THE EFFECT OF PRIVATE EQUITY INVESTMENTS ON FINANCIAL PERFORMANCE OF FIRMS IN KENYA

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DECLARATION

I declare that this research Project is my original work and has not been submitted in this form or any other form to this institution for examination purposes. Any quotation is well referenced.

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APPROVAL

This research project has been submitted with my approval as the university supervisor.

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LIST OF ABBREVIATIONS

BVCA	British Private Equity and Venture Capital Association
EBIT	Earnings before Interest and Tax
IFC	International Finance Corporation
IPO	Initial Public Offer
LBD	Longitudinal Business Database
NSE	Nairobi Stock Exchange
OECD	Organization for Economic Development
PE	Private Equity
ROA	Return on Assets
ROE	Return on Equity
R&D	Research and Development
SPSS	Statistical Package for Social Science
US	United States

ABSTRACT

Private equity investment has emerged as a key area of focus in the modern corporate world. The study analysed the effect of private equity funds on the financial performance of firms in Kenya. The study utilized a descriptive research design and secondary data was collected from 25 firms that used private equity during the year 2005 to 2017. Statistical Package for SPSS was used to analyze data using descriptive methods, correlation analysis, and regression analysis. Based on the findings, it was established that private equity strategy that was mostly adopted by the firms was venture capital while the least strategy adopted was mezzanine financing. In general, the study established that investment in private equity had statistically significant effect on the financial performance of the firms. Therefore, organizations are recommended to adopt the private equity funds since they boost financial performance. The study also recommended the firms to structure their private equity investment portfolios in a manner that ensures maximum returns at lower risks. Furthermore, the study recommended the government to put in place effective measures to make sure that the economic climate in the country is conducive for the investment in private equity fund to grow.

CHAPTER ONE: INTRODUCTION

1.1 Background of the Study

Private equity investment is widely practiced in the western countries to fund businesses and mainly comes in the form of debt and equity. According to Kazeem (2018), in the last few-decade, private equity has managed to make significant penetration in Africa and has since been appreciated as a potential means of funding both new and existing businesses.

Private equity are funds that are normally raised by offering prospectus to potential investors whose main interest is to provide capital to promising investments and therefore make returns with time (Bolton, 2012). Such funds are raised either in form of debt or equity capital. The investment mainly consists of investors and PE funds who invest directly in to privately owned companies or otherwise make buyouts in publicly listed firms. Private equity is mainly invested in unquoted securities and involves signing a contractual funding agreement between the PE funds and the company or the business seeking private equity funding.

The BVCA defines PE as the funds offered in return for an equity stake in potentially well performing firms. Instead of relying on trading stocks to raise capital, companies seek funding institutional investors such as pension funds, insurance firms, and endowments and from wealthy individuals. These funds are utilized along with debt funds as well as their own professional and commercial experience to help in setting up and investing in companies with high potential for future growth.

According to Mwangi, Makau and Kosimbei (2014), the private equity investment market has experienced impressive growth in Kenya since the year 2000, despite the global recession of 2008 which caused a strong negative impact upon the funds sourced from the private equity industries; PE investment has remained a credible source of corporate financing and a significant driver of the economy. On the other hand, Bloom, Sadun and Van Reenen (2015) highlighted that private equity investment is the most expensive corporate source of finance.

According to Bloom, this investment type is sought by companies that have no capacity of supporting debt due to their high-risk nature, as well as lack of historical financial data that would act as a track record to attract public equity. In fact, according to Demaria (2013), such companies are challenged when it comes to sourcing capital due to intensive needs for due diligence from the investors. However, such challenges are resolved in the private equity market by use of limited partnership structure where such financial engagements are well managed by investment experts such as buyout investors and venture capitalists, well known as general partners. According to Ongore (2011), general partners are the specialists that hint, structure and manage equity investments within closely-held private firms.

Private Equity is a major driver and a great source of funding for growth of companies and its use would be of great significance to firms in Kenya as they are seen to experience funding challenges, yet they have a very great potential for growth. According to IFC 2013 report on common wealth trade and investment," IFCsupported private equity funding noting that their previous experience was that, through combination of capital and commercial knowledge these funds assist businesses to grow and to generate employments. In particular, IFC found that private equity funds are good at reaching and helping those fast growing smaller and mid-sized companies which make a large contribution to job growth."

1.1.1 Private Equity Investments

According to Wilson (2012), Private equity investment is a source of equity that is not quoted in a stock exchange market. It comprises of investors and PE funds that invest in private companies or otherwise engage in buy outs from public companies. Such companies normally have potential of future growth but lacks funds and enough liquidity. Private equity investments are made up of institutional investors as well as other giant investors who can dedicate and spread their funds into long term investments. Extended time of investment is normally necessary to give distressed companies enough turnaround time to create sufficient liquidity.
Gultekin (2010) defined private equity as "an investment vehicle investing anywhere from early stage to late stage of companies with the hope that they can run these companies better". There are various stakeholders involved in a private equity engagement. Such stakeholders include; investors, whose aim is to attain a balanced portfolio of investments as well as realizing maximum returns on their investments, Fund raisers/transaction advisors who acts as a link between investors and investees and finally the investees who mainly engage the help of private equity investors with an aim of raising capital for their business.

According to Ngugi, Amanja, and Maana (2006), venture capital is as well considered as a branch of private equity and entails equity investments involved in the startup, early development or the expansion of a given business. Another subset of Private equity is Buy outs which involves buying an existing firm from the current shareholders.

Diller and Kaserer (2008) noted that there exist a number of PE investments, but the majority of them invest capital through fixed-life funds whereby portfolios of companies are formed, developed and in the end exited. When such deals are closed, Private Equity firms will be required to source more funds in order for them to remain in business.

From an economic perspective one of the major advantages that comes with Private Equity as compared to Public Equity is that Private Equity does not cause ownership dilution in the long run. This is because the Private Equity term sheet specifies the engagement terms and so the exit terms after which the ownership reverts to original owners. (Vaidya, 2009).

1.1.2 Firms Performance

Demaria (2013) defined performance as the efficiency with which something meets the intended results as measured against the present standards. Also, Groh, Liechtenstein, and Lieser (2011) defined performance measurement as a process used to quantify the effectiveness and efficiency of an action. Again, according to Venkatraman and Ramanujam (1986), the bigger picture of the performance of a firm revolves around three overlapping concentric circles, with the largest representing effectiveness of an organization.

Efficiency and effectiveness of an organization covers all aspects related to organisational functioning. Cameron (1986) noted that company performance or performance of a firm is a subset of organizational efficiency that encompasses both financial and operational outcomes. Effective performance of a firm is what any investor will focus on in order to establish whether the business is a going concern or not. In real business world, a firm is seen to perform financially well when there exists a favourable margin between average revenue and the average variable costs. On the other hand, a firm will be seen to perform poorly if its average revenues are lower than average variable costs. Financial Analysts plays a very critical role in carrying out financial analysis to assist private equity investors make a concrete decision on whether to invest in the company or not.

1.1.3 Private Equity Investment and Firm Performance

Injection of capital in to business whether at the starting stage or in the ongoing stages of a company affects the future performance of the firm. Private equity is a source of capital that come in form of venture capital to new and young businesses or in form of buyouts to already existing companies. According to Ongore (2011), evaluation of Private equity fund performance tends to be a demanding task. Various Studies on private equity performance have assessed the performance at the private equity firm level.

Gakure and Karanja (2012) measured the performance of the private equity-backed companies during the year 1987 and 2000 and the results showed that there was a greater growth in these firms. Also Durham (2004) analyzed the cash flow data of a large private equity investor in the US and established that 85 percent of the company's holding was in form of buyout funds, hence concluding that private equity fund investments have a greater effect on firms' performance.

According to Olweny and Chiluwe (2012), assessing the profitability of investments in private equity has been faced with various challenges. First, the available information in relation to the private equity sector with the description of 'private' is very limited as compared to the information in the public markets. Secondly, financial reporting for some private companies tends to be inconsistent and unclear especially on the gross and net returns.

According to IMF economic report, 2015, PE backed firms normally outperform other firms as such funds are seen to observe a lot of discipline with a lot of investment research been done prior to injection of such funds.PE funds also dictates a lot of management changes that would work towards profitability and hence assure favorable returns on their invested capital. Other factors that have been established to determine the level of performance for private equity supported firms include; whether the PE is in form of venture capital or buyout, the length of PE investment as well as the planned exit strategy i.e. whether IPO or other exit strategies. Private Equity has been appreciated by several firms in Kenya both private and public and has been seen to positively affect the growth in such companies with many of them growing from SME's to international companies.

1.1.4 Private Equity Investments Organizational Performance Kenya

Kenya like any other African country has marginal investments emanating from PE funds. This will however not be the case in years to come as Private Equity investments have greatly gained momentum and a number of Kenyan investors have gained a lot of interest in sourcing finances from the private equity.

Bouviere (2018) noted that the main challenge as to why Kenya has not been very successful in PE investments is because Kenyan firms lacks PE investment experience but according to him, one day it will come to be. Another issue he noted has been lack of integrity and book keeping capacity which pushes investors to bad investments and sometimes exposure to risks.

According to BDO International an investment information site by BDO Kenya, Private Equity has in the recent years grown exponentially moving its interest from developed economies to emerging markets like Kenya. He noted that Kenya has been an attractive destination for Private Equity deals which has offered quality resources and good deals.

The Kenyan economy has received mega growth in the last few years and this have been majorly contributed by the success of SME's. According to IKM Advocates website, A number of this SME's may however not be able to keep the pace of the growth due to the fact that they may not be able to access bank loans or debt financing as most of the banks require conventional collaterals to lend. It's therefore expected that most of them will turn to Private Equity Firms for them to invest required capital in the form of Equity or debt.

According to African business central magazine (2017), Kenya remains a hotspot for Private Equity investment as deal makers from around the world continue to be attracted by the favorable and improved business environment. A strong relationship is therefore expected to exist between Private Equity and firms in Kenya and the effect that such a relationship would have is therefore quite interesting and beneficial to current and future firms to be established in Kenya.

1.2 Research Problem

Private Equity investment is comparative to other alternative investments that are anticipated to have excellent risk-return payoffs contrary to the traditional assets. Private investment assets are considered to have lower correlations with the traditional assets. In most of the emerging economies, Private equity investment remains a new investment phenomenon as most of the investors in these markets are not very familiar to them. This is however not the case in developed economies such as European and US markets where most of the investors result to Private Equity to finance their business growth. According to Ongore and Kusa, (2013), private equity funds have longer investment perspectives an aspect that causes them to be illiquid and long-term investments. There are literature reviews of the current empirical field that have presented the overview of the private equity investments.

The literature works have offered a holistic focus of the private equity investments. For example, Jenkins (2013) researched on the governance and structure of the Venture Capital and the United State firms. Also, Gakure, and Karanja (2012) published a research detailing the core features of private capital investments. In addition, Kung'u, (2013) researched on investment strategies, entry modes as well as the performance of private equity funds.

However, private equity investment in Kenya has not received a lot of focus by researchers and is therefore not well recognized as a source of business finance. Lack of its knowledge in Kenya has restrained most of the companies to sourcing funds from the Banks with some companies that have space for market growth failing to grow beyond SME level and some closing down due to lack of conventional collaterals required by banks in Kenya to obtain loan facilities. Most of the available researches and studies on the topic have been undertaken in the American and European market. In 2013, Deloitte investigated the East Africa private equity investment. Research by Babarinde (2012) focused on assessing risks on the return trade-off among the private equity company in Kenya. Another study was conducted by Kamau (2012) focusing on the relationship between investment strategies and organizational performance of Private Equity funds in Kenya. With all these researches and studies, there are still no enough researches on the nexus between the private equity funds and the financial performance of companies in Kenya. Hence, there is a gap in the literature on the influence of private equity investments on the financial performance of firms in Kenya. The current research will explore the question: What is the effect of private equity investments on the financial performance of firms in Kenya?

1.3 Research Objective

The general purpose of the study was to determine the effect of private equity investments on the financial performance of firms in Kenya.

1.4 Significance of the Study

It is expected that the study will con tribute to a wider and intensive knowledge on the relationship between investment in private equity and the performance of firms which has been empirically established. Other researchers will be able to use the research findings to ensure that there is an understanding of the issues highlighted and use them in referencing their works or as a base for any other further studies (Silici & Locke, 2013).

On the other hand, the government will source an understanding of the role played by the informal and the formal private equity to ensure that it offers a suitable environment for its operations. In fact, the government is more likely to understand the need for formulating policies that are in the support of the private equity investments. The study will contribute significantly to the attainment of the Kenya vision 2030 (which consider the aspect of strengthening the small private firms to be the core industries in the future).

The study will also shed light on the impact of private equity investment to firm performance, and therefore private investors will use the study to evaluate the need to offer such financing- that is if the resulting impact of the study will be positive (Babarinde, 2012).

Businesses unaware of such private equity investments will gain the knowledge and henceforth consider private equity as a financing option to grow their businesses. Individuals who have financial capability will consider coming up with private equity funds to finance businesses in Kenya with a target of making good return hence creating employment which will in turn result in better performance and development of the economy (Blomstrom, 2014).

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

In this section, the study discusses the theoretical framework of the research study, the empirical literature review and the conceptual framework of the study. Under the theoretical framework, the study discusses the various theories that are relevant to the study. The empirical review section analyses the findings of various researchers on the nexus between private equity and organizational performance while the conceptual framework presents the pictorial representation of the relationship between the variables of the study.

2.2 Theoretical Review

In this research, it was worth relying on various theories that would provide explanations for the research. The study was informed by the agency theory, and the Pecking order theory.

2.2.1 Agency Theory

The Agency theory was developed by Jensen and Meckling (1976). They defined it as a contract between the principal party and the agent party whereby the agent is contracted to carry out some specific duties on their behalf. The principal normally relegates some decision-making functions to the agent and trust that the Agent will work towards maximising their wealth. Under this theory, the Agents/Managers are seen to be focused on self-gain and will only carry out the process of PE investment if it contributes to their personal gains (Agrawal & Knoeber, 1998; Ghoss &Ruland, 1998).This objective does not necessarily increase PE investors returns (Firth, 1980).

The Agency theory concurs with Larcker (1983) argument that Agents are interested with decisions that are short term in nature and that they try to maximise the available firm resources within the limited time frame. On the other hand, shareholders prefer maximizing their returns in the long run and not in the short run hence an agency problem arises. To minimise this problem, PE fund investors provide their managers with performance incentives such as share options as well as signing of performance reward system. Travlos and Waegele in (1987) suggested that companies with long term compensation plan perform better as compared to those without one. In addition, Lewellen, loderer and Rosenfield (1985) states that Companies with managerial stock ownership plan normally have higher returns.

However, through close monitoring and involvement of board of directors, better decisions that do not lead to conflicting interest can be made. The success of PE Investments requires that goals of managers and those of investors are well aligned and that they are focused towards wealth creation and maximization. The agency theory is thus very applicable to this study as it tries to align the interests of shareholders and those of managers. Engaging Managers whose personal wealth is closely linked to firms' value lead to better investment decision for PE funds. To increase investors returns and ensure better financial performance for these companies, managers can be compensated through performance-based compensation plans as well having close monitoring and where necessary, intervention by the shareholders.

2.2.2 Resource-Dependence Theory

Resource-dependence theories was originated by Jeffrey Pfeffer and Salancik (1970).They argued that a board of management exists to provide resources to the senior managers of the firm to assist them achieve firm's goals (Hillman, Cannella, &Paetzold, 2000; Hillman &Daziel, 2003). The theory advocates for interventions by the board of directors while insisting on having a strong financial, human, and intangible supports to the management. For instance, board of directors who are expatriates in certain areas can make use of their knowledge to couch and mentor senior managers in a way that increases the performance of the organization. Board of directors can also use their connections to attract resources to the firm. Resource-dependence theories argue that most of the high-end decisions should be made by the senior managers and where necessary approvals can be sought from the board of directors.

PE funds normally make use of this theory where they set pre-condition to be included in the board of directors to the firm in which they are to invest their funds. This helps them monitor and contribute to any board decision made in regard to the organization investment decisions.

2.2.3 Pecking Order Theory

Donaldson was the first to suggest this theory in 1961 which was later modified by Stewart, Myers and Malouf (19840. .The theory argues that firms' priority is to use their internal finances as the first option since they are cheaper and then proceed to use external sources in the order of their cost. Internal sources are therefore utilized first, and companies only issue debt when such internal funds are depleted. Equity is then given an option only when it's no longer sensible to continue using debt.

The theory starts with asymmetric information since executives would have more information relating to the company's prospects and associated risks more than external investors. Such information influences the decisions on whether to use internal or external financing as well as whether to use debt or equity. A pecking order therefore exists and would be very important in financing new or existing projects. In most cases, Asymmetric information works in favour of debt financing over equity financing as debt financing depicts confidence that an investment would be profitable. On the other hand, issuance of equity signals a pessimistic view about the board of management and that they feel the share price is over-valued. Issuing more shares may therefore contribute to reduction in the price of the shares. Barry, Bierlen and Sotomayor (2000) tested the applicability of the partial adjustment theory and pecking order theory for firms. From the study, it was established that firms adjust to long-run financial targets for equity, debt, and leasing, but that further financing requirements follow a pecking order that is stronger for firms with greater problem of asymmetric information.

Private Equity investment normally comes in two ways; Equity and debt. This theory is therefore relevant to the study as companies would use it to determine whether to source PE funds in form of Equity or in form of debt based on the pecking order of their companies. The theory would also be of great importance to the firms in determining the most appropriate and cost-effective source of financing to their projects.

2.3 Determinants of Performance of Firms in Kenya

Many firms in Kenya have experienced a number of challenges in their performance. Some firms have even closed down due to lack of capacity to sustain growth. Growth is often seen as the most crucial and reliable measure of organisational performance (Wicklund, 1999). The extent to which a firm grow financially would be determined by a number of variables such as Returns on Assets (ROA) and Returns on Equity (ROE).

2.3.1 Private Equity

Equity as source of financing to a business plays a very critical role on the extent to which a firm performs. According to Gilligan and Wright (2010), the effect of private equity on firm’s financial performance will mainly be influenced by a number of factors revolving around the manner in which the fund is invested. Private equity may be sourced as a venture capital or buyouts. Venture capital is a source of private equity fund that is provided to firms that are still at the early stage of growth and which have demonstrated high potential for future growth.

Venture capital are managed by venture partners who are normally compensated via a percentage of total returns coming from the fund investment and which is normally agreeable in writing before committing their funds to any investment (Hisrich & Peters, 1998).

On the other hand, Private equity may come in form of buyout. Joachim (2010) defined Buy out as private equity funding that are inclined to mature firms or firms that are already well established. Generally private equity firms are normally very active to ensure that pre-investment screening is well conducted as well as monitoring the investment during the holding period to ensure that the firms performs.

2.3.2 Financial Performance

Most of the firms in Kenya use financial performance measures to determine the performance of the firms. (Taylor, 2016) noted that Key performance metric for financial performance used by firms includes; Return on Assets (ROA), Earnings before interest and tax(EBIT),gross profit margin among others. Future PE investors will want to evaluate the effect that previous private equity funding has had on the financial performance of any firm.

Coleman (2007) noted that the main intention of any investment, made by the corporate sector, is to generate returns. PE investments are normally spread within a considerable duration to give firms enough turnaround time to be able to refinance the borrowed capital.

Ntim (2009) noted that Cost of debt capital can negatively affect the firm's ability to generate revenues and invest in projects. The terms in which private equity funding is sourced will therefore contribute significantly to the financial performance of a firm. Private equity is a cataract to business expansion and hence revenue growth that if invested properly would ultimately affect the financial performance of a firm. This study will be trying to establish the extent of financial performance when a Private equity is used to fund business growth.

2.3.3 Size of the Firm

The size of a firm refers to the array and quantity of production ability and the potential of a firm or the quantity and diversity of services it can offer to the clients (Shaheen & Malik, 2012). The size of a business is very crucial in current business world because of the theory of economies of scale. Big firms can make products on costs that are much lower as compared to small firms. Today firms are geared towards increasing their size in order to achieve a competitive advantage against their rivals by widening their market share and bringing down costs of production.

Abdurahman, Awad, Erik and Jeffrey (2003) argued that the relationship between the size of a firm and financial performance is a crucial matter that may provide guidance on the factors that improves financial performance. The size of a firm has been appreciated in the literature as a major variable used in the explanation of the financial performance of firms and several researches have tried to study the impact of the size of firm on the financial performance (Hardwick, 1997; Wu, 2006; Punnose, 2008; Serrasqueiro & Nunes, 2008). Nonetheless, the output of their studies has been controversial and inconsistent; such that as some results reported negative relationship, others reported positive relationship, meaning there is need for further study (Hardwick, 1997; Wu, (2006).

2.3.4 Capital Structure of a Firm

Capital structure includes equity capital and debt capital. Generally, equity capital includes shareholder's fund and reserve of the firm on the other hand debt capital considers preference share capital and other non-current liabilities of the firm. Generally, the capital structure of the firms is analyzed using debt to equity ratio.

Velnampy and Aloy (2012) stated that the term capital structure of a firm means combination of preference shares, equity shares and long-term debts. Most of such firms try to keep their capital structure to maximize their profitability and sustainability. This determines how much of fund should be maintained in the form of equity and debt capital. Every firm has to pay the interest or other compensation for their debt capital whether the firm has earned profit or not but in the case of equity capital the firm may pay the dividend to the equity shareholders only if the firm has earned profit.

Gitman (2003) noted that the value of a firm is maximized by low cost of capital. The ratio of debt and equity that will lower the cost of capital of firms and so maximizes the market value and the profitability of firms is the optimal capital structure. Misinformed capital structure decisions can cause higher cost of capital leading to lower net present value (NPV) for many of the company's investment projects to the point of making many investment projects not viable. Informed capital structure decisions will lead to a lower company's overall cost of capital and raise the Net Present Value of investment projects making more projects acceptable and therefore raising the general value of the firm.

Van der Sar (2011) argued that leverage improves the performance of a firm by reducing conflicts between managers and shareholders as due to excess liquidity. On the contrary, however, higher leverage will imply that the firm will have high commitments to accomplish its future obligations. Moreover, higher costs can result to higher leverage ratios which lead to financial distress.

2.4 Empirical Review

There exists different empirical literature evaluating the effect of private equity on performance of firms. This goes back to 1980's when equity investment was widely discussed leading to many changes on how equity investment is done. This empirical literature has been carried out both locally and internationally.

Amenya (2015) undertook a study on how capital structure influences the organizational performance of firms listed in Nairobi stock exchange. He established a negative relationship between higher financial leverage and organisational performance of firms. The study established that higher total debts led to less return on equity and thus a reduction in the shareholders wealth. This implies that there is need to inject more capital rather than borrowing more funds. This implies that injecting more capital in form of private equity will lead to a positive impact on performance as compared to borrowings.

Kaumbuthu (2011) undertook a study on the effect of capital structure on the return on equity on the firms in the NSE under the industrial sector for the period 2004 to 2008.Debt equity ratio was used as an indicator for capital structure while return on equity was used as a had a negative effect on the financial performance. From the analysis, the study established that debt equity ratio and ROE. The study was however focused on one sector and only concentrated on the aspect of financing option.

Mwirigi (2014) carried out a research on the effect of Private equity in emerging markets. His study conducted a research on books, articles data and information on the PE industry and its activities in Kenya. He concluded that the PE has contributed significantly to the growth of firms in emerging markets, though not without challenges posed by poor legal and institutional settings.

In an earlier study, Kiprop (2013) analysed the relationship between capital structure and the value of companies quoted in Nairobi stock exchange. He collected and analysed quantitative data so as to unravel the correlation between the two variables. Based on the analysis, a conclusion was made that there was a significant positive correlation between capital structure and the value of the firms. This empirical review is significant in this study since PE fund affect the capital structure of a company and so the value of the firm.

Prince Baah-Peprah and Priscilla Serwaah (2017) analyzed the impact of private equity on the organizational performance of firms in emerging markets. A multiple-approach was utilized to collect primary and secondary data which was then analyzed using a mixed methodology. From the analysis, the study established that the companies that the financial performance of firms that were funded through private equity was relatively higher than that of publicly quoted firms. In addition, the study established that the firms higher private equity ownership stake had marginally higher growth rate and return on equity (ROE) than the firms that had lower private equity ownership stake.

Bernstein, Lerner, Sørensen, and Per Strömberg (2018) analyzed the effect of private equity on industry performance. They combined two datasets to analyze how PE investments affect industries. One dataset contained information on private equity investments and other contained industry activities and performance data across member states of the Organization for Economic Cooperation and Development (OECD) that are captured in the OECD's Structural Analysis. The study found that firms in which PE funds had invested in the previous five years had grown much faster. They also found that there were minimal significant variations between industries with high and low PE activity, implying that the findings were partially driven by spillover effects from PE-backed firms to other firms in the industry. Again, they found no support showing that economic activities in industries that had private equity support was more exposed to aggregate shocks.

A study by American Economic Review (2011) examined the performance of more than 3,000 PE-owned firms from 1980 to 2005 and documented gains in total factor productivity. The study used the U.S. Census Bureau's Longitudinal Business Database (LBD) to look at individual business establishments (a smaller unit of observation than the business as a whole). The study found that PE firms tend to close or restructure less productive establishments while growing more productive ones, essentially reallocating resources within a company to their most productive use, yielding net gains in efficiency. This implies that private equity would have a positive effect on firms' performance through increased efficiency.

Amess, Stiebale and Wright (2015) analyzed the effect of private equity on firm's innovation activities. The study utilized a propensity score matching technique (to come up with the counterfactual) and combined it with a difference-in-differences estimator so as to determine the effect of Leveraged Buyout on portfolio firms. Their findings suggested that Private equity firms do not focus on short-term cost-cutting in the place of long-term performance; rather, they facilitate investments in innovative activities that have a long-term pay-off.

Brown (2005) undertook a study on the nexus between venture capital and firm's long term performance. He carried out a study on US based firms that werelisted during 1980-1989 in seven key-hi tech industries. He presented separate findings for a small sample of firms that are backed up with venture capital-and those that were not backed up, carefully matched, based on a three-digit industry and firm size before the initial public offer(IPO). The methodology of matched sample, also used by Megginson and Weiss (1991) and Jain and Kina (1995), provided an analysis on the complete sample results and helped to make sure that the venture-capital supported firms were evaluated against a set of firms with no back up from venture CapitaLand which possible similarities.

The results indicated that venture-backed firms raised considerably higher amount of funds from the IPO, and that both types of firms showed considerable increase investment spending as well as on their size as they go through the IPO. The IPO proves to be more important to the non-venture-backed firms in terms of financing capital expenditure and on R&D. After the IPO, firms that are venture-supported survive longer and have less hazard rates.

2.5 Conceptual Framework

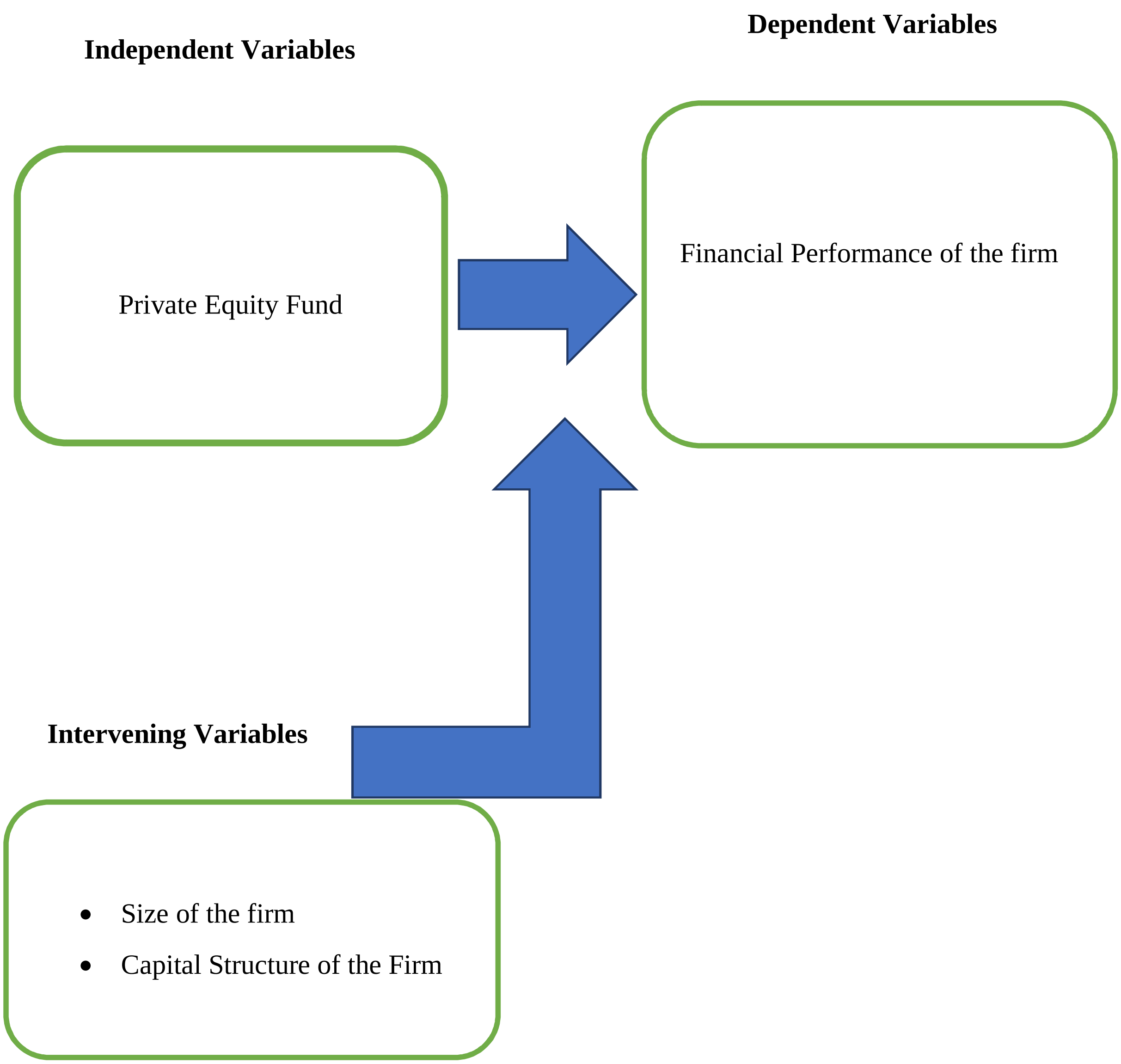

Figure 2.1: Conceptual Framework

2.6 Summary of Literature Review

The chapter has presented the theoretical background and key concepts of the study. The theories covered, better explains the relationship between firms and fund managers as well as the order in which firms structure their capital for business financing.

The Literature that has been reviewed in this paper shows that private equity fund has a major influence on the organizational performance of firms. Various researchers and scholars have conducted research studies to establish the relationship. Globally, there is extensive research work on the effect of private equity fund to firm’s financial performance.

Local studies however do not indicate any study carried out to establish any correlation between PE fund and financial performance. The only research available by Mwirigi (2014) focuses on the general role played by PE in emerging markets. His study however did not address the existing research gap on how Private Equity impacts on the financial performance of firms. This left a research gap that the current study sought to bridge.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This section discusses the methodology that was used to carry out the study. This entailed the research designs that are employed in this research. The chapter discusses the research design, the target population, sampling methods, data collection methods and procedures and the data analysis methods and procedures.

3.2 Research Design

A research design refers to an outline used to collect, measure, and analyze data. Mugenda and Mugenda (2009) define a research design as one on one plan demonstrating how a given study will be carried out. Research design involves the blueprint and the outline of assessment undertaken to source information on the research questions. Mainly, the outline covers the entire program or scheme of the research. The research design according to (Bogdan & DeVault, 2015) is a plan directed toward attaining the research objectives. Descriptive survey was employed as the research design in this study. Rijbarova (2005) defines descriptive study as a measure of two or more variables existing naturally and aims at finding out if a relationship exists between them. The research design was considered in the study to ensure that information related to the current status of the framework is sought with minimum bias.

3.3 Population and Sample

Research population refers to the set of all individual of interest in a study (Palinkas *et al*., 2015). The population of the study comprised of data from 25 firms that used private equity during the year 2005 to 2017.This data was sourced from private equity funds websites as well as from different business journals in Kenya (Appendix 1). Companies that have used PE between years 2005 to 2017.

There is minimal information in Kenya regarding Private equity investments and that is why the sample was extended for the last twelve years. The population covered the real operations in the private equity funded firms especially on the profit margins, operational expenses, sales revenue and the expenditures in other business-oriented activities and the general financial performance as indicated in the books of accounts.

3.4 Data Collection Technique

For the purposes of the current study, secondary data was used. Secondary data assisted in the formation of background information needed to carry out this study. The period of study for which data was obtained is fifteen years from 2000 to 2016. The secondary data was obtained from the financial reports and websites of the firms.

3.5 Data Analysis

After data collection, data cleaning was done to ensure completeness and to organize the data chronologically. From this part, the data was then assessed with use of descriptive statistics, correlation and regression analysis to set up the relationships between the private fund and the firm financial performance. The analysis was done using the Statistical Package for Social Sciences (SPSS).

The dependent variable that was used in the analysis is the financial performance by firms whereas the independent variables will be private equity fund and the size of firm as the control variable. Correlation between these variables was assessed to determine the relationship, and hence the effect of the private equity funds on firm's financial performance.

3.5.1 Diagnostic Tests

This study used various tests to achieve the research objective. The study used correlation analysis to analyze the relationship between the variables of the study. The p value was used to determine the significance of the correlation between private equity funds and financial performance of firms.

3.5.2 Analytical Model

The study used simple linear regression model to determine whether the predictor variable (Private equity fund) had any significant effect on firm financial performance.

The following regression equation was used:

$Y = \alpha + \beta 1X1 + \varepsilon$

Y = Financial Performance (ROA)

X1 = Private Equity Fund

β1= Coefficients of the independent variable

ε = Error Term

The purpose of this data analysis was to highlight the results of the data collected and to ensure that the data was more illustrative via presentation in form of tables to make it easier for observation of the general trends (Dörnyei, 2007).

CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter presents the data analysis and discussion of the findings. The analysis was divided into two sections. The first section presented the general information about the firms that were included in the study. The analysis here involved descriptive method. The second section sought to analyze the relationship between private equity investments on the financial performance of the firms sampled.

4.2 General Information

The purpose of the analysis here was to assess the general information about the firms in regard to investment in private equity funds. Specifically, the study analyzed the duration the companies had invested in private equity and the various private equity strategies that had been adopted by the firms.

4.2.1 Duration the Firms have invested in Private Equity

It was important to determine the duration the firms have been investing in private equity funds. This was important because, ascertaining this duration helped to determine whether the firms had enough experience in private equity to give reliable findings.

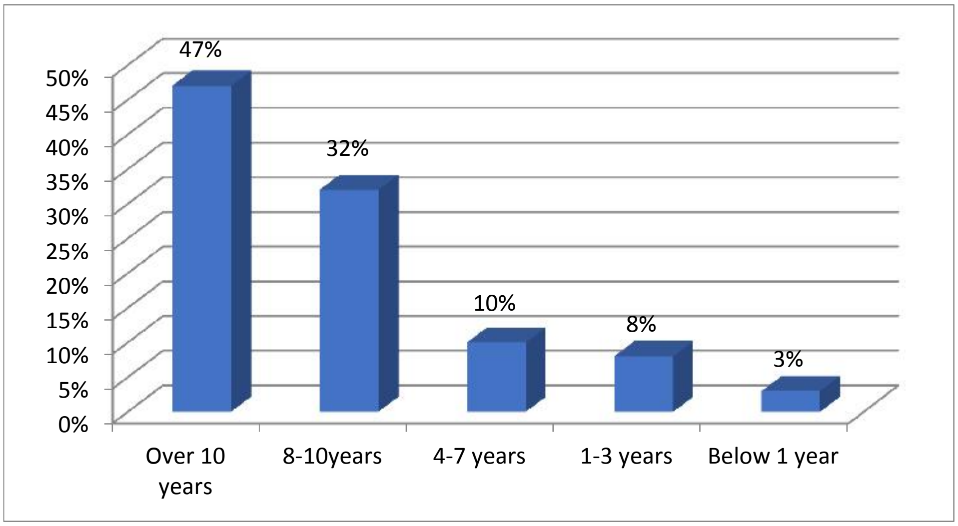

Figure 4.1: Duration the firms have invested in private equity

Based on the findings, 47% of the sampled firms had invested in the private equity funds for a period of over 10 years, 32% had invested in private equity for 8-10 years, 10% had invested in private equity for 4-7 years, 8% of the firms had invested in private equity for a duration of

1-3 years while a small proportion of 3% have invested in private equity for less than one year. The findings imply that the majority of the companies have invested in private equity for a considerable duration of time and they were therefore suitable for the study

4.2.2 The Private Equity Investment Strategy Adopted

In this section, the study sought to determine the PE investment strategies adopted by the companies. The analysis results are presented in the figure below;

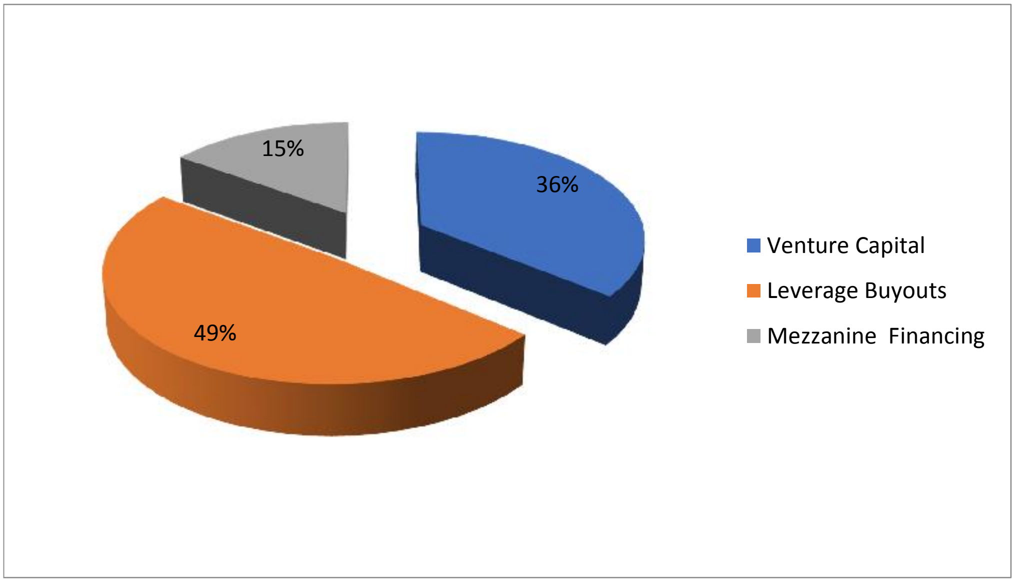

Figure 4.2: PE investment strategies

The analysis results in figure 4.2 above shows that 49% of the firms adopted leverage buyout as a strategy. The findings also show that 36% of the companies have adopted venture capital as a strategy, while 15% have adopted mezzanine financing as a strategy. The findings indicate that the most common PE strategy adopted by the firms was buy out capital which have been adopted by the majority of the companies. The findings are contrary to the findings of Gachoka (2013) who analyzed the effect of investment strategies on the organizational performance of private equity in Kenya and found that the majority of the companies had invested in venture capital.

4.3 Private Equity and Firms' Performance

The purpose of the analysis here sought to determine the effect of private equity on the financial performance of firms. This was done using correlation and regression analysis. To start, normality test was conducted to determine whether the data was normally distributed.

4.3.1 Normality Test

This analysis sought to test whether the data collected was normally distributed. A normality test of the dependent variable was therefore conducted using the Shapiro-Wilk Test. The following hypothesis was tested

Ho: The dependent variable is not normally distributed

H1: The dependent variable is normally distributed.

The test results are shown in the table below;

Table 4.1: Normality Test

Tests of Normality						
	Kolmogorov-Smirnov[a]			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
ROA	0.823	35	.057	0.872	35	.061

Based on the findings above, the Shapiro-Wilk test gave a p-value 0 .061>0.005. The null hypothesis was therefore rejected, and a conclusion made that the dependent variable was normally distributed.

4.3.2 Correlation Analysis

The analysis sought to establish the correlation between private equity investments and firm performance financial performance. The analysis results are shown below;

Table 4.2: Correlation Analysis

Correlations			
		ROA	PE
ROA	Pearson Correlation	1	.353*
	Sig. (2-tailed)		.038
	N	35	35
PE	Pearson Correlation	.353	1
	Sig. (2-tailed)	.038	
	N	35	35

*. Correlation is significant at the 0.05 level (2-tailed).

Based on the analysis results, the correlation coefficient obtained was 0.353 which implies that there was moderate positive correlation between private equity investment and financial performance of the firms. The analysis obtained a p-value=0.038<0.05 implying that there was statistically significant relationship between private equity funds and financial performance of the firms. Based on the findings, a conclusion can be made that private equity investments had significant effect on the financial performance of the companies sampled.

4.3.3 Regression Analysis

The regression analysis here sought to determine the general effect private equity on the financial performance of firms**.** The hypotheses tested are as follows;

Ho: Investment in private equity funds does not have statistically significant effect on the financial performance of firms in Kenya.

H1: Investment in private equity funds has statistically significant effect on the financial performance of firms in Kenya.

The analysis results are shown below;

Table 4.3: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.353	0.125	0.098	0.8466976

a. Predictors: (Constant), VAR00002

Based on the analysis findings, the R Square value obtained was 0.125. This implies that investment in Private Equity led to 12.5% variation in the financial performance of the firms.

Table 2.4: ANOVA

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	3.368	1	3.368	4.699	.038[b]
	Residual	23.658	33	.717		
	Total	27.026	34			

a. Dependent Variable: VAR00001

b. Predictors: (Constant), VAR00002

The analysis obtained an F-value of 4.699 which was significant since the p-value obtains was less than 0.05 (p value=0.038<0.05). This indicates that the overall regression model was significant at 95% level of significance. This implies that Private Equity is a significant predictor of financial performance of the firms.

Table 4.5: Coefficients Table

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.198	.161		19.839	.000
	PE	0.0003549	.000	.353	2.168	.038

a. Dependent Variable: VAR00001

The findings on table 4.5 shows that private equity has a positive coefficient (0.0003549) which indicates that PE is a positive predictor of financial performance of the firms. This implies that an increase in private equity investment increases the financial performance of the firms. The private equity value obtained was statistically significant (since p value=0.038<0.05). This indicates that Private Equity is a statistically significant predictor of financial performance. The findings were in agreement with the findings of Mwirigi (2014) who analysed the impact of private equity on the organisational performance in the emerging economies and concluded that the private equity contributed significantly to the growth of firms in emerging markets. The findings were also in line with the findings of Baah-Peprah and Priscilla Serwaah (2017) who analyzed the impact of private equity on organizational performance in emerging markets and found out that firms that are funded through private equity have relatively higher return on equity (ROE) and growth. The study findings were also in agreement to the findings of Bernstein, Lerner, Sørensen, and Per Strömberg (2018) who analyzed the effect of private equity on industry performance and concluded that firms that had invested in private equity funds had grown much faster than those that had not invested in private equity funds.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section presents a summary of the key findings, the conclusion, and recommendations of the study. The chapter also suggest others areas that other researchers and scholars can focus on.

5.2 Summary of the Key Findings

Private equity investment has experienced rapid growth over the years. Based on the academic literature review, there are various strategies associated with private equity investment which include venture capital, leveraged buyouts, and mezzanine financing. Based on the analysis findings, it was established that the majority of the firms had invested in private equity for a period of over 10 years. The study found out that the common private equity strategy that had been adopted by most firms is buyout capital.

In regard to the relationship between private equity funds and financial performance of the firms, the correlation analysis findings indicated that investment in private equity had moderate positive relationship with the financial performance of the firms. This relationship was significant at the 5% level of significance. Further, simple linear regression analysis established that private equity had statistically significant positive effect on the financial performance of the firms

5.3 Conclusions

The study established that private equity strategy that was mostly adopted by the firms was venture capital while the least strategy adopted was mezzanine financing. A conclusion can therefore be made that venture capital have the highest returns and are hence the most common while mezzanine financing had the least returns. Generally, the study established that the firms achieved statistically significant improvement as a result of investment in private equity. A conclusion can therefore be made that investment in private equity greatly improves the financial performance of the firms.

5.4 Policy Recommendations

From the analysis, the following recommendations were made;

The study recommends the organizations to adopt the private equity funds since they boost financial performance. Among the strategies adopted, venture capital was more common and was working well for the firms. Firms are thus recommended to adopt this strategy in order to improve financial performance.

The study recommends the firms to structure their private equity investment portfolios in a manner that ensures maximum returns at lower risks. The maximum returns will enable firms to attract more investors and thus facilitate their funding processes.

The study recommends the government to put in place effective measures to ensure that the economic climate is conducive for the investment in private equity fund to grow. The study recommends policy makers to utilize the findings of this study to obtain information about the investment areas that private investors have shied from, that requires government support. By providing support, the government will help to promote growth in the financial sector as well as an improvement in the economy in whole.

5.5 Limitations of the Study

The study was carried out at a time when Kenyan firms have not fully embraced the use of private equity as a source of capital and therefore the sample for the study is centered to just a few of the firms operating in Kenya.

The study also depended only on secondary data and therefore the accuracy of its findings is dependent on the data that was available. Still most of the firms are not willing to publish information relating to private equity investments more especially because some of the firms are privately owned and have no statutory obligation to publish such information.

The research is also an academic study that was critically subjected to tight deadlines. I believe that more time would have given the researcher more space to make detailed observations and conclusions on how the financial performance of firms in Kenya can be improved by investing in Private Equity.

The study was conducted with limited variables affecting financial performance. Other macro-economic variables could as well affect financial performance of firms especially in Kenya which is still a young economy.

5.6 Suggestions for Further Research

The study suggests the following areas for further research studies;

The current study only covered the period in which the firms were investing in the private equity funds. Another study should therefore be conducted to compare the performance of the firms before and after adopting private equity funds strategies.

The study analyzed the effects of private equity funds in general. Another study is thus suggested to isolate the effects of each private equity strategy in order to determine whether there are significant differences among the strategies based on their effect on financial performance.

The independent variable in the regression was private equity only. Another study should be conducted including other variables that impact on financial performance of the firms.

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List of Appendices

APPENDIX: LIST OF FIRMS THAT USED PE FUND BETWEEN YEAR 2005-2017 IN KENYA.

No	YEAR	FIRM	PE FUND	AMOUNT	SOURCE
1	2005	I&M Bank	IFC	5B	https://finances.worldbank.org/Projects/IFC-Investment-Projects-Kenya/pb5k-ythh/data
2	2006	Chase Bank	Amethis Finance	Ksh 890m	https://www.businessdailyafrica.com/markets/Kenya-leads-Africa-in-private-equity-firms-investments/539552-1754414-37ooaxz/index.html
3	2006	Africert	Pearl Capital Partners	36% stake	https://www.businessdailyafrica.com/markets/Kenya-leads-Africa-in-private-equity-firms-investments/539552-1754414-37ooaxz/index.html
4	2007	Equity Bank ltd	Helios	11B	https://biznakenya.com/helios-re-emerges-on-equity-banks-top-shareholders-list-with-sh-1-3-billion-shares/
5	2010	Family Bank ltd	DFIs Norfund, FMO and Africinvest	916M	https://www.businessdailyafrica.com/markets/Kenya-leads-Africa-in-private-equity-firms-investments/539552-1754414-37ooaxz/index.html
6	2010	Bank of Africa	International Finance Corporation	200M usd	https://finances.worldbank.org/Projects/IFC-Investment-Projects-Kenya/pb5k-ythh/data
7	2011	Family Bank	Helios	2.3B	
8	2011	Interswitch Ltd	Satya Capital	4.5B	
9	2011	KPLC	IFC	50B	https://finances.worldbank.org/Projects/IFC-Investment-Projects-Kenya/pb5k-ythh/data
10	2012	Gulf Bank Africa	IFC	4.98B	https://finances.worldbank.org/Projects/IFC-Investment-Projects-Kenya/pb5k-ythh/data
11	2012	Java coffee house	Emerging Capital Partners	21.6B	https://www.businessdailyafrica.com/Java+coffee+chain+sells+majority+stake+to+US+equity+firm+/-/539552/1414528/-/umlhqr/-/index.html
12	2012	Cellulant	IBO	2.5B	
13	2014	REMU microfinance bank	Fusion Capital	25%	http://www.theeastafrican.co.ke/business/private-equity-deals-in-east-africa/2560-2741046-10yjqv8z/index.html

14	2014	Faulu Bank Kenya	European Investment Bank	2.5B	https://www.the-star.co.ke/news/2015/10/27/faulu-sh200m-growth_c1230950
15	2014	Telkom Kenya	Helios	3.5B	
16	2014	Atlas Development & Support Services	Burbidge capital	450M	http://imburbidgecapital.com/wp-content/uploads/2018/05/EA%20Review/newsletter_-december_2014.pdf
17	2015	Medpharm holding	Ascent Capital	250M	https://www.businessdailyafrica.com/markets/Private-equity-firms-invest-Sh102bn-in-Kenyan-businesses/539552-3014118-a6155z/index.html
19	2015	Twiga chemicals	IFC	200M	
20	2015	Sumac Micro finance	Regmifa	100M	https://www.businessdailyafrica.com/markets/Private-equity-firms-invest-Sh102bn-in-Kenyan-businesses/539552-3014118-a6155z/index.html
21	2015	Stanlibfaharireit	IFC	15B	https://finances.worldbank.org/Projects/IFC-Investment-Projects-Kenya/pb5k-ythh/data
2	2015	Apex Africa capital	Axis	470M	https://www.businessdailyafrica.com/markets/Private-equity-firms-invest-Sh102bn-in-Kenyan-businesses/539552-3014118-a6155z/index.html
24	2016	Centum	Satya	1.7b	
25	2016	Transcentury	Kuramo Capital	2B	https://www.businessdailyafrica.com/markets/PE-deals-in-East-Africa-up-50pc-but-value-lags-behind/539552-3240642-jxtws1z/index.html
26	2016	Telcom Kenya	Helios	60%	https://www.heliosinvestment.com/telkom-kenya
27	2016	Mt Kenya bottlers	Abnerve	700M	+
28	2017	Pay go energy	Global Innovation Fund	1.43M usd	http://disrupt-africa.com/2017/04/kenyas-paygo-energy-raises-1-43m-funding-round/
29	2017	Africa talking ltd	International Finance Corporation	6B	https://finances.worldbank.org/Projects/IFC-Investment-Projects-Kenya/pb5k-ythh/data
30	2017	Safaricom		268.84B	http://www.mediamaxnetwork.co.ke/337418/kenya-tops-ea-sh520b-private-equity-deals/
31	2017	Osho Chemicals	IFC	450M	
32	2017	I&M Bank		34.6B	http://www.mediamaxnetwork.co.ke/337418/kenya-tops-ea-sh520b-private-equity-deals/

33	2017	UAP Insurance		16.1B	http://www.mediamaxnetwork.co.ke/337418/kenya-tops-ea-sh520b-private-equity-deals/
34	2017	EABL		23.2B	http://www.mediamaxnetwork.co.ke/337418/kenya-tops-ea-sh520b-private-equity-deals/
35	2017	Acorn Group-Kenya	Helios	68m USD	http://estatecloud.co.ke/kenyas-acorn-group-helios-to-construct-3800-hostels-worth-68m/