

**EFFECTS OF ACCESS TO VENTURE CAPITAL ON FINANCIAL  
PERFORMANCE OF SMALL AND MEDIUM SIZED  
ENTERPRISES IN MOMBASA COUNTY**

**HASSAN MOHAMED**

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## **DECLARATION**

This project report is my original work and has not been presented for any degree in any other university.

Signed.....Date.....

HASSAN MOHAMED

D61/64649/2011

This project report has been submitted for examination with my approval as University Supervisor.

Dr. Fredrick Ogilo

Lecturer, Department of Finance and Accounting

School of Business, University of Nairobi

Signed..... Date.....

## **DEDICATION**

To my family for the special part they occupy in my life and for the support they accorded me during the entire period of study.

## **ACKNOWLEDGEMENT**

Foremost gratitude to the Almighty God for seeing me through this part of the academic journey and all the challenges it presented. Am grateful to all those who supported me during this course especially the MBA lecturers at the Mombasa Campus and fellow students, thank you for your contribution and cooperation. Sincere thanks to my supervisor Dr. Fredrick Ogilo for his guidance and contributions that helped make this project a success.

## ABSTRACT

The objective of this study was to establish the effect of access to venture capital on the financial performance of small and medium sized enterprises in Mombasa County. The study also sought to establish the effect of age and size of the small and medium sized enterprises as well as the gender and level of education of the managers on financial performance. The study employed a descriptive research design. The target population was the 100 small and medium sized enterprises in Mombasa County for the year 2013. Purposive sampling was used to select the sample of study by which a sample of 40 small and medium sized enterprises was selected. The study made use of primary data which was collected by the use of a questionnaire. Descriptive analysis was used to describe the data collected using percentages while regression analysis was used to examine the effect of access to venture capital, age of the business, size of the business, gender of the business manager and manager's education level on returns on assets. The regression model was evaluated using the coefficient of determination  $R^2$  while the overall significance of the regression results was tested using F statistic at a 5% level of significance. The significance of the independent variables was tested using t-test at 5% significance level. It was found that 20 of the 32 respondents representing 62.5% had access to venture capital financing. The result of regression analysis indicated that access to venture capital had a positive effect on return on assets. The result of t-test indicated that the effect was not significant at the 5% level. The age of the business was found to have a negative effect on returns on assets but the result of t-test indicated that the effect was not significant. Size of the business was found to have a positive but insignificant effect on return on assets. Gender of the business manager had a negative effect on return on asset; however the t-test indicated that the effect was not significant. Education level of the manager was found to have a positive effect which was also found to be insignificant after conducting a t-test. The regression model had a coefficient of determination  $R^2$  of 16.2%. This indicated that the independent variables explained 16.2% of the variation in return on assets. The F-test for the significance of overall regression indicated that the regression was not significant at 5% level. The study concluded that access to venture capital had a positive but statistically insignificant effect of financial performance. It also concluded that size of the business and education level of the manager had positive though insignificant effect on financial performance while age of the business and gender of the manager had a negative but statistically insignificant effect on financial performance. The study recommends that since access to venture capital had a positive effect on financial performance entrepreneurs may expect that funding their business with venture capital fund will have a positive but not statistically significant effect on financial performance.

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## **LIST OF ABBREVIATIONS**

ANOVA	Analysis of Variances
GDP	Gross Domestic Product
MM	Modigliani and Miller
NVCF	Non-Venture Capital Financing
OLS	Ordinary Least Squares
POT	Pecking Order Theory
ROA	Return on Assets
SME	Small and Medium-sized Enterprises
SPSS	Statistical Package for the Social Sciences
V-C	Venture Capital
VCF	Venture Capital Financing
R&D	Research and Development



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## **CHAPTER ONE: INTRODUCTION**

### **1.1 Background of the Study**

Small and medium-sized enterprises (SMEs) are the backbone of all economies and are a key source of economic growth, dynamism and flexibility in emerging and developing economies. SMEs form a large proportion of the firm tissue in Kenya. One of the most important problems confronting SMEs concerns the issue of financing (Wanjohi, 2012). 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 (Wanjohi, 2012).

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.

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. Acacia Fund Limited provides risk capital to newer expanding enterprises, including the reorganization, rationalization and reconstruction. Aureos East Africa provides private equity and loan facilities and has replaced the activities of Acacia (Mwarari2013). Kenya Management Company Limited provides equity related investments in private sector to companies with high growth potential to expand well-run businesses.

In Mombasa 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 Nixson, 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. Thus the study is geared towards establishing the effects of venture capital on SME's performance and shall use the case of Mombasa County.

### **1.1.1 Venture Capital**

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 (Amissah, 2009).

As SMEs seek to grow, and given the role they play in economic growth of various countries, venture capital financing research has been growing as people look for alternative ways of financing businesses (Alperovych & Hubner, 2013). According to King (2008) venture capital firms operate in a rapidly changing environment. Normally, venture capitalists are looking for features such as competent management, competitive edge, growth potential, a viable exit strategy and other intangible factors (Smart, Meggison, & Gitman, 2004).

Theoretically, it has been established by Smolarski and Can (2011) that venture capital financing has a positive influence on SMEs in terms of their performance either in growth or financial performance. Smolarski and Can (2011) examined the impact of venture capital financing method on SME performance and found that type of equity-based venture capital financing affect performance and internationalization. Specifically, the study found that staged financing and financing through a syndicate has a positive effect on performance when used separately while a negative effect was observed when syndication and staged financing were used in combination. In Belgium, Alperovych and Hubner(2013) investigated the impact of incremental venture capital financing on 990 V-C backed SMEs and revealed that the presence of venture capital in SME's equity had a marginal effect on the operating cycle efficiency. These results point to the fact that venture capital has an impact on performance of SMEs but the results have been mixed while some of the methodologies flawed.

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 & Strömberg, 2001). This, in turn, should eliminate the possibility to access to 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 & 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.

According to Hellmann and Puri (2002) 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 capitalists help and adding-value are decanted in professionalization of 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.

Besides many features provided by the venture capitalist discussed above, venture capital has one more important attribute: providing credibility, it attracts new funding. Baeyens and Manigart (2003) explain 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.

### **1.1.2 SME Performance**

Performance according to Hornby (2000) is described as an action or achievement considered in relation to how successful it is. Performances are variously measured and the perspective are tied together and consistently monitored from the organization context (Jamil and Mohamed 2012+). Looking from the Hornby (2000) definition, it can be reasonably concluded that performance is synonymous to success. What connotes performance varies from one organization to another.

Prior to 1980s, financial indicators were the sole measurement rod of performance such as: profit, return on investment, sales per employees and productivity. Short after 1980s till date, attentions have been shifted from financial to less tangible and non-financial measure. This include: Just in-time delivery (JITD) total quality management (TQM), Communication, trust, stakeholder satisfaction, competitive position and quality of product Saad and Patel (2006) and Rosli (2011).

Garrigos-Simon, Marques and Narangajavana (2005) also categorised performance measurement into four, namely: (1) Profit which include: return on assets, return on investment and return on sales (2) Growth in term of: sales, market share and wealth creation (3) Stakeholder satisfaction which include customer satisfaction and

employees satisfaction and (4) competitive position which include: overall competitive position and success rate in launching new product. The research study was based on competitive strategies and performance in Spanish hospitality firms. The finding shows that there is no consensus agreement as to how performance should be measured in all organization.

According to Komppula, (2004), performance of small enterprises was viewed as their ability to contribute to job and wealth creation through enterprises start-up, survival and growth. The research study was focused on Success factors in small and micro enterprises. The results of the study show that there are no statistically significant differences in the views held by slowly or fast growing enterprises regarding the importance of the success factors. The same factors are considered important and less important in both slowly and fast growing enterprises in each branch of industry. Arising from the findings, it shows that the effectiveness of a particular factor on a business hang on the support of other determinant factors.

### **1.1.3 Venture Capital and Performance of SMEs**

Venture capital funds generally seek out investments that are intermediate term, equity-related investments, target technology-based private firms, and invest in those rare firms that have the potential of going public or being acquired at a premium within a few years (Gompers & Lerner, 2001). This involves helping firms develop compensation and human resources policies; hiring key executives, such as the marketing president; and intervening to replace poorly-performing managers early enough to promote effective change. Although informal venture capital provides a different perspective in terms of sector coverage and degree of risks absorption, Shepherd and Zaccarakis (2002) stress that the trend towards concentration of venture

capital under the control of a few firms is increasing. Thus, it is possible to find a situation where a venture capital firm has a controlling stake in some SMEs.

According to Manigart et al. (2002) 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. 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.

#### **1.1.4 Mombasa County**

One of the key challenges facing SMEs in Mombasa is poor government policies that fail to offer adequate support towards the small and medium enterprises. Small and medium enterprises in Kenya face a number of challenges such as lack of markets, lack of skilled staff, lack of growth potential and financing challenges. Financing challenges are the biggest as they affect expansion plans of SMEs and therefore performance in several financial and non-financial aspects.

Lack of access to credit is almost universally indicated as a key problem for SME's. This affects technology choice by limiting the number of alternatives that can be considered. Many SME's may use an inappropriate technology because it is the only one they can afford. In some cases, even where credit is available, the entrepreneur may lack freedom of choice because the lending conditions may force the purchase of



heavy, immovable equipment that can serve as collateral for the loan (Wanjohi, 2012).

The biggest problem to the growth of SMEs has been financing as commercial banks shy away from financing them. This financing gap has been recommended by other scholars as one that can be addressed by venture capitalists. But Bergquist and Dahg (2007) found that the financing gap is still a reality as SMEs are not confident or experienced enough to approach venture capitalists nor are they willing to let go of control of their firms. This was noted by Afua (2011) who found in a study in Ghana that SMEs prefer self-financing and had little or no knowledge about venture capital financing as an alternative to financing. This poses a challenge as to how venture capital should be approached as a recommendation for bridging the financing gap in Kenya.

## **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.

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. The size and credit demand of SMEs also have outgrown the capacity of microfinance institutions, which offer

small, short loans 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. Gakure, and Karanja (2012) examined the impact of venture capital on growth of SMEs in Kenya and found that venture capital financing led to improved growth of firms. Gikomo (2013) noted that there was a positive and significant relationship between growth of SMEs and venture capital financing. Out of all the studies reviewed, these two have expressly examined venture financing of SMEs in Kenya but they suffer from design flaws, however none of researchers looked at the effect of venture capital on the financial performance of SMEs in Mombasa county. It is against this background therefore

that the researcher sought to investigate; what are the effects of venture capital financing on the financial performance SMEs Mombasa County?

### **1.3 Research Objective**

To establish the effect of venture capital on the financial performance of small and medium sized enterprises in Mombasa County.

### **1.4 Value of the Study**

This study will add on to the growing theory on how venture financing affects SME performance especially using data from Kenya and Mombasa County in particular. This is important as it brings in the perspective from an African emerging economy.

This study will also prove helpful to existing and potential entrepreneur of SMEs since this study lends assistance in the effect of venture financing in the performance of a business in order to plan ahead. By exploring the impacts of venture capital on SMEs, the study will enable one carry out scenario analysis before considering VC as a source of financing.

The policy makers especially the government agencies responsible for policy formulation in the SME sector will find this study a valuable source of information as the policy recommendations can be used to enhance SME financing in Kenya. Initiatives such as Uwezo Fund and Youth Fund can benefit from the findings of this research. The research work could also serve as a source of future reference to future researchers who may find it helpful in carrying out a research work of similar nature or related topic.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.1 Introduction**

This chapter reviewed the literature of interest on the topic. First, theories related to venture capital financing are reviewed. This was followed by a review of empirical literature on the impact of venture capital financing and SME performance. Finally, a summary of literature and the research gap therefore was given.

### **2.2 Theoretical Review**

This section reviewed two theories that are specifically related to the issue of venture capital financing for SMEs. The theories reviewed are the pecking order theory and the entrepreneurial theory.

#### **2.2.1 The Static Trade-off Theory**

According to trade-off theory, optimal capital structure could be determined by balancing the different benefits and costs associated with debt financing. Debt benefits include tax shields (saving) induced by the deductibility of interest expenses from pre-tax income of the firm. Modigliani and Miller (1963) argued for a reduction of agency costs through the threat of liquidation which causes personal losses to managers' salaries, reputation and through the need to generate cash flow for interest payment. High leverage can also enhance the firm's performance by mitigating conflicts between shareholders and managers concerning the free cash flow Jensen (1986) optimal investment strategy Myers (1977) the amount of risk to be undertaken (Jensen and Meckling, 1976). Thus, according to trade-off theory more profitable firms have higher income to shield and thus should borrow more to take tax advantages.

Consequently, a positive relationship could be expected between debt level and firm's performance. Bankruptcy, financial distress costs and agency costs constitute the basics of the trade-off theory. The trade-off theory states that firms borrow up to the point where the tax savings from an extra dollar in debt are exactly equal to the costs that come from the increased probability of financial distress. Under the trade-off theory framework, a firm is viewed as setting a target debt to equity ratio and gradually moving toward it which indicates that some form of optimal capital structure exist that can maximize the firm value. The trade-off theory has strong practical appeal. It rationalizes moderate debt ratios. It is also consistent with certain obvious facts, for instance, companies with relatively safe tangible assets tend to borrow more than companies with risky intangible assets.

### **2.2.2 M & M Irrelevance proposition**

The modern theory of capital structure was developed by Modigliani and Miller (1958). They proved that the choice between debt and equity financing has no material effects on the firm value, therefore, management of a firm should stop worrying about the proportion of debt and equity securities because in perfect capital markets any combination of debt and equity securities is as good as another. However, Modigliani and Miller's debt irrelevance theorem is based on restrictive assumptions which do not hold in reality, when these assumptions are removed then choice of capital structure becomes an important value-determining factor. For instance, considering taxes in their analysis Modigliani and Miller (1963) proposed that firms should use as much debt as possible due to tax-deductible interest payments. Moreover, the value of a levered firm exceeds that of an unlevered firm by an amount equal to the present value of the tax savings that arise from the use of debt.

Miller (1977) presented an alternative theory by incorporating three different tax rates in his analysis (corporate tax rate, personal tax rate on equity income, and the regular personal tax rate which applies to interest income). Miller (1977) proposed that net tax savings from corporate borrowings can be zero when personal as well as corporate taxes are considered. Since interest income is not taxed at the corporate level but taxed at the personal level, whereas equity income is taxed at the corporate level but may largely escape personal taxes when it comes in the form of capital gains. So the effective personal tax rate on equity income is usually less than the regular personal tax rate on interest income. This factor reduces the advantage of debt financing. In Miller's analysis, the supply of corporate debt expands as long as the corporate tax rate exceeds the personal tax rate of investors absorbing the increased supply. The level of supply which equates these two tax rates establishes an optimal debt ratio.

In contrast to the tax benefits on the use of debt finance De Angelo and Masulis (1980) proposed that companies have ways other than the interest on debt to shelter income such as depreciation, investment tax credits, tax loss carry forwards, etc. The benefit of tax shields on interest payments encourages firms to take on more debt, but also increases the probability that earnings in some years may not be sufficient to offset all tax deductions. Therefore, some of them may be redundant including the tax deductibility of interest payments. So firms with large non-debt tax shields relative to their expected cash flow include less debt in their capital structure. This view suggests that non-debt tax shields are the substitute of the tax shields on debt finance, and therefore, the relationship between non-debt tax shields and leverage should be negative.

Although the benefit of tax shields may encourage the firms to employ more debt than other external sources available to them, this mode of finance is not free from costs. Two potential costs, namely, the bankruptcy costs and the agency costs are associated with this source of finance. Bankruptcy is merely a legal mechanism allowing the creditors to take over when the decline in the value of assets triggers a default. Thus, bankruptcy costs are the costs of using this mechanism. The costs of bankruptcy discussed in the literature are of two kinds: direct and indirect. Direct costs include fees of lawyers and accountants, other professional fees, the value of the managerial time spent in administering the bankruptcy. Indirect costs include lost sales, lost profits, and possibly the inability of a firm to obtain credit or to issue securities except under especially unfavourable terms. While analyzing the data of 11 railroad bankruptcies which occurred between 1930 and 1955, Warner (1977) observed that the ratio of direct bankruptcy costs to the market value of the firm appeared to fall as the value of the firm increased. The cost of bankruptcy is on the average about 1 percent of the market value of the firm prior to bankruptcy. Furthermore, direct costs of bankruptcy, such as legal fees, seem to decrease as a function of the size of the bankrupt firm. Thus, these findings suggest that direct bankruptcy costs are less important for capital structure decisions of large firms.

In order to investigate the impact of both direct and indirect bankruptcy costs, Altman (1984) collected the data related to retail and industrial firms' failure in the USA. Altman observed that bankruptcy costs are not trivial. In many cases, bankruptcy costs exceeded 20 percent of the value of the firm measured just before the bankruptcy and even in some cases measured several years before. On average, bankruptcy costs ranged from 11 to 17 percent of the firm value up to three years before the bankruptcy. Moreover, bankruptcy gobbles up a larger fraction of the

assets' value for small companies than for large ones. These findings suggest that the financial distress costs differ with respect to the size of the firm and are relevant in determining the capital structure of the firm.

### **2.2.3 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 (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.

The 'pecking order' model of firm financing is one method firms might use to address 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). In the case of the small firm or entrepreneurs, 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 & 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 behaviour by entrepreneurs (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 et al. (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.

The relevance of this theory is that it shows the level at which entrepreneurs would decide to use venture capital financing. As outlined above, entrepreneurs will not always consider venture capital financing as a first priority unless other sources especially personal finance are exhausted.

#### **2.2.4 Entrepreneurship Theory**

Cantillon (1755) while seeking to understand the very nature of commerce, wrote his seminal work on the entrepreneur as a person willing to take risks and able to manage uncertainty. 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 & 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 & Busenitz, 2001).

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 pro-activeness (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 (Miller, 1983).

This theory is relevant to the present study as it shows that one of the motivations for additional financing in an SME is expansion of operations of an SME. Thus, venture capital financing can be used as a source of financing to expand the activities of an SME.

## **2.3 Determinants of SMEs Performance**

There are a number of factors that have been shown to influence performance of SMEs. These include firm characteristics such as size and age, location of SMEs, external factors, and entrepreneur competencies. Below is a review of these factors.

### **2.3.1 Firm Characteristics**

Firm characteristics are defined as firm personalities or attributes that tend to describe a firm or tell us about the firm. Three major areas, the nature of firm, firm knowledge, and firm size, represent firm characteristics (Lucky, 2011). As micro or small

businesses owners are the heads of their particular enterprises, having a good understanding of the firm's nature, firm size and firm knowledge is very imperative for them to manage their firms effectively (Lucky and Minai, 2011).

Nature of firm could mean type of firm (e.g. marketing firm, service, advertising firm, etc) or the business the firm is into (Lucky, 2012). As to firm knowledge, it can be defined as owner's adequate knowledge in terms of customers, suppliers, employees and other stakeholders of the firm in order to effectively manage the business (Lucky, 2012). Firm size as defined by Lucky (2012) means either small, medium, or large or the sector the firm belongs to or conducts its business.

The most widely used measurement tool for firm size, number of workers, is applied to this present study. According to Kimberley (1967) and Child (1973), more than 80 percent of academic researchers used number of employees in measuring firm size. Size affects a firm's marketing capabilities, attitudes, needs, practices etc which are important determinants of firms' performance and success (Dean et al., 2000). However, the association between firm size, which is one of the elements of firm's characteristics and entrepreneurial performance, is a debate in the field of research.

### **2.3.2 Entrepreneurial Competencies**

As Hoffmann (1999) noticed, there are numerous definitions of entrepreneurial competencies. Bird (1995), for example, defined entrepreneurial competencies as fundamental characteristics, namely traits, self-image, motives, social roles, skills and knowledge that drive the growth of the organization. This is in line with Kiggundu's (2002) definition of entrepreneurial competencies as "the total sum of entrepreneurs' attributes such as attitudes, beliefs, knowledge, skills, abilities, personality, expertise

and behavioural tendencies needed for successful and sustaining entrepreneurship”. Entrepreneurial competencies also involve self-image, motives, entrepreneurial traits, behaviour, skills, attitude and knowledge (Boyatzis (1982). Baum et al. (2001) defined entrepreneurial competencies as “individual characteristics such as knowledge, skills, and/or abilities required to perform a specific job.” Man and Lau (2005) argued that entrepreneurial competencies can basically be divided into two parts. The first part includes the elements relating to the entrepreneur’s background such as traits, personality, attitudes, self image, and social roles. And the second part involves the components which can normally be learned from theory and practice like skills, experience and knowledge.

Entrepreneurial competencies can also be defined as the abilities of an entrepreneur to perform the successful entrepreneurship or business success. Iandoli (2007) defined entrepreneurial competencies as the capability of entrepreneurs to face effectively a critical situation by making sense of environmental constraints and by activating relational and internal specific resources.

Boyatzis (1982) argued that entrepreneurial competencies are strongly associated with managerial competencies. Competencies in this research are defined as the total capability of the entrepreneur to perform a job role successfully (Lau et al., 1998). Man and Lau (2000) have classified entrepreneurial competencies into six major areas: opportunity competencies, organizing competencies, strategic competencies, relationship competencies, conceptual competencies and commitment competencies.

Opportunity competencies are one of the most distinguishing competencies for the entrepreneur. Seeking and taking action on opportunities is a critical competency for successful entrepreneurs (McClelland, 1987). The ability to recognize and envision

taking advantage of opportunities is really crucial for successful entrepreneurs (Chandler and Jansen, 1992). It includes two main parts which are spotting the opportunities and developing the opportunities.

Relationship competencies relate to communication skills and person-to-person and individual-to-group interactions. According to Man et al. (2002), this group of competencies consists of cooperation and trust building, using business networks effectively. Persuasive ability and interpersonal skills are key concepts (McClelland, 1987; and Lau et al., 2000). Research shows that the success of a small firm depends mainly on the networks of business (Ramsden and Bennett, 2005; Ritter and Gemunden, 2004). The effective usage of contacts and networks is also important for both inside and outside of the firm.

Conceptual competencies involve abilities such as cognitive, analytical thinking, learning, decision making, problem solving, sustaining temporal tension, innovating, coping with uncertainty and risk (McClelland, 1987; Bird, 1995). Conceptual competencies can be defined as a high level of conceptual activities in relation to entrepreneur's behaviours such as a shorter-term perspective, resolving instant events, or requiring intuitive responses (Man et al., 2002).

The concept of organizing competencies somehow overlaps with that of managerial competencies as both involve ability to lead, control, monitor, organize, and develop the external and internal resources to ensure the firm's capabilities (Boyatzis, 1982). McClelland (1987) argued that to be able to keep an efficient firm operating, monitoring should be a required competencies in managing various functional areas.

Strategic Competencies relates to setting a direction for the whole firm. This is a major responsibility for every entrepreneur or business owner. These competencies are imperative for entrepreneurs to be able to set objectives for their firms from a broader and long term perspective. Strategic competencies include setting a vision, mission, goals, objectives, and strategies. Implementation and evaluation are components of strategic competencies. These actions are generally taken and implemented by entrepreneurs, owner/managers for the purpose of firm's sustainable growth (McClelland's, 1987).

The basic characteristics of successful entrepreneurs are diligence, commitment, determination, dedication, initiative and proactive orientation (Chandler and Jansen, 1992; McClelland, 1987). As a whole, commitment competencies are the elements which force the entrepreneur to move ahead with the business.

### **2.3.3 External Factors**

Mohd (2005) defined external factors as the determinants which contribute to the success or failure of entrepreneurial firms or entrepreneurs themselves. Simply put, external environmental factors are the outside factors affecting the performance of the business enterprises. External factors have a strong impact on entrepreneurial competencies and performance (Arowomole, 2000; Kuratko and Hodgetts, 2004). The situations faced by entrepreneurs in any economy can generally be defined as the external environment (Aldrich et al., 1999). The survival and growth of a firm and the likelihood of additional venture start-ups rely on the external environment (Colvin and Slevin, 1989). The external environment has been widely recognized as a critical component contributing to a firm performance. The personality, attitudes and

motivation of the entrepreneurs are also dependent on the environment (Gartner, 1985).

In a competitive and turbulent environment, external factors are commonly accepted as the determinants of firm performance and survival. Van de Ven (1993) suggested that every research in the field of entrepreneurship should take account of the external circumstances to be able to explain the entrepreneurial process in a more appropriate way. Kuratko and Hodgetts (2004) also argued that entrepreneurial decisions are primarily influenced in direct or indirect ways by external factors and consequently affect performance. According to Kader et al. (2009), it is unfeasible to fully cover the multiple dimensions of external factors in a single study. In order to ensure a fruitful outcome, it is really crucial to stick to a few dimensions such as the economic and environmental components rather than group everything into one single factor. Therefore, in this study, the researcher concentrates on the economic and environmental factors, which are only two of the many external factors mentioned in previous studies.

#### **2.3.4 Location**

Orloff (2002) defined location as economic situation, density of entrepreneur's per capita, composition of local communities etc. Possibly the strategic location is the most important factor of entrepreneurship. Small business development of the business may involve availability of raw material, accessibility to business premises, good road network, busyness of the area of the business etc (Ilian and Yasuo, 2005; Kala et al., 2010; Yancy and Christian, 2010). Thus, location can be described as nearness and accessibility of the firm to raw materials, infrastructures, busyness of the location and accessibility of location for the customers.



Kala et al., (2010) defined location as the choice of where a business is to be located (small, medium and large cities or urban or rural locations). Location has been widely recognized as an indispensable component in shaping and determining the success, failure and effectiveness of business activities and entrepreneurship (Lucky, 2011). Strategic location is very important for firms, policy makers and entrepreneurs or business owners due to the key role it plays in strengthening the effectiveness of the firms (Lucky and Minai, 2011). According to Greening, Barringer, and Macy (1996), although most studies neglect the important role of location, it is undoubtedly the crucial factor impacting firm performance.

## **2.4 Empirical Review**

Gans and Stern (2003) evaluated whether the relative concentration of funding for small, research-oriented firms in a small number of high-tech industries is related to the differences across industries in the level of appropriability or capital constraints facing small firms. To do so, the study exploited a novel test based on the relationship between industry-level private venture financing and the performance of government-subsidized R&D projects in those sectors. The study found that venture capital financing strongly impinge on firm's innovation, patenting processes and the influx of technological opportunities. The study concludes that industrial sectors differ in the degree of appropriability for research-oriented small businesses and that variation in the appropriability regime helps explain the concentrated nature of venture capital activity in the economy.

Peneder (2010) tested the impact of venture capital financing on corporate performance by applying a two-stage propensity score matching on Austrian micro-data. Controlling for differences in industry, location, legal status, size, age, credit

rating, export and innovation behaviour, the findings (i) assert the financing function of venture capital, showing that recipients lacked access to satisfactory alternative sources of capital; (ii) identify a positive selection effect, because venture capital is invested in firms with high performance potential; and finally (iii) confirm the presumed value adding function in terms of a genuine causal impact on firm growth, yet not on innovation output.

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. They argue that venture capitalists invest only in promising projects. At the very beginning, investors are deeply sceptical, bad mood reasoning with more answers 'no', rather than 'yes'.

Memba, Gakure, and Karanja (2012) examined the impact of venture capital on growth of SMEs in Kenya and found that venture capital financing led to improved growth of firms. The study sampled 100 SMEs using random sampling method and collected primary data using semi-structured questionnaires. The analysis was done using descriptive analysis and concluded that SME that use venture capital experience improved growth and thus more SMEs should be encouraged to use this form of finance if the country has to achieve its vision 2030. This study used a before-after analysis to conclude the results using data collected from firms that had venture capital financing. While the before-after analysis was used in providing evidence of differences between the growth of SMEs before and after venture capital financing, the researchers made no attempt to examine whether these differences were indeed

statistically significant through an analysis of variance. Thus, while these differences were observed, they cannot be said to be statistically significant and neither can the differences be attributed to venture capital financing.

In a recent study on the effect of venture capital financing on SMEs in Kenya, Gikomo (2013) noted that there was a positive and significant relationship between growth of SMEs and venture capital financing. The study had targeted top 100 SMEs and sampled out 30 firms using purposive sampling method. Secondary data from 2008 – 2012 was collected from their financial statements and analysed using both descriptive and regression analysis. While the study was important in examining the role of venture capital financing on SME growth in Kenya, the sample selected was flawed. The researcher selected only those firms that had received venture capital financing. What the study therefore addressed was not the impact of venture capital financing on growth but the impact of venture capital financing differential on the growth of SMEs. It is therefore not clear whether firms with venture capital financing are out-performing those without it or vice versa.

## **2.4 Summary of Literature Review**

This chapter has reviewed theories related to venture capital financing. Two theories have been specifically reviewed, pecking order theory and entrepreneurship theory. The pecking order theory claims that firms and individuals will use personal funds before acquiring external debt and equity. The entrepreneurship theory contends that entrepreneurs are important for economic growth of any country and therefore financing is necessary to help SMEs set up and expand their operations, develop new products, and invest in new staff or production facilities.

A review of empirical studies on venture capital financing and performance of SMEs was also done. The review is predominantly based on studies done outside Kenya and this confirms the lack of attention by scholars in Kenya on venture financing as a source of financing for SMEs in Kenya. From the review, it can be noted that there are inconsistencies in how venture capital financing affects performance of SMEs. Further, some of the methodologies used are not clear in providing useful information on how venture capital financing affects performance. The present study therefore seeks to bridge the inconsistencies in literature.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 Introduction**

This chapter presented the research design, population of the study, sampling procedure and size, data collection process and data analysis.

### **3.2 Research Design**

Descriptive research design was used since this study sought to provide further insights into the research problem. The descriptive research collects data in order to answer questions concerning the current status of the subject under study (Mugenda and Mugenda, 2010). A descriptive research is defined as a research that describes the characteristics of a population or phenomena (Zikmund, 2003). Such studies aim at answering who, what, when, and where questions (Coldwell and Herbst, 2004). Descriptive research design was chosen because it enabled the researcher to generalise the findings to a larger population. Descriptive design method provides quantitative data from cross section of the chosen population.

### **3.3 Population**

The target population for this study was the 100 SMEs (2013) in Mombasa County. Muhoro et al (2013) noted that there were over 100 SMEs operating in Mombasa County and therefore this forms the basis of the study's targeted population.

### **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 50% sample of the target population in each stratum. The final sample was selected using purposive sampling on each stratum. The sample size consisted of 40 small and medium sized enterprises.

### 3.5 Data Collection

Primary data was collected in this study. This was done using structured questionnaires. The questionnaires were administered to SME owners/managers in Mombasa County. Enumerators were trained to aid in the questionnaire administration. In some cases, drop and pick method was used to administer the questionnaire. The questionnaire had bio-data of respondents, venture capital financing, and performance of SMEs. These variables are explained in Table 1 below. The instrument was checked for validity and reliability using Cronbach's alpha method.

### 3.6 Data analysis

The analysis was done using descriptive and regression analysis. Descriptive analysis was done using percentages to describe the data. To examine the effect of access to venture capital on financial performance, a regression analysis was done using the following model:

$$ROA = a + \beta_1 ACCVCF + \beta_2 BAGE + \beta_3 BSIZE + \beta_4 GDR + \beta_5 EDCL + \varepsilon$$

Where ACCVCF=Access to venture capital funding

BAGE=Business age

BSIZE=Business size

GDR=Gender

EDCL=Education level

$\varepsilon$  =Error term

**Table 1: Operationalization of Variables**

<b>Variable</b>	<b>Measurement</b>
Performance	Return on Assets
Access to Venture Capital	Value of 1 if financed by venture capital, 0 otherwise
Age of Business	Number of years the business has operated
Gender	Value of 1 if business owned/managed by male, 0 otherwise
Education level	0 if secondary, 1 if bachelors degree, 2 if professional
Size of Business	Number of employees in the firm

## CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION

### 4.1 Introduction

This chapter focused on the analysis of the data collected and discussions of the findings. Primary data was collected using a questionnaire. The study targeted 40 small and medium sized enterprises in Mombasa County. Of the sampled companies response was obtained from 32 companies. The data was analyzed using regression analysis and the results are presented in the sections that follow.

### 4.2 Venture Capital Funding

Table 1 below report the respondent who had used venture capital funding at some stage in their businesses.

**Table 1: Venture Capital Funding Frequency**

	Frequency	Percent	Valid Percent	Cumulative Percent
Non venture capital funded	12	37.5	37.5	37.5
Venture capital funded	20	62.5	62.5	100.0
Total	32	100.0	100.0	

Table 1 indicates the frequency of venture capital funding involvement by companies sampled. Of the respondent 20 companies reported to have used venture capital funding. This represented 62.5% of the sampled companies.



### 4.3 Effects of Venture Capital Funding on financial performance

To evaluate the effect of venture capital funding on financial performance venture capital funding activity was regressed against returns on assets. A number of control variables were used namely; size of the business, age of the business, gender of the business manager and the managers level of education. The results are presented hereunder.

**Table 2: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.402 <sup>a</sup>	.162	.000	.3514081

a. Predictors: (Constant), Level of education, Size of business, Gender of business manager, Venture capital funding, Age of the business.

Table 2 provides a summary of the result of regression. The coefficient of determination, R- square for the model was found to be 0.162. This suggested that venture capital funding, business size, level of education, gender of the business manager and age of the business explained 16.2% of the variation in return on assets.

**Table 3: Analysis of Variance**

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	.619	5	.124	1.003	.436 <sup>a</sup>
Residual	3.211	26	.123		
Total	3.830	31			

a. Predictors: (Constant), Level of education , Size of business , Gender of business manager , Venture capital funding, Age of the business

b. Dependent Variable: Return on Assets

Table 3 provides the result from which the overall usefulness of the regression model was evaluated. The F ratio had a value of 1.003 with a significance level of 0.436. Since 0.436 is greater than 0.05, the regression results were not significant at the 5% level of significance.

**Table 4: Regression Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.146	.174		.840	.409
Venture capital funding	.112	.131	.157	.857	.399
Age of the business	-.120	.098	-.402	-1.222	.233
Size of business	.105	.105	.330	1.003	.325
Gender of business manager	-.174	.146	-.217	-1.193	.244
Level of education	.051	.082	.113	.620	.541

a. Dependent Variable: Return assets

Return on assets were regressed against access to venture capital funding, age of the business, size of the business, gender of the business manager and the managers level of education. The regression coefficients are reported in table 1. Access to venture capital funding had a coefficient of 0.112 with a significance level (p-value) of 0.399. The age of the business had a coefficient of -0.120 with a significance level (p-value) of 0.233. Size of the business had a coefficient of 0.105 and a p-value of 0.325.

Gender of the business manager had a coefficient of -0.174 with a significance level of 0.244 while level of education had a coefficient of 0.051 with a significance level of 0.541. The regression model obtained was of the form:

$$ROA=0.146+0.112ACCVCF-0.112BAGE+0.105BSIZE-0.174GDR+0.051EDCL$$

#### **4.4 Interpretation of Results**

This study sought to establish the effect of access to venture capital on financial performance of small and medium sized enterprises in the county of Mombasa. Table 1 indicate that of the respondent 62.5% indicated to have used venture capital funding in their businesses. The result of regression analysis in table 4 indicates that access to venture capital funding had a positive effect on return on assets with a coefficient of 0.112. This result was however not significant at 5% level since its level of significance (p-value) of 0.399 is greater than 0.05. Age of the business was found to have a negative effect on return on assets with a coefficient of -0.122 as reported in table 4. The effect of age was found to be insignificant because it had a p-value of 0.233 which is greater than 0.05. Size of the business had a positive effect with a coefficient of 0.105 and a significance level of 0.325 as indicated in table 4. Since 0.325 is greater than 0.05 the effect of business size had no significant effect on return on assets. In table 4 gender of the business manager was found to have a negative effect on performance with a coefficient of -0.174 and a p-value of 0.244. Since 0.244 is greater than 0.05 the result was not significant at 5% level. The level of education of the business manager was found to have a positive effect on return on assets with a coefficient of 0.051 with a significance level of 0.541, as indicated in table 4. Because 0.541 is greater than 0.05 the effect of the level of education was not significant at 5% level.

The coefficient of determination for the regression model was found to be 0.162 as reported in table 2. This meant that access to venture capital funding, age of the business size of the business, gender of the business manager and level of education of the business manager explained 16.2% of the variations in return on assets. This indicated a low explanatory power of these variables. From table 3 the F statistic had a significance 0.436 indicating that the overall regression model was not statistically significant at the 5% level of significance since 0.436 is greater than 0.05.

## **CHAPTER FIVE: SUMMARY, CONCLUSIONS AND RECOMMENDATIONS**

### **5.1 Introduction**

In this chapter a summary of the findings from the study, conclusions and recommendations are presented. Also areas for further research are suggested.

### **5.2 Summary of Findings**

This study sought to establish the effect of access to venture capital on the financial performance of companies in Mombasa County. It also sought to establish the effect of age of the company, size of the company, gender of the business manager and the managers level of education on financial performance of SME's in the county of Mombasa. Key findings are summarized below.

#### **5.2.1 Effects of Access to Venture Capital on Financial Performance**

The study found that 62.5% of the SME's sampled had access to venture capital funding as reported in table 1. Table 4 indicated that access to venture capital funding had positive effect on return on assets with a coefficient of 0.112 and a significance level of 0.399. This result was found to be statistically insignificant at the 5% level since 0.399 is greater than 0.05.

#### **5.2.2 Effect of Business Age on Financial Performance**

The study found that age of the business had a negative effect on return on assets for the SME's sampled. As reported in table 4 age of the business had a coefficient of -0.012 with a significance level of 0.233. Because 0.233 is greater than 0.05 the effect of business age on return on assets was not statistically significant at a 5% level.

### **5.2.3 Effect of Size on Financial Performance**

As reported in table 4 the size of the company as measured by the number of employees had a positive effect on returns on assets with a coefficient of 0.105 and a significance level of 0.325. This result was found to be statistically insignificant at 5% since 0.325 is greater than 0.05.

### **5.2.4 Effect of Gender of the Business Manager on Financial Performance**

The study found that gender of the business manager had a negative effect on the returns on assets. As reported in table 4 gender had a coefficient of -0.174 and a significance level of 0.244. Since 0.244 is greater than 0.05 the effect was not significant at the 5% level.

### **5.2.5 Effect of Education Level on Financial Performance**

The study found that the level of education of the business manager had a positive effect on return on assets. Table 4 reports that level of education had a coefficient of 0.051 and a significance level of 0.541. Because 0.541 is greater than 0.05, the effect of education level was not significant at 5% level of significance.

The overall regression of return on assets on access to venture capital, size of the business, age of the business, gender of the business manager and level of education had a coefficient of determination of 16.2% as reported in table 2. This meant that the variables explained only 16.2% of the variation in return on assets for the SME's. From table 3 the regression model had an F statistic of 1.003 with a significance level

of 0.436. The result of the regression was not significant at 5% level since 0.436 is greater than 0.05.

### **5.3 Conclusions**

This study sought to determine the effect of access to venture capital on the financial performance of SME's in the Mombasa County. The study concluded that access to venture capital by the SME's had a positive effect on the return on assets. Using a t-test it was found that the effect was not significant at a 5% level.

The study employed age of the company, size of the company, gender of the business manager and manager's level of education as the control variables. The study found that age of the company and gender of the business manager had a negative effect on return on assets. Using a t-test it was found that the effect of the age of the company and the gender of the manager was not statistically significant at the 5% level. Size of the business and education level of the business manager had a positive effect on return on assets. However the result of t-test indicate that the effect of business size and education level was not statistically significant at the 5% level.

### **5.4 Recommendations**

The study recommends that accessing venture capital financing had a positive but statistically insignificant effect on financial performance as measured using return on assets. Existing and potential entrepreneurs may expect that funding their business with venture capital fund will have a positive but not statistically significant effect on financial performance.

## **5.5 Limitations of the Study**

This study was limited because only Small and Medium Sized Enterprises in Mombasa County were considered. Thus other firms with different characteristics which otherwise could provide different results were not considered. Also the study considered whether the SME's had used venture capital funding without considering the proportion of funds that was provided by the venture capital investors.

## **5.6 Suggestion for Further Research**

Further research may seek to establish the effect of the extent of venture capital funding relative to the total funding on financial performance. Also the further research could evaluate the effect of venture capital funding on large enterprises rather than limiting it to small and medium sized enterprises. It would also be necessary to evaluate the effect of venture capital activities on financial performance on enterprises beyond the county of Mombasa.



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## APPENDICES

### Appendix I: Research Questionnaire

I am a postgraduate student at the University of Nairobi. As part of the requirements for the course, I am required to conduct research and develop a research project (report) thus the questionnaire is meant to help me in data collection. Kindly assist me by participating in answering the questions. The information collected will strictly be used for academic purposes. The topic for the project is **EFFECTS OF ACCESS TO VENTURE CAPITAL ON FINANCIAL PERFORMANCE OF SMALL AND MEDIUM SIZED ENTERPRISES IN MOMBASA COUNTY.**

#### **SECTION A: GENERAL INFORMATION**

This questionnaire consists of two sections; kindly answer all the questions by ticking in the appropriate box or filling in the spaces provided.

1. Respondents Gender: Male [ ] Female [ ]

2(a) Name of organization.....

(b) Organization address.....

2. What is the nature of your business? (*Tick appropriately*)

Manufacturing [ ]

Retailing [ ]

Hotel and restaurant [ ]

Other service [ ]

3. How long has the business been in operation

1-5 years [ ] 6-10 years [ ] 11-15 years [ ] 16-20 years [ ] Over 21 years [ ]

4. What is the number of employees in the business?

1-10 employees [ ]

11-30 employees [ ]

31-50 employees [ ]

Over 51 employees [ ]

5. Respondents age bracket (*Tick whichever appropriate*)

18 – 24 Years [ ] 25 - 30 Years [ ]

31 - 34 years [ ] 35 – 40 years [ ]

41 – 44 years [ ] 45 – 50 years [ ]

Over 51 years [ ]

6. What is your education level? (*Tick as applicable*)

Primary [ ] Secondary [ ]

College [ ] Bachelors' degree [ ]

Others-specify.....

## Part II: Venture Capital Financing

State the extent to which you agree or disagree with the following statements

(where 1 = strongly disagree, 2 = disagree, 3 = not sure, 4 = Agree, 5 = strongly agree)

	Statement	1	2	3	4	5
	The firm has at one point and time been financed by an investor					

	The firm is financed by both formal and informal venture capital					
	The investor financed the firm for a period of more than three years					
	There are benefits associated with investor financing relative to bank loans					
	The interest rate charged is lower and the payback period is spread over reasonable time					
	Terms and conditions of the financing are done through private placement					
	The repayment conditions are less stringent relative to commercial banks					
	Investor financing was done through loan					
	The firm seeks investor financing as the last resort during financial distress					
	Investor financing is frequently used by the firm					
	Venture capital is used for both long term and short term					
	The firm uses expansion venture capital					
	<b>Performance</b>					
	Investor financing increased the sales revenue by greater magnitudes					
	Venture financing is mainly used to finance short term assets					
	Return on assets increases with increase in venture capital					

	Value added income increased with venture capital usage					
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