European Journal of Business and Management www.iiste.org
ISSN 2222-1905 (Paper) ISSN 2222-2839 (Online)
Vol.7, No.29, 2015

Influence of Venture Capital Financing on the Growth of Micro, Small and Medium Enterprises in Kenya: The Case Study of Nairobi County

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Abstract
Greatest potentials in driving economies of the developing countries such as Kenya are within the Micro, Small and Medium Enterprises sector which account for almost over 90% of the businesses in these countries. Information asymmetries however, raise the pricing of credit to MSMEs in developing countries and Kenya in particular as well as the high levels of informality within the sector and inadequate systems of collateral verification which hinder the lending. In this 21st century MSMEs should focus beyond bank financing to meet their capital structure needs if they are to fully realize growth and job-creation potential. Via a descriptive survey this study examined the influence of venture capital financing on the growth of Micro, Small and Medium Enterprises (MSMEs), with a focus on venture capital firms in Nairobi-Kenya that have financed MSMEs in the country. Findings indicated that indeed both the venture capital finances and the capitalist expertise were crucial in fast growth of the MSMEs. However information asymmetry gap need to be bridged so as to ensure that MSMEs get a fair operation ground in comparison with the other big players in the developing economies that they operate such as Kenya. This however requires better policies setting by governments so as to encourage the venture capitalist and business angels' environment. This study provides resource information on venture capital financing and its influences on growth of MSMEs that the government and other stakeholders need in generation of appropriate policy actions that enhance economic development and growth for the achievement of the millennium development goals as stipulated in the vision 2030.
Keywords: Venture Capital Financing, Growth, Micro Small and Medium Enterprises, Kenya, Nairobi County.

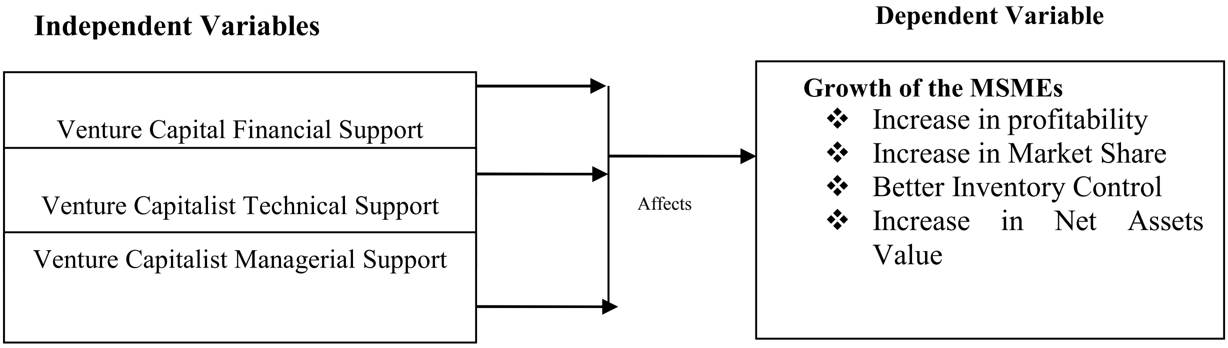
Introduction

Growth of Micro, Small and Medium Sized Enterprises (MSMEs) throughout the world has been of great interest to development economists, entrepreneurs, governments, venture capitalist, financial institutions and non-governmental organizations among other stakeholders (Baker, 2006). MSMEs are seed-beds for the development of large companies and are the life blood of commerce and industry at large in any economical sphere both developed and developing (Storey &West head, 2004). Globally, MSMEs are hailed for their pivotal role in promoting grassroots economic growth and equitable sustainable development in various societies' (IFC report, 2011). The MSMEs sector in Kenya, accounts for about 80% of the country's employable population and it's in dire need for government and private sector assistance to secure more funding (Memba, 2013). Researchers have been keen to determine the contributions of MSMEs to economic development and growth in particular, to job creation (Rondinelli, 1999).

The necessity to grow MSMEs and increase their contributions has increased over the last two decades, especially in developing nations, where MSMEs are believed to contribute significantly to unemployment and poverty alleviation and ownership of productive sectors. MSMEs growth ability depends highly on their potential to invest in restructuring, innovation and technology. All these investments need capital and therefore access to finance is the major MSMEs development and growth factor. MSMEs fail to obtain capital financing mostly due to their failure in providing sufficient business information; financial guarantees as well as they are insufficiently informed or poorly advised about the appropriate financial sources. MSMEs will and do play a significant role in contributing to the national goal of wealth creation and making Kenya an industrialized country as it aims to achieve its millennium development goals as outlined in the vision 2030 blueprint.

The limiting milestones to MSMEs in Kenya from acquisition of capital financing include lack of tangible and intangible security coupled with inappropriate legal and regulatory framework that does not recognize innovative strategies for lending to MSMEs by the various financial institutions. Limited access to formal finance due to poor and insufficient capacity to deliver financial services to MSMEs continues to be a constraint in the growth and expansion of the sector. Formal financial institutions perceive MSMEs as high risk and commercially unviable, as a result only a few MSMEs access credit from formal financial institutions in the country (IEA/SID, 2004). Venture Capital is one source of non-bank financing, which is quite prevalent in developed and developing countries in particular Kenyan financial markets for small or startup firms (Keuschnigg, 2005).

Conceptual Framework



Research Methodology

Descriptive research design was adopted. According to (Cooper & Schindler, 2003), a descriptive study is concerned with finding out the what, where and how of a phenomenon. (Saunder *et al, 2003*) further assert that descriptive research is used principally to gain a deeper understanding of something. The descriptive research collects data in order to answer questions concerning the current status of the subject under study (Mugenda &Mugenda, 2003).Studies on venture capital are few and this justified the use of this research design so as to explore and explain the phenomena while providing additional information. Further quantitative and qualitative methods were used. A quantitative approach is strongly linked to deductive testing of theories through hypotheses, while a qualitative approach to research generally is concerned with inductive testing (Saunders *et al.,* 2003). The main focus of this study was quantitative. However some qualitative approach was used in order to gain a better understanding and possibly enable a better and more insightful interpretation of the results from the quantitative study. Target population of composed of all venture capital firms that had financed MSMEs and are located in the county of Nairobi. This was a total of 42 venture capital fund firms (EAVCA report, 2014).

Table 3.1 Target Population

Population Stratus	Total Target Population	Percentage
Large Venture Capital Firms/Funds	25	59.5%
Medium Venture Capital Firms /Funds	12	28.5%
Small Venture Capital Firms/Funds	5	12%

Stratified sampling was used because the population of interest was heterogeneous in terms of type of the business and location. On ascertaining the MSMEs financed by venture finances the venture capital firms/funds were stratified according to their locality and simple random sampling carried. A sample of 25 firms/funds was picked at random from which data was collected. This was an adequate proportion as a representative sample should at least be 10% of the total target population for adequate results to be achieved (Mugenda & Mugenda, 2003).

Table 3.2: The Sample Size

Population Stratus	Target Population	Sample Size
Large Venture Capital Firms/Funds	25	16
Medium Venture Capital Firms /Funds	12	7
Small Venture Capital Funds	5	2

Data was collected from the two main sources namely; primary and secondary. Secondary data or desk research was the data from the internationally recognized news press on venture capital financing and the EAVCA reports. Primary sources were the major data sources. The data collection was done through the hybrid design of a "drop and collect" method and by emailing of the instruments. The reason for this was to ensure adequate response which is encouraged by the following: First, personal contact with potential respondents permits maximum flexibility when initially explaining the objectives of the study and when administering reminders. Secondly the potential respondent may feel under great compulsion to complete the questionnaire since s/he must face an encounter with the researcher who is dependent upon his action. The two factors thus contribute to the speed with which the research is conducted.

Validity of the instruments was assured through the use of two strategies: Expert opinions where the researcher requested an expert on qualitative research to evaluate the research instrument to ensure its validity. Member-check where the respondents were asked to read through the questionnaire, and interviews. The questions that were found ambiguous were reframed and those that were found irrelevant to the study were reconstructed.To ensure reliability the instrument were pilot-tested upon preparation hence aiding in identifying the problems, minimized errors, and refined the instruments for data collection.

After data organization, analysis was done by using statistical techniques; coefficient of correlation (*r*) or simple correlation method which is the most widely used for measuring the degree of relationship between two variables qualitatively. Spreadsheets and Statistical Package for Social Sciences 17 (SPSS) was used to facilitate analysis as they have in-built formulas. SPSS is a comprehensive system for data analysis and can take data from any type of file and use it to generate tabulated reports, charts, compare means, correlation and many other techniques of data analysis (Microsoft, 2003). These packages were used to carry out descriptive statistics like the measures of central tendency, extract frequency graphs and tables. Run tests of hypothesis like Chi-Square and carry out a correlation analysis where applicable. The data collected and analyzed was presented using appropriate frequencies, bar graphs and pie charts to provide a clear portray of the influences of venture capital financing of the growth of MSMEs in Kenya

Results and Discussions

The research targeted to gather information from 25 firms out of the total 42 firms. However, of the total 25 firms selected, 20 firms responded representing 80% of the total sample size. According to (Mugenda & Mugenda, 2003) this response rate was excellent since a response rate of 50% is what is deemed as adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent.

Data was collected from various categories of the respondents namely; investments associates, investments analyst and the investments managers drawn from the various firms. Majority of the respondents were Investments analyst at (50%), Investment associates (30%) while 20% were Investment Managers. The classification of the respondents was significant as it aided the researcher in collecting data from professionals who gave reliable data as they are custodians of databases relevant to the study. (Saunder, 2003) on data collection asserts that data that is considered confidential can best be gathered from employees on managerial level like the ones used in this study

The study revealed that venture capitalists finance any type of business. However, the agri-business, real estate and manufacturing sectors had highest percentages of venture capital financing 35%, 25% and 20% respectively. These findings showed that many firms in the agribusiness, real estate and manufacturing sectors have used venture capital hence an induction that venture capitalists have a preference of these sectors.

Venture capitalists have a great appetite of financing MSMEs that have existed for between 4-7 years as going concerns, as per the findings. This was attributed to the fact that at this point the MSMEs though going concerns had stagnated and thus required additional working capital for them to rise to the maturity stage of development. The youngest MSMEs to be financed had existed for 3 years. These findings imply that a firm could be in business for many years but still remains in the category of MSMEs due to lack of finance to expand its operations. The findings also indicate that despite the operational age of a MSME, venture capitalists are still willing to give funds if only a venture can meet the stringent requirements and if it can bear adequate returns.

Ninety Percent (90%) of the firms financed were limited liability companies and only 10% were under partnerships as per the findings. This meant that an overwhelming majority had registered their MSMEs as limited liability companies, though family members and friends forming the company membership. This finding concurred with (Wijewardena & Tibbits ,2002)'s study on SMEs in Australia that used equity capital which revealed that majority of the firms (64%) operated as limited liability companies and the rest were under sole proprietorship and partnership.

Data collected and analyzed revealed that 55% of the MSMEs financed said the funds were for expansion purposes, 25% for placement and 20% for startup. These findings show that venture capitalists availed a larger portion of their funds for expansion purposes. Venture capitalists provided fewer funds to start up businesses and none for seed financing. Seed financing involves small amounts of capital to an investor or entrepreneur to prove a concept (Hellman & Puri, 2001).

Sales data collected both before and after venture capital introduction was correlated to validate the extent of interdependence of the two variables. The result indicated that sales and the venture capital were significantly related. The correlation coefficient was $r = 0.912$ and $r^2 = 83\%$ which meant that 83% of the variation in sales was related to the use of venture capital. A number of factual evidence on the economic impact of venture capital has been published especially for the USA economy which supports this finding of this study. According to a study carried out by (Astrid & Bruno, 2004) on venture capital financed firms for the period 1970-2000, the sales doubled, paid almost twice the federal taxes, generated almost twice the exports and invested almost three times as much in research and development more than non-venture capital backed firms. The (EVCA,2001) also established that venture capital backed firms report a high growth in sales as compared to other firms. The result revealed that venture capital lead to growth on sales of the firms that used these funds.

Summary and Conclusions

The study's purposed to examine the influence of venture capital financing on the growth of the MSMEs in Kenya. This was achieved via answering the specific objectives; to establish whether venture capital financing leads to the growth of MSMEs, to investigate the influence of venture capital on the non financial growth of MSMEs, to determine the influence of venture capital on the managerial practices of MSMEs. This study involved computations of measures of central tendency, statistical tests like correlation and Chi square, to analyze the data guided by the research questions that were in reference to study objectives. It was found out that sales per annum in the MSMEs financed by the venture capitalist had an upward trend since the engagement of the venture capital, total profits and the net assets of the financed MSMEs too increased. This was not the scenario before the venture capital engagement by the MSMEs. There was correlation between annual sales and venture capital usage $r = 0.912$ and $r^2 = 83\%$. Thus the conclusion that use of venture capital financing influences growth in MSMEs.

The findings revealed that there was improved corporate image and perception which was observed due to various providers of credit finances having a turnaround after learning that the MSMEs was financed by the venture capitalist thus creating an upsurge of the sources of finances available to the MSME. The improved corporate image was a non –financial measure of growth. This study therefore affirms that upon use of venture capital the financed MSMEs corporate image improved, which lead to them getting additional capital funders which thus results to good growth margins.

The findings revealed that there was 100% percentile adoption of the budget forecasting and preparation by all the MSMEs financed through venture capital which thus meant that there is planned expansion and growth. The findings further show that 95% of the MSMEs did adopt adequate inventory control and management measures after they were financed through venture capital this thus provided for reduced slack and wastage which could have hindered growth if allowed. The MSMEs financed by venture capital had an improvement of up to 80% on their debt collection this thus meant that they had more cash for growth and less bad debts.

The researcher concludes that MSMEs financed by the venture capitalist that were under study experienced growth in both financial and non- financial aspects as well as in the managerial practices. This study reaffirms the correlation between MSMEs growth in any economy and poverty or lifestyle degradation. The economic impact of venture capitalist has been realized by MSMEs in sales, profit and asset upsurge. The social impact of venture capitalist involvement in MSMEs entail; employment opportunities creation which thus improve the citizen's lives and alleviated poverty in a particular economy. The venture capitalist also leads to increased governments revenue through collection of corporation tax as the MSMEs start making profits. Venture capital financing involvement has demonstrated that the partnership implicit in equity capital is as important as the finance and that these two aspects of the relationship are mutually reinforcing.

Recommendations

MSMEs have a potential for accelerated growth when venture capital financing is engaged. Kenyan based institutions and individuals should be encouraged to establish more venture capital funds to build more investment capacity for the upcoming and versatile entrepreneurs still in various incubation hubs and new ones. Private venture capital funds are more active as compared to public venture capital as it has financed many of the firms and they were the once used in this study. Currently, the many venture capital firms in Kenya foreign or owned by foreign citizens who know that private equity has worked well in their countries and they have a vision it can work for Kenya as well. Government owned venture capital firms need to be privatized to serve entrepreneurs better. The Youth and Women development funds which should be venture capital funds (but are not as interest is paid by borrowers and no monitoring of businesses) should be privatized to become a true venture capital fund to serve young entrepreneurs better. MSMEs using venture capital should be given tax concession to attract other MSMEs financed by venture capital. This will open an avenue for their growth after which they will be big industries. This study has shown that the influences of venture capital financing have been seen and felt and so more businesses should be encouraged to use this type of finance for economic development. This is a strategic way of achieving the Kenya's vision 2030 MDG goals.

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