



CM ADVOCATES LLP



PERFORMANCE-BASED FINANCING: HOW LENDERS CAN USE REVENUE-LINKED CAPITAL TO SUPPORT SMES IN KENYA

Performance-based financing—also widely referred to as revenue-based financing (RBF)—is rapidly emerging as a practical tool for closing the Small and Medium-sized Enterprise (SME) financing gap in Kenya. It represents a fundamental shift away from traditional collateral-driven lending and toward financing models that align repayment obligations directly with business performance.

For lenders seeking to serve SMEs more effectively, performance-based financing offers a commercially credible, scalable, and enforceable approach to deploying capital, while managing credit risk in a more adaptive and commercially grounded way.

What is Performance-Based Financing?

Performance-based financing is a structured form of private credit in which repayment is linked directly to the borrower's commercial performance, most commonly measured through revenue or operating cash flows.

Instead of imposing fixed instalments, the SME remits a contractually defined percentage of revenue until the lender achieves an agreed capped return.

The structure therefore responds dynamically to business activity:

- When revenues increase, repayments accelerate.
- When revenues decline, repayment pressure eases.
- Repayment is linked to actual outcomes rather than static projections.

This distinguishes the instrument from both conventional loans and equity investments. It is not collateral-heavy debt, nor does it dilute ownership like equity. Rather, it is a contractual, performance-linked financing arrangement with a defined cap.

Why SMEs in Kenya Need Performance-Aligned Capital

Kenyan SMEs face persistent structural barriers in accessing growth finance. Many operate with limited fixed assets, inconsistent cash flows driven by seasonality, and high sensitivity to interest-rate pressures. Founders are often reluctant to surrender strategic control through equity investment.



Performance-based financing is designed for enterprises with strong revenue traction but insufficient collateral or appetite for traditional debt. It provides an effective bridge between working-capital lending and long-term equity financing.

How Performance-Based Financing Works for a Lender

From the lender's perspective, revenue-based financing operates through a straightforward model:

- The lender advances capital upfront.
- The SME commits to pay a fixed percentage of monthly revenue.
- Payments continue until the lender receives an agreed return multiple.
- Obligations terminate automatically once the cap is achieved.

This creates a predictable return framework without imposing rigid repayment stress on the borrower. Lenders can structure RBF as a short-to-medium duration private credit product, a portfolio-based SME instrument, or even as a hybrid mezzanine alternative for growth-stage enterprises.

Why This Model is Attractive for SME Lending

Performance-based financing offers several commercially significant advantages to lenders. First, because repayments track revenue, lenders reduce the risk of borrower distress caused by fixed instalments during low-performance periods. Second, returns are realised through ongoing revenue participation, enabling faster capital recycling than equity exits.

Unlike equity, where return depends on uncertain future valuation events, RBF delivers contractually capped and therefore modelable upside. Furthermore, lender protections can be strengthened through cash-control mechanisms, ensuring repayment is operational as well as contractual.

Finally, SMEs often perceive the product as growth capital rather than burdensome debt, making it more acceptable and supportive of borrower retention.

Practical Steps for Lenders to Implement Performance-Based Financing

For Kenyan lenders and private credit providers, the pathway to adoption is both clear and scalable.

Step 1: Identify Suitable SME Segments

RBF is most effective for businesses with recurring, predictable, or digitally trackable revenue streams;

- SaaS and technology platforms.
- Hospitality and leisure operators.
- Healthcare providers.
- Consumer goods distributors.
- Professional service firms.
- Logistics and mobility businesses.

The core underwriting focus is revenue visibility rather than asset collateral.

Step 2: Develop Revenue Verification Infrastructure

Since repayment depends on revenue accuracy, lenders must implement strong verification mechanisms, including:

- Monthly management accounts.
- Access to bank statements.
- Revenue certification clauses.
- Audit and inspection rights.
- Platform-based payment tracking where applicable.

Ensuring revenue integrity is the critical foundation for contract enforceability.

Step 3: Use Collection Accounts and Waterfall Controls

A defining feature of lender-ready performance-based financing is cash control. SME revenues should be managed through:

- A designated collection account.
- A payment waterfall prioritising lender payment.
- Step-in rights on default through a control notice.

These controls ensure lender repayments are captured directly from active operating revenue streams.



Step 4: Embed SME-Appropriate Security Enhancements

While performance-based financing is typically collateral-light, lenders may still incorporate proportionate credit support to mitigate risk. These enhancements include:

- Floating charge debentures.
- Promoter guarantees (consumer-safe drafting).
- Corporate Holdco guarantees.
- Escrow reserves or revenue sweep mechanisms.

These protections strengthen the bankability of the facility without compromising SME accessibility.

Step 5: Price the Instrument as Hybrid Private Credit

Lenders should categorize Revenue-Based Financing (RBF) as a hybrid private credit product, with pricing determined by:

- Revenue stability.
- Sector risk profile.
- Return multiple.
- Expected duration.
- Strength of cash-control architecture.

This approach ensures disciplined underwriting that extends beyond the limitations of traditional interest-rate lending models.

The Strategic Opportunity for Kenyan Lenders

Performance-based financing presents a significant opportunity for lenders to deepen SME market penetration without the structural constraints of collateral-based lending.

This model aligns closely with Kenya's development priorities, supporting:

- SME growth and formalization.
- Job creation.
- Innovation and enterprise scaling.
- Expansion of private credit markets.

For lenders, RBF provides a product that is commercially scalable and legally enforceable when structured with appropriate controls and documentation.

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CONCLUSION

Performance-based financing or revenue-based financing is more than an emerging trend; it is a pragmatic response to Kenya's SME growth-capital gap.

By linking repayments to performance rather than fixed schedules, lenders can deploy capital in a way that supports enterprise expansion while preserving repayment discipline through cash-control architecture, tailored security support, and strong legal structuring.

At **CM Advocates LLP**, we advise lenders, private credit funds, and institutional investors on designing enforceable performance-linked financing structures that reflect Kenyan law and enhance long-term value.

CONTACT

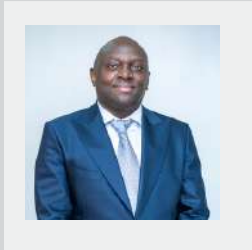
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