AN INVESTIGATION OF FACTORS THAT DETERMINE THE EXIT STRATEGIES OF VENTURE CAPITAL FIRMS IN KENYA

BY

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OCTOBER 2011
DECLARATION

I hereby declare that this is my original work and it has not been submitted to any other college or university for academic credit.

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DEDICATION

I dedicate this Project to my family, my mother Wangechi, my wife Christine, my son Christopher and my brother Edward for their invaluable support, encouragement and prayers.

I am grateful to my MHA student colleagues and lecturers who in one way or another contributed to the success of my studies and this project in particular. Their assistance will never be forgotten.

I appreciate the students who offered their expertise, information and sound advice on the various sources of this study. In particular, my heartfelt gratitude goes to the Nairobi Kenya, Financial Capital and its people. The Meru town staff whose cooperation and overall support went beyond expectations and their report is highly appreciated.

Last but not least, I am truly grateful to all the family, friends and numerous friends for their support, confidence and understanding throughout the duration of this course. Their prayers and messages of support have pulled me through it all.
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ABSTRACT

Venture capital has been defined simply as risk capital, that is, the investment of funds in a business where there is a significant element of risk. This financing can thus be all equity or all debt or a combination of both, in addition to providing management support for the invested firms, normally referred to as ‘investees’. An important part of any venture capital investment is the exit from the investment. Venture funds are meant to invest in a firm for an average of five years and reap from their investment. Venture capitalists can exit in various ways. In general, venture capitalists will exit their investments by one of the following five methods: an initial public offering (IPO), an acquisition exit, a buyback, a secondary sale, or a write-off.

The research design involved the study of the population of the sixteen firms in Kenya involved in venture capital activities as members of the Africa Venture Capital Association. The response rate from these firms was at 31% due to the high confidentiality in the industry. The results of the study were that the invested industry conditions and the management and performance of the investee firm were the most important factors, among others, in determining an exit mechanism. The data revealed that the few firms had made any exits as they have not been in existence long enough to go through a full cycle. The acquisition sale method for exit was picked as the most highly preferred method due to its likely high returns.

The paper recommends that government puts in place policy, legal and fiscal changes and incentives to aid in the development of the venture capital sector. Moves to avail more information, both by the government and the venture capitalists would help grow the sector in terms of investees and venture capital practitioners. Suggestions for further study in the area of venture capital were also made.
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LIST OF ABBREVIATIONS

PE- Private Equity

VC- Venture Capital / Venture Capitalist

IPO- Initial Public Offering

BPI- Business Partners International

AS- Acquisition Sale

CMA- Capital Markets Authority

NSE- Nairobi Stock Exchange

OECD- Organization for Economic Cooperation and Development

SMEs- Small and Micro Enterprises
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CHAPTER 1: INTRODUCTION

1.1 Background to the Study

Venture capital has been defined simply as risk capital, that is, the investment of funds in a business where there is a significant element of risk. In such a business, both the cashflows and the future creation of profits incorporate a huge element of risk. Amit et al (1999) describe venture capital as the provision of debt and equity financing to young privately held firms. This financing can thus be all equity or all debt or a combination of both, in addition to providing management support for the invested firms, normally referred to as ‘investees’. Venture capital plays a helping hand in the financing of startup and early stage businesses, as well as businesses in "turn around" situations. Tasci (2004) describes venture capital as investing in companies that have undeveloped or evolving products or revenue. Venture capital thus lays particular emphasis on entrepreneurial attempts and less mature businesses. Venture capital therefore entails an active and motivated working relationship in which the venture capitalists (and the investors of venture capital) take on important roles within their portfolio firms in which they have invested. Venture capitalists are therefore described as those desirous of accepting high risks in return for much higher rates of return. The venture capitalists seek out promising ventures, eventually placing money in risky ventures managed by entrepreneurs whose skills are unknown and whose future efforts are not predictable (Barry, 1994).

Venture capitalists operate in a variety of ways to bring together a pooled investment vehicle that typically invests third party funds in businesses that would be too risky for standard capital market investors or traditional sources of finance like bank loans. These vehicles are known as venture capital funds. Sahlman (1990) provides a detailed description of the way in which venture capital operates. There are various forms of venture capital organizations,
including publicly traded corporations, captive subsidiaries of large banks or of corporations, small business investment corporations and private limited partnerships. The most important is the limited partnership form, which accounts for roughly two-thirds of venture capital invested (Sahlman, 1990). In the limited partnership, the venture capitalists serve as general partners and typically put up about 1% of the funds raised. The limited partners consist of private individuals, pension funds, endowments, and insurance companies.

According to Tasci (2004), there are four recognized stages of venture capital financing. The first stage is known as the Seed stage. This is where financing is provided to research, assess and develop an initial concept before the business gets to the start up phase. It is in this stage that American venture capitalists have excelled in partnerships with universities and budding researchers to develop completely new industries like the computer software industry (Nuechterlein 1999). The second stage is the Start-up stage. This is financing for companies, either being set up or have been in business for a short time, which are yet to commercially sell their products and are therefore not generating profit soon. The Expansion stage involves venture capitalists providing financing for the growth and expansion of a company which has broken even and is generating a profit. This funding will involve product and market development. It also includes rescue and turnaround financing. The European venture capital industry has concentrated on this stage of financing unlike in the United States of America (OECD, 2004). The fourth stage according to Tasci (2004) is the Replacement capital stage. This stage involves the purchase of shares from other investors in the firm or to reduce the debt level of the firm through the refinancing of debt.
1.1.1 The History of Venture Capital

Venture capital can be said to have been existing in some form throughout human history. For example, Islamic finance, being tied to Islamic law, is an old system with few changes over time but some of its products, like ‘musharakah’ have the aspect of ownership and risk sharing (Al-Suwailem, 1998). Other forms of business start-up funding like angel investing—involving wealthy individuals lending to startup ventures—have been existing in Europe for centuries. This includes such ventures as Queen Isabella of Spain financing the voyage of Christopher Columbus (Landstrom, 2009). The beginning of modern venture capital can be traced to the period after World War II.

Three American investors, John Hay Whitney, Benno Schmidt and Georges Doriot, can be said to have been the pioneers of modern venture capital. Whitney and Schmidt founded J.H Whitney & Company, a venture capital firm that would engage in deals to develop firms and sell their stake to make profit. One of their greatest deals was the purchase of Florida Foods Corporation. This firm would later develop an innovative way to deliver nutrition for American soldiers, that later became known as Minute Maid and was sold to the Coca Cola Company in 1960. JH Whitney later left the venture capital market to concentrate on buyouts.

Georges Doriot would become known as ‘the father of modern venture capital’. His founding of the American Research and Development Corporation (ARD) is considered a key milestone in venture capital development. Doriot was a former banker, Harvard professor and head of a key military department during World War II. ARD was formed as a public corporation in 1946 to engage in funding of entrepreneurial ventures. Its successes and failures, both in the choice of investments and in its operations would govern how future venture capital funds were organized. A key example is the limited partnership model
adopted to run venture capital funds as a result of lessons learnt from regulatory problems faced by ARD as a public company.

1.1.3 Venture Capital in Other Markets

America, as expected, has the highest number of venture capital funds and successful businesses backed by venture capital and sold in the capital markets. Nuechterlein (1999) believes this is because of the entrepreneurial culture of the United States. In 1999, about US $75 billion was being managed by venture capital funds, against US $30 billion in all of Europe in the same period. Legal changes that allow institutional investors to invest in risky private equity have helped Americans raise funds for start ups. A higher proportion of American venture funds go to start ups than in any other market. This is also due to the interaction between universities and industry that helped propel innovation. Key technology and commercial firms like Microsoft, Cisco systems, Starbucks and Lotus were all venture capital products. The venture capital sector in other world economies has not been as successful. This is due to a mixture of culture and lack of appetite for risk though that is changing (Nuechterlein, 1999). According to the Organization for Economic Cooperation and Development (2004) the lack of entrepreneurial support has held back the Japanese markets. The European venture funds have been found to prefer financing more stable firms rather than startups.

1.1.4 Venture Capital Exit Mechanisms

An important part of any venture capital investment is the exit from the investment. Venture funds are meant to invest in a firm for an average of five years and reap from their investment (Barry, 1994). Lingelbach (2009) stated that the logic of the venture capital lifecycle requires exits at attractive internal rates of return as a precondition for fund managers to raise their
next fund. It is therefore a critical move that venture capitalists consider the likely exit mechanisms even before making the investment. Venture capitalists can exit in various ways. In general, venture capitalists will exit their investments by one of the following five methods: an initial public offering (IPO), an acquisition exit, a buyback, a secondary sale, or a write-off (Cumming and Mackintosh (2003). In an IPO, the firm embarks upon a sale of its shares to public investors. The investor will typically not sell all (or even a part of) its shares into the public market at the date of the public offering. Rather, securities will be sold into the market (or distributed to investors) over a period of months or even years following the public offering.

Sometimes a venture capitalist will exit via an acquisition exit in which the entire firm is purchased by a third party. There are a variety of means for effecting an acquisition exit, including a sale of shares, a merger, and sale of the firm’s assets. However the transaction is effected, the buyer in a strategic acquisition will be an entity that is referred to as a “strategic acquiror”. A strategic acquiror is a business entity that may be in any business at all, but will often be in a business that is the same as, or similar to that of the target firm. It may be a competitor of the target firm, a supplier, or a customer. It is typically larger, and often much larger than the target firm. Following the acquisition, it may leave the target firm as a wholly owned subsidiary or a separate division, in order to preserve the management/entrepreneurial team responsible for the firm’s past success. Alternatively, it may integrate the company’s assets with its own. In either case, a major motivation for the transaction will be to meld the target’s products and/or technology with its own, in order to produce synergistic gains (Cumming and Mackintosh, 2003)
In an exit effected by way of secondary sale, the venture capitalist sells its shares to a third party—again typically a strategic acquirer. In rare cases, the purchaser will be another venture capitalist. A sale from one venture capitalist to another can be motivated by the relative skill sets of the selling and purchasing venture capitalist. The purchaser may be more familiar with the firm’s technology or markets, for example, than the seller. Such a sale might also be motivated by differences in the confidence of the two venture capitalists in the future of the firm’s product or technology. A secondary sale differs from an acquisition exit in that in a secondary sale the venture capitalist alone sells its interest to a third party, the entrepreneur and other investors retain their investments. Where the purchaser is a strategic acquirer, it will usually be seeking a window on the firm’s technology, with a view to possibly effecting a 100% acquisition of the firm at some point in the future (Cumming and Mackintosh, 2003).

In a buyback, the entrepreneur and/or firm managers or the company (collectively referred to simply as "the entrepreneur") will repurchase the shares held by the venture capitalist. In many cases, the buyback will be triggered by the exercise of contractual rights taken by the venture capitalist at the time of initial investment. Such rights will often include, for example, the ability to “put” its shares to the entrepreneur after the elapse of stated periods of time, such as two or five years, the failure to achieve performance targets, or the failure to go public. A write-off occurs where the venture capitalist walks away from its investment. While a write-off will often involve the failure of the company, the venture investor may continue to hold shares in a non-viable or barely profitable enterprise, or a “lifestyle” company sufficient to support the entrepreneur in relative comfort, but lacking sufficient upside potential to maintain the venture capitalist’s involvement. The use of either of these methods will depend on various factors ranging from the industry specific factors to factors surrounding the goals
of the venture capitalists (and his/her investors) and the management of the venture by the entrepreneur (Cumming and Mackintosh, 2003).

1.1.5 Venture Capital in Kenya

The Kenyan venture capital history is relatively short. Funds such as the International Finance Corporation have operated for sometime in Kenya, being World Bank linked, to support growth of small and micro enterprises (SMEs). Other investors like Trans Century have operated to bring about start-ups but the aim has not been to exit. Other funds like Business Partners International and Aureos Capital, have only been in operation since the early 2000s (Kashangaki, 2008). In Kenya, the regulatory structure that prevents pension funds from undertaking more risky investments and the conservative nature of fund trustees and insurance company heads has constrained funds available for lending or financing new ventures (Kashangaki, 2008). By the year 2008, Kenyan venture capital funds had invested about US $ 200 million. Most of Kenyan venture capital investments were undertaken by arms of development finance institutions like the International Finance Corporation prior to 2001. The Kenyan VC sector is dominated by foreign owned firms and the few local firms are simply firms that had a focus in debt financing and investments in SMEs.

A key issue is on the exit options available for the funds to realize their returns. While the government and the Capital Markets Authority have worked to relax some of the requirements for listing in the Nairobi stock Exchange (NSE), there seems to be a lack of new listings. There is need to establish how venture capitalists have been exiting their arrangements and if not, why? If a fund cannot find private buyers for their share in a successfully run venture or be able to carry out an initial public offering (IPO) of the venture’s shares, then it won’t gain from its risk taking and won’t be able to get new funds
from investors, especially institutional ones. There will be no justification for the added risks the investors are being asked to accept.

1.2 Statement of the Problem

It is therefore clear that one of the key aspects of venture capital financing is the exit from the investment. Venture capital exits are an important aspect of the venture capital business as they provide a way for venture capital providers to evaluate the venture capitalists and determine whether to fund with them in the future (Schwienbacher, 2002). Nuechterlein (1999) states that one of the key factors that has helped the United States grow its venture capital market has been the existence and success of a key exit route, the stock exchange. The National Association of Securities Dealers Automated Quotation (NASDAQ) has been the outlet for technology related venture capital successes. Companies such as Microsoft, Google and Cisco systems emerged through the Dot Com boom of the 1990s. The European market has suffered from insufficient exit mechanisms.

In Kenya, the lack of appropriate mechanisms was indicated as a reason why fewer institutional investors are willing to go the venture capital way (Kashangaki, 2008). Few firms have been publicly traded and the fact that the NSE has only 53 listed companies is a testament to that. This paper thus investigates the exit mechanisms available to venture capitalists in Kenya for them to get a return from their risky investments. It also seeks to establish the options that have been used so far and why the firms chose them. Njoroge (2004) studied venture capital and concentrated on the availability of venture capital but did not study exits in depth. VC investments in Kenya cover a wide spectrum of sectors. Firms like Athi River Mining were able to grow as a result of venture financing under the Acacia Fund. This venture was exited by way of initial public offering (IPO).
In the case of current investments, locally owned firms have concentrated on debt financing for small and micro enterprises. A key sector that has grown from venture capital has been the health sector. The majority of the current investments of the Aureos Capital Fund have been in the health sector. All are currently active, with no exits undertaken from the Fund as yet. Ngigi (1997) conducted a study on venture financing for small firms at a time when there were few venture capitalists and did not study exits. The key fund then was the Acacia Fund, a part of the Aureos Capital investments. Chege (2003) studied venture capital in the medical industry and Koech (2008) studied control mechanisms and interests of investments in venture investing. There is thus a need to conduct indepth studies of exits in view of their importance in evaluating funds and therefore in the growth of venture capital in Kenya.

1.3 Objectives of the Study

The study had the main objective of establishing the exit strategies of venture capital initiatives in Kenya.

1.3.1 Specific objectives

The specific objectives of the study are

i) To establish the exit mechanisms available to venture capital investors in Kenya.

ii) To establish the factors which determine the choice of exit mechanisms used by venture capitalists in Kenya

1.4 Significance of the Study

The study is meant to be of benefit to venture capitalists, the likely investees and the government of Kenya.
1.4.1 Venture Capitalists

Firstly, new venture capitalists will gain from this study by gaining knowledge of exit mechanisms successfully used by other investors and those not used but are available. This will have the effect of increasing confidence in venture capital and attract institutional investors to take the risk and commit more of their funds to private equity.

1.4.2 Potential Investees

Potential investees will gain from this study by learning what their potential investors are looking for in a firm, that is, what is required to make a successful exit arrangement. A good business idea, coupled with good management will lead to an increase in value that can then be exploited by either organizing for leveraged buyouts or selling the firm to third parties who would be willing to support the next stage of growth for the firm and give returns to the initial investor.

1.4.3 The Government and Society

The government and society in general will gain from this study because more knowledgeable investors and investees will lead to increase in investment which will lead to job creation and higher economic growth. An increase in funding for innovation will push Kenya towards more industrialization and push the country further along the path to being a middle income nation.
CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

Venture capital has been defined as risk capital. Barry (1994) indicates that in Spanish, the term used to describe venture capital is simply ‘capital de riesgo’. Thus, despite the increased monitoring by investors, more than a third of venture capital funded initiatives result in losses, with a sizeable fraction resulting in complete loss of the original investment. However, the study of venture capital success has been hampered by the difficulty in obtaining private information from the investors.

2.2 Theories of Venture Capital

Various theories have emerged to justify the existence of venture capital and to explain various aspects of venture capital fund operations.

2.2.1 Asymmetrical Information Theory

Amit et al (1998) present the assertion that asymmetrical information forms the key reason why venture capital exists. Asymmetrical information can manifest itself in two ways. The first way is the ‘hidden information’ way. This way is clear in that the entrepreneur seeking venture capital financing knows more about the likely performance of the product or offering on which the venture is built. The entrepreneur is also fully aware of his/her skills and abilities than the venture capitalist. There is therefore incentive for the entrepreneur to misrepresent his ideas and his abilities in order to get financing. This is otherwise known as ‘adverse selection’. This phenomenon, while observed in other investments and in other industries, especially insurance, is a particularly troublesome issue in venture capital.
The second way in which asymmetrical information has an effect on the investment climate in venture capital is the ‘hidden action’ scenario. An investor cannot observe all the actions of a manager in affirm. It is not possible to verify if all actions taken are for the interest of the firm and for the investor. This problem leads to the moral hazard problem. The central hypothesis of the paper is therefore that, venture capitalists emerge due to specialized skills in dealing with and identifying effects of asymmetrical information. They therefore establish a niche which other more risk averse investors would be unwilling to commit most of their money.

However, a negative correlation between the venture capital ownership about and the firm. This might be the way of getting sufficient financial capital into

The formulation provides the relationship that reflects the idea that venture capitalists are those investors who become skilled at selecting good projects in environments with hidden information and are good at monitoring and advising entrepreneurs who might otherwise be vulnerable to moral hazard problems. The implications of this modeling framework are outlined as; firstly, venture capitalists will operate in environments where their relative efficiency in selecting and monitoring investments and providing value-enhancing services gives them a comparative advantage over other investors. Secondly, within the class of projects where venture capitalists have an advantage, venture capitalists will still prefer projects where selection, monitoring, and service costs are relatively low or, in other words, where the costs of informational asymmetry are less severe. Thus venture capitalists perceive informational asymmetries as costly, but they perceive them as less costly to deal with than do other investors.

Thirdly, if informational asymmetries are important, then the ability of the venture capitalist to “exit” may be significantly affected. Ideally, the venture capitalists might wish to sell off their share in the venture after it “goes public” on a stock exchange. If, however, these
investments are made in situations where informational asymmetries are important, it may be difficult to sell shares in a public market where most investors are relatively uninformed (Amit et al, 1998). The fourth implication is that, all other things equal, we can expect entrepreneurial firms in which venture capitalists own a large share to generate lower net returns. This would be due to the moral hazard problem. Higher values of the share meant to go to the venture capitalist reduce the incentives of the entrepreneur to provide effort. Nonetheless, it still might be optimal in a given situation for the venture capitalist to take on a high ownership share, as this might be the only way of getting sufficient financial capital into the firm. However, a negative correlation between the venture capital ownership share and firm performance is still expected (Amit et al, 1998).

2.2.2 Specialization of Venture Capital

Barry et al (1994) indicate that there is evidence that venture capitalists engage in specialization. This specialization occurs at the level of types of industries and at the stage of the firm (Barry, 1994). Thus, some investors might exclusively fund technology, others manufacturing and others in general merchandise. Others might opt to only finance start ups and others might be inclined to support established firms in need of expansion financing. Nuechterlein (1999) alludes to this specialization as one of the key differences between the American venture capital scene (known for mostly funding start-ups and innovation) and the European venture capital market (seen as preferring later stage financing for expansion. Tykvova (2007) indicates that specialization is a typical characteristic of venture capital firms and is a key reason for the diverse nature of the venture capital industry.

However, Han (2006) indicates that while there is theoretical specialization by industry, stage of financing and geography, most US venture capital funds are not that highly specialized.
His studies showed that while there was a great deal of heterogeneity in how US funds are specialized, not much research had gone into showing how and why funds developed specialization. His theory was that the specialized talent of venture capitalists and the performance of the fund governed specialization more than other factors. The knowledge of why funds specialize is therefore important for seekers of venture capital funds in knowing who to target and can presumably also give a guidance as to preferred exit modes of such funds.

Other related theoretical positions have been on the staging of capital financing and the syndication of the funds. Fluck et al (2006) postulate that staging of funds and contracting that allows it, is a key tool for correcting imperfections in venture contracts. However, the benefits of such contracting will only be realized by the added practice of syndicating (spreading out among many other venture capitalists) the latter stage investments to clear new imperfections brought about by staging contracts. These theories provide an inkling as to why venture capital funds exist, how they value their prospective investees and why they choose to be in the industries they invest in. An understanding of these and other factors about venture financing are key to understanding the way the funds will seek to maximize their value in the investment and make a profitable exit and continue this cycle to bring about growth in the venture capital industry in Kenya.

2.3 Venture Capital Exit Theories

(I) General Theory of Venture Capital Exits

Cummings and Mackintosh (2003) provide a general theory for venture capital exits based on the duration that the venture capitalists hold the investment. The theory argues that an entrepreneur is meant to utilize his/her specialized skill set in three areas, namely, entry,
during the investment and at the time of exit. At the point of entry, the venture capitalist, exercises expert judgment in winnowing the wheat from the chaff.

During the build up phase, the venture capitalist is an active, value-added, or relational investor. The venture capitalist intensively monitors managers and participates in strategic decision-making (including hiring and firing managers). During this phase, the investor also provides ancillary services to the entrepreneurial EF, such as providing advice on legal and accounting assistance, identifying other sources of financing or arranging financing, identifying suppliers and customers, etc. Finally, the venture capitalist exercises expert judgment in relation to the exit decision, determining when and by what means and for what consideration the investment will be exited (Cumming and Mackintosh, 2003).

The theory of duration makes various assumptions. These are that; Firstly, the venture capitalist has a unique ability to add value to the enterprise by functioning as an active investor (i.e. there are no other value-added investors). Secondly, at any given point in time, the investor’s investment in the firm can be sold to a third party for a price which represents the best estimate of the true value of the firm (i.e. there is no information asymmetry). Thirdly, that the exit price is not dependent upon the form of exit. Fourthly, that the fund has an infinite life span, so that the venture capitalist’s choice of when to exit is made independently of any need to exit investments in order to return both invested capital and profits to the fund’s investors and fifthly, that the venture capitalist can freely re-deploy capital harvested from one investment into other investments (Cumming and Mackintosh, 2003).
Thus, according to this theory, the longer an investor holds an investment, the investor’s ability to add value diminishes. The theory therefore argues that an investor will exit an investment in the event of three occurrences. Firstly, that the marginal value and maintenance cost curves cross implying the exhaustion of the venture capitalist’s skill set. The theorists argue that venture capital value added will decline over time until it is equal to or less than maintenance costs. The value added by the venture capitalist will be greatest at the start of the investment relationship, when the investor is most likely to be able to bring managerial and financial discipline to the enterprise, help identify and implement product development strategies, identify legal, accounting and marketing expertise, and so on. However, the ability to add value will decline over time as the firm matures, management becomes more seasoned, the most pressing product development and marketing issues have been worked out, and the firm’s various business contacts (including legal, accounting, investment banking, marketing channels, suppliers, and customers) have been put in place (Cumming and Mackintosh, 2003).

They also argue that maintenance costs will decrease over time. That is, the effort expended by the venture capitalist will be front-end loaded, for the reasons given above. Finally, they argue that maintenance costs contain a significant fixed cost element, since the investor must perform some baseline level of monitoring in respect of each of its investments, whether in need of active management or not. Thus, the maintenance costs curve will decline more slowly than the marginal value curve. Therefore, at some point in time the two functions will cross, at which point the investor will be unable to add further value to the enterprise, and will exit the investment (Cumming and Mackintosh, 2003).
The second occurrence is when internal or external shocks change the location of the marginal value added and/or maintenance cost curves. A variety of internal or external shocks (both systematic and unsystematic in nature) can shift either the marginal value added curve, the maintenance costs curve, or both, causing the exit criterion to be satisfied. For example, if the firm’s technology proves unworkable, this will presumably relocate the marginal value added curve. Other events that might relocate either or both of the curves include: the firm’s technology is rendered obsolete by external technological developments; the firm’s product is displaced in the market by those of competitors; a recession dries up demand for the firm’s product; complementary technological developments in the marketplace greatly increase the value of the firm’s technology, etc (Cumming and Mackintosh).

The third occurrence is when the venture capitalist receives new information about the location of the marginal value or maintenance cost curves. Upon entering into an investment, the investor will, at least at an intuitive level, draw marginal value added and maintenance cost curves. These curves may subsequently be revealed to have been drawn incorrectly. For example, the maintenance cost curve may have to be re-drawn because the entrepreneur turns out to be far more difficult to work with than originally forecast. Once re-drawn, the curves may intersect at a new location, causing the exit condition to be satisfied. The relaxing of the assumptions to the theory gives a set of exceptions to the theory that reveal why exits happen when they do (Cumming and Mackintosh, 2003).

II Principal Agency Theory of Venture Capital Exits

Schwienbacher (2002) develops the theory of venture capital exits based on the agency relationships developed by Sahlman (1990). Sahlman indicates that three relationships exist. Firstly, the form of organization of venture capital firms (with the venture capitalist as the
general partner and investors to the fund as limited partners) creates an agent-principal relationship, with the venture capitalist as the agent of his/her limited partner investors. The entrepreneur also acts as an agent for the venture capitalist in utilizing the invested funds. Finally, the venture capitalist also has a duty as an agent of the entrepreneur. In all these relationships, the possibility of abuse by one of the agents, of the trust placed in them, is possible due to self-interest.

Alon et al (1996) showed that venture capitalists sought to minimize their exposure to agency problems. The theory is thus based on the coping mechanisms employed by the various principals to try to deal with the information asymmetry and moral hazard problems that lead to agency problems. Their theory was based on the benefits of an exit by initial public offering (IPO) and by a trade sale (TS). The assumptions underlying the theory are that, firstly, an initial public offering (IPO) provides the entrepreneur with an “implicit contract” over control at the time the venture’s shares get listed. The idea is that going public allows the entrepreneur to remain in control over his firm, while under a trade sale control is transferred to the acquirer. Therefore, going public gives the entrepreneur control benefits that he does not get in a trade sale. This in turn provides him with additional incentives to make an IPO more likely (Schwienbacher, 2002).

Secondly, entrepreneurs do not voluntarily stop their projects, that is, they have a preference for continuation. It is assumed that they get more benefit when the venture is financed to the end. Thirdly, conditional on technological success, the likelihood that exit will occur through an IPO is increasing with the value of the venture. He thus assumes that the ratio IPO over TS is increasing with the value of the venture. One reason may be that a minimum size is required for the company to get attention from outside investors (they need to collect information on the venture which is costly to them). This then favors firms with higher
valuations for which liquidity is higher due to their greater trading volume. Through testing the theory in European and American exits, Schwienbacher (2002) concluded that while IPOs seemed more desired for their agency conflict solutions, the greater number of exits was by trade sales.

2.4 Empirical Studies

Amit et al (1998) showed that venture capitalists sought to minimize their exposure to information asymmetry problems through their choice of industry. The study also showed that for Canadian firms, the venture capitalists eventually found that the amount of resources needed to bring firms to a position of profitable exit was more than had originally been anticipated. This has an effect on the expectations and risk appetite for those seeking to raise venture capital funds.

Han (2006) conducted research on 1586 funds to establish the main causes of specialization. His study indicated that firm specialization was a key determinant of fund performance and that the degree of specialization was positively related to fund performance. Barry et al (1990) examined venture capitalists' activities by studying prospectuses of IPOs by venture-backed firms. They found that the average venture-backed IPO had three venture capital investors holding 34% of the pre-IPO equity in the firm. The average IPO had two venture capitalists serving as members of the board of directors, and an average of 1.8 venture capitalists remained on the board a full year after the IPO. Surprisingly few venture capitalists sold any of their shares in the IPO, even though participating in the IPO is viewed as a key exit strategy for the venture capitalists.
Huntsman and Hoban (1980) examined 110 investments by three venture capital firms over the period 1960-1975. They showed that venture capital returns depend on outliers. While the average return over the period was 18.9%, eliminating the top 10% of investments resulted in an average return of -0.28%. In other words, venture capital success is highly dependent on finding a few outstanding investments, and diversification is vital.

Gompers (1994b) presents an analysis of the pattern of returns in the venture capital industry, explaining why venture returns have fallen broadly since the early 1980s. Gompers points out that returns were relatively high, generally greater than 20% on an annual basis, in the first half of the 1980s. However, the early success of venture capital, a hot IPO market, and financial deregulation attracted capital in record amounts from pension fund investment managers. Lin and Smith (1994) developed a series of hypotheses to describe the role of venture capital in the IPO process. Because the venture capitalist is likely to return to the IPO market with future offerings of portfolio companies, the venture capitalist has reputational capital to protect, a factor that may influence whether, when, and at what price the company will go public. Lin and Smith argue that firms with venture capital will be able to come to the market earlier in their development, backed by the relationship with venture capital. Gompers (1994a) notes, however, that the venture capitalist may in fact choose to bring the portfolio firm public earlier than would be optimal for the entrepreneur in order to attract new investment funds. Gompers calls that phenomenon "grandstanding."

Chuan and Fang (2006) conducted a study in Taiwan on the "Venture Capitalists Choice of Exit Strategy". This study was focused on venture capitalist's activities in the Republic of China (Taiwan). The study results were obtained from a sample of 132 venture capital managers. The objective of the study was to identify the venture capital exit strategies most
used by venture capital managers in Taiwan and the factors which contribute to a choice of exit strategy. The factors identified were initially 14 factors. However, these factors were coalesced into five main factors and tested. The five factors tested were; the external economic environment, including three key factors, the economic conditions, the invested industry conditions and the liquidity of capital markets; the investee company’s technical risks; investee company’s capital; investee company’s management and operation and the venture capitalist’s financial affairs. The results of the study were that the the better the external economic environment, the less the investee company’s technical risks, the more the investee company’s capital and the better investee company’s management and operation, will all contribute to the venture capitalist being able to choose a better exit strategy with higher capital profits. The results also showed that in Taiwan, 47% of firms preferred exit through the IPO, 28% through mergers and acquisition and 25% of the exits were by secondary sale.

Venture capital studies in Kenya have been conducted by various parties concerned with entrepreneurial growth and for academic purposes. Fox (1996) identified the lack of a real demand for venture capital in Kenya as a key problem. The lack of full disclosure by entrepreneurs of their real financial statements made it difficult to properly assess the demand and requirements for venture capital. Insufficient capitalization had caused USAID Venture Capital initiatives to reinvent themselves as financial services firms as opposed to venture capital funds. An example of such a fund is the Investment Promotion Services (IPS), which is no longer listed as a venture capitalist. There are currently 16 firms listed as members of the African Venture Capital Association in Kenya (AVCA, 2011). From the available information on the websites of the firms, it was clear that most of the VC activities were undertaken by foreign firms.
Three firms, Cordiant, African Agricultural Partners and East Africa Capital Partners were firms based out of the country but using Kenya as a hub to conduct their investment activities around East Africa and the Indian Ocean islands of Mauritius and Seychelles. While the 16 are all broadly listed as practitioners in VC, some are debt financiers to SMEs that are interested in VC (for example Investeq Capital Ltd and Fusion Capital), while some are departments of development financiers and investment firms (for example African Development Bank, Business Partners International- an International Finance Corporation Department and Centum Investments). The other firms are extensions and subsidiaries of foreign venture capitalists originating from Canada, Mauritius and Tunisia, seeking to grow the VC sector in Kenya and East Africa. Funds like Ciel Capital’s Kibo Fund have invested around Africa but have not indicated if they have current investments in Kenya.

The size of funds was not easily determined due to the high level of confidentiality in the industry. As an example, Tuninvest –Africinvest have revealed the overall size of their fund as at $500 million but have not revealed how much of that fund has been allocated to the Kenyan arm of the firm. The locally owned funds, Fusion Capital, Investeq Capital and Centum Investments have not publicly availed information on the size of the funds available for venture capital financing. Fusion Capital and Investeq Capital have focused mainly on debt financing to SMEs across various economic sectors. Business Partners International (BPI) and TBL Mirror Fund concentrate on equity financing of start-up SMEs. Aureos Capital has concentrated its currently running fund on the health industry. The sectoral focus of Centum Investments’ venture capital operations was not publicly available.

Zavatta (2008) indicated that the Kenyan venture capital opportunities were limited. The study also indicated that Kenyan entrepreneurs in the industry did not require high capital
intensive first stage investments. Others like Lingelbach (2009) see Kenya as having weak institutional mechanisms to adequately support the growth of the venture capital sector. However, they also identify Kenya as being a larger player in the third world and in Africa (AVCA, 2009). Kashangaki (2008) identified the conservative nature of pension fund trustees and the rigid regulations for pensions fund investing in the Kenyan law as constraining the growth of venture capital funds in Kenya. The lack of appropriate exit mechanisms had also made it difficult to justify the high risk that would be taken by Kenyan institutional investors wishing to support a venture capital fund. Koech (2008) established that the form of initial investment in the venture, that is the instrument by which the venture capitalist would invest with, was determined by, among other factors, the desired exit strategy of the venture capitalist. 47% of venture capital firms indicated that they had the exit strategy in mind when choosing whether to invest by way of debt and/or equity instruments.

2.5 Conclusion

While there have been studies on the availability and constraints to venture capital growth in Kenya, the study of exit mechanisms has been limited. It is clear from the literature that exit mechanisms are key factors in the venture capital industry and are important in the process of the venture capitalist’s acquisition of investment funds and partners. They are just as important as the entrepreneurs of ventures funded by risk capital, their management and the governance of the funds. As the literature shows, various factors, including the external environment, specialization and how venture capitalists choose to influence the governance of invested firms affects how successfully they will eventually exit their investments.

This area has been studied in other more developed markets with the outlets of IPOs, mergers and acquisitions, management buyouts, secondary sales and write-offs being considered. The
same needs to be assessed for the Kenyan venture capital industry with the aim to showing how the venture capitalists can look to recoup their investments. From the studies that show that the top American technology firms (Microsoft, Google etc) were products of venture capital, the importance of this sector cannot be overstated. It could be the missing ingredient in pushing Kenya towards attainment of Vision 2030.
CHAPTER 3: RESEARCH METHODOLOGY

3.1 Introduction

The purpose of the study is to establish the factors for venture capital success in Kenya and in particular the exit mechanisms that are available to venture capitalists and their use by them in the local market. The following chapter discusses the methodology used in order to obtain the information required for the study. The chapter explains the choice of research design and justifies the use of a census approach to study Kenyan venture capitalists. Data collection and analysis methods are discussed as well.

3.2 Research Design

The research was conducted as a descriptive study of venture capital exit mechanisms in the Kenyan market. Due to the number of respondents, the study concentrated on the five firms and their experiences in venture capital. A descriptive study design is one that seeks to explain the relationship between various variables. It examines the situation as is and does not involve altering the situation under investigation (Leedy and Ormrod, 2005). The study seeks to answer questions related to exit mechanisms known to and used by venture capitalists in Kenya and their relationships to other factors such as the industry in which the firms are in and the entrepreneurs’ characteristics such as experience and management skills. The study will involve a survey of various venture capital funds by collecting data from as many as were willing to provide it.

This design has been selected in order to learn directly from the venture capital fund managers and thereby help other funds in making decisions as to which industries to target for investment, what factors contribute to choice of exit strategies and which exit mechanisms are most favoured as well as which have not been sufficiently exploited.
3.3 Population and Sample

The target population of the study was from the total number of venture capital firms in Kenya. The information on the VC funds was obtained from various sources including the Africa Venture Capital Association, regulators such as the Capital Markets Authority, other government sources, other published sources and the researchers’ contacts in various venture capital firms. 16 firms were identified as engaging in venture capital activities even though some were more of development finance institutions and micro finance lenders than pure venture capitalists (List in appendix 2). Due to the small number of these firms, the study was conducted as a census study with analysis and conclusions made from data provided by the willing respondents.

3.4 Data Collection

Data for the study was collected from various secondary and primary sources. Secondary data was sourced from publications of various regulators and public information sources like journals and business magazines. Primary data was obtained by way of questionnaires to managers of various venture capital funds. The questionnaire had two sections. The first sought general information on the venture capitalist. This included its origins, number of years in operation and amounts invested in various firms.

The second section sought information on the exit strategies known to the investor. This section sought to establish the exits undertaken by the capitalist and the strategies planned for any investments that they considered close to being exited from. The section also sought to establish the factors that contribute towards an exit strategy selection based on their experience.
3.5 Data Analysis

The data collected will be analysed by way of various descriptive analysis techniques to establish the results of the study. The statistical package for social sciences (SPSS Version 17) was used in this exercise. The results were analysed using the factor analysis technique, described as the statistical technique for classifying a large number of interrelated variables into a limited number of dimensions or factors (Nachmias and Nachmias, 1996).

3.6 Data Validity and Reliability

Reliability can be defined as the extent to which results are consistent over time (Golafshani, 2003). The results obtained by the study must be replicable if the same methodology was used at a different time by the same researcher. Reliability for this research was established by comparing the results in studies done elsewhere in relation to exits, for example by Chuang and Fang (2006) in Taiwan and by Koech (2008) in Kenya.

Validity, on the other hand is a determination as to whether the instrument of research measures what it is really meant to measure. It is thus concerned with the accuracy of the instrument. Validity in this research was established in the questionnaire construction by use of different questions, asking the same concept and ensuring they give the same answer as well as comparisons to instruments used in other studies in other parts of the world seeking information on venture capital exits.
CHAPTER 4: DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter presents the results of the analysis of the data collected from relevant sources. The data was analyzed mainly in two ways. Firstly, the general information of the venture capital firms and their response rates is presented as a background to the responses from the firms. Secondly data pertaining to the factors that determine venture capital exits in Kenya is presented as obtained from willing respondents. The final part of the section is a summary of the results and the interpretations made thereof.

4.2 Background Information

4.2.1 Response Rate

The study was focused on the population of 16 firms in Kenya that undertake venture capital activities either by specialization or as part of other firms in the financial sector. These firms are members of the African Venture Capital Association (AVCA). Five firms responded positively to the requests for data by questionnaire with the other 11 indicating their unwillingness to participate in the study. This represents a 31% response rate. The need to maintain a high level of confidentiality, and the purportedly sensitive nature of the high value transactions the firms engaged in were cited as the key reasons why the firms could not participate in the study.

4.2.2 Operations and Registration

From the five firms that agreed to participate in the study, it was observed that only two of these firms were registered in Kenya. From the overall list of AVCA members, it was observed that three of these firms did not have a presence in Kenya but had made investments in Kenya. These were The African Development Bank, African Agricultural Capital (Uganda
based) and Cordiant Capital Incorporated (Canada based). Ciel Capital/ Kibo Fund, is a Mauritius registered firm with an office in Kenya but has no investments in Kenya at the moment. This is the case too with Africinvest. The firm’s investments are in the wider Eastern African region with investments in Tanzania and Uganda among other places. It was also noted that only one of the firms involved in the study was a local firm. While one other firm was registered locally, it was a subsidiary of a foreign entity. The other three firms were extensions of foreign firms and partnerships, registered in the countries of origin of the mother firms.

A key observation also is that all the five firms began operations in Kenya after the year 2000. Additionally, only one of those firms commenced operations before the year 2005 in Kenya.

Table 4.1: Commencement of Operations in Kenya

<table>
<thead>
<tr>
<th>Year of Commencement</th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid between 2000 and 2005</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>From 2005 to 2010</td>
<td>4</td>
<td>80.0</td>
<td>80.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.1: Commencement of operations.
4.3 Venture Capital Investments and Exits

4.3.1 Size of Fund and Investment and Exit.

From the five respondents, the majority seem to have between Kshs 1 billion and Kshs 5 billion as a fund to invest in. One firm opted not to disclose the size of its fund in Kenya though its Tunisia parent company has $500 million (Approximately Kshs 50 billion) as its fund available to invest in Africa.

**Table 4.2 Size of Fund**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>between Ksh 1B to 5B</td>
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<td>60.0</td>
<td>60.0</td>
</tr>
<tr>
<td></td>
<td>Over Ksh 11B</td>
<td>1</td>
<td>20.0</td>
<td>80.0</td>
</tr>
<tr>
<td></td>
<td>No response</td>
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<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

In relation to investments made in various firms, the number of ventures invested in and those divested from, Tuninvest-Africinvest has the highest number of ventures invested in (73) and exited from (56) having started operations in 1994. However, the Kenyan based part of the Fund only began operations in 2009 and the company officials did not disclose the size of the fund available for its interests in Kenya. The data available in its website indicated that no investment had yet been made in Kenya.

In terms of exits, two firms had been involved in exit situations, Investeq Capital and Aureos Capital had been involved in exit situations. Aureos Capital’s current fund has not been involved in any exits though the firm has exited from investments made under another fund, the Acacia Fund. The firm made use of initial public offerings (IPO), acquisition exits, secondary sales and management buybacks to exit its investments. Investeq Capital indicated that its exits were by acquisition exits. None of the two firms had ever written off a venture.
4.3.2 Factors Determining Choice of Exit Strategy

Factor 1: External Economic Conditions

This factor had 60% of the respondents indicating it was a very important consideration for exits. The other 40% considered it important in determining the choice of exit mechanism.

Table 4.3: External Economic Conditions

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
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<tr>
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<td>60.0</td>
</tr>
<tr>
<td>Important</td>
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<td>40.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Figure 4.2 External Economic Conditions

Factor 2: Invested Industry Conditions.

This factor was viewed as very important by 100% of the respondents for selecting an exit mechanism.

Factor 3: Liquidity of Capital Markets

This factor was considered as very important by only 20% of the respondents and important by 60%. 20% of the respondents did not consider it so critical to the choice of exit mechanism.
Table 4.4: Liquidity of Capital Markets

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
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</thead>
<tbody>
<tr>
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<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Important</td>
<td>3</td>
<td>60.0</td>
<td>60.0</td>
<td>80.0</td>
</tr>
<tr>
<td>somewhat important</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.3: Liquidity of Capital Markets

Factor 4: Competitive Position of Investee Company

This factor was rated as very important by 60% of the firms and important by the other 40%.

Table 4.5: Competitive Position of Investee Company

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very important</td>
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<td>60.0</td>
<td>60.0</td>
</tr>
<tr>
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<td>40.0</td>
<td>40.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
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<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.4 Competitive Position of Investee Company
Factor 5: Investee Company’s Financial position

This factor was viewed as very important by 40% of the respondents with the other 60% viewing it as important but not very important a consideration in venture capital exits.

Table 4.6 Investee Company’s Financial Position

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very important</td>
<td>2</td>
<td>40.0</td>
<td>40.0</td>
<td>40.0</td>
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<tr>
<td>Important</td>
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<td>60.0</td>
<td>60.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.5: Investee Company’s Financial Position

Factor 6: Size of Investee Company

This factor was not viewed as very important by any of the respondents. However, 60% of the respondents viewed it as a still important consideration in Venture capital exits. 40% considered it a less important consideration in deciding on an option.

Table 4.7: Size of Investee Company

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
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<tr>
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<td></td>
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</tr>
<tr>
<td>Important</td>
<td>3</td>
<td>60.0</td>
<td>60.0</td>
<td>60.0</td>
</tr>
<tr>
<td>somewhat important</td>
<td>2</td>
<td>40.0</td>
<td>40.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
Factor 7: Management and Performance of Investee Company

This factor was viewed as very important by 80% of the respondents with the other 20% viewing it as an important consideration.

Table 4.8: Management and Performance of Investee Company

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
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</thead>
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<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very important</td>
<td>4</td>
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<td>80.0</td>
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<td>Important</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
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<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Factor 8: Maintenance Costs Incurred By the Venture Capitalist

This factor was not viewed as being very important to the choice of exit mechanism by the respondents. 40% of the respondents indicated that it was an important consideration, 40%
expressed that this factor was somewhat important and 20% viewed it as being of minimal or
low importance to the decision on exits

**Table 4.9: Maintenance Costs**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Important</td>
<td>2</td>
<td>40.0</td>
<td>40.0</td>
</tr>
<tr>
<td>somewhat important</td>
<td>2</td>
<td>40.0</td>
<td>80.0</td>
</tr>
<tr>
<td>low importance</td>
<td>1</td>
<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

**Figure 4.8: Maintenance Costs**

**Factor 9: Liquidity Needs of the Venture Capitalist**

This factor had a varied response. 20% of the respondents considered it very important and
another 20% considered it important. 20% considered it of low importance and 40%
considered it irrelevant in decision making for a venture capital exit.

**Table 4.10: Liquidity Needs**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid Very important</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Important</td>
<td>1</td>
<td>20.0</td>
<td>40.0</td>
</tr>
<tr>
<td>low importance</td>
<td>1</td>
<td>20.0</td>
<td>60.0</td>
</tr>
<tr>
<td>Irrelevant</td>
<td>2</td>
<td>40.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>
Factor 10: Desire of the Venture Capitalist to Exit Quickly

This factor was viewed as important by the majority of the respondents at 60% but not very important a factor in determining exit mechanisms. However, 40% disagree and contend that it is a very important consideration in determining an exit mechanism.

Table 4.11: Desire for Quick Exit

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very important</td>
<td>2</td>
<td>40.0</td>
<td>40.0</td>
<td>40.0</td>
</tr>
<tr>
<td>Important</td>
<td>3</td>
<td>60.0</td>
<td>60.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.10: Desire for Quick Exit

Factor 11: Taxation Factors

60% of the respondents identified taxation considerations as being important in the evaluation of choice of exit mechanisms. 20% viewed it as being very important while another 20% viewed it as being of low importance.
Table 4.12: Taxation Factors

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very important</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>Important</td>
<td>3</td>
<td>60.0</td>
<td>60.0</td>
<td>80.0</td>
</tr>
<tr>
<td>low importance</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.11: Taxation Factors

Factor 12: Opportunity Cost

The opportunity cost consideration for money held in one investee project was not viewed as an important consideration by the majority of respondents. Only one respondent viewed it as very important to the choice of exit strategy. Other respondents viewed it as being somewhat important (40%), of low importance (20%) and irrelevant to the decision (20%).

Table 4.13: Opportunity Cost

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Very important</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td>somewhat important</td>
<td>2</td>
<td>40.0</td>
<td>40.0</td>
<td>60.0</td>
</tr>
<tr>
<td>low importance</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>80.0</td>
</tr>
<tr>
<td>Irrelevant</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
Factor 13: Legal Reasons

None of the respondents consider legal reasons as being a very important factor in the determination of exit mechanisms from a venture. However, 60% believe legal and related factors such as political factors are an important consideration for deciding on an exit mechanism. 20% believe it is a somewhat important factor while another 20% consider it a factor of low importance.

Table 4.14: Legal Reasons

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Important</td>
<td>3</td>
<td>60.0</td>
<td>60.0</td>
<td>60.0</td>
</tr>
<tr>
<td>somewhat important</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>80.0</td>
</tr>
<tr>
<td>low importance</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 4.13: Legal Considerations
Other Factors

Other factors identified by some of the respondents as important in determining the exit mechanism include the fact that some funds are created with a finite life, both for the fund and for investments held. In one example, one fund has a ten-year life and no investments should be held longer than 7 years. This will impact the choice of exit especially where the investments have not been divested from as the set deadline gets closer. Also identified as a factor was the need for venture capitalists to have successful exits in order to gain experience in exits and thereby retain and attract more investors for future funds. This in effect creates pressure when a set time, seen as reasonable for holding an investment passes.

4.3.3 Length of Holding of Investments

It was observed that only two of the companies had exited from investments and thus represented 40% of the respondents. The other respondents, representing 60% had not been involved in any exit scenarios and thus the question was not applicable to them.

Table 4.15: Length of Holding for Exited investments

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td>3 to 6 years</td>
<td>1</td>
<td>20.0</td>
<td>20.0</td>
</tr>
<tr>
<td></td>
<td>6 to 10 years</td>
<td>1</td>
<td>20.0</td>
<td>40.0</td>
</tr>
<tr>
<td></td>
<td>not applicable</td>
<td>3</td>
<td>60.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>5</td>
<td>100.0</td>
<td></td>
</tr>
</tbody>
</table>
In terms of the consideration of the optimal length of time that venture capitalists should hold on to investments, 60% indicated that 6 to 10 years is an optimal time for holding onto the investments while 40% indicated that 3 to 6 years was sufficient time to hold a venture and be able to profitably exit.

**Table 4.16: Optimal Holding Length of Time**

<table>
<thead>
<tr>
<th></th>
<th>Frequency</th>
<th>Percent</th>
<th>Valid Percent</th>
<th>Cumulative Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valid</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 to 6 years</td>
<td>2</td>
<td>40.0</td>
<td>40.0</td>
<td>40.0</td>
</tr>
<tr>
<td>6 to 10 years</td>
<td>3</td>
<td>60.0</td>
<td>60.0</td>
<td>100.0</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
<td>100.0</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
In terms of factors that contributed to ventures being held for longer than the optimal time as understood by the venture capitalist firm, this was a question that most of the respondents did not answer. This can be attributable to the fact that most of the firms have not been in operation for long in Kenya to have faced any of the scenarios leading to over-holding of the ventures. However, the firms that responded indicated that there were various regulatory complications both at engagement and in the case of exits involving the capital markets. The underdeveloped stage of the Kenyan stock markets also contributed to delayed exits. The dearth of managerial skills among entrepreneurs also led to delayed exits as the venture capital firms worked on making the investees viable entities for sale.

In terms of ventures ready for exit only two firms had ventures ready for exits. They both indicated that an acquisition exit would be the preferred method of disposal of their interest. One firm indicated that this was because such a sale had the likelihood of higher value with less regulatory requirements than an initial public offering. The other firm indicated that this
option was backed by the trend of companies outside Africa seeking to enter the African markets by way of mergers and acquisition with and of existing companies.

4.3.4 Difficulties Experienced By Venture Capital Firms

In reply to the question of challenges faced by venture capital/private equity firms in Kenya, the most commonly raised issue was the lack of understanding by local entrepreneurs on the role of private equity. The entrepreneurs did not quite understand what venture capital brings on board to a firm. This led to less enthusiasm for venture capital and conflicts when unreal expectations are not met for those engaged with the venture capitalists. The second challenge that was widely identified was the lack of systems and poor corporate governance of privately owned businesses. This was a major problem since these were the firms most likely to seek venture capital financing. Other problems identified included the difficulties for locally owned venture financing firms in establishing themselves, the regulatory environment and lack of incentives for growth and the environmental problems of credit risk and political interference.

Suggested solutions by the venture capitalists included the education and sensitization of entrepreneurs on how venture capital/private equity arrangements work. This could include increased incubation/mentorship of start-up and existing small businesses. The introduction of direct incentives to assist local venture capitalists and the venture capital sector as a whole was also suggested. The proper enforcement of industry and general business regulations and laws was identified as a factor that would help in improving the quality of businesses operating in sectors of interest to venture capitalists. This would be of great help in large privately owned firms that have the potential to grow but are hindered by poor business practices.
4.4 Summary and Interpretation of Findings

The findings as enumerated above provide a picture of the venture capital/private equity market in Kenya and especially as it relates to exits. From the background information it is clear that venture capital or risk capital financing has not been taken up by many local firms. The majority of members of the African Venture Capital Association are foreign owned firms operating in Kenya or Kenyan registered subsidiaries of foreign venture capital firms. Locally owned firms are former trade finance firms venturing into the private equity industry or investment firms that have started venture capital divisions, for example Centum. This would indicate either a propensity for risk averseness in financing industry practitioners or a lack of backing from the holders of capital who would ordinarily work as limited partners to the general partners running the funds.

From the response rate, it is clear that there is still a high level of protectionism and caution among venture capital players. This attitude, if carried over in the exercise of business would also account for the lack of growth in the venture capital sector in Kenya. The lack of information on challenges faced and experiences faced in business would discourage other potential venture capital players. This would thus affect those willing to exercise their expertise as general partners and the owners of capital like commercial banks, pension funds and insurance firms who would be limited partners for a locally originated fund. It is also possible that this lack of information increases the misconceptions and wrong notions of private equity among the target market of entrepreneurs. This limits growth of the sector in Kenya. This would also account to the relatively small amount of money available for the respondents in their funds. It is conceivable that East Africa’s largest economy has the potential to raise billions of shillings currently in savings in various vehicles like pension and provident funds, insurance companies, commercial banks and even savings cooperatives.
The fact that most venture capital firms have been in operation for less than a decade would account for the lack of exit activity and thus practical experience in venture capital exits. This lack of exits also feeds the risk-averse nature of potential investors who are holders of capital. A majority of exits in the firms have been the natural end of term of debt instruments with very few equity exits. It thus remains to be seen how venture capital exits will be handled with the passing of time as the funds grow in experience from dealing with different economic conditions. It is positive sign also that from the exits already undertaken, non was undertaken by way of a write off. This augurs well for the future attractiveness of the sector to potential investors.

From the factors that determine the choice of exit strategy, the invested industry condition seems to be the strongest with all respondents identifying it as a very important factor. It is therefore possible to conclude that the choice of industry to invest in will guide an investor in planning ahead for the potential exit. The management and performance of the investee company is also a key factor in determining the choice of exit option to be used in making a profitable exit as identified by 80% of the respondents. This would thus indicate that the venture capitalist has to invest in a firm with good management or with potential for improvement in both management and performance. This also means that there will be more supervision to ensure good governance and business practices.

The external economic condition and the competitive position of the investee company at the time of exit are also valued by investors with 60% viewing them as very important factors and the other 40% as important. This could possibly be because those conditions affect the likely attractiveness and value of the firm as its being evaluated for an exit. Its good
competitive position would make it an attractive candidate for an acquisition exit especially as a candidate for a take-over or a merger.

Summary

The investee company’s financial position seems to rank as an important consideration as well with 40% of the respondents viewing it as very important and the other 60% viewing it as important. This seems to be the case as well with the desire of the venture capital to make a quick exit. This scenario would be likely in case of pressure due to the conditions of the fund for example a set period for investments and a finite life for the fund. The pressure could also come from the need to make exits to retain and attract future limited partners. Other factors like the size of the investee company, legal considerations, the maintenance costs incurred by the venture capitalist, taxation factors and opportunity cost were not universally viewed as being very crucial to the choice of exit strategy. The liquidity needs of the venture capitalist were viewed as being of low importance to irrelevant by the majority of respondents. This would probably be because the venture capitalists have a lot of money that is yet to be invested at the moment.

The optimal length would seem to be somewhere between 3 and 7 years as per the views of the venture capitalists and the experience of the ones that have made exits. There is therefore a need to observe how the currently held investments will be handled and for how long they will be held in the case of the majority of firms that have not undertaken any exits. This will help add to the information gap about viability of venture capital funds in Kenya seeing as one of the challenges identified is the information aspect and the lack of understanding by entrepreneurs as potential candidates for venture financing. The involvement of government in giving incentives to help the process of exits, and directly affect the factors such as the economic environment and management expertise would help in the growth of the sector.
CHAPTER 5: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Summary

This study is on the venture capital industry, with venture capital being described as investing in companies that have undeveloped or evolving products or revenue (Tasci, 2004). Venture capitalists are therefore described as those desirous of accepting high risks for much higher rates of return. This sector has led to the development of various world leading companies in the United States, especially in the technology sector. In Kenya, the sector has really developed in the decade from the year 2000 (Kashangaki, 2008). The main focus of the study was the area of venture capital exits by which the venture capitalists make their returns. The objectives of the study were to establish the exit mechanisms that have been used by venture capitalists in Kenya and the factors that determine the choice of exit mechanism.

A study of published literature on venture capital exits indicated that the methods used for exits include initial public offers (IPO), acquisition sales/exports, and secondary sales to other venture capitalists, management/entrepreneur buybacks and in extreme cases, write-offs by the investors (Cumming and Mackintosh, 2003). Venture capital exits were indicated as being critical in evaluating the performance of venture capitalists (Schwienbacher, 2002). The lack of appropriate exit mechanisms was indicated as the reason for the slow growth of the sector in Kenya (Kashangaki, 2008). Chuang and Fang (2006) in a study in Taiwan identified various factors that determine the choice of exit strategy including the external economic conditions, the investee company's management and operation and the venture capitalists financial affairs.
The study had as a population the 16 companies that engage in venture capital/private equity arrangements in Kenya as members of the African Venture Capital Association. The response rate of the study was 31% with the high level of confidentiality and the sensitive nature of the high value transactions involved cited as the reason for declining cooperation with the study. The data was collected by way of questionnaires for primary data and the study of available public information on various websites connected with the firms and venture capital in general. The data was analyzed by use of the Statistical Package for Social Sciences (SPSS). The data showed that there have indeed been few exits in the Kenyan market. This was mainly because most funds operating in Kenya have been in operation for between 3 and 8 years. It also revealed that most firms in Kenya are foreign in origin. The study shows that the acquisition exit is the most favoured exit option even though the other options of IPOs, secondary sales and management buybacks are available. The invested industry condition was viewed as the most important factor in determining the choice of exit mechanism, followed by the management and performance of the investee company.

5.2 Conclusions

From the findings it is possible to make various conclusions. Firstly, the nature of the Kenyan market is such that it is unattractive or too risky for local practitioners. Most of the venture capital firms operating in Kenya are either foreign firms or local extensions of foreign firms. Secondly, there is a lot of untapped potential funds for investment in venture capital as the firms currently operating in Kenya do not have large funds for investment. The foreign firms operating in Kenya are using funds mainly sourced by their parent companies. In view of the fact that Kenya has a lot of saved funds in pension schemes, insurance companies, commercial banks and cooperative societies, there is a potential to mobilize a lot of funds for use in venture capital financing. There is also too high a level of confidentiality which keeps
information tight with the currently operating venture capitalists and could be a serious hindrance to the growth of the industry both for potential investees and also for potential venture capitalists.

In terms of the factors that determine choice of exit mechanism, the conclusion can be made that attention should be given to the invested industry conditions when making a venture invested as it will be very important in determining the exit mechanism. Investment will also have to be made in improving the management capacity and performance of a firm in order to ensure a high value exit. Other considerations like the competitiveness of a firm and the external economic conditions will also need to be considered as critical to the success of the venture capitalists' exit strategies. Thus, assessing these conditions before the investment and making plans for the changes in these conditions over the period of holding the investments will aid in making profitable exits.

The conclusions can be made that the favoured exit options for venture capitalists in Kenya is the acquisition sale exit method. This method seems preferable due to the nature of the capital markets that are still developing and currently have few investors and the venture capital sector which is also developing and hence secondary sales are still unlikely. There is also presumably less regulatory oversight and requirements in mergers and acquisitions exits. The external economic factor of firms seeking to invest in Africa also favours this method. The optimal period of holding of the investments in the Kenyan scene cannot as yet be conclusively determined based on the fact that many of the firms are yet to undertake any exits. Thus, it will be possible to assess the optimal time and the factors that will make this hard to achieve when exits are made by more venture capitalists.
5.3 Policy Recommendations

From the findings and conclusions of the study, it is possible to make some policy recommendations. Firstly, the government should review its regulatory structure and policies in relation to venture capital. The fact that various world leading firms like Google and Microsoft as well as African firms like the Bank of Africa have grown from venture capital makes the sector a likely crucial part of the development needed to attain vision 2030. Policy and legal initiatives that will free up funds for investment currently held by savings vehicles will lead to growth in the sector and growth in local businesses. Tax incentives for venture capitalists could see explosion in growth of the sector. Direct incentives to locally owned venture capital initiatives will also benefit the country.

Secondly, the government should encourage the growth of programs that make entrepreneurs better managers and ensure compliance with good corporate governance and prudent management principles by privately owned firms. Incubation and mentorship programs will produce better managed firms that can assure venture investors of a good return in future. Regulatory compliance in various industries together with enforcement of rules that govern ownership and management of private firms will make their running more consistent with generally accepted management and governance principles. For example, the fact that both private and publicly owned banks have to adhere to minimum requirements on management and governance has helped the sector. These moves, coupled with sensitization campaigns on the workings of venture capital will lead to growth in businesses seeking venture financing and able to qualify for it.

As for venture capitalists, more information sharing could help in demystifying the venture capital industry and freeing up local resources for investment. More information will make
the sector more understood and more attractive to potential investees and also other venture investors and open up the secondary sale market.

5.4 Limitations of the Study

There were various limitations in the conduct of the study. Firstly, there was the lack of cooperation and support from the venture capital practitioners on account of the high level of confidentiality practiced in the sector in Kenya. Some officials in the various firms refused to divulge seemingly harmless information that would not give a competitor any advantage if it was seen by that competitor. The 31% response rate for what is a small population was quite low and hence findings and results obtained, as well as conclusions made, must be viewed with this limitation in mind.

The second limitation encountered was the fact that most of the practitioners are relatively young in the Kenyan financial sector. The fact that most of the venture capital/private equity firms have not been operating for more than a decade and indeed most were not engaged in the sector prior to 2006 is a limitation. Most of these firms have not had direct experience in venture capital exits and would thus not be certain on the optimal holding period and the factors that would lead to delayed exits, beyond what they know from other firms in other markets.

The third limitation experienced was that the firms involved were small organizations where the main investment decision makers were few and highly placed in the organizations. They were thus likely to be fairly busy and involved in day to day management of the operations as well as tasked with strategic thinking for future business. They were thus unavailable for direct interviews which would help in clarifying any unclear replies. Also, the fact that a lot
of the firms were foreign owned meant that some of the critical decision makers do not reside in Kenya and did not respond to electronically transmitted questionnaires.

5.5 Suggestions for Further Study

From the study, suggestions for further studies can be made as follows. Firstly, there is benefit in studying on the effect on sustainability that the various exit mechanisms have on firms that the venture capitalist exits from. In view of the fact that industry specific factors affect exits mechanism choices, it would be prudent for entrepreneurs in industries where there is venture capital financing to know the likely effect of venture capital on other firms exited and if the exit mechanism has a positive or detrimental effect on the firms.

A second suggested area of study would be the effect of venture capital on the management practices and performance of firms both within the period of holding and after the period. This would help entrepreneurs and other stakeholders like the government and potential investors in a share floatation of a firm currently or formerly in a VC arrangement understand the positive or otherwise effect of VC on the management and performance of such a firm. This would help prepare venture capitalists on their responsibilities in relation to firms they hope to invest in and prepare owners and managers of such firms on their requirements and expectations to ensure the arrangement works for all parties.

A further suggested area of study would be on the hindrances that make local players not enthusiastically participate in venture capital. It can be concluded from the various institutions of higher learning that Kenya has a wealth of well trained finance and investment graduates who would invest funds given to them prudently and make returns for their investors. Similarly, as mentioned above, Kenya has a multitude of savings vehicles whose
funds are not being used for VC activities. It would thus be wise to study the challenges in getting this money to VC activities and how these challenges can be addressed.
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APPENDIX 1: QUESTIONNAIRE

Introduction

The MBA study for which this questionnaire seeks to gather data is titled “AN INVESTIGATION OF THE FACTORS THAT DETERMINE THE EXIT STRATEGIES OF VENTURE CAPITAL FIRMS IN KENYA”. The study seeks to establish the exit options available to venture capitalists (VCs) in Kenya and the factors influencing the choice of exit strategy. The study will seek to establish the exit strategies used so far by those venture capitalists that have made exits from venture investments and the strategies planned for use for companies that the venture capitalist sees as ripe for exit. All the information gathered from the respondents will be treated as confidential and will only be used for the purpose of this study.

Thank you

Chrispus R. Mbogo

Section 1: General Information

1. Name of firm

2. Name of officer and position in firm

3. Number of years involved in venture capital
4. Nature of firm i.e. (limited company, partnership, subsidiary of foreign firm, division/department of other company etc)

5. Country of registration (if not kenya)

6. Date of commencement

Section 2: venture capital investments and Exit

7. Size of fund in Kshs

8. Number of ventures invested in over time

9. Number of currently held investments and length of holding

10. Has the firm made exit from any investment(s)? If yes, how many?

11. Which of these exit options has your firm made use of?
   a) Initial public offering (sale through a stock exchange to the public)
b) Acquisition exit (sale of a whole firm to a third party)  

- [ ] Very Important  
- [ ] Important  
- [ ] Somewhat Important  
- [ ] Low importance  
- [ ] Irrelevant  

c) Secondary sale (sale of VC shares to a third party e.g another VC)  

- [ ] Very Important  
- [ ] Important  
- [ ] Somewhat Important  
- [ ] Low importance  
- [ ] Irrelevant  

d) Management buyback (venture’s owners/managers buy out VC)  

- [ ] Very Important  
- [ ] Important  
- [ ] Somewhat Important  
- [ ] Low importance  
- [ ] Irrelevant  

e) Write off (VC walks away from the investment on account of failure)  

- [ ] Very Important  
- [ ] Important  
- [ ] Somewhat Important  
- [ ] Low importance  
- [ ] Irrelevant  

12. Please rate how important these factors are to the choice of exit strategy in Kenya?

<table>
<thead>
<tr>
<th>Factors</th>
<th>Very Important</th>
<th>Important</th>
<th>Somewhat Important</th>
<th>Low importance</th>
<th>Irrelevant</th>
</tr>
</thead>
<tbody>
<tr>
<td>a) External economic conditions</td>
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<tr>
<td>b) Invested industry conditions</td>
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<td>c) Liquidity of capital markets</td>
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<tr>
<td>d) The competitive position of the investee company</td>
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<tr>
<td>e) Investee company’s financial position</td>
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<td>----------------------------------------</td>
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<tr>
<td>Very Important</td>
<td>Important</td>
<td>Somewhat Important</td>
<td>Low importance</td>
<td>Irrelevant</td>
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<table>
<thead>
<tr>
<th>f) Size of investee company</th>
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<tr>
<td>Very Important</td>
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<tr>
<th>g) Management and performance of investee company</th>
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<tr>
<td>Very Important</td>
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<tr>
<th>h) Maintenance costs incurred by the venture capitalist</th>
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<td>Very Important</td>
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</table>

<table>
<thead>
<tr>
<th>i) Liquidity needs of the venture capitalist/investors</th>
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<tbody>
<tr>
<td>Very Important</td>
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</table>

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<tr>
<th>j) Desire of the venture capitalist to exit quickly</th>
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<tr>
<td>Very Important</td>
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<tr>
<th>k) Taxation factors</th>
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<tr>
<td>Very Important</td>
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</tbody>
</table>
l) Opportunity cost

Very Important □ Important □ Somewhat Important □ Low importance □ Irrelevant □

m) Legal reasons for sale whether related to the industry, the firm or the venture capitalist’s operations

Very Important □ Important □ Somewhat Important □ Low importance □ Irrelevant □

n) Other factor(s) (please specify)


14. For how long were the exited investments held?

0 to less than 3 years □ Between 3 and 6 years □ Between 6 and 10 years □ More than 10 years □

15. According to you, what is the optimal length of time that a venture capitalist should hold on to venture investments?

0 to less than 3 years □ Between 3 and 6 years □ Between 6 and 10 years □ More than 10 years □
16. What factors contributed to ventures being held longer than the optimal time (as stated above)?

a) Regulatory restrictions

explain

b) Capital market restrictions/Difficulties

Explain

c) Management/ Entrepreneurs' underdeveloped management skills

Explain

d) Competitive difficulties

Explain

e) Industry related difficulties

Explain

f) Other factor(s)

Explain
17. In the current portfolio, how many ventures would be considered as ready for exit?

18. What exit strategy does the firm favour/plan to use for the above ready ventures, and why?

a) Initial public offering (sale through a stock exchange to the public) □

b) Acquisition exit (sale of a whole firm to a third party) □

c) Secondary sale (sale of VC shares to a third party e.g. another VC) □

d) Management buyback (venture’s owners/managers buy out VC) □

e) Write off (VC walks away from the investment on account of failure) □

Justification

19. What difficulties are experienced by venture capital firms in Kenya?
20. What solutions to the above difficulties can you suggest?

23. Any other comment on venture capital exits

Thank you for your cooperation
APPENDIX 2: VENTURE CAPITAL FIRMS

List of firms engaged in venture capital activities in Kenya as members of the African Venture Capital Association (AVCA)

Full Members

ACTIS

African Development Bank

African Agricultural Capital- Ugandan firm but invests mainly in Kenya

Africinvest Capital Partners

Aureos Capital One

Business Partners International

Catalyst Principal Partners

Centum Investments

Ciel Capital

Citadel Capital

Cordiant Capital Inc.

East Africa Capital Partners

Fanisi Capital

Fusion Capital Limited

Investegq Capital Ltd

Associate Members

TBL Mirror Fund