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Deutsches Institut für Entwicklungspolitik

German Development Institute

Discussion Paper 18/2021

Employing Capital: Patient Capital and Labour Relations in Kenya's Manufacturing Sector

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Bonn 2021

Discussion Paper / Deutsches Institut für Entwicklungspolitik
ISSN (Print) 1860-0441
ISSN (Online) 2512-8698

Die Deutsche Nationalbibliothek verzeichnet diese Publikation in der Deutschen Nationalbibliografie; detaillierte bibliografische Daten sind im Internet über http://dnb.d-nb.de abrufbar.
The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data is available on the Internet at http://dnb.d-nb.de.

ISBN 978-3-96021-155-6 (printed edition)

DOI:10.23661/dp18.2021

Printed on eco-friendly, certified paper

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Published with financial support from the Federal Ministry for Economic Cooperation and Development (BMZ).

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Abstract

Generating decent employment is key to the creation of a new social contract and social cohesion in Sub-Saharan Africa. The crucial question is, thus, how can more decent jobs be created? Much of the extant research has focused on the role of states and businesses in shaping employment relations. In this paper, we draw attention to a third type of actor that has been largely absent in the literature on the determinants of employment relations in developing countries: financial institutions. Based on data from 38 interviews of Kenyan manufacturing firms, financiers and labour representatives before and during the COVID-19 pandemic, we examine the relationship between the patience of capital and labour relations. In particular, the evidence presented in this paper suggests that access to more patient sources of capital may help to enhance the quantity and quality of jobs in African countries. We discuss three mechanisms through which this occurs. Our paper contributes to the growing body of research on patient capital (which largely focuses on developed countries) by extending it to the context of lower income African countries; it also speaks to the broader debates about how to enhance the contribution of finance capital to social cohesion.

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Abbreviations

AfDB	African Development Bank
CMA	Capital Markets Authority (Kenya)
CME	coordinated market economy
DEG	Deutsche Investitions- und Entwicklungsgesellschaft (German development finance institution)
DFI	development finance institution
ESAP	Environmental and Social Action Plan
ESG	Environmental and social, governance
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
ILO	International Labour Organization
LME	liberal market economy
OHS	occupational health and safety
PE	private equity
SMEs	small and medium enterprises
SSA	Sub-Saharan Africa

1 Introduction

The 2018 African Economic Outlook report concludes, "in the face of rapidly growing populations and heightened risks of social unrest or discontent, jobless growth is the most serious concern for African policymakers". This echoes the concerns among both workers and policymakers on the continent (AfDB/OECD, 2018, p. xv). The African Development Bank warns that 10-12 million new workers enter African labour markets each year, while only 3.2 million jobs are created (AfDB, 2017). Not only the quantity but also the quality of the jobs that are created are of concern. In Sub-Saharan Africa (SSA), where social protection, labour regulations and stable incomes tend to be linked to formal employment, most workers face social insecurity as, on average, around 75 per cent of total employment is informal (World Bank, 2019, pp. 8-9). Moreover, pressure for short-term cost reduction in firms and a lack of enforcement of labour rights by governments or international organisations help to account for violations of workers' rights in developing countries (Barrientos, Gereffi & Rossi, 2011; Mosley, 2017; Rudra, 2007; Ruwanpura & Wrigley, 2010). Generating decent employment has, therefore, become a key social issue in Africa, and there is broad agreement in both the popular discourse and policy debates that the creation of decent employment is essential for the creation of a new social contract and social cohesion (UNRISD, 2016, p. 215; World Bank, 2019).

The crucial question is, thus, how to create more decent jobs in Africa. Much of the extant research has focused on the roles of two types of actors in shaping employment relations in developing countries: the state and its adoption, implementation and enforcement of policies to create decent jobs; and businesses in employment relations. In this paper, we draw attention to a third type of actor that has been largely absent in the literature on the determinants of employment relations in developing countries, namely financial institutions. In particular, we explore whether access to more patient sources of capital enhances the quantity of jobs, which refers to the number of jobs, and quality of jobs, which refers to employment conditions, in African countries and if so, in what ways. We define patient capital as having three characteristics, the first two of which build on Deeg and Hardie (2016) and the third we have identified as important in the context of developing countries. Patient capital is (a) long term, (b) capital that financiers continue to provide to firms despite risks to poor short-term performance and (c) capital that reflects financiers' willingness to assume some exchange rate risks. Both literature on the varieties of capitalism (VoC), a body of work in comparative political economy, and literature on financialisation – which we, following (Epstein, 2005, p. 3), define as the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of an economy – suggest that short-termism in finance may negatively affect employment and labour standards (Amable, Ernst & Palombarini, 2005; Black, Gospel & Pendleton, 2007; Meyer, 2017). However, an important drawback of both the literature in the VoC tradition and on financialisation dealing with employment relations is its limited applicability to the African context and to lower income economies more generally because of differences in the landscape of financial institutions. As the landscape of capital providers differs in Africa, so do financiers' interests and incentives to provide patient capital and, thus, their ability and willingness to shape employment relations. In this paper, we offer a categorisation of capital providers in Kenya in terms of their ability and willingness to provide patient capital and link their patience to employment relations.

Based on data from 38 interviews of Kenyan manufacturing firms and financiers before and during the COVID-19 pandemic, we argue that access to more patient sources of capital may help to enhance the quantity and quality of jobs in African countries. In particular, the evidence presented in this paper suggests three mechanisms through which this occurs. Access to more patient capital may (1) directly enhance the quality and quantity of jobs because patient capital providers tend to care about employment relations and firms are responsive to the interests of their financiers as they seek to avoid a situation where financiers withdraw patient capital because of a lack of responsiveness; (2) directly enhance the quality and quantity of jobs because patient capital enhances the space for firms to pursue long-term growth strategies, which include the expansion of the labour force or the investment in skills that may only generate profits in the longer run; and (3) indirectly enhance the quality and quantity of jobs because patient capital may enhance firm growth, which, in the longer term, may facilitate improvements in the quantity and quality of labour. Our finding that access to more patient sources of capital may help to enhance the quantity and quality of jobs is in line with studies on financialisation and the VoC literature focusing on developed countries. Yet, we offer a conceptualisation of patient capital that looks beyond the time-horizon of investors, and the providers of patient capital that we identify differ from those in developed countries, as do the mechanisms through which they shape outcomes.

The contribution of this paper is threefold. First, we develop a conceptualisation of patient capital in the context of African countries. While much of the existing VoC and financialisation literature on labour relations in advanced countries focuses merely on the length of the time horizon of financiers, we also consider two additional dimensions that are relevant in the context of African countries, which tend to have volatile economies that are vulnerable to external influences but have been missing in the literature. One dimension is the extent to which financiers continue to provide capital when firms go through difficult times; the other, which has been missing in the literature, is whether financiers assume or share exchange rate risks in their provision of capital. We also seek to offer a more wholistic and nuanced picture of who the providers of patient capital are by looking beyond banks and equity markets, to include development finance institutions (DFIs) and private equity (PE) funds, which are central to the landscape of patient capital in many lower income countries, such as Kenya, but are neglected in the VoC and financialisation literature on labour relations.[1]

Second, we offer an empirical contribution by addressing a gap in the literature, which has examined the relationship between patient capital and employment relations only in the context of developed countries, where the providers of patient capital, the interests and the institutional environment differ. Specifically, given the limited public data available, we have conducted interviews with both the providers of capital and Kenyan manufacturing firms as recipients to identify the degree of patience of various capital providers and shed light on the mechanisms linking the provision of patient capital and employment relations in the context of a lower income African country.

1 We use the term "lower income countries" to refer to countries in the World Bank's low income and lower-middle-income category.

Finally, our findings speak to the emerging literature that argues that capital needs to play a greater role in a new social contract if we are to enhance social cohesion. As Meagher contends, generally, the conception of a new social contract focuses

> only on a dyadic contract between citizens and the state, evaluates distributive 'fairness' in terms of inequalities between different types of workers, and represents the unravelling of the old social contract as a product of agentless forces of economic progress. The role of capital is largely airbrushed out of the discussion. (Meagher, 2018, p. 4)

Indeed, the World Development Report (World Bank, 2019, p. 124), for instance, states that a "social contract envisions the state's obligations to citizens and what the state expects in return". This dyadic view is untenable given that domestic and transnational businesses have major impacts on workers by affecting their income, social security and working conditions; on the state, notably through the payment of taxes and social contributions and their engagement with labour laws and regulations; and, as a consequence, on social cohesion. By focusing on the commitments made by some financiers to enhance the quality and quantity of work and the extent to which they live up to those commitments, we seek to move the relationship between capital and labour towards centre stage in discussions about a new social contract and social cohesion.

The next section provides an overview of the relationship between financiers and employment relations. We first provide an overview of the insights we can gain from the extant literature on this relationship that focuses on advanced countries and discuss its limitations. Then we develop a conceptualisation of patient capital in the context of developing countries and delineate our argument about why and how we expect the access to patient capital to shape the quantity and quality of labour. Section 3 specifies our methodological approach and presents the findings of the study. Section 4 concludes by highlighting the policy implications of our findings.

2 Finance and employment relations

Much of the extant research examining the factors shaping employment relations in developing countries has focused on the role of two types of actors: states in developing countries and firms. The first strand on developing country states discusses how states in conjunction with and/or pressured by international organisations like the International Labour Organization (ILO) and non-governmental organisations (NGOs), play a crucial role in the development, adoption and enforcement of labour standards that provide an environment for the growth of decent jobs. While public policies towards labour markets are affected by globalisation, developing country states have also opened up their economies, often in response to pressures by international financial institutions (IFIs), and subjected national labour markets to various aspects of globalisation, such as increased trade, capital mobility and immigration. Research has, thus, looked into the ability and willingness of national governments to pass labour laws and regulations that enhance employment and strengthen labour standards and trade unions (Berliner, Greenleaf, Lake & Noveck, 2015; Mosley, 2017; Payton & Woo, 2014). In addition, the literature has examined the ability and willingness of national governments to devote resources towards the monitoring and enforcement of labour standards and to cooperate with other governments to avoid "race to the bottom" situations in which governments react to the capacity of firms to reduce employment and relocate their production or sourcing to other jurisdictions by lowering labour standards (Amengual & Chirot, 2016; Mosley, 2017).

The second strand of existing research on employment relations in developing countries has focused on the firms employing workers. In particular, there has emerged a rich body of research that explores how the response of firms in developing countries to the opportunities and pressures arising from various aspects of globalisation, such as competition by foreign products and the ability to relocate production, shapes employment relations (Mosley, 2010; Shepherd & Stone, 2013). Much of this work focuses on firms' engagement with labour standards. In line with the more general trend towards private governance (Büthe & Mattli, 2011), and in response to a series of high-profile cases that brought to light harsh working conditions and labour rights violations, multinational companies often jointly with international organisations promoted private sector regulation of labour, where firms implemented their own codes of conduct or subscribed to industry-wide standards. The view underlying such efforts was that, especially in contexts where national governments and international organisations were unable to effect protection of workers' rights, private actors might themselves be able to ensure appropriate labour standards (Mayer & Gereffi, 2010). Research then examined the conditions under which firms were adopting voluntary labour standards and the effectiveness of such standards and their effects on employment (Lim & Tsutsui, 2012; Locke, 2013).

A third type of actor that has been largely absent in the literature on the determinants of employment relations in developing countries, are the financiers of firms. While there is a strand of literature that has examined how IFIs have shaped labour markets in developing countries, research that examines how financial institutions shape the quantity and quality of labour through their provision of financing to firms as creditors and investors in developing countries is scant. This paper seeks to contribute to filling this gap in the literature on employment relations in developing countries by examining whether and how financiers may enhance the quantity and quality of jobs.

2.1 Patient capital and labour in research on VoC and financialisation

Literature on the relationship between finance and employment relations in developed countries has emerged in two distinct but interrelated fields of literature, namely the literature on VoC and on financialisation, both of which suggest that firms that have access to more long-term sources of financing offer more and better employment.

The literature on VoC examines the different historically embedded, institutional environments in which firms operate to explain variation in corporate governance and corporate strategy at the national level. From the perspective of this literature, cross-national variation in institutions creates cross-national variation in corporate strategy (Hall & Soskice, 2001). An important claim of scholarship in this tradition relates to institutional complementarity, namely that nations with institutions providing a particular type of mechanism to solve coordination problems in one sphere are likely to develop certain types of institutions in other spheres.

Typically, the literature contrasts types of economies. The first type is the coordinated market economy (CME), as in Germany and France, where a set of complementary institutions encourages firms to solve coordination problems through the establishment of close relations with labour, other firms and government in a context of incomplete contracts. The second type is the liberal market economy (LME), as in the United States and the United Kingdom, where a set of complementary institutions encourages firms to solve coordination problems by interacting through market relations and enforceable contracts. Importantly, from the perspective of this paper, Hall and Soskice (2001) argue that patient capital provided by banks in long-term relationships with firms is a central institution of CMEs and enables long-term, stable relationships with unions, in which banks promise to finance skill investments and protect workers' specific skills during market downturns in return for success in niche, specific, skill-intensive markets. Patient capital usually refers to long-term capital in this literature and banks can supply two kinds of patient capital: long-term holdings of equity or long-term bank loans (Hardie, Howarth, Maxfield & Verdun, 2013, p. 695). In LMEs, stock markets, as opposed to banks are major providers of corporate finance and dispersed shareholders exert pressure to maximise the value of their shareholdings (Hall & Soskice, 2001). Central to the concept of shareholder value is the idea of companies as a bundle of assets that are deployed in order to maximise shareholders' short-term earnings (Sjöberg, 2008, p. 522). The focus on short-term financial returns in firms listed on equity markets may discourage firms from offering long-term career prospects to employees, which in turn will make employees reluctant to invest in firm-specific training when the payoff of such investments, in terms of long-term career employment, is insecure (Amable et al., 2005; Sjöberg, 2008). Consequently, education and training systems tend to be fragmented in this corporate governance model and/or focus on general skills that are portable between employers (Hall & Soskice, 2001). The key point from the perspective of this paper is that the VoC literature has provided considerable evidence that firms with access to more patient sources of financing have a greater ability and willingness to offer long-term employment and decent working conditions as indicated by lower downward pressure on wages and training of employees by employers than firms with less patient sources of capital (Amable et al., 2005; Black et al., 2007; Sjöberg, 2008).

The second type of literature that has examined the relationship between finance and employment relations in developed economies is the literature on financialisation, which explores the structural transformation from an economic growth regime based on productive investment towards a finance-led economic growth regime, as evident on multiple levels, such as at the national level, the global level, in everyday life and at the sectoral level. While the conceptualisation of financialisation differs in this literature, there is broad agreement that the key characteristics of financialisation include the rise of market-based banking, where banks rely for funding less on the mobilisation of local deposits and more on international capital markets; a greater reliance on financial markets as opposed to banks for financing; and the ascendency of the shareholder value orientation (Hardie et al., 2013; Meyer, 2017; Peters, 2011; van der Zwan, 2014). As van der Zwan (2014, p. 107) explains, researchers have pointed to two interrelated processes in the ascendency of shareholder value resulting from greater reliance of firms on financial markets for funding. First, financial markets exert pressures on nonfinancial corporations (NFCs), and the managers running them, to adopt business practices promoting shareholder value. Second, corporations themselves establish shareholder value by diverting financial market pressure onto other constituents of the firm, in particular the employees. How and why may promoting shareholder value then affect labour outcomes? The main explanation in the literature linking financialisation and labour outcomes focuses on the time horizon of investors, and studies usually use reliance on equity markets as a proxy for reliance of investors with a short-term horizon. Importantly, there is considerable evidence suggesting that when firms rely on financing from investors with short-term horizons, workers suffer poorer outcomes (Dallery, 2009; Gospel & Pendleton, 2003; Lazonick & O'Sullivan, 2000; Meyer, 2017; Sjöberg, 2008). The reason is that investors that have short-term horizons tend to seek to enhance short-term profitability by reducing employment protection, lowering labour costs and reducing investment. In contrast, the involvement of financiers in long-term governance relationships facilitates a greater awareness of the interests of labour and the value of human capital among financiers (Gospel & Pendleton, 2003).

While the empirical connection between the short-termism associated with the rise of shareholder value and a declining quantity and quality of jobs is less straightforward in the context of CMEs due to mediating factors, such as the strength of organised labour, financialisation seems to erode some of the distinctions between CMEs and LMEs. For instance, Hardie et al. (2013) find that large banks in CMEs have become less willing to provide patient capital because they are dependent on international markets for funding, which makes them more vulnerable to financial market pressures and, thus, less able to fulfil long-term commitments to corporate clients. Peters (2011) shows that for both LMEs and CMEs, the ascendency of shareholder value has led many companies to respond to investors with short-term horizons and restructure and lower labour costs by reducing jobs and expanding low-wage employment.

Together, the two strands of literature, VoC and financialisation, provide considerable evidence for developed countries that firms that have access to more patient sources of capital, defined in this literature as long-term funds, are more likely to provide more jobs and better working conditions because they face less pressure to respond to short-term concerns about profitability of investors by reducing labour costs. An important limitation of the literature is, however, that it merely focuses on the context of advanced economies, raising questions about the extent to which the findings can be extended to the context of developing countries.

Some recent empirical evidence from developing countries confirms the claim that firms with access to longer-term finance tend to offer better working conditions. Sommer (2021) finds in a study using more than 17,000 firm-level observations from 73 mostly low- and middle-income countries between 2002 and 2009 that firms with loans of a maturity of more than two years have a significantly higher share of permanent employees and offer more training to their production workers than firms that have loans of a shorter maturity. In addition, Hansen, Ishengona, and Upadhyaya (2018) provide evidence suggestive of an indirect link between finance and better working conditions through firm performance and show that "gazelle" or higher performing firms in SSA offer higher wages.

However, there are limits to the extent to which we can apply the insights from the extant VoC and financialisation literature on finance and employment in developed countries to developing countries because the landscape of capital providers differs in lower income countries. As the landscape of financiers differs, so do financiers' interests and incentives to provide patient capital, and, as a result, their ability and willingness to shape employment relations. In most African countries, equity markets have low capitalisation and low liquidity and banks continue to provide short-term capital despite increases in the financial depth and breadth of the banking sector (Beck, Maimbo, Faye, & Triki, 2011). Instead, development financing institutions (DFIs), often financed by donors, provide long-term financing and support the achievement of social goals, such as the creation of decent jobs.

Moreover, there are at least two other limitations as we seek to apply the findings of extant research to the context of developing countries in general and African countries in particular. One is that using the maturity of debt and equity as a proxy of patience, as much of the VoC and financialisation literature and Sommer (2021) do, seems too narrow a conceptualisation. Given that the core of the argument is that durable commitments by financiers allow firms to offer durable commitments to employees, there emerges the question whether patience has dimensions in addition to the maturity of funds.

Another limitation of the extant literature on financialisation and VoC is that it gives insufficient attention to the characteristics of the holders of equity, such as whether they are pension funds, PE firms or hedge funds, even though this may matter for labour relations as the interests and time-horizons of those actors differ (Deeg & Hardie, 2016; Meyer, 2017). Much of this research does not look beyond the bank-market dichotomy when comparing financial systems. Gospel, Pendleton, Vitols, and Wilke (2011) argue, for instance, that PE firms have mid-term time horizons and are most likely to take an activist role in corporate governance, while hedge funds are less likely to take an activist role but have shorter time horizons and have as a primary goal pressuring managers to increase returns to shareholders. While they find little evidence of a substantial change in labour relations after assumption of ownership by PE funds or increased ownership by hedge funds in case studies of firms in Spain, Germany and the UK, and shares of firms are rarely traded on equity markets in African countries, there is value in paying closer attention to the type and interests of equity holders in African firms.

2.2 A framework for examining patient capital and employment relations in developing countries

While we seek to build on the important insight of the VoC and financialisation literature that access to more patient sources of capital may lead to better outcomes for workers, we seek to offer a conceptualisation of patient capital that can be applied to African countries and address some of the limitations in the extant literature.

When should we consider capital as "patient" in the African context? As already mentioned, much of the VoC and financialisation literature narrowly uses the maturity of debt and equity as a proxy of patience and fails to assess the degree of patience of different equity investors and debt providers as it sticks to the bank-market dichotomy. As Deeg and Hardie (2016) explain, a richer conceptualisation of patient capital looks beyond time horizons and considers also financiers' "loyalty", which refers to their reluctance to exit under adverse conditions. Building on this insight, we consider the following three criteria in assessing the patience of equity investors and debt providers, each of which considers the extent to which concerns about short-term profitability or creditworthiness influences their decisions.

First, the investment or loan is intended for a long rather than a short period of time. As Deeg and Hardie (2016, p. 630) argue, an investment planned to be short-term is by definition motivated by short-term performance and represents low patience. By contrast, an investment planned to be longer term looks beyond short-term performance, representing higher patience. While there are various definitions of short- and long-term financing, we consider an investment or loan intended for less than a year as short term, for one to five years as medium term and for more than five years as long term.

Second, the investor or lender does not exit when the firm experiences difficulties in reaction to poor short-term performance. Using the classic concepts of Hirschman (1970), an investor that exits when there are threats to short-term performance, that is, demonstrates low loyalty, has lower levels of patience; an investor that does not exit has high patience. For instance, if a sector is hit by an external shock (e.g., an agro-processing firm is hit by a drought), a patient investor would not exit as only short-term performance would be affected. Several factors may lead creditors and investors to be more loyal, including regulation and accounting rules that significantly raise the cost of exit, such as a financial transaction tax, the limited availability of alternative attractive investment outlets or unwillingness to lose the private benefits of control, as is often the case for family-owned firms (Deeg & Hardie, 2016, p. 636).

While Deeg and Hardie (2016) consider it a characteristic of patient capital that the investor is not engaged with management in pursuit of short-term share price performance or creditworthiness, we drop this criterion for two reasons. First, short-term concerns about share price performance or creditworthiness are partly captured by the time-horizon of the investment or loan. Second, engagement with management to pursue goals beyond short-term share price performance or creditworthiness is linked with our dependent variable, namely the adoption of strategies to raise the quantity and quality of employment.

Instead, we have identified a third criterion that applies, in particular, to the context of developing countries and has been missing in the extant literature, namely that the investor or lender is willing to take on some exchange rate risk. Many African countries experience, as lower income economies more generally, experience exchange rate volatility, which is partly a consequence of their vulnerability to external economic forces. In addition, there is a tendency among African countries that have floating exchange rates for currencies to depreciate over time or for currencies to not recover after a depreciation caused by an external shock (IMF, 2011). Recent analysis has shown that the pandemic has further weakened the ability of these economies to stabilise prices and exchange rates as the majority of African countries experienced widespread currency depreciation and reduction in reserves in 2020 (IMF, 2020). We argue that where financiers do not lend in their own currency but are willing to provide funds in local currency, they take on the risk that they must bear the costs of a depreciation. This is a form of loyalty that is of particular relevance when the investment or loan is intended for a longer period of time.

We follow Deeg and Hardie (2016, p. 630) in their conceptualisation of patient capital in considering a long-term investment or loan as a precondition for capital to be patient. Specifically, we consider that an investment or loan is long-term as necessary and sufficient for capital to be categorised as patient. We differ, however, in considering patience as a continuous variable with the fulfilment of the other two criteria being neither necessary nor sufficient but enhancing the degree of patience.

As we seek to establish whether the access to more patient sources of capital improves the quantity and quality of jobs in African countries and, if so, in what ways, we also need to specify our dependent variable and the causal mechanism. In this study, quantity refers to the number of employees and quality to working conditions, notably workers' rights and labour standards. Rules covering working conditions may be national or international, like the ILO's Decent Work Agenda, which covers four dimensions: first, rights at work, which are grounded in fundamental principles and international labour standards; second, employment and income opportunities; third, social protection and social security; and fourth, social dialogue and tripartism.

We propose that there are three different mechanisms at work linking the patience of capital and the quality and quantity of work. First, access to more patient capital may directly enhance the quality and quantity of jobs because the more patient capital providers are, the more they tend to care about the social performance of firms as they look beyond short-term profitability. Firms in turn are responsive to the interests of their financiers as they seek to avoid a situation in which financiers withdraw patient capital because firms show a lack of responsiveness to their interests. Second, access to more patient capital may directly enhance the quality and quantity of jobs because access to more patient types of capital enhances the space for firms to pursue long-term growth strategies, which include the expansion of the labour force or the investment in skills that may only generate profits in the longer run. Third, access to more patient capital may indirectly enhance the quality and quantity of jobs because access to more patient types of capital enhances firm growth, which consequently enhances the financial space to increase the quantity and quality of work.

3 Patient capital and employment relations in Kenya

In this section we consider whether variations in access to capital help to account for variation in employment relations within and across firms in Kenya. We conduct a single unit study as opposed to a cross-national analysis because a cross-national analysis would require considerable cross-country variation in reliance on patient capital providers, and we still know little about who supplies patient capital in lower income countries.

We selected Kenya as a case study country because compared with other lower income African countries it has a relatively deep financial market with a wide range of suppliers of firm financing, which allows us to consider the patience of a wide range of financiers and map their patience. As regards the firms, the focus is on SMEs (small and medium enterprises) because they are considered the backbone of African economies as they are important employers, as is the manufacturing sector more generally (UNIDO, 2013). We decided to focus on the manufacturing sector because the drivers of employment relations differ across sectors, especially productive and services sectors. Moreover, in manufacturing formal employment and, thus, the reach of labour regulation tends to be higher than in other productive sectors such as agriculture.

Our analysis is based on 38 interviews with representatives from financial institutions, such as banks, DFIs and PE firms; senior executives from manufacturing firms; representatives from labour and employers' organisations; and senior officials in ministries and aid organisations. All interviewees were guaranteed anonymity. As regards the firms, we interviewed 13 SMEs in the manufacturing sector in Nairobi, which have between 15 and 1,400 employees (the median and the average are 500 employees), covering the wide range in the size of firms categorised as SMEs. The firms are, as the vast majority of the companies in Kenya or in SSA, unlisted on domestic and international capital markets.

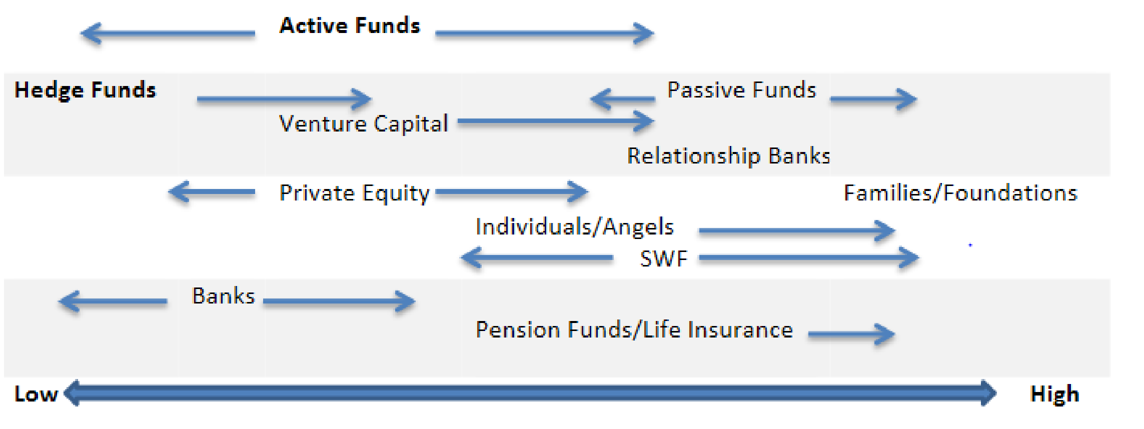
The interviews were conducted in person between November 2019 and February 2020 in Nairobi and through videocalls in November 2020. When assessing the link between patient capital and employment relations, we sought to establish whether the investor was engaged with firm management in employment issues or whether firm management perceived that access to patient capital shaped employment relations. The interviews conducted amidst the COVID-19 pandemic, which hit Kenya's economy hard, allowed us to collect data on the relationship between patient capital and employment relations before the pandemic by asking backward-looking questions, and, by asking questions about the role of patient finance during the pandemic, to gain additional insights into our second criterion, namely whether investors or lenders continued to supply patient capital when there were challenges to short-term firm performance. Moreover, in analysing the data on the effects of patient capital during the pandemic, we also employ counterfactual thinking and consider whether the quality and quantity of employment would have declined without patient finance. The remainder of this section will first provide an overview of the landscape of patient capital in Kenya and then present evidence on the relationship between patient capital and employment relations.

3.1 The landscape of patient capital suppliers in Kenya

The landscape of patient capital suppliers in Kenya differs significantly from that of developed countries, both in terms of the types of actors that supply funds to firms and in terms of their patience (see Figures 1 and 2). For instance, hedge funds and venture capital, which Deeg and Hardie (2016) categorise as relatively impatient capital providers in developed country contexts, hardly play a role in providing financing to SMEs in Kenya, whether in the form of direct investment in firms or through PE firms. Similarly, pension funds, insurance and sovereign wealth funds, which the authors (2016) categorise as relatively patient capital providers, barely play a role in providing, directly or indirectly, financing to SMEs in Kenya. Pension funds in Kenya, for instance, are limited in their investments to real estate and listed public companies and do not invest directly into companies. They are, thus, not relevant suppliers of patient capital to SMEs in Kenya's manufacturing sector.

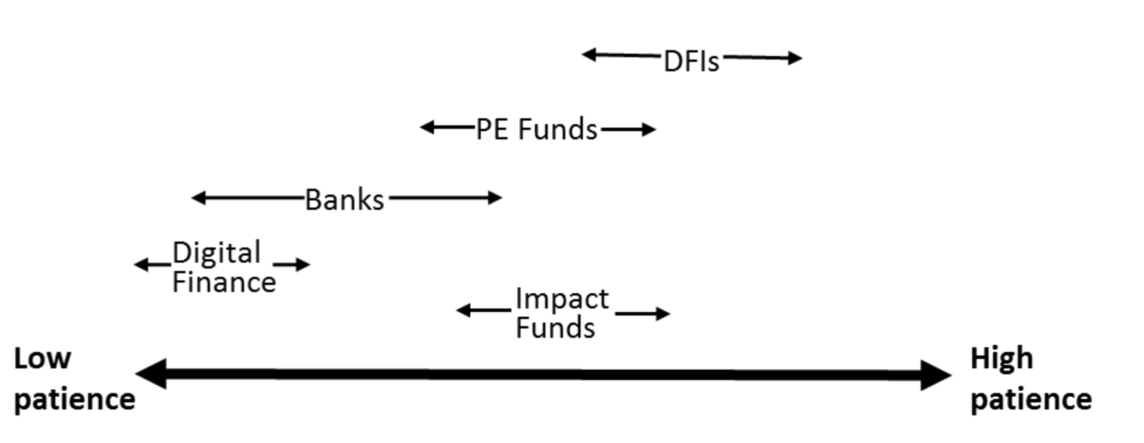
Our interviews and secondary data (for instance, Beck et al., 2011) suggest that there are five main types of suppliers of external capital to SMEs in manufacturing in Kenya, with varying levels of patience: DFIs, commercial banks, PE firms and impact funds. While there has been a proliferation of digital finance providers, we do not consider these, as the lending is extremely short term and not patient. Long-term bonds, particularly corporate bonds, have been recognised as having the potential to fulfil some of the gaps in access to long-term finance for firms (Berensmann, Dafe, & Volz, 2015). However, we do not include them in this case study as the bond market in Kenya dried up after 2015, when two banks and two firms were placed under receivership due to governance issues soon after they raised debt from the market. This decimated the confidence of investors in this market, and there has been only one new issue since 2015 (CMA, 2018).

Figure 1: The continuum of investor/creditor patience for developed countries



Source: Deeg and Hardie (2016)

Figure 2: The continuum of investor/creditor patience in Kenya's lower income economy



Source: Authors

3.1.1 DFIs

The most patient capital providers in Kenya are DFIs, such as Germany's DEG, the UK's CDC (formerly the Commonwealth Development Corporation), France's Proparco, the World Bank's International Finance Corporation (IFC) and the African Development Bank (AfDB), a development bank that also lends directly to firms. DFIs supply funds to SMEs directly in the form of loans or equity stakes. They also offer such funds indirectly though the provision of credit lines to banks for on-lending to SMEs or certain types of sectors and DFI investments in impact funds and PE firms. DFIs are donor organisations and raise their funds through both international capital markets and aid funds. Thus, they not only seek to ensure the financial sustainability and repayment of their investments, but they also have a developmental mandate that includes goals such as environmentally and socially sustainable financial market and private sector development. Given the lack of publicly available data, it is difficult to determine the exact volume of financing that DFIs supply to Kenyan firms, banks and PE funds; how long term DFI finance in Kenya is on average; and, to what extent DFIs actually achieve their social and environmental goals, including in areas such as employment.

In regard to our first criterion, namely that the investment or loan is intended for a long rather than a short period of time, our interview data suggests that of all capital suppliers we consider, their capital is intended for the longest period. Depending on the firm or project, international DFIs tend to have a target investment period that lies between seven and 12 years but may sometimes go up to 15 years (Interviews 1 and 2). No other major capital supplier, besides impact investors and potentially some individuals, provide such long-term finance. This, as a senior DFI official explains,

> technically speaking, means that the companies have longer financial resources that they don't need to repay before a long time. And hence, all the profits and the cash flow generated can be reinvested in the growth of the company and not going to repay the initial investment of a shareholder. (Interview 1)

Moreover, DFIs often build in a moratorium during which, often for two to three years, firms do not have to pay the principal but only interest payments. Given that DFIs can provide financing at subsidised costs and that they do not want to crowd out banks, their funds are more long-term but not necessarily more costly than bank loans with much shorter maturities (Interview 3). When DFIs provide credit lines to commercial banks for on-lending to firms, they ask the banks to consider certain types of environmental, social and governance (ESG) criteria when selecting the borrowers and to report back on fulfilment of the criteria and certain impacts as well. These funds are also intended to be "long-term enough for them to then be able to downstream that to their underlying targets to be able to provide long-term or at least kind of okay maturities to their own clients" (Interview 1). As a senior banker explains, DFI funding "has opened up opportunities for us in the three, four, five, seven year space, which we would not otherwise have done" (Interview 4).

DFIs also stand out regarding our second criterion for patience, namely that the investor or lender does not exit when the firm experiences difficulties in reaction to poor short-term performance. DFIs are more inclined than private investors to provide waivers on repayment of debts or to stay longer on the equity when a company is not doing well. As a senior DFI official explains,

> If the management is delivering, is still committed and acting in the right way, we would tend to be flexible and to be, as you say, loyal, which is for us agreeing to postpone repayments, postpone our exit, wave our interest or our principal repayment for a specific year because, otherwise, it would put the company in a very difficult situation. (Interview 1)

The reasons for the loyalty are that DFIs have, besides the imperative of financial sustainability, a developmental mandate and, as a DFI official explains, reputational costs:

> I don't think a development finance institution which is linked to a state would take the risk of putting a company in bankruptcy for bad reasons. So, the reputational and political risk is too high for France or Germany or the UK to put a company in bankruptcy just because they have missed one payment of interest on principal because the oil prices have doubled over the past few months. (Interview 1)

DFIs are, however, not loyal under all circumstances. For instance, they would be loyal to clients and continue to provide funds or reschedule repayments when short-term performance suffers due to factors outside their control, such as a spike in commodity prices or the COVID-19 pandemic, but less so when the underlying cause is mismanagement or gross negligence

(Interviews 1, 2 and 5). Often, loyalty in the continued provision of funds is supplemented with technical assistance. During the COVID-19 pandemic, DFIs have become more risk-averse and "cherry-picked" new clients, including in their investments in PE and impact funds (Interviews 6, 7 and 8). Yet, they were also keen to demonstrate loyalty to their existing clients, by reaching out to them to discuss their financing reads and supplying new funds when firms fulfilled certain criteria, such as need and good management practices.

While standing out in terms of the first two criteria of patience, DFIs do usually supply their firm financing in foreign currency. The reason is that they raise their funds in international capital markets and tend not to be willing to take on the exchange rate risk (Interviews 1 and 2). As a senior DFI official explains,

> At the end of the day, the kind of companies that we back are the ones that in any case need dollar and are able to generate part of their revenues in dollar because they're exporting. So generally, it's not a massive issue for them that we lend to them in dollar. The problem is more with SME investing or SME lending. SMEs, they cannot afford to have a mismatch between their liabilities, so their debt, and their currency of sales. (Interview 1)

The exchange rate risk is thus likely to be, together with the large minimum amount of DFI investments and the difficulties to fulfil ESG criteria, a reason why few SMEs actually use DFI funding.

3.1.2 PE firms

Second in our ranking of suppliers of patient capital are PE firms. We found there is a considerable heterogeneity of PE firms and the kinds of investment they make. What they have in common in the Kenyan context, and SSA more generally, is that they are largely funded by donors. According to a representative from a PE firm, the structure of investors "varies from fund to fund. Over time it's really gone from, I would say, virtually 100 per cent DFI funding. Today it's around 70 per cent DFI funding" (Interview 9). Other investors include family offices, sovereign wealth funds and funds of funds. PE investors tend to be highly engaged in influencing the management of their investee firms, including by exercising pressure to increase returns and, due to the large role played by DFIs as investors in PE firms on the continent, monitoring compliance with ESG standards. As with DFIs, there is a lack of publicly available data on the volume of finance PE actually supplied to Kenyan firms, how long term PE finance in Kenya is on average, and to what extent PE firms actually achieve their social and environmental goals, including in areas such as employment.

Exit is fundamental to PE's realisation of returns, so they are under significant pressure to achieve their target returns and, hence, work towards a timely exit. Yet, despite pressure to realise a certain return in a limited amount of time, our interview data suggests that PE firms operating in Kenya are patient capital providers if we consider our first criterion, namely that the investment or loan is intended for a long rather than a short period of time. While it is not uncommon to only hold on to investments for four to six years (Interviews 11 and 12), it is standard industry practice to design 10-year investment funds (Interviews 9 and 10). While PE firms are, thus, according to our definition relatively patient, many PE firms and manufacturing firms we spoke to consider this period not long enough. According to a representative of a PE firm her "investing in Africa takes more than 10 years. So, if you're raising a PE firm and you're selling yourself as a 10-year closed fund, you're already exposing yourself to some unrealistic expectations" (Interview 9). As one firm representative, whose firm had received PE investment puts it,

> Private equity ideally would like to do something in five years but at seven years they won't complain, at ten years they are, like, desperate to get out. So, the speed of everything increases when a private equity comes in. And that requires a different style of management. The same person who was running the business at a time when it was a 100 per cent family-owned enterprise would be able to do things in a different way in terms of speed. There is no five-year, seven-year, ten-year type of a target. We can cherry-pick the way we want to do things, you know if I want to, before the private equity came in, I was running the whole business and in between I have to go away for three months to deal with my children's health. Everybody understands that, right, nobody in the family is going to say 'Oh, it's gonna slow down the work of the company'. Now it's not possible. (Interview 13)

PE firms also score relatively high in regard to our second criterion for patience, namely that the investor or lender does not exit when the firm experiences difficulties in reaction to poor short-term performance. That exiting lies at the core of the business model of PE firms operating in Kenya where capital markets are not developed and their funding is, thus, less easily replaced may mean that PE firms have to sell the firms when the timing is not right as the performance of the firm may be impacted by short- and medium-term factors. Therefore, despite the clearly limited time-horizon of PE firms, it is not uncommon that PE firms in the Kenyan context do not exit their investment and liquidate a specific fund at the time originally envisaged, but instead communicate to the investors that they may need more time and postpone the exit (Interviews 9 and 10). As one representative from the PE sector explains,

> I think if you talk about patient capital, it doesn't get more patient than investing in Africa. It's because between elections and inflation and currency concerns, you will really have to be patient. Not so much due to internal factors [i.e., in the client firm] per se, but if you're not able to sell a business because at hard-currency level your profitability is devalued, then no one's buying it. So, you have to sit back and wait for the next best time to sell. (Interview 8)

PE firms have also employed this strategy during the COVID-19 pandemic. According to a sector expert,

> We normally invest, turn around and exit. And I don't know anyone who's exited this year. I don't know anyone who would want to exit in the current environment because of erosion of value. So, they're preferring to hold the portfolio for now….What they are trying to do now is protect the enterprise value of the portfolio. And now what that has led to is a lot more active management from the private capital investors where there's a lot more involvement, not just at a strategic level, but operations. (Interview 8)

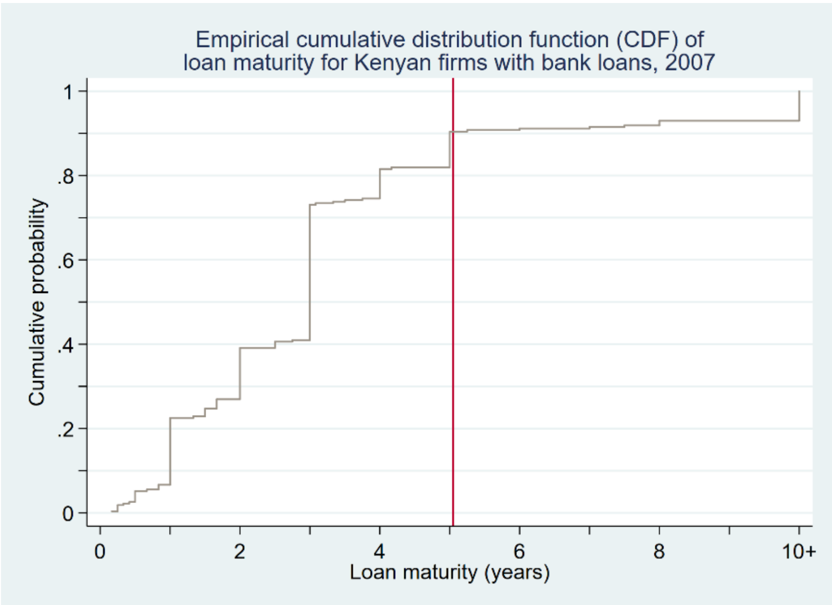
PE firms have, thus, intensified engagement with the firm management and in some cases helped to secure additional finance. It is probably of no small importance for explaining the loyalty of PE firms that DFIs are the major investors in African PE funds, and this enhances their ability to exercise patience.

The drawback of PE funds' reliance on DFIs and other international financiers is, however, that PE funds generally provide funding in hard currency and are, thus, not willing to take on some exchange rate risks of the investee firms. Thus, while PE firms score relatively high in terms of patience in regard to the time horizon of lending and loyalty, they perform poorly in regard to our third criterion. The pressure to realise a certain return within a limited amount of time, the high level of governance and due diligence that PE firms require from the management of PE firms, the fear of losing private control, and exchange rate risks when firms earn revenues in local currency are among the chief reasons why reliance of Kenyan manufacturing on funds from PE firms is limited (Interviews 10, 13, 14, 15).

3.1.3 Banks

Of all the financial institutions we consider in this paper, banks are the most widely used source of formal external finance for Kenyan firms. In 2018, the latest year for which data is available, 43 per cent of manufacturing firms in Kenya had a loan or line of credit from a bank (compared with 37 per cent in other sectors) according to the World Bank's Enterprise Surveys (Enterprise Surveys, 2018). Small- and medium-sized manufacturing firms only receive about 7 per cent and 12 per cent, respectively, of banks' lending to business in Kenya (Berg, Fuchs, Ramrattan, Totolo and Central Bank of Kenya, 2015, p. 15). To get a glimpse at the loan maturity structure, we have to rely on Enterprise Surveys data from 2007: Figure 3 depicts the empirical cumulative distribution function of loan maturities for Kenyan firms with a bank loan (about 41 per cent of Kenyan firms in the sample had a loan then), indicating that only 10 per cent of loans were long term with a maturity beyond five years (Enterprise Surveys, 2007).

Figure 3: Loan maturities for Kenyan firms with a bank loan, 2007

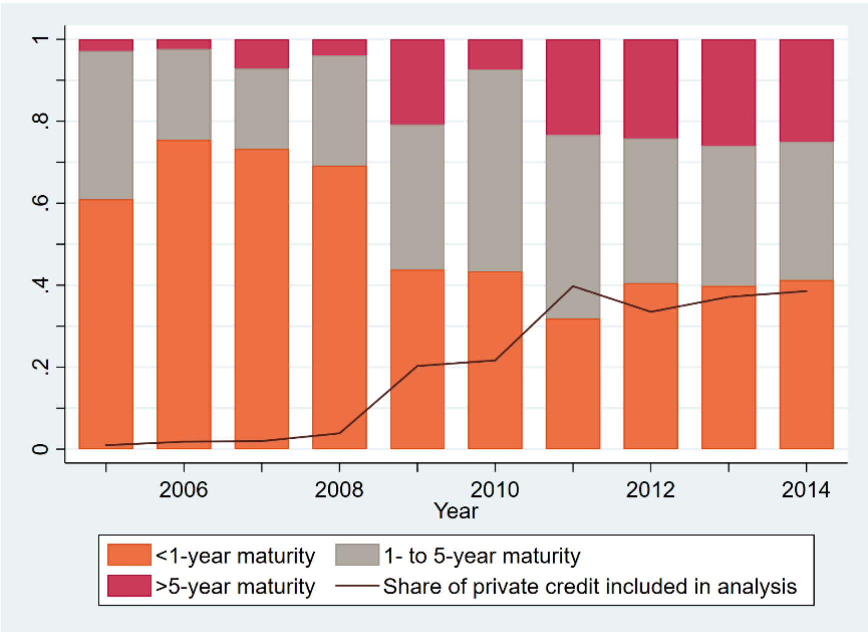


Source: Based on data from Enterprise Surveys (2007)

Compared with the other sources of financing we consider, the availability of data on bank lending is better, but it is nonetheless difficult to say exactly how much financing banks actually supply nowadays to SMEs and manufacturing at which maturity due to differences in the classification of loans across banks and to what extent banks actually monitor social and environmental criteria of their debtors, including in areas such as employment.

If we only consider our first criterion, namely that the investment or loan is intended for a long rather than a short period of time, banks are not a source of patient financing. Gutierrez, Karmali, and Sourrouille (2018), for instance, find for a sample of Kenyan banks that maturities have been lengthening since the 2010s but that about 40 per cent of all credit is short term, with a maturity of less than a year, about 25 per cent is long term with a maturity of five years or more and the rest of all lending is medium term (see Figure 4). Given that Gutierrez et al. (2018) only consider data from an unknown sample of Kenyan banks, we also calculated the maturities of seven major Kenyan banks in 2017 and 2018 and find that on average one third of their lending is long term. Compared with other lower income African countries, Kenya's share of long-term bank lending is, however, relatively high (see Figure 6).

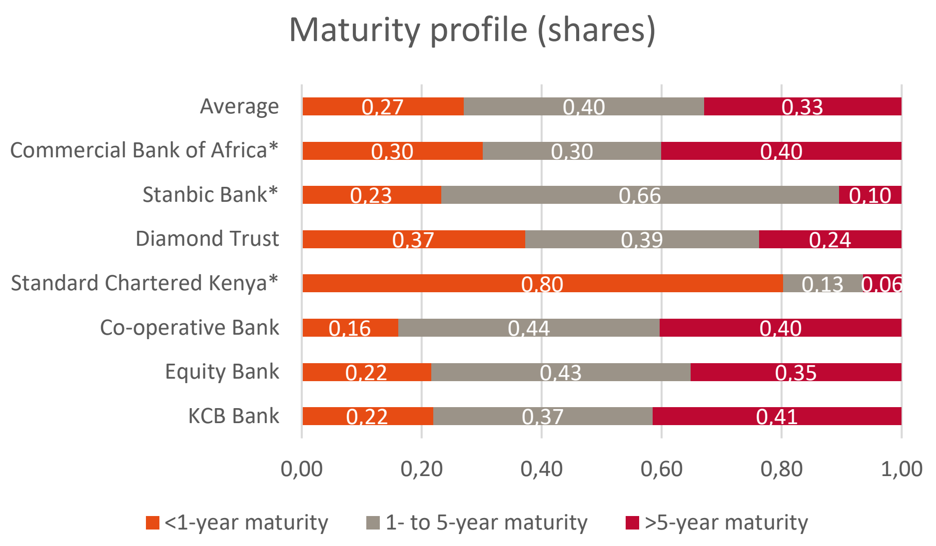
Figure 4: Share of short-, medium- and long-term bank credit in Kenya



Source: Based on data from Gutierrez et al. (2018)

The key reason for the reluctance of banks to lend more long term lies in the liability side. Deposits are usually short-term, running for a period of 12 months or, when rolled over, for a period of up to 48 months. In order to avoid a maturity mismatch in their lending, any lending that is based on the use of these deposits is shorter term. Three main factors allow banks to provide more long-term lending. One reason is that they receive funds from a DFI to expand long-term lending to certain types of businesses. As one senior banker explains, "We have gradually increased our longest tenure loans, especially after our partnership with EIB [European Investment Bank], from about five years to about seven years" (Interview 17). Second, banks may provide collateralised asset financing (Interviews 15 and 21). Third, international banks have the ability (though the willingness depends on the specific project and firm to be funded) to access capital from elsewhere, for instance foreign subsidiaries and international money markets (Interview 16). However, the data above suggests that even those manufacturing firms in need of growth capital hardly receive such long-term funds from banks.

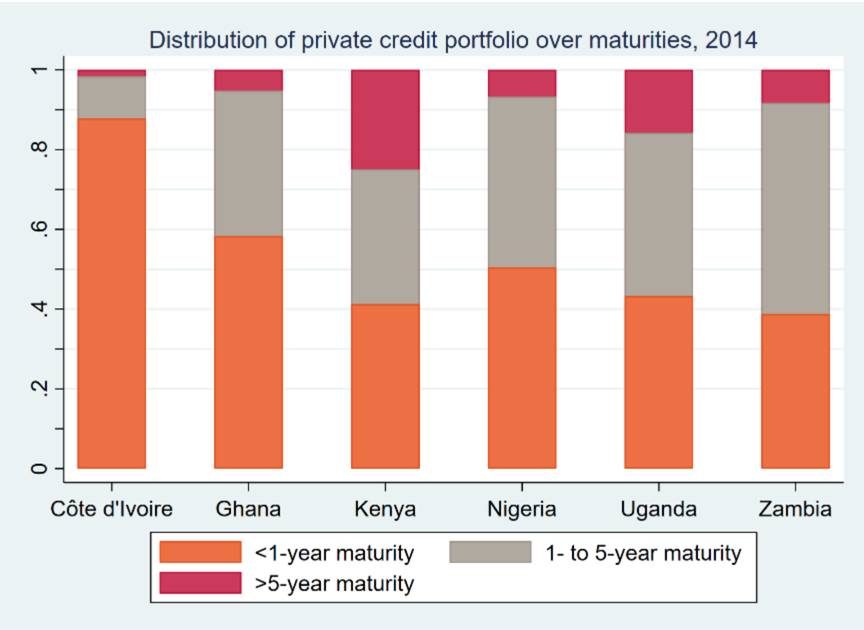
Figure 5: Share of short-, medium- and long-term bank credit in major Kenyan banks



Note: * indicates data is from 2017

Source: Based on banks' 2018 balance sheets.

Figure 6: Share of short-, medium- and long-term bank credit in select African countries, 2014



Source: Based on data from Gutierrez et al. (2018)

Banks perform better in terms of the second criterion, namely that they do not exit when the firm experiences difficulties in reaction to poor short-term performance. Prudential regulation and international financial standards, such as the Basel Standards and the International Financial Reporting Standards (IFRS), constrain regulatory forbearance and provide clear guidelines regarding loan-loss calculations and provisioning for bad loans. It is, for instance, unusual for banks in Kenya to convert loans into equity when their clients are distressed, which was a core feature of the relationship banking practiced in CMEs, according to VoC scholarship. As a senior banking representative explains, in contrast to DFIs,

> commercial banks don't have that liberty of converting loans to equity because of, for instance, governance requirements. The regulation may not allow you to have an equity stake in an entity that you lend to because that's close to insider lending. (Interview 16)

That said, all banks and firms we spoke to explained that banks sought to deal with the opacity of information about the continued creditworthiness of SMEs and challenges to firms' ability to repay loans by intensifying the communication and monitoring of firms, which is at the core of relationship banking (Interviews 13, 15, 16, 17, 18 and 19). When firms present a request to reschedule payments, banks exercise due diligence to ascertain that all the funds were utilised for the intended purpose and to identify the reasons why their clients are not able to meet the obligations, which may happen through discussions with management, on-site visits or an exchange with, for instance, suppliers of the firm. Banks will then develop a plan to reschedule the loans if the firm has a credible strategy to ensure financial sustainability. This approach was also evident during the COVID-19 pandemic. As the Central Bank of Kenya lowered interest rates and gave banks guidelines and leeway to reschedule business loans from 2 March 2020, banks then examined whether their clients, either after having been approached by them or after approaching the clients themselves, would qualify for rescheduling, for instance, in the form of a moratorium on debt repayments (Interviews 15, 18 and 19). In assessing whether the client qualified for a restructuring, the banks then considered the impact that the pandemic had had on their business. While this suggests that banks have been quite loyal during the pandemic, it is worth noting that the Central Bank of Kenya facilitated this loyalty through issuing guidelines for automatic restructuring and providing an environment of low interest rates.

In regard to our third criterion, namely that the investor or lender is willing to take on some exchange rate risk, the evidence is at best mixed. Banks largely mobilise funds in local currency and largely lend in local currency, so they do not assume any exchange rate risks, except if clients specifically ask for foreign currency loans. That being said, when banks get lines of credit from DFIs that are in foreign currency, their on-lending is in foreign currency as well; so, while these loans may be more patient in terms of time and loyalty dimension, they do not meet our third criteria of sharing exchange rate risk. In summary, banks are at the lower end of patience when it comes to lending to SMEs in Kenya due to their shorter-term lending, limited willingness to assume exchange rate risks and considerable loyalty.

3.1.4 Other sources of finance

While DFIs, PE firms and banks are certainly the key actors in Kenya's landscape for formal firm financing, three other players are worth noting, namely, digital finance institutions and impact funds. Impact funds have, like DFIs, a developmental mandate and, thus, consider both developmental goals and financial sustainability in their lending. Both the firms and the financial sector experts we interviewed largely deemed digital finance, offered through banks or by other financial services providers, often through banks, as not patient. According to a senior banking representative,

> When you talk about digital finance, you're basically looking at people who [are] just financing either for consumption [or] for their small business. And that's what we call very high velocity and if there's anything that's the opposite of patient capital it is digital finance because it's money that is available today and may be repaid tomorrow. That's why the digital loans, many of them are repayable within one month. And when you start seeing products being stretched to one year it doesn't mean that somebody has borrowed and you'll repay over one year. It's a revolving facility that is available over a one-year period. Just like an overdraft. An overdraft is basically approved on an annual basis. (Interview 16)

However, as digital financing evolves, there may be room for it to become more patient. A senior banker explains,

> As a practitioner of SME finance, I still think relationship banking is extremely relevant because digital banking has not been – well, it has not evolved to the level where it can address and touch all the parameters of information data points that you need to manage an SME borrower….But you can use elements of digital to augment whatever you're doing in relationship banking. (Interview 17)

The lending of impact funds, in contrast, tends to be relatively patient, as the lending is longer term, sometimes between five and ten years (Interviews 1 and 20). Impact funds' ability to lend longer term rests on their funding from family offices and DFIs, both of which often provide longer-term funding. Often, impact funds provide equity and have a close relationship with their investee firms. As one impact funder explains, providing equity

> gives me a seat on the board, and we insist on meeting every month, so I'm getting a lot of high-quality interactions with the team. And through those interactions, I'm able to assess them, and thankfully, constantly doing diligence, I'm able to assess whether I think this company can make it or not over an extended period of time. (Interview 7)

Close monitoring, in turn, enhances the loyalty of impact funds when short-term performance declines. While their patience is enhanced by offering longer-term lending and being loyal when firms experience short-term difficulties, much of the financing offered is, due to impact funds' reliance on investors from developed countries, in hard currency. Besides the usually limited willingness to take on some currency risk, the limited availability of this form of patient finance is the major drawback from the perspective of firms. While there is a lack of data on the availability of funds from impact funds for Kenyan SMEs, it is fair to say that a negligible number of firms have access to this source of financing (KNBS 2016; Interview 12). In fact, according to a survey of the Kenya National Bureau of Statistics (KNBS, 2016, p. 11), 78 per cent of credit to licensed micro enterprises and SMEs came from commercial banks, followed by microfinance institutions and savings and credit cooperatives.

3.2 The link between patient capital and employment relations in Kenya

In this section, we provide suggestive evidence that the access to more patient sources of capital enhances the quantity and quality of jobs in African countries and examine the mechanisms through which finance has such effects. In examining the link between finance and employment relations, reverse causality and selection bias are important concerns because it may be the case that firms that offer more and better jobs may also have an easier time accessing more patient sources of financing, for instance because good employment outcomes are considered a signal of creditworthiness. Indeed, to qualify for funding from DFIs and PE funds that have DFIs in their investor base, firms need to fulfil certain minimum requirements in terms of labour standards (Interviews 2, 10 and 12). Therefore, we seek to shed light on the causal mechanism linking access to more patient sources of capital and labour relations, tracing the links in the causal chain. In examining the causal mechanism, we also seek to establish whether the influence of finance is direct or indirect. We consider the influence to be direct when the financier requests improvements in the quality and quantity of labour or when the access to longer-term funds enhances the capacity of the firm to think more in the long term, one element of which is investments in the workforce. We refer to the influence as indirect when the financier provides funds that lead to firm growth, which in turn encourages workforce-related improvements.

Another concern is that it is difficult to ascertain the level of compliance with labour standards without actually monitoring the operations of firms closely, which was not possible due to the resource constraints of this study and the COVID-19 pandemic of 2020. Therefore, instead of assessing the level of standard adoption or compliance, we focus on *changes* in policies, strategies and standards at the firm level once the financing is provided.

The remaining section will discuss how labour relations are shaped by the three main sources of formal financing in Kenya's patient capital landscape, namely banks, PE firms and DFIs. In discussing the role of each of these financiers, we also examine how the relationship between patient capital and employment relations was affected when the Kenyan economy was hit by an external shock: the COVID-19 pandemic in 2020. Except for sectors that manufacture essential goods, the pandemic has had a negative effect on labour, increasing the number of layoffs. As a trade union representative explains,

> We are taking COVID as a double tragedy because we already had, before COVID… a very huge unemployment rate. Then COVID comes, disrupts businesses, the young manufacturing firms, some of them have closed shop and we don't see any hope of them being revived again. So that's a double shock, for the young unemployed workers, and they are many. (Interview 22)

We expect, therefore, employing counterfactual thinking, that access to more patient sources of capital helps to retain staff and put in place measures that enhance working conditions in the face of COVID-19. As we will see, our evidence supports this claim.

3.2.1 DFIs

Our analysis of DFIs, which provide long-term financing in the form of both loans and equity, is consistent with the claim that access to more patient sources of financing has positive implications for labour. In particular, we find that DFIs shape labour relations directly, by encouraging firms to expand employment and strengthen labour standards.

Such encouragement, which takes place once the DFI has begun to provide funds, may take two forms. First, it may come as technical assistance. As a senior DFI official puts it,

> As part of our funding, we usually provide some funds, which are called Business Support Services. What we do in these Business Support Services, we identify areas in

> the business which need improvement, in form of human resource capital, in form of training or development of environmental policies or development of [human resources] policies, ESAPs [Environmental and Social Action Plans]. (Interview 2)

Second, the DFIs have regular reporting mechanisms to monitor to what extent the firms they provide funding to have expanded the workforce or improved labour standards, especially in areas the DFIs deem deficient (Interviews 1, 2 and 3). To check the quality of the reporting, the DFIs may occasionally conduct on-site visits and organise an external audit of the firm. Monitoring intensifies when the quality of the firm's reporting deteriorates. As a senior DFI official explains,

> As long as the company is doing well, it is not a problem to report because there is management ability, bandwidth to report on all the different things. When things are starting to go bad, then it is hard to collect the data. This is not the priority anymore. (Interview 1)

Next, interventions may follow. According to another DFI official,

> If you don't submit the report that we require from you, or [are] submitting them late, that already is a red flag for us. So, we prefer that our clients are just honest and tell us: we don't have this and this and we help them…. We have a whole back-office operation that looks at this information and red flags, once they are raised, they are able to immediately plan visits, go sit down and talk to the management and come up with remedial measures before it becomes a bigger problem. (Interview 2)

When it turns out that firms do not report accurate numbers and are unwilling to correct policies, they are in breach of contractual obligations and risk losing future funding. However, "given the importance of DFIs in this market…it is pretty rare that people take the risk," explains a senior DFI official (Interview 1), with DFIs "providing potentially up to a third of the financing needs in this market". Importantly, our interviews with DFIs suggest that the channel through which DFIs provide funds shapes the extent to which they can influence employment relations. Commenting on the extent of influence on and involvement in labour relations, a DFI official explains that it is

> quite a lot actually, particularly in direct investments, I mean less so on the debt side, it's a bit harder, unless the firm itself asks for it…. On the equity side, obviously we are a little better positioned to dictate, kind of some of the things we need to see from the firm, from the investee and the sort of transitions in progress we want them to make…. On the social side, you know, it's about ensuring they have the right policies and procedures in place for their staff at the very base level; it's also about safeguarding and educating their staff on sort of, you know, it could be anything to do with gender biases. (Interview 5)

In fact, when the DFI provides equity, it is usually represented at the board of the investee company. "So, by definition, we are engaged and involved in the definition of the strategy and in the follow-up of the implementation of the strategy", explains a DFI representative (Interview 1). As another DFI official comments on the monitoring of loans,

> With the loan it is relatively low, unless there are specific strategic reasons for us to be involved. We tend to collect monthly and quarterly data and assess it, whether there is any intervention required, then we do that. We do relatively regular assessments…. But unless it is a large strategic client, in which case immediately after the loan you might

> have other engagements… we are relatively hands-off when it comes to loans. (Interview 3)

The least engagement and monitoring occurs when DFIs provide funds to banks for on-lending to firms. While banks must report for each credit line whether the funds reach the targeted beneficiaries and how the firms score on ESG indicators, a DFI official admits that efforts to achieve labour-related and other developmental goals are weaker than for their direct financing activities: "I will not say that the reporting is always perfectly done and that the objectives are always met" (Interview 1).

During the COVID-19 pandemic, DFIs intensified their monitoring of and support to extant clients. As a DFI representative explains,

> On the fund side, we work with our fund managers to make sure that… they were looking for the right things, cash management, trying to help them through correct employee practices, you know, retrenchment and things like that. (Interview 5)

Another area in which the DFIs have stepped up support is occupational health and safety (OHS). According to a DFI official,

> That has been a key focus area… because a lot of these manufacturing entities can't necessarily work from home, so you want to see, do they have sufficient health and safety measures to deal with this pandemic. Not the routine OHS issues that they usually have to deal with. (Interview 28)

In sum, our findings suggest that DFIs have both the ability and willingness to improve the quantity and quality of employment. This *willingness* rests on their mission to look beyond short-term profitability and achieve wider social goals. The *ability* to improve labour relations originates in the pressures that firms seeking to continue to receive long-term DFI financing feel because of concerns that DFIs withdraw financing if firms demonstrate insufficient efforts to achieve employment-related goals.

3.2.2 PE firms

We also find evidence for PE, which provides both longer-term financing in the form of equity, that is consistent with the claim that access to more patient sources of financing has positive implications for labour. We find that PE shapes labour relations mostly directly. In particular, our interviews with PE firms and firms receiving PE funding confirm that PE firms shape labour standards through our first channel, namely by encouraging firms to strengthen labour standards. Like DFIs, PE investors that sit on the boards of companies and tend to have DFIs as major investors in the African context, closely monitor the policies and operations of their investee firms and require regular reporting from the managers of the firm on elements of firm performance, including in the area of employment. As a company executive director confirms,

> There are board committees, and I would say 80 to 90 per cent of engagement is through that structure. But even if things are not going right in the company, targets are not being met or there are other concerns around governance or performance or senior-level [human resources]. Then we will see private equity individuals come and start

> having meetings outside of committee meetings and board meetings. Then they would want to engage with us and find out what is happening. (Interview 13)

The extent to which PE investors monitor changes in the quantity and quality of employment depends, as the executive director of a company explains,

> largely on who is funding the PE fund. So, on the investment committee of the PE Fund X there are some DFIs. And those need to have reasonably strong ESG – environment, social and governance – standards in place. It is not just kind of a nice to have. It's a critical requirement for the DFI to report back to their stakeholders that our portfolio is ESG-compliant. And that then trickles down to us where the private equity would send at least once a year someone who comes and then does an ESG-audit, you know identifies various gaps. We then have to put in actions and investments to close those gaps. (Interview 13)

The PE investor might then help to arrange trainings of the work force or mobilise some additional financing for labour-related investments. One firm, for instance, reports that PE investors provided some grant funding for health- and safety-related improvements, such as gas masks and lavatories, and fan extraction systems "that we would otherwise not have had access to. That has helped us a lot" (Interview 15). We did not find evidence that PE shapes employment relations in firms indirectly, through our third channel, by increasing firm growth, which may be because access to PE funding is still a relatively recent phenomenon. Yet our evidence is consistent with the claim that PE firms may shape employment relations directly through our second channel, namely by enhancing the space for firms to pursue long-term growth strategies through the provision of longer-term capital. The director of one firm responded, for instance, when asked about the effects of PE capital on job creation,

> The fact that we have [PE] capital will allow us to move to that place because we can see a predictability to our manufacturing processes, how many machines will be used, and, therefore, comfortably appoint people to permanent posts, whereas without that, we will not have done it. (Interview 15)

Even though firms occasionally complain about the intensity of the monitoring and the expectation to justify their actions vis-à-vis their PE investors (Interviews 10 and 13), they feel intense pressure to be responsive to the interests of their investors as unresponsiveness equals a breach of contract with potentially legal and, given the PE firms ability to exit, financial implications. As a PE firm representative explains,

> The companies must adhere to ILO or labour laws, right? ... And the companies who don't and no company fully complies with anything and so what you do is you have an action plan it's called an ESAP…. So, we sign it off as a contract, what they are going to do, what the company is going to do. (Interview 12)

Other reasons that firm owners, who know that PE investment comes with a loss of control, might be willing to enter this sort of financing arrangement are that the firm has a significant capitalisation problem and needs long-term capital (Interview 15) or that, as one company representative explains, the firm is "not looking so much at the financing, but we want the expertise, as well, to come in with the PE" (Interview 21).

While PE firms seem to have a positive influence on labour standards, the effect on the quantity of employment is more ambiguous. On the one hand, our evidence suggests that

PE investment may allow firms to maintain staff when companies are in dire need of capital and facing pressure to downsize (Interview 14); hire people for new, higher ranking positions, such as human resources, as part of a professionalisation process (Interviews 12 and 23); or just considerably expand the sales of a company (EAVCA, 2016, p. 19), which is likely to expand employment. On the other hand, PE's focus on increasing efficiency may actually reduce employment due to automation, outsourcing or the introduction of new ways to measure performance, as well as hiring and firing staff based on these performance measures. As one firm representative reports, with PE investment,

> headcounts are going down. So, I think it's again the difference between a family-owned company where you are running a marathon versus when, you know, when you are a private equity co-owned space, it's definitely not patient in any sense of the word…. I think the word 'dehumanise' is wrong because that paints a bad picture…. Private equity never, rarely, ever looks at your past performance. Private equity is always looking at your current and future performance. So, even if somebody has been a superstar employee in the past, if they can't contribute to future performance, then that person has very little value. So, if that's the culture at the board, right, because when you got a private equity in then that culture obviously permeates….then the [human resources] committee is essentially driving that message through the management that the management has to become, a bit more ruthless with a performance-based culture as opposed to a loyalty-based culture. (Interview 13)

During the COVID-19 pandemic, PE firms intensified their monitoring of and support to extant clients, especially in the area of employment. According to a Kenyan PE representative, while environmental issues moved to the background,

> protecting work, protecting jobs was one of the big things that COVID brought out this year. Preserving human or employee earning capacity, right? And then tied to governance was also, and interestingly so, how are women being supported in this day when they have to work from home having children in the background. (Interview 8)

In fact, a survey the PE representative carried out in July 2020 in which 16 PE firms operating in East Africa participated suggested that of all the concerns PE firms had regarding their investee companies, labour issues were ranked highest (Interview 8).

In sum, the findings suggest that PE firms have, overall, both the ability and willingness to improve the quality of employment. This willingness rests on their mission to look beyond short-term profitability, which is mainly due to their patient DFI funding. The ability to improve labour relations stems from the pressures that firms seeking to continue to receive long-term PE investment feel because of concerns that PE investors will withdraw financing if firms seem unresponsive to the interests of their investors. That said, the effect on the quantity of employment is more ambiguous. On the one hand, PE firms may encourage an expansion of employment as part of their strategy to enhance firm growth and by providing the financial base to expand staff numbers. On the other hand, the drive for efficiency may result in declining numbers of staff and outsourcing of positions.

3.2.3 Banks

Our analysis of banks, which provide shorter-term financing in the form of loans is consistent with the claim of this study that access to more patient sources of financing has positive implications for labour. In particular, we find that banks’ focus on short-term profitability means that they have less incentives to encourage firms to expand employment and strengthen labour standards. As we will see, banks’ effect on employment relations seems to have become more positive when banks’ patience increased during the COVID-19 pandemic.

Regarding banks’ engagement with the employment relations in the firms they are financing, it is important to differentiate between normal bank loans and the loans given through credit lines that banks receive from DFIs. As regards the normal bank loans, which, as we have seen in Section 3.1, are predominantly short-term, banks increasingly request some reports from the firms, in line with the increasing pressure on banks to become responsible financiers and consider ESG standards (Interviews 13, 16, 17, 18). As one firm explains, “you know the relationship we have with our bank is the occasional whatever reports that they want from us… they have the relationship manager once in a while to check how things are going” (Interview 13). That said, the reporting merely focuses on very basic standards that are anyway enshrined in national law, such as the use of child labour or compliance with tax rules, whereas reporting requirements of DFIs and PE firms look beyond what is legally required. Moreover, except when there are gross violations, which are likely to affect firm performance and creditworthiness, firms do not fear that banks will scale back their financing when there are labour issues. One firm manager explains,

> Banks don’t care about these metrics whatsoever. For them it’s about your interest coverage ratios and it’s your cash flows. They don’t want to know if you’re a good employer or you’re a good environmentally responsible corporate. Those are all nice to have, but they’re not more than lip service from the bank. I don’t think any bank will, if your cash flows and your numbers make sense, deny you a loan if your environmental record is not good. (Interview 24)

Monitoring of labour increases, however, when banks provide more longer-term financing. As a senior banking sector representative explains,

> I think if you’re going into a long-term relationship with our customer, and that customer is, for instance, in manufacturing… then what is likely to happen is that you’re going to look at it from a longer-term standpoint. And that long-term standpoint is basically from a risk management standpoint. Now if you’re a good risk manager… you have to go beyond this guy ticking a box [saying] ‘I have all the NEMA [National Environment Management Authority] certification’…. There’s a social angle to it where you look at whether by investing in a certain enterprise you are generating jobs, for instance, even if it’s not hitting your bottom line in generating of jobs… Banks are not going to look at it philanthropically, but they’re saying I’ll generate the job which has a social angle to it, but those jobs that have been generated will create future customers. So that’s the sustainability angle. (Interview 16)

That said, banks rarely provide longer-term loans, except if they have funds from DFIs. In this case, as we have already explained, the reporting requirements on issues, such as labour, increase and banks get monitored in regard to the extent to which loans are provided for the intended purposes (Interviews 1, 4 and 18). Note, however, that when firms receive bank loans through the DFI credit line, banks are largely required to collect data, not to enforce the compliance of the firm with certain labour standards.

While the bank representatives that we interviewed claimed that their lending had a positive effect on the quantity of employment in their client firms, none of the banks systematically tracked such impacts (Interviews 4, 17 and 18). They perceived the link to be largely indirect, by supporting firm performance, which in turn allows an expansion of the workforce. As a senior banker explains,

> I mean the capital allows them to stay afloat and continue production, even if I didn't follow through whether it sustains jobs. It makes a difference between what level of productivity you are able to achieve and none at all, so to the extent that there is access, I can almost guarantee yes, it's been able to sustain jobs, if not grow them. (Interview 4)

That any potential effects are indirect is in line with the claims of firm representatives that it would be unsustainable to borrow to pay salaries and that salaries are considered operating expenses and, as such, are financed from current earnings (Interviews 13, 25 and 26).

Interestingly, as the patience of banks increased during the COVID-19 pandemic, the effects of bank lending on the quantity of employment become more visible. As already explained, the Central Bank of Kenya instructed banks to look at their portfolios and facilitate a restructuring of loans for firms fulfilling certain criteria in order to support the private sector during the pandemic. As a result, banks remained loyal to their customers despite risks to their short-term performance. Specifically, banks extended new financing and granted extensions more easily, which helped firms to retain staff. According to one firm representative, "the banks allowed us to let the overdraft drift to some degree to ensure… protection of people" (Interview 15). Another firm also reports that continued access to bank financing was central to retaining staff "because there was a period, literally, where we were not selling anything, and we just had to keep going. And basically, our own financing mechanisms helped us to continue without having to reduce jobs" (Interview 21). Patient bank finance during COVID helped, as one firm representative puts it, "because if the banks were reluctant to give us finance, then we will not be able to grow, in which case, we would not be able to employ" (Interview 14).

In sum, the findings suggest that usually banks have few incentives to improve the quantity and quality of employment as they are largely concerned about the short-term creditworthiness of their client firms, corresponding to their short-term lending. It is only through public interventions, for instance in the form of DFI credit lines or pressure to be more patient in the face of the COVID-19 pandemic, that banks become more patient and we find greater evidence that is suggestive of a positive impact on employment relations or at least of measures that have the potential to improve employment outcomes.

4 Conclusion and policy considerations

The evidence in this paper suggests that access to more patient sources of capital may help to enhance the quantity and quality of jobs in African countries. In particular, we find that access to more patient capital may directly enhance the quality and quantity of jobs because the more patient capital providers are, the more they tend to care about the social performance of firms as they look beyond short-term profitability. Firms, in turn, are responsive to the interests of their financiers as they seek to avoid a situation in which financiers withdraw patient capital because of a lack of responsiveness to their interests. We also identify a second causal mechanism, namely that access to more patient capital may directly enhance the quality and quantity of jobs because access to more patient types of capital enlarges the space for firms to pursue longer-term growth strategies, which include the expansion of the labour force and investment in skills that may only generate profits in the longer run. There is also some evidence to suggest a third causal mechanism, namely that access to more patient capital may indirectly enhance the quality and quantity of jobs because access to more patient types of capital enhances firm growth, which consequently enhances the financial space to increase the quantity and quality of work.

Our paper seeks to contribute to addressing gaps in the literature on the relationship between patient capital and employment (Black et al., 2007; Deeg & Hardie, 2016; Gospel & Pendleton, 2003; Hall & Soskice, 2001; Hardie et al., 2013; Meyer, 2017; Peters, 2011), which largely focuses on developed countries, by conceptualising patient capital in the context of African countries and providing empirical evidence on this relationship from a lower income country.

Moreover, our findings speak to an emerging body of literature (Breman & van der Linden, 2014; Meagher, 2018; UNRISD, 2016, p. 934) that argues that capital needs to play a greater role in a new social contract if we are to enhance social cohesion. In particular, we find that there is a lack of transparency regarding the amount of patient capital provided by DFIs and PE and its impacts because such data is not publicly available. Given that both types of financiers use public financing sources and thus taxpayers’ money, making such data publicly available would enhance the accountability and allow researchers, NGOs and other stakeholders to assess the impacts of their activities more easily.

In addition, the findings of this paper suggest that DFIs can enhance their impact on employment relations by ensuring that they monitor the impact of all their investments – debt, equity and credit lines – through banks. While channelling DFI funds through commercial banks might seem less costly in terms of the administrative costs, this is likely to come at the expense of developmental impact if DFIs do not find ways to ensure that the firms that receive funds face greater pressure and support to enhance the quantity and quality of employment.

Our research also suggests that we can enhance the contribution of finance capital to employment relations by ensuring that DFIs supporting PE firms monitor and request from PE fund managers greater efforts to address any potential negative effects of PE financing on the quantity of employment.

Another policy implication of our research relates to the lack of patient capital in local currency. In order to reduce the exchange rate risks for firms, it is necessary for DFIs, impact funds and PE firms to increase the availability of funding in local currency.

Finally, the findings of our paper suggest that governments can influence the degree of patience in the financing landscape and that this can serve as a lever to affect employment positively. As we saw, the Central Bank of Kenya increased the patience of banks by facilitating rescheduling, which had a positive effect on employment. While this is not an option for normal times, governments may consider other ways to enhance the patience of financiers. One option for the regulatory authorities may be to consider a change in liquidity ratios so that deposits that are short-term on paper but never move out of banks are categorised as longer term, allowing banks to do more long-term lending. Furthermore, regulators can encourage banks to collect data on the impact of their lending in terms of employment. More generally, governments in developing countries and donors should place greater scrutiny on digital finance providers and the extent to which they provide long-term, patient financing. Many of the current efforts in the donor community and by developing country regulators support an expansion of digital finance even though, due to its primarily short-term nature, it has limited developmental benefits in areas such as employment and bears financial risks. Instead, long-term public finance and the promotion of relationship banking promises to hold greater developmental benefits. What emerges from this is that there is no shortage of options that we can consider for enhancing the patience of various capital providers and, in turn, their outcomes for labour. What is left for policy and research is to assess these options in the context of African countries and "bring finance capital back in" when it comes to defining responsibilities of key actors in a new social contract.

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Appendix

Table A1: List of cited interviews

Interview number	Type	Place, Date
1	DFI	Nairobi, 14 November 2019
2	DFI	Nairobi, 11 November 2019
3	DFI	Nairobi, 27 February 2020
4	Banking sector	Nairobi, 11 November 2020
5	DFI	Nairobi, 18 November 2020
6	DFI	Nairobi, 8 November 2019
7	Impact fund	Nairobi, 23 November 2020
8	PE	Nairobi, 24 November 2020
9	PE	Nairobi, 13 November 2020
10	PE	Nairobi, 12 November 2019
11	PE	Nairobi, 26 November 2020
12	PE	Nairobi, 26 November 2020
13	Manufacturing firm	Nairobi, 20 November 2019
14	Manufacturing firm	Nairobi, 25 November 2020
15	Manufacturing firm	Nairobi, 14 November 2019
16	Banking sector	Nairobi, 4 December 2019
17	Banking sector	Nairobi, 30 November 2020
18	Banking sector	Nairobi, 30 November 2020
19	Manufacturing firm	Nairobi, 18 November 2020
20	Manufacturing firm	Nairobi, 18 November 2020
21	Manufacturing firm	Nairobi, 23 November 2020
22	Trade union	Nairobi, 23 November 2020
23	Manufacturing firm	Nairobi, 13 November 2020
24	Manufacturing firm	Nairobi, 12 November 2019
25	Business association	Nairobi, 13 January 2020
26	Manufacturing firm	Nairobi, 5 December 2019
27	Manufacturing firm	Nairobi, 12 November 2019
28	DFI	Nairobi, 7 December 2020

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