

**DETERMINING THE VENTURE CAPITAL
INVESTMENT FRAMEWORK FOR MSMEs: THE
PERSPECTIVE FROM VENTURE CAPITAL
FUNDS IN KENYA**

JULIANA NJERI KAMAU

**SUBMITTED IN PARTIAL FULFILMENT OF THE
REQUIREMENTS FOR THE DEGREE OF MASTERS OF
COMMERCE AT STRATHMORE UNIVERSITY**

SCHOOL OF MANAGEMENT AND COMMERCE

STRATHMORE UNIVERSITY

NAIROBI, KENYA

JUNE, 2011

This thesis is available for library use on the understanding that it is a copyright material and that no quotation from the thesis may be published without prior acknowledgment.

Declaration and Approval

Declaration

I declare that this work has not been previously submitted and approved for the award of a degree by this or any other University. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

© No part of this thesis may be reproduced without the permission of the author and Strathmore University.

Juliana Njeri Kamau

June, 2011

Approval

The thesis of Juliana Njeri Kamau has been reviewed and approved by the following:

Professor Ruth Kiraka

School of Graduate Studies

Strathmore University

Mr. David Wangombe

School of Management and Commerce

Professor Ruth Kiraka

School of Graduate Studies

ABSTRACT

The purpose of this study was to develop the venture capital (VC) investment framework for micro, small and medium enterprises (MSMEs) in Kenya. The study extended previous works done on the venture capital investment process (VCIP) from other countries to the Kenyan context. The researcher collected data in 2010 through in-depth interviews and secondary sources from seven venture capital funds (VCFs). Data were presented and analyzed using cross case matrices, figures and content analysis.

The study examined the three phases of the investment process: pre-investment, investment and post-investment phases. The study explained how VCFs made their investment decisions from when they generated a deal with an MSME until the time they exited from the deal.

The key results showed the differences found in the VCIP in Kenya. The results indicated that MSMEs in Kenya received more benefits at the pre-investment phase. One noted benefit was that VCFs assisted entrepreneurs to prepare business plans. VCFs also educated entrepreneurs on the VCIP thus committed more resources in the pre-investment phase.

The results also showed that micro enterprises did not receive VC because of the risks involved. This was a key result because the expectation was that VC was essentially for micro enterprises. However, market and industry data on micro enterprises were often either inadequate or unavailable thus making it difficult for VCFs to make decisions on investment opportunities and increasing investment risks. The results also suggested that lack of VC associations, local VCFs and inadequate support from the Kenyan government increased the challenges faced by VCFs that attempted to invest in MSMEs in Kenya.

Areas for further research include a study on the entrepreneurs' perspective, to suggest ways to improve the VCIP. Further study is also required on why local investors have not established VCFs in Kenya. A comparative study on the success of those MSMEs financed by debt capital versus those MSMEs financed by VC could also be conducted.

Table of Contents

Declaration and Approval.....	II
ABSTRACT	III
Table of Contents.....	V
List of Abbreviations.....	IX
List of Figures.....	X
List of Tables	XI
Acknowledgments.....	XII
Dedication.....	XIII
CHAPTER 1: Introduction	1
1.1 Background on Kenya’s VC Industry	2
1.2 Problem Statement	3
1.3 Purpose of Study	4
1.4 Objectives.....	5
1.5 Research Questions	5
1.6 Significance of the Study	6
1.7 Delimitations of the Study.....	7
CHAPTER 2: Literature Review	8
2.1 Overview	8
2.2 Characteristics of Micro, Small and Medium Enterprises (MSMEs).....	8
2.3 Venture Capital.....	9
2.4 Benefits Derived From Investing In Venture Capital.....	11
2.5 The Venture Capital Investment Process	13
2.5.1 Pre - Investment Phase.....	14

2.5.2	Post - Investment Phase.....	17
2.6	Challenges facing the Venture Capital Industry.....	17
2.7	Proposed Solutions to the Challenges	20
2.8	Summary of Findings on Key Previous Studies.....	23
2.9	MSMEs and Venture Capital in Kenya.....	29
2.9.1	Venture Capital Industry in Kenya.....	29
2.9.2	Micro, Small and Medium enterprises (MSMEs) in Kenya	30
2.10	Theoretical Framework.....	32
2.11	Conceptual framework	34
	Conceptual Framework Explained	35
2.12	Gap in Literature Review	35
CHAPTER 3: Research Methodology		37
3.1	Overview	37
3.2	Research Design.....	37
3.2	Population and Sampling.....	38
3.3	Data collection.....	38
3.3.1	Interviews and Secondary Data.....	38
3.3.2	Response rate	39
3.4	Data Analysis	39
3.5	Quality of Research	40
3.5.1	Validity.....	40
3.5.2	Reliability	40
3.5.3	Objectivity.....	41
3.5.4	Subjectivity	41
3.6	Limitations of the Study	41

CHAPTER 4: Presentation of Research Findings	43
4.1 Introduction.....	43
4.2 Preliminary Information on Venture Capital Funds in Kenya	43
4.3 Venture Capital Investment Process.....	46
4.4 Criteria in the Pre – Investment phase	47
4.4.1 Deal origination	47
4.4.2 Deal Screening.....	51
4.4.3 Deal Evaluation and Structuring.....	55
4.5 Activities in the Investment and Post-Investment Phase	57
4.5.1 Monitoring and Value Addition Stages	57
4.5.2 Exit Stage.....	61
4.6 Advice from VCF to MSME	63
CHAPTER 5: Discussion on Findings.....	64
5.1 How do VCF make investment decisions? What criteria do VCFs use before investing in an MSME in Kenya?	64
5.1.1 Deal Origination	64
5.1.2 Deal Screening.....	65
5.1.3 Deal Evaluation and Structuring.....	67
5.2 How do VCF operate having invested in an enterprise?	69
5.2.1 Investment Phase.....	69
5.2.2 Post- investment Phase	70
5.3 What recommendation could be offered by VCFs to MSMEs in Kenya?	71
CHAPTER 6: Conclusion and Recommendations	72
6.1 Conclusion.....	72
6.1.1 The Venture Capital Investment Framework for MSMEs in Kenya	74

6.1.2	Revisiting the Venture Capital Investment Framework for MSMEs in Kenya	76
6.2	Implications for Policy and Practice	76
6.3	Areas for Further Research.....	78
REFERENCES		80
APPENDICES		92
Appendix A: Sample Invitation Letter of Study (Venture Capitalist)		92
Appendix B: Semi-Structured Interview Guide.....		93
Appendix C: Venture Capital Funds in Kenya		95
Appendix D: Venture Capital Investing by Venture Stage		96
Appendix E1: Venture Capital Investment Processes for VCFs in Kenya		98
Appendix E2: Venture Capital Investment Processes for VCFs in Kenya		99

List of Abbreviations

CEE – Central and Eastern Europe

CMA – Capital Markets Authority

EU – European Union

EVCA - European Private Equity and Venture Capital Association

ICDC – Industrial and Commercial Development Corporation

IOV – Industrial Organization View

IPO – Initial Public Offering

IRR – Internal rate of return

KEM - Kenya Equity Management

KIPPRA - Kenya Institute for Public Policy Research and Analysis

MOTI – Ministry of Trade and Industry

MSMEs – Micro, small and medium enterprises

NGOs – Non-Governmental Organizations

NVCA – National Venture Capital Association

RBV – Resource-Based View

UNIDO – United Nations Industrial Development Organization

US – United States

USAID – United States Agency for International Development

VC – Venture capital

VCF – Venture Capital Fund

VCIP – Venture Capital Investment Process

List of Figures

FIGURE 2.1 VENTURE CAPITAL INVESTMENT PROCESS MODEL.....	13
FIGURE 2.2 CONCEPTUAL FRAMEWORK	34
FIGURE 4.1 VENTURE CAPITAL INVESTMENT PROCESS	46
FIGURE 6.1 VENTURE CAPITAL INVESTMENT FRAMEWORK FOR MSMEs IN KENYA.....	73

List of Tables

TABLE 2.1 MSMEs DEFINITION	8
TABLE 2.2 STAGES OF VENTURE CAPITAL FINANCING	10
TABLE 2.3 BENEFITS DERIVED FROM THE STAGES OF VENTURE CAPITAL FINANCING ..	12
TABLE 2.4A SUMMARY ON FINDINGS ON PREVIOUS STUDIES	23
TABLE 2.5 VENTURE CAPITAL INVESTMENT CRITERIA BASED ON TWO THEORETICAL FRAMEWORKS.....	33
TABLE 4.1 VCFs COMPANY INFORMATION.....	45
TABLE 4.2 DEAL ORIGINATION	47
TABLE 4.3A DEAL SCREENING.....	51
TABLE 4.4 DEAL EVALUATION AND DEAL STRUCTURING	55
TABLE 4.5A MONITORING AND VALUE-ADDITION	57
TABLE 4.6 EXIT STAGE	62
TABLE 6.1 SUMMARY TABLE OF THE VC FRAMEWORK RESPONDING TO THE PROBLEM STATEMENT.....	72

Acknowledgments

I thank God for His love and guidance all throughout my life.

I thank my parents, brothers and sisters for their continuous support.

Special thanks to Patrick Muteti for his motivation, guidance and support.

I thank Strathmore University for sponsoring me for my Masters of Commerce degree.

Special thanks also to my supervisor Professor Ruth Kiraka for her advice, guidance and motivation throughout my thesis writing.

Special thanks to Professor Gikiri – Thuo and Dr. Robert Mudida for their guidance and support.

I also wish to thank my MCOM classmates for their encouragement and support.

I thank all who have enabled me in one way or another to complete my thesis.

Dedication

This thesis is dedicated to my Heavenly Father, thanking Him for His unconditional Love.

“.....in everything God works for good with those who love him” (Romans 8.28).

CHAPTER 1: Introduction

Micro, small and medium sized enterprises (MSMEs) form one of the most important players for economic growth (Storey, 1994). Accessing financing for entrepreneurs of micro enterprises is not an easy task and because of their short life history and unsteady cash flows these firms have problems accessing capital especially debt capital (Isaksson, 2006). A study by the United Nations Industrial Development Organization (UNIDO) (2001) noted that debt capital was the wrong type of capital for MSMEs. The highly leveraged entrepreneur ended up paying interest rates that deprived the enterprise of funds exceeding their cash-flow capabilities and preventing them from achieving sustainability (Fox, 1996). As debt financing increased firms financial risk, equity financing was seen as the most suitable way to finance MSMEs (Isaksson, 2006). Other than lack of equity financing, these firms also suffered from competence issues (Barth, 1999). Venture capital therefore acts as the bridge for MSMEs equity and competence gap.

Venture capital (VC) is a significant innovation of the twentieth century (Koh and Koh, 2002). It is a subset of private equity focused on MSMEs with perceived long-term growth potential (Holger, 2005). VC is based on the principle that a partnership can be forged between the entrepreneur and the venture capitalists. Pandey (2005) noted that venture capital funds could prove to be a powerful mechanism to institutionalize innovative entrepreneurship.

Venture capitalists are of two types: institutional venture capital funds and angel venture capitalists. Institutional venture capital funds (VCFs) are ran by full-time professionals who seek out and fund promising ventures while angel venture capitalists are wealthy individuals who make venture capital investments (Megginson, Smart, and Lucey, 2008).

Venture financing has four stages: Seed financing, start-up financing, expansion financing and buy-out financing (Appendix D illustrates these four stages). Most institutional VCFs invest in all stages, although some focus on a particular venture stage (Clercq, Fried, Lehtonen and Sapienza, 2006).

In the 1990s, VC was a key investment feature, where venture backed dotcoms and technology companies reaped spectacular returns for private investors in the United States (US). This was the success of the Silicon Valley model in the US. The Silicon Valley model of VC transformed the innovation process in the United States, leading to successful firms for example Microsoft, Apple, Sun Microsystems, Intel, Amazon, Genentech and eBay (Koh and Koh, 2002). The success of the Silicon Valley model has made the US a technology leader, which has led to job and wealth creation. The National Venture Capital Association (NVCA) underlies the importance of VC availability by showing how VC has been a successful tool in supporting high-risk innovative and growth-oriented firms across sectors and regions in the United States (NVCA, 2004).

VC activity is advanced in developed countries and it is taking root in a number of developing countries. Governments in countries for example Singapore, China and India have replicated the Silicon Valley model of VC leading to their current vibrant economies. India and China are superpowers in the making with the fastest growing economies and a strong VC sector (Barnerjee, 2008). Holger (2005) indicates that an economy that does not have a strong VC sector is one that displays symptoms of deeper economic problems.

1.1 Background on Kenya's VC Industry

The VC industry in Kenya can be traced back to the 1960s and 1970s where the government of Kenya established investment companies in particular the Industrial and Commercial Development Corporation (ICDC) (Ngigi, 1997).

However, many such schemes collapsed in the 1990s due to poor management and lack of resources (Kashangaki and Simba, 2008). In the 1990s, the government with donors such as the United States Agency for International Development (USAID) and the European Union (EU) set up VCFs which also closed down due to similar reasons. Acacia Fund was the first private VCF established in the mid – nineties. It was a US regional scheme with a fund of US \$ 20 million. It invested in almost 20 deals yielding positive results over a period of 10 years (Zavatta, 2008). During this time, the legal framework was unclear and restricted the development of the VC industry. It was not until 2007 that the Capital Markets Authority (CMA) published the regulations for VCFs. Acacia Fund was the only locally registered VCF in Kenya (Capital markets Authority (CMA) 2008). Acacia Fund was however acquired in 2008 by Swefund a Swedish VC company (Swedfund, 2008). The current VCFs with operations in Kenya are incorporated in foreign countries but have a legal structure that enables them to carry out their business locally. It is therefore not surprising that the term VC in Kenya is foreign to many entrepreneurs of MSMEs.

1.2 Problem Statement

The 2009 Kenya Economic report showed MSMEs as important players for the growth and development of the Kenyan economy. The report indicated that MSMEs constituted 74.4% of all businesses in Kenya but only contributed 18.4% of country's GDP (Kenya Institute for Public Policy Research and Analysis (KIPPRA) 2009). The Minister for Trade and Industry stated that the reason why the MSME sector was not developing was that it was facing several problems. These included: lack of access to finance; inadequate skills and technology; poor quality of products, inadequate business skills; limited access to information; and limited linkages with large enterprises, which affected the productivity and competitiveness of the MSMEs thus hindering their growth (Ministerial Speech,

2009). InvesteQ Capital Ltd. (2008) in their study also found that access to and cost of financing were major constraints hindering growth of MSMEs.

The then Ministry of Trade and Industry's (MOTI) MSME Competitiveness Project recognized the fact that VCFs would solve these problems (MOTI, 2005). VCFs not only finance MSMEs but also provide professional management skills and strategic support for these enterprises that would curb the problems faced by MSMEs (Koh and Koh, 2002).

This represents a significant research opportunity to develop a framework for MSMEs when seeking VC from VCFs in Kenya.

In the international scene, there is growing literature focused on understanding how VCFs form their decisions regarding their investments (Tyebjee and Bruno, 1984; Roberts, 1991; Chotigeat, Pandey and Kim, 1997; Shepherd, Ettenson and Crouch, 2000; Suksriwong, 2003; Clercq et.al, 2006; Hellquist and Kraljevic, 2006; Yiallourou, 2006). Several questions hence emerge for the VC industry in Kenya. Should MSMEs in Kenya seek VC? If so, what benefits will the MSMEs derive from VC? How do VCFs make investment decisions? What criteria do VCFs use when investing in a particular venture? How do VCFs operate after investing in an MSME? How do the entrepreneurs of MSMEs ensure a positive relationship with VCFs leading to successful ventures?

1.3 Purpose of Study

The purpose of this study was to determine the VC investment framework for entrepreneurs of MSMEs when seeking VC, from the perspective of the VCFs. The study extended previous works done on the VCIP from other countries to the Kenyan context. The study investigated the VCIP through three phases: pre-investment (before making an investment), investment (actual investment) and

the post investment phase (after making the investment). The criteria used by the VCFs in the three phases were identified. Advice was also sought from VCFs on how MSMEs should manage the relationship with the VCFs, maximizing the value of their relationship. Differences found from the VCIP in Kenya compared to previous research were illustrated.

1.4 Objectives

The study was guided with the following research objectives:

- 1) To investigate the pre-investment phase of the venture capital investment process used by venture capital funds in Kenya.
- 2) To investigate the investment and post-investment phases of the venture capital investment process used by venture capital funds in Kenya.
- 3) To create a framework for entrepreneurs of MSMEs on how they can engage in a fruitful relationship with VCFs to ensure successful enterprises.

1.5 Research Questions

The objectives were translated to the following research questions:

- 1) In the pre-investment phase:
 - a. How do venture capital funds make investment decisions?
- 2) In the investment and post-investment phase:
 - a. How do venture capital funds operate having invested in an MSME?
 - b. How should entrepreneurs conduct themselves to ensure a positive relationship with venture capitalists leading to successful ventures?
- 3) What would be a viable framework of engagement between entrepreneurs of MSMEs and VCFs to ensure fruitful relationships leading to successful enterprises?

1.6 Significance of the Study

The study is important for a number of reasons. First, it creates awareness of the VCFs expectations for entrepreneurs of MSMEs. This increases the entrepreneurs' chances in finalizing the investment deals.

Second, it identifies the importance of VC in entrepreneurship development, leading to innovation, technological and economic development.

Third, the study suggests implications for policy and practise which could make VC a more viable and preferred alternative to traditional debt financing and offer public funding options for MSMEs in future.

Fourth, it enables business incubators strengthen their role as facilitators ensuring that incubated firms meet venture capitalists expectations. In this way, the economic resources and efforts allocated to operate and manage business incubators could better contribute to the sustainability of the incubated firms (Callegati, Grandi and Napier, 2005).

Fifth, for centres of innovation in Kenyan Universities, the study provides a link between the university students' innovative ideas and the venture capital industry. It also shows the importance of introducing venture capital as a unit in finance courses within the universities or development of a venture capital programme.

Sixth, for prospective venture capitalists, the study forms a basis for the development of their own, firm-specific VCIP and for existing venture capitalists; it provides a framework to formalize their VCIP.

Last, for academic researchers it contributes to the knowledge in this subject area and highlights areas for further research.

1.7 Delimitations of the Study

The scope of this study has been limited to the institutional venture capital funds in Kenya. The researcher found no structures that could assist in collecting data from angel venture capitalists in Kenya.

CHAPTER 2: Literature Review

2.1 Overview

Chapter Two discusses the literature on venture capital guided by the research questions stated in chapter one. The chapter starts with a brief overview of the micro, small and medium enterprises (MSMEs). Second, it defines venture capital and venture capitalists. Third, the pre-investment and post investment phases of the venture capital process are discussed. Fourth, an overview of the venture capital industry in Kenya is given. Finally the theoretical frameworks guiding the study, the conceptual framework and the gap in literature are highlighted.

2.2 Characteristics of Micro, Small and Medium Enterprises (MSMEs)

The MSME sector is the backbone of any economy and is an important source of economic growth, dynamism and flexibility in developed, emerging and developing economies (Organization for Economic Co-operation and Development (OECD), 2006). The World Bank defines MSMEs as shown in Table 2.1 below and the current study adopted this definition:

Table 2.1 MSMEs Definition

Category	Employees	Turn-over (US \$)
Micro	Up to 10	Up to 100,000
Small	Up to 50	3M
Medium	Up to 300	15M

Source: InvesteQ Capital Ltd. (2008) accessed from the World Bank Group

The formation of the MSMEs is one of the most important factors for economic growth (Storey, 1994). Accessing financing for micro enterprises is not an easy task and due to their short life history and unsteady cash flows these firms have problems accessing capital especially debt capital (Isaksson, 2006). A study by the UNIDO (2001) noted that debt capital was the wrong type of capital for MSMEs. The highly leveraged entrepreneur ends up paying interest rates that deprive the enterprise of funds exceeding their cash-flow capabilities and prevent them from achieving sustainability (Fox, 1996). As debt financing increases a firm's financial risk, equity financing is seen as a most suitable way of financing the MSMEs (Isaksson, 2006). Other than lack of equity financing these firms also suffer from competence issues (Barth, 1999). Venture capital therefore acts as the bridge for MSMEs equity and competence gap (Isaksson, 2006).

2.3 Venture Capital

VC is a significant innovation of the twentieth century (Koh and Koh, 2002). It is a subset of private equity focused on start-up firms and small and medium sized businesses with perceived long-term growth potential (Holger, 2005; Peters, 2009). VC is based on the principle that a partnership can be forged between the entrepreneur and the VCF. Pandey (2005) noted that VCFs could prove to be a powerful mechanism to institutionalize innovative entrepreneurship. Bygrave and Timmons (1992) emphasized that VC has played a vital role in the entrepreneurial process and has sustained economic growth of economies. Mason and Harrison (1999) also noted that VC is recognized globally as playing a key role in innovation, wealth creation and job generation and a key element in government efforts, generating economic growth.

In the 1990s, VC was a key investment feature, where venture backed dotcoms and technology companies reaped spectacular returns for private investors in the US. This was the success of the Silicon Valley model in the US. The Silicon Valley

model of VC transformed the innovation process in the United States, leading to successful firms for example Microsoft, Apple, Sun Microsystems, Intel, Amazon, Genentech and eBay (Koh and Koh, 2002). The success of the Silicon Valley model has made the US a technology leader, which has led to job and wealth creation. The NVCA underlies the importance of VC availability by showing how VC has been a successful tool in supporting high-risk innovative and growth-oriented firms across sectors and regions in the United States (NVCA, 2004). In 2005, nearly €15 billion was invested by VCFs located in Europe (EVCA, 2006). According to NVCA, this figure was roughly 86 percent of the size of the U.S. market (PricewaterhouseCoopers/National Venture Capital Association, 2006).

This shows that VC activity is advanced in developed countries and it is taking root in a number of developing countries. Governments in countries for example Singapore, China and India have replicated the Silicon Valley model of VC leading to their current vibrant economies. India and China are superpowers in the making with the fastest growing economies and a strong VC sector (Barnerjee, 2008). Holger (2005) indicates that an economy that does not have a strong VC sector is one that displays symptoms of deeper economic problems.

Venture capitalists are of two types: institutional venture capital funds (VCFs) and angel venture capitalists. Institutional venture capital funds are full-time professionals that seek out and fund promising ventures while angel venture capitalists are wealthy individuals who make venture capital investments (Megginson et.al., 2008).

Venture capital financing has four stages: Seed financing, start-up financing, expansion financing and buy-out financing. Table 2.2 below illustrates the four stages as described by Clercq et.al. (2006).

Table 2.2 Stages of Venture Capital Financing

Stages of financing	Description
Seed financing	Micro enterprises with one or two entrepreneurs, undeveloped technology and business concept. Business plan not validated
Start-up financing	Small enterprises with management team in place, product ready for marketing. A pilot and other information about the product available
Expansion financing	Medium enterprises where marketing has been started. Venture is ready to start growing and expanding.
Buy-out	Established company

Source: Clercq et.al. (2006), pp 93

Most institutional VCFs invest in all stages, although some focus on a particular venture stage (Clercq et.al., 2006; Peters, 2009).

2.4 Benefits Derived From Investing In Venture Capital

VCFs are interested in the success of the firm they finance and therefore are closely involved in the firm's subsequent development and growth (Yiallourou, 2006). The VCFs add value to the MSMEs by not only providing finance but also implementing better decisions through monitoring the MSMEs, providing non-financial assistance that leads to business survival (Sahlman, 1990; Sapienza and Gupta, 1992). The non-financial support by venture capital funds reduce the costs of information asymmetry and enhance the MSMEs reputation (Black, 1998). Pratch (2005) also stated how VCFs gave useful advice on strategic, marketing and organizational issues, helped in developing strong internal financial management procedures. The VCFs also play an active role developing capital strategies, arranging financing from other investors (Lerner, 1994) and assisting the enterprise when moving towards an initial public offering (IPO) or acquisitions (Gladstone and Gladstone, 2003).

Entrepreneurs of MSMEs benefit from the reputation and networks of contacts from the VCFs. The contacts assist them locate business experts, additional financing opportunities, key service providers, acquisition candidates among others (Pratch, 2005). VCFs serve as a mentor, friend and confidant when MSMEs are faced with challenges and uncertainties. VCFs also play the crucial role of ensuring that the achieved objectives are met and evaluate or replace the management when necessary for the success of the enterprise (Pratch, 2005).

Kortum and Lerner (2000) concluded that VC-backed companies innovate and produce more valuable patents than the non-VC-backed companies produce because they adapt to new technologies faster. VC-backed firms bring their product to market faster while they pursue more aggressive strategies than non-VC-backed firms (Hellman and Puri, 2000).

Clercq et.al. (2006) illustrated as summarized in Table 2.3 below the benefits VC-backed firms derive according to the stages of financing.

Table 2.3 Benefits Derived from the Stages of Venture Capital Financing

Stages of financing	Benefits
Seed financing	• Structure, discipline, sounding board and attraction of additional (external) funding • Insights on how to establish the venture legal form • Technological insights
Start-up financing	• Marketing experience, recruiting help, contacts, help with follow-on financing • Technological insights, test marketing and piloting possibilities • Reputation benefits
Expansion financing	• Marketing experience, recruiting help, contacts, help with follow-on financing, help to plan and execute the exit

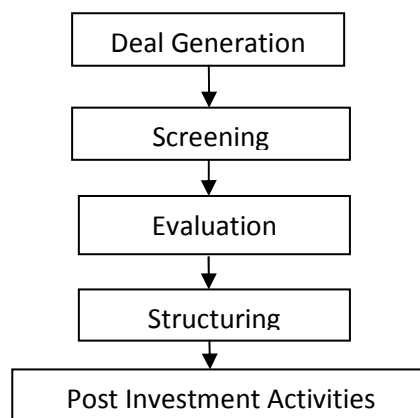
	• Technological insights, test marketing and piloting possibilities • Reputation benefits
Buy-out	• Legal and other expertise on how to execute a buyout deal

Source: Clercq et.al (2006), pp 93

2.5 The Venture Capital Investment Process

When seeking VC, the MSMEs have to take into account the VCIP. Wells (1974) developed the first extensive VCIP that was then modified and elaborated on by Tyebjee and Bruno (1984). Most research done on the VCIP from all over the world has built on the Tyebjee and Bruno model (Sweeting, 1991; Bygrave and Timmons, 1992; Fried and Hisrich, 1994; Manigart et.al., 1997; Bliss, 1999; Chu and Hisrich, 2001; Pandey, 2005; Clercq et.al., 2006 and Klonowski, 2007). Tyebjee and Bruno (1984), proposed a model with five stages: deal origination, screening, evaluation, deal structuring and post investment activities as illustrated in Figure 2.1.

Figure 2.1 Venture Capital Investment Process Model



Source: Tyebjee, T.T and Bruno, A.V. (1984), pp 1053

They distinguished the VCIP into two phases: pre-investment (deal origination, screening, evaluation, deal structuring) and post-investment phases (monitoring,

value-addition and exit). In the pre-investment phase, the MSMEs needed to understand what the VCFs and in the post-investment phase, the MSMEs were able to maintain a positive relationship with VCFs leading to successful enterprises (Clercq et.al., 2006).

2.5.1 Pre - Investment Phase

In the pre -investment phase the entrepreneur needed to perform several activities for him to obtain VC funding (Fried et. al., 1998). The entrepreneur first secured good referrals from his lawyer, friends and industry contacts in getting VC (Shane & Cable, 2002). Gladstone & Gladstone (2003) found that a well prepared business plan and the initial meeting with the VCFs were important criteria in the pre-investment phase.

The stages VCFs undertook in the pre-investment phase were deal origination screening, evaluation and deal structuring (Tyebjee and Bruno, 1984; Fried and Hisrich, 1994; Klonowski, 2007).

Deal Origination

In deal origination, potential deals were brought to the attention of the VCFs from four sources: unsolicited cold calls from entrepreneurs, referrals (venture capital community, prior investees and personal acquaintances), bank referrals and investment brokers (Tyebjee and Bruno, 1984; Klonowski, 2007).

Deal Screening

The criteria for screening the business plans of entrepreneurs of MSMEs were; the size of investment, the industry sector, the stage of financing and the geographical proximity (Tyebjee and Bruno, 1984; Fried and Hisrich, 1994; Shepherd, 1999 and Zacharakis & Meyer, 2000). Fried and Hisrich (1994), Koh and Koh (2002) and Peters (2009) found that VCFs focus was mainly the seed

capital stage. Fried and Hisrich (1994) found two stages in the deal screening stage: VCF specific screening and generic screening. Bliss (1999) found that the criteria in the VCF specific screening were rarely used by VCFs.

Zacharakis and Meyer (2000) found that VCFs would not invest in an enterprise without a business plan. Robert (1991) also emphasized that business plans were important for VCFs to make investment decisions. According to Elango et.al (1995) the significance of business plans varied according to the stage of financing. Clercq et.al. (2006) and Hellquist and Kraljevic (2006) concluded that an important criterion was meeting the entrepreneurs and management team of the enterprises to built rapport with them. VCFs wanted entrepreneurs and management teams that were honest, trustworthy, motivated, and passionate about the venture (Shane, 2003).

Deal Evaluation

This stage was also known as the due diligence phase. Tyebjee and Bruno (1984) noted the criteria were market attractiveness (size and growth potential, market used and ability of venture to access the market), product differentiation (uniqueness of product, technical skills, profit margins/ value added, patents), managerial capabilities (management, marketing, financial skills, entrepreneur background) and competition. Koh and Koh (2002) and Pandey (2005) found that the criterion was quality of the entrepreneur for this stage. Fried and Hisrich (1994) and Clercq et.al. (2006) also found management capabilities as a significant criterion. VCFs also gathered information from external sources to determine if the business plan presented by the entrepreneurs was realistic and achievable.

Klonowski (2007) found several criteria for deal evaluation: quality and breadth of the enterprise management team, a preliminary assessment of the company's

financial projections and the ability to successfully liquidate the investment within three to five years.

Deal Structuring

Tyebjee and Bruno (1984) reviewed researches done by Golden (1981); Cooper and Carleton (1979); Glassmeyer (1981); Leland and Pyle (1977); Ross (1977). They identified three ways of structuring the deal: first by establishing the price of the deal (equity share the entrepreneur would give up in exchange for the venture capital). Second protective covenants were established which limit capital expenditures and management salaries. Third, through a mechanism known as the earn-out arrangement, where the entrepreneur's equity share was determined by meeting agreed upon performance objectives, the VCFs was able to assess the entrepreneur's expectations for the venture (Leland and Pyle, 1977; Ross, 1977).

Pandey (2005) confirmed that the VCFs preferred a deal structured in such a way that their interests were protected, earned reasonable return, minimized taxes, had enough liquidity to operate the venture company and remained in commanding position of the venture. Sahlman (1990), Gompers (1997), Black and Gilson (1998) and Kirilenko (2001) focused on the degree of control exercised by VCFs and confirmed that VCFs enjoyed a disproportionately large degree of control. Kaplan and Stromberg (2003) and Sahlman (1990) concluded that in the deal structuring phase the criteria used were the composition of the board of directors, types of spending that require VCFs approval, the mechanisms given to the VCFs to force a future exit or the terms of the top management's employment contracts. However, the exit route was not an important criterion when making the investment decisions (Jeng and Wells, 1998; Peters, 2009).

2.5.2 Post - Investment Phase

Monitoring and Value Addition

Clercq et.al. (2006) noted that this was the most crucial phase for the entrepreneur. The VCFs engaged in two types of activities: monitoring and providing value addition to the MSMEs. Sapienza and Gupta (1994) noted that the monitoring activities conducted by the VCFs reduced the agency risks associated with VC-entrepreneur relationship. The VCFs added value to the enterprises through their various roles: strategists, financiers, providing contacts, mentoring and ensuring objectives are met (Sapienza, 1992; Clercq et.al., 2006).

Maximizing the entrepreneur and VCFs relationship required that the entrepreneur respected and recognize the expertise, experience and the formal legal power of the VCFs (Shane and Cable, 1997). Regular effective communication and mutual trust were also crucial (Gladstone and Gladstone, 2003). Objectivity between the two parties was also important to avoid compromises when making decisions (Gladstone and Gladstone, 2003).

Exit

A successful exit was achieved when the relationship between the VCFs and entrepreneur in the pre-investment and post-investment phases was successful. Preventing a premature exit and exiting in harmony were crucial points for an entrepreneur (Clercq et.al., 2006). Exits occurred through IPOs, acquisitions, liquidation, buyback of VCFs stock by MSME (Cumming and MacIntosh, 2003; Pandey, 2005; Klonowski, 2007).

2.6 Challenges facing the Venture Capital Industry

The VC industry has faced various challenges in the past 10 years. The key drivers to these challenges have been the commercialization of the internet (1999-

2000), credit crunch and the inability of VCFs to attract viable entrepreneurs (Ghalbouni and Rouziès, 2010).

According to Lerner (2002), the bubble period of 1999-2000 in the United States was due to the imperfect nature of the VC industry. The commercialization of the internet led to VCFs, devoting funding to firms that were uneconomical and attracted too many inexperienced VCFs. Funding was concentrated on the internet and telecommunication investments thus neglecting promising sectors. However, despite the 1999 – 2000 bubble period, the VCFs were still the most efficient financial intermediaries (Lerner, 2002; Amit, Brander and Zott, 1998).

Block and Sandner (2009) found that the credit crunch led to VCFs reducing their amount of funding by 20% for each enterprise. This resulted to VCFs lengthening time to liquidity thus slowing down the exit. However, according to the *Money tree report* by PWC and NVCA (2008), despite the exit crisis VCFs continued to invest and raise funds. Haque (2008) suggested that VCFs needed new exit options since the IPOs were tough and acquisitions were trapping innovative start-ups in corporate bureaucracy.

According to Ghalbouni and Rouziès (2010), VCFs were losing their ability to attract the entrepreneurs that would generate better returns. The VCFs were no longer marketing their relevance to entrepreneurs. Instead of marketing their operational expertise, their well-developed networks of experts, and the personalized attention they offered, many VCFs had resorted to peddling wildly attractive financing options. VCFs therefore needed to refocus their strategies and return to their roots of being patient, hands-on consultancies that nurtured start-ups until they were sustainable (Ghalbouni and Rouziès, 2010).

Within the VCIP, entrepreneurs and VCFs also encountered challenges. The challenges varied according to the different stages of the VCIP.

In the deal origination stage, VCFs faced the challenge that some entrepreneurs confused venture capital with other types of financing for example loans (Klonowski, 2007). The VCFs had to find ways of educating the entrepreneurs on VC. Second, the entrepreneurs were not prepared to receive VC because they lacked any formal documentation describing their businesses. The entrepreneurs seeking VC had good ideas but lacked business plans or financial forecasts key to any VCIP.

In the deal evaluation stage both the entrepreneurs and VCFs had the challenge of limited resources. Both parties thus negotiated the major terms of the deal before the VCFs started extensive due diligence (Clercq et.al., 2006). The deal evaluation stage was time consuming for both parties.

The deal structuring stage faced key problems related to evolving accounting rules, taxation regimes and poor legal infrastructure (Allchorne, 2004; Sormani, 2003; EVCA Yearbook, 2002). Klonowski (2006) found that local VCFs continued to rely on offshore legal structures in deal structuring to manage the imperfections of the local legal infrastructure. Bliss (1999) and Klonowski (2007) found that VCFs in the Central and Eastern Europe (CEE) region considered some government-related challenges. For example, some VCFs in the region had purposely decided not to participate in privatization deals due to undue influence by the government in the process.

In the post investment phase, the VCFs faced agency relationship risks. Sahlman (1990) noted that the VCFs investments were illiquid and unlike public market investors, they could not sell their investments at a moment's notice. According to Sapienza and Gupta (1994), there was much uncertainty involved when a venture received VC, such that the VCFs had to spend more time, monitoring activities at the present and in the future.

Ahlstrom and Bruton (2006) found that legal institutions in emerging economies were generally flimsy. The relative absence of formal institutions such as laws and accounting standards resulted in a VCF having difficulty knowing whether proposed ventures were what they seem to be and were not merely vehicles for funnelling money to an overseas account (The Economist, 2004).

According to Klonowski (2007), these challenges often forced VCFs to structure transactions “more creatively”. This then led to excessive “deal fatigue” for both entrepreneurs and VCFs which resulted in many uncompleted transactions and wasted resources.

2.7 Proposed Solutions to the Challenges

Pandey (2005), concluded that the following points were important for the success of the venture capital investment process:

- An entrepreneurial tradition meaning encouragement from the society and government for innovations, creativity and enterprise.
- Less regulated business environments which would create attractive customer opportunities and high-tech quality products.
- Divestment mechanisms. For example; Over-the counter stock exchanges catering for the MSMEs.
- Fiscal incentives, which would render equity investment more attractive.
- Broad based education with a more general, business and entrepreneurial oriented education system where scientists and engineers have knowledge of accounting, finance, and economics and accountants understand engineering and physical sciences.

- An effective management education and training programme for developing professionally competent and committed venture capital managers; they should be trained to evaluate and manage high tech, high risk ventures.
- Promotional efforts through venture fairs, venture clubs, venture networks, business incubation etc. for the growth of venture capital.
- Institute-industry linkages - linkage between universities/technology institutions, R&D organisations, industry and financial institutions including venture firms.
- Research and development (R&D) activities - encouraging and funding of R&D by private and public sector companies and the government ensuring technological competitiveness.

Ahlstrom and Bruton (2006) found that venture capitalists substituted the problem of not having formal institutions by using networks with entrepreneurs and government officials. Meyer (2001) also noted that in emerging economies where the environment had few enforceable accounting standards or legal recourse, networks and alliances assisted venture capitalists in negotiating contracts in the venture process. Batjargal and Liu (2004); Ahlstrom and Bruton (2006) suggested that networks played an important part in China's venture capital industry, gathering information and also substituting key formal institutions such as the rule of law.

Koh and Koh (2002) noted that the government played an important role in supporting the venture capitalists in emerging economies. They noted that in Singapore the venture capital industry was thriving because of the Government offering tax incentives and backing the funding of venture firms. One of

objectives of Singapore's Government was to foster entrepreneurship and develop a risk-taking business culture. The South Korean Government also had encouraged high-tech start-ups by giving tax breaks and subsidies for venture capital investments. As a result, the venture capital investments in South Korea jumped from US\$1m in 1995 to US\$65m in 2000. Privately financed R&D accounted for 80% of all R&D investment in 1999, compared with only 20% in the 1970s.

In Japan, the Government had also amended regulations promoting the venture capital industry. For instance, the corporate pension funds were allowed to invest in venture investment since 1997. Also, under the *Angel Tax Incentive* introduced in 1997, a person investing in start-up ventures enjoyed a special tax deduction, for up to three years, on any loss due to the investment. In Hong Kong, the authorities had established a US\$100 million fund to invest in private equity and venture capital funds, while the Malaysian Government had launched the MSC Venture Corporation, a US\$30 million venture fund with a mandate to invest in high-tech startups (Koh and Koh, 2002).

2.8 Summary of Findings on Key Previous Studies

Eight research studies discussed in the literature above were selected and their research findings presented on Table 2.4A – Table 2.4F below. The other studies not included mentioned several aspects, which were similar to those discussed by the eight studies. The eight studies discussed extensively the criteria used by VCFs when making investment decisions.

Table 2.4A Summary on Findings on Previous Studies

Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
1) Tyebjee and Bruno (1984)	United States	Study 1: Telephone structured survey. Study 2: Mail Questionnaire	Study 1: 46 Study 2: 156 (41 responses)	Deal origination: Referrals and unsolicited calls from entrepreneur; Screening: Size of investment, industry, stage of financing and location; Evaluation: Market attractiveness, product differentiation, managerial capabilities, competition; Structuring: Price of deal, protective covenants, Earn-out management	VCFs provide management guidance and business contacts, sits on the board of the company and plays a significant role in the exit phase (acquisition, merger or IPO)

Table 2.4B Summary on Findings on Previous Studies

Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
2) Roberts (1991)	United States	In-depth Interviews	2	Screening: Product, location, high growth potential, equity interest, realistic, qualitative business plans, size of investment; Evaluation: technical leadership, technical markets, non-price sensitive markets, effective work relationship.	Criteria not defined
Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
3) Fried and Hisrich (1994)	United States	In-depth Interviews	18	Deal origination: Referrals; Screening: Size of investment, industry, stage of financing and location; Evaluation: Meeting with entrepreneur and management, tour company facilities, information from external sources, financial projections; Structuring: Details of structure finalized and legal documents negotiated.	Criteria not defined

Table 2.4C Summary on Findings on Previous Studies

Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
4) Fried and Hisrich (1994)	United States	In-depth Interviews	18	Deal origination: Referrals; Screening: Size of investment, industry, stage of financing and location; Evaluation: Meeting with entrepreneur to understand the business and management capabilities, tour company facilities, information from external sources, financial projections; Structuring: Details of structure finalized and legal documents negotiated.	Criteria not defined
Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
5) Chotigeat et.al (1997)	Taiwan, Sri Lanka and Thailand	Mail Questionnaire	Taiwan 20, Sri-Lanka 7, Thailand 15	Evaluation: Characteristic of entrepreneur, product, market, financial considerations, management team technical, financial, marketing skills and team work.	Criteria not defined

Table 2.4D Summary on Findings on Previous Studies

Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
6) Suksriwong (2003)	United States, Canada, Asia and Europe	Secondary data		Product (competitive advantage, economically justifiable); Market (distribution system, sound business plan, strong financial management); Financial consideration (exit route); entrepreneur personality, experience, financial commitment.	Criteria not defined
Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
7) Hellquist and Kraljevic (2006)	Sweden	In-depth Interviews	7	Sound business plans; Market share, entry and global presence; product; management capabilities; financial considerations; location and industry.	Criteria not defined

Table 2.4E Summary on Findings on Previous Studies

Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
8) Clercq et.al. (2006)	United States	Secondary data		Deal origination: Referrals and unsolicited calls from entrepreneur; Screening: Size of investment, industry, stage of financing and first meeting with entrepreneur and management team; Evaluation: realistic and achievable business plan, extensive reference checking on the management team, valuation ; Structuring: Price of deal, control of VC, mechanism for exit.	VCFs monitors the performance of the company, maintains effective communication through board meetings and regular financial reports. VCFs serve as a mentor, providing advice and networking contacts and helps achieve the agreed objectives. VCFs guide the exit process either through IPOs, acquisitions, buy-back of stock by enterprise, liquidation.

Table 2.4F Summary on Findings on Previous Studies

Study	Location	Methodology	Population/ sample	Pre-Investment criteria	Post-Investment criteria
9) Klonowski (2007)	Central and Eastern Europe	In-depth Interviews	14	Deal origination: Referrals and unsolicited calls from entrepreneur; Screening: Management, product, market, competition, size of investment, assessment on the business plan and financial projections ; Evaluation: Quality of management team, size and projected growth of target markets, competitive advantage, potential for capital appreciation relative to overall risk; financial projections, ability to liquidate the investment within three to five years; Structuring: structures of the deal and legal negotiations	VCFs help the company focus on the operational and financial milestones. VCFs expect monthly, quarterly and annual reports. VCFs guides the exit process (e.g. IPO)

As can be seen from the summary studies, most had not studied the post-investment phase and therefore did not provide data on how this part of the investment process progressed. The current study addressed this research gap.

2.9 MSMEs and Venture Capital in Kenya

2.9.1 Venture Capital Industry in Kenya

The VC industry in Kenya can be traced back to the 1960s and 1970s where the Government of Kenya established investment companies in particular the Industrial and Commercial Development Corporation (ICDC) whose objective was to invest in indigenous enterprise growth (Ngigi, 1997). These efforts by the government however had mixed results. Most of the schemes collapsed in the 1990s due to poor management and lack of resources. In the 1990s the government with donors such as the United States Agency for International Development (USAID) and the European Union (EU) set up VC funds among them the Kenya Equity Management (KEM) and Rehabilitation Advisory Services Ltd which also closed down leaving no clear path for the VC industry in Kenya (Kashangaki and Simba, 2008).

In the mid-nineties a US regional scheme, Acacia Fund, was established as a VC fund of US \$ 20 million. The fund invested in over 20 deals yielding positive results over a period of 10 years (Zavatta, 2008). It was acquired in 2008 by Swedfund, a Swedish state's VC company (Swedfund, 2008). Acacia Fund was the only locally registered VCF in Kenya (Capital Markets Authority (CMA), 2008). The current VCFs (listed on appendix C) are incorporated in foreign countries but have a legal structure that enables them to carry out their business in Kenya. In addition to private VCFs, the Industrial and Commercial Development Corporation (ICDC) also provides equity financing; a State owned institution with has a significant share of operations in the SME segment (Zavatta, 2008).

In the past, the legal framework for the VC industry had been unclear, restricting the development of this industry. It was not until 2007 that the CMA published the regulations for VCFs (CMA 2007).

2.9.2 Micro, Small and Medium enterprises (MSMEs) in Kenya

In Kenya, most financial providers adopted their own working definitions of MSMEs based on their financing requirements or the World Bank definition (InvesteQ Capital Ltd., 2008). MSMEs are incorporated in both the formal and informal sector but majority of the micro and small enterprises (MSEs) are in the informal sector (Kenya Institute for Public Policy Research and Analysis (KIPPRA), 2009). Ronge et.al (2002) identified the characteristics of MSEs. Among others: ease of entry; small scale of activity; family businesses; labour intensive technologies; minimal access to organized markets, informal credit, lack of education and training or services and amenities.

The 2009 Kenya Economic report showed MSMEs as important players for the growth and development of the Kenyan economy. The report indicated that MSMEs constituted 74.4% of all businesses in Kenya but these only contribute 18.4% of country's GDP (KIPPRA, 2009). The Minister for Industrialization stated that the reason why the MSMEs sector was not developing was that they were facing several problems. These included; lack of access to finance; inadequate skills and technology; poor quality of products, inadequate business skills; limited access to information; and limited linkages with large enterprises, which affected the productivity and competitiveness of the MSMEs thus hindering their growth (Ministry of Trade and Industry, 2008). InvesteQ Capital Ltd. (2008) in their study also found that access and cost of finance were major constraints hindering growth of MSMEs.

The government of Kenya through the Ministry of Industrialization was undertaking a MSMEs Competitiveness Project to improve the performance of the sector. The project, initiated in 2005 under the Ministry of Trade and Industry and running until 2012 has three mutually reinforcing components, namely access to finance, strengthening enterprise skills and market linkages, and what was improving the business environment which has now changed to Institutional Capacity Building. The project has recognized the fact VCFs would solve majority of the problems experienced by the MSMEs (MSME Competitive Project Document 2008, 2010).

2.10 Theoretical Framework

A theoretical framework did not explicitly guide most previous exploratory research studies on the VCIP. However, the researchers validated their findings within their local contexts replicating the criteria established by previous studies (Fried and Hisrich, 1998; Suksriwong, 2003).

Reviewed literature showed that VCFs would only invest in a firm with competitive advantage leading it to perform well having a high chance of survival and success (Tyebjee and Bruno, 1984; Bygrave and Timmons, 1992; Knight, 1994; Bliss, 1999; Chu and Hisrich, 2001; Suksriwong, 2003; Pandey, 2005; Clercq et.al., 2006 and Klonowski, 2007).

Two theoretical frameworks regarding competitive advantage were identified as guiding the current research. The theoretical frameworks were Industrial Organization View (IOV) and Resource-Based View of the firm (RBV). According to Coulter (1998), IOV focuses on the structural forces within an industry, the competitive environment of firms and how these influence competitive advantage. RBV theory focuses on the individual firm attributes and characteristics of its resources to build competitive advantage (Raduan et.al., 2009). Fahy (2000) noted that RBV enables researchers to understand the nature and determinants of competitive advantage, which assists the VCFs in making their investment decisions. Suksriwong (2003) research was built on the IOV theory considering the investment criteria outside the entrepreneurial firm and RBV theory considering the internal characteristics of entrepreneurs and their firms to build competitive advantage. Knight (1994) using the two theoretical frameworks presented the criteria shown in Table 2.5 below:

Table 2.5 Venture Capital Investment Criteria Based on two Theoretical Frameworks

Industrial Organization View (IOV)
• Characteristics of the product or service Export potential, competitive advantage, economically justifiable • Characteristics of market Known distribution system, sound business plan, strong financial management • Financial consideration Exit Route • Other criteria General business conditions, trend venture, capital activity
Resource-Based View
• The Entrepreneur's personality Honesty and integrity, self-confidence, doer, team player • The Entrepreneur's experience Functional areas ability, technical understanding • Financial consideration Entrepreneur's commitment, strong financial management

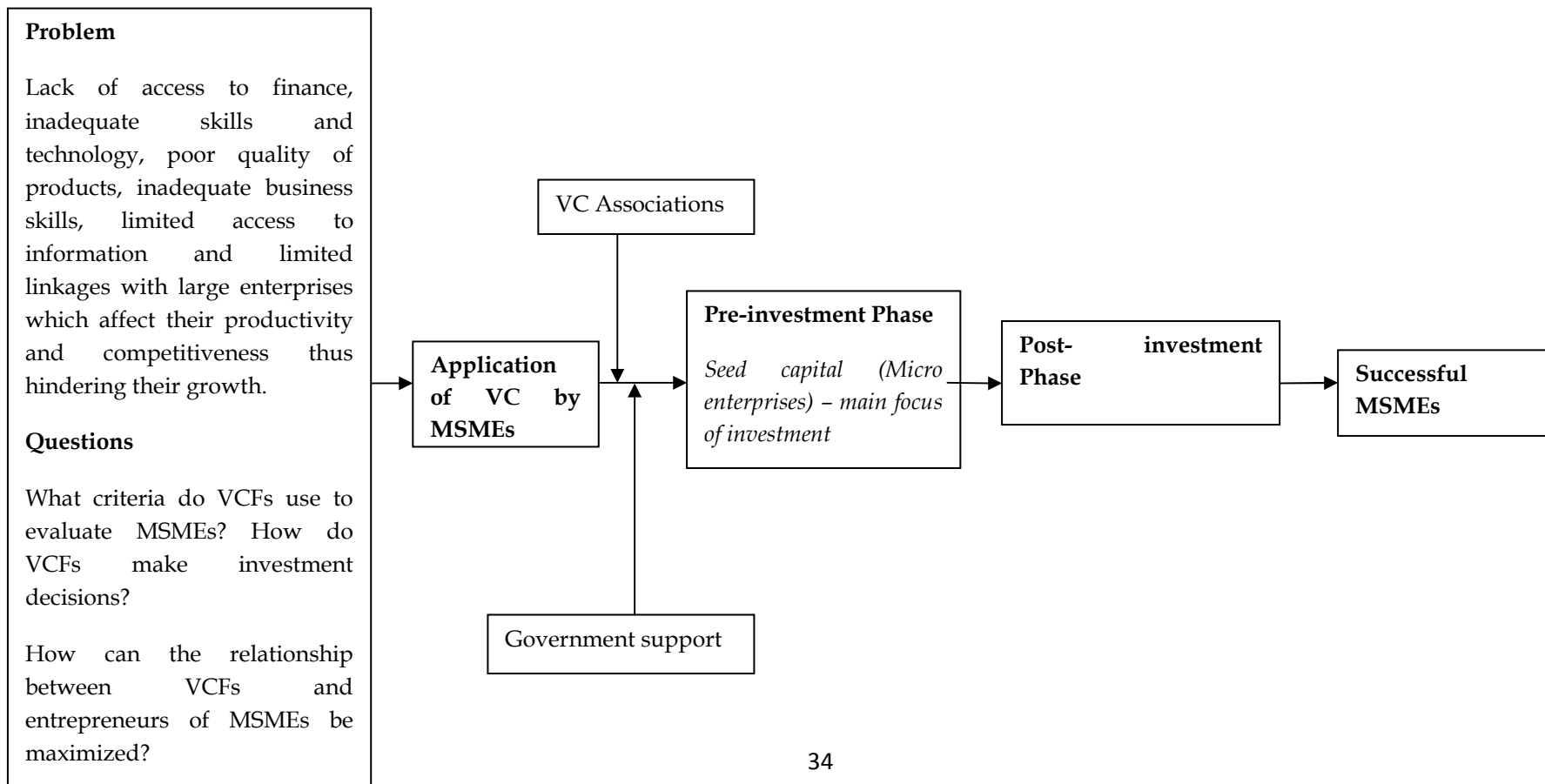
Source: Knight (1994) pp. 26-37

The two theoretical frameworks guided the study, recognizing the need for VCFs to evaluate the entrepreneurial firms with the required competitive advantage.

2.11 Conceptual framework

The reviewed literature and two theoretical frameworks, IOV and RBV, guided the formulation of the conceptual framework. Figure 2.2 below shows the conceptual framework:

Figure 2.2 Conceptual Framework



Conceptual Framework Explained

The conceptual framework was formulated from the literature reviewed. It sheds light to the problem statement as indicated in figure 2.2 above. The VCIP begins by the entrepreneur of the MSME applying for VC as indicated by figure 2.2 above. As seen from figure 2.2, the VC associations and the government play an important role in the VCIP which leads to a vibrant VC industry and successful MSMEs. As shown on figure 2.2, micro-enterprises were the main focus of investment for VCFs.

2.12 Gap in Literature Review

The reviewed literature has investigated the benefits of VC for MSMEs and discussed how and why VCFs make their investment decisions in the VCIP. It has also discussed how to maximize the VCFs and MSMEs relationship in the post-investment phase. All this was discussed from the international scene.

The reviewed literature has led the researcher to identify several gaps in knowledge. First, entrepreneurs from previous research were well educated and well informed on VC unlike the Kenyan entrepreneur. Entrepreneurs in Kenya have also been relying on debt financing, which require significant collateral and charge high interests, burdening the MSMEs and hindering their growth. This raises several questions as to whether these differences, among others, influence the criteria used by VCFs in their investment process.

Second, the VC industries in developing countries have been vibrant for a long-time unlike in Kenya where most VCFs collapsed. It would be interesting to identify how the existing VCFs in Kenya select their investment deals to ensure their success in the industry.

Third, the industry and market sector information in Kenya was not reliable and accessible (InvesteQ Capital Ltd., 2008). Reviewed literature showed that market

and industry information was crucial for the VCIP. How does the lack of reliable and accessible information influence the investment process for VCFs in Kenya?

The gaps that emerged from literature led the researcher to investigate the VCIP used by VCFs in Kenya. The research questions were formulated based on these gaps.

CHAPTER 3: Research Methodology

3.1 Overview

The purpose of this study was to; develop a venture capital investment framework for entrepreneurs of MSMEs when seeking VC, from the perspective of the VCFs. The study extended previous works done on the VCIP from other countries to the Kenyan context.

Chapter 3 has been structured as follows: research design, population of the study, data collection, data analysis and research quality. The focus of this chapter was to show how data were gathered answering the research questions identified in chapter 1.

3.2 Research Design

The study utilized a qualitative exploratory research design as information on the VC industry in Kenya is not well documented. According to Jupp (2006), qualitative research investigates aspects not measurable using quantitative techniques. It uses a range of methods focused on meanings and interpretations of social phenomena and processes in particular contexts they occur. Miles and Huberman (1994) confirmed that qualitative research allows the researcher to ask the questions “how” and “why” key for this study. Previous researchers such as Klonowski (2007), Hellquist and Kraljevic (2006), Pandey (2005), Bliss (1999), Fried and Hisrich (1994) and Robert (1991) examined the VCIP using qualitative methodology. The study sought to find out why MSMEs should access VC and how the VCFs make investment decisions which led to a VC framework for MSMEs in Kenya.

3.2 Population and Sampling

There exists no single database for VCFs in Kenya thus three sources were used to identify the VCFs in Kenya. Eight VCFs were therefore identified through the African Venture Firm Association, a report done by InvesteQ Capital Ltd (2008) and referrals from the VCFs. The researcher found that one of the VCFs was not operational.

Given the small population, no sampling was required and data were collected from all VCFs.

3.3 Data collection

The firms in the study were contacted through letters and personal visits to the firms.

3.3.1 Interviews and Secondary Data

Data were collected through semi-structured interviews to obtain in-depth data necessary for the study. In addition to interviews, data were collected from secondary sources. Documents were received from the respondents and from their websites.

As the respondents were experts who would provide valuable information and not just a source of data, interviews were seen as most appropriate for the study (Sarantakos, 2005). Previous researchers such as: Klonowski (2007), Hellquist and Kraljevic (2006), Fried and Hisrich (1994) and Robert (1991) found interviews appropriate for data collection. Interviews also allowed freedom to respondents to express their views without external limitations, which was necessary for this study (Sarantakos, 2005). One investment analyst from each of the VCFs was interviewed face to face and data recorded. Each interview lasted between one and a half hours to two hours. Two investment analysts allowed for the

interviews to be recorded using a video camera. The interview guide in Appendix B helped to collect consistent data from the interviewees.

3.3.2 Response rate

Data were collected from all the operational seven VCFs. As noted by Sarantakos (2005), the number of interviews in qualitative research is flexible and depends on whether the data collected is consistent. The researcher found the data collected from the seven VCFs was consistent and the investment analysts mentioned the other funds as peers.

3.4 Data Analysis

Data obtained from the interviews (hand written and video recording) were transcribed. Data collected through interviews and secondary sources were coded to maintain confidentiality and facilitate the process of data analysis and discussion of findings. The responses were coded as VCF 1 to VCF 7.

The next step was to structure the substantial amount of information whose purpose was to get an overview of commonalities and disparities between the VCFs (Hellquist and Kraljevic, 2006). Cross-case matrices were used to represent the data, which resulted in appropriate categories from the information obtained from respondents. Matrices are a form of summary table containing verbal information, summarized text and extracts from notes (Sarantakos, 2005). Figures, which are also useful in qualitative research, were also used to represent the data (Miles and Huberman, 1994).

The matrices facilitated cross case comparisons between the VCFs and the categories developed in the interview guide. Cross-case analysis deepened the understanding and explanation of the findings (Miles and Huberman, 1994). Data were analyzed through content analysis focused on meanings and interpretations from the data (Sarantakos, 2005). Data were also interpreted by

making comparisons and contrasts between the VCFs. Content analysis focused only on the data relevant to the study and developed themes, categories and patterns.

3.5 Quality of Research

The four aspects of research quality, validity, reliability, objectivity and subjectivity were considered during the research process.

3.5.1 Validity

In qualitative research, validity is important although it appears through different names such as credibility and trustworthiness (Lancy, 1993). Validity in qualitative research raises the question 'Do the researchers see what they think they see?' (Sarantakos, 2005). To guarantee validity, the use of triangulation of the methods used in data collection is proposed (Silverman, 2000). Researchers can also validate their findings if they are supported by other studies (Sarantakos, 2005).

Validity for this study was guaranteed through triangulation of data collection methods (interviews and secondary data). Comparisons with the previous studies in literature review were also conducted to validate the findings.

3.5.2 Reliability

Reliability is the capacity of the data collection method to produce consistent results (Sarantakos, 2005). In this study, reliability was improved in three ways. One: using a semi-structured interview guide which allowed some consistency, two: only investment analysts were interviewed and three: interviews were administered by only one researcher. This was to ensure consistency in the results produced.

3.5.3 Objectivity

Objectivity requires that the findings are free from bias (Silverman, 2000). This means that all the personal values and views of the researcher are kept out of the research process. Objectivity in this study has been achieved by choosing relevant methods for data collection and professionally analyzing the data.

3.5.4 Subjectivity

According to Leedy and Ormrod (2001) subjectivity is a research principle referring to the extent the researchers' personal impressions, feelings, assumptions, beliefs and values and opinions influences their judgment. The researcher in this study may have been subjective when conducting the interviews. Since data on the venture capital industry is not well documented, the researcher may have been biased as to what to expect. However, the researcher was very aware of this aspect and sought to ensure such biases were minimized.

3.6 Limitations of the Study

First, the use face to face interviews was very time consuming. The respondents shared a lot of information that sometimes was not required and the researcher had to guide the process. Follow up interviews were also made difficult owing to unavailability of respondents. Second, the use of matrices to represent data may have lead to some details being omitted; however, a comprehensive data analysis was done to ensure all-important aspects were included. Third, not all secondary sources had complete information and some may have been biased, unreliable and out-of-date. The researcher tried to ensure that data from secondary sources was relevant to the study contributing additional data and patterns. The use of interviews helped to confirm or clarify data from the secondary sources.

Despite these limitations, the study provided valid, reliable, and objective information, to answer the research questions and create a framework for MSMEs to access venture capital.

CHAPTER 4: Presentation of Research Findings

This chapter presents the results of the study. The results have been presented using matrices and figures as explained in the data collection section. The results from the interviews and secondary data (fund documents and website information) have been presented.

4.1 Introduction

The study identified eight VCFs operating in Kenya but one of the VCF was not fully operational. Data was therefore gathered from seven VCFs, which have been represented as VCF 1 to VCF 7. The categories used in the interview guide (Section A to Section D) have been used to outline the results. The findings are presented as per the research questions.

4.2 Preliminary Information on Venture Capital Funds in Kenya

The researcher identified seven VCFs operating in Kenya which are managed by foreign investors. All the seven VCFs were found to be foreign owned whose focus was on MSMEs in Kenya and the East African region. The parent companies based in foreign countries had funds in other regions. Two investment analysts emphasized:

“The funds activities in Kenya adhere to global standards drawing from our collective international experiences and knowledge” (VCF 3).

“Our parent company is specialized in lending to the SME market and has expanded its expertise into other countries. However, we as a subsidiary, focus on the Kenyan SMEs drawing from the experience and expertise offered by the parent company” (VCF 2).

All Seven VCFs were established in recent years (2006 – 2009). Four VCFs had only one company in their portfolio of investments. The fund sizes varied with the lowest at US\$ 5 million and the highest at US\$100 million. Four of the VCFs not only offered venture capital but also quasi-equity financing as indicated by VCF 3:

“Due to the risks involved when dealing with the MSMEs in Kenya, such as their lack of financial knowledge and their past involvement in debt, we also offer them a mixture of equity and debt depending on their risk levels.”

Presented below is a summary of the preliminary information from the VCFs.

Table 4.1 VCFs Company Information

Company information	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
Type of Business	Foreign fund – focus on Kenya	Foreign Fund – focus on Kenya	Foreign Fund – focus on East Africa	Foreign Fund – focus on East Africa	Foreign fund – focus on Kenya	Foreign fund – focus on East Africa	Foreign fund – focus on East Africa
Year company of establishment	2007	2006	2009	2008	2007	2006	2009
Number of companies in the portfolio	Approximately 30	Approximately 40	One	One parent portfolio with 8 subsidiary acquisitions	One	More than 20	One
Fund Size	\$ 40 million	\$ 14.1 million	\$ 20 million	\$ 100 million	\$ 18 million	\$ 5 million	\$ 50 million (target)
Fund term	5-7 years	5 years	10 years	Not indicated	5 - 10 years	3 - 5 years	3 - 5 years
Other than venture capital they offer:	Quasi-Equity, Debt	Quasi-Equity, Debt	Quasi-Equity	None	Quasi-Equity	Debt finance linked to performance based incentives	None

4.3 Venture Capital Investment Process

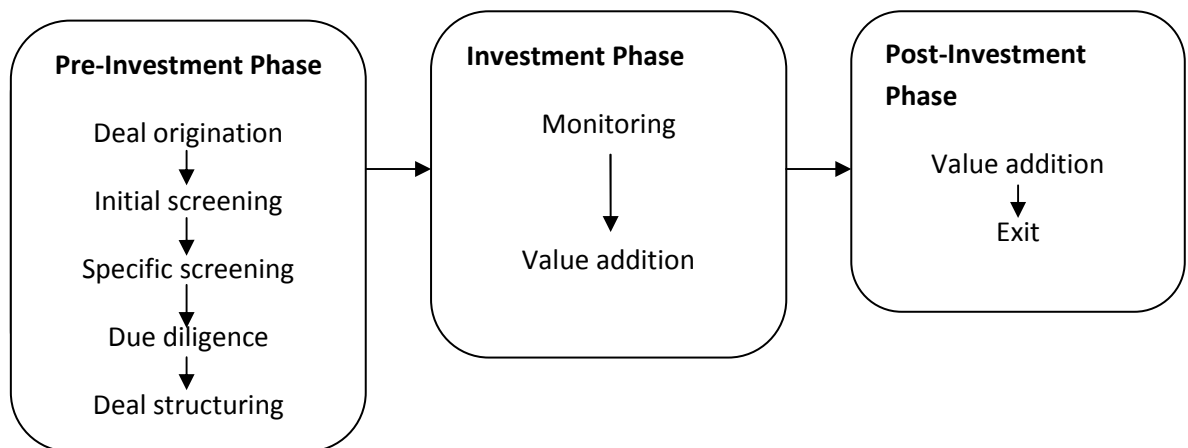
The researcher found that the VCIP of the VCFs was adapted from their parent companies located in the foreign countries but was adjusted for the Kenyan environment.

The researcher found that the VCIP was more challenging in the Kenyan environment due to various challenges not faced in developed countries. Some of the challenges faced by VCFs included entrepreneurs not educated about VC, entrepreneurs having no financial knowledge, capacity constraints for VCFs and no reliable market and industry data available on MSMEs. All the VCFs agreed on these challenges. This therefore made the VCIP more time consuming and tedious leading the VCF to invest in a limited selection of deals. As the investment analyst of VCF 3 stated:

“It has taken us almost 12 months for us to make the decision to invest in the current deal. It is difficult to access reliable market and industry data for us to make decisions.”

Figure 4.1 below shows a summarized VCIP model used by Kenyan VCFs. Appendix E illustrates the VCIP for the seven VCFs.

Figure 4.1 Venture Capital Investment Process



Source: Research Data (2010)

4.4 Criteria in the Pre - Investment phase

The findings about the criteria used by VCFs when deciding whether to invest in an MSME have been presented below.

4.4.1 Deal origination

The researcher classified the sources used in the deal origination stage into six categories: referrals (from VC community, banks, insurance companies, investors among others), VCF research, advertisement (press), business plan database (BID network), unsolicited contacts by entrepreneurs of the MSMEs and sponsorship of enterprise awards.

Table 4.2 below shows a summary of the sources used by VCFs in the deal origination stage.

Table 4.2 Deal Origination

Source of deal	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
Referrals from banks, venture capital community, investors, insurance companies	✓	✓	✓	✓	✓	✓	✓
Own research	✓	✓	✓	✓	✓	✓	✓
Advertisement (press)		✓					
Business plan database	✓	✓	✓	✓	✓		
Unsolicited contacts by MSMEs	✓	✓	✓	✓	✓	✓	✓
Sponsorship of enterprise awards		✓					

Referrals, own research and unsolicited contacts by MSMEs were the key sources used by all VCFs. Advertisement and sponsorship of enterprise awards were the

sources least used by VCFs, only one VCF used it. As mentioned in the responses below:

“We receive more than 600 business proposals through referrals from banks, consultants and also through our own research and marketing activities. Seventy percent of the proposals come from the banks, consultants, and 30% from our own research and marketing activities. We hope in the near future to reverse this rating and our research should generate more than 70% of the deals. However, we are still learning the Kenyan market and most deals will have to come from referrals” (VCF 3).

“Most of the investment analysts in the fund have worked in the banking industry. This explains why most of our deals are generated through referrals from the banks. We are four years old in the industry, which means we have to rely on referrals. The bank refers entrepreneurs who are seeking funds and could meet the banks criteria. However, we also generate deals through advertisements in the print media, referrals from existing clients, venture capital community, market seminars, unsolicited contacts from entrepreneurs, sponsoring business awards and private networking” (VCF 2).

“The challenge we encounter mostly is that entrepreneurs have no idea about VC and they confuse it with debt. We have to educate them and this takes a lot of our time. It’s the reason why, we would have 100 deals and invest in only one at the end of the investment process” (VCF 4).

In the deal origination stage VCFs assisted entrepreneurs of MSMEs in developing and or improving the enterprise operating systems; preparing financial accounts and offered direct or indirect support in developing business plans. All VCFs also noted that collateral was not a requirement in the deal origination stage. They did these before the screening stage in the VCIP.

All VCFs agreed that they assisted the entrepreneur in either developing or improving the MSMEs operating systems before giving VC. The VCF would then assist the entrepreneur computerize his operations or guide him on how to improve the systems in the enterprise. As shown by the responses below:

“The entrepreneur would have no records on his business operations and most systems were manual. We would assist him to put in place computerized systems and offer advice on preparing records for his business” (VCF 1).

“We would advise an entrepreneur on how to keep proper records by either employing an accountant or training his staff” (VCF 2).

Three VCFs assisted the entrepreneur prepare financial accounts. As shown by their responses below:

“Most entrepreneurs do not have accountants and hence do not have financial records. We recommend that the entrepreneur employ an accountant before we can go further with evaluating the business. Once the records are in place then we move to the next stage of evaluating the business” (VCF 3).

“The investment process is quite tedious and takes a lot of time. This is because of the high risks involved and we also have to assist the entrepreneur generate proper financial records” (VCF 4).

“Most entrepreneurs we deal with have no financial background but they know every transaction taking place in their business. We therefore advice them to employ an accountant or train the current staff on how to keep records” (VCF 2).

The other four VCFs expected the entrepreneur to have financial records when seeking VC as indicated by VCF 1:

"It is crucial that before the entrepreneur approaches the VCF to have proper records. The financial knowledge of the entrepreneur is an important criterion in the investment process."

Three VCFs supported the entrepreneur in developing a business plan. The investment analyst of VCF 3 emphasized:

"We do not prepare the business plan ourselves but we refer the entrepreneur to a consultant who know our investment requirements. This is beneficial to the entrepreneur because he is able to tailor his business plan focused on the essential details required by us."

The other four VCF expected the entrepreneur to have already formulated a business plan when seeking VC as indicated in the responses below:

"A well formulated business plan is an important criterion. The entrepreneur should have a good business plan before approaching the VCF" (VCF 1).

"The business plan gives us the first impression about the entrepreneur. The business plan is the first item that determines whether we will have an initial meeting with the entrepreneur" (VCF 2).

All VCFs in the study agreed that collateral was not a requirement when selecting an MSME. The VCFs thus when giving VC expected higher returns because of the high risks involved in their investments. VCF 6 indicated:

"A challenge facing SMEs is lack of collateral or adequate collateral. We do not require any collateral. This is a benefit for entrepreneurs of SMEs."

4.4.2 Deal Screening

The researcher found that the criteria used in the screening stage were further divided into two stages, which were categorized as VCF specific and generic screening. The VCF specific screening stage criteria were based on items specified by the VCFs on their fund brochures and websites such as the industry sector, stage of financing and investment period. The generic screening criteria were focused on the business plan, entrepreneur and management team.

Table 4.3A and Table 4.3B below show a summary of the criteria used by VCFs in the deal screening stage.

Table 4.3A Deal Screening

Criteria	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
1st Stage							
Stage of financing	✓ (Start-up, expansion)	✓ (Start-up, expansion)	✓ (Start-up, expansion)	✓ (Seed, Start-up, expansion)	✓ (Start-up, expansion)	✓ (Seed, Start-up)	✓ (All stages)
Industry sector	✓ (Health, water, housing, energy)	✓ (All, except: NGOs, agriculture, health, primary and secondary education)	✓ (Agriculture, ICT, media, energy, manufacturing, finance)	✓ (ICT)	(Not specified)	✓ (All sectors)	✓ (All sectors)
Investment period	✓ (5-7 years)	✓ (5 years)	✓ (10 years)	Not specified	✓ (5-10 years)	✓ (3-5 years)	✓ (3-5 years)

Table 4.3B Deal Screening

Criteria	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
2nd Stage							
Business plan	✓	✓	✓	✓	✓	✓	✓
Meeting entrepreneur and Management team	✓	✓	✓	✓	✓	✓	✓
Market	✓	✓	✓	✓	✓	✓	✓
Product /service	✓	✓	✓	✓	✓	✓	✓
Financials	✓	✓	✓	✓	✓	✓	✓
Physical visit to premises			✓	✓			

VCF specific screening was based on four factors: stage of financing, sector in the industry, investment period and the financing amount required by the enterprise. The study found that only one VCF invested in all stages of financing, three focused on micro enterprises while the other four VCFs invested in SMEs. As indicated below:

“We make investments in start-ups, early stage businesses, established businesses with high growth potential and buyouts from going concerns” (VCF 7).

“We do not invest in the seed stage due to the high risks involved. The micro enterprises have barely any structures and the entrepreneurs are not committed to their business ideas. Most ideas are not feasible. We prefer to invest in an entrepreneur who has already tested his products in the market” (VCF 3).

“We invest in the start-up and expansion stages. We do not have capacity and resources to invest in the buy-out stage” (VCF 2).

Two VCF funds invested in all sectors of the industry while the other five VCFs invested in different sectors in different industries. As emphasized by the VCFs below:

“We invest in all other sectors except agriculture, on-lending (SACCOs, MFIs), Secondary and lower levels of education, hospitals. This is due to the high risks involved, for example in the agricultural sector; one has to rely on weather patterns, which are unpredictable” (VCF 2).

“The initial screening is based on two criteria: ICT sector and East Africa region. We only screen the SMEs business plan if it meets the two criteria. The ICT industry returns are higher and more realizable” (VCF 4).

“We invest in specific sectors: Agro and food processing, ICT, media, energy, manufacturing, logistics, finance” (VCF 3).

“We do not have specific sector focus, but invest widely across a range of sectors” (VCF 6).

The study found that six VCFs invested in an enterprise based on the investment period. The period varied from a minimum of three years to a maximum of ten years. Six VCFs invested in within a period of three to five years.

The second stage, generic screening involved assessing the enterprise based on the following criteria. One, the entrepreneur needed to present the VCF with a well-formulated business plan. All the VCFs in the study expected from the enterprise a well-formulated business plan. Two, the VCF assessed the business plan based on the market (growth, share), product/service (marketable, competitive), and its financial projections. As emphasized by the investment analyst of VCF 1:

“A well formulated business plan gives us a better understanding of the deal.”

Three, the VCFs meet with the entrepreneur and management team, building rapport and finding out whether they understood the business. The meeting with the entrepreneurs and management team was crucial for all the VCFs. As the investment analyst of VCF 2 noted:

“The meeting could either break or make the deal. The first impression created by the entrepreneur and management team is crucial.”

Fourth, VCFs conducted a physical visit to the premises. Only two VCF visited the enterprises at the deal screening stage. The other VCFs conducted the physical visits during the evaluation stage. As emphasized by two investment analyst below:

“We call this the initial diligence. Once we have accepted the business proposal based on the financing amount, investment period, industry sector, we then use a checklist to screen the business plan. The checklist is based on three criteria (social impact, scalability and financial sustainability). We accept the deals that meet the criteria. Social impact refers to a product that generates competitive social outputs. Scalability refers to the ability of the ventures business model reaching one million end users within a five year period and if not then a checklist with other related questions for example does it have a strong management team that has the requisite skills to execute the business plan and a clear and compelling vision? Financial sustainability refers to financial projections showing a potential for financial sustainability within a five to seven year period including the ability to cover operating expenses with operating revenues. We also have an initial meeting with the entrepreneur and management team” (VCF 1).

“The physical visit to the business premises after screening the business plan is important before the due diligence stage. We are able to proceed to the next stage, which is time consuming, once we have ascertained the business physically exists. There have been many frauds” (VCF 4).

4.4.3 Deal Evaluation and Structuring

The researcher found out that once the enterprise passed through the screening phase, the VCF would assess in more detail the criteria used in the screening stage.

Table 4.4 below shows a summary of the criteria used by VCFs in the deal evaluation and structuring stage.

Table 4.4 Deal Evaluation and Deal Structuring

Criteria	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
Achievable business plan	✓	✓	✓	✓	✓	✓	✓
Background check on entrepreneur and management team	✓	✓	✓	✓	✓	✓	✓
Market	✓	✓	✓	✓	✓	✓	✓
Product/service	✓	✓	✓	✓	✓	✓	✓
Financial analysis	✓	✓	✓	✓	✓	✓	✓
Risk analysis	✓	✓	✓	✓	✓	✓	✓
Physical visit to premises	✓	✓	✓	✓	✓	✓	✓
Price of deal	✓	✓	✓	✓	✓	✓	✓
Legal documents signed	✓	✓	✓	✓	✓	✓	✓
Exit route stated	✓	✓	✓	✓	✓	✓	✓
Financing amount required	✓	✓	✓	✓	✓	✓	✓

All seven of the VCFs in the study conducted due diligence and structured the deal simultaneously. The investment analysts commented as shown below:

“When we get new information during the structuring stage, we conduct due diligence again on the enterprise based on the new information. This is time consuming because the new information may break or make the deal. Most times, it leads us to change the structure of the deal” (VCF 3).

“We already have an idea of how we would structure the deal once we begin due diligence. So due diligence and structuring go hand in hand” (VCF 4).

“We assess the criteria used in the screening phase in more detail. Additional factors such as physical background checks on the entrepreneur and management team are included. The background checks focus everything on the entrepreneur and management team. The information is obtained from various external parties” (VCF 1).

“It is crucial that the enterprise is the only business the entrepreneur and management team are engaged in” (VCF 3).

Financial and risk analysis were conducted with the information provided by the entrepreneur and management team. The VCFs used financial projections for analysis.

The deal structuring was based on pricing the deal (stating how the VCF will receive the returns), stating the exit route, amount of funding and signing legal documents. The VCF ensured they retained the commanding position of the enterprise.

The VCFs interviewed stated that before the legal documents were signed and funds disbursed, the investment analyst prepared an investment report/ memo to the investment committee for approval. The investment committee made up of foreign investors in the VCF approved or disapproved the investment based on

the recommendations made by the investment analysts. Two investment analysts emphasized:

“The funds to be disbursed are held where the parent company is situated. Once the investment committee approved the deal, the funds would then be disbursed to the local fund in Kenya” (VCF 3).

“The actual funds are not located in Kenya. We access them from the parent company” (VCF 1).

4.5 Activities in the Investment and Post-Investment Phase

The activities conducted by VCFs in the investment and post-investment phases have been summarized below. The monitoring activities were done at the investment phase. Value-addition cuts across the investment and post investment phases while ways of exit are in post investment phase.

4.5.1 Monitoring and Value Addition Stages

The researcher found out from all seven VCFs, that once the VCF invests in an enterprise, it monitors and offers additional value to the enterprise during the term of investment.

Table 4.5A and Table 4.5B show a summary of the activities used by VCFs in the monitoring and value-addition stages.

Table 4.5A Monitoring and Value-Addition

Activities	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
Strategy							
Board representation	✓		✓	✓	✓	✓	✓
Advice on strategic, technology and marketing issues	✓	✓	✓	✓	✓	✓	✓

Table 4.5B Monitoring and Value-Addition

Activities	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
Financing							
Develop financial management systems	✓	✓	✓	✓	✓	✓	✓
Arranging financing from other investors	✓	✓	✓	✓	✓	✓	✓
Play significant role during the exit	✓	✓	✓	✓	✓	✓	✓
Networking							
Offer contacts of experts	✓	✓	✓	✓	✓	✓	✓
Interpersonal							
Mentorship	✓	✓	✓	✓	✓	✓	✓
Reputation							
Persuade other stakeholders to interact with the business	✓	✓	✓	✓	✓	✓	✓
Capacity building							
Training staff	✓	✓	✓	✓	✓	✓	✓
Monitoring							
Focus on attaining agreed objectives	✓	✓	✓	✓	✓	✓	✓
Evaluation of management performance	✓	✓	✓	✓	✓	✓	✓
Financial reporting							
Monthly reporting	✓	✓	✓	✓	✓	✓	✓
Quarterly reporting	✓	✓	✓	✓	✓	✓	✓
Semi-annual reporting	✓	✓	✓	✓	✓	✓	✓
Annual reporting	✓	✓	✓	✓	✓	✓	✓

The activities in the investment and post-investment phases were placed into eight categories, each with a sub – category. The categories were strategy, financing, networking, interpersonal working relationship, reputation, capacity building, monitoring and reporting.

VCFs role was therefore more than providing financing to the business as indicated by three VCFs below:

“We offer technical assistance to the SME. This is beneficial for the SME as we are able to offer more than just capital” (VCF 2).

“Our teams of local professionals offer much more than finance. We partner with SMEs, sharing expertise, understanding and supporting, giving them the opportunity to succeed” (VCF 6).

“We offer support at all levels (shareholder, board and management) and provide crucial and strategic information, knowledge and strategy” (VCF 7).

Strategic role

Strategic role, referred to the board representation by the VCF and the advice given on strategic, marketing and technology issues. Six VCFs had a representative on the board of the enterprise, while all the seven VCF gave advice on the strategic, marketing and technology issues. The investment analyst of VCF 2 emphasized:

“Due to capacity constraints, we do not have a representative on the board of the SMEs. However, for each enterprise we invest, we assign a project officer who monitors it until when we exit the deal.”

Financing role

Financing role, focused on:

- Developing financial systems, done by all the seven VCFs;

- Arranging financing from other investors, done by four VCFs; and
- Playing a significant role in the exit stage, which all VCFs engaged in

Two investment analysts indicated:

“We only engage in an equity deal once we foresee the exit strategy. We therefore assist the SME during the exit stage” (VCF 3).

“We have experts who assist the entrepreneur put in place financial management systems. This is beneficial for us and for them” (VCF 2).

Networking role

Networking role, the third category, focused on VCF funds offering contacts of experts to the enterprise. The experts included external managers, key service providers, acquisition candidates, key customers among others. All VCFs offered this benefit as emphasized by VCF 7:

“The MSMEs will benefit from the funds team of professionals who have deep local and global knowledge, extensive networks and investment experience.”

Interpersonal role

Interpersonal role, the fourth category, focused on the mentorship provided to the entrepreneurs. All the VCF offered this benefit. As mentioned by the investment analysts below:

“The entrepreneur needs moral support in periods of crisis, which happens many times” (VCF 1).

“MSMEs are mentored by industry experts” (VCF 7).

Reputational role

Reputational role, the fifth category, focused on the VCF reputation among various stakeholders in the industry, which persuaded the stakeholders to engage with the enterprise. This benefit was offered by all VCFs.

Capacity building

Capacity building, the sixth category was explicitly stated by the investment analyst of VCF 2. The other VCFs indirectly recognized this benefit. The investment analyst stated:

“One of the technical assistance services is training the enterprises staff” (VCF 2).

Monitoring

Monitoring, the seventh category, focused on the VCF ensuring that the management team focused on attaining the enterprise objectives and evaluated their performance. This was done by all the VCFs as emphasized by the investment analyst below:

“We are hands-on on every deal we invest in. Business runs on information hence we monitor regularly the enterprises we have invested in. We collect information from them regularly, through financial reports, calls and meetings” (VCF 1).

Reporting

Reporting the eighth category, focused on VCFs assessing the performance of the enterprise by reviewing the financial reports provided by the management team of the MSME. All the seven VCFs expected monthly, quarterly, semi-annual and annual reports. As indicated by VCF 1:

“We are hands-on on every deal we invest in. Business runs on information hence we monitor regularly the enterprises we have invested in. We collect information from them regularly, through financial reports, calls and meetings.”

4.5.2 Exit Stage

The researcher found that after the term of investment, it was expected that the VCFs would assist the enterprise in the exit phase. Two investment analysts indicated:

“The criterion used to exit is normally agreed upon during the deal structuring stage” (VCF 7).

“We determine the exit criteria after due diligence” (VCF 1).

No VCF had carried out an exit in Kenya yet. The researcher found that five VCF funds preferred selling back shares to the shareholders as the most probable exit route. As VCF 1 stated:

“IPO is a possible future exit but our current financial environment is not ready for this. Hence, selling back shares to the shareholders would be the most probable option”

Table 4.6 below shows a summary of the criteria expected to be used by VCFs in the exit stage.

Table 4.6 Exit Stage

Forms of Exit	VCF 1	VCF 2	VCF 3	VCF 4	VCF 5	VCF 6	VCF 7
VCF assist the MSME to take the company public through an (IPO)	✓ (possible future exits)		✓ (possible future exit)	✓ (possible future exits)		Forms of exit not explained	
VCF assist the MSME to be acquired							
VCF Sells back shares to shareholders		✓ (possible future exit)	✓ (possible future exit)		✓ (possible future exit)		
VCF assist the MSME merger with another enterprise							

4.6 Advice from VCF to MSME

The advice to MSMEs from VCFs was structured into five categories: Trust, achievable business plans, clear and prompt communication (usually through financial reports) and commitment from the entrepreneur and management. The investment analysts also stated that the entrepreneur and management team needed to meet these criteria for them to have a positive and future relationship with the VCFs. The investment analyst of VCF 4 stated:

“An entrepreneur needs to be educated on what the VCF expects from them.”

A trusting relationship between the entrepreneur and the VCF was important. The complexity of investment period required both parties to work efficiently together. The VCFs noted that mutual trust enabled the VCF to also re-invest in the MSME in future.

The VCFs eliminated most proposals from MSMEs because of unachievable business plans. Entrepreneurs were therefore advised to prepare an achievable business plan because it was a communication mechanism for the VCF.

The researcher noted that VCFs expected prompt communication from the entrepreneurs. Preparation of timely and regular financial reports was crucial to ensure financial goals were met.

CHAPTER 5: Discussion on Findings

The discussion section answers the research questions to address the problem statement. It also compares and contrasts the findings with previous research studies and theories.

This section has been guided by the research questions.

5.1 How do VCF make investment decisions? What criteria do VCFs use before investing in an MSME in Kenya?

The study found that the VCFs investment process was adapted from their parent companies located in the foreign countries and adjusted for the Kenyan environment. The similarities between the VCIP stages from Kenyan VCFs with previous research were attributed to VCFs in Kenya having foreign origins (Tyebjee and Bruno, 1984; Roberts, 1991; Sherpherd et.al., 2000; Suksriwong, 2003; Clercq et.al., 2006; Hellquist and Kraljevic, 2006; Yiallourou, 2006).

VCFs in Kenya engaged in not only venture capital financing but also offered a mixture of both equity and debt known as quasi-equity financing. Previous research shows the VCFs engaged in VC (Tyebjee and Bruno, 1984; Roberts, 1991; Sherpherd et.al., 2000; Suksriwong, 2003; Clercq et.al., 2006; Hellquist and Kraljevic, 2006; Yiallourou, 2006). This explains why the VCFs in Kenya also had to tailor their investment strategies and offer a mixture of debt and equity.

VCFs before making the investment decisions (the pre-investment phase), focused on several stages: deal origination, VCF specific and generic screening, due-diligence and structuring of the deal.

5.1.1 Deal Origination

The VCFs used referrals, their own market research and unsolicited contacts by entrepreneurs as the main sources in generating investment deals. This is

consistent with previous studies by Tyebjee and Bruno (1984) and Klonowski (2007). In addition, VCFs in Kenya also generated deals through advertisements and market seminars, although these were not commonly used.

All VCFs when generating deals did not require collateral. This was a benefit for MSMEs because debt capital (the alternate source of finance) required collateral as a key requirement and most MSMEs did not have the form of collateral required for debt capital.

All VCFs at the deal origination stage also assisted MSMEs in developing or improving the enterprises operating systems, prepare financial accounts and develop business plans. Hellquist and Kraljevic (2006) and Roberts (1991) found out that VCFs expected the entrepreneur to have already formulated their own business plans before approaching the VCFs. The difference could be attributed to the fact that entrepreneurs in Kenya are not well educated in the developing business plans. VCFs therefore had to assist them.

5.1.2 Deal Screening

The screening stage was based on two stages: VCF specific and generic screening stages. The current study found the criteria used in the VCF specific screening were; stage of financing, investment period and industry sector, consistent with Fried and Hisrich (1994). According to Bliss (1999) the VCF specific screening criteria were rarely used by VCFs.

The VCFs in the current study invested in the start-up and expansion stages focusing therefore on SMEs and not the micro enterprises. Previous research shows that VCFs focus was mainly the seed capital stage (Fried and Hisrich, 1994, Koh and Koh, 2002 and Peters, 2009). The reason given for not investing in the seed stage in the current study was the high risks involved and inadequate information from the market and industry. The buy-out stage was only done by

one VCF because the other funds did not have capacity and experience to focus on this stage. Previous research shows that VCFs focused on the buy-out and had the capacity and experience in funding this stage (Koh and Koh, 2002 and Peters, 2009).

The VCFs placed emphasis on the investment period and the maximum period stated was 10 years and the minimum three years. The VCFs that invested across all sectors in the economy had the shortest investment period of 3 - 5 years. This was because of their smaller fund sizes and capacity constraints. However, one of the VCFs had a bigger fund size. This could be because the fund specialized in offering only VC to all MSMEs. Previous research shows that the investment period did not have a significant impact in the investment process (Peters, 2009).

The study found that the industry sector was an important criterion. The VCFs avoided industry sectors such as agriculture, education because of the risks involved. Only two VCFs invested in specific sectors. Previous research shows that VCFs preferred to invest in specific sectors and the technology sector was a key investment focus due to the high returns (Gompers and Lerner, 2004 and Fichera, 2001).

In the specific screening stage, VCFs focused on whether the entrepreneur had a good business plan and whether it contained factors such as market, product/service and the financial projections. This was supported by the industrial organization view (IOV) theory that identified characteristics of the market, product/service, financials and a sound business plan, as important criteria. Klonowski (2007) in his research noted product differentiation as criterion in this stage but the VCFs in the current study did not lay special emphasis on this. The study also showed that VCFs would invest in an enterprise that did not have a prepared plan, although they stressed the importance of establishing one with the VCFs assistance or referring them to consultants. This

was not supported by the IOV theory and previous research that expected entrepreneurs to have developed business plans before approaching the VCF (Zacharakis and Meyer, 2000). Robert (1991) also emphasized that business plans were important for VCFs to make investment decisions. Elango et.al (1995) stated that the significance of the business plan varied according to the stages of financing. However, for VCFs in Kenya the stage of financing did not influence the importance of business plans.

The meeting with the entrepreneur and management team was also important for the VCFs in the current study. Hellquist and Kraljevic (2006) and Clercq et.al. (2006) found that confidence and rapport between the investment analyst of the VCF and entrepreneur could make or break the deal. This was supported by the resource-based view (RBV) theory, which emphasized the entrepreneur's personality as a key criterion for the VCF investment decisions. Peters (2009) also found that due diligence on the entrepreneurs qualities was a significant criteria in the investment process.

5.1.3 Deal Evaluation and Structuring

The study showed that once the deal passed the screening phase, then a more detailed analysis of the business plan, entrepreneur and management team was conducted through the stage known as evaluation/ due-diligence. The criteria were similar to the screening phase but done in more depth. This supported both the IOV and RBV theories (Knight, 1994). The IOV theory, emphasized on a sound business plan and strong financial management and the RBV theory emphasized on the entrepreneurs personality. However, the RBV theory also emphasized on the entrepreneurs experience (functional areas ability, technical understanding) which was not supported by the current study. The study found that entrepreneurs lacked the functional and technical expertise and VCFs had to assist them.

Previous research supported that the quality of the entrepreneur was an important criterion at this stage (Koh and Koh, 2002 and Pandey, 2005). However, the current study found that the managerial capabilities were not as significant as presented by Fried and Hisrich (1994) and Clercq et.al. (2006).

In addition, the VCFs also visited the physical premises of the enterprise to assess whether the location was suitable, the working conditions of the employees, verifying the facts of the business plans, for example; financial reports. This supported the IOV theory, which identified that, the general business conditions and financial considerations were important criteria for the VCF when investing in a deal. In the current study, the physical visit was crucial because entrepreneurs had previously defrauded VCFs. Previous research did not find this as a crucial criterion (Peters, 2009).

The VCFs in the current study found it difficult to collect the information because no reliable market and industry data was available. This supported the findings by InvesteQ Capital Ltd. (2008). In previous research, the VCF collected complete information in the deal evaluation stage (Tyebjee and Bruno, 1984; Clercq et.al., 2006; Klonowski, 2007).

The researcher found that deal evaluation/ due diligence and deal structuring were done simultaneously and any new information resulted to the enterprise being evaluated again based on the new information. The evaluation stage helped the VCF formulate the structure of the deal between the entrepreneur and the VCF. In previous studies this two stages were separately done (Kaplan and Stromberg, 2003). Pandey (2005) emphasized that the VCF needed to remain in commanding position of the MSME. This was also supported by the current study.

The VCFs in the current study presented an investment report/ memo to the investment committee who were located in foreign countries for approvals.

The current study identified the exit route as an important criterion. However none of the VCF had carried out an exit yet. This supports the IOV theory which considered the exit route as an important criterion when structuring a deal. Previous research found that the exit route was not a significant factor in the investment process (Jeng and Wells, 1998; Peters, 2009).

5.2 How do VCF operate having invested in an enterprise?

The researcher distinguished the investment phase from the post-investment phase because VCFs were involved with the enterprise throughout the investment period until exit. Previous research categorized the investment process into only two phases: pre-investment and post-investment (Tyebjee and Bruno, 1984; Clercq et.al., 2006; Klonowski, 2007). The current study considered monitoring and value addition in the investment phase. This gave a more clear distinction on what happened during the actual investment period. This is illustrated in *Figure 4.1* in the previous chapter.

5.2.1 Investment Phase

In the investment phase, the VCFs carried out monitoring and value-addition activities. The VCFs monitored the MSMEs by evaluating the performance of the management, maintaining the focus of the enterprise in attaining the set objectives and expecting regular communication through various financial reports. This enabled the VCFs to assess the financial performance of the enterprise. Gladstone and Gladstone (2003) also found that effective communication was crucial. This supported the RBV theory, which considered the entrepreneurs commitment as an important criterion. The VCFs thus offered technical assistance to the enterprise according to its needs. Clercq et.al. (2006) supported this as the most crucial phase for the entrepreneur.

The value-addition activities done by VCFs in the current study were also experienced in previous research (Sapienza, 1992; Clercq et.al., 2006). Previous research showed that representation in the board of the company was significant in the monitoring process (Klonowski, 2007). However, this study indicated that one VCF was faced with capacity constraints and thus did not have a representative on the board. Previous research was also concerned about the agency risks associated with the VC-entrepreneur relationship (Sapienza and Gupta, 1994).

5.2.2 Post- investment Phase

In the post-investment phase the VCFs carried out some value-addition activities as they prepared to exit the MSME. The value-addition activities cut across the investment and post-investment. The researcher classified some of the value addition activities (financing from other investors, networking) in the post investment phase.

None of the VCFs in Kenya had exited an investment in an enterprise. As such they only identified speculative ways of exit. This was because the VCFs in the current study were established in Kenya in recent years between 2006 and 2009. Four VCFs had only one company in their portfolio of investments. This explained why none of the VCFs had reached the exit stage. Previous research showed that VCFs in previous research had carried out the exit stage after at least five years (Tyebjee and Bruno, 1984; Klonowski, 2007).

The exit criterion mostly speculated by the VCFs in Kenya was selling back of the shares to the shareholders once the investment term was over. Cumming and MacIntosh (2003), Pandey (2005), Clercq et.al. (2006) and Klonowski (2007) supported the IPO exit criterion. The current study saw the IPO as a possible future criterion, but Kenya's current financial environment was not able to support it.

5.3 What recommendation could be offered by VCFs to MSMEs in Kenya?

The VCFs gave specific recommendations to entrepreneurs of MSMEs accessing venture capital. They stated that trust, an achievable business plan, prompt communication and commitment from entrepreneurs and management team were key aspects.

Since the investment period was complex for both the VCF and entrepreneur, they needed a trusting relationship to work efficiently together. Mutual trust would also enable the VCF to re-invest in the MSME in future.

The business plans from MSMEs were often rejected because they were unachievable. Entrepreneurs therefore needed to prepare achievable business plans because it was a communication mechanism for the VCF.

The researcher concluded that for prompt communication between entrepreneurs and VCFs, timely and regular reports were crucial.

Overall, the entrepreneurs needed to understand the VCFs investment process. Previous research supported these recommendations (Shane and Cable, 1997; Gladstone and Gladstone, 2003).

CHAPTER 6: Conclusion and Recommendations

This section summarizes the basic answers that emerged from the research data.

6.1 Conclusion

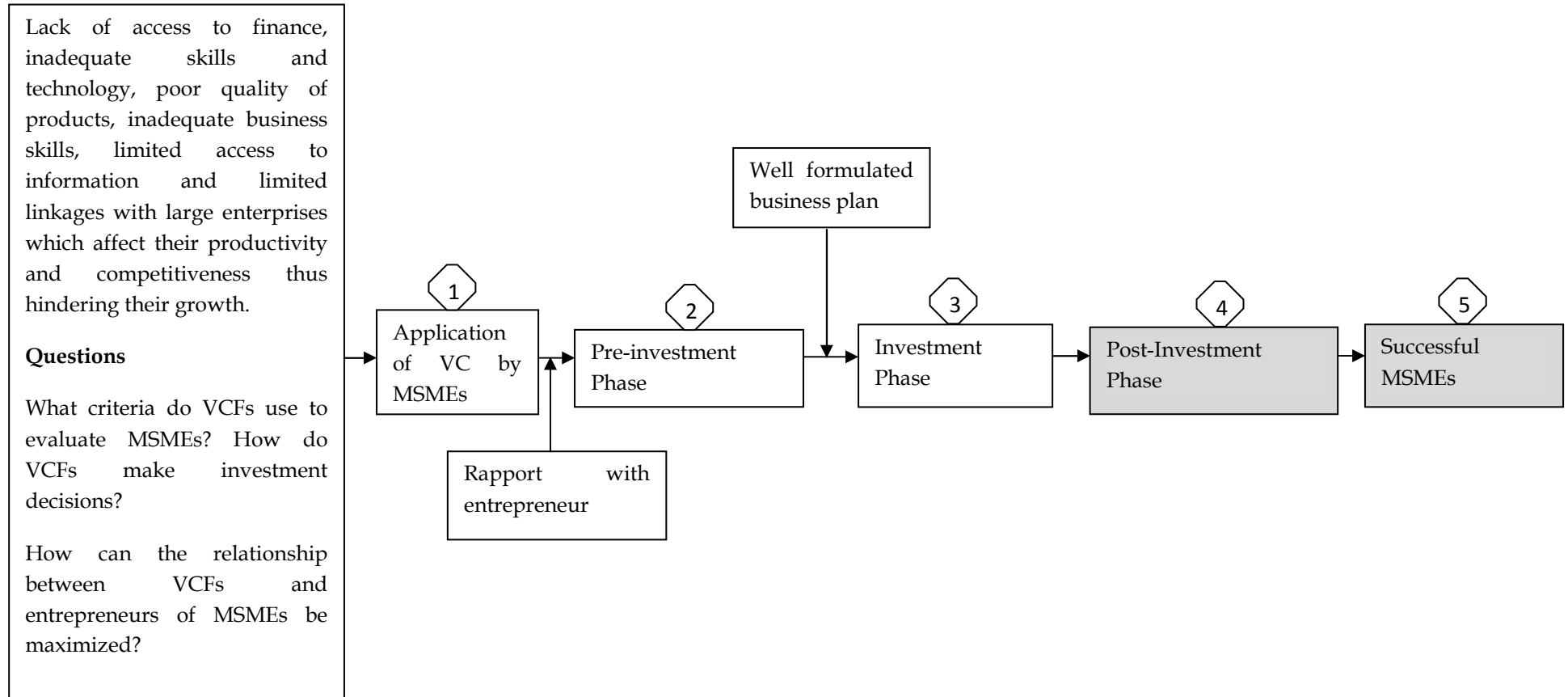
The purpose of this study was to; develop the venture capital investment framework for entrepreneurs of MSMEs when seeking VC, from the perspective of the VCFs. The study extended previous works done on the VCIP from other countries to the Kenyan context.

The key results showed that VCFs in Kenya experienced varied investment decisions from those in the previous studies. The key findings are illustrated on table 6.1 and figure 6.1 and explained below.

Table 6.1 Summary table of the VC Framework responding to the problem statement

Problems faced by MSMEs in Kenya		Venture Capital framework responding to the problems facing MSMEs
1.	Lack of access to finance	Venture capital funds (VCFs) in Kenya finance MSMEs requiring no collateral among other benefits. The current study has created awareness of VCFs expectations for entrepreneurs which makes VC accessible to MSMEs in Kenya.
2.	Inadequate business skills and technology	VCFs in Kenya provide professional management and technical skills
3.	Poor quality of products	VCFs in Kenya are hands-on managers and provide strategic and technical support.
5.	Limited access to information and limited linkages with large enterprises	VCFs in Kenya provide contacts of experts to the MSMEs.

Figure 6.1 Venture Capital Investment Framework for MSMEs in Kenya



Source: Research data (2010)

6.1.1 The Venture Capital Investment Framework for MSMEs in Kenya

The figure above shows the venture capital investment framework as developed from the current study. The framework responded to the problem statement and the research questions indicated.

1. Application of venture capital by MSMEs

The current study has developed the framework for entrepreneurs of MSMEs when applying for VC. This led to the venture capital investment framework which has been developed into three phases: pre-investment, investment and post-investment phase.

2. Pre-investment phase

The key findings contrasting with previous studies are explained as follows:

Benefits

VCFs in Kenya assisted entrepreneurs prepare their business plans in the pre-investment phase. Most entrepreneurs in Kenya lacked functional and technical expertise thus VCFs helped them prepare their business plans. VCFs educated entrepreneurs on the VCIP thus committing more resources in the pre-investment phase. For VCFs in Kenya, the importance of business plans was not influenced by stage of financing.

Stage of financing

VC is high risk capital and key for micro enterprises (seed capital). However, VCFs in Kenya focused mainly on the start-up and expansion stages. This was because of the high risks involved and inadequate industrial and market data. The VCFs also lacked the capacity and experience to focus on the buy-out stage and the Kenyan financial environment was not prepared for buy-outs.

Quasi-Equity

VCF offered not only VC but also a mixture of debt and equity (Quasi – Equity). This was because most entrepreneurs did not understand VC and confused it with debt capital. The risks involved also led VCFs give a portion of debt finance for collateral purposes.

VCF specific screening stage

VCFs invested in diverse sectors but avoided sectors such as agriculture due to the high risks involved. The investment period was a significant criterion for the VCFs to ensure they realized their returns within a specific time frame.

Entrepreneur and management

It was crucial that the entrepreneurs and management team were committed to only one business.

3. Investment Phase

The current study found it appropriate to distinguish the investment phase from the post-investment phase. This gave a more clear explanation of what happens in the actual investment period which was mainly focussed on monitoring the performance of the MSMEs, and offering value addition by giving managerial and technical expertise.

4. Post investment Phase

None of the VCFs in the study had experienced the post-investment stage in Kenya. The VCFs were foreign funds established in recent years (2006 – 2009). No VCF had carried out an exit yet. Selling back of shares to the shareholders once the investment term was over was the exit route mostly speculated by VCFs in Kenya. The financial environment was not ready for IPOs, acquisitions and mergers. VCFs may need to find other exit options suitable for the Kenyan market.

6.1.2 Revisiting the Venture Capital Investment Framework for MSMEs in Kenya

The current study shows key variations from previous studies. The key differences include:

Government support

VCFs in Kenya did not receive adequate support from the government. As commented by Peters (2009), government investments on MSMEs attract funding from VCFs. The government need to support the VCF industry which will lead to the establishment of local VCFs that understand the Kenyan market.

VC associations

No VC association was in existence in Kenya. A VC association was crucial for the VC industry in Kenya, fostering a greater understanding of VC, promoting innovation and entrepreneurial activity. It would also facilitate interaction among the VCFs.

Local venture capital funds

The VC industry had only foreign VCFs. Local VCFs would be crucial because they would better understand the Kenyan entrepreneur and hence MSMEs would effectively benefit from VC.

6.2 Implications for Policy and Practice

1. For the entrepreneurs of MSMEs

The current study has shown how venture capital solves the problems facing MSMEs in Kenya. Venture capital funds not only provide finance to entrepreneurs of MSMEs but also provide professional management skills and strategic support. The current study has also created awareness of the venture capitalists expectations for the entrepreneurs. The pre-investment phase is beneficial for any entrepreneur who makes contact with the VCF. Even if a deal was not successful to proceed to the investment phase, the entrepreneur would

benefit from the interaction with the VCF. The benefits would include: having operational systems in place, prepared financial accounts and achievable business plans.

2. For the government

The current study has shown the importance of venture capital for MSMEs in Kenya. The policy makers therefore need to facilitate the creation of local VCFs that support the MSMEs. The policies should be favourable to allow for creativity and innovation. Policies such as: offering tax incentives and subsidies and backing VCFs funding. This also facilitates for more foreign direct investments.

As found from the current study, VCFs were not offering seed capital because of the high risks involved. VC is risky capital thus micro enterprises should be the key target for VCFs. The government should invest in the micro enterprises thus enable them attract funding from VCFs.

3. For prospective venture capital funds and existing venture capital funds

The current study helps them understand the challenges in the Kenyan market. In the pre-investment phase VCFs utilized vast resources because of inadequate market and industry data. VCFs thus needed to employ more resources in research thus adequately utilizing resources used in the venture capital investment process. As recommended by Ghalbouni and Rouziès (2010), VCFs should not lose focus of their key role. They should not prioritize the marketing of their financial options rather they should market their operational expertise, their well-developed networks of experts, and the personalized attention offered to MSMEs. MSMEs need to know that VCFs offer more than just capital and that they are hands-on consultants that nurture MSMEs until they are sustainable.

VCFs should also form a Kenyan VC association which would facilitate interaction among the VCFs. The VC association will promote innovation and entrepreneurial activity in the Kenyan context. The VC association will also strengthen the role of the VC industry as one of the key facet to economic development. The VC association will also promote the understanding of VC and the VCIP for investors and MSMEs.

4. For academic researchers and industry consultants

Academic researchers and industry consultants could contribute industrial and market data for VCFs in Kenya.

In the field of finance, academicians could find ways of mitigating risks encountered by VCFs. Industry consultants could help identify and develop risk management tools to assist VCFs.

Academic researchers and industry consultants could also suggest and create exit options required by MSMEs and VCFs during the exit stage.

Universities in Kenya could incorporate venture capital units in the finance curriculum or develop a venture capital programme.

6.3 Areas for Further Research

The current study has focused on how venture capital funds make their investment decisions and why venture capital is an important source of financing for entrepreneurs of MSMEs in Kenya. Further research could focus on the entrepreneurs' perspective suggesting ways to improve the VCIP in Kenya.

The study identified seven VCFs, which were all foreign owned and incorporated in foreign countries. One other area of study could investigate why local investors had not established VCFs in Kenya. Another could explore further

the effect of the regulations for VCFs published by the Capital Markets Authority (CMA) in 2007 on the current VCFs.

The current study identified the benefits derived by MSMEs when accessing VC. A comparative study on the success of those MSMEs financed by debt capital versus those financed by VC could also be conducted.

REFERENCES

- Andrews, K.R. 1995, 'Initial public offerings: the experience of eight Canadian growth companies', *A paper presented at Conference Board of Canada*, Canada: Ottawa.
- Ahlstrom, D. & Bruton, G.D. 2006, 'Venture capital in emerging economies: Networks and Institutional change', *Entrepreneurship Theory and Practice*, Vol. 30, No. 2, pp.299-320.
- Allchorne, T. 2004, 'Assessing CEE private equity post accession', *European Venture Capital Journal*, Vol. 113, pp.48-53.
- Amit, R., Brander, J., & Zott, C. 1998, 'Why do venture capital firms exist? Theory and Canadian evidence', *Journal of Business Venturing*, Vol. 13, No. 6, pp 441-466.
- Banerjee. A. 2008, 'Private Equity in Developing Nations', *Journal of Asset Management*, Vol. 9, No. 2, pp. 158-170.
- Barry, C. 1994, 'New direction in research on venture capital finance', *Financial Management*, Vol. 23, No. 3, pp.3-15.
- Barth, H. 1999, 'Barriers to growth in small firms', *Licenciataavhandling*, Sweden: Luleå Tekniska Universitet.
- Bellas, R.C. 1993, 'The value of relationships with venture capitalists', *Healthcare Financial Management*, Vol. 2, No. 43, pp.63-64.
- Black, B. S. 1998, 'Information Asymmetry, the Internet and Securities Offerings', *Journal of Small and Emerging Business Law*, Vol. 2, No.1, pp. 91-99.
- Black, B.S., Gilson, R.J. 1998, 'Venture capital and the structure of capital markets: banks versus stock markets', *Journal of Financial Economics*, Vol. 47, No.3, pp.243-277.
- Bliss, R. 1999, 'A venture capital model for transitioning economies: the case of Poland', *Venture Capital*, Vol. 1, No.3 pp.241-257.

- Block, J., & Sandner, P. 2009, 'What is the Effect of the Current Financial Crisis on Venture Capital Financing? Empirical Evidence from US Internet Start-ups', *MPRA Paper*, No. 14727, viewed January 2010, <http://mpa.ub.uni-muenchen.de/14727/>
- Bygrave, W & Timmons, J. 1992, *Venture Capital at the Crossroads*, Boston: Harvard Business School Press, MA.
- Cable, D. M., & Shane, S. 1997, 'A prisoner's dilemma approach to entrepreneur-venture capitalist relationships', *Academy of Management Review*, Vol. 22, No. 1, pp 142-176.
- Callegati, E., Grandi, S & Napier, G. 2005, '*Business Incubation and Venture Capital - An International Survey on Synergies and Challenges*' Sweden: Joint IPI/IKED Working Paper.
- Carter, R. & Van Auken, H. 1994, 'Venture capital firms' preferences for projects in particular stages of development', *Journal of Small Business Management*, Vol. 32, No.1, pp.60-73.
- Capital Markets Authority (CMA) current licenses on the website, viewed November 2009: http://www.cma.or.ke/index.php?option=com_docman&task=cat_view&gid=15&Itemid=30.
- Chartered Financial Analyst Level I, *Alternative Investments*, viewed October 2009: <http://www.investopedia.com/exam-guide/cfa-level-1/alternative-investments/venture-capital-investing-stages.asp>.
- Chan, Y., 1983, 'On the Positive Role of Financial Intermediation in Allocations of Venture Capital in a Market with Imperfect Information', *Journal of Finance*, Vol. 38, No. 5, pp. 1543-1561.

- Chan, Y., Siegel, D., Thakor, A.V. 1990, 'Learning, corporate control and performance requirements in venture capital contracts', *International Economic Review*, Vol. 31, No. 2, pp.365-381.
- Chotigeat, T., Pandey, I.M., Kim J.D. 1997, 'Venture capital investment evaluation in emerging markets', *Multinational Business Review*, Vol.5, No. 2, pp. 54.
- Chu, P & Hisrich, R.D. 2001, 'Venture Capital in an economy in Transition', *Venture Capital*, Vol. 3, No. 2, pp. 169-182.
- Clercq, D.D, Fried ,V.H, Lehtonen, O & Sapienza, H.J. 2006, ' An Entrepreneur's Guide To The Venture Capital Galaxy', *Academy of Management Perspectives*, Vol. 20, No. 3, pp. 90-112.
- Cooper, I. A. & Carleton W. T. 1979, 'Dynamics of Borrower-Lender Interaction: Partitioning Final Payoff in Venture Capital Finance', *Journal of Finance*, Vol. 34, No. 2, pp. 517-529.
- Coulter, M.K. 1998, '*Strategic Management in Action*', New Jersey: Prentice-Hall Inc.
- Cumming, D., & MacIntosh, J. 2003, 'A cross-country comparison of full and partial venture capital exits', *Journal of Banking and Finance*, Vol. 27, No. 3, pp. 511-548.
- Dorsey, T. K. 1977, 'The Measurement and Assessment of Capital Requirements, Investment Liquidity and Risk for the Management of Venture Capital Funds,' *unpublished doctoral dissertation*, Austin: University of Texas.
- Elango, B., Fried, V. H., Hisrich, R. D., & Polonchek, A. 1995, 'How venture capital firms differ', *Journal of Business Venturing*, Vol. 10, No. 2, pp 157-179.
- EVCA 2002, '*Annual survey of pan-European private equity and venture capital activity*', Brussels: European Private Equity and Venture Capital Association Yearbook, Utrecht.
- EVCA 2006, '*European Private Equity and Venture Capital Association Yearbook*', Brussels: European Private Equity and Venture Capital Association, Utrecht.

- Farag, H., Hommel, U., Witt, P. & Wright, M. 2004, 'Contracting, monitoring, and exiting venture investments in transitioning economies: a comparative analysis of Eastern European and German markets', *Venture Capital*, Vol. 6, No. 4, pp.257-282.
- Fahy, J. 2000, 'The resource-based view of the firm: some stumbling-blocks on the road to understanding sustainable competitive advantage', *Journal of European Industrial Training*, Vol. 24, no. 2/3/4, pp. 94-104.
- Fichera, D. 2001, *'The insider's guide to Venture Capital'*, California, USA: Prima Publishing.
- Florida, R & Smith, D Jr. 1993, 'Venture Capital Formation, Investment, and Regional Industrialization' *Annals of the Association of American Geographers*, Vol. 83, no. 3, pp. 434-451.
- Fox J. W, 1996, *'The Venture Capital Mirage: Assessing USAID Experience with Equity Investment'*, Assessment Report, No. 17, Washington, USA: USAID Program and Operations.
- Fried V. H., Bruton G. & Hisrich R. 1998, 'Strategy and the board of directors in venture capital-backed firms', *Journal of Business Venturing*, Vol. 13, No. 6, pp. 493-503.
- Fried, V. H., & Hisrich, R. 1994, 'Towards a model of venture capital investment decision-making', *Financial Management*, Vol. 23, No 3, pp. 28-37.
- Ghalbouni, J., & Rouziès, D. 2010, 'The VC Shake-out' *Harvard Business Review*, Vol.88, No 7 – 8, pp. 21-23.
- Glassmeyer, E. F., 1981, *Guide to Venture Capital Sources: Venture Financing Techniques'*, Wellesley, Mass: Capital Publishing Corp, pp. 64-66.
- Gladstone, D., & Gladstone, L. 2003, *'Venture capital investing: The complete handbook for investing in private businesses for outstanding profits'*, Upper saddle River, NJ: Financial Times, Prentice Hall.

- Golden, S. C. 1981, *Structuring and Pricing the Financing: Guide to Venture Capital Sources*, Capital Publishing Corp., Wellesley, Mass.
- Gompers, J. 1997, 'Ownership and control in entrepreneurial firms: an examination of convertible securities in venture capital investments', *working paper*, USA: Harvard Business School.
- Gompers, P. & Lerner, J. 2004, *'The venture capital cycle'*, Massachusetts, USA: MIT Press.
- Green, M. 2004, 'Venture Capital Investment in the United States 1995-2002', *The Industrial Geographer*, Vol. 2, No. 1, pp. 2-30.
- Haque, U. 2008, 'How to Fix Venture Capital', *Harvard Business review Blogs*, USA: Harvard Business School.
- Hellman, T. & Puri, M. 2000, 'The interaction between product market and financing strategy: the role of venture capital', *Review of Financial Studies*, Vol. 13, No. 4, pp. 959-984.
- Hellquist, U. & Kraljevic, M. 2006, 'Venture Capital: what factors lie at the basis for venture capital investment decisions?' *unpublished thesis*, Jönköping, Sweden: Jönköping International Business School.
- Hoffman, C. A. 1972, 'The Venture Capital Investment Process: A Particular Aspect of Regional Economic Development,' *unpublished doctoral dissertation*, Austin: University of Texas.
- Holger, E., Witt. P., & Brachtendorf, G. 2005, 'Corporate Venture Capital as Strategy for External Innovation an Exploratory Study', *R&D Management*, Vol. 35, No. 3. pp. 233-242.
- Holger, R. 2005, 'The Role of Venture Capital in Fostering Economic Development' *FEMIP Expert Committee Meeting*, Germany: Deutsche Investitions- und Entwicklungsgesellschaft (DEG).
- Isaksson, A. 2006, 'Studies on the Venture Capital Process', *unpublished thesis*, Umeå, Sweden: Umeå School of Business.

- InvesteQ Capital Ltd. 2008, '*Capacity Constraints Facing Risk Fund Managers*', Final Report, Nairobi: Financial Sector Deepening (FSD) Kenya.
- Jeng, L.A. & Wells, P.C. 1998, 'The Determinants of Venture Capital Funding: Evidence across Countries', *Journal of Corporate Finance*, Vol. 6, No. 3, pp. 241-289.
- Jupp, V. 2006, *The SAGE Dictionary of Social Research Methods*, London: SAGE publications.
- Kaplan S.N. & Stromberg, P. 2003, 'Financial Contracting Theory Meets the Real World: An Empirical Analysis of Venture Capital Contracts', *Review of Economic Studies*, Vol. 70, No. 2, pp. 281-315.
- Kashangaki, J. & Simba, J. 2008, '*SME Risk Capital Funds: Constraints to Kenyan Institutional Investors*', report, Nairobi: Financial Sector Deepening (FSD).
- Karsai, J., Wright, M., Dudzinski, Z., Morovic, J. 1998, 'Screening and valuing venture capital investments: evidence from Hungary, Poland, and Slovakia', *Entrepreneurship & Regional Development*, Vol. 10, No. 3, pp. 203-224.
- KIPPRA 2009, '*Kenya Economic Report: Building a Globally Competitive Economy*', Nairobi: Kenya Institute for public policy research and analysis (KIPPRA).
- Kirilenko, A. 2001, 'Valuation and control in venture finance', *Journal of Finance*, Vol. 56, No. 2, pp. 565-87.
- Klonowski, D. 2005, 'The evolution of the venture capital industry in transition economies: the case of Poland', *Post-Communist Economies*, Vol. 17, No. 3, pp. 331-348.
- Klonowski, D. 2006, 'Local laws and venture capital contracting in transition economies: evidence from Poland', *Post-Communist Economies*, Vol. 18, No. 3, pp. 327-343.
- Klonowski, D. 2007, 'The Venture Capital Investment Process In Emerging Markets: Evidence from Central and Eastern Europe', *International Journal of Emerging Markets*, Vol. 2, No. 4, pp 361-382.

- Knight, R. M. 1994, 'Criteria Used by Venture Capitalists: A Cross Cultural Analysis,' *International Small Business Journal*, Vol. 13, No. 1, pp. 26-37.
- Koh, F. & Koh, W. 2002, 'Venture Capital and Economic Growth: An Industry Overview and Singapore's Experience, *Working Paper No. 21*, Singapore: Singapore Management University.
- Kortum, S. and Lerner, J., (2000), 'Assessing the Contribution of Venture Capital to Innovation', *Rand Journal of Economics*, Vol. 31. No.4, pp. 674-692.
- Langeland, O. 2008, ' Financial innovation: The role of Norwegian Venture Capitalists in Financing Knowledge intensive Enterprises', *European Studies*, Vol. 15, No. 9, pp. 1143-1161.
- Lancy, D.E. 1993, *Qualitative Research in Education: An introduction to the Major Traditions*, New York: Longman.
- Leland, H. E. & Pyle, D. H. 1977, 'Informational Asymmetries, Financial Structure, and Financial Intermediation', *Journal of Finance*, Vol. 32, No. 2, pp. 371-387.
- Leedy, P. D. & Ormrod, J. E. 2001, *Practical Research: Planning and Design*. Upper Saddle River, N.J: Merrill Prentice Hall.
- Lerner, J. 1994, 'The syndication of venture capital investments', *Financial Management*, Vol. 23, No. 3, pp 16-27.
- Lerner, J. 2002, 'Boom and Bust in the Venture Capital Industry and the Impact on Innovation', *Economic Review*, Vol. 84, No.4, pp 25-39.
- Lim, J.Y. 1990, *Initial Public Offerings: The Role of Venture Capitalists*, Charlottesville: Institute of Chartered Financial Analysts.
- Manigart, S., Wright, M., Robbie, K., Desbrieres, P. & De Wale, K. 1997, 'Venture capitalists' appraisal of investment projects: An empirical European study', *Entrepreneurship Theory & Practice*, Vol. 21, No. 4, pp.29-42.
- Mason, C & Harrison, R. 2004, 'Does investing in technology-based firms involve higher risk? An exploratory study of the performance of technology and non-

- technology investments by business angels', *Venture Capital*, Vol. 6, No. 4, pp. 313-333.
- Mason, C. & Harrison, R. 1999, 'Editorial: Venture Capital: Rational, aim and scope', *Venture Capital*, Vol. 1, No. 1, pp 1-46.
- Maxwell, J.A. 1992, 'Understanding and Validity in Qualitative Research', *Harvard Educational Review*, Vol. 62, No. 3, pp. 279-300.
- Megginson, W.L., Smart, S.B., & Lucey, B.M. 2008, *Introduction to Corporate Finance*, London: Cengage Learning EMEA.
- Ministry of Trade and Industry competitiveness project (MOTI, 2005): viewed October 2009, <http://www.msmkenya.org/Project-component1.html>.
- Ministry of trade and Industry, 2008, *Minister's speech* viewed October 2009: <http://www.tradeandindustry.go.ke/speech.asp?ID=83><http://www.tradeandindustry.go.ke/speech.asp?ID=83>.
- Miles, M. B. & Huberman, A. M. 1994, *Qualitative Data Analysis: An Expanded Sourcebook*, Thousand Oaks: Sage Publications.
- Murray, G. C. 1998, 'A policy response to regional disparities in the supply of risk capital to new technology based firms in the European Union: The European seed capital fund scheme', *Regional Studies*, Vol. 32. No. 5, pp. 405-419.
- National Business Incubation Association (NBIA) 2004, viewed October 2009: <http://www.nbia.org>.
- National Venture Capital Association (NVCA) 2004, viewed October 2009: <http://www.nvca.com>
- Ngigi, P. W. 1997, 'An Investigation into Venture Capital Financing For Small and Medium - Scale Enterprises in Info-Tech', *Unpublished thesis*, Nairobi: University of Nairobi.
- OECD 2006, 'Financing SMEs and Entrepreneurs', *Policy Brief*, Paris, France: Organization for economic co-operation and development (OECD).

- Oliver, C. 1997, 'Sustainable Competitive Advantage: Combining Institutional and Resource-Based Views', *Strategic Management Journal*, Vol. 18, no. 9, pp. 697-713.
- Pandey, I., Nair, R., Awasthi, D. & Ramachandran, K. 2003 'Entrepreneurship and Venture Capital', *Vikalpa*, Vol. 28, No. 1, pp. 99-112.
- Pandey, I.M. 2005, *Financial Management: Venture Capital Financing*, New Delhi: Vikas Publishing House.
- Peters, T.E. 2009, 'Venture Capital Deal Selection in Australia', *Unpublished Thesis*, Australia, University of New South Wales Australian School of Business.
- Pratch, L. 2005, 'Value-added investing: A framework for early stage venture capital firms', *Journal of Private Equity*, Vol. 8, No. 3, pp 13-29.
- Poindexter, J. B. 1976, 'The Efficiency of Financial Markets: The Venture Capital Case,' *unpublished doctoral dissertation*, New York: New York University.
- PWC & NVCA 2008, 'The exit slowdown and the new venture capital landscape', The Money tree report, *a quarterly survey*, USA: PricewaterhouseCoopers and the National Venture Capital Association.
- Raduan, C. R., Jegak, U., Haslinda, A & Alimin, I. I. 2009, 'A Conceptual Framework of the Relationship between Organizational Resources, Capabilities, Systems, Competitive Advantage and Performance', *Research Journal of International Business Studies*, No. 12, pp. 45-58.
- Rind, K.R. 1997, 'Profitable exiting: forming strategic partnerships, IPOs, sale backs, mergers and other mechanisms', Atlanta GA paper: presented at Venture Capital Institute Conference.
- Roberts, E.B. 1991, 'High Stakes for High-Tech Entrepreneurs: Understanding Venture Capital Decision Making', *Sloan Management Review*, Vol. 32, No. 2, pp. 9

- Ronge, E., Ndirangu, L., & Nyangito H. 2002, '*Review of Government Policies for the Promotion of Micro and Small scale Enterprises*', Discussion Paper No. 20, Nairobi: Kenya Institute for public policy research and analysis (KIPPRA).
- Ross, S. A. 1977, 'The Determination of Financial Structure: The Incentive Signalling Approach', *Journal of Economics*, Vol. 8, No.1, pp 23-40.
- Sahlman, W.A., 1990, 'The Structure and Governance of Venture-Capital Organizations', *Journal of Financial Economics*, Vol. 27, No. 2, pp. 473-521.
- Sapienza, H. 1992, 'When do venture capitalists add value?' *Journal of Business Venturing*, Vol. 7, No. 1, pp.9-27.
- Sapienza, H.J. & Gupta, A.K. 1994, 'Impact of agency risk and task uncertainty on venture capitalists-CEO interactions. *Academy of Management Journal*, Vol. 37, No. 6, pp. 1618-1632.
- Sarantakos, S. 2005, '*Social Research*', New York: Palgrave Macmillan.
- Shane, S & Cable, D. 2002, 'Network Ties, Reputation, and the Financing of New Ventures', *Management Science*, Vol. 48, No. 3, pp. 364-381.
- Shepherd, D.A, Ettenson, R., & Crouch, A. 2000, 'New Venture Strategy and Profitability: A Venture Capitalist's assessment', *Journal of Business Venturing*, Vol. 15, No. 5, pp. 449-467.
- Shepherd, D.A. 1999, 'Venture Capitalists Assessment of New Venture Survival', *Management Science*, Vol.45, No.5, pp. 631-632.
- Silver, D.A. 1985, *Venture Capital: The Complete Guide for Investors*, New York: Wiley.
- Silverman, D. 2000, *Doing Qualitative Research: A Practical Handbook*, Thousand Oaks: Sage Publications.
- Sormani, A. 2003, 'Central and Eastern Europe: the accession years', *European Venture Capital Journal*, Vol. 101, pp.63-71.
- Storey, D. J. 1994, *Understanding the Small Business Sector*, London: Routledge.

- Suksriwong, S. 2003, 'Investment Criteria of Venture Capital Companies', *Journal of Business Administration*, Vol. 98, pp. 57-78.
- Sweeting, R. 1991, 'UK venture capital funds and the funding of new technology-based businesses: process and relationships', *Journal of Management Studies*, Vol. 28, pp.601-22.
- Swedfund, 2008, 'Swedish State buys into Kenya', *Swedfund news*, viewed August 2009, <http://www.swedfund.se/en/press-room/news/swedish-state-buys-into-kenya>
- The Economist. 2004, 'Survey: A disorderly heaven', *The Economist*, Vol. 370, No. 8367, pp. 10.
- The MSME Competiveness Project: Catalyzing the Competitiveness and Growth of MSMEs: *Project coordinator PriceWaterHouseCoopers* viewed November 2009: <http://www.msmekenya.org/downloads/MSMEBrochure.pdf>.
- Timmons, J & Gumpert, D. 1982, 'Discard Many Old Rules About Getting Venture Capital', *Harvard Business Review*, Vol. 60, No. 1, pp. 273-280.
- Tyebjee, T & Bruno, A. 1984, 'A Model of Venture Capitalist Investment Activity', *Management Science*, Vol. 30, No. 9, pp. 1051-1066.
- Tyebjee, T & Bruno, A. 1985, 'The entrepreneurs' search for capital', *Journal of Business Venturing*, Vol. 1, No. 1, pp.61-74.
- United Nations Industrial Development Organization (UNIDO), 2001, 'Venture Capital for Industrial Development', viewed November 2009, www.un.org.
- Valliere, D & Peterson, R. 2007, 'When Entrepreneurs Choose VC's: Experience, Choice Criteria and Introspection Accuracy', *Venture Capital*, Vol. 9, No. 4, pp. 285-309.
- Wells, W. A. 1974, 'Venture Capital Decision Making', *unpublished doctoral dissertation*, Pittsburgh, USA: Carnegie-Mellon University.

- Wright, M., Karsai, J., Dudzinski, Z & Morovic, J. 1999, 'Transition and active investors: venture capital in Hungary, Poland, and Slovakia', *Post-Communist Economies*, Vol. 11, No. 1, pp.27-46.
- Yiallourou, C. 2006, 'Investment Activities of European Venture Capital Funds and the Influences of Fund Providers on their Specialization Patterns', *unpublished dissertation*, United Kingdom: University of Nottingham.
- Zavatta, R. 2008 'Financing Technology Entrepreneurs & SME's in Developing Countries: Challenges and Opportunities', *Kenya Country study*, The World Bank, USA: The International Bank for Reconstruction and Development.
- Zacharakis, A. & Meyer, D. 2000, 'The potential of actuarial decision models: can they improve the venture capital investment decision?' *Journal of Business Venturing*, Vol.15, No. 4, pp. 323-346.

APPENDICES

Appendix A: Sample Invitation Letter of Study (Venture Capitalist)

[Date]

[Addressee]

[Company Name & Address]

Dear [Sir/Madam or Addressee's Name],

RE: ACADEMIC RESEARCH THESIS

I am a Masters of Commerce Second Year student at Strathmore University, undertaking academic research for my thesis. The subject of my research is the venture capital industry and my research focuses on venture capital as a source of financing for MSMEs. The purpose for the research is to develop a framework that would enable MSMEs access venture capital. MSMEs will also gain knowledge of the significance of venture firms and how they can benefit from them.

Your firm has been identified to participate in the study owing to your involvement in venture capital. I would like to request for an interview with a senior venture capitalist from your firm. The information gathered from your firm will be treated with utmost confidentiality and your firm will remain anonymous. No specific reference will be made to the firm or the individual(s) interviewed, in the research report. I will provide a generic overview of the research findings with your firm upon completion of my research.

Let me thank you in advance for your collaboration. My contact details are Juliana Kamau, Tel: 0734 863500, Email: jkamau@strathmore.edu. You may also contact my university supervisor Dr. Ruth Kiraka at rkiraka@strathmore.edu for any clarification or queries.

Yours Sincerely,

Juliana Kamau

Masters of Commerce Student

Strathmore University

Appendix B: Semi-Structured Interview Guide

Structured Interview Guide Used With Investment Analysts in the Venture Capital Funds

Key: (VC) = Venture capitalist

Entrepreneurs of MSME = Start-ups, micro, small, medium enterprises

Section A: General Information

1. Company Name (VC):
2. Position in the company (for the Interviewee) (VC):
3. Type of business (VC) [Foreign subsidiary, Local company, Subsidiary of financial institution, Subsidiary of non-financial institution, Government subsidiary, _____ other _____ (what type)?]_____
4. Year the company was founded (VC):
5. How many companies are currently in your portfolio (number of companies) (VC)? _____
6. Which of the four stages of venture financing do you engage in (VC)? [Seed financing, Start-up financing, expansion financing, Buy-out financing] _____

Section B: Criteria in the Pre-investment Phase

1. Deal origination: What criteria do you use before investing in an MSME?
Which are most critical? Which are more critical and why?
E.g. Referrals from venture capital community
2. Deal screening: When you have identified an MSME, what criteria do you use when screening? Which are more critical and why?
E.g. Size of investment

3. Deal evaluation/ due diligence: What criteria do you use when evaluating? Which are more critical and why?

E.g. Market attractiveness: size and growth potential, market used and ability of venture to access the market

4. Deal structuring: What criteria do you use when evaluating? Which are more critical and why?

E.g. Composition of the board of directors

Section C: Activities in the Investment and Post-investment Phases

1. What criteria do you use when investing in an MSME? Why?

E.g. Monitoring the performance of investment

2. What are the exit options from the venture?

E.g. Acquisitions

Section D: Additional advice to MSMEs when accessing venture capital

What advice would you give MSMEs to maximize the **MSMEs - venture capitalist** relationship?

Appendix C: Venture Capital Funds in Kenya

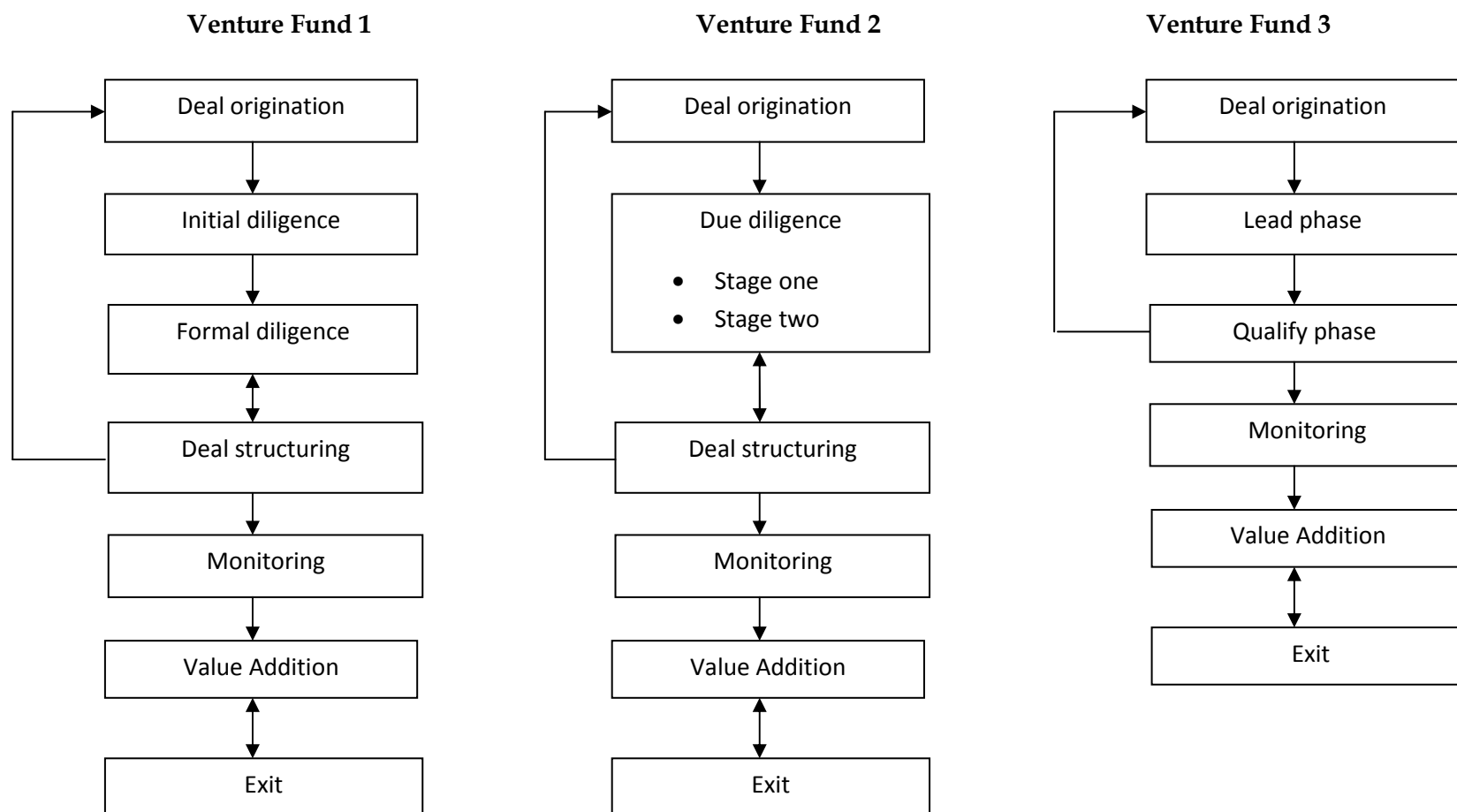
Name	Location
East Africa Capital Partners	2nd Floor, Loita House, Loita Street Nairobi, Kenya
TBL Mirror fund BV	Nairobi Business Park Block A, Ground Floor Ngong Road ,Nairobi +254 (0)20 2019374 - T
Business Partners International Kenya SA(BPI-K)	Africa Re Centre, 1st Floor Hospital Road, Upper Hill Nairobi, Kenya
Acumen fund	1st Floor, Cape Office Park, opposite Yaya Centre Ring Road, Kilimani Phone: + 254-20-386-1559/60/61
Fanisi	Fanisi Capital Limited 7th Floor Purshottam Place Westlands Road Tel: +254-20-360-1831
InReturn Capital (K) Ltd	Statehouse road, Opposite gate B of Statehouse Next to Philippines Embassy Tel +254 (0) 20 250 4775/6
GroFin	Ground Floor, CIC Plaza Mara Road Upper Hill Nairobi, Kenya
InvesteQ Capital fund	The venture fund not operational

Appendix D: Venture Capital Investing by Venture Stage

	Seed Financing	Start-up Financing	Expansion Financing	Buy-out Financing
Characteristic of the Venture	• 1-2 entrepreneurs • Undeveloped technology and business concept • Business plan not validated	• Management team in place • Product ready for marketing • A pilot and other information about the product available	• Marketing has been started • Venture is ready to start growing and expanding	• Established company
Main purpose of the funding	• Enabling research development • Developing business concept	• Establishing the marketing and sales activities	• Launching full scale marketing activities	• Management buyout • Leverage buyout • Delisting
Typical venture capital investor	• Angel venture capitalist (AVC) • Institutional venture capital funds (IVCF)	• Angel venture capitalist (AVC) • Institutional venture capital funds (IVCF)	• Institutional venture capital funds (IVCF)	• Institutional venture capital funds (IVCF)
Main expertise or benefit beyond money provided by the venture capitalist	• Structure, discipline, sounding board and attraction of additional (external) funding	• Marketing experience, recruiting help, contacts, help with follow-on financing	• Marketing experience, recruiting help, contacts, help with follow-on financing,	• Legal and other expertise on how to execute a buyout deal

	• Insights on how to establish the venture legal form • Technological insights	• Technological insights, test marketing and piloting possibilities • Reputation benefits	help to plan and execute the exit • Technological insights, test marketing and piloting possibilities • Reputation benefits	
Major trouble spots of venture capital funding	• Time consuming to locate and negotiate and close the deal • Involvement (e.g. reporting requirements and governance takes a lot of time) • Valuation of a new venture may be very low: a problem to the entrepreneur.	• Time consuming to locate and negotiate and close the deal • Involvement (e.g. reporting requirements and governance takes a lot of time) • The venture capitalists might want to direct the strategy of the venture, which may be a problem for the entrepreneur.	• Time consuming to locate and negotiate and close the deal • Involvement (e.g. reporting requirements and governance takes a lot of time) • The venture capitalists might want to direct the strategy of the venture, which may be a problem for the entrepreneur.	• Time consuming to locate and negotiate and close the deal • Involvement (e.g. reporting requirements and governance takes a lot of time) • The venture capitalists might want to direct the strategy of the venture, which may be a problem for the entrepreneur.

Appendix E1: Venture Capital Investment Processes for VCFs in Kenya



Appendix E2: Venture Capital Investment Processes for VCFs in Kenya

