 2017). This in-depth case study of the retirement benefits sector of Kenya discusses the way ESG factors are manifested in Kenya and explores the practical difficulties of introducing a concept such as RI which is primarily developed and practised in developed countries to a developing country. As such, it contributes to the empirical body of knowledge on RI challenges in a developing country context. However, it not only identifies the main challenges for RI development in the retirement benefits sector of Kenya but also contributes to the knowledge of how such challenges can be overcome.

In addition, this study makes a specific contribution to the literature that speaks of the heterogeneity of the RI market in terms of definition, strategy, terminology and in the way it is practised. As established, many names are used to define RI, some of which are used by the participants of this study. In addition to the existing names, a section of the participants of this study uses a somewhat new phrase to define RI. They define RI to mean the strict implementation of the mandate given to them by the trustees of the schemes. As I have reflected in Chapter 8, this literal definition of RI suggests that the participants would integrate ESG issues if the prudent investment policy statement required them to be considered. If so, and it seems plausible to suggest that they would, then they would be acting in accordance with an RI ethos without necessarily branding themselves as RI investors.

9.4 Implications for practice

In addition to the contribution to academic literature, this study suggests practical recommendations that would facilitate the development of the RI market in the retirement benefits sector of Kenya. The recommendations are:

- The National Treasury of Kenya should establish comprehensive RI policy guidelines, covering the entire finance sector. This requires coordination across the five financial sectors to agree on principles for RI development and implementation. The policy guidelines should clarify what constitutes RI in the Kenyan finance sector and state the minimum standard expected regarding ESG integration. Moreover, the Retirement Benefits Act (1997) and the related regulations should be amended to ensure that consideration of ESG issues is part of the prudent investment policy statement of each scheme. The amendments should encourage longer-term performance monitoring of asset managers to discourage short-term practices that go contrary to RI strategies.
- The CMA and the RBA should build capacity in terms of developing technical training programmes and raising awareness among all the actors in the retirement benefits sector. Further, my study recognises the importance of academic researchers becoming involved, along with the regulators, lawmakers and asset managers, in collaborative and long-term dialogue and engagement exercises that could facilitate a better understanding of how domestic ESG issues affect investment returns.

Overall, my study suggests that RI can only be developed and successfully implemented if the existing ESG-related laws and guidelines are strictly enforced. Since the development of the RI market depends on the disclosure of ESG information, it is crucial that the government establishes legislative follow-up systems to monitor and enforce the disclosure of ESG information accurately and consistently. Some challenges, such as the capital market deepening, will take a long time to overcome sufficiently. However, building up databases and enforcing existing laws and guidelines is achievable in the short to medium term.

9.5 Limitations of this study

The findings of this study may have limited applicability to other settings because this research is setting-specific, that is, it focuses on RI development in Kenya. Thus, data collection and analysis are limited to the retirement benefits sector of Kenya.

The limitation specific to this study is that the participants were selected based on their response to my email invitation. The participants who responded were willing to share their understanding of RI with me. Some asset managers did not respond to my emails. Although the response rate was almost 70 per cent, those who did not participate may have had unique insights to offer.

My opinions and perspectives may have encouraged the development of one-sided conclusions. As discussed in Chapter 4, I addressed this issue by using data-driven thematic analysis and observing the patterns that emerged from the data. I documented the data analysis process, describing how I developed the constructs and the decisions I made in interpreting the data. Through this process, I show the degree to which my findings derive from the data instead of from my biases.

The summary of the key ESG issues in Table 7 is my compilation and it is by no means exhaustive of all the ESG issues. I compiled the factors from the information that I gathered in Chapter 2 and from the participants' responses. I may have left some important factors out without my knowledge. Similarly, the weight that I ascribed to each factor is my construction based on the information provided by the participants and the information I gathered from the document review in Chapter 2.

9.6 Suggestions for future research

This study opens various avenues for research on RI development in a developing country context. As stated, the findings from this study may have limited generalisability to other jurisdictions. Future researchers can extend the findings of this study and discuss how RI can be developed in other developing countries that have slightly different ESG issues and other factors unique to them. It would be interesting to trace the RI journey of Kenya, Nigeria, and South Africa, the three major economies of sub-Sahara Africa.

While this research has explored the challenges of RI development in the retirement benefits sector, future researchers can extend this to include other sectors in the finance industry. Also, this research investigated the challenges for RI development in an institutional investor setting. There is a chance for future researchers to extend this to retail investors.

Further, this study excludes elements of investment theory because some of the theories do not serve the purpose of this thesis. Therefore, questions of how investments are valued and priced are outside the scope of this thesis. Future research can evaluate the risk-adjusted performance of the schemes that integrate any aspect of ESG issues.

9.7 Concluding comments

This study provides elaborate views and country-specific information on the RI scene in Kenya, to both current and future RI investors. By conducting an in-depth study of the retirement benefits sector of Kenya, the study contributes to the literature that speaks of challenges for RI development by offering a developing country perspective. The study shows that RI is growing rapidly and spreading in many countries at a fast rate. Although the strategies differ from country to country, RI thrives in markets that possess a certain combination of factors. These factors include the availability of ESG data, asset managers that possess expert knowledge on ESG integration, supportive regulatory regimes, and demand from clients, to name but a few. Given that most of these elements are lacking in the retirement benefits sector of Kenya, developing the RI market will not happen instantaneously and may require stronger incentives from the regulatory authorities. This study opens avenues for accounting, finance, policy and development studies, in order to continue discussing the potential of RI practices to raise ESG standards and, in the process, help redistribute capital to where it is needed the most.

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Appendices

Appendix 1. Information sheet for participants

Responsible Investment in the Retirement Benefits Sector of Kenya

INFORMATION SHEET FOR PARTICIPANTS

Thank you for your interest in this project. Please read this information before deciding whether or not to participate. Thank you in advance if you decide to participate and if you decide not to take part, thank you for considering my request.

Who am I?

My name is Elizabeth Mathenge, and I am a Doctoral student in the School of Accounting and Commercial Law at Victoria University of Wellington, New Zealand. This research project is work that will contribute to my PhD thesis.

What is the aim of the project?

This research is to explore the challenges for Responsible Investment in Kenya, using the retirement benefits sector as the unit of analysis. The study explores the role that a well-developed responsible investment framework can play in addressing socio-economic, environmental and governance issues facing Kenya today. This research has obtained ethics approval by the Victoria University of Wellington Human Ethics Committee, application ID: 0000025797.

How can you help?

If you agree to take part in the project, I will interview you at your workplace during office hours (at a time that is convenient for you). The interview question will seek your views and opinions regarding responsible investment in Kenya, challenges, and perceived benefits or disadvantages. The interview session will be recorded, and it will last for about one hour. However, you can stop at any time without explaining. You can also withdraw from the study by contacting me at any point one week after the interview. If you withdraw, the information you provided will be destroyed.

What will happen to the information you give?

This research is confidential, which means that only I and my PhD supervisors will be aware of your identity and your name will not be disclosed in any reports, presentations, or public documentation. Moreover, any information that would identify you will not be used in the reports.

I will transcribe the interview and only my supervisors and I will read the notes of the interview. The interview transcripts, summaries and any recordings will be kept securely and destroyed five years after the research ends.

What will the project produce?

The information from my research will be used in my PhD dissertation and academic papers.

If you accept this invitation, what are your rights as a research participant?

You do not have to accept this invitation if you do not want to. However, if you decide to participate, you have the right to:

- choose not to answer any question;
- ask for the recorder to be turned off at any time during the interview;
- withdraw from the study one week after the interview;
- ask any questions about the study at any time;
- read over and comment on a written summary of your interview;
- ask for a summary of findings by emailing me to request a copy.

If you have any questions or problems, who can you contact?

If you have any questions, either now or in the future, please feel free to contact either:

Student: **Supervisor:**

Name: **Elizabeth Mathenge**
Email: elizabeth.mathenge@vuw.ac.nz

Name: Professor Lisa Marriott
Role: Primary Supervisor
School: Accounting and Commercial Law
Phone: 044635938
Email: lisa.marriott@vuw.ac.nz

Human Ethics Committee information

In case of any concerns about the ethical conduct of this research, you may contact the Victoria University HEC Convener: Associate Professor Susan Corbett. Email susan.corbett@vuw.ac.nz or telephone +64-4-463 5480.

Appendix 2. Participants' consent form

Responsible Investment in the Retirement Benefits Sector of Kenya.

CONSENT TO PARTICIPATE IN THE STUDY

This consent form will be held for five years.

Researcher: Elizabeth Mathenge, School of Accounting and Commercial Law, Victoria University of Wellington

I have read the Information Sheet and the project has been explained to me. My questions have been answered to my satisfaction. I understand that I can ask further questions at any time.

I agree to participate in the face-to-face, semi-structured interview session, which will take at least one hour. I understand that I can leave the interview at any point and I can choose not to answer some questions.

I understand that:

- I may withdraw from this study one week after the interview date and any information that I have provided will be destroyed.
- The information I have provided will be destroyed five years after the research is finished.
- Any information I provide will be kept confidential to the researcher and her PhD supervisors. I understand that the results will be used for the researcher's project and a summary of the results may be used in academic reports, journal articles and/or presented at conferences.

- My name will not be used in reports, nor will any information that would identify me.

Signature of participant: ________________________________

Name of participant: ________________________________

Date: ________________________________

Contact details: ________________________________

Appendix 3. Interview questions to participants

Responsible Investment in the Retirement Benefits Sector of Kenya

Semi-structured Interview Questions

Researcher: Elizabeth Mathenge, School of Accounting and Commercial Law, Victoria University of Wellington, New Zealand.

<u>For funds that are PRI signatories</u>

1. What does Responsible Investment (RI) mean to you?
2. What are your motives for engaging in RI?
3. In your opinion, what are the most important environmental, social and governance (ESG) issues in Kenya? How do those factors affect your investment decisions?
4. What strategies does your fund use to influence investee companies on matters of ESG?
5. Do you view RI as a risk-minimising or a value-creating activity? Please explain your answer.
6. Do you think that a well-developed RI framework can play a pivotal role in improving the socio-economic, environmental and governance issues of Kenya? How?
7. What do you think are the challenges for developing the RI market in Kenya?
8. What challenges does your firm encounter in administering its investment policy in Kenya?
9. Do you think that Kenyan citizens are aware of RI benefits?

<u>For funds that are not signatories to PRI</u>

1. What do you understand by RI?
2. Do you view ESG as a material factor that could present both risks and opportunities? Why?

3. Do you view ESG integration as a risk-minimising or a value-creating activity? Please explain your answer.
4. Does your firm engage in RI in any way? Why?
5. In your opinion, what are the most important ESG issues in Kenya? How do those factors affect investment decisions?
6. What are the challenges for developing an RI market in Kenya?
7. Do you think that a well-developed RI framework can play a role in improving the ESG issues of Kenya? How and why?
8. Do your current investment strategies anticipate the opportunities of contemporary investment factors and trends including RI?
9. Does your fiduciary duty extend beyond strict financial benefits for stakeholders?
10. Is positive influence on ESG issues an explicit part of your primary objectives?
11. Are there specific investment preferences based on the nature of your beneficiaries and customers?

For the Retirement Benefits Authority and the Capital Markets Authority

1. What are the overall market dynamics in the Retirement Benefits Industry?
2. Do you foresee possible regulatory changes occurring in the retirement benefits industry soon?
3. What is your definition of fiduciary duty?
4. To what extent will fiduciary duty in the future include responsibility for broad societal interests, such as combating climate change and social inequality?
5. Do you expect policy changes to require investors to incorporate ESG in their analysis?
6. Do you see a trend from a risk-based approach of ESG to more opportunity-based? If so, will this trend continue?
7. What macro trends can you influence?

Appendix 4. Ethics approval

Maggie Teleki

From: researchmaster-help@vuw.ac.nz

Sent: Monday, 14 May 2018 10:59 AM

To: Lisa Marriott; Elizabeth Mathenge

Cc: Maggie Teleki

Subject: Human Ethics Approval 0000025797 (Pipitea Subcommittee). Automated Email, Do Not Reply.

Dear Elizabeth Mathenge,

Thank you for your application for ethical approval (Responsible Investment in the Retirement Benefits Sector of Kenya., reference 0000025797), which has now been considered by the Pipitea Sub-Committee of the Human Ethics Committee.

Your application is approved as of today.

You may wish to check whether there are any new comments on your application. To do this, click on the Comments button (it looks like a speech bubble). If any particular page has comments, they will be marked with a flag on the left-hand side of the screen. To access them, navigate to the desired page, and then click on the Page Comments button (it looks like a speech bubble with a page behind it).

Best wishes with the research.

Pipitea Human Ethics Sub-Committee

*****This is an automated email. Do not reply to this email address*******

Pipitea Ethics subcommittee queries can be sent to pipitea-hec@vuw.ac.nz

Appendix 5. Email to the CEO of the Retirement Benefits Authority

TE WHARE WĀNANGA O TE ŪPOKO O TE IKA A MĀUI
VICTORIA
UNIVERSITY OF WELLINGTON

School of Accounting and Commercial Law

15 June 2018

Mr [name redacted]

Acting Chief Executive Officer

Retirement Benefits Authority

Dear Sir

Responsible Investment in the Retirement Benefits Sector

I write to you to seek your permission to undertake this research project with your industry. The research is an exploration into understanding how responsible investment is conceptualised in Kenya.

This research is part of my fulfilment of the Doctor of Philosophy in Accounting under the direct supervision of the School of Accounting and Commercial Law, Victoria University of Wellington, New Zealand. I am the principal researcher of this project. Ethics Approval has been obtained from the Victoria University of Wellington and research protocols will be observed to maintain confidentially during the research in Kenya.

As part of the data collection, I would like to interview key stakeholders and conduct desktop and documentary analysis on key documents of your industry about how responsible investment is conceptualised and understood from a developing country's context. I am particularly interested in the fund managers and insurance issuers' views and experiences. I am also interested in the views of the RBA as the industry regulator concerning responsible investment.

Your industry has been selected for this study because of its size and the strategic role it plays in the Kenyan financial sector and indeed the whole of the East African region. In this respect, I would like to seek your approval for interviews with the fund managers and insurance issuers who operate within the retirement benefits industry.

I would also like to guarantee you that participation in this research will be voluntary and based on the participants' willingness. This will be further elaborated in the Information Sheet and Consent Form that will be provided to each participant before the interview. These documents will explain the purpose and nature of the project and how the information provided will be handled in terms of confidentiality. With your approval, I will contact them individually to confirm their willingness to participate and their availability for an interview.

The findings of the research project can be made available to your office upon request. It is hoped that findings from this study will contribute to an improved understanding of how responsible investment is understood in Kenya and that this research will help contribute towards improving the Kenyan financial sector.

Your favourable approval will be greatly appreciated.

I can be contacted using the following details.

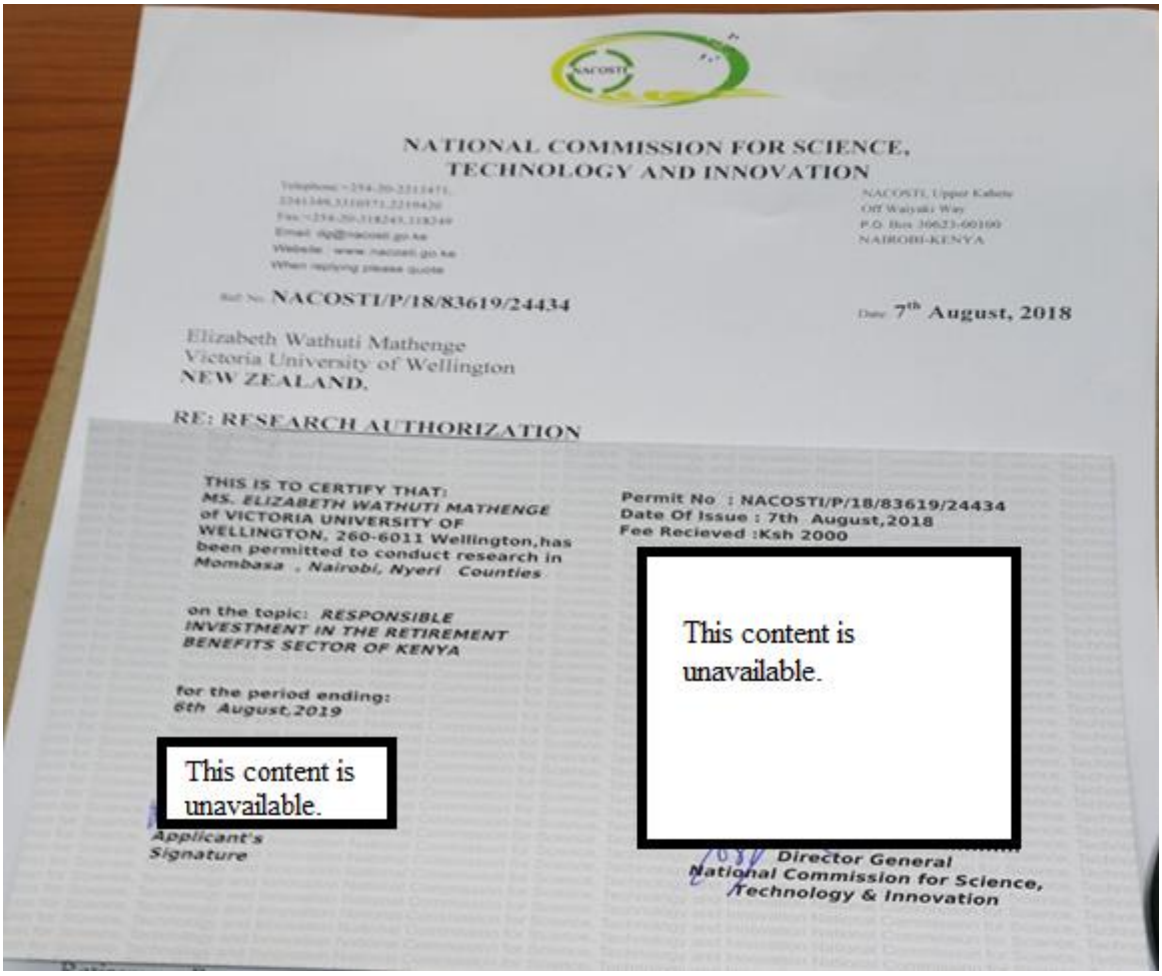
Yours sincerely,

Elizabeth Mathenge

Researcher Detail:
Elizabeth Mathenge
PhD Student
School of Accounting and Commercial Law
Victoria University of Wellington
PO Box 600
Wellington, NZ
Email: elizabeth.mathenge@vuw.ac.nz
Phone: xxxxx

Under Supervision of:
Professor Lisa Marriott
Primary Supervisor
School of Accounting and Commercial Law
Victoria University of Wellington
PO Box 600
Wellington, NZ
Email: lisa.marriott@vuw.ac.nz
Phone: +64-4-463 5938

Appendix 6. Permit to research in Kenya – photo redacted



NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY AND INNOVATION

Email: dg@nacosti.go.ke
Website : www.nacosti.go.ke
When replying please quote

NACOSTI, Upper Kabete
Off Waiyaki Way
P.O. Box 30623-00100
NAIROBI-KENYA

Ref No. NACOSTI/P/18/83619/24434

Date 7th August, 2018

Elizabeth Wathuti Mathenge
Victoria University of Wellington
NEW ZEALAND.

RE: RESEARCH AUTHORIZATION

THIS IS TO CERTIFY THAT:
MS. ELIZABETH WATHUTI MATHENGE
of VICTORIA UNIVERSITY OF WELLINGTON, 260-6011 Wellington,has been permitted to conduct research in *Mombasa , Nairobi, Nyeri Counties*

on the topic: *RESPONSIBLE INVESTMENT IN THE RETIREMENT BENEFITS SECTOR OF KENYA*

for the period ending:
6th August,2019

This content is unavailable.

Applicant's Signature

Permit No : NACOSTI/P/18/83619/24434
Date Of Issue : 7th August,2018
Fee Recieved :Ksh 2000

This content is unavailable.

Director General
National Commission for Science, Technology & Innovation

Appendix 7. Email to participants

Dear Mr John Citizen,

My name is Elizabeth Mathenge, and I am a PhD student at the School of Accounting and Commercial Law, Victoria University of Wellington, New Zealand.

I am researching on responsible investment in Kenya. This research is part of my fulfilment of the Doctor of Philosophy in Accounting under the direct supervision of Professor Lisa Marriott and Dr Jonathan Barrett. I am the principal researcher of this project. Ethics Approval has been obtained from Victoria University of Wellington and research protocols will be observed to maintain confidentially during the research in Kenya.

I am kindly emailing to ask you if you would like to take part in my research. If you agree to take part, I will interview you either at your premises or at a café in the city of Nairobi. Before that, I will provide you with an information sheet, which details your rights as a participant. I will also provide you with a consent form for you to sign before the interview.

Participation is voluntary and you can leave at any point during the interview. The interview will be recorded, and it will take approximately one hour, and your answers will be completely confidential, which means that only I and my PhD supervisors will be aware of your identity and your name will not be disclosed in any reports, presentations, or public documentation. Moreover, any information that would identify you will not be used in the reports.

If you are interested, please reply to me on this email or via my phone number xxxxxxxx

Please do not hesitate to contact me if you have any questions.

Thank you for your time,

Elizabeth Mathenge