

**EFFECT OF VENTURE CAPITAL FINANCING ON THE GROWTH
OF SMALL AND MEDIUM-SIZED ENTERPRISES IN KENYA**

BY

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DECLARATION

I hereby declare that this research project is my own work and effort and has not been presented in any other university for an award.

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

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DEDICATION

This thesis is dedicated to my family for their love, support, patience, encouragement and understanding. They gave me the will and determination to complete my postgraduate studies.

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ACRONYMS

GDP	Gross Domestic Product
IEA/SED	Institute of Economic Affairs & Society for Economic Development
IPO	Initial Public Offering
POT	Pecking Order Theory
ROK	Republic of Kenya
SA	South Africa
SMEs	Small and medium-sized enterprises
UNIDO	United Nation Industrial Development Organization
VC	Venture Capital

ABSTRACT

The aim of the study is to investigate the effect of venture capital financing on the growth of SMEs in Kenya. This study is expected to be of great value to the small and medium enterprises in Kenya as the study will highlight the effect that venture capital financing and to the financial institutions financing these enterprises, they would benefit greatly as they would understand the needs of SMEs and how best venture capital can enhance their growth. The study adopted descriptive cross sectional research design. The target population for this study was the Top 100 Mid-sized companies (2012) in Kenya. Stratified sampling was adopted where a 30% sample was chosen to give a sample size of 30 SMEs. The SMEs were chosen through purposive sampling whereby the firm was chosen based on the basis that they had received venture capital financing. The study collected secondary data which included the financial statements: the profit and loss account and the balance sheets for a period of five years starting from 2008 to 2012. The data was analyzed through inferential statistics by employing a regression model to establish the form of relationship between the dependent and the independent variables. The analyzed data was presented in frequency distributions tables. The study found out that there was a positive and significant relationship between growth in SMEs and venture capital financing. The study concluded that the effect of venture capital on growth of SME is real and practical, and that increased venture capital financing improves SMEs credit rating, marketing and distribution networks, improves technical expertise and management expertise/skills which in turn enhance growth in these firms. With good management expertise and technical expertise, the firms have the ability to strategically use information and resources available to them to present well-crafted business growth strategies that also reduce risk to the business. The study recommends that SMEs need to recognize the potential advantages of seeking external equity finance from corporate sources. Corporate investors can therefore become very important assets for SMEs both financially and strategically as they provide tangible and intangible value-added resources which can play a valuable role in SME growth. Both the government and the venture capital fund managers also can do more to encourage venture capital investment. The government should provide credit and equity financing to eligible venture capital finance companies to support SMEs.

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Small and medium-sized enterprises (SMEs) play a pivotal role in the national economies of countries around the world. This is especially true of emerging markets. They are considered to be an engine for growth in both developed and developing countries; the benefits of a vibrant SME sector include: the creation of employment opportunities; the strengthening of industrial linkages; the promotion of flexibility and innovation; and the generation of export revenues (Lerner, 2002; Rangamohan *et al*, 2007). In SA, for instance, eight out of 10 jobs that are created occur in the SME sector (Karungu et al, 2000). In the US, Japan and Germany, small business contributes more than half of the gross domestic product (GDP) in each of those economies.

Though SMEs have been the engine for growth in various developed and developing economies, they have always faced problems in accessing finance. Without proper finance, SMEs can neither expand to compete globally nor can they acquire technology or meet their fixed and working capital requirements (Wanjohi and Mugure, 2008). SMEs face significant challenges, which include access to finance (Iwisi et al, 2003) and financial management skills and support (Gem Report, 2003). This contributes to slow development and high mortality rates of small businesses in Kenya. Access to finance is particularly relevant for previously disadvantaged entrepreneurs who do not have access to collateral and the networks of wealthy individuals who could provide angel financing.

Financing is necessary to help SMEs set up and expand their operations, develop new products, and invest in new staff or production facilities. Many small businesses start out as an idea from one or two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. But if they are successful, there comes a time when they need further funds to expand or innovate further. Some SMEs often run into problems, because they find it much harder to obtain financing from banks, capital markets or other suppliers of credit (Afua, 2011).

Almost every company we know of began as an SME. Vodafone as we know it today was once a little spin-off from Racal; Hewlett-Packard started in a little wood shack; Google was begun by a couple of young kids who thought they had a good idea; even Volkswagen at one point was just a little car maker in Germany (as opposed to being a giant small car maker globally) (Lukacs, 2005). Microsoft may be a software giant today, but it started off in typical SME fashion, as a dream developed by a young student with the help of family and friends. Only when Bill Gates and his colleagues had a saleable product were they able to take it to the marketplace and look for investment from more traditional sources (Amissah, 2009).

The growth of SMEs has been hampered by the lack of adequate knowledge and a well structured financial market for the mobilization of capital. The role of finance has been viewed as a critical element for the development of SMEs (Cook and Nixon, 2000). However, venture capital has had a significant impact on Small and Medium Enterprises (SME) in the developed countries; small businesses have been and are the stepping stone of industrialization in these countries. But among the developing countries and especially Kenya venture capital has been present since independence yet industrialization is slow.

1.1.1 Venture Capital Financing

Venture capital is an investment in a start-up or growing SME that is perceived to have excellent growth prospects. Venture capitalists raise and manage funds which are a pool of money raised from both public and private investors. Venture capitalists identify entrepreneurs with promising new ideas and assist with funding and professional management. Venture Capital is one source of non-bank financing, which is quite prevalent in developed financial markets for small or start up firms (Keuschnigg 1998). Venture Capitalists are organized providers of financing for winning but risky business proposals by small and medium firms that have a promising but as yet unproven idea. If the Venture Capitalists are convinced that a business idea is promising, they will take an ownership stake in the business businesses and provide the needed fund while sharing the risk. Businesses whose growth has been constrained by shortage of capital or increased cost of borrowing will have another source of finance.

Venture capital assists investors to access equity capital to finance expansion of business while maintaining control. The expertise and extensive relationships of the venture capitalist through its network add value to the company and increase credibility with customers, and finally, the company gain access to the venture capitalist knowledge in accounting, budgeting, computer systems, and back-office operations (Amissah, 2009). In venture capital financing agreement the venture capital firm will provide financing to enable a business to undertake a project and in return the venture capital company gets an ownership stake in the business (Boateng, 2010)

In Kenya private Venture Capital firms include: Kenya Equity and Term Financing which supports existing companies that wish to expand rather than start-up operations. Aureos

East Africa which provides private equity and loan facilities has replaced the activities of Acacia (The Finance Mail Vol 9 no.6, 2003). Acacia Fund Limited provided risk capital to new or expanding enterprises, including the reorganization, rationalization and reconstruction. Kenya Management Company Limited, which provides equity, related investments in private sector to companies with high growth potential to expand well-run businesses.

1.1.2 Growth in SMEs

Business growth may be defined as the process of improving some measure of an enterprise's success. Business growth can be achieved either by boosting the top line or revenue of the business with greater product sales or service income, or by increasing the bottom line or profitability of the operation by minimizing costs. The concept of growth has been based upon the idea that an organization is a voluntary association of productive assets, including human, physical, technological and capital resources, in order to achieve a common purpose (Barney 2002).

Growth in SMEs have received considerable attention from researchers and policy-makers around the world for reasons identified by Turok (1991) as follows: There is considerable interest within the field of small firms policy and research in the identification of features that distinguish firms which grow from those that stand still or fail. This is thought important if more selective small firms policies are to be developed. Identifying distinctive features of more and less successful firms may also provide insights into the factors influencing small firm development and hence improve understanding of the growth process. It has become very common amongst scholars to

view SME growth as a series of phases or stages of development through which the business may pass in an enterprise life-cycle.

1.1.3 The SME Sector in Kenya

SMEs comprises of firms varying widely in size & characteristics, namely from very small start- up firms to established SMEs. In Kenya is characterized by the employment of between 50 to 200 employees and capital assets of a substantial amount of about KES 2 million (excluding property). The size and credit demand of SMEs have outgrown the capacity of micro finance institutions, which offer small, short loans via group-lending methodologies, while the opacity of the SME risk profile combined with the lenders' lack of sophisticated risk assessment techniques makes many of them appear undesirable as credit customers for business banking (ROK, 2005).

SMEs contribute to output and to the creation of “decent” jobs; on the dynamic front they are a nursery for the larger firms of the future, are the next step up for expanding micro enterprises, they contribute directly and often significantly to aggregate savings and investment, and they are involved in the development of appropriate technology (United Nation Industrial Development organization (UNIDO), 2002). The SME sector also a make a significant contribution to Kenya's economy; the Small and Medium Enterprises (SME) segment is a key segment that fuels economic growth, create employment, improve productivity and thereby contribute immensely to the GDP growth. According a survey on SME market done in 2007 by the IFC (International Financial Corporation), it was established that majority of SMEs have immensely contributed jobs to the country.

Lack of access to credit is a major constraint inhibiting the growth of SMEs sector. The issues and problems limiting SMEs acquisition of financial services include lack of tangible security coupled with inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to SMEs. Limited access to formal finance due to poor and insufficient capacity to deliver financial services to SMEs continues to be a constraint in the growth and expansion of the sector. Formal financial institutions perceive SMEs as high risk and commercially unviable. As a result only a few SMEs access credit from formal financial institutions in the country. Various types of assistance have been provided to SMEs to boost their growth and development by making them more profitable (Institute of Economic Affairs & Society for Economic Development [IEA/SED] 2001).

1.2 Research Problem

Lack of finance has been regarded as one of the major problems contributing to slow development and high mortality rates of small businesses in Kenya (Muteti, 2005). The World Bank report (2003) states that SMEs do not experience greater difficulty than other emerging countries (surveyed by world bank) in obtaining finance and argues instead that in Kenya, lack of adequate financial management support is the second biggest weakness in the national environment for entrepreneurial activity. The precarious nature of many SMEs is borne out by a statistic quoted by Karungu et al (2002): of all the jobs created in the SME sector, up to 75% are lost within a year.

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via group-lending methodologies. However, the opacity of the SME risk profile combined with the lenders' lack of sophisticated risk assessment techniques makes many of them appear undesirable as credit customers among banks and other financial institutions (International Financial Corporation, 2007). In Kenya, most SMEs are under-capitalized and over-leveraged (Kinyanjui, 2000). Moreover, many entrepreneurs have a lack of collateral acceptable to the banks. This means that capital venture finance would be more suitable than debt finance and is one of the only options for entrepreneurs without collateral (Falkena et al, 2001).

Various studies have been conducted on venture capital on SMES; International, Mansa, (2011) did a study on the impact of venture capital financing on small and medium enterprises in the Tema Metropolis, Ghana; Mbhele, 2011 also did a study on the effects of venture capital finance and investment behaviour in the small medium-sized enterprises. Locally; Koech, (2008) also did a study on the use of venture capital instruments and other control mechanisms on venture capitalist in Kenya while Njoroge (2011) did a study on the effect of venture capital on financial performance of small and medium enterprises in Nairobi, Kenya; however, none of researchers looked at the effect of venture capital on the growth of SMEs in Kenya. It is against this background therefore that the researcher seeks to investigate; what is the effect of venture capital financing on the growth of SMEs in Kenya?

1.3 Objective of the Study

The aim of the study was to investigate the effects of venture capital financing on the growth of SMEs in Kenya.

1.4 Value of the Study

1.4.1 To The Small and Medium Enterprises

This study was expected to be of great value to the small and medium enterprises in Kenya. The SMEs would benefit from the findings as the study would highlight the impact that venture capital financing has over the other financing methods and its relationship with the growth of the SMEs.

1.4.2 To Policy Makers

The policy makers would be able to know how well to incorporate the sector and how effectively to ensure its full participation. The financial institutions financing these enterprises as well would benefit since they would understand the needs of SMEs and how best venture capital can enhance their growth.

1.4.2 To researchers and academicians

To researchers and academicians, the study would add value to the body of knowledge in the area of venture capital financing and SMEs and also form a basis for further research in the same field.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter reviews literature that would help inform the study as well as illuminate issues related to venture capital financing. The literature review was divided into areas that deal with: the theoretical review in relation to venture capital financing; the empirical review showing the various past works of authors in venture capital financing and SMEs growth.

2.2 Theoretical Review

2.2.1 Pecking Order Theory

The “pecking order theory” of financing says that firms and individuals will use personal funds before acquiring external debt and equity. Pecking Order Theory (POT) is a framework for examining firm financing that states that firms attempt to reduce information asymmetries and maintain ownership by first using internal financing, followed by external debt and equity (Myers, 1984; Berger & Udell, 2003). POT was originally devised to examine the financing of large corporations, but it has also been applied to small and medium-sized businesses.

Traditional finance theories are centered on agency conflicts between shareholders and debt holders. Up until the 1990s, the vast majority of finance studies focused on large corporations and publicly traded companies. Scholars began to realize that small firms, on the other hand, differ considerably from larger firms. Small and medium-sized businesses face different agency and information asymmetry challenges. For example,

they are not likely to be publically traded or incorporated, which limits the sources of financing available to them. And, because they are not required to share as much information as public companies, they are information opaque (Ang, 1991). Financing decisions for small and new ventures may also be more complex because they are closely linked to the personal wealth or contacts of the owner/manager. Consequently, agency problems may be more intense as shareholders and partners are often made up of family and friends (Ang, 1992).

The “pecking order” model of firm financing is one method firms might use to address these agency problems. According to this theory, firms do not aim for a target debt ratio. Instead, firms select from funding sources that minimize the cost of capital (Myers, 1984; Myers and Majluf, 1984). In the case of the small firm or entrepreneur, personal sources are used first, external debt next, followed by outside equity. Equity is acquired last because the entrepreneur presumably has more information than the investor. The presence of significant information asymmetries causes the investor to charge a higher rate of return on equity than on debt (Frank and Goyal, 2003). Indeed, information asymmetry costs may be much higher for small firms than for large, and the pecking order framework may therefore explain a great deal of financing behavior by entrepreneurs (Scherr, 1993; Hall et al., 2000).

Some research seem to validate the view that SME owners/managers’ financing decisions are consistent with the “pecking order” theory (Sogorb and Lopez-Gracia, 2003; Watson and Wilson, 2002). For instance, Watson and Wilson (2002) suggest that under these circumstances an owner(s)/manager will choose first – a personal source of finance; second – short-term borrowing; third – longer-term debt; and – finally, the least

preferred, equity finance which might affect his/her control upon the business. Sogorb and Lopez-Gracia (2003) also suggest that owners/managers tend not to sufficiently organise their finances in order to obtain an optimal capital structure (i.e. debt versus equity ratio) but prefer financing options that both ensure and maintain their control upon a business.

2.2.2 Entrepreneurship Theory

The entrepreneurial function implies the discovery, assessment and exploitation of opportunities, in other words, new products, services or production processes; new strategies and organizational forms and new markets for products and inputs that did not previously exist (Shane and Venkataraman, 2000). The entrepreneurial opportunity is an unexpected and as yet unvalued economic opportunity. Entrepreneurial opportunities exist because different agents have differing ideas on the relative value of resources or when resources are turned from inputs into outputs. The theory of the entrepreneur focuses on the heterogeneity of beliefs about the value of resources (Alvarez and Busenitz, 2001).

Entrepreneurship –the entrepreneurial function- can be conceptualized as the discovery of opportunities and the subsequent creation of new economic activity, often via the creation of a new organization (Reynolds, 2005).

Entrepreneurship is often discussed under the title of the entrepreneurial factor, the entrepreneurial function, entrepreneurial initiative, and entrepreneurial behaviour and is even referred to as the entrepreneurial “spirit. The entrepreneurial factor is understood to be a new factor in production that is different to the classic ideas of earth, work and

capital, which must be explained via remuneration through income for the entrepreneur along with the shortage of people with entrepreneurial capabilities. Its consideration as an entrepreneurial function refers to the discovery and exploitation of opportunities or to the creation of enterprise. Entrepreneurial behaviour is seen as behaviour that manages to combine innovation, risk-taking and proactiveness (Miller, 1983). In other words, it combines the classic theories of Schumpeter's innovative entrepreneur (1934, 1942), the risk-taking entrepreneur that occupies a position of uncertainty as proposed by Knight (1921), and the entrepreneur with initiative and imagination who creates new opportunities. Reference to entrepreneurial initiative underlines the reasons for correctly anticipating market imperfections or the capacity to innovate in order to create a "new combination". Entrepreneurial initiative covers the concepts of creation, risk-taking, renewal or innovation inside or outside an existing organization. Lastly, the entrepreneurial spirit emphasizes exploration, search and innovation, as opposed to the exploitation of business opportunities pertaining to managers.

SMEs are vital for economic growth and development in both industrialised and developing countries, by playing a key role in creating new jobs. Financing is necessary to help them set up and expand their operations, develop new products, and invest in new staff or production facilities. Many small businesses start out as an idea from one or two people, who invest their own money and probably turn to family and friends for financial help in return for a share in the business. But if they are successful, there comes a time for all developing SMEs when they need new investment to expand or innovate further. That is where they often run into problems, because they find it much harder than larger businesses to obtain financing from banks, capital markets or other suppliers of credit.

This “financing gap” is all the more important in a fast-changing knowledge-based economy because of the speed of innovation. If SMEs cannot find the financing they need, brilliant ideas may fall by the wayside and this represents a loss in potential growth for the economy.

2.3 Factors that Banks Consider when Financing SMEs

According to Abor (2000), while the banks are definitely more qualified to talk about lending to SMEs, it is a widely held view that banks, particularly commercial banks, have difficulties in financing start-ups and SMEs in spite of the significant number of SMEs. In addition, SMEs dominate economic activities and make a very significant contribution to GDP.

Aryeetey *et al.* (1994) outline some of the reasons why banks are reluctant to lend to SMEs: limited branch network, limited range of financial instruments and lending conditions, banks’ risk-averse behaviour; preference for investing in Treasury bills, non-performing assets, which make the banks too cautious to undertake further lending, lack of established information network such as a credit reference bureau for tracking defaulters, weak inter-bank collaboration, banks’ inadequate capacity to appraise the creditworthiness of SMEs.

According to Abor (2000), banks require cash flow forecast and budget before considering any financing proposal. If customers are unable to produce these themselves, banks usually look out to accountants to assist them. Once those documents are produced, the bank then question assumptions behind them. Abor (2000) argue that lack of

historical sales data then makes it difficult to verify whether the sales targets are realistic and therefore bankers face the difficulty to distinguish between impressive-looking documents produced and designed to maximize the chances of obtaining a loan and the underlying soundness of the lending proposition.

Black and Strahan (2002), also argue that, it is ironic that cash flow forecasts are always positive and therefore it would be prudent for bankers to be skeptical of these forecasts unless they are supported by recent actual performance.

According to Husain (2005), many small scale firms are owner- or family-operated, and as a result, they do not keep business and personal finance separate. Thus, when a family problem appears, such as school fees for a relative's child, inevitably the cash for the business is used. This means that while one immediate problem is solved, a potential future cash flow problem for the business ensues. He adds that there is a need for trust between a banker and his customer. He suggested that, one approach to mitigate the high degree of uncertainty that surrounds small business lending is to insist on „good“ security in all cases.

Tagoe, Nyarko and Anuwa-Armah (2005) asserts that, banks see SME lending as a high-risk activity, given the larger proportion of business failures in this sector. As a result, they will inevitably charge a higher risk premium. They suggested that, the price to some extent could be mitigated depending on: The level of capital that the owner has in the business, the degree of profitability, the extent to which profits remain in the business, the value/desirability of security offered

2.4 Determinants of Growth of SMEs

Growth is sometimes regarded as the most important, reliable and easily accessible measure of a firm's performance (Wicklund 1999). As growth is a complex, multidimensional phenomenon (Weinzimmer 1993), a purely internal approach to its investigation, limited to the impact of resources, neglects the predictive potential of variables linked to the firm, its strategy, its environment, and the interactions between these factors. An exhaustive analysis of the factors possibly influencing them origin of firm's growth is available in Coad (2007).

2.4.1 Location

Many external factors may influence the growth of the firm. Population ecology theory suggests that organizational survival and performance are determined by environmental selection (Aldrich 1979). The founding conditions (Carroll and Hannan 1989,) and environmental characteristics have been found to play important roles in organizational growth. For example, Carlsson (2002) or Davidsson and Henreksson (2002) find that institutional factors, such as regulations, taxation, scientific resources or capital availability, may affect the growth of independent businesses. Shane and Kolvereid (1995) suggest that variations in national environments account for almost all performance changes. Storey (1994) supports this suggestion by arguing that firm location may be important in determining growth because the local market binds firms.

2.4.2 Age

The relationship between a firm's age and its growth rate has also been frequently investigated. One of the first empirical studies on the influence of age on growth was undertaken by Fizaine (1968), who examined the growth of enterprises based in the

French county of Bouches-du-Rhone. She concluded that age has a negative effect on the growth of establishments and she found that the older the firm, the smaller the variance in the growth rate. Fizaine (1968) presented this evidence about the causality between the two variables almost twenty years before

Evans (1987). While many investigations into firm growth that are based on Gibrat's Law assume that the causality moves from size to growth, Fizaine demonstrated that the reverse is true. The same conclusion was reached by Dunne et al. (1989). Analyzing US establishments, they conclude that both the expected growth rate and the variance in growth decrease with age. This finding is consistent with the suggestion that firms gradually learn their relative efficiency after entering the market and need to grow at a higher rate if they want to survive (Baldwin and Rafiquzzaman 1995).

This review of existing literature on the relationship between firm age and growth rates would not be complete without a mention of the paper by Brock and Evans (1989), which contrasts with the other results in that it indicates the importance of two regimes based on firm size. They find that firm growth decreases with firm age for firms with fewer than 25 employees but increases with firm age for firms with more than 25 employees.

2.4.3 Legal form and management structure

Several factors might explain an association between legal form and firm growth. For instance, listed companies have the ability to issue stock and their stockholders have the freedom to sell their shares. These options facilitate the process of raising capital for expansion but such a factor does not fit analyses of SME growth. However, even when one is not considering listed companies, it is possible to assume that legal status has an influence and that firms with limited liability have significantly higher growth rates than

other companies (Harhoff et al. 1998). We enlarge and adapt this possibility by considering what is often presented as a clear-cut distinction among firms according to their legal form, i.e., whether they belong to a group or are independent.

When incorporated into a group, a firm drastically changes its strategic behavior and its development, as shown by Thollon-Pommerol (1990). Taking such a characteristic into account is essential in empirical analyses, as groups of firms have become a salient fact in the transformation of productive systems (Picart 2006). Ownership structure affects growth when the latter is analyzed on the plant level - the evidence suggests that the expected growth rate of a plant declines as plant size increases for plants owned by single-plant firms but increases with size for plants owned by multiplant firms (Dunne et al. 1989).

2.4.4 Financial resources

Marris and Wood (1971) bring evidence that financial resources might also constrain firm growth. In fact, a wide range of financial characteristics can be introduced. They could include retained earnings, borrowing or new issues of stock. On the national level, Rajan and Zingales (1998) find that industrial sectors with a great need for external finance grow substantially less in countries without well-developed financial markets. This work induced a large number of subsequent comparative studies. However, few empirical studies have measured the effect of financial resources on firm growth. One important exception is Becchetti and Trovato (2002), who test both the effect of the firm's leverage ratio and the effect of financial constraints on growth. They conclude that although the effect of the leverage ratio is not significant, the qualitative dummy variable representing finance shortage appears to be an important restraint on growth.

The same ambiguity characterizes the results presented by Fagiolo and Luzzi (2006). In their investigation of the evolution of the distributions of size and growth, conditioned on liquidity constraints and/or age, they find that liquidity constraints do not seem to have a strongly negative impact on firm growth in any given year. However, the methodology used clearly influences the conclusion: the negative impact of liquidity constraints on firm growth is strong in the pooled sample, but tends to dissipate when the sample is disaggregated over time. Credit shortages constrain firm growth because of limited investment opportunities, and, more generally, assuming that a lack of financial resources reduces the possibilities for long-term development.

2.5 Empirical Review

A growing stream of empirical literature has analyzed the effects of VC financing on the performances and growth of portfolio companies

Aleman and Marti (2005) compare the population of the 323 Spanish firms that obtained VC financing in the period 1993-1998 with a control sample of similar but non VC-backed companies; matching is based on the province in which firms are located, sector of activity, age and size in the year in which VC financing was obtained. They consider both early and mature stage financing, including restructuring and MBOs/LBOs. They compute average growth of firms' sales, employment and total assets from the "event" year up to the third year after the event, distinguishing according to the stage of firms' life (i.e. start-up, growth, mature) in which VC financing was obtained. VC-backed companies are found to outperform their non VC-backed counterparts if VC investment takes place in the start-up or growth stage.

Bottazzi and Da Rin (2002) similarly consider growth of sales and employees in the three years that follow an IPO in a sample composed of 511 firms that have been listed in the Euro. All else being equal, VC financing has no effect on employment growth, while it has a moderate negative effect on sales growth. The studies that were mentioned above exhibit serious methodological weaknesses. Bürghel *et al.* (2000) analyze growth of sales and employees of 500 start-ups localized in Germany and the United Kingdom; they fail to detect any effect of VC financing.

Astrid & Bruno (2004) carried out a study on venture capital funded firms for the period 1970-2000, the sales doubled, paid almost twice the federal taxes, generated almost twice the exports and invested almost three times as much in research and development as the average non-venture capital backed firms. The European Venture Capital Association (2001) has also established that venture capital backed firms report a high growth in sales as compared to other firms. The result reveals that venture capital leads to growth on sales of the firms that use these funds.

Gans and Stern (2003) found that venture capital financing strongly impinge on firm's innovation, patenting processes and the influx of technological opportunities. This is the unique way to extract the social significance of an innovation. Hence, triggering innovations, along with the firm's professionalization, is another valuable feature of the venture capital funding.

Hellmann and Puri (2002) revealed that it can be inferred that, once the investor introduces its money in a business, he must devote much of his time in helping the business to succeed, structuring internal organization and appropriate human resources

management. In other words, venture capitalist's help in adding value to professionalization in the firm. By and large, it seems that firm's professionalization is the major benefit from the venture capital financing.

Hellmann and Puri (2000) offer good explanation of the process of professionalization. Besides above mentioned features, they point out the speed of developing and bringing ambitious product to the market by venture backed companies. This is crucial to achieve market leadership, especially among innovative firms. Venture backed companies are, in fact, found to pursue more radical and ambitious product or process innovations than other companies.

Jain and Kini (1995) compare a sample composed of 136 US listed firms that obtained VC financing prior to the IPO with a control sample of non VC-backed IPO firms that were in the same sector and went through an IPO of similar size. They consider sales growth from the year before the IPO up to the year of listing and the three following years, respectively. Over this period, VC-backed firms substantially outperform their non VC-backed counterparts.

Manigart and Van Hyfte (1999) find that the rate of growth of total assets of a sample composed of 187 Belgian VC-backed firms is significantly greater than that of the control sample in each year starting in the year in which the firm obtained VC financing and over the following five years. Similar results are obtained as to the growth rate of sales of firms that at the time of the first round of VC financing were at least three years old, while there are no significant differences for younger firms. Lastly, the growth rate of employment is greater in the VC-backed sample only when one considers star performers

that are the firms that belong to the percentiles with the greatest growth, and a sufficiently long period of time (at least three years after the investment).

Manigart et al. (2002) reveals that venture capital is thought to be an important alternative for companies that have difficulties accessing more traditional financing sources and it (venture capital) is a strong financial injection for early-stage companies that do not have evidence for persistent profitability yet.

Mason and Harrison (2004) claim that venture capital financing is associated with high levels of risk, which refers to the uncertainty of the positive returns that may occur even after a number of years or never. Not only this, but venture capitalist may also embark on a new business strategy which defers from entrepreneur's one; the former can even throw the entrepreneur out of the firm.

Mason and Harrison (2004) argue that venture capitalists invest only in promising projects. At the very beginning, investors are deeply skeptical, bad mood reasoning with more answers "no", rather than "yes". Baeyens and Manigart (2003) assert that venture capitalists screen potential investments in regards to the collecting information about business, its market approach, management team or entrepreneur, all in order to reduce the initial information asymmetry and potential problems with entrepreneurs. In other words, before final contracting, venture capitalist spends much of his time and efforts in assessing and observing the opportunity, in terms of its market size, strategies, customer adoption etc. (Kaplan and Strömberg, 2001). This, in turn, should eliminate the possibility to access a non-quality project (adverse selection problem) and should ensure that the funds will not be diverted to fund an alternative project (moral hazard problem)

(Berger and Udell, 2002). In this phase of initial scanning, investor should be convinced that his money will not simply „evaporate“. Instead of that, it should make future value for him.

Reynolds (2000) asserts that venture capitalist needed to trigger, maintain and to speed up the small enterprise's growth and its performance, and therefore to result in improved profitability. Thus, its primary role: it is the main contributor in getting rid of the most financial impediments that occur in the establishing phase of a new business. Nevertheless, it is „seed money“ for the small business; it helps smart ideas to rise up.

Baeyens and Manigart (2003) assert that venture capital has one more important attribute: providing credibility, it attracts new funding. He explains this by the fact that, through screening, observing and value-adding, venture capitalists reduce the information asymmetries and financial risks, and therefore adjoin legitimacy to the venture backed company and consequently influence on further financing. The last is an admirable fundament for further expansion of the firm. This, in turn, spurs the growth and development of entrepreneurship in the national economy in general.

First of all, VC investors generally focus on specific industries (Gompers 1995, Amit *et al.* 1998, Bottazzi and Da Rin 2002). Due to their sectoral specialization, they allegedly develop context-specific screening capabilities that make them able to judge quite accurately the commercial value of entrepreneurial projects and the entrepreneurial talent of the proponents (Chan 1983, Amit *et al.* 1998. For an opposed view see Amit *et al.* 1990). Therefore, they are able to deal effectively with the adverse selection problems

that would otherwise prevent great hidden value firms from obtaining the financing they need. In turn, relaxation of financial constraints leads to higher firm growth.

Second, VC firms are no silent partners (Gorman and Sahlman 1989, Barry *et al.* 1990). On the one hand, they actively monitor portfolio companies. For instance, Kaplan and Strömberg (2003) show that VC firms control 41.4% of the seats of the board of directors of the US VC-backed companies that are considered in their study; in 25% of the companies they control the majority of the board seats. Bottazzi *et al.* (2004) document that in 66% of the deals of European VC firms the VC investor obtained one or more seats of the board of the participated company. Moreover Lerner (1995) highlights that the number of VC investors who sit in the board of directors is more likely to increase between two financing rounds if during the same period the top manager of the participated firm is replaced, that is in situations where monitoring is most important. On the other hand, VC investors make use of specific financial instruments and contractual clauses (e.g. stage financing) that protect their investments from opportunistic behavior on the part of entrepreneurs and create high powered incentives for them (Sahlman 1990, Gompers 1995, Hellmann 1998, Kaplan and Strömberg 2003, 2004).

Third, VC investors allegedly perform a key coaching function to the benefit of portfolio firms (Gorman and Sahlman 1989, MacMillan *et al.* 1989, Bygrave and Timmons 1992, Sapienza 1992, Barney *et al.* 1996, Sapienza *et al.* 1996, Kaplan and Strömberg 2004). In fact, they provide advising services to portfolio companies in fields such as strategic planning, marketing, finance and accounting, and human resource management, in which these firms typically lack internal competencies. Accordingly, Hellmann and Puri (2002) document that VC investor's favor the recruitment of external managers, the adoption of

stock option plans, and the revision of human resource policies by portfolio firms, thus contributing to their managerial “professionalization”. Bottazzi *et al.* (2004) show that European VC firms helped portfolio companies in recruiting outside directors and senior managers in 40.8% and 48.4% of the deals they analyze, respectively. Moreover, portfolio companies take advantage of the network of social contacts of VC investors with potential customers, suppliers, alliance partners, and providers of specialized services like legal, accounting, head hunting, and public relation services (Lindsey 2002, Colombo *et al.* 2006, Hsu 2006).

Lastly, VC-backed companies find it easier to get access to external resources and competencies that would be out of reach without the endorsement of the VC (Stuart *et al.* 1999). In accordance with the existence of a “certification effect”, Megginson and Weiss (1991) find that US VC-backed IPOs exhibit smaller under pricing than non VC backed ones that are matched by sector and IPO size. Nonetheless, it is important to acknowledge that the agency relation between the VC investor and the entrepreneurs of portfolio companies may engender conflicts, leading to a deterioration of the performance of these latter companies. In fact, entrepreneurs and external investors may have different strategic visions; disagreements may absorb the entrepreneurs’ effort and attention to the detriment of the pursuit of business opportunities.

Even if no conflict arises, the need of VC investors to monitor managerial decisions may increase bureaucracy and formalization of decision processes, hampering flexibility and the ability of firms to timely grasp business opportunities. Furthermore, as VC investors are competent investors, they might be able to expropriate entrepreneurs of their innovative business ideas and exploit them also in their absence (Ueda 2004). The

associated appropriability hazards may induce entrepreneurs to take decisions aimed at protecting their firm's technological knowledge that are detrimental to firm growth.

2.6 Summary of the Literature

A review of literature shows that in SMEs financing, banks are reluctant to lend or finance SMEs due to various reasons which includes; limited branch network, limited range of financial instruments and lending conditions, risks, lack of established information network such as a credit reference bureau for tracking defaulters, weak inter-bank collaboration, banks' inadequate capacity to appraise the creditworthiness of SMEs. However, venture capital has tried to fill that gap by providing non-bank financing as an investment for start-up or growing SMEs that are perceived to have excellent growth prospects. This study will therefore seek to establish whether venture capital financing has an impact on the growth of SMEs in Kenya.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the methodology adopted by the researcher in carrying out the study. The chapter also presents the information on population studied, the methods used to sample it, the instruments used in data collection and procedures that were used in data analysis.

3.2. Research Design

Descriptive cross sectional research design was adopted for this study. According to Cooper and Schindler (2003), a descriptive study is concerned with finding out the what, where and how of a phenomenon. Descriptive research design was chosen because it enabled the researcher to generalise the findings to a larger population. Descriptive design method provided quantitative data from cross section of the chosen population. The descriptive research collects data in order to answer questions concerning the current status of the subject under study (Mugenda and Mugenda, 2003).

3.3 Population of the Study

A population is defined as the total collection of elements about which we wish to make some inferences (Cooper and Schindler, 2003). The target population for this study was the 100 SMEs (2012) in Kenya. Kenya Top 100 Mid-sized companies is a survey carried out annually to facilitate identification of the Top 100 companies survey participants are required to submit data on several financial indicators; such as business confidence

outlook, growth, human resource policies, involvement in corporate social responsibility, and the role played by innovation in their operations.

3.4 Sample and Sampling Technique

Stratified sampling was adopted so as to give each item in the population an equal probability of being selected. The sample was selected from the population target of 100 possible respondents by taking a 30% sample of the target population in each stratum. Hence the sample size of the study was 30 SMEs. The SMEs were chosen through purposive sampling whereby the firm was chosen based on the basis that they have used venture capital financing.

3.5 Data Collection

The study collected secondary data. The secondary data collected included the financial statements such as the profit and loss account and the balance sheets of the targeted SMEs from a period of five years starting from 2008 to 2012.

3.6 Data Analysis and Presentation

The questionnaire responses were first cleaned, grouped into various categories and entered in the SPSS software to facilitate for analysis. Inferential statistics was employed to analyze the data using a regression model. The analysed data was presented in frequency distributions tables and pie charts for ease of understanding and analysis.

3.6.1 Analytical Model

The regression model was used to establish the form of relationship between the dependent and the independent variable. The regression equation took the following form;

$$Y = a + B_1 X_1 + B_2 X_2 + B_3 X_3 + B_4 X_4 + \epsilon$$

Where:

Y = Dependent Variable (Growth- measured through profitability, asset growth, market growth)

X₁ = Credit rating (CR) - ability of the SMEs to attract finance/ credit from financial institutions

X₂ = Marketing/distribution networks (MDNs)- Market growth, growth of distribution networks

X₃ = Technical expertise (TE)- Improved skills in production, innovativeness

X₄ = Management expertise (ME)- managerial skills

a = the constant

ε = error term

Venture capital in specific organizations was measured by total investments (TI) less the investments from private sources (IPS). It can therefore be presented as:

Venture Capital (VC) = Total investments (TI) - Investments from Private Sources (IPS)

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the findings of the study based on the data collected from the field. The study sought to investigate the effects of venture capital financing on the growth of SMEs in Kenya. The study used the secondary data which included the profit and loss account and the balance sheets of the targeted SMEs from a period of five years starting from 2008 to 2012.

4.2 Study Findings

The regression model was used to establish the relationship between venture capital financing and the growth of SMEs in Kenya. The study sought to establish whether credit rating, marketing/distribution networks, technical expertise management expertise and managerial skills which had been enhanced by the existence of venture capital financing in SMEs; improves growth. The following regression model was adopted.

$$\text{Growth} = a + B_1 \text{CR} + B_2 \text{MDNs} + B_3 \text{TE} + B_4 \text{ME} + \epsilon$$

Table 4.1: Model Summary for Year 2008

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.880(a)	0.774	0.653	4.042

a Predictors: (Constant), Credit rating, Marketing/distribution networks, Technical expertise, Management expertise

Adjusted R^2 is called the coefficient of determination and tells us how close the data are to the fitted regression line. In this case, the R^2 will tell us the variability between credit rating, marketing/distribution networks, technical expertise, management expertise (independent variables) and growth (dependent variable).

The value of adjusted R^2 is 0.653. This implies that, there was a variation of 65.3% of growth in SMEs with the independent variables (credit rating, marketing/distribution networks, technical expertise, and management expertise). It therefore means that the regression line accounts for 65.3% of the total observations.

Table 4.2: Coefficients Results for Year 2008

Model		Unstandardized		Standardized	t	Sig.
		Coefficients		Coefficients		
		B	Std. Error	Beta		
1	(Constant)	4.568	3.156		1.839	0.000
	Credit rating	0.453	0.061	0.097	0.097	0.000
	Marketing/distribution networks	0.187	0.018	0.094	0.094	0.041
	Technical expertise	0.148	0.311	0.090	0.090	0.008
	Management expertise	0.035	0.418	0.097	0.097	0.423

a Dependent Variable: Growth in SMEs

The regression analysis for the year 2008 shows that there is a positive relationship between growth of SME and the predictor factors; credit rating, marketing/distribution networks, technical expertise, and management expertise. The following regression equation was established.

$$\mathbf{Growth} = 4.568 + 0.453 \mathbf{CR} + 0.187 \mathbf{MDNs} + 0.148 \mathbf{TE} + 0.035 \mathbf{ME}$$

Venture capital financing in SMEs improves credit rating of the firms, marketing/distribution networks, technical expertise and managerial skills/expertise. The results show that, holding credit rating, marketing/distribution networks, technical expertise, and management expertise constant, growth of SMEs would be achieved at a unit of 4.568. A unit increase in credit rating would cause an increase in growth of SMEs by a factor of 0.453, a unit increase in marketing/distribution networks would cause an increase in growth of SMEs by a factor of 0.187, a unit increase in technical expertise would cause an increase in growth of SMEs by a factor of 148. Moreover, a unit increase in management expertise would cause an increase in growth of SMEs by a factor increase of 0.035.

The study further shows that there is a significant relationship between growth of SMEs and credit rating ($p= 0.038 <0.005$), marketing/distribution networks ($p= 0.041 <0.05$), and technical expertise ($p=0.008 <0.005$).

Table 4.3: Model Summary for Year 2009

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.787(a)	0.619	0.528	3.304

a Predictors: (Constant), Credit rating, Marketing/distribution networks, Technical expertise, Management expertise

Table 4.3 above shows that the value of adjusted R^2 is 0.528. This implies that, the independent variables (credit rating, marketing/distribution networks, technical expertise, and management expertise) had a 52.8% variation with the dependent variable (growth of SMEs).

Table 4.4: Coefficient's Results for Year 2009

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.441	3.156		0.871	0.000
	Credit rating	0.386	0.067	0.109	0.675	0.000
	Marketing/distribution networks	0.142	0.051	0.023	0.145	0.046
	Technical expertise	0.215	0.411	0.246	1.461	0.041
	Management expertise	0.374	0.518	0.256	1.601	0.015

a Dependent Variable: Growth in SMEs

Table 4.4 above shows that there is a positive relationship between the independent variables- credit rating, marketing/distribution networks, technical expertise, and management expertise and the dependent variable- growth of SMEs. From the summary model, the following regression equation was established

$$\text{Growth} = 3.441 + 0.386 \text{ CR} + 0.142 \text{ MDNs} + 0.215 \text{ TE} + 0.374 \text{ ME}$$

Holding the entire independent variables constant, growth of SMEs would be achieved at 3.441. A unit increase in credit rating as a result of venture capital financing in SMEs would cause an increase in growth of the firms by a factor of 0.386, also a unit increase in marketing/distribution networks would cause an increase in growth of SMEs by a factor of 0.142 while a unit increase in technical expertise would cause an increase in growth of SMEs by a factor of 0.215. Moreover, a unit increase in management expertise would cause an increase in growth of SMEs by a factor of 0.374.

The study further established that there is a significant relationship between growth of SMEs and the predictor factors: credit rating ($p=0.000<0.005$), marketing/distribution networks ($p= 0.046<0.05$), technical expertise ($p=0.041<0.005$) and management expertise ($p=0.015<0.005$).

Table 4.4: Model Summary for Year 2010

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.866(a)	0.750	0.669	4.021

Predictors: (Constant), Credit rating, Marketing/distribution networks, Technical expertise, Management expertise

A correlation value of 0.866 was established which shows a high relationship between dependent and independent variables; and a coefficient of determination (R^2) value of 0.669. The determination coefficient value indicates that the regression line accounts for 66.9% of the total observations. This is to mean, the independent variables (credit rating, marketing/distribution networks, technical expertise, and management expertise) explained 66.9% of the dependent variable (growth of SMEs).

Table 4.5: Coefficient's Results for Year 2010

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.116	1.715		3.133	0.002
	Credit rating	0.014	0.057	0.195	0.093	0.113
	Marketing/distribution networks	0.497	0.063	0.051	0.094	0.035
	Technical expertise	0.355	0.610	0.094	0.092	0.018
	Management expertise	0.232	0.670	0.214	0.091	0.003

a Dependent Variable: Growth in SMEs

The study shows a positive relationship between growth of SMEs and the independent variable. This implies that with increased venture capital financing, it improves SMEs credit rating, marketing and distribution networks, improves technical expertise and management expertise which in turn enhances growth. From the analysis, the following regression equation was established:

$$\mathbf{Growth} = 3.116 + 0.014 \mathbf{CR} + 0.497 \mathbf{MDNs} + 0.355 \mathbf{TE} + 0.232 \mathbf{ME}$$

It was further established that holding all independent variables constant, growth in SMEs would be achieved at a unit of 3.116. A unit increase in credit rating would cause an increase in growth of the SMEs by a factor of 0.497, a unit increase in technical expertise would cause an increase in growth of the SMEs by a unit of 0.355, while a unit increase in management skill/expertise would cause an increase in growth of the SMEs by a factor of 0.232.

The study further established that there was a significant relationship between growth of the SMEs and three of the variables: marketing and distribution networks ($p=0.035<0.05$), technical expertise ($p=0.018<0.05$) and management expertise ($p=0.003<0.05$). Credit rating has an insignificant relationship as shown by ($p=0.113>0.05$).

Table 4.1 Model Summary- Year 2011

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.784(a)	0.615	0.545	0.312

a Predictors: (Constant), Credit rating, Marketing/distribution networks, Technical expertise, Management expertise

The regression model shows the value of adjusted R^2 (coefficient of determination) as 0.545. This implies that credit rating, marketing and distribution networks, technical expertise, management expertise (independent variables) explained 54.5% of growth in SMEs (dependent variable). The regression line accounts for 54.5% of the total observations.

Table 4.3 Coefficients Results- Year 2011

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	2.438	0.604		3.436	0.000
Credit rating	0.213	0.110	0.202	1.424	0.157
Marketing/distribution networks	0.319	0.067	0.682	2.842	0.000
Technical expertise	0.164	0.072	0.155	1.162	0.005
Management expertise	0.226	0.106	0.040	0.322	0.001

a Dependent Variable: Growth in SMEs

From the regression model, the following regression equation was established:

$$\mathbf{Growth} = 2.438 + 0.213 \mathbf{CR} + 0.319 \mathbf{MDNs} + 0.164 \mathbf{TE} + 0.226 \mathbf{ME}$$

The study shows that there is a positive association between the growth in SMEs and credit rating, marketing and distribution networks, technical expertise and management expertise. A unit increase in credit rating, marketing and distribution networks, technical expertise and management expertise would lead to an increase in growth at a unit of 0.213, 0.319, 0.164 and 0.226 respectively. The study further established that at there was a significant relationship between growth in SMEs and the predictors: marketing and distribution networks ($p=0.000 < 0.005$), technical expertise ($p=0.005 < 0.005$) and management expertise ($p=0.001 < 0.005$).

Table 4.4 Model Summary for Year 2012

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.849(a)	0.721	0.647	2.105

a Predictors: (Constant), Credit rating, Marketing/distribution networks, Technical expertise, Management expertise

The value of adjusted R^2 is 0.647. This implies that there was variability of 64.7% between the predictors- credit rating, marketing/distribution networks, technical expertise, management expertise and growth in SMEs. This is to mean that the regression line explained 64.7% of the total observations.

Table 4.5 Coefficients Results for Year 2012

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	0.324	0.186		0.623	0.005
Credit rating	0.037	0.068	0.559	8.478	0.132
Marketing/distribution networks	0.114	0.043	0.257	3.676	0.000
Technical expertise	0.582	0.024	0.139	2.115	0.012
Management expertise	0.232	0.001	0.505	2.097	0.001

a Dependent Variable: Growth in SMEs

The regression analysis findings show that there is a positive relationship between growth in SMEs and the predictors- credit rating, marketing and distribution networks, technical expertise and management expertise. The established regression equation was:

$$\mathbf{Growth} = 0.324 + 0.037 \mathbf{CR} + 0.114 \mathbf{MDNs} + 0.582 \mathbf{TE} + 0.232 \mathbf{ME}$$

The study also shows that there is a significant relationship between growth in SMEs and the three predictors as shown; marketing and distribution networks ($p=0.000<0.05$), technical expertise ($p= 0.012<0.05$) and management expertise ($P= 0.001<0.05$).

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This chapter is a synthesis of the entire report and contains summary of findings, conclusions arrived at, the recommendations and the suggestions for further study.

5.2 Summary of the Findings

In 2008 an Adjusted R value 0.653 was established. This implies that, there was a variation of 65.3% of growth in SMEs with the variables- credit rating, marketing/distribution networks, technical expertise, and management expertise). On the other hand, the study shows that there is a positive relationship between growth of SME and the predictor factors and a significant relationship was established between growth of SMEs and credit rating ($p= 0.038 <0.005$), marketing/distribution networks ($p= 0.041 <0.05$), and technical expertise ($p=0.008 <0.005$).

In the year 2009, the value of adjusted R^2 was 0.528 which shows that credit rating, marketing/distribution networks, technical expertise, and management expertise explained 52.8% of growth in SMEs. There is a positive relationship between the independent variables- credit rating, marketing/distribution networks, technical expertise, and management expertise and growth in SMEs. Moreover, the study further established that there is a significant relationship between growth of SMEs and credit rating ($p=0.000 <0.005$), marketing/distribution networks ($p= 0.046 <0.05$), technical expertise ($p=0.041 <0.005$) and management expertise ($p=0.015 <0.005$).

In 2010, the study established a variation of 66.9% between the variables- credit rating, marketing/distribution networks, technical expertise, and management expertise and growth in SMEs. The study also established a positive relationship between growth of SMEs and the independent variable. There was also a significant relationship between growth of the SMEs and the variables: marketing and distribution networks ($p=0.035<0.05$), technical expertise ($p=0.018<0.05$) and management expertise ($p=0.003<0.05$). However, credit rating had an insignificant relationship ($p=0.113>0.05$).

In the year 2011, it was found out that credit rating, marketing and distribution networks, technical expertise and management expertise explained 54.5% of growth in SMEs. There is a positive association between the growth in SMEs and credit rating, marketing and distribution networks, technical expertise and management expertise. The study also established a significant relationship between growth in SMEs and marketing and distribution networks ($p=0.000<0.005$), technical expertise ($p=0.005 <0.005$) and management expertise ($p=0.001 <0.005$).

In 2012, the regression analysis established a positive relationship between growth in SMEs and the predictors- credit rating, marketing and distribution networks, technical expertise and management expertise. Moreover, the established that there is a significant relationship between growth in SMEs and marketing and distribution networks ($p=0.000<0.05$), technical expertise ($p= 0.012<0.05$) and management expertise ($P= 0.001<0.05$). However, credit rating had an insignificant relationship

5.3 Conclusions

It can be concluded that the effect of venture capital on growth of SME is real and practical as established by this study. The study has shown a positive and significant relationship between growth in SMEs and venture capital financing. This is to say that increased venture capital financing improves SMEs credit rating, marketing and distribution networks, improves technical expertise and management expertise/skills which in turn enhance growth in these firms.

SMEs have been constrained by lack of skilled human, physical, technological resources as well as capital resources. But with good management expertise and technical expertise, the firms have the ability to strategically use information and resources available to them to present well-crafted business growth strategies that also reduces risk to the business; strong management team can also demonstrate past successes in similar businesses.

SME risk profile combined with the lenders' lack of sophisticated risk assessment techniques makes many of them appear undesirable as credit customers for business banking. But with evidence of venture capital financing improving credit rating of SMEs makes these firms have available sources for more capital/finances in the future. It can therefore be concluded that venture capital has demonstrated that it can lay the foundation for an emerging generation of locally owned enterprises.

5.4 Recommendations

In view of the findings, the following recommendations were made:

SMEs need to recognize the potential advantages of seeking external equity finance from corporate sources. Corporate investors can therefore become very important assets for

SMEs both financially and strategically as they provide tangible and intangible value-added resources which can play a valuable role in SME growth. Moreover, SMEs should be trained and assisted to set up basic planning and record keeping systems, and to write financing proposals.

Venture capital fund managers can do more to encourage venture capital investment. Non-financial companies can be a very significant alternative source of funds for independent venture capital groups specializing in investing in SMEs at a time when they are experiencing difficulties in raising funds from financial institutions. Venture capital fund managers need to recognize the motivations of the corporate investor and to tailor their funds accordingly. Venture capitalists have a role to play in stimulating direct venture capital investment via co-investments with corporations.

The government and Policy makers should provide credit and equity financing to eligible Venture Capital Finance Companies to support SMEs and also provide money to support other activities and programs for the promotion of Venture Capital Financing. The government should also serve as both facilitators and educators in encouraging the venture capital process and provide tax incentives to companies prepared to make venture capital investments. This would be an important method for initially stimulating interest in an activity that many corporate executives are possibly not currently considering.

5.4 Limitations of the Study

The researcher encountered a number of challenges. One of the challenges was lack of cooperation from some of the SMEs managers who were unwilling to give information. This study was dependent on financial statements and records from the SMEs but some

organizations were unwilling to give such information in fear that it would be exposed to the public. However, the researcher explained to the management of these organizations that the sought information was just for academic purposes only and would be treated as confidential.

Another limitation was that, due to lack of enough information, it was difficult to identify those SMEs that have actually benefited from venture capital funding since some were not willing to open up on whether they dependent on venture capital funding or other forms of financing from financial institutions. Another limitation was difficulties to measure the venture capital financing in the SMEs sampled. It was a little bit difficult to differentiate the venture capital in the SMEs and the capital from other sources.

5.5 Suggestions for Further Research

A review of the findings of this study poses the following research question is worth more exploration: Why are SME's not still willing to use Venture Capital Finance as alternative source of funding when they don't get funding from financial institutions? There is also need to conduct a further study to establish why SMEs do not prefer Venture Capital Funds in spite of the ranging benefits that are accrued to SME's in using Venture Capital Financing as a means of financing.

This study looked at the relationship between credit rating, marketing/distribution networks, management expertise, technical expertise (as component of venture capital) with growth of SMEs; a future study should seek to establish whether there is a direct relationship between Ventura capital financing and growth.

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APPENDICES

Appendix I: Kenya Top 100 SMEs- 2012

1. ATLAS PLUMBERS AND BUILDERS
- 2 TROPIKAL BRANDS AFRIKA
- 3 KEPPEL INVESTMENTS LTD
- 4 SHIAN TRAVEL
- 5 RUPRA CONSTRUCTION CO.
- 6 POWERPOINT SYSTEMS (E.A) LTD
- 7 CHEMICAL AND SCHOOL SUPPLIES
- 8 SATGURU TRAVEL AND TOURS
- 9 RADAR LTD
- 10 KENTONS LTD
- 11 AVTECH SYSTEMS LTD
- 12 SAI PHARMACEUTICALS LTD
- 13 KUNAL HARDWARE AND STEEL
- 14 CONINX INDUSTRIES LTD
- 15 R & R PLASTIC LTD
- 16 CAPITAL COLOURS C. D LTD
- 17 ASL CREDIT LTD
- 18 KANDIA FRESH PRODUCE SUPPLIERS LTD
- 19 FURNITURE ELEGANCE LTD
- 20 MURANGA FORWARDERS LTD
- 21 BBC AUTO SPARES LTD

- 22 DIGITAL DEN LTD
- 23 XRX TECHNOLOGIES LTD
- 24 NAIROBI GARMENTS ENTERPRISE LTD
- 25 CHARLESTON TRAVEL LTD
- 26 SPICE WORLD LTD
- 27 MASTER POWER SYSTEMS LTD
- 28 SOFTWARE TECHNOLOGIES LTD
- 29 KENBRO INDUSTRIES LTD
- 30 SKYLARK CREATIVE PRODUCTS LTD
- 31 GANATRA PLANT & EQUIPMENT LTD
- 32 SECURITY WORLD TECHNOLOGY LTD
- 33 SPECIALIZED ALUMINIUM RENOVATORS LIMITED
- 34 WINES OF THE WORLD LTD
- 35 VIRGIN TOURS LTD
- 36 ARAMEX KENYA LTD
- 37 CANON ALUMINIUM FAB LTD
- 38 PANESAR'S KENYA LTD
- 39 TYRE MASTERS LTD
- 40 LANTECH AFRICA LTD
- 41 WARREN ENTERPRISE LTD
- 42 AFRICA TEA BROKERS LTD
- 43 MERIDIAN HOLDINGS LTD
- 44 DUNE PACKAGING LTD

- 45 THE PHOENIX LTD
- 46 FAIRVIEW HOTEL LTD
- 47 SPECICOM TECHNOLOGIES LTD
- 48 PUNSANI ELECTRICALS & INDUSTRIAL HARDWARE LTD
- 49 BISELECT (K) LTD
- 50 VICTORIA FURNITURES LTD
- 51 GINA DIN CORPORATE COMM
- 52 AMAR HARDWARE LTD
- 53 MELVIN MARSH INTERNATIONAL
- 54 LANOR INTERNATIONAL LTD
- 55 SYNERMED PHARMACEUTICALS (K) LTD
- 56 SAHAJANAND ENTERPRISES LTD
- 57 VEHICLE & EQUIPMENT LEASING LTD
- 58 SILVERBIRD TRAVELPLUS
- 59 WAUMINI INSURANCE BROKERS LTD
- 60 KENAPEN INDUSTRIES LTD
- 61 HARDWARE AND WELDING SUPPLIES
- 62 ISOLUTIONS ASSOCIATES
- 63 MOMBASA CANVAS LTD
- 64 EAST AFRICA CANVAS CO
- 65 TOTAL SOLUTIONS LTD
- 66 PRINT FAST (K) LTD
- 67 OPTIWARE COMMUNICATIONS LTD

- 68 DEEPA INDUSTRIES LTD
- 69 ENDEAVOUR AFRICA LTD
- 70 TRAVEL SHOPPE CO LTD
- 71 KEMA (E.A) LTD
- 72 AMAR DISTRIBUTORS LTD
- 73 PWANI CELLULAR SERVICES
- 74 SHEFFIELD STEEL SYTEMS LTD
- 75 GENERAL ALUMINIUM
- 76 CREATIVE EDGE LTD
- 77 BROLLO KENYA LTD
- 78 TRIDENT PLUMBERS LIMITED
- 79 PHYSICAL THERAPY SERVICES LTD
- 80 PRAFUL CHANDRA & BROTHERS LTD
- 81 DHARAMSHI LAKHAMSHI & CO / Dalco Kenya
- 82 MADHUPAPER KENYA LTD
- 83 UNION LOGISTICS LTD
- 84 OIL SEALS AND BEARING CENTRE LTD
- 85 SKYLARK CONSTRUCTION LTD
- 86 BIODEAL LABORATORIES LTD
- 87 WARREN CONCRETE LTD
- 88 RONGAI WORKSHOP & TRANSPORT
- 89 COMPLAST INDUSTRIES LTD
- 90 KINPASH ENTERPRISES LTD

- 91 SIGHT AND SOUND COMPUTERS LTD
- 92 DE RUITER EAST AFRICA LTD
- 93 ACE AUTOCENTRE LTD
- 94 KENYA SUITCASE MFG LTD
- 95 HEBATULLAH BROTHERS LTD
- 96 MARKET POWER INT. LTD
- 97 NIVAS LTD
- 98 SIGMA SUPPLIERS LTD
- 99 IMPALA GLASS INDUSTRIES LTD
- 100 EGGEN JOINEX LTD

Source: *KPMG East Africa and the Nation Media Group*

Appendix II: SPSS Data Summary

Year/Variables	Beta Co-efficient	Sign. (P Value)
Year 2008		
(Constant)	4.568	0.000
Credit rating	0.453	0.000
Marketing/distribution networks	0.187	0.041
Technical expertise	0.148	0.008
Management expertise	0.035	0.423
Year 2009		
(Constant)	3.441	0.000
Credit rating	0.386	0.000
Marketing/distribution networks	0.142	0.046
Technical expertise	0.215	0.041
Management expertise	0.374	0.015
Year 2010		
(Constant)	3.116	0.002
Credit rating	0.014	0.113
Marketing/distribution networks	0.497	0.035
Technical expertise	0.355	0.018
Management expertise	0.232	0.003
Year 2011		
(Constant)	2.438	0.000
Credit rating	0.213	0.157
Marketing/distribution networks	0.319	0.000
Technical expertise	0.164	0.005
Management expertise	0.226	0.001

Year 2012		
(Constant)	0.324	0.005
Credit rating	0.037	0.132
Marketing/distribution networks	0.114	0.000
Technical expertise	0.582	0.012
Management expertise	0.232	0.001
