EFFECTS OF INVESTMENT STRATEGIES ON FINANCIAL PERFORMANCE OF PRIVATE EQUITY FUNDS INVESTING IN KENYA

BY

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D61/74216/2014

A RESEARCH PROJECT SUBMITTED IN PARTIAL FULFILMENT OF THE REQUIREMENTS FOR THE AWARD OF THE DEGREE OF MASTER OF BUSINESS ADMINISTRATION,

UNIVERSITY OF NAIROBI

DECEMBER 2018

DECLARATION

This research project is my original work and has not been presented for an award in any other University.

Signature……. Date…….

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This research project has been submitted for examination with my approval as the University Supervisor

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DEDICATION

I dedicate this research project to my family. They have created a suitable environment that enabled me to continue with my further studies.

ACKNOWLEDGEMENT

I thank Almighty God for enabling me persevere and overcome all the challanges that came my way. I pay gratitude to my friends and acknowledge their valued contribution.

My supervisor, Mr. Abdulatif Essajee and fellow scholars who have given me their sincere support for which I thank them.

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LIST OF ABBREVIATIONS AND ACRONYMS

AFC	**:**	Agricultural Finance Corporation
BO	**:**	Buyout Funds
CDC	**:**	Commonwealth Development Corporation
CKIE	**:**	Capital, Kenya Industrial Estate,
CMA	**:**	Capital Markets Authority
DFIs	**:**	Development Finance Institutions
ICDC	**:**	Industrial and Commercial Development Corporation
IDB	**:**	Industrial Development Bank
IPO	**:**	Initial public offering
KTDC	**:**	Kenya Tourism Development Corporation
LBO	**:**	Leveraged buyout
MPT	**:**	Modern Portfolio Theory
NASDAQ	**:**	National Association of Securities Dealers Automated Quotations
NAV	**:**	Net Asset Value
NSE	**:**	Nairobi Stock Exchange
PE	**:**	Private Equity
ROA	**:**	Return on Assets
ROE	**:**	Return on Equity
S&P	**:**	Standard & Poor's Index
SMEs	**:**	Small Enterprises
UK	**:**	United Kingdom
VC	**:**	Venture capital

ABSTRACT

Globally, PE investing has undergone several transformations and has become a very important sector in comparison to small niche market it was. Its role in the economy is very important. It improves innovativeness and development in provision of startups or growing industries and also facilitating the restructuring of already existing industries. It's been seen as new and an effective form of an organization that comes up with economies that are efficient. This study sought to assess the effects of investment strategies on the financial performance of private equity funds investing in Kenya. The study targeted all the funds managed by the 20 private equity fund investment management companies in Kenya. Descriptive survey research design was adopted. The study was conducted for a span of 5 years which was from the year 2013 to 2017. Data was sourced from the reports and websites of the various fund management companies as well as from the CMA website and the NSE website. Data collected was tested for reliability then coded and analysed using SPSS. The association that existed between the study variables was determined by performing both inferential and descriptive statistics. The effect of strategies of investment on performance of PE funds was determined by computing Linear regression. The study found that 79.8% of the financial performance of private equity funds investing in Kenya could be accounted for by leveraged buyouts, venture capital, and mezzanine financing. The study also revealed that there was a strong positive relationship between financial performance and leveraged buyouts, venture capital, and mezzanine financing. The study further revealed that leveraged buyouts significantly affected financial performance of private equity funds investing in Kenya.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Globally, PE investing has undergone several transformations and has become a very important sector in comparison to small niche market it was (Davis & Shaver, 2012). Its role in the economy is very important. It improves innovativeness and development in provision of startups or growing industries and also facilitating the restructuring of already existing industries. It's been seen as new and an effective form of an organization that comes up with economies that are efficient. PE is an alternate asset for individuals investing in institutions because it offers returns and also the advantage of diversifying relative to traditional stock and bond market investments. In the years between1998 to 2000 PE market experienced a tremendous growth (Tuck, 2003).

According to the Modern Portfolio Theory (MPT), risk-averse investors are able to create portfolios which make it possible for returns that are dependent on the level of market risk to be maximized (Kaplan & Schoar, 2005). The agency theory makes it clear on the association of portfolio firms and PE Company.

In 2016 private equity firms invested close to 105 billion shillings into Kenyan businesses in the first eight months, whereby majority of the deals were attracted to financial services industries.According to investment data by Burbidge Capital, the biggest deal was buying of Helios stake in Equity Bank for 23 billion shillings and Old Mutual 23 billion shillings purchase of a 60.7 per cent stake in UAP Holdings. In the years 2016 the financial services industry became the preference investment for majority of the PE companies drawn in by high returns and improved growth. In East Africa, Kenya remains the favorite investment destination for private equity snapping up 18 deals of the 25 deals

that were on offer. The high returns offered by insurance and banking firms are what draw investors. This study sought to assess the effects of investment strategies on the financial performance of PE funds investing in Kenya.

1.1.1 Investment Strategies of Private Equity Funds

A PE fund is referred to as a collective investment scheme that is applied to invest in different equity and debt in line with the specific investment strategy selected by the investment managers. Private equity firm's use various investment strategies which include leveraged buyout (LBO), mezzanine financing, venture capital (VC), buyouts investment and fund-of-funds investments. Venture capital is one of the main investment strategies adopted by private equity funds. Venture capital explains the early stages of investment where a firm invests in small businesses or companies that are just staring up but have a great potential of growing. Portfolio companies in a venture capital fund usually are beneficiaries of specialized skills and managerial experts of the managers of venture capital fund's. The strategy includes having investments in a certain firm believing that it will grow due to some events relating to the firm being speculated to happen. The events speculated to happen may be a shift in the market trend or changes in regulations by the government (Kaplan & Stromberg, 2009).

In a situation where a PE fund controls another firm assets or even operations by buying most of the firms targeted voting stocks then there is occurrence of what's referred to as Leveraged buyouts. When a great percentage of funds used by a company to buy portfolio company's equity is borrowed then a leveraged buyout (LBO) takes place. There are some instances when the acquiring body in a leverage buyout pledges the assets of the targeted firm as collateral for acquiring loans (Ayash & Schütt, 2013).

In some cases it's called late-stage VC, Mezzanine financing is where the PE fund will be the holder of the debt in a firm. It's usually the last before an IPO, mezzanine financers are hopeful that there will be appreciation in capital as a result of successful initial offer on the shares of the firm to the public (Soderblom, 2011).

A buyout investment is whereby the shares of a particular company are bought and the company that buys it gains control over the company. In the U.S., Europe and some locations in Asia Buyout investments prevail (Fraser-Sampson, 2011). In general the focus of buyouts is those firms that are well established and not small/growing companies and in most cases they apply the use of debt and equity financing where the company that acquires will be the majority stakeholder (Fraser-Sampson, 2011). Buyouts are smaller compared to VC investments and true buyouts in most cases takes control of the firm through majority shares or through voting rights and they always have one round of financing.

A fund of funds (FOF) investment also known as multi-manager investment - is a strategy used in investment whereby a fund is invested in a different form of funds. In this kind of strategy, investment is done in portfolio that has various underlying assets instead having a direct investment on bonds, stocks and various types of security (Bergin & Pyun, 2016). The intention of FOF strategy is to have greatly diversified and have assets allocated in an appropriate and investment in various categories of fund all combined in a single fund. These are FOF traits that draw small investors who want to be exposed with less risk in comparison to having direct investment in securities. The advantage of FOF is that the investor gets professional services on management of finances and also it makes it possible for an investor to venture into diversified portfolios which could be difficult accessing as a personal investor (Ghosh & Van Tassel, 2011).

1.1.2 Financial Performance of Private Equity Funds

Financial performance is the measure on how effective a company can apply assets in generating revenues. Return on investment is noted as a key identifier of financial performance in an investment and consists of the income and the capital gains relative to an investment.

There are 2 specific techniques that are applied in measuring Return on PE; Internal Rate of Return (IRR) and Times Money (TM) (cash multiple/total value to pay in capital). The best IRR provides measurement from the time it was incepted, whereby all cash flows (or deal) and recent evaluations are applied in computing. Backward-looking measures of returns may be prevalent as well. They are usually known as 'ten year' or 'three year' returns, varying depending on the duration in which the returns are computed. Backward-looking return measures are computed by 'liquidating' the residual fund value at the beginning of the time span (and treated as negative cash flow), and having consideration of cash flows and the final Net Asset Value (NAV) over the remaining life of the fund. The study will use Internal Rate of Return to measure performance in the study. This is because IRR provides a more accurate measure of return by taking into account metrics such as varying cash flow and time passed.

1.1.3 Investment Strategies and Performance of Private Equity Funds

Research carries out have shown that PE is responsible for improved financial performance and total factor productivity. Additionally, work done recently have revealed that employment seems to be the first under PE ownership, followed by a significant increase (Kaplan and Stromberg, 2009)

Harris, Jenkinson and Kaplan (2014) did an analysis of 746 PE funds based in the US, 78% of them were VC-based, over 1980 to 2001.They established that the S&P 500

index was a bit higher than the average fund returns net of fees and that fund returns tend to be stable. Applying the same sample as the one used by Harris, Jenkinson and Kaplan (2014) but doing adjustments on selecting the samples, found out that PE funds performed poorly. Harris *et al.* (2015) did an analysis on the performance of 1,700 US PE funds. They revealed that the attractiveness of PE is overly stated.

Heterogeneity and skewness have been revealed to be part of performance of PE; this means that variation of funds with the best performance and the ones with the worst performance is very huge (Kaplan & Schoar, 2005; Phalippou & Gottschalg, 2009). For instance, Gottschalg (2010) stated that BO funds averagely perform less in comparison the indices of the public market which are wide.

Kaplan and Strömberg (2009) did a study and established that the net effect of a highly leveraged BO which later end up being a distress is to leave the value of the company being a bit high. Therefor the evidence on PE ownership and distress is mixed. Here is need to have more time in order to get a clear picture on the impacts of the recently boomed leveraged BO. This study seeks to assess the effects of investment strategies on the way PE funds that have invested in Kenya perform financially.

1.1.4 Private Equity Fund Investing in Kenya

A PE fund is defined as a collective scheme of capital/ money that is raised to invest in equity or debt in line with the fund's investment strategy namely venture capital, buyout,

and mezzanine and growth capital (CMA, 2016). PE as an alternative asset class remains largely unregulated in Kenya as it is treated as a private company. However, the government through the Capital Markets Authority has tried to nurture the venture capital space by offering a ten year tax break as long the Private Equity Fund register with the

CMA. Since this project was passed into law, only one fund has registered, Acacia Capital Fund Limited (NSE, 2013). Practitioners in the private equity industry in Kenya have formed an association to best push the private equity agenda in Kenya and the region called the East Africa Venture Capital Association.

Private equity funds in Kenya have concentrated in the growth capital investment strategy in Small to Medium Enterprises and large corporates. Currently over 32 active private equity funds operate in Kenya. In the last two years, the private equity growth funds in Kenya have concentrated on the following industries; infrastructure, real estate, financial services, agribusiness, manufacturing, healthcare and food and beverages (Tuimising, 2012). Kenya's private equity market has been on a steady growth plan since 2005. Between 2010-2013 closed deals in private equity in Kenya moved from $36.1 million to $105.2 million. (Gatauwa, 2014) It is important to note that these are from deals that have been made public, it is therefore speculated to be much higher in value. The exact impact on the economy is yet to be researched and quantified but private equity initiatives have been noted by the government.

Kenya has been placed as the third best destination for private equity investment in Africa after South Africa and Nigeria, and the best destination in East Africa as at 2014. This has been attributed to a growing middle class with high consumerism, stable macroeconomic factors and renewed stable political and governance practices.

Financial performance in private equity funds in Kenya has been addressed from a regional outlook. Financial performance in the region has been measured in terms of return on capital which has been estimated to between 11% to as high as 22% (Rice 2012). In a recently conducted survey on boosting the country's ambition of being a

financial hub it was revealed that in Africa Kenya is the preferred market for PE firms. PE companies tend to prefer investing in Kenya other that other African regions because Kenya shows a potential of growth an also its policies are favourable. In Kenya there are 20 licensed investment fund managers.

1.2 Research Problem

PE investing has over the years witnesses a tremendous growth and has become significant industry. Academic literature reveals that there are several varying strategies related to PE investments (Kiungu, 2012). VC, leveraged BO, special situations and mezzanine financing are the most common strategies (Murithi, 2012). Managers specializing in some of the strategies might target applying their investment funds and experts over various points in the life cycle of the firm. Those points could be inclusive of early seeding, start-up, expansion or replacement capital (Deloitte, 2013).

In the past several decades, PE investing has undergone several evolutions and is currently a very important sector in comparison to the small market it was. Currently, it has a significant task to perform in the economy through enhancing innovation and development in providing start-ups or growing companies, and also encouraging the restructuring of companies that are mature (Davila, Foster & Gupta, 2013).

Gottschalg (2009) did an analysis on a sample of 133 BO investments based in the US from the year 1984 to 2004 established positive and significant alpha for BO, i.e., BO investments performed better than S&P 500 over than span of time. Chen, Baierl and Kaplan (2012) studied 148 VC funds which had undergone liquidation between 1969 and 2000. They established 9.99% average annual return, 74% being the highest annual IRR and -72% being the lowest. A study done by Sensoy (2013) established that PE fund

investments performed better than the S&P 500 by 6-8% and the NASDAQ Composite Index by approximately 3-6%. Conroy and Harris (2007) did an analysis on how 1,700 PE funds bases in the US performed. The findings revealed that the attractiveness of PE haven't been suitable on the basis of risk-adjusted as it was the assumption of majority.

Most of the studies conducted were done in reference to European and American Markets. There is little evidence on how the strategies that are used in investment on how the affect how PE funds in Kenya perform. Based on the background of the study, this reseach aimed at filling the gap by investigating the effects of strategies of investment on the way PE funds investing in Kenya perform financially.

1.3 Research Objective

To determine the effects of investment strategies on the financial performance of PE funds investing in Kenya

1.4 Value of the Study

Management of PE fund investment firms will benefit since the findings will enable them to comprehend on the impacts and application investment of strategies on fund performance. Privately investing individuals will also benefit because they will comprehend the impacts of investment strategies in use on how PE funds perform and therefore enable them in identifying the ones that will provide maximum return to their investments. Academicians will also benefit from the study's findings since it will add knowledge to the field of research studied. The study findings will also be significant to policymakers as it will provide guidelines to them in coming up with policy regarding PE fund investing.

CHAPTER TWO: LITEREATURE REVIEW

2.1 Introduction

The chapter covers a review of the theories that relates to the area of study, determinants of financial performance of private equity funds and previous related studies. -

2.2 Theoretical Review

There are several theories that relate to the area of study which include modern portfolio theory, investment theory, capita asset pricing model and three factor model. All these attempt to show the relationship between selection of portfolio and expected return for a given amount of portfolio risk.

2.2.1 Modern Portfolio Theory (MPT)

MPT is a finance theory that explains how investors can optimize portfolio which is being anticipated as the return from a certain portfolio risk. The theory is a math formulation of ideas on diversified investments with the intention choosing investment assets whose collective risk is lower than any individual risk. The development of the theory was done in the 1950s through the early 1970s and it was seen as a significant advancement in the mathematical modeling of finance.The theory was first developed by Nobel Laureate Harry Markowitz, and it was improved over the years by other noted economist, the theory gives a suggestion that it is possible to limit the volatility in a portfolio,while bettering how it performs by distributing the risk to different types of securities which always don't behave in the same manner (Markowitz, 1952).The theory works under the principle that in the case of having lower risk then the returns expected will be lower as well and vice versa the greater the risk the greater the returns expected.The theory suggests that,a portfolio shows a risk and character of the traits on

the foundation of what it composes and how those components relate to each other. Every risk level has an optimum asset allocation which is in place in order to balance risks and returns. An optimal portfolio has no ability to produce the highest possible returns or even lower risk it will try to balance lowest risk for returns and great returns for an acceptable level of risk. The point of intersection between level of risk and reward is referred to EF. This theory helps in explaining how the choice of investment affects financial performance of entities.

2.2.2 Investment Theory

Keynes and Fisher (1960) did argue that investments are continuously made until there is equilibrium between opportunity cost of capital and the value of future revenues. This suggests that investing done until net present value reaches zero. Investments that are done now are expected to generate cash flow in the future.

Fisher defined returns on cost as discount rate. Keynes (1936) did argue that investing is done until it reaches a point where the interest rate is below the margin of efficiency (as quoted in Baddeley, 2003, p. 34). The primary variation between "Keynesian view" and Fisher is the concept of risk and uncertainty, how to come up with expectations. Keynes didn't see investment as a process towards equilibrium while Hayek (1941) and Fisher (1930), saw it as a path that leads to optimum capital stock. As per the theory, determination of investment isn't done by the use of optimal capital stock but what takes the centre position is the radical uncertainty. The belief of Keynes is that people use to behave like animals and when that is in combination with irrational expectation it came up with the idea of investing towards equilibrium futile.

From Keynes and Fisher, modern investment theories were created and had some elements of Keynes and Fisher ideas. Jorgenson's (2003) neoclassical theory of investment just gives a formal idea of Fisher. The work that was done by Keynes' on the subjective probabilities was used as the foundation of modern approaches on the same topic like Markowitz (2002), which was the basis of wide literature on portfolio theory. Keynes has also been an influence to the accelerator theory of investment, which is famous for being applied in business cycles by Samuelsson (2003). Tobin and Brainard got inspiration from Keynes to develop Tobin's Q (Brainard & Tobin, 1968, & Tobin, 2003) and add in expectations. The methodology of measuring marginal q which was created by Mueller and Reardon (2003) is also in line with the idea of Keynes.

2.2.3 Capital Asset Pricing Model (CAPM)

Fama & French (1992) did an update and synthesized proof on shortcomings of the CAPM. By applying the use of cross-section regression technique, they did a confirmation on the size, earnings-price, debt equity and book-to-market ratios and it was included in explaining stock returns which are created by market beta. According to CAPM what is expected from security as returns is the same as the rate on a risk-free security plus a risk premium. If the returns that are being expected do not attain the required then the investment shouldn't be carried out. The findings of the CAPM at various risk levels are plotted in the security market line. CAPM in the context of finance is applied in determining suitable rate on returns on assets if the asset is to be included in an already existing portfolio, considering that asset is a risk that cannot be diversified. The model considers how sensitive the assets are to risks that cannot be diversified/market risk, beta (β) is usually used to denote it in the field of finance, also the returns expected of a theoretical risk-free asset. CAPM "suggests that an investor's cost of equity capital is determined by beta".

The idea of CAPM is that the individuals who have invested require compensation in two various techniques: time value of money (rf) where it gives compensation to the individuals who have invested over a certain time and risk. The rest part of the formula is the representation of the risk and computes the value that the investor needs for taking risks. It's computed by taking beta which gives a comparison of the returns on assets over a span of time and the market premium (Rm-rf). Therefore expected return of an asset is given be sum of risk-free (RF) and product of quantity beta (β) in the financial industry with premium (Rm-rf). The theory helps in explaining that the expected return of investment influences the choice of investment strategies.

2.2.4 Three Factor Model

This model was created by Eugene Fama and Kenneth French (1992) for the purpose of describing stock returns. The traditional asset pricing model, also referred to as CAPM applies one variable in describing the returns of a portfolio. Contrary, Fama–French (2000) model applies the use of three variables. Fama's and French's first observation was that 2 classes of stocks had the tendency of performing better compared to the market: small caps and stocks with a high book-to-market ratio.

Fama & French wanted to improve the measure of market returns, by researching they established value stocks exhibited good performance in comparison to growth stocks;

also, small cap performed better than large ones. Therefore, any individual who purchases traded stock is taking a risk. If a person's portfolio is different in its design then its results will be different as well. There're other premiums that can be used to accept a portfolio that is either large or small than the market, or has a tilt towards growth or its value differs from that of the market. (The risks are at times referred to as priced risk, reason

being it's possible to identify additional returns their acceptance.) Fama-French gave a definition of size premium as the variation in returns between large and small stocks in the CRSP database. They also gave the definition of value premium as the variation in returns between the stocks with 30% highest BTM and the 30% lowest BTM. The theory helps in explaining that the expected return of investment influences the choice of investment strategies.

2.3 Determinants of Financial Performance of Private Equity Funds

Financial performance can be said to be a means of establishing the level to which a certain financial ambitions like an increment in shareholder value, profitability and cash flows are attained in a certain time span. To differentiate the association between strategies applied in investing and firms value in a distinctive manner, control over other elements that could impact how the firm performs is necessary (Liebenberg and Hoyt, 2003; Beasley et al, 2005; Hoyt et al, 2008)

2.3.1 Exchange Rate

In Kenya PE companies often have a high proportionate ownership of foreign partners. The exchange of currency that takes place between the investee country and the investors' home currency affects PE company's' performance financially (Cumming & Johan, 2007). Real exchange rate is usually referred to as the measure of competition at an international level. It's also referred to as an index of how currency in a certain country competes and also there is the inverse association between the index and the competition. A lower index value indicates high competitiveness of the currency. The opinion that volatility of exchange rate is supposed to have an effect on the expected cash flow of corporate and thus affect how it performs by being the cause of change in the cost of home denominations and competition terms for companies that get involved in

activities at an international level is shared widely (Hinchberger, 2013). Metrick and Yasuda (2010) studied a casual association between exchange rates and how PE performed and it was revealed that fluctuations had an effect on profits repatriated to PE foreign investors. The Kenyan shilling losing value against USD is expected to cause reduction on how PE Company's perform financially.

2.3.2 Level of Interest Rate

A major component of PE is debt. The performance of PE is determined by the amount of interests they are able to generate and the arbitrage chances they produce. It is mainly about how available global savings are and the policy for liquidation. In the case when liquidity and savings are in plenty, and there are low rates, the individuals investing will have a greater urge of investing and PE companies are there to fill the gap.

PE companies provide finances for buyouts of company by the use of high debt levels, reason being its cheap compared to equity financing (Hinchberger, 2013). Because of compensation, those providing equity capitals need a higher volume of returns. Because in this context debt capital is greatly effective, debt financing ensures high returns on investment. The other reason that makes debt financing cheap is because of the inherent tax shield. Interests paid on debt are taxed and therefore investment returns greatly depend on tax shield (Hinchberger, 2013).

2.3.3 Inflation

Inflation refers to the general increase in the price of commodities over a given duration. Inflation tends to push up the price of commodities without a corresponding increase in their real value. Private equity firms are adversely affected by inflation since they tend to hold investment over duration of time between acquisition and exit (Nielsen, 2011).

Private equity investors give privately owned companies funds for expanding, developing new products, structuring of the firms operations.

As the company develops, the individuals who invested in PE sell their shares in order to either return capital to limited partners or to look for a new company through IPO or private placement that wants to invest. Several academicians and practitioners argue that successful PE firms' BO and how they perform financially by extension stems at least in part from a gradual inflation rate which does not distort the value of investments. PE firms are also extremely wary of government measures to control inflation through currency devaluation since it ultimately affects private equity firm's illiquid investments which cannot be easily disposed (Parra-Bernal & Blount, 2011). Inflation has an adverse effect on the exit returns when PE firms divest or dispose their stake in an investment (Parra-Bernal & Blount, 2011). IPOs is a favorable channel for PE companies whenever they decide to withdraw their investment or even sell their shares in those firms they had acquired in the past.

2.4 Empirical Studies

In this section the studies that were conducted by other researchers on strategies of investment and PE funds are reviewed. They are inclusive of global studies which are studies that were not conducted in the country. Local studies were also reviewed which are studies that were conducted within the country.

2.4.1 Global Studies

Kumar and Sandip (2012) did an analysis on the elements that affected the decision by PE to invest: evidence from Singapore. The study tries to establish, investigate and do analysis on the elements, and their associations, affecting PE fund manager's decisions on investing. The study investigated 36 PE companies in Singapore basing on a survey

across the companies with parameters documented in different studies done in the past. Identification of the respondents was done by use of published database of PE companies. The sample for the study was a total of 74 PE and VC companies. The study applied the use of principle component analysis, and the results were interesting as the study was done when recession was at its peak. The study found out that most influential elements were the expected products in the market and the portfolio that is used by the firm to market and the character of the entrepreneur. Growth potential of a firm's product market was established to be strongly correlated with regulatory and legal framework of the firm's country.

Martí and Balboa (2011) did a study on the determining factors for PE fundraising in Western Europe. The study intended to establish the primary elements lying behind VC/PE fundraising in regions experiencing scarcity and asymmetric information concerning the end outcome. The technique used in the study was panel data and data was obtained from 16 European countries in the 90s. Because of the long span of time that is needed for investing and the illiquid nature of the investments, the focus was now on the ability of fund managers to invest. It was found that fundraising was affected positively by the amount of funds invested.

Kaplan and Schoar (2005) studied how PE performed: returns, persistence and capital flows in U.S.A. The study did an investigation on how they perform and capital inflows of PE partnerships. The source of data was Venture Economics. Venture Economics collected information on personal funds in the PE sector every three months. The sample was between the years 1980 to 2001. In the 1990s there was a tremendous growth in the sector, before then there were few fund observations. Two data samples were applied. 746 funds satisfied the criteria with majority of them created before 1995. Greater sample

used in the study were those companies that had officially undergone liquidation or were established before 1997. Using the criteria the study came up with a sample of 1090 funds. The findings of the study were that, average fund returns were roughly 500 million dollars but the funds exhibited heterogeneity, returns were continuously strong through various funds that were raised by partnership; partnerships whose performance were good had a higher likelihood of raising funds. This association was concave such that the partnership that performs greatly grows less compared to partnerships that averagely perform.

Chu, Lentz and Robak (2011) studied the comparison of character and how companies offering PE perform study of companies in California offering equity. The study investigated the reason for most of the PE is selling at substantial discounts, with only few selling at premiums. The study did a comparison of PEO companies with seasoned equity offering (SEO) companies and established that PEO companies performed poorly financially compared to SEO companies both before and after the year of issue. It further established that, PEO companies displayed signs of financial distress before they were issued with the equity. FMV Opinions Inc. was the source of the data used in the study. The part of FMV's data used was inclusive of PE problems from 1985 to the end of 1995. The data that was obtained was cleaned and the results were 189 plain vanilla private placements with a strict mutual stock for the sample period. The PE premiums can give a reflection of the future chances of growth and also the potential takeover premiums.

See and Jusoh (2012) did an investigation on the character of fund and how they perform: evidence of Malaysian Mutual Funds. The study did an investigation on the characters of fund that have an effect on how the fund performs through a study of 69 Malaysian equity funds. From the list of Securities Commission, the only funds that were selected were the

domestic open-ended private equity. The sample of the study was equity funds, 75% of the funds were being invested in security market. The study covered the years 2005 to 2009; therefore those funds whose launching was done after the year 2005 were excluded. Testing of the hypothesis was done by use of various techniques to establish if, the variables under study were significantly associated with how the fund performed. The findings revealed that high risks fund results to high returns. The funds that that invested in doing their research had more results in comparison to those who invested less. The results also revealed that performance of young funds were better compared to the old ones. On the other hand, Fund Size and Turnover Ratios were revealed to be insignificantly associated with how funds performed. Overall, the findings established that the individuals investing need to have their focus on young funds and choose risks on the basis of their preferred level of risk. It's the role of the fund managers to understand those characters that may have an impact on how the fund performs and come up with strategies that can help in improving how the fund performs.

2.4.2 Local Studies

Gachoka (2013) investigated the effect of strategies used in investing on how PE funds investing in Kenya perform. The study's intention were; to evaluate the strategies used in investing by private equity fund investors in Kenya; to evaluate how PE fund sector in Kenya perform and to evaluate the impacts of strategies used in investing on how PE funds in Kenya perform. The population of this study was the 20 licensed investment fund managers in Kenya. The findings showed that 45% of the companies adopted venture capital as a strategy, 33% adopted leveraged buyouts and 22% adopted mezzanine financing as an investment strategy. The results also showed that venture capital as an investment strategy had a significant positive impact on how PE funds performed (β = 1.727). This effect was significant at 5% level of confidence. The study

also found that leveraged buyouts as an investment strategy had a significant positive effect on performance of PE funds (β = 1.947). This effect was significant at 5% level of confidence. Finally, the results showed that mezzanine financing as an investment strategy had a significant positive effect on performance of PE funds (β = 1.175). The significance level of the effects was at 0.05 confidence level. The conclusion of the study was that all the investment strategies positively and significantly affected how PE fund investing in Kenya performed. The study recommends that PE fund managers should adopt the strategies discussed above based on their expected returns. This will help ensure that the PE funds give maximum returns to their investors. This study was conducted in 2013 that is five years ago, therefore the investment strategies might have different effects on financial performance of PE companies, hence the reason for conducting the current study.

Kung'u (2013) did an investigation on the impacts of chosen macroeconomic variables on how PE companies in Kenya performed financially. The period of study was from 2005 to 2012 within every three months, thus 32 observations. Analysis of data was done with the aid of SPSS version 11. The study used multivariate regression model. ANOVA and F test were applied to make sure that the model was a good fit. The study found out that ROI of PE companies in Kenya were highly affected by chosen macroeconomic variables; GDP had the greatest effect and systematic risk had the lowest effect. The study further found that the dependent and the independent variables were positively correlated. Gross domestic product, inflation and banks' lending interest rates were found to be the elements that had the highest effect on how PE Company's performed financially. Therefore, these macro-economic variables need to be put into consideration by stakeholders in the PE sector. This study gives affirmation to the researcher's theory that how PE companies perform financially is impacted by key elements of macroeconomic. In summary, it is very important that those factors be put into consideration

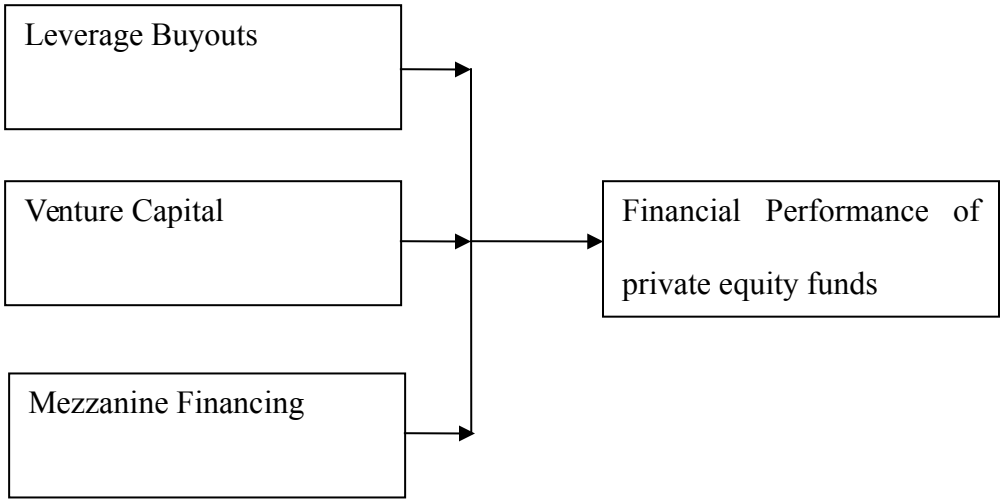
by the managers and stakeholders of PE companies since it has been established that they affect hoe the company performs financially.

Osano (2013) studied the impact of investment strategies how investment funds in Kenya perform financially. The aim of the study was to determine investment strategies that were being applied by Kenyan investment funds and the impacts of the strategies on how investment funds in Kenya perform financially. Targeted group of study was all investment funds in Kenya and census was carried out on the nineteen investment funds since they are not many as given by Capital Market Authority Cap. 485A as of 2013. Data was collected from ten investment managers who turned out to give a positive response. Secondary data was also collected from respective investment funds financial reports for the year 2012. Descriptive analysis was used to find out the type of investment strategy that was used and classified them either as active investment strategy or passive investment strategy. The study concluded that investment funds in Kenya take an active investment strategy. From inferential statistics, ROA and the Predictor variables were positively related. Chisquare test results showed that companies with high liquidity can be said to be better performing as compared to those without or with lower liquidity. This study was conducted in 2013 that is five years ago, therefore the investment strategies might have different effects on the way PE funds perform financially, hence the reason for conducting the current study.

Ndirangu (2017) did an investigation on the effect of firm performance on impact investment in Kenya: a case study of Jamii Bora Bank. The study was explanatory or exploratory as it attempted to lay the groundwork that will lead to future studies on the subject. The study mainly used secondary data which was gathered Jamii Bora bank in

the light of the research questions. Time series data was collected for the six-year period from 2010 to 2015. Effectiveness and efficiency was ensured by analyzing the data using simple linear regression as well as multiple regression analysis using SPSS software. This helped to determine whether the independent variables (operational efficiency, expenditure on social programs and financial returns) had any significant effect on impact investing. Findings indicated that operational efficiency impact investment in Jamii Bora Bank was strongly and positively correlated. From the findings, operational efficiency explained 77.3% of the variation on impact investment at Jamii Bora Bank. Regarding the effect of expenditure on social programs on impact investing, it was revealed expenditure on social programs and impact investment in Jamii Bora Bank were positively correlated. Findings indicated that, expenditure on social programs explains 22.4% of the changes in impact investment in the bank. On the effect of financial returns on impact investing, findings indicated a strong positive correlation between financial returns and impact investment. At Jamii Bora Bank, financial returns were found to account for 28% of the changes in impact investment jointly, from the multiple linear regression analysis; findings indicated that the correlation between the independent and dependent variables was positive. It was revealed that operational efficiency, expenditure on social programs and financial returns jointly explain nearly 76% of the variation in impact investment at Jamii Bora Bank.

2.5 Conceptual Framework



Independent Variables **Dependent Variable**

Figure 2.1: Conceptual Framework

2.6 Summary of Literature Review

A number of theories have been evaluated in respect to the area of study. The theories are important in explaining the investment decisions of PE funds as well as the investment strategies adopted and their effects on how these private equity funds perform. The empirical review of studies carried out above has also clearly shown that private equity fund investing has become a very attractive sector and a lot of academicians and researchers have been giving it a lot of attention. The literature shows that investment strategies adopted are different and this is due to the different motives of fund managers.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methodology. First, there is presentation of the research design. Explanation of the target population, description of research instruments, description of data gathering techniques and description of data analysis techniques follows.

3.2 Research Design

Descriptive analysis is the method of analysis that captures the objectives the study therefore the research study is descriptive research design. In this manner, the study described the association of the study variables. Descriptive research design is the appropriate design for the research study.

3.3 Population

The study was a survey of the private equity fund investment management companies in Kenya. According to CMA (2017) there are 20 licensed private equity fund investment management companies in Kenya (Appendix 1). The study targeted all the funds managed by the 20 private equity fund investment management companies in Kenya, this is in order to ascertain the proportion of each investment strategies used by these companies and how it influence their performance. The study was carried out for a span of five years which was from 2013 to 2017.

3.4 Data Collection

Secondary data was collected through the use of data collection sheet. Secondary data was sourced from the reports and websites of the various fund management companies as well as the CMA website and the NSE website. One respondent was selected in each organization to help in filling the data collection sheet on data relating to investment

strategies which was not readily available in the company financial report. The respondent selected was senior finance staff who helped in filling in the data collection sheet that was used to gather secondary data. The study collected information on the effects of investment strategies on the financial performance of private equity funds for five years between 2013 – 2017.

3.5 Validity and Reliability

To determine how valid the instruments are the researcher sought the opinion of experts in the field especially lecturers in Finance and Accounting departments. This helped in facilitating the needed changes in the research instruments and therefore improves validity. Walliman and Nicholas (2011) defined reliability as how consistent measurements are and its measures using test–retest technique. To ensure reliability, the study adopted the test retest technique. This was achieved by testing the questionnaire to a sample of the population to test its consistency and adjust for any inconsistencies before the real field work begun.

3.6 Data Analysis

The gathered data was coded and analyzed using SPSS software. The study applied descriptive and inferential statistics to determine the association between the variables. Percentages mean and standard deviations were descriptive statistics applied. Linear regression was performed to test the effect of various investment strategies on how PE funds perform financially. The significance level of the model was 0.05 and the findings were interpreted using coefficients of variables, p-values, and R-squared statistics. The study used the following linear regression model

$$Y = \beta_0 + \beta_1 LBO + \beta_2 VC + \beta_3 MF + \beta_4 SIZE + \alpha$$

Where:

Symbol	Variable	Type of Variable	Method of measurement
Y	Financial Performance	Dependent variable	Return on Investments (ROI)
LBO	Leveraged Buyouts	Independent variable	Percentage of Leveraged Buyouts to total capital employed
VC	Venture Capital	Independent variable	Percentage of Venture Capital to total capital employed
MF	Mezzanine Financing	Independent variable	Percentage of Mezzanine Financing to total capital employed
SIZE	Size of the organization	Control Variable	Log of total assets
β_0	constant or intercept		
α	error term		

CHAPTER FOUR: DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the data findings on investment strategies on the financial performance of private equity funds investing in Kenya, in particular, section 4.2 covers the descriptive statistics which summarizes the data collected, in section 4.3 presents the estimated /empirical model for the study, section 4.4 presents the discussion of the study findings in relation to existing literature and section 4.5 covers the summary of the chapter.

4.2 Summary Statistics

In section 4.2 the study present the research finding on the descriptive statistic of the data collected.

Table 4.1: Descriptive Statistics

	N-Unit	Minimum	Maximum	Mean	Std. Deviation
Leveraged Buyouts	100	.01	.34	.1151	.08743
Venture Capital	100	.56	.97	.8782	.11784
Mezzanine financing	100	.02	.34	.1371	.08046
Valid N (list wise)	**100**				

Source: Author Computation

From the data presented in table above, the study found that leverage buyouts has a mean of 0.1151, venture capital had an average of 0.8782, and mezzanine financing had average of 0.1371.

4.3 Empirical Model

The influence among the independent variables was tested by conducting regression analysis. Coding, entering, and computing of the regression analysis was done using SPSS. This section presents the finding on the regression analysis which was between the various

predictor variable and response variable which was financial performance of PE funds investing in Kenya.

4.3.1 Model Goodness of Fit Test

Table 4.2: Model Goodness of Fit Test

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Sign
1	.912[a]	.832	.798	.01210	.001

Source: Author Computation

He variation that is witnessed on the dependent varoible because of the variation that takes place in the response variables is shown by the adjusted R^2. The study found that the value of the adjusted R^2 was 0.798 meaning that there is a change of 79.8% on financial performance of PE funds investing in Kenya because of change in LBO, VC, and mezzanine financing this was at a confidence interval of 95%. Implying that 79.8% change in the way PE funds that have invested in the Kenya perform financially can be explained by changes in LBO, VC, and mezzanine financing. The association between the variables being studied is shown by R. The findings reveal that the variables were strongly associated as shown by a value of 0.912.

4.3.2 Results of Analysis of Variance

Table 4.3: Results of Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Residual	2.844	3	0.948	8.369	.001[b]
	Regression	10.875	96	0.113		
	Total	**13.719**	**99**			

Source: Author Computation

From the finding of the ANOVA table from data processed, the population parameters were suitable for inferring on the population parameter since the level of significance was 0.01 which is less than 0.05. The F-critical value was less than the F-calculated (2.311<8.369) implying that leverage buyouts, venture capital, and mezzanine financing significantly affects financial performance of private equity funds investing in Kenya. The model was considered to be significant because the p-value was less than 0.05.

4.3.3 Results of Estimate Model

Table 4.4: Results of Estimate Model

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	Constant	1.445	0.453		3.190	.002
	Leverage buyouts	0.532	0.197	.014	2.701	.005
	Venture capital	0.499	0.174	.212	2.868	.001
	Mezzanine Financing	0.262	0.092	.188	2.848	.015

Source: Author Computation

The resulting regression model was;

$Y = 1.445 + 0.532\ X_1 + 0.499\ X_2 + 0.262\ X_3$

The regression equation show that holding leverage buyouts, venture capital, and mezzanine financing to a constant zero, the way PE funds investing in Kenya perform financially would be at 1.445. From the findings shown in the table above, coefficient of leveraged buyouts was

significant (B= 0.532, p value=0.005); suggesting that leveraged buyouts had positively and significantly affected financial performance of private equity funds. Also coefficient of venture capital was significant (B= 0.499, p value=0.001); suggesting that venture capital had positively and significantly affect financial performance of private equity funds. Further it was established that coefficient of mezzanine financing was significant (B= 0.262, p value=0.015); implying that mezzanine financing positively and significantly affects financial performance of private equity funds.

4.4 Discussion

The study found that that 79.8% of the way PE funds that have invested in the Kenya perform could be accounted for by leveraged buyouts, venture capital, and mezzanine financing. The study also revealed that financial performance and leveraged buyouts, venture capital, and mezzanine financing were strongly related. The study further revealed that leveraged buyouts significantly affect the way PE funds that have invested in the Kenya perform. The findings concur with Gachoka (2013) who investigated the effect of strategies used in investing on how PE funds investing in Kenya perform. The study found that leveraged buyouts as an investment strategy had a significant non-negative impact on the way PE funds perform.

From the finding the study found that venture capital had positive significant effect on financial performance of PE funds. The study agrees with Martí and Balboa (2011) in their study on the determining factors for PE fundraising in Western Europe; where they found that fundraising was positively affected by the amount of funds invested. Metrick and Yasuda (2014) studied a casual association between exchange rates and how PE performed and it was revealed that fluctuations had

an effect on profits repatriated to PE foreign investors. The Kenyan shilling losing value against USD is expected to cause reduction on how PE Company's perform financially.

The study also revealed that mezzanine financing had positive significant effect on financial performance of PE funds. The study findings are in line with findings of Gachoka (2013) who investigated the effect of strategies used in investing on how PE funds investing in Kenya perform and found that companies adopted mezzanine financing as an investment strategy. The results further showed that mezzanine financing as an investment strategy had a significant positive effect on performance of PE funds.

4.5 Summary

This chapter has captured the study findings on the effects of investment strategies on the financial performance of PE funds investing in Kenya; the chapter has presented the data in systematic manner from the descriptive statistics, empirical model for the study and discussion of the study findings in relation to existing literature.

From the findings the study found that changes on financial performance of PE funds could be accounted for by changes in leveraged buyouts, venture capital, and mezzanine financing. It was also estabished that financial performance of private equity funds and leveraged buyouts, venture capital, and mezzanine financing were strongly related. The study found that leveraged buyouts, venture capital, and mezzanine financing positively influence the financial performance of PE funds investing in Kenya.

CHAPTER FIVE: SUMMARY AND CONCLUSION

5.1 Introduction

This chapter presents the summary of finding, conclusion and recommendations on effects of investment strategies on the financial performance of PE funds investing in Kenya.

5.2 Summary of the Study

The study sought to establish the effect of investment strategies on the way PE funds in Kenya performed financially. The study adopted descriptive research design study and collected data over the period 5 years from 2013 to 2017 for 20 licensed private equity fund investment management companies in Kenya. Secondary data was used. The effect of various strategies of investing on the way PE funds perform financially were tested through multiple regression analysis. The study found that that 79.8% of the way PE funds perform financially could be accounted for by leveraged buyouts, venture capital, and mezzanine financing. The study also revealed that financial performance and leveraged buyouts, venture capital, and mezzanine financing were strongly related. The study further revealed that leveraged buyouts significantly affect the way PE funds that have invested in Kenya perform. From the findings, the study revealed that leveraged buyouts had a significant positive effect on the way PE funds that have invested in the Kenya perform. The study found that venture capital positively and significantly impact on the way PE funds that have invested in the Kenya perform. The study further revealed that mezzanine financing had positive significant effect on financial performance of PE funds.

5.3 Conclusion

The study revealed that changes in leveraged buyouts, venture capital, and mezzanine financing could determine the way PE funds that have invested in Kenya perform. Thus the study concludes that leveraged buyouts, venture capital, and mezzanine financing are the determinant of the way PE funds that have invested in Kenya perform.

The study also revealed financial performance of private equity funds and leveraged buyouts, venture capital, and mezzanine financing are stomngly related. The study found that leveraged buyouts, venture capital, and mezzanine financing positively influence the way PE funds that have invested in Kenya perform

5.4 Limitations of the Study

The study was limited to 20 licensed private equity fund investment management companies in Kenya. CMA website and the NSE website were used to source secondary information. The study had a degree of limitation to how precise the data collected was.

The study focused only on determining the effects of investment strategies on the way PE funds that have invested in the Kenya perform. For this reason only private equity funds could not be incorporated in the study. Data that was used I the study was for a period of 5 years only i.e. 2013-2017. Id data was collected for a longer period then to could have provided wider view of recession in the market and booming and therefore it could have provided a wider dimension of the problem.

5.5 Recommendations for Further Research

The study considered three investment strategies which explained 79.8% of financial performance of the private equity funds. The study therefore recommends further research to be conducted on other factors that affect the financial performance of the private equity funds.

The study targeted private equity funds of only 20 licensed companies, the study therefore recommends further research to be done in the entire sector this would help in uncovering more information. The study was conducted in PE companies; the study recommends replication of the research study in other industries such as financial service industries.

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APPENDICES

Appendix I: Data Collection Sheet

	2013	2014	2015	2016	2017
Number Of Funds Managed By The Company					
Net Profit					
Total Assets					
Amount invested in Leveraged Buyouts					
Amount invested in Venture Capital					
Amount invested in Mezzanine Financing					
Total Amount invested in all the funds					

Appendix II: Summary of Data

	ROI	LBO	VC	MF	SIZE
Old Mutual Asset Managers (K) Limited	7.24%	32.28%	28.06%	22.27%	14.097
Old Mutual Investment Services (K) Limited	3.90%	29.64%	28.17%	23.70%	13.756
ICEA Lion Asset Management Limited	9.87%	29.21%	28.11%	23.97%	13.684
Pinebridge Investments East Africa Limited	7.70%	31.86%	26.89%	23.16%	13.366
Genesis (K) Investment Management Limited	7.08%	30.79%	29.80%	22.13%	13.109
British American Asset Managers Limited	8.25%	25.15%	26.12%	27.37%	13.228
Stanlib Kenya Limited	7.47%	27.27%	28.33%	24.94%	13.034
Sanlam Investment Management Kenya Limited	5.69%	27.54%	28.61%	24.62%	12.989
Standard Chartered Investment Services Limited	6.13%	27.36%	28.42%	24.84%	12.965
Co-optrust Investment Services Limited	5.64%	28.52%	28.10%	24.37%	12.966
CIC Asset Management Limited	9.46%	26.54%	27.57%	25.77%	12.642
Madison Asset Management Services Limited	5.00%	30.26%	31.43%	21.51%	12.258
Apollo Asset Management Company Limited	7.77%	27.74%	28.81%	24.40%	12.302
Dry Associates Limited	6.43%	39.74%	24.10%	20.31%	12.185
Canon Asset Managers Limited	4.17%	26.28%	27.30%	26.07%	12.080
Amana Capital Limited	5.84%	27.02%	28.06%	25.23%	11.806
Aureos (K) Managers Limited	2.64%	28.72%	29.83%	23.28%	11.691
FCB Capital Limited	3.77%	27.18%	28.24%	25.03%	11.646
Zimele Asset Management Company Limited	5.60%	30.13%	31.30%	21.66%	11.092
Fusion Capital Asset Management Limited	3.98%	27.18%	28.24%	25.04%	11.089

Appendix III: Licensed Equity Fund Management Firms

1. Old Mutual Asset Managers (K) Limited
2. Old Mutual Investment Services (K) Limited
3. ICEA Lion Asset Management Limited
4. Pinebridge Investments East Africa Limited
5. Genesis (K) Investment Management Limited
6. British American Asset Managers Limited
7. Stanlib Kenya Limited
8. Sanlam Investment Management Kenya Limited
9. Standard Chartered Investment Services Limited
10. Co-optrust Investment Services Limited
11. CIC Asset Management Limited
12. Madison Asset Management Services Limited
13. Apollo Asset Management Company Limited
14. Dry Associates Limited
15. Canon Asset Managers Limited
16. Amana Capital Limited
17. Aureos (K) Managers Limited
18. FCB Capital Limited
19. Zimele Asset Management Company Limited
20. Fusion Capital Asset Management Limited

Source, CMA (2017)