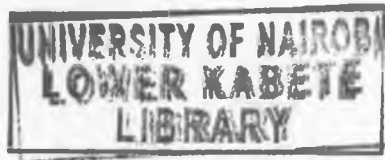


VENTURE CAPITALISTS APPROACH TO STRATEGY AND CORPORATE
GOVERNANCE OF PORTFOLIO COMPANIES: THE CASE OF TBL MIRROR
FUND

By

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A Research Project submitted in partial fulfillment of the requirements for the degree of
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DECLARATION

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

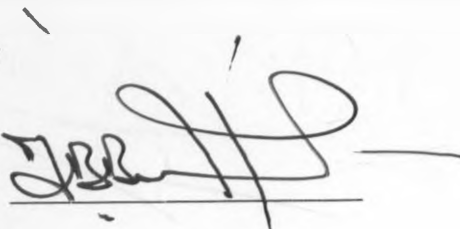
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This research project has been submitted for examination with my approval as the university supervisor

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DEDICATION

I dedicate this thesis to the Managing Partner and Investment Director of TBL Mirror Fund, Mr. Jacco Brink and Ms. Eline Blaauboer, who also happen to be my bosses, for their unyielding support and belief in me.

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I wish to express first my sincere appreciation to God Almighty because without Him this thesis would not be made possible.

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ABBREVIATIONS AND ACRONYMS

ARD - American Research and Development

AVCA - African Venture Capital Association

CEO - Chief Executive Officer

CMA - Capital Markets Authority

EADB - East Africa Development Bank

ESOP - Employee Share Option Pool

IPO - Initial Public Offer

KPIs - Key Performance Indicators

LBO - Leveraged buy outs

SMEs - Small and Medium Enterprises

TBL - The Blue Link

U.S.A - United States of America

ABSTRACT

Venture capital refers to a full range of financial services provided by experienced professionals to new or radically innovative changing firms. The financial services include financing of ventures, providing expertise with business planning, providing industry knowledge, instilling corporate governance and providing guidance to management. The purpose of the study was to examine establish the approach of venture capitalists to the strategy and corporate governance of its portfolio companies. The study sought to determine the influence by the venture capitalist on the strategic direction of its portfolio companies, establish the corporate governance practice which the venture capitalist applies and the impact of these practices on the portfolio companies. The study was on one of the practicing venture capitalists in Kenya, TBL Mirror Fund. Primary data used in the study was collected using interviews which the researcher conducted with the Fund managers of TBL Mirror Fund. The results showed that the studied firm undertakes significant actions towards corporate governance and strategy re-direction of its portfolio companies. The firm assists to strengthen the portfolio companies' governance system through proper due diligence, the appointment of a competent and independent board of directors, an appropriate management incentive program, establishment of a close relationship with management, and periodic management reports. The key to efficient governance is to give the portfolio firms support to focus on operational and strategic issues in the board meetings. Further studies should be carried out to determine whether the different characteristics of different venture capitalists lead to different approaches towards the strategy and corporate governance of their portfolio companies.

CHAPTER ONE: INTRODUCTION

1.1. Background of the study

Venture capital refers to a full range of financial services provided by experienced professionals to a firm for new growing ventures (Kuratko & Hodgets, 1995). It is an alternative form of equity financing either from private investments or public investment funds for enterprises that have high risk and high potential. Venture Capitalists invest in a business through the use of debt and equity instruments in order to gain long term appreciation on their investment. They provide capital for new ventures, development funds to businesses in their early stages of growth and expansion funds to ventures growing rapidly. Venture capitalists also provide assistance and expertise with business planning. They provide the management with industry knowledge and expertise gained from assisting other similar businesses. Venture-backed companies pursue more radical and ambitious product or service innovations than other companies. They seek to help companies grow but eventually exit between three to about seven years (Holt, 1992).

According to Wright and Robbie (1998), there are two types of venture capitalists; informal and formal. Informal venture capitalists are individuals who invest part of their personal wealth in an entrepreneurial venture. Informal venture capitalist markets do not have sufficient communication channels between investors and entrepreneurs. The limited information makes them place more emphasis on agency risk which is the risk of having comparatively limited information about the performance of the company as compared to the entrepreneur and also having conflicting objectives with the entrepreneur.

They lack time flexibility and expertise to perform close monitoring. Formal venture capitalists use stringent contracting and are therefore able to replace underperforming entrepreneurs. Formal venture capitalists take a more active role by carrying out extensive monitoring and giving advisory feedback to the management (Wright & Robbie, 1998).

The complexity of the contracts and the staging of finance by venture capitalists suggest that corporate governance is a crucial component of venture capital. Prior research has examined the governance role of venture capitalists portraying them as active investors who closely monitor and provide strategic and managerial guidance to the businesses in which they invest (Sahlman 1990, Lerner 1995, Hellman and Puri 2002)

Venture capital involves financing of new or radically innovative changing firms which contrast in informational ways to established companies quoted on the stock market (Wright & Robbie, 1998). Radical innovations are revolutionary and their impact is considerably dramatic. They create new markets, change existing markets and stimulate economic growth. Innovation plays a central part in entrepreneurship and is an instrument for competition amongst firms. Revolutionary changes caused by radical innovations have an enormous contribution to economic development (Marvel & Lumpkin, 2007). According to Bottazzi and Rin (2002), business leaders, economists and policy makers have a consensus that the United States of America (USA) vibrant venture capital industry is the main reason it has leadership in the commercialization of technical radical innovations. This indicates strongly that venture capital plays a major role in the financing of radical innovations.

Many dynamic and successful corporations received venture capital in their initial stages these include Microsoft, Apple, Intel, Amazon, Cisco, Sun Microsystems and Netscape. Traces of venture capitalism begun in 1946 when the American Research and Development (ARD) was created. ARD raised funds from college endowments and wealthy individuals. The funds were invested in entrepreneurial start-ups in technology-based manufacturing (Bottazzi & Rin, 2002).

1.1.1 The Concept of Venture Capital

Venture capital in the past has been based on the agency theory. This has raised questions whether this theory can provide a complete base for understanding venture capital and its applications across different environments. The argument raised is that the theory does not provide a full insight on economies outside the developed countries (Mark Mutitu 2009).

The institutional theory which assists to address issues in the international arena is another theoretical foundation that takes into account social and cultural elements which assist in explaining how networks in an institutional context impact on the venture capital function. The institutions provide the rules to be followed in the society (Bruton & Ahlstrom, 2006).

The institution theory is divided in to three force categories, which are normative, cognitive and regulatory. The normative forces assist in defining behaviors and values expected from organizations and individuals'. Cognitive forces shape peoples views on what shouldn't be considered and what is possible in terms of actions.

Regulatory forces include laws and political powers that regulate the actions of organizations and individuals. The formal institutions are represented by regulatory institutions. The regulatory institutions represent standards provided by laws and other sanctions. The standards seek to provide general uniformity amongst the venture capitalists behaviour (Bruton *et al*, 2005).

Venture financing offers provision of capital and managerial experience to assist the innovative firms in their survival. The control and advisory role carried out by the venture capitalists assist the firms in making principal decisions and providing important contacts such as investment bankers, lawyers, consultants and advisors. The innovative firms also benefit from risk sharing with the risk neutral venture capitalists. The development of a viable market for venture capital depends on the existence of exit routes; the exit routes provide the high returns. Venture capitalists normally exit between five to ten years after the investment (Tykvova, 2007).

1.1.2 Venture Capital, Strategy and Corporate Governance

The active role of venture capitalists in portfolio companies has been documented by several studies (e.g., Bottazzi, Da Rin, and Hellmann (2005), Gorman and Sahlman (1989), Lerner (1995)). In particular, studies have documented that venture capital speeds up product commercialization (Hellmann and Puri (2000)) and the adoption of human resource policies (Hellmann and Puri (2002)), and that it strengthens companies' commercialization strategies (Gans, Hsu, and Stern (2002), Hsu (2006)).

The role of venture capital in this context is potentially very important. Venture capital firms are sophisticated investors, whose partners have extensive knowledge of the industry and often previous managerial experience. Their strong commitment to generate high returns in the medium term makes them active investors (Bottazzi, Da Rin, and Hellmann (2007)). They could therefore make the difference by effectively steering portfolio companies' strategy towards commercial success.

Eun & Resnick (2007) define corporate governance as "the economic, legal, and institutional framework in which corporate control and cash flow rights are distributed among shareholders, managers, and other stakeholders of the company" (Eun & Resnick, 2007, p.78). In that sense, corporate governance is an attempt to protect shareholders' rights by developing mechanisms to deal with the agency problem.

Venture capitalists do not manage the day-to-day operations of the businesses they invest in; instead, they intensively monitor the managers of those businesses (Gorman and Sahlman 1989). This close monitoring by venture capitalists is a valuable form of support and guidance for relatively inexperienced entrepreneurs. Venture capitalists negotiate complex control rights, including board representation rights, at the time of their investment and utilize sophisticated mechanisms to monitor and advise their companies (Kaplan and Stromberg 2003).

Corporate governance provides the basis for investors to examine their investments. Lin and Chou (2005) suggest corporate governance is important when venture capital is used to finance projects because venture capital is not risk free hence corporate governance strategies must be set in place to monitor and give guidance to the companies with venture capital backed investment. In this sense investment backed by venture capitalists produces financier and active investor effect on corporate governance.

1.1.3 Venture Capital in Kenya

The first formal trace of venture capital in Kenya was in 1996 when the Acacia fund which is under Aureos Capital was introduced. The Acacia fund is the first private equity fund registered in Kenya under the Capital Markets Authority (CMA).

Kenya is yet to formalize the venture capital industry (East African Development Bank, 2007). The CMA which governs the capital market has developed a draft comprehensive legal framework in an effort to address the legal and financial requirements for the industry (CMA, 2008). The CMA has recently posted regulations on their website which firms are to meet in order to be considered registered venture capital firms. (CMA, 2009).

1.1.4 TBL Mirror Fund

This paper is a case study on one of the practicing venture capital funds in Kenya, TBL Mirror Fund. TBL Mirror Fund stands for The Blue Link Mirror Fund. It is a venture capital fund originated from The Netherlands with the goal of bringing together companies in developing countries with involved investors from the Netherlands, combining the investment of both capital and entrepreneurial know-how. The fund currently has a focus on East African companies.

TBL Mirror Fund is a venture capital fund which focuses on small and medium enterprises (SMEs) in various sectors operating in growth markets where value can be added through the know-how and involvement of the investors of the Fund. TBL Mirror Fund provides long term equity, hands-on involvement and a global investor network towards fast growing East African businesses.

The TBL Mirror Fund facilitates and manages the combined investment of capital and know-how in promising companies. Investors are invited to participate in the management of the portfolio companies through annual visits, board membership and membership in the investor board of the Fund, leading to: Joint creation and implementation of a growth strategy in the portfolio companies; Direct involvement of the investors in the Fund and portfolio companies; Capital investment; A profitable exit strategy. However even though the study will be centered on TBL Mirror Fund, the findings can not be acutely limited in application since Venture Capital firms normally act in the same way and sometimes in syndicates.

1.2. Research problem

Since venture capitalists have been organized in many countries over the past two decades to generally improve innovation and entrepreneurship they should therefore have some impact on strategic direction and corporate governance of their portfolio companies. According to Zong (2005) there are important governance lessons to be learnt from venture capital and private equity. Venture capital backed investment has some impact on corporate governance and performance and determines how managers and chief executive officers are compensated (Zong 2005). Financing a project with private equity helps to provide strategic direction, maintain performance discipline and commitment in managers and ensures shareholder activism.

TBL Mirror Fund is pioneer venture capitalist in Kenya in regard to financing small and medium enterprises. It views providing strategic direction and corporate governance to its portfolio companies as being critical in helping to give support to the small and medium enterprises in this market especially in lieu of lessons learnt from financial crisis worldwide in recent times.

Venture capital has been studied mainly under the corporate finance discipline extensively. Ngigi (1997) conducted a study on venture financing for small firms at a time when there were few venture capitalists. Chege (2003) studied venture capital in the medical industry and Koech (2008) studied control mechanisms and interests of investments in venture investing. Corporate governance on the other hand has been studied only in relation to listed and state owned companies. Muriithi (2003) studied corporate governance and financial

performance of state corporations with a focus on the Kenya Cooperative Creameries. Owuor (2001) also conducted a survey on the corporate governance processes in state corporations. Mukoba (2005) related corporate governance reforms to performance of companies listed at the Nairobi Stock Exchange. There has not been any research conducted which related venture capitalists' activities in Kenya to the strategic direction and corporate governance of the companies they invest in. In order to address the issues discussed in this section and to fulfill the research purpose the following questions will guide this study:

- i. Does the venture capitalist have influence on the strategic direction of its portfolio companies?
- ii. What are the corporate governance practices the venture capitalist applies and what is their impact on value addition?

1.3. Objective of the Study

This study will establish the approach of TBL Mirror Fund to the strategy and corporate governance of its portfolio companies.

1.4. Value of the Study

The study seeks to identify and understand whether venture capitalists have an influence on the strategic direction and corporate governance of their portfolio companies with a view of providing additional knowledge that will enhance the development of the venture capital industry in Kenya.

The findings will be helpful to current venture capitalists and also individuals or organizations that would wish to take part in venture capitalism in future. It will also give insights and awareness to organizations and innovative startups as they make decisions on strategic alliances that would add value to their companies.

The study will also add to the strategic management knowledge body by providing a linkage between venture capital and strategy where venture capital is discussed as a driver of strategy within portfolio companies. Previously venture capital has been studied from a corporate finance perspective.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

Venture Capital financing has evolved to become one of the most important sources of finance. This type of revolutionary capital financing provides both capital and managerial experience. The additional service activities provided by the venture capitalists make it the most ideal source of capital for innovative ideas. The service activities include establishing important contacts with advisors, lawyers, business partners and recruitment of quality managers. Venture capital is most ideal for young innovative firms (Stratling, Postma & Wijnbenga, 2007).

The literature on private equity suggests a variety of methods to how venture capital and private equity firms can add value to their portfolio companies. The two main themes researched by the author are input in strategic direction and corporate governance. Many authors have argued for different aspects of value creation that could be classified under these two themes. Corporate governance was suggested as a cornerstone in value creation by many studies (e.g., Hochberg, 2003; Engel et al , 2002; Jensen et al., 2006). The second theme has emerged from several articles (e.g., Rogers et al., 2002; Lieber, 2004; Zong, 2005) since strategic redirection also leads to value creation by the venture capital firms.



Hochberg (2003) Venture capitalists play governance roles in their portfolio firms by closely monitoring the internal activities and provide valuable support to management. According to Belke and Schaal (2004), venture capital is a hybrid system between arm's length and relationship-based financing and thus bridges the financing constraints and adds value to sector specific business knowledge. As a result venture capital firms are not merely financiers or financial intermediaries such as banks but monitors and provide guidance to their portfolio firms.

2.2 The Development of Venture Capital

Under a traditional or private venture capital model, the venture capitalist pools funds from limited partners to form a venture fund. The venture capitalist reviews business proposals from entrepreneurs, who need either to continue to develop a product, or to build a company around a developed product. The venture capitalist as investor provides funds to the entrepreneur (or "startup" company) in exchange for a proportionate ownership in the company.

Venture capital originated around 1946 when the first modern firm begun operations. The firm called American Research and Development (ARD) operated as a group of venture capitalists who made investments that were high-risk. The firm invested in emerging companies formed to commercialize technology designed for the Second World War. The firm had great success with profits growing to above \$350 million. Institutional investors were reluctant to invest in the firm therefore ARD was marketed to individuals. Venture capital organizations began to develop after the success of ARD (Lerner, 2002).

The venture capital industry evolved from the USA government's efforts to establish the Small Business Investment Corporation (SBIC) program. The SBIC was a company under the federal government to assist small businesses. They trained numerous venture capitalists and assisted the industry by channeling large sums to start-ups, though their performance was limited by lack of professional expertise, bureaucratic constraints and faulty capital structure design. During the early 1960's, over 400 SBICs were operating in the US. Private investment capital was provided to them and they in turn invested in small businesses. In the late 1960s private investors decided to be independent of government involvement, the investors pioneered the venture capital industry (Holt, 1992).

In 1979 there was a major contribution to more efficient organization of the industry through the clarification of the Employment Retirement Income Stabilization Act that allowed pension funds to invest in venture capital (Bottazzi & Rin, 2002). Initial venture capital activity occurred in the early 1980s in Europe. Experienced venture capital managers with experience from the U.S.A industry set up the early European venture capital firms. Some of the firms were set up as affiliates of the U.S.A firms. Continental European firms were partially or wholly owned by financial institutions (Bruton & Ahlstrom, 2006). In 1987 there were 587 venture capital firms in the U.S.A, they had increased by about 150 percent since 1977. The industry between 1978 and 1987 gained 800 percent in total capital that is from \$3.5billion to \$31.1billion (Kuratko & Hodgets, 1995). Venture capital in Asia emerged in the mid 1980s to late 1980s. Asia had roughly over 300 venture capital firms towards the end of the 1980s (Bruton & Ahlstrom, 2006).

The 1990 period had a slump and the capital begun to decrease. 1991-1992 had a resurgence of the venture capital market. In 1992 there was a disbursement of money for venture fund investments by the industry in order to lift it out of the slump that begun earlier. Sources of venture capital have changed from 1984 to 1992. The investor class are progressively transforming from individuals and foundations to institutions. The industry has become more diverse, specialized and less uniform. Objectives for investment strategies, criteria for particular stages, sizes and market technology of firms have changed. Venture capital has evolved to become a form of financial intermediation linked with dynamic start-ups especially in high-tech industries such as e-commerce, information technology and bio technology. The venture capitalists take on a dual role as suppliers of finance and managerial expertise (Kuratko & Hodgets, 1995).

2.3 Strategy Role of Venture Capitalists

A number of studies (Rogers et al., 2002; Zong, 2005; Heel & Kehoe, 2005) assents that the most successful venture capital and private equity firms actively participate in the strategic decision-making of their portfolio companies.

A study by Rogers et al. (2002) reveals that top venture capital and private equity firms determine an investment strategy at the beginning of the investment horizon. Rogers et al. (2002) refer to this strategy as an investment thesis, which lays out the fundamental change needed to transform the portfolio company in three to five years.

Developing an investment thesis involves identifying the main problem inherent in the existing business model or a unique opportunity that could help the company make a leap. The venture capital firm will then define a strategy aimed at reshaping the business model or exploiting the opportunity. Zong (2005) further advocates that venture capital firms should apply a laser-focus strategy. Instead of pursuing multiple goals, the investment thesis should target only one goal; the achievement of which leads to higher profitability and increases the firm value. Zong argues that chasing multiple goals is likely to cause a divergence of goals and dispersion of resources.

After defining the investment thesis, the next step is to construct a business plan to execute the strategy. According to Zong (2005), the plan concentrates on two or three strategic issues that are directed towards goal attainment. The business planning process involves a frequent interaction between the venture capital firms and management of the portfolio companies. Venture capital firms evaluate the management's plan skeptically and develop their well researched viewpoint to challenge managers (Heel & Kehoe, 2005).

Venture capital firms can incorporate a scenarios plan in their business planning. Best/worst scenarios can be modeled by simulating market factors, company cost and revenue factors. Such a contingent plan helps the portfolio company be more flexible in the strategic decision-making and better react to unexpected events (Lieber, 2004).

Jensen et al (2006) stress the importance that venture capital and private equity firms should have a long term focus when giving advice on strategic issues. First, an effective communication plan will help private equity firms better understand managers' intention and help managers being aware of the emphasis on long-term gains (Jensen at al., 2006). Further, the long-term perspective should be embedded in the investment thesis that focuses not on cost reduction but on entrepreneurial activities (Rogers et al., 2002; Mills, 2006).

2.4 Governance Role of Venture Capitalists

Jensen (1968) stated that venture capitalists like institutional investors are active investors who monitor closely the activities of the portfolio firms and are represented on the boards of directors. They also usually retain the controlling rights (decision rights) that permit them to intervene in the issues concerning their portfolio firms when they judge it to be necessary. Venture capital firms also provide their entrepreneurs with access to consultants, legal experts and investment bankers.

The first step is to appoint an independent board of directors. Jensen points out that the size of the board is relatively small under the private equity governance system (Jensen et al., 2006). Private equity and venture capital firms typically appoint a general partner(s) to represent them on the board (Rogers et al, 2002). The rest of the board may be made up of the company's largest shareholders (Jensen et al., 2006). Further, Kaplan suggests that venture capital firms welcome industry experts to the management board to assist the portfolio companies in their development (Jensen et al., 2006).

The appointed general partner goes beyond the role of an administrator by adopting a hands-on approach to the management of the portfolio companies on behalf of the private equity firm. The general partner is responsible for all aspects that lead to value advancement of the portfolio companies. The scope of the general partner's work ranges from developing long-term strategies, crafting business plans, to designing an incentive system and having ongoing dialogue with management on operational and strategic issues (Rogers et al. 2002; Zong 2005).

As mentioned earlier, private equity and venture capital firms often involve the company's largest owners in the board of directors (Jensen et al., 2006). The lesson drawn from the private equity industry is to let shareholders actively participate in the management process. Controlling shareholders are encouraged to question and influence managers' decisions, make key compensation and directly get involved in hiring and firing managers (Rogers et al., 2002; Zong, 2005). According to Jensen, there are significant differences in the kinds of discussions taking place in the board meetings of public companies and those of private-equity and venture capital backed companies. In pricing the deal, the buyout principals go through a due diligence process, which enables them and the managers of the target company to learn more about the business. An extensive knowledge of the business is believed to raise the quality of those discussions, compared to public companies. Jensen further observes that there are a lot of conflicts and disagreements during public board meetings. Decisions are often made by voting. And due to disagreements, business issues that come up are ended up with no vote and are never resolved.

The board of venture capital backed companies, intensively discuss the issues, generally reach agreement and every body is happy at the end of the day (Jensen et al., 2006). To keep their detailed specific knowledge of the business, its customers, suppliers, competitors, employees, and so on, staying up to date, Jensen supports a close contact to be maintained between the board and the managers (Jensen et al., 2006). Feldberg, a Senior Adviser at Morgan Stanley, notices that directors representing private equity firms meet with the CEO and other members of management every couple of weeks for years. The meetings will typically address operational and strategic issues (Jensen et al., 2006).

The management team can benefit from the wide knowledge and experience of those employed by the venture capital firm. In some extreme cases, the venture capital firm can decide to change the entire management team (Jensen et al., 2006). Heel & Kehoe (2005), however, suggest that replacing a management team should be done at the early stage of the investment. Berg & Gottschalg (2004) refer to this process as removing managerial inefficiencies

The board of directors has many tools at its disposal to align manager's interest with those of the owners. In their study of sixty buyout deals done by eleven leading private equity and venture capital firms, Heel & Kehoe (2005) find out that the most successful deals involved establishing a proper performance-based incentive program. Significant changes in performance-based incentives are often cited by famous researchers and practitioners as a conventional way to better align the interest of managers with that of shareholders (Gregory, 2000; Jensen et al., 2006).

The incentives can take different forms but the most common ones are pay-for performance incentives and share options. The successful deal partners in Heel & Kehoe's study (2005) reported to have a system of rewards equaling fifteen to twenty percent of the total equity, depending on the firm performance.

With share options, management has the right to buy ownership stake in the company at a stated (i.e., exercise) price some time in the future (Fabozzi & Peterson, 2003). An important feature of these incentives is to replace cash payment with equity grant. By doing so, managers' interest is more closely tied to the interest of the owners (Gregory, 2000). In addition to equity grant, private equity firms often require managers to make significant investment in the business (Heel & Kehoe, 2005; Jensen et al., 2006). According to Kaplan, the rationale behind this is to create both upside and downside for managers. Managers should not only be rewarded for improved performance but must also share losses resulting from poor performance. By contributing their own money to the company, managers are as likely to gain as to lose depending on the firm's performance. To a great extent, managers are motivated to run the business in a way to maximize shareholder value, not to destruct their own wealth (Jensen et al., 2006).

Regarding the scope of the incentive program, Moon – Managing Director and founding partner of Metalmark - stresses the importance of giving incentives to the right people. Equity grant should not be limited to the CEOs or top managers. "Equity should be pushed as deep into the organizations as there are people who move the needle" (Jensen et al., 2006,

p.23). Another issue in structuring the compensation is the liquidity of the equity ownership. Kaplan emphasizes that it is insufficient to provide managers with significant equity. More importantly, management's equity must be made illiquid until the increase in value is proved. In another way, managers can not sell stocks or exercise options until they have created value to the company (Jensen et al., 2006). Millson & Ward (2005) reveal that the right to exercise share options should be conditional upon meeting performance targets or only be enforceable after a specified time period.

Hence venture capital backed investment is a complementary in that financing and management through corporate governance is provided by the venture capitalists while entrepreneurs provide the idea, knowledge and technology. When there is a gap in the management team, Venture capitalists involvement increases. Lerner (1995) finds that the board representation of venture capitalists increases around the time of CEO turnover, while the number of other outsiders remains the same. In the absence of direct monitoring by venture capitalists companies employ substitute control mechanisms.

Engel et al. (2002) find that, compared to companies with no venture capitalist involvement, those with direct monitoring by venture capitalists make less use of accounting and stock based measures as explicit performance criteria in CEO compensation contracts. Venture capitalists usually secure board representation rights in the initial negotiations, including contingency clauses that increase these rights in adverse conditions. Acting through the board of directors, venture capitalists have the power to hire and fire the senior management of their portfolio companies (Kaplan and Stromberg 2003).

Venture capitalists' influence also extends to board characteristics and financial reporting quality of companies after they have gone public. At the time of IPO, venture capital-backed companies have more independent outsiders and fewer inside and instrumental directors (commercial bankers, lawyers, accountants, and consultants, who advise the company) (Baker and Gompers 2003). Hochberg (2005) finds that venture capital-backed IPO companies have more independent boards, audit and compensation committees, and a higher likelihood of separating the roles of CEO and chairman of the board, higher stock market reaction to the announcement of poison pill adoption, as well as lower earnings management in the year of the IPO.

Venture capitalist's carry out governance activities such as providing services and monitoring the firms operations and performance. The governance activities usually assist in the use of the firm's control systems. Viability and continuity of the firm depends on the critical resources that the venture capitalist controls. The relationship between the firm's use of control systems and its financial performance is moderated due to the venture capitalist's information needs and experience with other firms. Each governing activity influences the degree of control systems in the firm. The monitoring activities are done for value protection while the service activities are for value creation. Sophisticated control systems in an entrepreneurial firm allow the venture capitalists to align its governance activities to the resource needs of the systems and hence create value. Venture capitalist's governance activities have two main sets related to agency theory and resource theory (Bruton & Ahlstrom, 2006).

2.5 Agency Theory

The essence of the agency problem is the separation of ownership and control. The problem is studied under the agency theory, which is the analysis of the conflicts between managers and shareholders. Agency theory has received much attention in the economics literature (Jensen, 1986). Jensen and Meckling (1976) define the agency relationship as a contract between at least two persons, a principal and an agent. In the context of a corporation, the firm's owner – the principal engage the managers – the agent, to perform some service on behalf of him, which includes entrusting the agent with residual control to run the company. However, the principal can never assure himself that the agent will do what benefits the principal the most. By assuming that both parties in the relationship are utility maximizers, it is believed that the agent instead of acting on the principal's interest, will act upon his own interests first.

This theory suggests that principals such as venture capitalists use incentives and managerial processes to monitor agents' actions and align their interests. The venture capitalists safeguard their investment by monitoring and reducing goal conflict through tying the firm's team rewards to performance. Goal conflict may exist in strategic goals, risk management, valuation of stock and allocation of resources. Divergent interests between principals and agents may lead to inefficient use of resources. Information gaps and incentive problems are avoided through monitoring of the firm's financial, and operation performance in addition to evaluating the firm's business strategy and market opportunities. Venture capitalist focuses on development and implementation of managerial incentive systems that is managerial

remuneration and ownership. The entrepreneurs usually have a large equity share in order to induce them to put great effort. Contracts between entrepreneurs and venture capitalists usually have restrictive covenants on the entrepreneur's rights and duties. Control rights include voting, board, liquidation and cash-flow rights. Such rights are contingent on the development of the firm. Rights are allocated separately, are interrelated and change gradually with the performance of the firm (Bruton & Ahlstrom, 2006).

No matter which form that the agency problem may take, the main issue pointed out by Jensen (Jensen et al., 2006) is the absence of active investors. According to Jensen, managers left unchecked and unmonitored by investors were the cause of massive inefficiencies across corporate America in the late 1960s and 1970s. Many attempts to restructure defective corporations took place in the U.S. in the later periods, in which leveraged buyout (LBO) and private equity contributed an important part. Jensen believes that there is potential for large value gains from strengthening corporate governance and compares the emergence of private equity with the "rebirth of new active investors" (Jensen et al., 2006, p.11). Other authors researching on private equity firms (e.g., Rogers et al., 2002; Zong, 2005; Heel & Kehoe, 2005; Wright, 2006) also advocate corporate governance as the traditional way for value creation by venture capital firms.

Numerous ways to cope with the agency problem in the particular context of leveraged buyout and venture capital have been proposed. In addition to interest alignment, other objectives of corporate governance are to ensure the transparency of managerial activities and to have a proactive management ownership (Zong, 2005). These three objectives can be obtained simultaneously by employing several mechanisms.

2.6 Resource Dependency Theory

This theory suggests that venture capitalists act as an effective mechanism to help in management of external resource dependencies. They are a go in between the firm and the environment, facilitating access to external resources required by the firm. Venture capitalists also assist in other activities such as development of networks with other organizations; they use their cognitive capabilities and information expertise to enhance the quality in decision making. The main goal of the service activities is to enhance corporate decisions through the flow of the necessary resources to the firm. Service activities include recruiting managers, approaching of new finance partners, creating a network with advisors, providing guidance in the introduction of new products or services to the market and assisting in business operations of the firm.

The use of control systems establish the Venture capitalist's control and influence on the firm, they act as dominant partners who demand tight discipline of procedures and efficient operation in order to meet the goals of the firm. Cost control systems enable the firm to know their cost structures and assist in improving the efficiency and competitiveness of the firm in the market. Incentive and reward systems increase employee motivation. The venture capitalist ensures the payoff structures of the firm's management and employees align with the goal of the organization (Bruton & Ahlstrom, 2006).

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The purpose of the study is to establish the effect of venture capitalists activities on the strategy and corporate governance of their portfolio companies. The following chapter discusses the methodology used in order to obtain the information required for the study. The chapter explains the choice of research design and justifies the use of case study of the TBL Mirror Fund. Data collection and analysis methods are discussed as well.

3.2 Research Design

Research design has two main functions. The first involves development of logistical requirements and procedures required to undertake a study. The second function focuses on the importance of quality in the procedures used to ensure objectivity, validity and accuracy. The research design enables the researcher to conceptualize a plan of operation, to undertake the various procedures and tasks required for the completion of the study being undertaken (Kumar, 2005).

This particular study is a case study on one of the practicing venture capital funds in Kenya. “A case study is an in-depth investigation of an individual group, institution or phenomenon. Most case studies are based on the premise that a case can be located that is typical of many other cases. The case under study is viewed as an example of a class of events or a group of individuals (Mugenda and Mugenda, 2003).

TBL Mirror fund has been in operation from 2007 as a pioneer venture capital fund filling the missing middle gap by financing small and medium enterprises which are not served by the larger private equity funds such as Actis and Aureos. Following their entry, there has been an inflow of other funds setting up having gained confidence that there was opportunity in filling this gap. In order not to reinvent the wheel, most of the incoming funds have taken up the practices of the funds that had already been in place. The findings of the study can therefore not be acutely limited in application since the venture capital firms normally act in the same way and sometimes in syndicates.

This research was conducted as a descriptive study of TBL Mirror fund's influence on strategy and corporate governance. A descriptive study design is one that seeks to explain the relationship between various variables. It examines the situation as is and does not involve altering the situation under investigation (Leedy and Ormrod, 2005). The study seeks to answer questions related to exit mechanisms known to and used by venture capitalists in Kenya and their relationships to other factors such as the industry in which the firms are in and the entrepreneurs' characteristics such as experience and management skills.

This design was selected in order to learn directly from the venture capital fund managers and thereby help other funds in making decisions as to how to influence strategy of the companies they invest in, what corporate governance practices are most favored as well as which have not been sufficiently exploited.

3.3 Data Collection

There are few possible methods for data collection. The most common methods for data collection in academic research are observations, questionnaires and interviews. Observation involves "the systematic observation, recording, description, analysis and interpretation of people's behavior" (Saunders et al., 2003, p.221). Questionnaires are concerned with data collection techniques in which each respondent faces the same set of questions in a predetermined order. Interviews involves a discussion between two or more people and it can help to gather a more valid and reliable data that are relevant to the research questions and objectives (Saunders et al., 2003).

As the aim of the study is to understand how TBL Mirror Fund influences strategy and corporate governance in its portfolio companies, observations in the firm and the portfolio companies could have been an appropriate method for data collection. Observation is strong at explaining particular social situations and processes (Saunders et al., 2003). However, it can be very time consuming and therefore, not possible to be applied in this study due to time constraint. In addition, applying only observations may introduce an observer bias and would not help to explain fully why TBL Mirror Fund chose to take particular actions.

A questionnaire refers to an instrument delivered to the participant via personal or non personal means that is to be completed by the participant (Copper & Schindler, 2007). Questionnaires represent a list of questions which respondents give their answers to. The respondents read the questions interpret them and then provide answers to them.

Questionnaires may be a faster method for data collection. However, it provides the same set of questions to all respondents and it may be more appropriate when a large sample is required. In addition, questionnaires may suffer from a weak internal validity as respondents may misinterpret the asked questions (Saunders et al., 2003).

Interviews are a commonly used method in collecting data from people. They refer to a person to person interaction between two or more individuals with a specific purpose in mind. Interviews may be powerful and flexible where the interviewer has the power to formulate questions randomly as the issue to be discussed is investigated. Interviews can either be structured or unstructured (Kumar, 2005). As the study is based on one venture capital fund, interviews with the fund managers of TBL Mirror Fund was found suitable method for data collection.

Data for the study was collected from various secondary sources and primary sources. Secondary data was sourced from strategic business plans of TBL Mirror fund's portfolio companies, publications of various regulators and public information sources like journals and business magazines. Primary data was also obtained by way of interviews with the fund management department of TBL Mirror Fund. The respondents were the managing director, investment director and investment analysts in the fund. The interviews were conducted in accordance with the interview guide (Appendix 1) which is in two sections. The first section asks questions regarding TBL Mirror Fund's approach towards influencing strategy of portfolio companies while the second section has questions regarding the corporate governance practices used by the fund.

3.4 Data Analysis

According to Saunders et al. (2003), there is no standardized approach to the analysis of qualitative data. Instead, there are several strategies and methods to the analysis of qualitative data put forward by the literature. The method or the strategy a researcher chooses depends on the intended analysis.

According to Mugenda and Mugenda (2003), qualitative analysis of data refers to non-empirical analysis. "A researcher may be interested in studying an area which may not require quantifiable data. A researcher may be interested in studying an area which may not require quantifiable data. Examples are case studies, content analyses and historical studies (Mugenda and Mugenda, 2003).

The data collected was subjected to a content analysis. According to Mugenda and Mugenda (2003), content analysis is the systematic qualitative description of the composition of the objects or materials of the study.

CHAPTER FOUR: DATA ANALYSIS AND INTERPRETATION OF RESULTS

Introduction

This chapter presents the findings of the study that was carried out to explore the approach by venture capitalist to strategy and corporate governance in the companies they invest in. The data from the interviews was analyzed, in line with the purpose and objectives of the study that were set out and the corresponding interview questions that guided the study. The purpose of the study was to establish the approach of TBL Mirror Fund to the strategy and corporate governance of its portfolio companies. The objectives of the study were; to determine the influence venture capitalists have on the strategic direction of their portfolio companies, to identify the corporate governance practices the venture capitalists applies, and to determine the impact of these corporate governance practices. The researcher in this chapter presents and interprets the findings of the research.

The nature of qualitative data has both implication on the data collection and data analysis. Data will probably need to be classified to categories before it can be analyzed as the nature of the data is often non-standardized and complex (Saunders et al., 2003).As the study employed semi-structured interviews, the data needed to be categorized in order to ease the analysis. After the interviews the data was then classified according to the different actions that emerged.

Strategic Direction

TBL Mirror Fund invests in companies in which there is potential to influence strategy and add value. To accomplish this, the fund has some set approach in the investment criteria it uses to select the potential companies to invest in, business planning and the strategy focus of the companies when they eventually become portfolio companies.

Investment Criteria

TBL Mirror Fund relies on several criteria while searching for potential portfolio companies. Ideally, the target companies are small and medium enterprises in East Africa in fast growing industries. They should hold a good market position, or have the potential to become market leaders and possess a strong management team. These companies are, however, not performing at their full potential for clearly identifiable reasons. To discover where unearthed value exists, TBL Mirror Fund continuously benchmarks companies in the same industry and/or those in different industries but having similar characteristics.

While screening potential investments, TBL Mirror Fund looks at a number of selection criteria. First, the target company should be able to absorb investments which range from one hundred thousand euros to one million euros.

Second, the target company is usually a market leader in a well defined niche. Third, the company has demonstrated its capability to generate strong and steady future cash flow. Finally, there must be a potential to grow. TBL Mirror fund often looks for companies with the possibility of maximizing their value in three to seven years.

Ideally, the potential companies should have gone through some business cycles, so they have reached a critical mass. These companies should have a great growth potential over a short period of time. This growth potential is often the ability to transform a business, facing difficulties, into a healthy business.

TBL Mirror fund cited several reasons why these companies under-performed their potential. The reasons range from a lack of clear focus by many companies in their business strategy and operations. For the owner managed businesses, the owners tend to be more technical than managerial. For family businesses, there is often a lack of management and a great exposure to financial risk. The owners may be comfortable having the business as a “bread and butter” outfit and therefore avoid carrying extra risk from financing growth and making add-on acquisitions.

Business Planning

Before the acquisition, the firm does what it calls “industrial-due diligence” of the target company to see if it is of interest. It looks at the market as a whole and the company’s position in the market, what are the value drivers in the market, growth potential, and threats. To ensure a proper due diligence TBL Mirror Fund also involves industry experts in the acquisition. These experts possess in-depth industry knowledge which assures the firm a thorough understanding of the businesses that they seek to invest in. The findings from the due diligence are what advises TBL Mirror Fund whether to invest in the company or not.

After the due diligence, TBL Mirror Fund together with the management team develops a business plan. To a large extent, the business plan is based on the management's belief in what is possible to achieve. The firm then actively challenges the management's views. Different scenarios covering base case, good case and low case are incorporated in the plan. The cases are constantly revised when the company progresses throughout the years. TBL Mirror Fund initially looks back at the history of the company, "ideally up to 5 years". They are able to see the full business cycle and how the company has performed in that entire cycle. This preliminary assessment helps the firm understand the cyclical characteristics of the company and the risks associated.

After making fundamental changes, the firm will re-evaluates the business's exposure to risk. For example, the company is now less exposed to risk by having better geographic mix and product mix. Understanding the risk will then enable TBL Mirror Fund to assume some growth scenarios – whether the company will grow with or quicker than the GDP. Other factors that the firm builds into the base plan are the likelihood and timing of changes in public policy (e.g., privatization, deregulation) and the company's sensitiveness to such changes. According to TBL Mirror Fund, all these elements will affect the company's capability for undertaking strategic actions in the future, such as add-on acquisitions or exits.

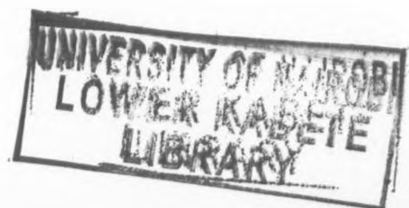
Strategy Focus

Most of the unrealized value that TBL Mirror Fund sees in its portfolio companies is due to a lack of focus. TBL Mirror Fund does not change the strategy of its portfolio companies completely. Instead, it seeks to sharpen the strategy by concentrating more on core business activities.

TBL Mirror Fund has a full-day strategy meeting every year with the first strategy meeting being just before the investment is done. The firm sits and discusses with the board and the management what is going to happen in the next 2-3 years. The first meeting derives the Strategic plan which becomes the basis of the investment. They are therefore constantly working with the strategy of the company because changes will happen.

Divestments of product lines are not common in TBL Mirror fund's portfolio companies. The firm explains that it is more common in large investments, where the target companies have many business lines some of which may be underperforming. Meanwhile, most of its portfolio companies are relatively small.

TBL Mirror fund recognizes the need of having a long-term value enhancing strategy if it wants to sell the company in the future. The potential buyer must be able to see the long-term growth prospect of the company. While reformulating the strategy and implementing necessary changes, the firm takes a long-term view. TBL Mirror Fund and the managers have a common understanding that many re-engineering activities need to be undertaken during the early years of the investment.



TBL Mirror Fund points out that some actions at the beginning of the ownership are mandatory, such as creating a base plan and putting together a board of directors. Also, the firm finds it important to build up a high momentum outright by implementing a change program within the first year of investment. “Doing most of the changes within the first year of your ownership enables a better result”. According to the firm, making early changes enables it to correct the actions if things have gone wrong.

Corporate Governance Practices

In most of the companies TBL Mirror Fund invests in, there are no corporate governance structures and where present, only exist as a formality and not for value addition purposes. TBL Mirror Fund believes that strong governance systems are an important driver of shareholder value. For this reason, corporate governance structures are mandatory for TBL Mirror Fund and this is built into the shareholder agreements at the point of investment into the companies.

Network of experts and Board of directors

The first measurement taken is always to add human capital to the portfolio company. In addition to its own sector knowledge and experience, TBL Mirror fund has a wide advisory network, consisting of knowledgeable industrialists. These include the private investors into the fund.

When TBL Mirror Fund first looks at a potential company to invest in, they will match at least two experts from their investor base who have some specific skill or knowledge that would add value to the company they wish to invest in. These two provide a team that the fund managers can use for quick knowledge transfer regarding the industry the potential company operates in as well as its business model.

To assist its portfolio companies, the firm assists in setting up a board of directors. "We always put a new board in place". The board of directors can be determined early, right from the due diligence process. It usually takes six to twelve months to buy a company. While investigating the business before the acquisition, the firm already knows exactly who will be on the board. These boards typically consist of five to seven people.

There are usually one or two representatives from TBL Mirror Fund. They are the people who were involved in the transaction. Then, the firm always appoints one external chairman, who acts as a link between TBL Mirror Fund, the rest of the board and the management. The chairman would be an independent or non-executive director from the firm's network and will be brought in depending on what kind of changes are to be made or what the challenges are.

To ensure that managers act for the interest of the owner and the company, TBL Mirror fund documents a board guideline that sets out the responsibility of the board and the managers. There are certain matters that are strictly the board's responsibility such as; changes in strategy, acquisitions, divestments, entering into major contracts.

TBL Mirror Fund also recognizes an advantage of keeping the board small. “If there is a need to take decisions, they can be taken very, very quickly”. As explained by the firm, everyone on the board has the same interest. Therefore, the board can be pooled together, which hastens the decision-making process. “It is a significant part of the success story”. Board meetings are held on a regular basis, every second month during the first two years. In the subsequent periods, the board may meet less frequently.

However, board committee meetings between selected board members to the committees and the management are often arranged on a need basis and can be as frequent as daily if there is much happening. By frequently interacting with managers, the momentum can be kept up in between board meetings. The board committees set up include; Human Resource Committee, Finance and Audit Committee, Remuneration and nomination committees among others. TBL Mirror Fund provides the board charters which detail the appointment of members, frequency of meetings, authority, roles and responsibilities of the committee members

Management Team

TBL Mirror Fund seeks for companies with a strong management team as it prefers to keep the current management team. However If the current management lacks sufficient competence, the firm may change its structure.

According to the firm it is always possible to replace /or to assist in recruiting key personnel such as the Chief Finance officer, Chief Operating officer, Sales and Marketing director , but it may take a lot of time. Moreover the firm argues that it may also be hard to find a good and experienced management that is willing to take on smaller companies.

In some portfolio companies there has been major restructuring of management. For example, the portfolio company may enter into different phases of development (e.g., expansion, turnaround) that require distinctive skills by the management to implement fundamental changes in that particular period.

Reporting Standards, Performance Indicators and Incentive Programs

TBL Mirror Fund expects a detailed report to be handed in every month. In addition, for every board meeting, the CEOs of the portfolio companies put together a report of the performance, year to date. This report includes the activities, financials, business prospects, and market trends for the coming quarter. This report is thereafter sent out to all the shareholders.

The firm also uses several KPI's for keeping track of the company such as sales growth, margin expansion, and cost control. A number of financial and non-financial key performance indicators are examined carefully, which enables the firm not to only track the company's performance against the targets but also to spot new development trends. Examples of non-financial indicators are the number of clients gained and lost, change in average purchase value per customer and so on.

As an incentive, TBL Mirror Fund allows for the creation of an Employee Share option Pool (ESOP) of five percent to ten percent for the management. By doing so, the management's interest is closely tied to the owner's interest and the company's performance. In addition, the management is not allowed to sell their shares until the company is sold. The scope of the equity program varies on case-by-case basis. TBL Mirror Fund often consults with the board of directors, mainly the remuneration and compensation committee, to determine who should be involved in this program. In some companies, there may be five or six managers. In other companies where there is a high degree of decentralization with a number of branch managers, there can be up to fifty or sixty involved in the incentive program

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

The study was a case study on TBL Mirror fund as a venture capitalist, on their approach to strategy and corporate governance of the companies they invest in. This chapter contains summary of the key findings of this study. The chapter also gives possible recommendations for the involvement of venture capitalists in their portfolio companies and recommendations for possible further research areas.

5.1 Summary

TBL Mirror Fund conducts governance engineering as an attempt to remove managerial inefficiencies. A number of governance mechanisms have been used by the firm in designing an effective monitoring and incentive system. Before the acquisition, a due diligence is performed with the participation of industry experts. Information gathered from the due diligence serves as guidelines for subsequent controlling activities. The information is also used to develop a strategic business plan which forms the basis for the investment.

After the deal is concluded, the board of directors is restructured to consist of representatives from the private equity firms, industry experts and sometimes, previous owners, depending on the post investment ownership structure. Keeping the board small and independent of management warrants an objective and effective decision-making. To keep close control of managers' activities and to foster the change process, scheduled board meetings (most frequently in the first year) and weekly meetings with management are arranged.

During these meetings, the board focuses extensively on operational and strategic issues so as to ensure that portfolio companies receive the most advices on how to better run the business. Such a focus proves to be an important value-creation element for companies which were previously not given full attention before the venture capitalist invested.

The studied firm usually keeps the current management team and seeks to strengthen it on financial, operational, controlling and supply chain management by appointing additional personnel. Alignment of managers' interests with the owners' is achieved through incentive programs which involve ESOPs. It is important that managers purchase an equity stake and become effective owners of the companies. Monthly reports and evaluation of KPIs are additional mechanisms to govern managerial activities.

5.2 Conclusion

The essence of this thesis has been set out in the research question to investigate into whether venture capitalists have an influence in the strategy of their portfolio companies and what impact the corporate governance practices they apply have in adding value to these companies.

There is not usually a very radical change on the strategy of the acquired companies. The companies continue to operate a significant part of the pre-investment business with two added twists, focus and expansion. TBL Mirror Fund sharpens the portfolio companies' strategic focus by divestment of non-core businesses and then extends their geographic reach and product mix.

The approach to strategy and corporate governance practices are so far claimed to generate values for the portfolio companies. In most of these companies, it is obvious that value has actually been created after the venture capitalist has invested and these practices implemented mainly because most of these companies will not have had these structures in place to begin with.

5.3 Recommendations

The researcher recommends the establishment of an association for the venture capital industry that will focus on the venture capital industry specifically. This would encourage the sharing of knowledge regarding how to effectively and positively steer the strategies of the SMEs they invest in given that these SMEs are the engines for growth of the economy.

Due to the recent finance-ridden scandals in Europe and the USA, Corporate Governance has again captured the imagination of policymakers, lawmakers and company executives worldwide. The researcher recommends that the venture capitalists within their associations, lobby for the introduction of important legal and regulatory reforms regarding corporate governance framework for non-listed companies. With most venture capitalists like TBL Mirror Fund in the region taking up minority stakes, there should be some effective regulations which ensure both continued investment and minority protection.

The government should develop incentives that attract investors both local and international to the venture capital industry in Kenya. This would encourage investment that not only provides capital but also other value addition structures which spur growth of the economy

5.4 Limitations of the study

There are several caveats and limitations in this study. Given that the study was on one practicing venture capitalist, the assumption is made that the actions of this one firm mirror that of other venture capitalists. There is a limitation on the extent that the actions of TBL Mirror fund are the same as those of all other venture capitalists.

In a venture capital transaction there is always at least two parties, the venture capital firm and the acquired company. It is natural that these two parties have different views on what actions are best for the company, and what actions really create value. The researcher decided to only interview the acquiring side since they are the ones who decide on what actions to be taken. However, to fully cover all aspects of the problem in a study like this, the researcher realizes that all parties should be heard. The researcher recognizes that the inclusion of only the acquiring firm may lead to biased conclusions since all parties involved were not heard.

5.5 Suggestions for further studies

Different venture capitalists possess different characteristics in terms of size, preference of portfolio companies, and way of operating. As the study was only done on one venture capitalist the researcher sees that this is one research direction in which this study can serve as a starting point for. Further studies can be directed toward finding out if different characteristics can be linked to different approaches.

5.6 Implication of the study on Policy, Theory and Practice

Regulators and policymakers would gain an understanding on the activities of venture capitalists activities in the country from this study. The region has received an increase flow of capital flowing in through venture capitalists. An understanding on the impact of these activities to the companies invested in and consequently to the economy enables the policymakers to create policies that would enforce investment climate frameworks to improve their investment climate because this should increase the impact of venture capital on the economy.

The study represents one of the first attempts to provide a linkage between venture capital activities to strategy and corporate governance. It therefore contributes to the Strategic Management Body of Knowledge. Previous studies have focused on the financial aspects of venture capitalists activities ignoring the unquantifiable benefits venture capital backed companies experience from the investors. The study has shown that there is some clear effort by the venture capitalist to focus and sharpen the strategies of its portfolio companies as well as to instill professionalism by applying best practices in corporate governance.

This study also has an impact on the practice of venture capital to the portfolio companies. Potential investees will have a better understanding on the value they can obtain from choosing to have venture capitalists as investors rather than going for the traditional forms of financing which are only concerned with pay back of the finance and not in further adding more value to the companies.

Other venture capitalists would also benefit greatly from the study from the knowledge share on how TBL Mirror Fund has managed to influence strategy and corporate governance. It could be that due to the different characteristics of the venture capital funds, their approaches have been different. Some of the approaches in the study could be borrowed as well as recommendation for lobbying fostered by the practicing venture capitalists.

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APPENDICES

APPENDIX 1: INTERVIEW GUIDE

Introduction

The study for which this interview guide seeks to gather data is titled “**A VENTURE CAPITALISTS’ APPROACH TO STRATEGY AND CORPORATE GOVERNANCE OF PORTFOLIO COMPANIES**”. The study seeks to establish the influence that venture capitalists have on the strategic direction and corporate governance practices of the companies they invest in. All the information gathered from the respondents will be treated as confidential and will only be used for the purpose of this study.

Section 1: Questions regarding the activities towards strategic direction of portfolio companies.

1. As a successful and experienced venture capital firm what do you do to create additional values in way of strategy to the portfolio companies?
2. In determining whether to invest in particular companies, must they possess a strategic business plan?
3. Do you change or modify the business strategy of the company either before or after the acquisition?
4. What aspect must a business strategy focus on if it is to be a long-term strategy?

Section 2: Questions regarding the activities towards corporate governance practice of portfolio companies.

5. What corporate governance structures does TBL Mirror Fund require to be in place before making an investment?
6. Do you change the corporate governance structures within the company after acquisition?
7. Do you have influence on the board of the portfolio companies?
8. What actions do you take to ensure a transparency of managerial activities (e.g., monitoring activities, appointment of an outside board member, external auditor, frequent meeting with management team, etc.)?

APPENDIX 2: LETTER OF INTRODUCTION



UNIVERSITY OF NAIROBI SCHOOL OF BUSINESS MBA PROGRAMME

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P O. Box 30197
Nairobi, Kenya

DATE..... 29/09/2011

TO WHOM IT MAY CONCERN

The bearer of this letter..... Sarah Wainimu Ngamau

Registration No..... 061/71608/2008

is a bona fide continuing student in the Master of Business Administration (MBA) degree program in this University.

He/she is required to submit as part of his/her coursework assessment a research project report on a management problem. We would like the students to do their projects on real problems affecting firms in Kenya. We would, therefore, appreciate your assistance to enable him/her collect data in your organization.

The results of the report will be used solely for academic purposes and a copy of the same will be availed to the interviewed organizations on request.

Thank you.

JUSTINE MAGUTU
ASSISTANT REGISTRAR
MBA OFFICE, AMBANK HOUSE

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The University of Nairobi,
School of Business,
Nairobi, Kenya.

Dear Sir/Madam,

RE: DATA COLLECTION FOR RESEARCH THESIS

This is to confirm that approval has been given to allow Sarah W. Ngamau, registration no. D61/71608/2008 to gather data for her research proposal "Venture Capitalists Approach to Strategy and Corporate Governance of Portfolio Companies: The Case of TBL Mirror Fund".

Yours faithfully,


.....

FRANCIS NASYOMBA
INVESTMENT ANALYST

