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**DETERMINANTS OF FINANCING DECISIONS TO FUND STARTUPS BY VENTURE  
CAPITAL FIRMS IN KENYA**

**DORCAS KYENI WAMBUA**

**(71189)**

**A DISSERTATION SUBMITTED IN PARTIAL FULFILMENT OF THE DEGREE OF  
MASTERS IN DEVELOPMENT FINANCE AT STRATHMORE UNIVERSITY**



**STRATHMORE BUSINESS SCHOOL**

**STRATHMORE UNIVERSITY**

**NAIROBI, KENYA**

**NOVEMBER 2024**

## 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 document contains no material previously published or written by another person except where due reference is made in the research concept itself.

Name: Dorcas Kyeni Wambua

Reg. No. **71189**

Signature ...  .....

Date ...01/11/2024.....

### Approval by Supervisor

This thesis has been submitted with my approval

Signature:  .....

Date: ...8/11/2024

Dr. Farida Abdul (Supervisor)  
Strathmore Business School.



## DEDICATION

This paper is dedicated to my family, I am always grateful for the support.



## ACKNOWLEDGEMENT

I wish to thank and appreciate my supervisor Dr. Farida Abdul for her guidance and support throughout the study. Above all, I thank God for blessing me with the opportunity to undertake this course.



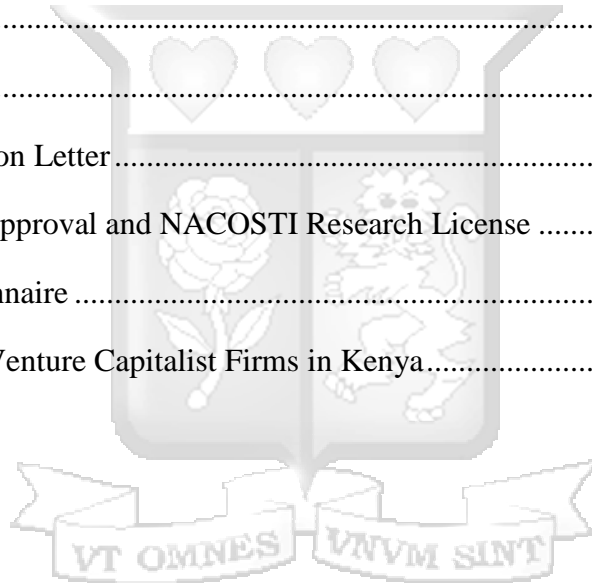
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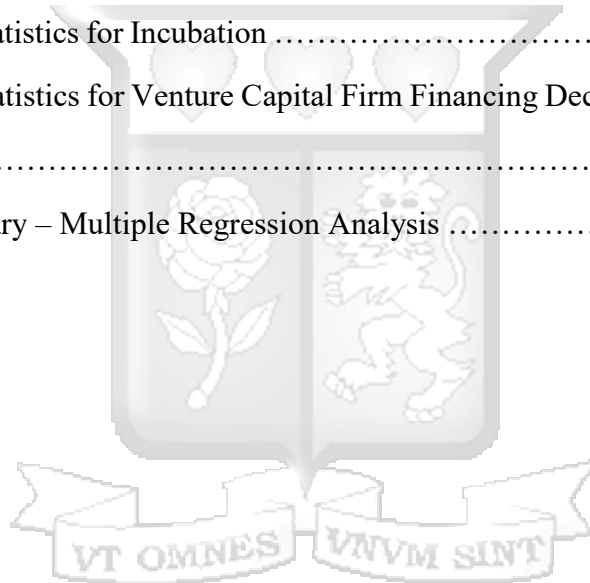
## ABSTRACT

Kenya's startup ecosystem presents unique dynamics that distinguish it from those of more developed economies, warranting a tailored examination of venture capital determinants. The local ecosystem is shaped by specific needs such as access to scalable funding, sector-focused support (especially in technology and agribusiness), and strategic guidance suited to an emerging market. Unlike established markets, regulatory frameworks in Kenya are evolving, creating an environment where venture funding decisions must consider varying levels of compliance and market volatility. The growing presence of incubators and accelerators further shapes the investment climate by offering essential mentorship, networks, and early-stage funding, which are crucial to the survival and growth of Kenyan startups. These context-specific elements underscore the importance of a region-focused study on venture capital financing and address gaps in existing literature predominantly focused on developed markets. This study sought to address this gap by investigating the determinants of Kenyan venture capital firms' financing decision for startups Kenya. The specific objectives of the research were to investigate the influence of internal organizational determinants, external determinants, and incubation on Kenyan venture capital firms' decision to finance startups in Kenya. The study was anchored on the Theory of Equilibrium Credit Rationing. The positivism philosophy was adopted for this research, which was performed using the cross-sectional research design. The sample for the current study comprised of finance and operation managers of venture capital firms in Kenya. The population of the study comprised 50 venture capital firms listed on the East African Venture Capital Association (EAVCA). A census was selected. Primary data was collected using structured questionnaires through a drop and pick approach and analyzed using Statistical Package for Social Sciences (SPSS). The findings showed that internal organizational determinants had a significant positive regression coefficient, suggesting a positive effect on Kenyan venture capital firms' decision to finance startups. The analysis also showed that external determinants had a significant positive coefficient, indicating the positive influence of external determinants on the decision by venture capital firms to finance startups. Moreover, the findings indicated that incubation had a significant positive regression coefficient, which suggests a positive effect. Based on the findings of this study, it is recommended that policy makers should consider formulating policies to improve the external determinants and support incubation of startups. It is also recommended that owners and managers should improve their internal organizational determinants in order to favorably position themselves among venture capitalists.

Keywords: Venture capital, financing, startups, Kenya

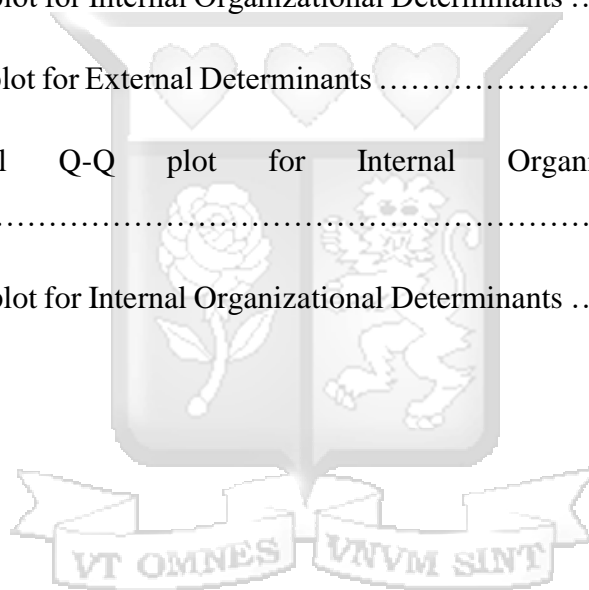
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## ABBREVIATIONS AND ACRONYMS

EAVCA	East Africa Venture Capital Association
SMEs	Small and Medium-Sized Enterprises
CMA	Capital Markets Authority
GDP	Gross Domestic Product
MENA	Middle East and North Africa
NACOSTI	National Commission for Science, Technology and Information



## DEFINITION OF KEY TERMS

<b>External Determinants</b>	External determinants are factors beyond the control of the organization. With respect to access to equity finance, the relevant external factors are demanding investor requirements and lack of access to capital markets (McKelvey, 2022). The external determinants that were studied were investor requirements and lack of access to capital markets
<b>Incubation</b>	Incubation is a process in which startups receive financial management, managerial and networking support from entities that help star ups in their early stages to grow (Muriithi et al., 2018).
<b>Organizational Determinants</b>	Organizational determinants refer to the internal features of an organization associated with its management model, strategy, structure and culture (Gilligan & Wright, 2020). The organizational determinants that were studied were management experience, investor readiness and corporate governance.
<b>Startup</b>	Startups were defined as enterprises that are in the early stages of their operations, have not existed for more than five years, and focus on developing and marketing a single product/service (Friesendorf & Haschemi, 2023)
<b>Venture Capital</b>	Venture capital is a type of private equity where investors invest in startups in exchange for a fraction of ownership (Friesendorf & Haschemi, 2023)



# CHAPTER ONE

## INTRODUCTION

### 1.1 Background to the Study

Venture capital represents a viable pathway for startups to access funding, which entails investors putting money into startups in exchange for a fraction of ownership (Friesendorf & Haschemi, 2023). This form of funding enables startups to scale operations, develop products/services and expanding market presence. Venture capital is pivotal during the early stages of startups' existence when resources are needed for transforming concepts into practical business solutions (Giaretta & Chesini, 2021). Besides facilitating access to capital, venture capitalists offer other benefits to startups including access to professional guidance, networks, strategic partners and industry experts, which can contribute to the success of startups (Chen & Ewens, 2021). Two forms of private equity funds exist – venture capital and growth capital. Venture capital targets startups that are in their early stages while growth capital targets late-stage established companies (Friesendorf & Haschemi, 2023). Some globally renowned companies that benefited from venture capital funding during their start-up stages include Airbnb, SpaceX and Uber (Friesendorf & Haschemi, 2023).

Despite the importance of venture capital, access to these funds is one of the key challenges faced by startups (Friesendorf & Haschemi, 2023). In developed economies, venture capital funding of startups is declining (Teare, 2023). In the first quarter of 2023, global venture capital funding reached \$ 76 billion, which was a 53% drop compared to the venture capital funding amount to \$ 162 billion in the first quarter of 2022 (Teare, 2023). Seed funding from venture capitalists have reduced significantly across the globe with more funding being allocated towards late-stage companies compared to early-stage startups (Teare, 2023). In the United States, venture capital funding for startups reached a nine-year low in 2023 (Jin, 2023). Similar trends have been reported in developing economies where startups are struggling to attract venture capital funding.

In the Middle East and North Africa (MENA) region, startups secured only 2 percent of the global venture capital funding in 2023 (AVCA, 2023). North America receives the largest share of venture capital deals, followed by Europe, Asia, Latin America and lastly Africa. Venture capital funding for startups in Africa reduced by nearly \$ 1 billion in the first half of 2023 compared to

the first half of 2022 (AVCA, 2023). This drop in venture capital funding for startups shows that investors are increasingly becoming cautious of which startups to fund (AVCA, 2023).

Locally, significant funding gaps for startups have been reported. In 2023, African startups collectively raised \$4.8 billion, marking a 53% decrease from 2022's \$10 billion funding milestone. Within this downturn, Kenya experienced a sharper decline, receiving only 15% of the continent's total venture funding, compared to 27% in 2022 (AVCA, 2023). Startups in Kenya raised around \$650 million in 2022, significantly lower than Nigeria (\$1.2 billion) and South Africa (\$1 billion) (AVCA, 2023). This funding gap highlights Kenya's need for more accessible venture capital. In addition, Kenyan startups, particularly at the seed and early growth stages, face substantial barriers to venture funding. In 2023, only 30% of Kenya's funding went to seed-stage companies, a decrease from 42% the previous year, underscoring limited capital for early-stage businesses (AVCA, 2023). In comparison to startups in other countries in Africa like Nigeria, startups in Kenya received a relatively lower fraction of venture capital funding (Disrupt Africa, 2022b).

### **1.1.1 Financing Decisions by Venture Capital Firms**

Various conceptualizations of financing decisions by venture capital firms exist in the literature. Shava (2018) defined financing decisions by venture capital firms as the verdict to invest and support entrepreneurs who seek funding. The indicators used by Shava (2018) to measure financing decisions by venture capital firms included providing investment support, advisory role, constant communication with entrepreneurs, and consultation services. These indicators were measured using a five-point Likert scale.

Another conceptualization of venture capital financing decisions was provided by Frey (2023), who defined financing decision as the process by the venture capitalists assess potential entrepreneurs to determine whether or not to lend funds or invest in them. To measure venture capitalists' financing decisions, the indicators used by Frey (2023) included investing funds in entrepreneurs' ventures and advising them. These indicators were measured using a five-point Likert scale.

According to Ozmel et al. (2013), venture capital financing decisions is defined as providing entrepreneurs with access to financing and access to managerial and technical expertise needed to

ensure the success of startups. The measures of venture capital financing decision used by Ozmel et al. (2013) included funding entrepreneurs, providing technical expertise and providing managerial expertise to entrepreneurs.

Divakaran et al. (2014) defined venture capital firm's financing decisions as the provision of capital to entrepreneurs in exchange for equity as well offering strategic advice and expertise. For Divakaran et al. (2014), venture capital investment decisions not only consist of access to financing but also knowledge of venture capitalists, such as access to markets, financial accounting, governance as well as other operational areas. Divakaran et al. (2014) operationalized venture capital financing decisions using providing financing, facilitating access to markets, providing operational support, and business guidance.

According to Friesendorf and Haschemi (2023), venture capitalists' financing decisions is defined as the process of selecting and financing startups and high growth firms. This process entails screening, evaluating and inspecting startups and high-growth firms to be potentially funded and the amount to be funded. Friesendorf and Haschemi (2023) operationalized financing decisions by venture capitalists solely in terms of provision of funding to entrepreneurs.

Evidently, venture capital firm's financing decision has been conceptualized and operationalized differently in the literature. For this study, the conceptualization of venture capitalists' financing decision by Shava (2018) and Divakaran et al. (2014) was adopted. Therefore, venture capital firms' financing decision was defined as providing financing and support to entrepreneurs in terms of providing funding to entrepreneurs, managerial expertise and technical support from venture capitalists (Divakaran et al., 2014; Shava, 2018). The indicators that were adopted to operationalize venture capital firm's financing decision included providing financing, managerial expertise, technical support, and access to markets to entrepreneurs who are seeking funding from venture capitalists, which have also been used by Divakaran et al. (2014) and Shava (2018).

### **1.1.2 Determinants of Financing Decisions by Venture Capital Firms**

Venture capitalists often evaluate potential startups before making the financing decision. The process of identifying a startup to fund usually involves numerous steps and is influenced by several factors. Numerous determinants of financing decisions by venture capital firms have been discussed in existing literature. These determinants include macro-economic factors, such as gross

domestic product growth (GDP) growth, interest rate, unemployment rate, corporate tax rate, rigidities in the labor market, and population demographics – these factors have been examined to compare cross-country differences in Venture Capital funding (Wang, 2019). Favorable macro-economic conditions are often associated with increased likelihood of venture capitalists' financing entrepreneurs.

Venture capitalists also evaluate the unique selling point or competitive advantage of the venture. This entails evaluating what distinguishes the startup from the existing market players and whether it can withstand competition. Venture capitalists are more likely to finance startups that have unique selling positions and have a market growth potential (Giaretta & Chesini, 2021). In this respect, venture capitalists usually evaluate a startup's growth rate, size, target market, and the customer problems it addresses. Venture capitalists are more likely to finance startups that have large target markets that expected to grow (Giaretta & Chesini, 2021).

In addition, organizational determinants have been studied, especially the characteristics of entrepreneurs (Grilli et al., 2019). The passion, experience and expertise of a startup's founders are often evaluated before making a decision by venture capitalists – these characteristics of founders have a positive influence on the financing decision (Hong et al., 2020). Also, venture capitalists assess the startup team's knowledge, capacity to execute the business plan, and their knowledge (Islam et al., 2018). Venture capitalists tend to prefer a capable and strong team of cofounders (Islam et al., 2018).

Financial projections and risk factors are also considered by venture capitalists (Khan, 2022). Financial projections offer insights into the growth trajectory of a startup as well as its revenue potential. As a result, venture capitalists look for startups with reasonable projections and those whose path to profitability is clear (Lee et al., 2015). Risks, such as technological obstacles, regulatory hurdles and market volatilities that a startup might experience are also key considerations by venture capitalists when making investment decisions. Other determinants of financing decisions by venture capitals include industry insights, market trends, political stability, portfolio diversification, disruption and innovation potential of startups, exit potential, and investor-founder fit (Hong et al., 2020).

This study focused on three categories of determinants – organizational determinants, external determinants and incubation. These determinants have been used in other similar studies (Prohorovs et al., 2019; Wang, 2019). Organizational determinants refer to the internal features of an organization associated with its management model, strategy, structure and culture (McKelvey, 2022). This study focused on three organizational determinants, including management experience, investor readiness and corporate governance, which has been used in other studies (Lim & Busenitz, 2020; Prohorovs et al., 2019). Internal organizational factors, such as management expertise, investor readiness, and corporate governance, are critical for startups seeking venture capital funding. Corporate governance, even in a simplified form, is increasingly relevant for startups as they seek to attract venture capital by building credibility and investor confidence (Hong et al., 2020). Startups that implement basic governance structures, such as an advisory board or transparent decision-making processes, signal a level of professionalism and operational stability valued by investors. This form of governance can mitigate information asymmetry—a primary concern for venture capitalists—by offering transparency in financial oversight and strategic planning, which enhances trust in the startup’s leadership (Wang, 2019). However, there is limited understanding of how these internal factors impact funding decisions specifically within Kenya’s startup ecosystem, which faces unique challenges like limited resources and high market volatility (Lim & Busenitz, 2020). By analyzing these determinants within the Kenyan context, insights that could be obtained help startups better align their organizational structures with investor expectations, ultimately enhancing their funding prospects.

Apart from internal organizational determinants, external determinants can also affect financing decisions by venture capital firms. External determinants are beyond the control of the startup (McKelvey, 2022). The external determinants that were examined in this study were macroeconomic conditions, perceived control of the startup by the venture capitalist, and market growth potential of the startup. These determinants have been used in similar studies on venture capital decision-making (Köhn, 2018; Shafi, 2021; Zarrouk et al., 2021). External factors—such as macroeconomic conditions, market growth potential, and investor control over startups—can significantly shape venture capital funding decisions, especially in emerging markets like Kenya. Given Kenya’s evolving regulatory landscape, economic variability, and sectoral growth, it is important to understand how these factors impact investor decisions uniquely in this context. This helped to identify and contextualize the external barriers and opportunities that influence venture

capitalists in Kenya, providing essential information for both investors and policymakers aiming to support the local startup ecosystem (Köhn, 2018).

Business incubators are increasingly becoming an important component of the startup ecosystem in Kenya. Business incubation is defined as a process in which an incubator provides support to start-up companies, such as training, mentorship and access to capital (Muriithi et al., 2018). Incubation also denotes a process in which startups receive financial management, managerial and networking support from incubators (Muathe & Otieno, 2022). For this study, the indicators of business incubation that were used included the support of incubators, access to networks, access to markets, and access to training and mentorship offered by incubators. Business incubation, through support mechanisms such as mentorship, networking, and access to resources, has become integral to startup growth and sustainability in Kenya. However, the extent to which incubators and accelerators directly impact venture capital funding decisions remains underexplored in the Kenyan context (Muathe & Otieno, 2022). This helped to understand the role of incubation in bridging early-stage funding gaps, thereby highlighting how incubation can serve as a critical factor in attracting venture capital. By examining this influence, the study provided strategic insights for incubators, investors, and startup founders on leveraging incubation for improved access to venture capital.

### **1.1.3 Venture Capitalists in Kenya**

The growth of the startup ecosystem has spurred the increase in venture capital firms in the country. The Capital Markets Authority (CMA) is the regulatory body that oversees the operations of venture capital firms in the country. For this study, the list of 50 venture capital firms operating in Kenya was obtained from the website of East Africa Venture Capital Association (EAVCA, 2024).

Despite the vibrant startup environment in Kenya, there has been a decline in venture capital funding (AVCA, 2023; Disrupt Africa, 2022b). In 2023, Kenyan startups raised approximately \$650 million, a significant decrease from \$1.1 billion in 2022. This 40% drop reflects broader economic constraints impacting venture funding across emerging markets (AVCA, 2023). Also, Kenya's share of total African venture capital funding dropped from 27% in 2022 to around 15% in 2023. This shift placed Kenya behind Nigeria and South Africa, which captured 30% and 22%

of African funding, respectively (AVCA, 2023). Despite the importance of venture capital, access to these funds is one of the key challenges faced by startups. Venture capital funding for startups in Africa reduced by nearly \$ 1 billion in the first half of 2023 compared to the first half of 2022 (AVCA, 2023). Kenya saw a 20% reduction in participation from international venture funds in 2023, signaling increased caution from foreign investors due to global economic uncertainty. This trend further constrains the availability of growth capital for Kenyan startups (Disrupt Africa, 2022b).

The research gap addressed by this study emerges from the limited regional focus on Kenya's unique startup ecosystem within existing venture capital literature. Although global and regional studies have examined venture capital determinants extensively, few concentrate on the specific contextual challenges faced by Kenyan startups, particularly in light of early-stage funding shortages and distinct sectoral demands such as agritech and fintech. Furthermore, while venture capital funding studies typically overlook the role of local incubators and accelerators, these entities play a pivotal role in shaping funding decisions by providing tailored mentorship, networking, and market access support specific to Kenya (Muriithi et al., 2018). Additionally, limited research explores how venture capitalists weigh investment determinants differently across high-growth sectors in Kenya. This study also seeks to address the underexplored trend of investor reluctance to fund seed-stage startups in Kenya, a recent challenge that constrains early-stage growth despite the country's vibrant startup environment. By focusing on these contextual, sector-specific, and early-stage factors, this study aims to add depth to the current body of venture capital literature.

## **1.2 Statement of the Problem**

Despite the importance of venture capital, access to these funds is one of the key challenges faced by startups, especially in developing economies, such as Kenya (Vandenberg et al., 2020). Researchers and entrepreneurs usually cite limited access to capital as a key barrier faced by startups (Marrus & Blaho, 2023; Vandenberg et al., 2020). While venture capital (equity) and bank lending (debt) are the dominant sources of external capital for businesses, an estimated 83% of newly established businesses have no access to external private institutional capital during their startup stages (AVCA, 2023). In the developed world, venture capital funding offered to startups is declining with investors preferring to fund late-stage companies over startups (Teare, 2023).

Significant funding gaps for startups have been reported (Disrupt Africa, 2022a). Additionally, in comparison to startups in other countries in Africa like Nigeria, startups in Kenya received a relatively lower fraction of venture capital funding (Disrupt Africa, 2022b). The limited access to venture funding by startups has adverse implications for these enterprises. Lack of adequate funding is one of the factors implicated in the failure and stagnation of startups in Africa as well as Kenya in particular. An estimated 70 percent of Kenyan startups fail after three years, which is partly due to the lack of adequate funding (Douglas et al., 2017). While venture capital has been described as an affordable and alternative financing model for startups and can fill the financing gap, access to this form of capital by startups is also limited (Gerd Sri & Manotungvorapun, 2021).

Conceptual, contextual and methodological gaps exist in the literature. Using an experimental design with U.S startups, De Rassenfosse and Fischer (2016) examined the factors that influence lending decisions by venture capitalists. Their findings showed that access to venture capital was influenced by the presence of patents and warrants. De Rassenfosse and Fischer (2016) showed that venture debt lenders preferred startups that offered patents and warrants as collaterals. Thus, having patents was associated with the increased likelihood of accessing venture debt due to increased security of the investment.

In another study with FinTech startups based in the UK, Giaretta and Chesini (2021) examined the determinants of receiving venture capital financing by startups. Giaretta and Chesini (2021) used secondary data from various database. Their analysis showed that the likelihood of venture capital financing for these startups was influenced by owner characteristics, asset structure and the specific FinTech activity, which were found to have a positive effect on the likelihood of getting financed by venture capitalists.

Seong and Kim (2021) conducted a descriptive study with a sample of South Korean startups to determine the factors that influence the decision to award financing to startups by venture capital firms. This study focused on the entrepreneur characteristics, market, product and service characteristics. The findings indicated that the decision to award financing by venture capitalists was influenced by characteristics of the entrepreneur and the suitability and reliability of the business.

Regionally, a descriptive survey study by Shava (2018), using a sample of South African startups examined the influence of entrepreneur characteristics in influencing access to financing from venture capitals. The study identified gender as a factor that explains the differences in obtaining venture capital, which is due to variations in business approaches between male and female entrepreneurs. Male entrepreneurs were more likely to get financing compared to female counterparts.

Eniola (2018), using a descriptive survey design with a sample of Nigerian startups, examined the influence for firm characteristics in accessing debt financing. The findings reported that firm characteristics, especially size, assets, sales and location, influenced access to venture debt. These characteristics had a positive effect on access to debt financing.

In Uganda, Nanyondo (2017) conducted a descriptive cross-sectional study to examine the determinants of access to debt finance in SMEs. The findings debt financiers often consider entrepreneurial experience, education, collateral, financial transparency and size and age of the firm when making financing decisions. These determinants had a positive effect on access to debt finance in Ugandan SMEs.

Locally, Weru and Rotich (2017) conducted a descriptive survey study aimed at examining the determinants of venture capital financing in SMEs. The findings from this study showed that venture capital financing in SMEs in Nairobi was influenced by information awareness, availability of resources/collateral, and entrepreneurial competence, which had a positive influence on access to this form of financing.

Njubi (2018) conducted a descriptive cross-sectional study to examine the determinant of venture capital decision-making. The study focused on management characteristics, entrepreneur characteristics and business characteristics. Their findings reported that venture capitalists' decision to finance SMEs in Kenya was influenced by entrepreneurial characteristics, management factors, product factors and the ability of the business seeking funding to generate adequate cash flows as well as profitable exit options.

Despite Kenya's active startup ecosystem, entrepreneurs face significant challenges in securing venture capital, limiting their ability to scale and contribute to economic growth (Muriithi et al., 2018). The issue is particularly acute at early funding stages, where investor reluctance and high-

risk perceptions reduce access to necessary capital (Teare, 2018). Additionally, the determinants influencing venture capital decisions in Kenya remain insufficiently understood, especially regarding the role of startup characteristics, venture capital control over startups, and the supportive influence of incubators and accelerators. While general research exists on venture capital funding globally and regionally, these studies often do not address Kenya's distinct challenges, such as limited regulatory clarity, early-stage funding gaps, and the unique landscape of high-growth sectors. Therefore, this study aims to explore the determinants influencing venture capital funding for Kenyan startups, providing insights that may enhance accessibility to venture capital and guide policy recommendations tailored to Kenya's entrepreneurial context.

### **1.3 Overall Objective of the Study**

The aim of this study was to examine the determinants of financing decisions by venture capital firms in Kenya.

#### **1.3.1 Specific Objectives of the Study**

1. To examine the influence of internal organizational determinants on financing decision to fund startups by venture capital firms in Kenya
2. To examine the influence of external determinants on financing decision to fund startups by venture capital firms in Kenya.
3. To determine the influence of incubation on financing decision to fund startups by venture capital firms in Kenya.

### **1.4 Research Questions**

1. What is the influence of internal organizational determinants on financing decision to fund startups by venture capital firms in Kenya?
2. What is the influence of external determinants on financing decision to fund startups by venture capital firms in Kenya?
3. What is the influence of incubation on financing decision to fund startups by venture capital firms in Kenya?

## **1.5 Scope of the Research**

The focus of this research was on the determinants of access to venture capital by startups in Kenya. The determinants of interest are internal organizational determinants, external determinants, and incubation. The geographical scope of this study is Kenya. The methodological scope for the current research was quantitative, which was conducted using a descriptive cross-sectional design. The target population consisted of the 50 venture capitalists in Kenya. The sample size for this study consisted of these 34 venture capitalist firms. The time scope for the study was March 2024 to April 2024.

## **1.6 Significance of the Study**

### **1.6.1 Policymakers and Regulators**

This study might be beneficial to policymakers and regulators, practitioners (owners, managers and directors of startups), and scholars. For regulators and policymakers, this study might provide useful insights to help inform the development of policies and guidelines to increase access to venture capital by startups. The findings can also provide useful information to guide policies that govern the interactions between incubators, startups and venture capital investors.

### **1.6.2 Industry Players**

For practitioners, this study might provide recommendations that they can adopt to enhance their chances of access venture capital. The results of this research might help startups adopt appropriate internal organizational determinants. The findings can also help venture capital firms with decision-making in terms of choosing the startups to fund.

### **1.6.3 Scholars**

Lastly, for scholars, this study might contribute towards the unresolved debate regarding the determinants of access to venture capital by startups. The results might spur additional research to better understand issue of access to venture capital by startups.

## 1.7 Chapter Summary

This chapter has described the concepts and context for the current study. It has also outlined the general and specific objectives of the study. The chapter has also discussed the problem statement, research significance, and its scope.



## CHAPTER TWO

### LITERATURE REVIEW

#### 2.1 Introduction

In this chapter, theoretical and empirical literature are reviewed. In addition, the research gap is identified. The chapter also presents the conceptual framework and the operationalization of the study variables.

#### 2.2 Theoretical Review

This section discusses the theories that anchored the current study. Numerous theories exist that can be used to explain the concept of access to financing. This study was anchored by the Theory of Equilibrium Credit Rationing.

##### 2.2.1 Theory of Equilibrium Credit Rationing

The Theory of Equilibrium Credit Rationing was developed by Hodgeman (1960). This theory posits that lenders and investors tend to assess the businesses on the expected return-expected loss ratio. If the expected loss is greater than the expected return, the chances of obtaining financing is reduced compared to situations where the expected returns are greater than the expected. Therefore, lenders and investors might be less interested in dealing with bad borrowers and risky business ventures (Hodgeman, 1960). This is usually the case for startups, wherein these enterprises are less likely to receive funding from lenders and investors who have little information about these companies. By contrast, large companies having stable business models and public firms are likely to receive funding from lenders and investors because of the vast information available about them. The Theory of Equilibrium Credit Rationing also holds that lenders and investors do not grant all the financing that businesses need because they are incapable of differentiating between risky and safe businesses (Hodgeman, 1960). This theory is based on the assumption that credit markets are imperfect because of information asymmetry, which lenders and investors try to correct using collateral and interest rates.

The theory effectively explains how information asymmetry impacts financing decisions. This is relevant to venture capital as startups often lack extensive operational histories, which increases

uncertainty for investors (Mc Namara et al., 2020). Venture capitalists face similar challenges of assessing startups with limited track records, making the theory's insights on information asymmetry applicable. By highlighting lenders' cautious behavior in uncertain environments, the theory provides a foundation for understanding why venture capitalists might avoid certain high-risk investments or adopt rigorous selection criteria (Beltrame et al., 2023). This approach is relevant when exploring why Kenyan venture capitalists are selective, especially given the country's regulatory and market volatility (Muriithi et al., 2018). Also, the theory suggests that lenders adopt screening mechanisms to distinguish between high- and low-risk borrowers. This is applicable in venture capital, where investors screen startups based on factors like management expertise, business model, and scalability. This screening aligns with the internal organizational and external determinants examined in this study (Beltrame et al., 2023).

Existing literature validates this theory by indicating that startups often experience more financing barriers in comparison to established firms, which is linked to the phenomenon of credit rationing (Mc Namara et al., 2020). In addition, this theory has been validated by studies affirming the important role played by collateral in enabling funds to secure funding (Yu and Fu, 2021). Lenders and investors rely on collateral to solve the problem of information asymmetry. Studies show that collateral lowers the extent of credit rationing in that having collateral increases the chances of obtaining funding (Mc Namara et al., 2020). For the case of investors, collateral can be likened to meeting the requirements of investors, such that firms that meet these requirements have a higher likelihood of securing investors (Beltrame et al., 2023).

The Theory of Equilibrium Credit Rationing was relevant for the current study since it provides an explanatory framework for the determinants of access to venture capital, including organizational determinants, external determinants and incubation. Based on this theory, due to inadequate information about startups, venture capitalists are expected to solve this problem by looking at organizational characteristics (such as managerial experience and corporate governance mechanisms) and impose some requirements to be met by startups in order to determine the expected returns – expected losses ratio, which they can in turn use to inform their decision on whether to finance the organization or not (Beltrame et al., 2023).

In this study, the Theory of Equilibrium Credit Rationing can help explain how venture capitalists manage risks associated with financing startups in Kenya, particularly under conditions of high

uncertainty. For example, Kenyan venture capitalists might apply rigorous screening and adopt higher requirements for startups due to perceived risks and information asymmetry in the local market (Beltrame et al., 2023). The theory's focus on asymmetry and screening processes could offer insight into how venture capitalists evaluate internal factors, like corporate governance, and external determinants, such as market potential and economic stability. Thus, the theory supports an understanding of why venture capitalists may require robust organizational structures or incubator backing as signals of reliability in a relatively volatile market.

## **2.3 Empirical Review**

This section reviews past studies focusing on the determinants of financing decision by venture capital firms. The focus is on three determinants outlined in the objectives, which include internal organizational determinants, external determinants, and incubation.

### **2.3.1 Internal Organizational Determinants and Financing Decision by Venture Capital Firms**

Organizational determinants refer to the internal features of an organization associated with its management model, strategy, structure and culture (Gilligan & Wright, 2020). Investors, including venture capitalists often conduct an organizational analysis of its performance, operations, financial structure, resources, and organizational structure and human resources to make a decision on whether or not to invest in a firm. An analysis of organizational factors helps in identifying the risks faced by a company, which in turn facilitates informed decision-making. The process of organizational analysis involves gathering and analyzing financial data, assessing risk, reviewing investment opportunities, and evaluating corporate governance mechanisms and financial controls (Gilligan & Wright, 2020).

Lee et al. (2015) conducted a descriptive survey study to assess the influence of firm innovation in access to finance in UK SMEs. The findings from their study showed that extremely innovative firms have a higher likelihood of being declined for financing due to the high-risk profile. Another study by Chowdhury and Alam (2017) examined the determinants of access to finance amongst Bangladeshi SMEs. Using secondary data analysis, Chowdhury and Alam (2017) showed that skills and education of owners, age and size of the business, and lack of collateral security influenced access to finance by these enterprises. In Turkey, Yildirim et al. (2013) conducted a

descriptive survey with SMEs and showed that legal status, stability and volume of sales, and size of assets has a significant positive effect on access to credit.

Regionally, the influence of firm determinants has been studied. For instance, in Ethiopian SMEs, Zelalem and Wubante (2019) investigated the influence of firm characteristics on access to finance. Using a mixed methods approach, Zelalem and Wubante (2019) showed that access to finance in these enterprises was positively influenced by their location (physical closeness to investors or lenders), industry, size, collateral, age, and legal status (incorporation). In another study using secondary data, Amahalu (2019) examined the influence of firm characteristics on the capital structure of firms listed in the Nigeria Stock Exchange. The firm characteristics of interest in this study were tangibility of assets whereas capital structure was measured using Debt-Common Equity ratio, Debt-Asset ratio and Debt-Capital ratio. Amahalu (2019) showed that the two firm characteristics exerted a significant influence on the capital structure of the listed firms. Another descriptive survey study by Shava (2018) using a sample of South African startups identified gender as a factor that explains the differences in obtaining venture capital, which is due to variations in business approaches between male and female entrepreneurs. Eniola (2018), using a descriptive survey design with a sample of Nigerian startups, reported that firm characteristics, especially size, assets, sales and location, influenced access to venture debt. In Uganda, Nanyondo (2017) reported that debt financiers often consider entrepreneurial experience, education, collateral, financial transparency and size and age of the firm when making financing decisions.

Locally, Kirugumi and Makori (2022) used an explanatory research design to examine the influence of firm characteristics on access to working capital financing among listed non-financial companies at the Nairobi Securities Exchange. Kirugumi and Makori (2022) demonstrated that firm size (defined as the log of total assets), tangibility of assets, profitability (measured using return on assets), and leverage had a positive influence on access to working capital financing. In another study, Nguli and Odunga (2019) conducted an explanatory survey research to assess how firm characteristics influenced financial inclusion in women-owned enterprises. Their results showed that firm age had a significant negative effect while firm size had a positive influence on financial inclusion of these enterprises. In addition, Weru and Rotich (2017) conducted a descriptive survey study and reported that venture capital financing in SMEs in Nairobi was influenced by information awareness, availability of resources/collateral, and entrepreneurial

competence. Njubi (2018) reported that venture capitalists' decision to finance SMEs in Kenya was influenced by entrepreneurial characteristics, management factors, product factors and the ability of the business seeking funding to generate adequate cash flows as well as profitable exit options.

### **2.3.2 External Determinants and Financing Decision by Venture Capital Firms**

External determinants are factors beyond the control of the organization. With respect to access to equity finance, the relevant external factors are demanding investor requirements and lack of access to capital markets (McKelvey, 2022). In addition to internal firm characteristics, lenders and investors also evaluate factors in the firm's external environment to make a decision on whether or not to provide financing. In some cases, investors impose demanding requirements in order to filter out firms that they finance. These requirements also serve as a selection tool (McKelvey, 2022).

Numerous external determinants have been studied in international studies. Zivari et al. (2020) conducted a systematic review of empirical articles from across the globe that examined the determinants of access to finance. The external factors that influence access to finance identified in this review included macro-economic volatility, corruption, debt conditions (repayment periods and interest rates), concentration of lenders and investors and information asymmetry. After surveying venture capitalists in the US, Drover et al. (2014) reported that their perceived level of control over the entrepreneur is positively associated with their likelihood of funding the venture. In Romania, however, a descriptive study by Diaconu (2012) showed that the amount of venture capital is not influenced by external factors, such as the annual inflation, tax rate levied on corporate income, market capitalization and the real interest rate.

Regional studies also show the significant influence of external determinants in access to finance. In Mozambique, Osano and Languitone (2016) examined the factors that influenced access to finance using a descriptive design. The factors examined included collateral requirements, support for startups and small businesses by the government, and structure of the financial sector. Access to finance was conceptualized as the number of financings offered to SMEs and startups as a total funding (Osano & Languitone, 2016). The findings showed that collateral requirements had a negative effect while support services for small businesses and startups and the financial sector

structure had a positive effect on access to finance. In Egypt, Ismail & Medhat (2019) examined the determinants of venture capitalists' decisions. Using secondary data analysis, Ismail & Medhat (2019) identified market factors that had a significant influence on venture capitalists' investment decisions, which include the market characteristics, high growth of the startup ecosystem, and the acceptance of the startup in the market as evidenced by having a customer base. A South African study by Van Deventer (2009) also reported that the acceptance of the startup in the market is a key factor that influences the decision-making processes of venture capitalists

Locally, the aforementioned study by Njubi (2018) identified market factors as being critical in investment decision made by venture capitalists. In particular, the study affirmed the positive influence of huge market growth potential as well as the huge market for a product, on access to venture capital. In addition, Weru and Rotich (2017) conducted a descriptive survey study and reported that venture capital financing in SMEs in Nairobi was hindered by demanding requirements of venture capitalists.

### **2.3.3 Incubation and Financing Decision by Venture Capital Firms**

Incubation is a process in which startups receive financial management, managerial and networking support from entities that help star ups in their early stages to grow (Muriithi et al., 2018). The aim of business incubation is to provide support to enable the growth of early-stage businesses. Incubators provide startups with an enabling environment during their early stage, which in turn increases their confidence, and helps to connect them to networks and resources that they need to scale their businesses (Pompa, 2013). Therefore, incubation plays a key role in fostering the growth of startups.

A review article by Pompa (2013) demonstrated the positive influence of business incubation in enabling startups to access finance as well as other resources critical for their success, such as networks and markets. Pompa (2013) conducted a literature review of technical, research and academic papers as well as government reports, and examined the impact of business incubation from a qualitative and a quantitative perspective. The findings showed that startups under incubation experienced fewer external financing obstacles compared to that were not under incubation. The value of business incubation was also demonstrated in another Norwegian study conducted by Pettersen et al. (2015), who used qualitative interviews to show that incubators

provided technology startups with access to network resources, such as venture capitalists and markets. In Chile, Chandra and Medrano (2012), using a qualitative method involving interviews with incubators, showed that incubators play a key role in connecting startups to angel investors as well as linking them to markets.

Regional studies have also demonstrated the role played by incubators in influencing financing decisions by investors. For instance, in Nigeria, Akanle et al. (2019) conducted a mixed methods study that adopted an explorative, descriptive and explanatory design to examine the impact of incubation hubs on startups. Akanle et al. (2019) reported that incubation hubs provide startup enterprises with a shared co-working space, access to equity capital, mentorship and training. In South Africa, a qualitative case study by Masutha and Rogerson (2015) presented evidence showing how incubators carefully pre-select startups and provide them with networking opportunities to enable them access funding. A Tanzanian study by Anderson (2017) identified lack of effective incubators as one of the barriers to accessing finance and growth of SME startups.

Studies conducted in the local Kenyan context also show the influence of incubators on startups. Muathe and Otieno (2022) conducted a desktop research to assess the role played by startup accelerators and incubators in Kenya. They collected and summarized secondary data, which revealed the important role played by incubators and accelerators, including providing these enterprises with mentorship, physical space, guidance, and linkages to investors. In another study, Mwasi and Aluoch (2023) used secondary data from incubation centers to show that incubation support services were positively associated with access to financing. A cross-sectional survey by Momanyi et al. (2023) also reported that business incubation through networking and mentorship positively influenced the financial performance of startups through linking them to resources as well as finance.

## **2.4 Research Gap**

While access to venture capital has been extensively studied, methodologies, concepts and contexts vary. Lee et al. (2015) examined the influence of innovation on the likelihood of getting financed in startups in the UK. Chowdhury and Alam (2017) focused on the influence of skills and education of owners, age and size of the business, and lack of collateral security on the likelihood of being financed in Bangladesh. Yildirim et al. (2013) conducted a descriptive survey with

Turkish SMEs and showed that legal status, stability and volume of sales, and size of assets has a significant positive effect on access to credit. In Ethiopian SMEs, Zelalem and Wubante (2019) investigated the influence of firm characteristics on access to finance using a mixed methods approach. Amahalu (2019) examined the influence of firm characteristics on the capital structure of firms listed in the Nigeria Stock Exchange. Kirugumi and Makori (2022) used an explanatory research design to examine the influence of firm characteristics on access to working capital financing among listed non-financial companies at the Nairobi Securities Exchange. In Mozambique, Osano and Languitone (2016) examined the factors that influenced access to finance using a descriptive design

Financing decision by venture capital firms has been conceptualized differently. Existing studies have adopted different methodologies that include qualitative, quantitative and mixed methods. In addition, existing studies on access to venture capital have been conducted across different contexts. As a result, there is lack of clarity regarding the determinants of access to venture capital since findings from existing research cannot be applied in the Kenyan context. This study sought to address this gap by investigating the determinants of financing decisions by startups in Kenya.

Additionally, the determinants influencing venture capital decisions in Kenya remain insufficiently understood, especially regarding the role of startup characteristics, venture capital control over startups, and the supportive influence of incubators and accelerators. While general research exists on venture capital funding globally and regionally, these studies often do not address Kenya's distinct challenges, such as limited regulatory clarity, early-stage funding gaps, and the unique landscape of high-growth sectors. Therefore, this study aims to explore the determinants influencing venture capital funding for Kenyan startups, providing insights that may enhance accessibility to venture capital and guide policy recommendations tailored to Kenya's entrepreneurial context. Table 2.1 shows a summary of the research gaps.

Table 2.1: Summary of Research Gaps

Study	Focus of the Study	Methodology	Findings	Research Gap	Focus of the Current Study
Lee et al. (2015)	The influence of firm innovation in access to finance in UK SMEs	Descriptive survey	Extremely innovative firms have a higher likelihood of being declined for financing due to the high-risk profile	Conceptual and contextual gaps	This study examined the factors that influence venture capital financing decision in Kenya. The business environment in Kenya poses different challenges from that in the UK, Also, this study looked at external determinants.
Zelalem and Wubante (2019)	The influence of firm characteristics on access to finance in Ethiopian SMEs	Mixed methods	Access to finance in these enterprises was positively influenced by their location (physical closeness to investors or lenders), industry, size, collateral, age, and legal status (incorporation	Conceptual	This study examined the factors that influence venture capital financing decision in Kenya. The business environment in Ethiopia has different challenges compared to Kenya. Apart from firm characteristics this study looked at other external factors
Amahalu (2019)	The influence of firm characteristics on the capital structure of firms listed in the Nigeria	Secondary data analysis	Tangibility of assets whereas capital structure influenced access to finance	Methodological and contextual gaps	This study examined the factors that influence venture capital financing decision in Kenya. The Nigerian business, regulatory and economic environment is different from Kenya. The current study used primary data.

	Stock Exchange				
Eniola (2018)	Influence of firm characteristics on access to venture debt	Descriptive survey	Firm characteristics, especially size, assets, sales and location, influenced access to venture debt	Conceptual and contextual gaps	This study examined the factors that influence venture capital financing decision in Kenya  Apart from firm characteristics this study looked at other external factors
Weru and Rotich (2017)	Factors that influence venture capital financing in Kenya	Descriptive survey study	Venture capital financing in SMEs in Nairobi was influenced by information awareness, availability of resources/collateral, and entrepreneurial competence	Conceptual gap	Present study also focused on external determinants and incubation
Ismail & Medhat (2019)	Determinants of venture capitalists' decisions in Egypt	Secondary data analysis	Market characteristics, high growth of the startup ecosystem, and the acceptance of the startup in the market as evidenced by having a customer base, influenced the	Methodological and contextual gaps	This study examined the factors that influence venture capital financing decision. The business environment in Egypt differs from Kenya  The current study used primary data.

			decisions of venture capitalists		
Pettersen et al. (2015)	Influence of incubation on startups in Norway	Qualitative interviews	Incubators play a key role in connecting startups to angel investors as well as linking them to markets	Contextual and conceptual	<p>This study examined the factors that influence venture capital financing decision and look at firm and external characteristics besides incubation.</p> <p>The business environment in Norway is different from Kenya</p> <p>Present study used a descriptive cross-sectional design</p>
Akanle et al. (2019)	Influence of incubation hubs on Nigerian startups	Mixed methods	incubation hubs provide startup enterprises with a shared co-working space, access to equity capital, mentorship and training	Conceptual and contextual	<p>This study examined the factors that influence venture capital financing decision and look at firm and external determinants.</p> <p>The business environment in Nigeria is different from Kenya</p> <p>Present study used a descriptive cross-sectional design</p>
Muathe and Otieno (2022)	Assess the role played by startup accelerators and incubators in Kenya	Desktop research with secondary data	Findings showed the important role played by incubators and accelerators, including providing these enterprises with mentorship, physical space, guidance, and	Methodological	This study used primary data

			linkages to investors		
Mwasi and Aluoch (2023)	Assess the impact of incubation on startups in Kenya	Secondary data analysis	incubation support services were positively associated with access to financing	Methodological and conceptual	This study used a descriptive cross-sectional design  Apart from incubation, this study looked at firm and external determinants

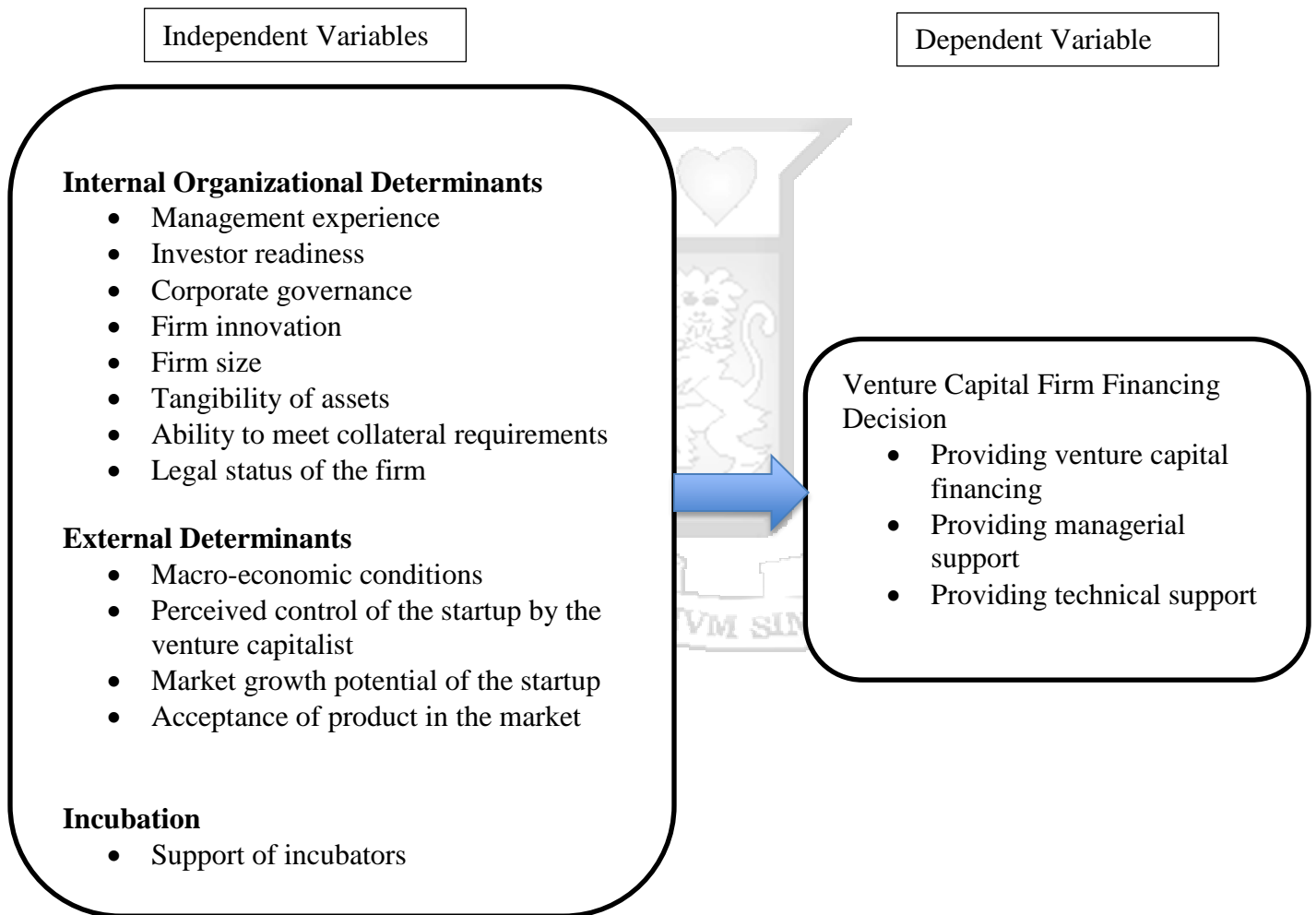
Source: Author (2024)



## 2.5 Conceptual Framework

Figure 2.1 shows the conceptual framework that was used in the present study. It depicts the independent variables, including internal organizational determinants, external determinants and incubation, and the dependent variable of access to venture capital. The indicators for the variables are also shown the conceptual framework together with the association between the variables.

Figure 2.1: Conceptual Framework



Source: Researcher (2024)

## 2.6 Operationalization of the Study Variables

Table 2.2 shows how the variables for this study were operationalized. The table shows the definition and indicators for the variables as well as how they were measured.

Table 2.2 Operationalization of Study Variables

Variable	Constructs	Operational Definition	Indicators	Measurement Scales	Source(s)
Independent variable (Determinants of Venture Capital Firm Financing Decision)	Internal organizational Determinants	The internal features of an organization associated with its management model, strategy, structure and culture (Gilligan & Wright, 2020)	Management experience	Five-point Likert scale	Gilligan & Wright (2020).
			Investor readiness	Five-point Likert scale	Gilligan & Wright (2020).
			Corporate governance	Five-point Likert scale	Gilligan & Wright (2020).
	External Determinants	External determinants are factors beyond the control of the organization (McKelvey, 2022)	Macro-economic conditions	Five-point Likert scale	McKelvey (2022)
			Perceived control of the startup by the venture capitalist	Five-point Likert scale	McKelvey (2022)
			Market growth potential of the startup	Five-point Likert scale	McKelvey (2022)
	Incubation	Incubation is a process in which startups receive financial management, managerial and networking	Support of incubators	Five-point Likert scale	(Muriithi et al., 2018)
			Access to networks	Five-point Likert scale	(Muriithi et al., 2018)
			Access to markets	Five-point Likert scale	(Muriithi et al., 2018)
			Access to training and mentorship	Five-point Likert scale	(Muriithi et al., 2018)

		support from entities that help star ups in their early stages to grow (Muriithi et al., 2018).			
Dependent Variable	Venture Capital Firm Financing Decision	Providing funds, managerial expertise and technical support from venture capitalists (Divakaran et al., 2014; Sahava, 2018).	Providing venture capital financing	Five-point Likert scale	Divakaran et al., (2014); Sahava, (2018)
			Providing managerial support	Five-point Likert scale	Divakaran et al., (2014); Sahava, (2018)
			Providing technical support	Five-point Likert scale	Divakaran et al., (2014); Sahava, (2018)

Source: Author (2024)

## 2.7 Chapter Summary

This chapter has discussed the theories that underpinned the current research as well as the existing empirical studies on the determinants of access to venture capital. The research gaps emerging from the existing literature were also identified. The conceptual framework and the operationalization of variables have also been presented.

## CHAPTER THREE

### RESEARCH METHODOLOGY

#### 3.1 Introduction

This chapter describes the methodology that was adopted to conduct the research, collect and analyze the collected data. It discusses the research philosophy, research design, the population, procedures for data collection and analysis, steps to enhance research quality and the ethical issues that were taken into consideration.

#### 3.2 Research Philosophy

The research philosophy denotes a researcher's perspective regarding how valid knowledge should be developed. Two main philosophies exist – interpretivism and positivism. Interpretivism is based on the belief that reality is subjective and experienced differently rather than objectively (Stokes, 2017). Thus, interpretivism seeks to understand and interpret the meanings of human behavior instead of generalizing and predicting cause and effect relationships, which makes this philosophy suitable for qualitative research. By contrast, the positivism philosophy views objective knowledge as valid. It is based on the view that reality can be observed and measured in an objective manner (Stokes, 2017). Positivism focuses on predicting and explaining phenomena, which was consistent with the current research that attempted to explain access to venture capital using organization and external determinants and incubation. Positivism was also adopted for this study in order to generate findings that can be applied to startups in Kenya.

#### 3.3 Research Design

The research design is akin to a framework that guides the researcher on the techniques and methods used to perform a study (Bell et al., 2022). A quantitative research method was appropriate for this study because it enabled systematic measurement and analysis of specific variables influencing venture capital financing decisions for startups in Kenya. By using structured data collection tools, this method allowed for the collection of measurable data across a sample of venture capital firms (Shava, 2018). Quantitative methods facilitate identifying patterns and relationships between variables, such as the impact of internal organizational factors, external determinants, and incubation support on funding decisions. Additionally, quantitative analysis

supports statistical techniques that can determine the strength and significance of these relationships, providing clear, objective insights into which factors most strongly influence venture capital funding (Bell et al., 2022). This approach is especially suitable given the study's aim to generalize findings across Kenya's startup ecosystem, thus offering evidence-based conclusions that can guide investors and policymakers.

For the current study, the specific quantitative design that was adopted is the descriptive cross-sectional research design was used. This design is useful for collecting information with a goal to describe the phenomena being study. The choice of the descriptive design for the current study was influenced by the need to describe the variables for the study as well as the relationships between them. Similar studies to explore the determinants of access to venture capital have employed the descriptive cross-sectional design (Nanyondo, 2017; Shava, 2018).

### **3.4 Population of the Study**

The population for the current study consisted of registered venture capitalists in Kenya. For this study, the list of venture capital firms operating in Kenya was obtained from the website of East Africa Venture Capital Association (EAVCA, 2024), which served as the population for this research. Therefore, the unit of analysis for this study was the venture capital firm.

### **3.5 Sampling Design**

This study used census approach wherein all the venture capital firms in Kenya were targeted to access respondents (Bell et al., 2022). In the census approach, data is collected from all units in the population due to its small size instead of taking a sample from the population. In this case, the researcher approached the senior partners, owners, managing directors, or investment committee members who directly oversee funding allocations and strategic guidance. These roles are more suited to capturing insights into the factors influencing financing decisions, as they involve deeper engagement with startup evaluation, risk assessment, and portfolio management. For this research, the target is to select one respondent from each venture capitalist firm, bringing the total sample size to 50 respondents consisting of finance and operations managers of venture capital firms in Kenya.

### **3.6 Data Collection Method**

In this study, primary data was collected using a structured questionnaire. These questionnaires are quick to administer and provide standardized data that can be analyzed with ease (Stokes, 2017). Structured questionnaires are also efficient and facilitate the collection of data from a huge sample pool (Bell et al., 2022). The structured questions used a five-point Likert scale to measure the indicators of the variables. The questionnaire had three sections. Section A gathered information regarding the demographic information for respondents. Section B contained questions to collect information about the determinants while Section C contained statements regarding to access to venture capital.

The drop-and-pick approach was used to distribute the questionnaires. This approach is useful in increasing the response rate because it allows respondents to complete the questionnaire at a time of their convenience (Bell et al., 2022). In addition, the use of trained research assistants were adopted in order to help improve the response rate.

### **3.7 Research Quality**

This section describes the steps that were taken to enhance the validity and reliability of the findings

#### **3.7.1 Validity**

Validity is defined as the extent to which the instruments measure what they are designed to measure (Bell et al., 2022). To enhance the validity of the research, the questionnaire was developed with the guidance of a supervisor at Strathmore University. The questionnaire was also be reviewed by five experts in finance selected from the author's contacts. Their feedback was incorporated in the final questionnaire that was distributed to respondents. A pilot study was conducted with 10 respondents from venture capital firms to assess the understandability of the questionnaire.

#### **3.8.2 Reliability**

Reliability is defined as the extent to which a data collection instrument is consistent. The Cronbach's alpha coefficient was used to assess the reliability of the subscales in the questionnaire

and the entire questionnaire. A Cronbach's coefficient of at least 0.7 is deemed acceptable (Bell et al., 2022). Stokes (2017) recommended a range of 0.7-0.9 since above 0.9 is excessive and might need the scale to be shortened. For this study, the recommendation by Bell et al. (2022) of at least 0.7 was used to assess the reliability of the questionnaire. Table 3.1 shows the Cronbach's alphas for the variables in the questionnaire.

Table 3.1: Reliability Statistics

Variable	Cronbach's Alpha Coefficient	Number of Items	Interpretation
Internal Organizational Determinants	0.944	8	Reliable
External Determinants	0.878	5	Reliable
Incubation	0.950	4	Reliable
Venture Capital Firm Financing Decision	0.932	6	Reliable

Source: Researcher (2024)

### 3.8 Data Analysis

The first step to analyze the data involved sorting the data and checking for missing data. Listwise deletion was used to handle missing data, which involves removing incomplete data from the dataset and analyzing only complete responses (Bell et al., 2022). The cleaned data was analyzed by the Statistical Package for Social Sciences (SPSS) software, using descriptive and inferential statistics. The descriptive statistics that were used included mean and standard deviation. Inferential statistics, using correlation and regression, were used to examine the association between the variables. The multiple linear regression were used to model the relationship between access to venture capital as the dependent variable, and internal organizational determinants, external determinants and incubation as the independent variables. Multiple regression is appropriate for analysis since the dependent variable is continuous – whereas the questions are Likert scale items, the final score for the dependent variable is an average of this scale items, making it a continuous variable. Averaging Likert items, which are ordinal individually, creates a composite score that approximates interval-level data. This allows you to use it in statistical analyses that assume continuity, like regression or correlation analysis, as it represents a range of values with a meaningful order and consistent intervals (Bell et al., 2022). The diagnostic tests that

were before running linear regression were normality and linearity. The regression equation that was used in this study is shown below:

$$VC = \beta_0 + \beta_1 OD + \beta_2 ED + \beta_3 IN + \epsilon$$

Where: -

VC = Venture Capital Financing Decision

OD = Internal Organizational Determinants

ED = External Determinants

IN = Incubation

$\epsilon$  = Error Function

### **3.8 Ethical Considerations**

Before commencing the process of collecting data, approval was obtained from the Ethical Review at Strathmore University as well as the National Commission for Science, Technology and Information (NACOSTI). Secondly, the confidentiality and respondents of participants were upheld. The researcher did not collect any personal information, such as names, physical address, and mobile phone numbers, that can be used to identify respondents. The collected data was kept in a password secure computer under lock-and-key and accessible only by the researcher. Thirdly, informed consent was obtained from respondents to ensure that participation is voluntary. A letter of introduction accompanied the questionnaire detailing the nature of participation in the research as well as the confidentiality and privacy guarantees.

### **3.10 Chapter Summary**

This chapter has outlined the methodology that was adopted to conduct the research, collect and analyze the collected data. It has also discussed the research philosophy, research design, the population, procedures for data collection and analysis, steps to enhance research quality and the ethical issues that were taken into consideration.

## CHAPTER FOUR

### PRESENTATION OF RESULTS

#### 4.1 Introduction

The aim of this study is to examine the determinants of financing decisions by venture capital firms in Kenya. The determinants that were examined included internal organizational determinants, external determinants, and incubation. The findings of this study are presented in this chapter. In particular, this chapter presents the response rate, respondents' demographic information, descriptive analysis, and inferential analysis.

#### 4.2 Response Rate

Fifty questionnaires were distributed to either finance operations managers in venture capital firms in Kenya. Thirty-four questionnaires were returned, which translates to a response rate of 68% as illustrated in Table 4.1. The threshold response rate recommended by Bell et al. (2022) is 50%, which is considered acceptable. Using this criterion, the response rate obtained from the present research was sufficient to continue with the analysis.

**Table 4.1: Response Rate**

Questionnaires	Frequency	Percent
Distributed	50	100%
Returned	34	68%
Not returned	16	32%

Source: Researcher (2024)

#### 4.3 Demographic Information of Respondents

Regarding gender, the majority of the respondents were male the sample in this study (65%, n = 22), which is consistent with the gender representation of males in managerial positions. Regarding educational level, most respondents had a Bachelor's degree (65%, n = 22), followed by Master's (18%, n = 6), PhD (9%, n = 3) and College Diploma (9%, n = 3). This is consistent with the representation of educational attainment among managerial personnel in Kenya. Regarding age, the majority of respondents were aged between 36 and 45 (56%, n = 19), which is expected in Kenya since this population would now be in middle management. In terms of experience, most

respondents indicated having an experience of 6-10 years (47%, n = 16), which is expected since most respondents were aged 36-45 years. Detailed demographic information of respondents is presented in Table 4.2.

**Table 4.2: Demographic Information of Respondents**

		Frequency	Percent
Gender	Male	22	65%
	Female	12	35%
	Total	34	100%
Education	College diploma	3	9%
	Bachelor's Degree	22	65%
	Masters	6	18%
	PhD	3	9%
	Total	34	100%
Age	18 - 25	1	3%
	26 - 35	7	21%
	36 - 45	19	56%
	46 - 55	4	12%
	56 and above	3	9%
	Total	34	100%
Experience working for the company	0 - 5 years	7	21%
	6 - 10 years	16	47%
	11 - 15 years	4	12%
	16+ years	7	21%
	Total	34	100%

Source: Researcher (2024)

#### 4.4 Descriptive Analysis

The descriptive statistics relating to the variables in this study are presented in this section, which included internal organizational characteristics, external determinants, incubation and venture capital financing decision.

##### 4.4.1 Descriptive Statistics for Internal Organizational Determinants

The indicators used to measure internal organizational determinants included management experience, investor readiness and corporate governance. Table 4.3 shows the descriptive statistics

for internal organizational determinants considered by venture capital firms when making a financing decision. The findings suggested that venture capital firms moderately consider the following aspects when making financing decisions: experiences of startup managers (Mean = 3.62, Standard Deviation = 1.015), startup readiness (Mean = 3.59, Standard Deviation = 0.925), startup innovativeness (Mean = 3.53, Standard Deviation = 1.134) and the presence of corporate governance structures (Mean = 3.53, Standard Deviation = 0.929). In addition, the results also showed that venture capital firms moderately consider the following aspects when making financing decisions: startup size (Mean = 3.44, Standard Deviation = 1.133), tangible assets (Mean = 3.35, Standard Deviation = 1.098), ability of startup to meet collateral requirements (Mean = 3.41, Standard Deviation = 1.019), and the incorporation status of the startup (Mean = 3.56, Standard Deviation = 0.927). The average score for internal organizational determinants was moderate (Mean = 3.5037, Standard Deviation = 0.86956). These findings suggest that organizational determinants are moderately considered by venture capital firms when making financing decisions for startup firms.

**Table 4.3: Descriptive Statistics for Internal Organizational Determinants**

	N	Mean	Std. Deviation
The firm considers that experiences of managers when making the decision to fund startups	34	3.62	1.015
The firm assesses the readiness of startups when funding them	34	3.59	.925
The presence of corporate governance structures in startups is an important criterion that determines the funding of startups by the firm	34	3.53	.929
The firm considers the innovativeness of startups when making the decision to finance startups	34	3.53	1.134
The size of the startup (number of employees) is considered when deciding to finance a startup	34	3.44	1.133
The firm looks at the tangible assets that the startup has before deciding to finance it	34	3.35	1.098
We have collateral requirements that must be met by the firm before we agree to finance them	34	3.41	1.019
The firm takes a keen interest in whether the startup is incorporated	34	3.56	.927
<b>Internal Organizational Determinants</b>	<b>34</b>	<b>3.5037</b>	<b>.86956</b>

Source: Researcher (2024)

#### 4.4.2 Descriptive Statistics for External Determinants

The indicators used to measure external determinants were macro-economic conditions, perceived control of the startup by the venture capitalist, and market growth potential of the startup. Table 4.4 presents the descriptive statistics for external determinants that venture capitalism firms consider when making financing decisions for startups. Table 4.4 shows the descriptive statistics for external determinants. The analysis shows that venture capital firms moderately consider the following aspects when making financing decisions for startups: prevailing condition of the economy (Mean = 3.50, Standard Deviation = 0.896), gathering information about a startup (Mean = 3.38, Standard Deviation = 0.888), startups that agree to relinquish some part of control (Mean = 3.15, Standard Deviation = 4.048), and startups having products/services that have been already accepted in the market (Mean = 2.94, Standard Deviation = 1.127). The average score for external determinants was moderate (Mean = 3.5, Standard Deviation = 0.896). These findings suggest that external determinants are moderately considered by venture capital firms when making financing decisions for startup firms.

**Table 4.4: Descriptive Statistics for External Determinants**

	N	Mean	Std. Deviation
The prevailing condition of the economy, such as inflation and unemployment rate, determines the funding awarded to startups	34	3.50	.896
The firm tries to gather as much information as it can before making the decision to finance a startup	34	3.38	.888
The firm only finances startups if they agree to relinquish some level of control by the firm	34	3.21	.845
The potential for the startup to grow and capture the market is assessed when making a decision to invest in a startup	34	3.15	1.048
The firm only finances startups that have products/services that have already been accepted in the market	34	2.94	1.127
<b>External Determinants Score</b>	<b>34</b>	<b>3.50</b>	<b>.896</b>

Source: Researcher (2024)

#### 4.4.3 Descriptive Statistics for Incubation

The indicators used to measure incubation were the support of incubators, access to networks, access to markets, and access to training and mentorship. Table 4.5 shows the descriptive statistics for incubation. The analysis reveals that venture capital firms are moderately likely to fund startups that are supported by incubators (Mean = 3.68, Standard Deviation = 1.093), those that have access to networks facilitated by incubators (Mean = 3.50, Mean = 1.052), those that have startups that have access to markets facilitated by incubators (Mean = 3.68, Standard Deviation = 0.912), and those that have received training and mentorship from incubators (Mean = 3.65, Standard Deviation = 1.07). The average score for incubation was moderate (Mean = 3.625, Standard Deviation = 0.96383). These findings suggest that incubation is moderately considered by venture capital firms when making financing decisions for startup firms.

**Table 4.5: Descriptive Statistics for Incubation**

	N	Mean	Std. Deviation
The firm is more likely to fund startups that are supported by incubators	34	3.68	1.093
The firm is more likely to finance startups that have access to networks facilitated by incubators	34	3.50	1.052
The firm is more likely to finance startups that have access to markets facilitated by incubators	34	3.68	.912
The firm is more likely to finance startups that have received training and mentorship from incubators	34	3.65	1.070
<b>Incubation Score</b>	<b>34</b>	<b>3.625</b>	<b>.96383</b>

Source: Researcher (2024)

#### 4.4.4 Descriptive Statistics for Venture Capital Firm Financing Decision

Venture capital firm financing decision was measured in terms of providing financing, managerial support and technical support. Table 4.6 shows the descriptive statistics for venture capital firm financing decision. The analysis revealed that a moderate likelihood of venture capital firms financing startups meet their criteria and requirements (Mean = 3.53, Standard Deviation = 1.107), providing managerial advice to those that meet the firm's criteria (Mean = 3.71, Standard Deviation = 1.169). providing technical support to startups that meet their requirements and criteria

(Mean = 3.59, Standard Deviation = 1.158), providing strategic advice and business guidance among startups that qualify for funding (Mean = 3.53, Standard Deviation = 1.134), providing technical support to startups that qualify for funding (Mean = 3.65, Standard Deviation = 1.178), and monitoring the performance of startups that have been funded (Mean = 3.62, Standard Deviation = 1.074) 0.561). The average score for venture capital financing decision was moderate (Mean = 4.1609, Standard Deviation = 0.42604).

**Table 4.6: Descriptive Statistics for Venture Capital Firm Financing Decision**

	N	Mean	Std. Deviation
Startups that meet the firm's criteria and requirements receive financing	34	3.53	1.107
Startups that meet the firm's criteria and requirements receive managerial advice	34	3.71	1.169
Startups that meet the firm's criteria and requirements receive technical support in areas like operations, human resources and financial management	34	3.59	1.158
Startups that qualify for funding get strategic advice and business guidance	34	3.53	1.134
The firm provides technical support to startups that qualify for funding	34	3.65	1.178
The firm closely monitors the performance of startups that have been funded.	34	3.62	1.074
Venture Capital Financing Decision Score	34	3.6029	.98303

#### 4.5 Inferential Analysis

For this study, inferential analysis was performed using Pearson's correlation and multiple linear regression. Pearson's correlation was used because the scores were ratio variables and not ranked data. Correlation analysis was used to examine the relationships between the dependent variable (venture capital firm financing decision) and independent variables (internal organizational determinants, external determinants, and incubation) as a pre-requisite for performing the multiple linear regression in order to model the relationship between the dependent and independent variables.

### 4.5.1 Correlation Analysis

The results of the correlation analysis are presented in Table 4.7. There is a moderate positive correlation between Internal Organizational Determinants and External Determinants ( $r=0.587$ ,  $p<0.05$ ). There is a moderate positive correlation between Internal Organizational Determinants and Incubation ( $r=0.529$ ,  $p<0.05$ ), suggesting that startups with strong internal organizational attributes are moderately likely to have access to incubation resources, such as mentorship and networking. A weak to moderate positive correlation exists between External Determinants and Incubation ( $r=0.409$ ,  $p<0.05$ ). This implies a modest association, where external factors being favorable might slightly relate to access to incubation resources. There is a moderate to strong positive correlation between Internal Organizational Determinants and Venture Capital Firm Financing Decision ( $r=0.642$ ,  $p<0.05$ ). This indicates that internal organizational factors significantly influence the likelihood of receiving venture capital funding. A strong positive correlation exists between External Determinants and Venture Capital Firm Financing Decision ( $r=0.753$ ,  $p<0.05$ ). This suggests that favorable external factors are highly associated with the decision to finance startups. There is a very strong positive correlation between Incubation and Venture Capital Firm Financing Decision ( $r=0.847$ ,  $p <0.05$ , implying that startups involved in incubation programs are highly likely to receive venture capital funding, perhaps because incubation enhances their perceived viability.

Table 4.7: Correlation

		Internal Organizational Determinants	External Determinants	Incubation	Venture capital firm financing decision
Internal Organizational Determinants	r	1			
	p				
External Determinants	r	.587**	1		
	p	.000			
Incubation	r	.529**	.409**	1	
	p	.000	.000		
	r	.642**	.753**	.847**	1

Venture capital firm financing decision	p	.000	.000	.000	
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Source: Researcher (2024)

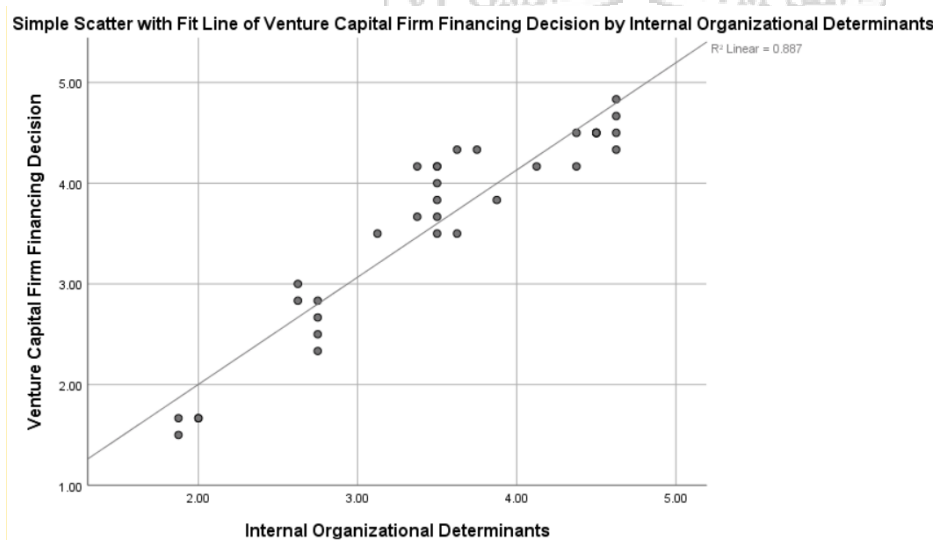
## 4.5.2 Regression Analysis

Both simple and multiple linear regression analysis were performed to examine the relationships between the dependent and independent variables. Simple regression was used to assess the effect of individual variables on the dependent variable while multiple regression was used to model the relationship with all the variables included.

### 4.5.2.1 Regression Diagnostics

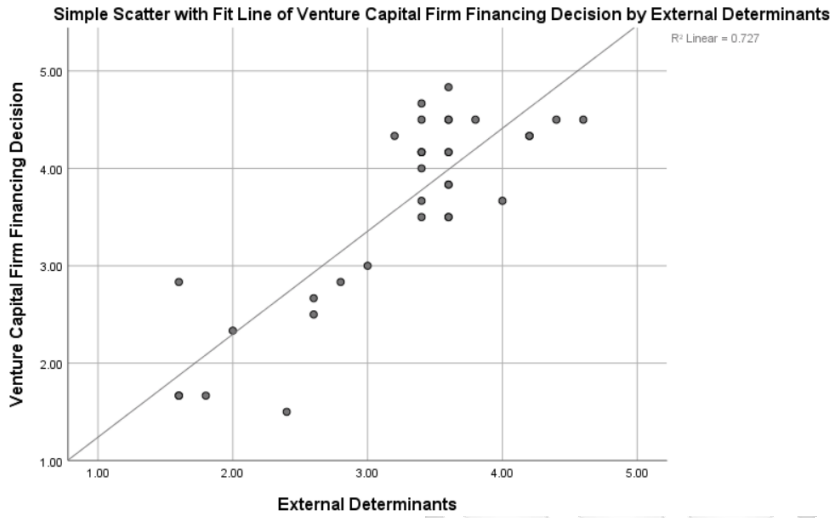
The diagnostics needed to perform regression are linearity and normality. Linearity means that a linear association should exist between the dependent and the independent variables. This can be established by visually checking the scatter plots – if the data points are close to the fit line, there is a linear relationship. Figures 4.1, 4.2, and 4.3 confirm the linearity the relationships between the dependent and independent variables in this study.

**Figure 4.1: Scatter Plot – Venture Capital Firm Financing Decision by Internal Organizational Determinants**



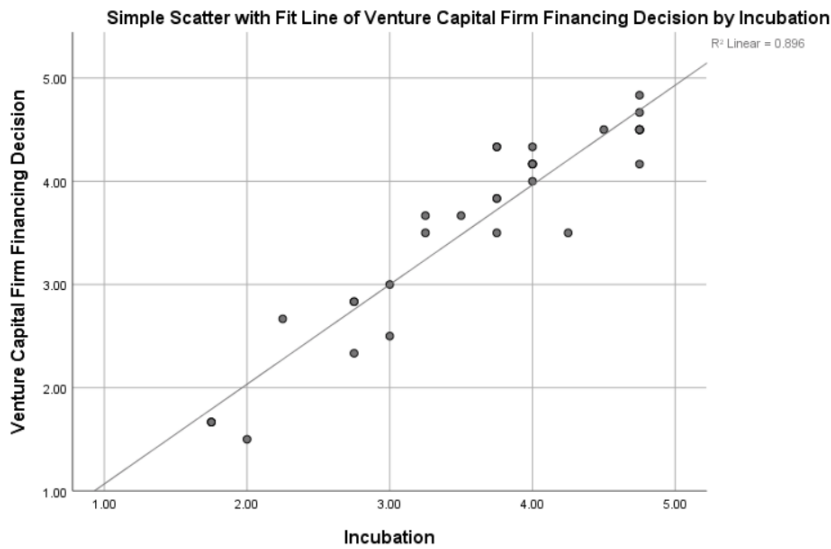
Source: Researcher (2024)

**Figure 4.2: Scatter Plot – Venture Capital Firm Financing Decision by External Organizational Determinants**



Source: Researcher (2024)

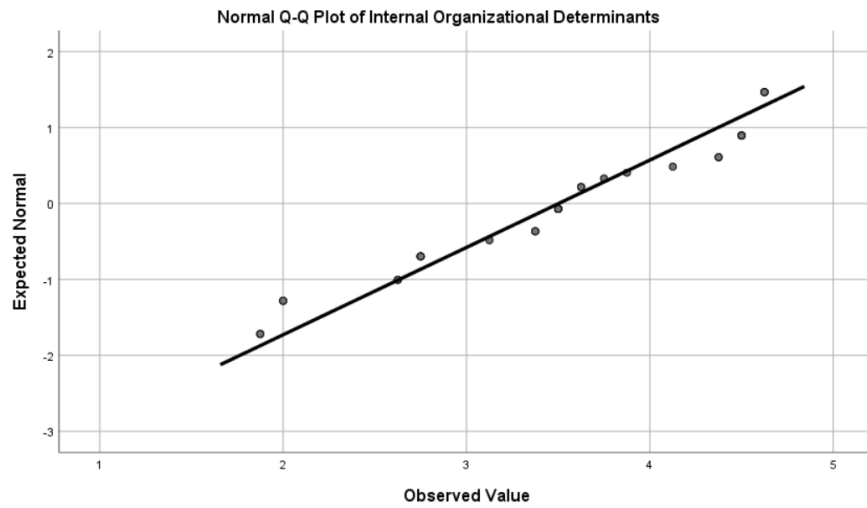
**Figure 4.3: Scatter Plot – Venture Capital Firm Financing Decision by Incubation**



Source: Researcher (2024)

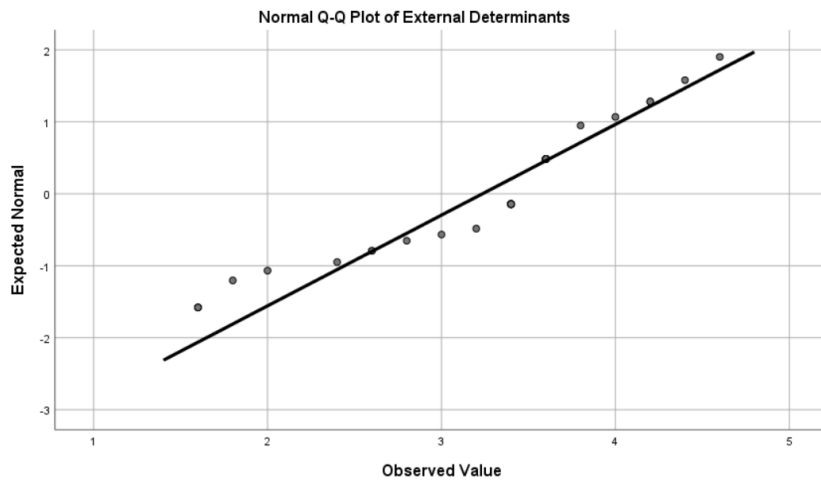
Normality of data can be established using normal Q-Q plots. For data that is distributed normally, points in the normal Q-Q plots are close to the diagonal line. A visual inspection of the normal Q-Q plots in figures 4.4, 4.5 and 4.7 confirm that the data was distributed normally.

**Figure 4.4: Normal Q-Q plot for Internal Organizational Determinants**



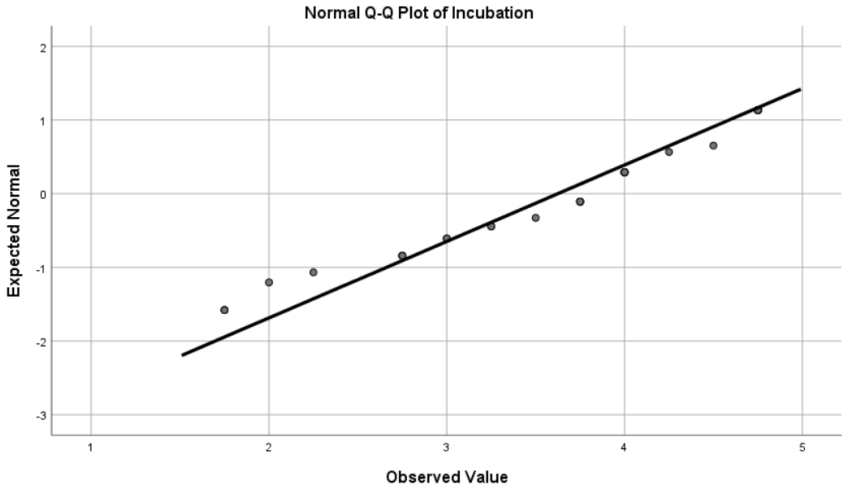
Source: Researcher (2024)

**Figure 4.5: Normal Q-Q plot for External Determinants**



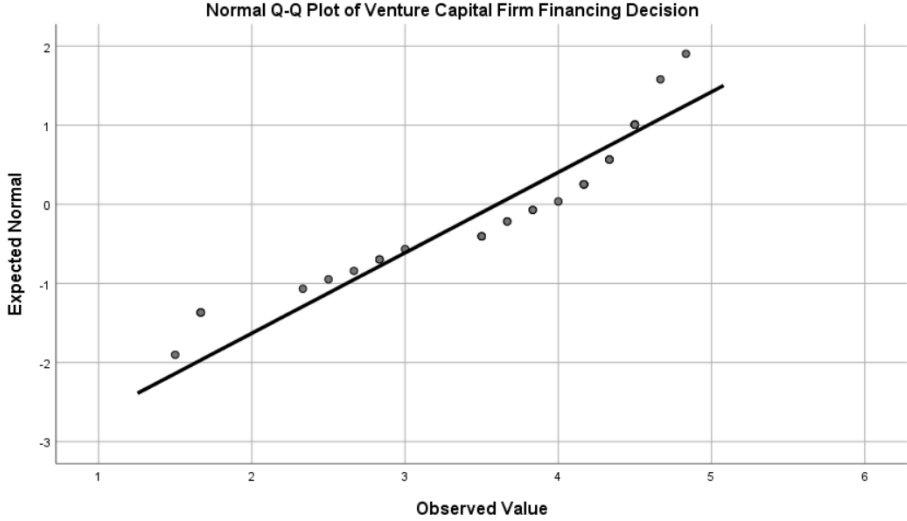
Source: Researcher (2024)

**Figure 4.6: Normal Q-Q plot for Internal Organizational Determinants**



Source: Researcher (2024)

**Figure 4.7: Normal Q-Q plot for Internal Organizational Determinants**



Source: Researcher (2024)

#### 4.5.2.2 Multiple Regression Analysis

Multiple linear regression was used to examine the relationship between venture capital firm financing decision and the independent variables, which included internal organizational determinants, external determinants and incubation. The model summary shown in Table 4.8 indicated an R-square 0.938, which shows that the internal organizational determinants, external determinants, and incubation explains 93.8% of the variation in venture capital firm financing decision for startups. This R-square value suggests a strong predictive model. Also, the collinearity diagnostics showed there is no problem of multi-collinearity in the model. VIF values that exceed 5 indicate severe correlation between the independent variables in the model, which can lead to an unreliable estimated coefficients and p-values.

The F-statistics summary for the multiple regression indicates that the model was significant ( $F [3, 30] = 151.293, p < 0.05$ ). The regression analysis further revealed that the constant had an insignificant coefficient ( $\beta = -0.306, p > 0.05$ ). Internal organizational determinants had a significant positive regression coefficient ( $\beta = 0.438, p < 0.05$ ). External determinants had a significant positive coefficient ( $\beta = 0.249, p < 0.05$ ). Additionally, incubation had a significant positive regression coefficient ( $\beta = 0.433, p < 0.05$ ). From this analysis, the regression model for this study becomes:

$$VC = 0.438(OD) + 0.249(ED) + 0.433(IN)$$

Where: -

VC = Venture Capital Financing Decision

OD = Internal Organizational Determinants

ED = External Determinants

IN = Incubation

Table 4.8: Model Summary – Multiple Regression Analysis

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.969 <sup>a</sup>	.938	.932	.25672
F-statistic				

Model		Sum of Squares	Df	Mean Square	F	Sig.		
1	Regression	28.293	1	28.293	251.736	.000 <sup>b</sup>		
	Residual	3.597	32	.112				
	Total	31.890	33					
Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-.306	.197		-1.552	.131		
	Internal Organizational Determinants	.438	.142	.387	3.077	.004	.102	2.354
	External Determinants	.249	.098	.201	2.539	.017	.014	2.248
	Incubation	.433	.132	.424	3.284	.003	.025	3.401
a. Dependent Variable: Venture Capital Firm Financing Decision								

#### 4.6 Chapter Summary

The findings obtained from this study have been presented in chapter. A strong predictive model was found with an R-square of 0.938. The regression analysis showed that internal organizational determinants, external determinants and incubation were significant predictors of venture capital firm financing decision for startups.

## CHAPTER FIVE

### DISCUSSION, CONCLUSION AND RECOMMENDATIONS

#### 5.1 introduction

This study sought to examine the determinants of financing decisions by venture capital firms in Kenya. This chapter summarizes and discusses key findings as well as the recommendations for policy, managers and theory. The limitations of this study are also discussed together with the recommendations for future research.

#### 5.2 Summary of Key Findings

The first objective of this research was to examine the influence of internal organizational determinants on venture capital firm financing decision for startups. In this regard, the findings showed that internal organizational determinants had a significant positive regression coefficient ( $\beta = 0.438$ ,  $p < 0.05$ ). This means that a unit change in internal organizational characteristics results in an increase in venture capital firm financing decision for startups by 0.438 units. An implication of this result is that improving internal organizational characteristics of a startup, such as the management experience, investor readiness and corporate governance, has a positive influence on venture capital firm's decision to finance startups.

The second objective of this research was to examine the influence of external determinants on the decision by venture capital firms to finance startups. The analysis showed that external determinants had a significant positive coefficient ( $\beta = 0.249$ ,  $p < 0.05$ ). This means that a unit change in external determinants can result in an increase the venture capital firm financing decision by 0.249 units. This result implies that improving the macro-economic conditions, startups' market growth potential, and relinquishing some level of control to venture capital firms can have a positive influence on their decision to finance startups.

The third objective of this study was to examine the influence of incubation on venture capital firm financing decision for startups. In this respect, the findings indicated that incubation had a significant positive regression coefficient ( $\beta = 0.433$ ,  $p < 0.05$ ), which suggests a positive effect. This result means that a unit increase in incubation can produce an increase in venture capital firms' decision to finance startups by 0.433. The implication of this result is that the support of

incubators and access to networks, markets and training and mentorship provided by incubators can positively influence the decision by venture capital firms to finance startups.

### **5.3 Discussion of Key Findings**

This section discusses the results of this study with respect to its objective. Reference is made to theories as well as previous empirical research related to the objectives of this research.

#### **5.3.1 Internal Organizational Determinants and Financing Decision by Venture Capital Firms**

The findings from this research showed the positive effect of organizational determinants, such as management experience, investor readiness, corporate governance, innovativeness, tangible assets, and ability to meet collateral requirements on the financing decision by venture capital firms. This finding is aligned with the propositions of the Theory of Equilibrium Credit Rationing, which postulates that due to inadequate information about startups, venture capitalists are expected to solve this problem by looking at organizational characteristics (such as managerial experience and corporate governance mechanisms) when making a decision on whether or not to finance a startup (Beltrame et al., 2023). These attributes make a startup less risky; hence, can favorably influence the financing decision by venture capital firms (Mc Namara et al., 2020).

The positive effect of organizational determinants on the financing decision by venture capital firms is also consistent with the results reported in the extant literature. According to Gilligan & Wright (2020), venture capitalists often conduct an organizational analysis of its performance, operations, financial structure, resources, and organizational structure and human resources to determine a startup's risk profile and make a decision on whether or not to invest in a firm. Chowdhury and Alam (2017) showed that skills and education of owners, age and size of the business, and lack of collateral security influenced access to finance by startups enterprises. In the same vein, Yildirim et al. (2013) showed that legal status, stability and volume of sales, and size of assets has a significant positive effect on access to financing by startups. The significant influence of firm characteristics on access to venture capital has also been demonstrated by Zelalem and Wubante (2019) investigated the influence of firm characteristics on access to finance. Using a mixed methods approach, Zelalem and Wubante (2019), Amahalu (2019), Nanyondo (2017), Kirugumi and Makori (2022), and Nguli and Odunga (2019). Therefore, the

findings of the current study add to the existing literature supporting the positive influence of internal organizational determinants on the financing decisions by venture capital firms in Kenya.

### **5.3.2 External Determinants and Financing Decision by Venture Capital Firms**

The findings from this study supported the significant positive influence of external determinants, including macro-economic conditions, startups' market growth potential, and relinquishing some level of control to venture capital firms. This finding supports the propositions of the Theory of Equilibrium Credit Rationing, which holds that lenders and investors do not grant all the financing that businesses need because they are incapable of differentiating between risky and safe businesses (Hodgeman, 1960). This theory is based on the assumption that credit markets are imperfect because of information asymmetry, which lenders and investors try to correct using measures, such as seeking control of startups and evaluating their growth potential. If the expected loss is greater than the expected return, the chances of obtaining financing is reduced compared to situations where the expected returns are greater than the expected (Yu and Fu, 2021).

Past studies have also reported the positive effect of external determinants on venture capital firm decision to finance startups. Zivari et al. (2020) reported that macro-economic volatility, corruption, debt conditions (repayment periods and interest rates), concentration of lenders and investors and information asymmetry influenced lender's decisions regarding financing businesses. Also, Diaconu (2012) showed that the amount of venture capital is influenced by external factors, such as the annual inflation, tax rate levied on corporate income, market capitalization and the real interest rate. Osano and Languitone (2016) reported that collateral requirements, support for startups and small businesses by the government, and structure of the financial sector influenced financing decisions by venture capital firms. Additionally, Ismail & Medhat (2019) identified market factors that had a significant influence on venture capitalists' investment decisions, which include the market characteristics, high growth of the startup ecosystem, and the acceptance of the startup in the market as evidenced by having a customer base. Therefore, the findings of the current study augment existing literature supporting the significant influence of external determinants on the financing decisions of venture capital firms.

### **5.3.3 Incubation and Financing Decision by Venture Capital Firms**

The results of the present study indicated incubation has a positive effect on the financing decision by venture capital firms. This result confirms the positive influence of the support of incubators and access to networks, markets and training and mentorship provided by incubators on the decision by venture capital firms to finance startups. This finding is consistent with the expectation of the Theory of Equilibrium Credit Rationing wherein investors are more likely to finance ventures that they perceive less risky (Hodgeman, 1960). Incubation reduces the risk profile of startups; hence, can be expected to increase their chances of being funded by venture capitalists. Incubation, like collateral, can be expected to lower credit rationing; thus, leading to increased availability of funding for startups from venture capitalists (Yu and Fu, 2021).

The positive effect of incubation has also been reported in the existing literature. Through incubation, startups receive financial management, managerial and networking support from entities that help them during their early stages to grow (Muriithi et al., 2018). According to Pompa (2013), incubators provide startups with an enabling environment during their early stage, which in turn increases their confidence, and helps to connect them to networks and resources that they need to scale their businesses (Pompa, 2013). Pompa (2013) showed that startups under incubation experienced fewer external financing obstacles compared to that were not under incubation. Similarly, Pettersen et al. (2015) reported that incubators provided technology startups with access to network resources, such as venture capitalists and markets. Chandra and Medrano (2012) showed that incubators play a key role in connecting startups to angel investors as well as linking them to markets. According to Akanle et al. (2019), incubation hubs provide startup enterprises with a shared co-working space, access to equity capital, mentorship and training. Taken together, the current study contributes to the existing literature that supports the beneficial impact of incubation on startups, especially in terms of ensuring enhancing the likelihood of being financed by venture capital firms. [in this section the results were well done]

### **5.4 Recommendations**

The recommendations for policy, managers and theories are discussed in this section.

### **5.4.1 Policy Recommendations**

Based on the findings of this study, it is recommended that policy makers should consider formulating policies to improve the external determinants and support incubation of startups. The findings from this study have shown the positive influence of external factors on the decision by venture capital firms to finance startups. Therefore, external determinants constitute an area that requires policy attention, especially with respect to adopting policies that improve the macro-economic condition of the country, setting up a central information repository for venture capitalists to access information on startups, and developing regulations to guide ownership transfers between venture capitalists and startups. Incubation constitutes another area that might require policy attention. This study has reported the positive effect of incubation on the decision by venture capital firms to finance startups. This underscores the need for policies to support the role played by incubators in the startup ecosystem in Kenya

### **5.4.2 Managerial Recommendations**

From this study, it is recommended that owners and managers should improve their internal organizational determinants in order to favorably position themselves among venture capitalists. The results of this study show that venture capitalists consider managerial experience, investor readiness, innovativeness, presence of tangible assets, corporate governance, and incorporation of startups. Owners and managers of startups can address these aspects to increase their chances of funding. Additionally, it is recommended that owners and managers of startups should consider leveraging the incubators in order to benefit from their networks, training and mentorship.

### **5.4.3 Theoretical Recommendations**

The findings of this study provide evidence that supports the Theory of Equilibrium Credit Rationing. The findings of this research showed that organizational determinants are one way through which venture capitalists evaluate the risk profile of a startup when making a decision on whether or not to grant funding. This finding supports the propositions of the Theory of Equilibrium Credit Rationing, which holds that lenders and investors do not grant all the financing that businesses need because they are incapable of differentiating between risky and safe businesses. In addition, results of the present study indicated incubation has a positive effect on the financing decision by venture capital firms, which is consistent with the expectation of the

Theory of Equilibrium Credit Rationing wherein investors are more likely to finance ventures that they perceive less risky. Thus, incubation reduces the risk profile of startups; hence, can be expected to increase their chances of being funded by venture capitalists. Furthermore, the findings of this study add to existing empirical literature on the determinants of venture capital firm decision-making when it comes to financing startups.

### **5.5 Study Limitations and Suggestions for Future Research**

A limitation of this study was the small sample size. Even though the population was small and the response rate was adequate, the size of the sample was small, which could have affected the reliability of the findings. Future studies should consider increasing the sample size by collecting data from various people in venture capital firms involved in making funding decisions. Another limitation of this study is that its scope was on decision to finance startups by venture capital firms in Kenya. In this regard, future studies could consider investigating the determinants of funding decisions by other sources of financing for startups, such as banks, crowdfunding, angel investors, and microfinance institutions. Another limitation of this research was on the use survey data, which is a form of self-report that can lead to response bias in the form of socially-desirable answers. A mitigation for this limitation that can be adopted in future studies is to use secondary data, which is more accurate and devoid of such bias.

### **5.6 Chapter Summary**

This chapter has summarized and discusses key findings and the recommendations for policy, managers and theory. The limitations of this study have also been discussed together with the recommendations for future research.

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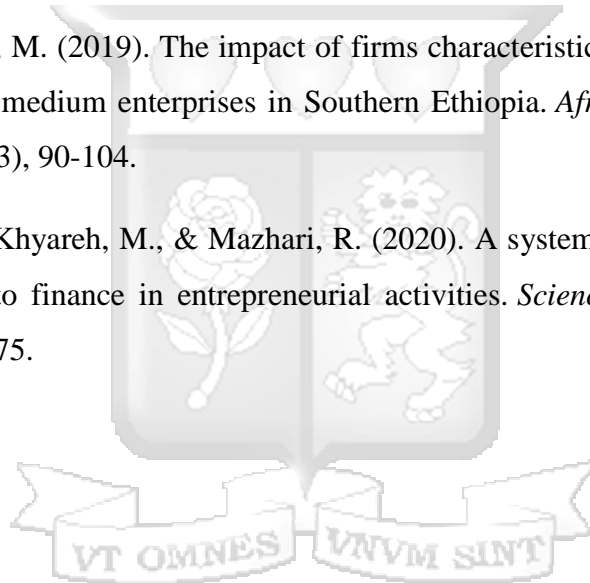
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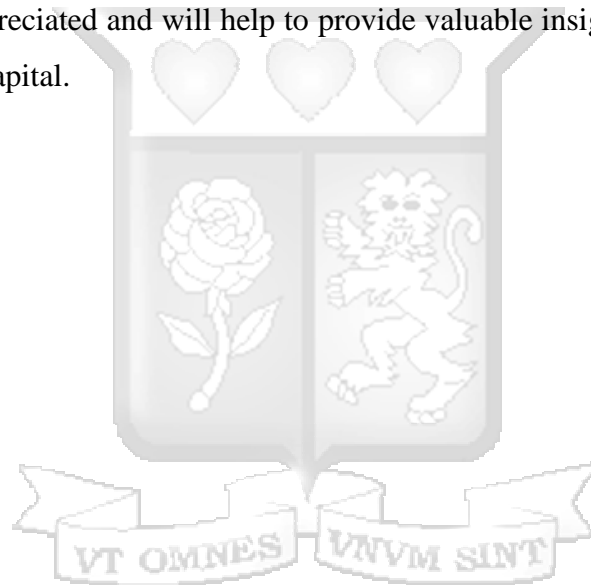
## APPENDICES

### Appendix I: Introduction Letter

**Dorcas Wambua** a Strathmore University Student (Admission Number: 71189 is conducting a study titled, “Determinants of Financing Decisions to Fund Startups by Venture Capital Firms in Kenya.” To that effect, you are being invited to take part in this study. To inquire more about the study, feel free to contact the researcher at 0726021551 or [dwambua@strathmore.edu](mailto:dwambua@strathmore.edu).

The information collected in this study will only be used for academic purposes. The collected data will remain confidential and will not be disclosed to anyone.

Your participation is appreciated and will help to provide valuable insights that can help Kenyan startups access venture capital.



## Appendix II: Ethical Approval and NACOSTI Research License



17<sup>th</sup> May 2024

Ms Wambua Dorcas  
kyeniwambua@gmail.com

Dear Ms Wambua,

### **RE: Determinants of Financing Decisions to Fund Startups by Venture Capital Firms in Kenya**

This is to inform you that SU-ISERC has reviewed and approved your above SU-masters proposal. Your application reference number is SU-ISERC2224/24. The approval period is from 17<sup>th</sup> May 2024 to 16<sup>th</sup> May 2025.

This approval is subject to compliance with the following requirements:

- i. Only approved documents including (informed consents, study instruments, MTA) will be used.
- ii. All changes including (amendments, deviations, and violations) are submitted for review and approval by SU-ISERC.
- iii. Death and life-threatening problems and serious adverse events or unexpected adverse events whether related or unrelated to the study must be reported to SU-ISERC within 72 hours of notification.
- iv. Any changes anticipated or otherwise that may increase the risks or affected safety or welfare of study participants and others or affect the integrity of the research must be reported to SU-ISERC within 72 hours.
- v. Clearance for the export of biological specimens must be obtained from relevant institutions.
- vi. Submission of a request for renewal of approval at least 60 days prior to the expiry of the approval period. Attach a comprehensive progress report to support the renewal.
- vii. Submission of an executive summary report within 90 days of completion of the study to SU-ISERC.

Before commencing your study, you will be expected to obtain a research license from National Commission for Science, Technology, and Innovation (NACOSTI) <https://research-portal.nacosti.go.ke/> and obtain other clearances needed.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Ambrose Rachier".

Mr Ambrose Rachier,  
Chairperson; SU-ISERC



REPUBLIC OF KENYA

Ref No: 477500



NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION

Date of Issue: 28/May/2024

RESEARCH LICENSE



This is to Certify that Miss.. Dorcas Kyeni Wambua of Strathmore University, has been licensed to conduct research as per the provision of the Science, Technology and Innovation Act, 2013 (Rev.2014) in Baringo, Bomot, Bungoma, Busia, Elgeyo-Marakwet, Embu, Garissa, Homabay, Isiolo, Kajiado, Kakamega, Kericho, Kiambu, Kilifi, Kirinyaga, Kisii, Kisumu, Kitui, Kwale, Laikipia, Lamu, Machakos, Makueni, Mandera, Marsabit, Meru, Migori, Mombasa, Muranga, Nairobi, Nakuru, Nandi, Narok, Nyamira, Nyandarua, Nyeri, Samburu, Siaya, Taita-Taveta, Tanariver, Tharaka-Nithi, Transzoia, Turkana, Uasin-Gishu, Vihiga, Wajir, Westpokot on the topic: DETERMINANTS OF FINANCING DECISIONS TO FUND STARTUPS BY VENTURE CAPITAL FIRMS IN KENYA for the period ending : 28/May/2025.

License No: NACOSTI/P/24/36038

477500

Applicant Identification Number

Handwritten signature of Director General

Director General NATIONAL COMMISSION FOR SCIENCE, TECHNOLOGY & INNOVATION

Verification QR Code



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See overleaf for conditions

## Appendix III: Questionnaire

Instructions: Kindly answer the following questions by ticking or putting a mark on the appropriate box.

### Section A: Respondent Profile

1. Indicate your gender

Male

Female

2. Indicate your highest level of education

College diploma

Bachelor's Degree

Masters

PhD

3. Indicate your age (years)

18 - 25

26 - 35

36 - 45

46 - 55

56 and above

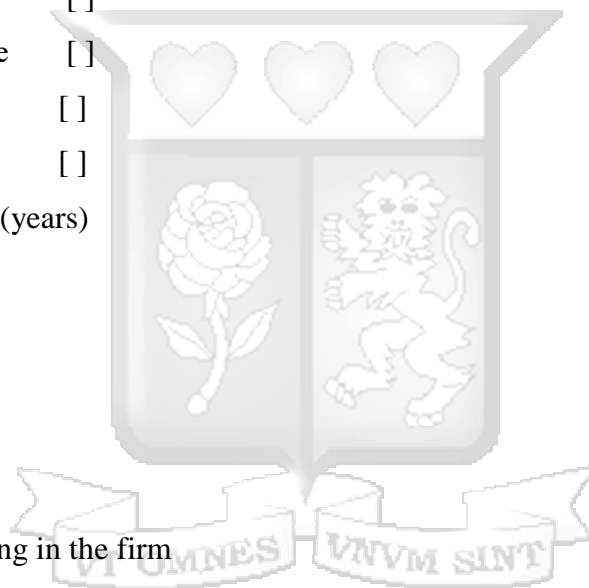
4. Experience working in the firm

0 - 5 years

6 - 10 years

11 - 15 years

16+



## Section B: Determinants

### *Internal Organizational Determinants*

The following statements relate to organizational characteristics that might be considered when making a decision to invest in a startup. Please indicate the degree to which you agree with them (strongly disagree – 1, disagree – 2, neutral – 3, agree – 4, and strongly agree – 5).

Statement	1	2	3	4	5
The firm considers that experiences of managers when making the decision to fund startups					
The firm assesses the readiness of startups when funding them					
The presence of corporate governance structures in startups is an important criterion that determines the funding of startups by the firm					
The firm considers the innovativeness of startups when making the decision to finance startups					
The size of the startup (number of employees) is considered when deciding to finance a startup					
The firm looks at the tangible assets that the startup has before deciding to finance it					
We have collateral requirements that must be met by the firm before we agree to finance them					
The firm takes a keen interest in whether the startup is incorporated					

### *External Determinants*

The following statements relate to external determinants that might be considered when making a decision to invest in a startup. External determinants are aspects beyond the control of the startup. Please indicate the degree to which you agree with them (strongly disagree – 1, disagree – 2, neutral – 3, agree – 4, and strongly agree – 5).

Statement	1	2	3	4	5
The prevailing condition of the economy, such as inflation and unemployment rate, determines the funding awarded to startups					
The firm tries to gather as much information as it can before making the decision to finance a startup					
The firm only finances startups if they agree to relinquish some level of control by the firm					
The potential for the startup to grow and capture the market is assessed when making a decision to invest in a startup					

The firm only finances startups that have products/services that have already been accepted in the market					
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***Incubation***

The following statements relate to incubation support offered to startups. Please indicate the degree to which you agree with them (strongly disagree – 1, disagree – 2, neutral – 3, agree – 4, and strongly agree – 5).

Statement	1	2	3	4	5
The firm is more likely to fund startups that are supported by incubators					
The firm is more likely to finance startups that have access to networks facilitated by incubators					
The firm is more likely to finance startups that have access to markets facilitated by incubators					
The firm is more likely to finance startups that have received training and mentorship from incubators					

**Section C: Venture Capital Firm Financing Decision**

The following statements relate the financing that you provide to startups. Please indicate the degree to which you agree with them (strongly disagree – 1, disagree – 2, neutral – 3, agree – 4, and strongly agree – 5).

Statement	1	2	3	4	5
Startups that meet the firm’s criteria and requirements receive financing					
Startups that meet the firm’s criteria and requirements receive managerial advice					
Startups that meet the firm’s criteria and requirements receive technical support in areas like operations, human resources and financial management					
Startups that qualify for funding get strategic advice and business guidance					
The firm provides technical support to startups that qualify for funding					
The firm closely monitors the performance of startups that have been funded.					

**Thank you for participating**

## Appendix IV: List of Venture Capitalist Firms in Kenya

1. Voxtra
2. Terrafirma Africa
3. TBL Mirror
4. Silk Invest
5. Pinebridge East Africa
6. SANLAM
7. Quantum Global
8. Progression Capita;
9. Phatisa
10. Pearl Capital
11. Novastar Ventures
12. Milost Global Inc
13. Metier
14. Kuramo Capital
15. Kibo
16. Kestrel Capital
17. Kenyal Climate Ventures
18. Intercontinental Trust
19. Jacana Partners
20. Helies Investment Partners
21. Grofin East Africa
22. Grassroots Business Fund
23. GenAfrica
24. Frintier Energy
25. Fanisi
26. Energy Access Ventures
27. ECP
28. East Africa Capital Partners
29. DOB Equity
30. Cytonn



31. Cross Boundary
32. Catalyst Principal Partners
33. Business Partners International
34. Burnbridge Capital
35. Bamboo Capital Partners
36. Ascent Capital
37. AOG Invest
38. Amethis Finance
39. Alpha Africa Asset Managers
40. Alios Finance
41. AHL Venture Partners
42. Agrivie
43. Africinvest
44. AECF
45. Acumen
46. Actis
47. Action Rich Investment
48. Catalysts Principal Partners
49. Centum Investment
50. Actis

