

**ANALYSIS OF THE EFFECTIVENESS OF VENTURE CAPITAL ON GROWTH OF  
SMALL AND MEDIUM ENTERPRISES IN KENYA: A CASE OF NANYUKI TOWN,  
LAIKIPIA COUNTY.**

**PRESENTED BY**

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**THIS PROJECT HAVE BEEN SUBMITTED TO THE SCHOOL OF BUSINESS, IN  
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## **DECLARATION**

I, Gachagua Alice Wangari declare that the entire body of work contained in this research project is my own original work; and that I have not previously submitted it, in its entirety or in part, for obtaining any other qualification.

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This is to certify that this project has been submitted for examination with my approval as the supervisor.

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This is to certify that this project has been submitted for examination with my approval as the chairman of the department.

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This project has been a long journey and I feel indebted to those who participated in their own ways to make it a success.

I thank the almighty God for his special grace and protection over the entire period of my work.

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Once again may God bless you all!

## **DEDICATION**

To my daughter Yvonne who have a dream of establishing her enterprise.

To all entrepreneurs whose main challenge is capital but have great business ideas.

## **ABSTRACT**

Small and medium enterprises (SMEs) play important roles in the economic growth and sustainable development of any economy (Ariyo, 2005). According to the International Finance Corporation (IFC) (2010), the formal SME sector contributes 33 per cent to gross domestic product (GDP) and accounts for about 45 per cent of total employment in developing countries. Despite their significance and the increased efforts by the government of Kenya and other stakeholders to ensure the success of small scale enterprises, past statistics indicate that they exhibit high birthrates and high death rates with 40% of the startups failing by year two and at least 60% closing their doors by year four (Kenya National Bureau of Statistics, 2007; Fina Bank Report, 2007). As James (2003) argues that smaller firms lack finance, managerial and technical skills which inhibit their effectiveness, this study will therefore seek to analyze the effectiveness of venture capital on small and medium enterprises (SMEs) in Nanyuki town Laikipia County. The study was guided by four specific objectives which are: to find out how effective venture capital is on increase in assets, increase in sales of SMEs, increase in number of employees and establish how venture capital has influenced the increase of start- up/new businesses in Nanyuki town. This study followed the theory of entrepreneurial bustle by Joseph Schumpeter (1983) where he discovered the reality of an evolution from being entrepreneurial to a traditionally managed organization. It adopted a descriptive research design. Stratified sampling method was used to draw samples from the selected active SMEs in Nanyuki town. The data was collected using questionnaires given to the sample owners and employees of the selected SMEs. Data was analyzed using Statistical Predictive Analytical Software (PASW). Descriptive statistic was used, that is mean, and standard deviation. Cross tabulation was also carried out to determine the relationship between variables. The output were presented in tables and figures.

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## **Abbreviations and Acronyms**

EU	European Union
GDP	Gross Domestic Product
IEA	Institute of Economic Affairs
IFC	International Finance Corporation
IPO	Initial Public Offer
IVC	Independent Venture Capital
KWFT	Kenya Women Finance Trust
PASW	Predictive Analytical Software
PVC	Public Venture Capital
SED	Society for Economic Development
SMEs	Small and medium enterprises
SMIs	Small- and Medium-scale Industries
SPSS	Statistical package for Social Sciences
UK's	United Kingdom's
US	United States
VC	Venture Capital

## **OPERATION DEFINITION OF TERMS**

**Effectiveness of venture capital:** To what extent has venture capital helped in the expansion and growth of small and medium enterprises through funding, monitoring and training of both owners/managers and employees.

**Expansion:** A business strategy in which growth is obtained by increasing the number of stores in which customers can buy a company's products and services. Unlike relocation, business expansion entails opening up new stores in different physical locations while still maintaining the current business locations.

**Growth:** The process of improving some measure of an enterprise's success. Business growth can be achieved either by boosting the top line or revenue of the business with greater product sales or service income, or by increasing the bottom line or profitability of the operation by minimizing costs.

**Return:** The gain or loss of a security in a particular period. The return consists of the income and the capital gains relative on an investment. It is usually quoted as a percentage.

**SME:** Small and medium enterprises or small and medium-sized enterprises (SMEs, small and medium-sized businesses, SMBs, and variations of these terms) are companies whose personnel numbers fall below certain limits.

**Venture capital:** Money provided by investors to startup firms and small businesses with perceived long-term growth potential. This is a very important source of funding for startups that do not have access to capital markets. It typically entails high risk for the investor, but it has the potential for above-average returns.

**Venture capitalist:** person who invests in a business venture, providing capital for start-up or expansion. Venture capitalists are looking for a higher rate of return than would be given by more traditional investments

# **CHAPTER ONE: INTRODUCTION**

## **1.1 BACKGROUND OF THE STUDY**

Over the last two decades, many governments and regional authorities in Kenya and other countries in the world have implemented programs to mobilize venture capital in support of newly established, innovative firms, with the objectives to remedy funding gaps in private capital markets, leverage private sector financing and fostering the creation and growth of technology-based companies. (World Bank, 2009-2012). Stimulated by the implementation of such initiatives, in recent years several works in the field of entrepreneurial finance have tried to assess the effectiveness of different public policy instruments for the creation of active venture capital markets (Cumming, 2007; Cumming and MacIntosh, 2006; Lerner, 2002b).

Venture capital has had a significant impact on SME in the developed countries (World Bank, 1989). Small businesses have been and are the stepping stone of industrialization in these countries.

In Africa, FinMark Trust (2006) provides evidence that only 2% of new SMEs in South Africa are able to access bank loans. In addition, Foxcroft et al. (2008) report that 75% of applications for bank credit by new SMEs in South Africa is rejected. Improving access to finance is one of the ways to increase the creation rate and reduce the failure rate of new SMEs in South Africa. In the recent years, the government in conjunction with non-governmental organizations and international donors has established policies that enhance the development of venture capitalists that provide funds to new SMEs (Alain F. and Joseph L., 2009-12).

The attempt to improve the framework conditions for the spontaneous growth of VC has been a significant policy effort (Bertoni and Croce, 2011). Often policymakers have accompanied this long-term endeavor with a direct intervention in capital markets: the creation of public VC (PVC) funds. The investment process of PVC funds is normally set to resemble that of independent VC (IVC) investors: PVC selects companies based on their business plan, invests in their equity, may impose covenants and agree with other shareholders on a state-contingent allocation of cash-flow and control rights, and eventually aims at exiting the investment. However, typically PVC funds invest public money, are controlled by a public agency, and normally pursue political goals (e.g. job creation and local development) alongside financial ones. This engenders significant differences between PVC and IVC in terms, for instance, of their skills, investment horizon, and compensation structure (Brander et al., 2010). This suggests that we should not give for granted that IVC and PVC have a similar impact on their portfolio companies.

World Bank, 1989 did a study which found that among the developing countries and especially Kenya venture capital has been present since independence yet industrialization is slow. The purpose of the study was to find out the impact of venture capital on growth of SME which indicated that the lack of finance has been cited as a major contributor to SME failure in Kenya.

To capture all the required information, World Bank adopted the method of collecting data before and after use of venture capital. The findings indicated that Venture capital which is the best source of business finance has been in Kenya for long but little used. The findings also revealed that venture capital has an impact on growth of SME they

finance. The study has demonstrated that use of venture capital can be profitable in Kenya even in an inauspicious political and economic climate. The study concluded that SME that use venture capital experience improved growth and thus more SMEs should be encouraged to use this form of finance if the country has to achieve its vision 2030. Similarly, The World Bank in its 1989 report notes that finance is the key to investment and hence to growth (World Bank, 1989).

Although the reasons to seek venture capital are obvious, the entrepreneur and the venture capitalist must be aware of the conflicts of interest that exist between them. Deal terms structured by the venture capitalist should address these conflicts of interest by minimizing the risk and maximizing the returns for the VC. Structuring deal terms in the venture capital world can be a very complex process.

## **1.2 STATEMENT OF THE PROBLEM**

Despite their significance and the increased efforts by the government of Kenya and other stakeholders to ensure the success of small scale enterprises, past statistics indicate that they exhibit high birthrates and high death rates with 40% of the startups failing by year two and at least 60% closing their doors by year four (Kenya National Bureau of Statistics, 2007; Fina Bank Report, 2007). SMEs, in Kenya have difficulties in growth. They hardly grow beyond the start-up stage. Others go out of business at a very early stage (Browyn, 1995). The study undertaken by Hallberg (1998), and Mead & liedholm (1998) revealed that access to finance is an important ingredient to the development of SME. They have few alternatives of accessing finance other than relying on their retained earnings to finance their investments.

Notwithstanding the financial difficulties faced by SMEs presently in Kenya, alternative sources of funds have to be sought to sustain this important sector.

Venture Capital is one source of non-bank financing, which is quite prevalent in developed financial markets for small or start up firms (Keuschnigg 1998). Venture Capitalists are organized providers of financing for winning but risky business proposals by small and medium firms that have a promising but as yet unproven idea. If the Venture Capitalists are convinced that a business idea is promising, they will take an ownership stake in the business and provide the needed fund while sharing the risk. It is expected that many country's small businesses whose growth has been constrained by shortage of capital or increased cost of borrowing will have another source of finance.

Venture capital, which is quite prevalent in developed countries, has played a big role enhancing growth of SMEs by providing equity capital. In countries where both forms of venture capital participate in financing SME, they are value adding investors who bring significance benefits of their business Know. The researcher feels that though venture capital firms have been present in Kenya as early as 1970 their impact on SMEs has not been significant.

### **1.3 GENERAL OBJECTIVE**

The general objective of this study was to analyze the effectiveness of venture capital on SMEs in Nanyuki Town Laikipia County.

### **SPECIFIC OBJECTIVES WERE:**

- i) To find out how effective venture capital is on SMEs' increase in assets/capital in Nanyuki town.
- ii) To explore how effective venture capital has been on increase of sales of SMEs' in Nanyuki town.
- iii) To analyze the extent to which venture capital has influenced the increase of employees in SMEs' in Nanyuki town.
- iv) To establish how venture capital has influenced the increase in number of start-ups of SMEs' in Nanyuki town.

### **1.4 RESEARCH QUESTIONS**

- i) How does venture capital affect SMEs' increase in assets/capital in Nanyuki town?
- ii) How effective has venture capital been on increase of sales of SMEs' in Nanyuki town?
- iii) To what extent has venture capital influenced the increase of employees of SMEs in Nanyuki town?
- iv) How has venture capital influenced the increase in number of start-ups of SMEs' in Nanyuki town?

### **1.5 SCOPE OF THE STUDY**

The scope of this research was limited to SMEs which are registered in Nanyuki town council from documents collected from the Revenue section of Town council (2011). The SMEs are classified as Retail shops, Hardware shops, Salons, Chemists, Restaurants Supper-markets and Cyber Cafes. The researcher seeks to analyze the effectiveness of venture capital on SMEs in Nanyuki Town Laikipia County.

### **1.6 SIGNIFICANCE OF THE STUDY**

The results to this study will fill the knowledge gaps by giving information regarding the effectiveness of venture capital on SMEs growth in terms of assets expansion and employees turn-up.

The results will also help the government policy makers in improving the management and control of public venture capital firms to ensure that the firms are able to provide better services to the SMEs. Scholars who have interests in this research area will use the findings and recommendations as a background for their future academic research work.

### **1.7 ASSUMPTIONS OF THE STUDY**

The study assumed that the sample selected was a representative and hence the findings of the study would be generalized to represent the entire target population. The study also assumed that the information given by the respondents was reliable and accurate.

## **1.8 LIMITATIONS OF THE STUDY**

Some of the limitations that the researcher encountered included: language barrier since Nanyuki is occupied by people from diverse ethnic groups some who have not embraced formal education like the Maasai. Also finance to search and identify those registered and using VC in funding SMEs. A lot of money is required to carry out the research. Money is needed to move around to collect the data, type, print and bind the final documents. There was constraint of time due to the fact that the researcher was involved in full-time employment.

## **1.9 RESEARCH GAP**

A substantial portion of the SME sector may not have the security required for conventional collateral based bank lending, nor high enough returns to attract formal venture capitalists and other risk investors. In addition, markets may be characterized by deficient information (limiting the effectiveness of financial statement-based lending and credit scoring). This has led to claims of an "SME finance gap" – particularly in emerging economies.

## **CHAPTER TWO: LITERATURE REVIEW**

### **2.0 INTRODUCTION**

The definition of SME varies by country, or more specifically, by market size. Countries with large economies like the US and member states of the EU use cut-of points of fewer than 500 workers to describe SMEs. In developing countries cut-of points of fewer than 100 workers or 250 workers are often used. Small and medium enterprises (SMEs) play important roles in the economic growth and sustainable development of any economy (Ariyo, 2005). The potential benefits of SMEs to any economy include contribution to the economy in terms of output of goods and services; creation of jobs at relatively low capital cost; provision of a vehicle for reducing income disparities; development of a pool of skilled and semi-skilled workers as a basis for future industrial expansion, among others (Ariyo, 2005). Despite the fact that SMEs play crucial roles in the development of an economy most of the African countries have not been able to establish an environment conducive for the development of SMEs (Stiglitz & Weiss, 1981). The major constrain is lack of proper policies by the governments to ensure easy access of funds by the entrepreneurs. World Bank, 1989 did a study which found that among the developing countries and especially Kenya venture capital has been present since independence yet industrialization is slow.

This chapter will consider looking on inspiring theoretical foundation formulated by Joseph Schumpeter in 1983 assisted by other Entrepreneurs like Drucker Peter. It will

also state the characteristics and definition of Venture Capital and Venture Capitalist giving the best side of the two on SMEs especially those SMEs on VC.

## **2.1 THEORETICAL LITERATURE REVIEW**

Joseph Schumpeter (1983) mechanized the shaping of the theory of entrepreneurial bustle, discovering the reality of an evolution from being entrepreneurial to a traditionally managed organization. This transition is characterized by increase of sales, assets, profit, sustainability of employees and establishment of new businesses among others. The entrepreneur is inventive and innovative, whether by invention or by innovative combinations of previously existing elements. Emeric and Atilio (2005) facilitated by saying this entrepreneurial behavior is driven by opportunity, and in turn, drives economic progress. As the “innovation” is assimilated over time and becomes established (the firm is successful), Schumpeter (1983) observed that the firm changed from being entrepreneurial to being managerial; administered and managed as a traditional, established businesses. This was the vehicle by which the organization achieved economy of scale and efficiency. This transition was significant to Schumpeter. In his theory Schumpeter highlighted the key indicators of growth in a business. Among them: increase in assets, increase in sales, profit making and establishment of new businesses.

The practice of venture formation, or any stages following a firm is having achieved operational success were not as significant - from either the economic or administrative views.

Peter Drucker (1999) focused on the managerial complexities presented by growth though he had seen the transition. Focusing on the managerial activities related with the

firm provides insight regarding the size of the company, its evolution, and a very specific linkage to the behavior of the entrepreneurial individual:

“The size, then, changes neither the nature of the business nor the principles of its direction. It does not affect the basic managerial problems of managers. It does not affect in any way the direction of the work or the worker. But the size does affect to a great extent the management structure. A certain size requires a certain kind of behavior and attitude from the management bodies. And even more important than the size itself is the change in size, i.e., growth.”

“In the small business, neither the active position of the chief executive nor the task of setting the goals requires a full-time occupation. The person in charge of a small company can even simultaneously manage the business and perform another function such as being in charge of sales or manufacturing.

“The following stage of the size of the business is probably the most common; and it is also one of the most difficult to handle. The disability to solve the problems of the managerial organization in this stage is one of the most common and more serious causes of difficulties. Yet this stage does not have its own name and is not even recognized customarily as a specific stage.” (Drucker, 1999)

Concurrently, Arthur Chandler’s (1962, 1980) seminal research into successful organizations looked at the relationship between an organization’s intentions (strategy) and its structure. Underlying his work is the central assumption that organizations seek growth. His discovery that the organization’s structure was the result of the organization’s strategy was revolutionary.

Entrepreneur having no structure are merely organizations. As a result of entrepreneurial strain, the organization implements a functional structure to gain efficiency. As it once again encounters pressures, the functional structure is modified to incorporate additional structures for vertical integration. Subsequent pressures result in divisional levels being added, retaining the central efficiencies of functional structures. Subsequent research has not altered this understanding of an organization's initial stages of structure. These fundamentals are taught to every business student as the basic concepts of organization theory. Furthermore, based on the work of Chandler et al., (1962) measures for determining an organization's "structure" are generally accepted, and likewise have been taught to business students for at least 30 years.

These measures include: formalization, standardization, centralization, span of control, specialization, hierarchy of authority, complexity, professionalism and personnel ratios (Hall, 1972; Daft, 2001).

Churchill and Lewis's (1983) decisive work focused on small, entrepreneurial businesses while Chandler's work focused on large firms. They identified some of the problems and patterns exhibited by growing entrepreneurs, and discovered that firms could be classified within five growth stages. A firm begins its existence as an entrepreneurial firm, without formality of processes or organizational structure per se. The entrepreneur fulfills multiple roles – performs multiple tasks, including the tasks of management by direct supervision. The initial stage of venture initiation is followed by the survival stage. With success, resources are required to facilitate growth. While Churchill and Lewis emphasize the resource requirements and the varying demands placed upon the entrepreneur during growth, their stages of growth parallel Chandler's. The resource

requirements at formation are predominantly financial, whereas during growth, managerial skills and human resources become critical. As a result of growth, the entrepreneur transitions into 2 stages of functional structure, then into a divisional structure.

Churchill and Lewis' research complements Chandler's research with large, established organizations. Both sets of researchers identify organizational characteristics that can be associated with stages of growth and expansion. The firm both adapts and changes or it fails after experiencing challenges (or crises). Each change modifies the firm's management and structure. The firm transitions from an entrepreneurial firm to a functional structure, seeks economies of scale and efficiencies. This requires the implementation of formal structures and a functional style of management - a significant change from the previously unstructured entrepreneurial firm. Overlaying these two researcher's classification systems with the Schumpeter's simple point of demarcation reveals theoretical accord about there being a critical transition point - the point at which the entrepreneur (and the entrepreneurial firm) makes a transition to a functionally managed organization.

### **2.1.1 Characteristics and definitions of venture capital**

Venture capital is one of the most up-to-date forms of investment. Its nature is that private firms are financed through increasing their basic capital for concrete period. This is a cooperation and partnership between investor and entrepreneur resulting from former agreed conditions about both-side advantageousness. Concerning different authors and points of view on venture capital investments, we may define venture capital in several

ways. Venture capital is thus the alternative form of obtaining the financial sources for small and medium enterprises. Unfortunately, in transitive countries this form of financing is rarely used.

Venture capital is capital provided by outside investors for financing of new, growing or struggling businesses. Venture capital investments generally are high risk investments but offer the potential for above average returns. A venture capitalist (VC) is a person who makes such investments. A venture capital fund is a pooled investment vehicle (often a partnership) that primarily invests the financial capital of third-party investors in enterprises that are too risky for the standard capital markets or bank loans. For aspiring entrepreneurs looking to locate and secure venture capital they have the option of seeking the support of a mentor capitalist. A mentor capitalist is an expert not only in acquiring capital but he can also provide support and direction to early start-ups and seeds (Mc Kinsey, 2002).

European Venture Capital Association defines venture capital as “equity capital offered by professional firms investing together with firm managers for the establishment, development, or transformation of private firms that have a growing potential. Venture capital offers support in a form of advisory in strategy. Relatively high risk is compensated by high expected revenues.”

On the other hand, according to the European Venture Capital and Private Equity ‘venture capital’ is defined as “subset of private equity and refers to equity investments made for the launch, early development, or expansion of a business.” Private equity is broader in meaning and is also used to define “external equity capital that is raised to

strengthen a company's balance sheet, to make acquisitions or to finance a management buy-out or buying" (Romain and Pottelsberghe, 2004; Wright and Robbie, 1998.)

Venture capital or private equity is a financing alternative for entrepreneurial firms when traditional financing mechanisms like bank loans and other credits are difficult or even impossible to obtain. As such, private equity has developed as an important intermediary in financial markets and is especially appropriate for the financing of firms where large information asymmetries and agency problems are present (Admati and Pfleiderer, 1994; Gompers and Lerner, 2001)

Venture capitalists intervene as an intermediary in financial markets providing capital to small firms with high growth potential. Venture funded firms are generally very small and young, often called innovative start-up, and are plagued with very high levels of uncertainty and an important information asymmetry between investors and entrepreneurs (Berger and Udell, 1998; Gompers and Lerner, 2001). The venture capitalists provide financial support, as equity to support fast growth, and nonfinancial support as guidance and expertise may sit as board of directors and may perform key corporate functions for the venture-backed companies or provide valuable governance and advisory support. A growing number of empirical investigations outlines the crucial importance of VC for high-tech start-up growth (Campbell, 2003), product marketing strategy [Hellman and Puri, 2002] and survival (Manigart, Baeyens and Van Hyfte, 2002). The aggregate role of VC in the economy begins also to be an important area of research but very few quantitative investigations have been performed so far.

Moreover, survey evidence shows that more than 70% of professional investors labels accounting disclosure as the most important item which impacts their investment decision (Mc Kinsey, 2002) Private equity investors are intensively involved in their portfolio firms' day-to-day activities and contract a substantial number of controls like cash flow and control rights contingent upon observed performance measures. Since these private equity investors are involved in governance, they bring the professionalism into firm management except of all other positive effects described later on in dissertation.

### **2.1.2 What venture capital firms look for**

Swaab Attorneys (2012) stated that venture capitalists are higher risk investors and in accepting these higher risks, they desire a higher return on their investment. The venture capitalist manages the risk/reward ratio by only investing in businesses that fit their investment criteria and after having completed extensive due diligence.

Venture capitalists have different approaches to investment, which may relate to the location of the business, the size of the investment, the stage of the company, the industry specialization, the structure of the investment, the financial state of the company and the amount of involvement of the venture capitalists in the company's activities. You should not be discouraged if one venture capitalist does not wish to proceed with an investment in your company. The rejection may not be a reflection of the quality of the business, but rather a matter of the business not fitting with the venture capitalist's particular investment criteria (Swaab Attorneys 2012).

A venture capitalist typically seeks: superior businesses - venture capitalists generally look for companies with superior products or services targeted at fast-growing or untapped markets with a defensible strategic position quality and depth of management - venture capitalists must be confident that the business has the quality and depth in the management team to achieve its aspirations.

Swaab Attorneys continues to state that venture capitalists rarely seek managerial control, but sometimes they will assist the founders to identify and hire new managers. They want to add value to the investment where they have particular skills including fundraising, mergers and acquisitions, international marketing and networks. The venture capitalist will want to ensure that the company has the willingness to adopt modern corporate governance standards, such as nonexecutive directors, including a representative of the venture capitalist appropriate investment structure - as well as the requirement of being an attractive business opportunity, the venture capitalist will also be seeking to structure a satisfactory deal to produce the anticipated financial returns to investors.

Venture capitalists are put off by complex corporate structures without a clear ownership base and where personal and business assets are merged exit plan - venture capitalists look for clear exit routes for their investment such as public listing or a third-party acquisition of the company. If a company does have the qualities venture capitalists seek such as a solid business plan, a good management team, investment and passion from the founders, a good potential to exit the investment before the end of their funding cycle, and target minimum returns in excess of 40% per year, it becomes much easier to get venture capital (Marián Gál, 2007).

### **2.1.3 Is VC suitable for all Entrepreneurs?**

Venture capital is not suitable for all entrepreneurs (Marián Gál, 2007), firms suffering from lack of attainable capital from foreign sources try to find new ways and possible financial means in order to continue in their entrepreneurial activities. Moreover, banks usually are not willing to provide loans to start-up companies and thus such loans may become too expensive for small entrepreneurs if they use them to improve their financial position. On the other hand, since SMEs are indebted they seek for different forms of capital that would allow further survival and latter also development and improvement of their position on the market. At present, one of such new forms of capital is a venture or equity capital (Marián Gál, 2007).

Venture capitalists are very selective in deciding what to invest in; as a rule of thumb, a fund invests only in about one in four hundred opportunities presented to it. They are most interested in ventures with high growth potential, as only such opportunities are likely capable of providing the financial returns and successful exit event within the required timeframe that venture capitalists expect. Because of such expectations, most venture funding goes into companies in the fast-growing technology and life sciences or biotechnology fields. Because of these strict requirements, many entrepreneurs seek initial funding from angel investors (Gladstone and Gladstone, 2002)

### **2.1.4 Concept of VC on SMEs: Role played by venture capital**

Venture capital providers are found to invest a large portion of their funds into young firms that exhibit potential for large scale (Puri and Zarutskie, 2008). This evidence suggests that venture capital may play an increasingly critical role for small businesses,

not only to close a possibly emerging funding gap, but also for firms that might otherwise face impediments attracting funding due to information asymmetries, the absence of a convincing track record for marketable products, and the lack of assets that can be pledged as collateral for bank loans (Gompers and Lerner, 2001). It is also argued that venture capital is not only critical in helping firms overcome credit constraints, but it also helps firms to be born in the first place (Bottazzi and Da Rin, 2002; Mollica and Zingales, 2008). Venture capital organizations can contribute to small and innovative firms in a number of different ways. Lerner (1995) and Gompers and Lerner (1996) highlight that venture capitalists finance firms with few tangible assets that banks would find difficult to finance because venture capital providers are more effective in monitoring their investments. Black and Gilson (1998) propose that a venture capital provider can enhance a firm's reputation to receive better terms and conditions when applying for financing, and Hellmann and Puri (2000) and Bottazzi et al. (forthcoming) show venture capitalists help professionalize the firms in which they invest.

Moreover, the venture capital industry can also play a crucial role in the expansion of a business. It is in the expansion stage of a business that most jobs are usually created. It is also the time when the management team will probably need to expand and become 'professional'. The involvement of venture capital providers is essential to the success of this process. About a quarter of business angel activity takes place in the expansion stage, where the practical guidance angels can offer is again immensely valuable. Indeed, it has been argued that the UK's venture capital industry is much more effective at this stage than at the start-up stage (Centre for Policy Studies, 2001).

Venture capital financing is attractive due to many reasons. Venture capitalists (VCs) allow the entrepreneur to raise all the money from one place. Given that VCs are in the business of building businesses, they have plenty of experience with the challenges of start-ups. Also, VCs usually have been through the process growing the company to Initial Public Offering (IPO) and other desired liquidation events (Kramer, B., Patrick, M., 2003.). VCs usually have a large rolodex of contacts which can help the company become successful. VCs can also give assistance in hiring members of the management team if necessary.

Furthermore, “venture-backed firms also perform significantly better after they go public than similar non-venture-backed firms” (Bratton, W., 2002).

### **2.1.5 Venture capitalist in Kenya**

Venture capital can be provided by business angels, independent venture capital firms (IVCs), corporations, or universities (Alain F. and Joseph L., 2009-12) Due to perceived market opportunities and demonstrated success of the USA, Venture Capital industry had a capital base of USA. \$3.8 billion in 1995. Other developed countries like United Kingdom, Australia, Israel and shelters to encourage investors to create Venture Capital pools (Keushnigg, 1998).

In Kenya private Venture Capital firms include: Kenya Equity and term financing which supports existing companies that wish to expand rather than start-up operations. Acacia Fund Limited provides risk capital to new or expanding enterprises, including the reorganization, rationalization and reconstruction. Aureos East Africa which provides private equity and loan facilities has replaced the activities of Acacia (The Finance Mail

Vol 9 no.6, 2003). Kenya Management Company Limited, which provides equity, related investments in private sector to companies with high growth potential to expand well-run businesses. International Journal of Business and Social Science Vol. 3 No. 6; [Special Issue -March 2012].

**Donor backed public Debt Corporation that offer Venture Capital includes:**

- i. Industrial credit and Development Corporation (ICDC) provide capital directed at profitable existing small and medium sized industrial or commercial projects seeking expansion, modernization, restructuring or diversification of existing activities. They also support business start-ups with firm prospects for financial and technical development. However its performance has been poor in the recent past and the World Bank which is the major source of its funds has called for liquidation. International Journal of Business and Social Science Vol. 3 No. 6; [Special Issue -March 2012].
- ii. Industrial Development Bank (IDB), which is a subsidiary of ICDC, currently restructuring its operations to serve SMEs better.
- iii. Commonwealth Development Corporation

The presence of both private and government venture capital in Kenya is evidence that firms have a wide range of different sources of finance.

## 2.2 EMPIRICAL LITERATURE

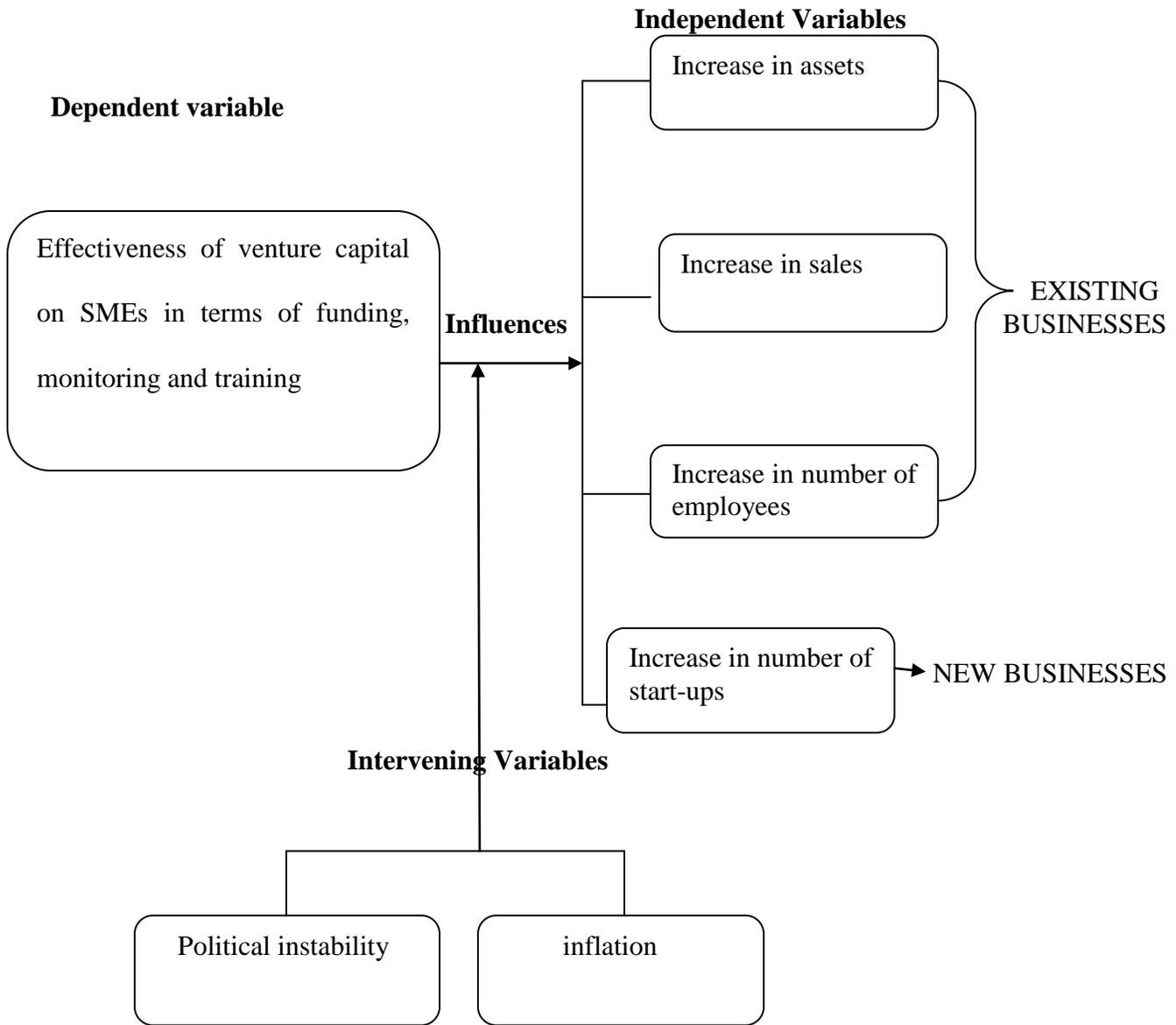
A number of factual evidence on the economic impact of venture capital has been published especially for the USA economy which supports the finding of this study. According to a study carried out by Astrid & Bruno (2004) on venture capital funded firms for the period 1970-2000, the sales doubled, paid almost twice the federal taxes, generated almost twice the exports and invested almost three times as much in research and development as the average non-venture capital backed firms. The European Venture Capital Association (2001) has also established that venture capital backed firms report a high growth in sales as compared to other firms. The result reveals that venture capital leads to growth on sales of the firms that use these funds.

In a study done by Memba, Gakure and Karanja (2012) their analysis indicated that the minimum profit of studied SMEs before use of venture capital was Ksh 34,866. Upon use of venture capital, the minimum profit increased to Ksh 600,000. This shows an increase in minimum profit of 94%. The maximum profit respondents reported before use of venture capital was Ksh 38,567,951 which increased to Ksh 62, 864,152 an increase of 63%. The average profit also increased by 69% (from Ksh 7,204,653 to Ksh 12,202,775). This finding then implies that firms that use venture capital experience growth in profit. Again in a similar study by Chaganti and Mahajan (1983) reported similar trend in Indian SME that used venture capital. The important aspect here is not just the finance the venture capitalists provide value creation in the venture. Empirical evidence (Brav and Gompers 1997) confirms that increase in profit by venture capital-backed firms is often attributed to better management teams and corporate governance structures that help these companies to perform better in the long run.

Memba, *et al.*, (2012) also realized that merchandizing types of business reported an average growth in profit margin of 18.2%, followed by agriculture 14.4%, service 12.8% and manufacturing 9.3%. As a result of use of venture capital this implied that all the businesses from whatever sector they belong realized growth in profit. Puri & Zarutskie, 2008, justifies by saying that while merchandizing is considered a low technological sector that venture capitalists are careful in investing their money, it seems to have a high (18.2%) average growth rate compared to manufacturing which is a preferred type of business with high chances of initial public offering (Gompers & Lerner, 2001). This finding relating to high profit margin for merchandising in relation to other types of business is interesting and could have been related to cost saving and increased efficiency in use of recourses and cross monitoring by venture capitalists. This result suggests that venture capitalists focus on scale or potential for scale rather than profitability. However each type of business has shown that profit margin grew upon use of venture capital indicating that venture capital has an influence on performance of SMEs.

### **2.3 CONCEPTUAL FRAMEWORK FOR THE STUDY**

The conceptual framework presented on figure 2.1 shows the various determinants of executive staffing approach in subsidiaries in multinational companies. The framework shows that the variables are interlinked; none of them operates in isolation. Increase in assets stock, increase in stock and increase in number of employees together with increase in number of startups of SMEs in Nanyuki town.



**Figure 2.1: Conceptual Framework adopted from Schumpeter’s theory on growth of a business.**

### **2.3.1 Increase in assets**

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

Increase in assets is every SMEs dream as it signifies the firms or businesses growth and capability of managing capital. Like some of studies has focused on SMEs growth this study will go ahead to consider viewing companies or businesses increase in assets stock. This will provide a clear view of the effectiveness of venture capital on SMEs growth.

### **2.3.2 Increase in sales**

Melissa Campeau (2013) reported findings from a survey Conducted by Industry Canada; the survey compiled responses from 9,997 SMEs and found nearly two thirds reported an increase in sales over the 2009 to 2011 period. More than 4 in 10 (44%) saw their business grow between 1 and 10% per year, 11% grew between 11 and 20% and 8% were considered high-growth firms, growing more than 20% per year. Only 22% indicated their sales had not grown at all, while 16% experienced declining sales. The majority (56%) expect their sales to grow either moderately (between 1% and 10%) or significantly (12% expect to grow between 11% and 20% and 8% expect to grow more than 20%). Only 18% of firms expect no growth, while 7% forecast a decline in sales.

Memba, Gakure and Karanja on their study agree that a number of factual evidence on the economic impact of venture capital has been published especially for the USA economy which supported the finding of their study. They cited Astrid & Bruno (2004) on venture capital funded firms for the period 1970-2000 which indicated that the sales doubled, paid almost twice the federal taxes, generated almost twice the exports and invested almost three times as much in research and development as the average non-venture capital backed firms. They also cite the European Venture Capital Association (2001) which established that venture capital backed firms report a high growth in sales as compared to other firms. Later their result revealed that venture capital leads to growth on sales of the firms that use these funds.

### **2.4.3 Increase in number of employees**

The economic impact of venture capital has been realized by SME in sales growth, profit, asset and improvement in management of finance and other resources. The social impact from venture capital perspective include the employment opportunities created which have improved peoples' lives and alleviated poverty among the employees. It is common sense that the employees have joined cooperatives which help them to alleviate cash flow problems.

This study reaffirms the correlation between SME development and poverty alleviation. The study has demonstrated that use of venture capital can be profitable in Kenya even in an inauspicious political and economic climate. The impact touched on both economic and social-economic factors. The economic impact of venture capital has been realized by SMEs in sales growth, profit, asset and improvement in management of finance and other resources. The social impact from a venture capital perspective includes the employment opportunities created. The increased profits imply revenue collection for government expenditure through collection of tax. Also venture capitalists do not just provide funds, but add value to SMEs, that is, they are not only involved in financing but also spur entrepreneurs who are responsible for economic growth.

Venture capital 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. Venture capital not only assists SMEs in the provision of funds, but also in the internal operations of the business and especially in policy formulation. As a result, this study concluded that venture capital has demonstrated the business case for SME investment.

In Belgium, for example, data from May 2010 show that employment is now growing in SMEs, due in particular to a growth in part-time work. Indeed, skills shortages in some sectors are now reported in Belgium. In some countries, such as Bulgaria, microenterprises are reported to have increased in number during the crisis. In the Czech Republic there has been a significant growth in SMEs functioning as internet shops, of which there are estimated to be over 10,000. This indicates that, as there has been an overall decrease in the number of SMEs in the country, there has been a shift between sectors. In Poland, although job losses have been reported in SMEs in sectors such as construction and manufacturing, 80% of SMEs have indicated that they have not reduced employment.

Kenya is a developing country with lots of number of unemployed youths. Most of youths in Kenya tend to start business and others start with micro enterprises which are difficult to maintain since there are no sources of fund and if some exist requirements are beyond accessibility. The research is therefore intending to seek information on how Venture capital has affected the increase of employees in many SMEs in Nanyuki town with the aim of alleviating poverty.

#### **2.4.5 Increase in number of start-ups/new businesses.**

Funding is an unreasonably important hindrance for high-growth firms compared to other businesses. NESTA (2011) approximates that 18 per cent of high-growth firms consider funding, either short-term cash flow (13 per cent) or longer-term finance (5 per cent), to be the most important barrier to growth that they face.

There are good facts to suggest that access to investment does have a beneficial impact on business start-ups and growth, which will contribute to economic growth. For instance, a review of empirical studies exploring business growth done by Stam and Garnsey (2008) showed that of the five studies which examined the impact of start-up capital on the growth performance of businesses, three found a positive relationship, while two found no statistically significant relationship. These three empirical studies show a positive correlation between start-up capital and growth after controlling for characteristics of the founder, but do not necessarily provide evidence of a causal relationship. In addition, Aghion, Fally and Scarpetta (2007) found that higher finance development increases new firm entry in sectors which are heavily dependent upon external finance. The authors find finance is most important for smaller businesses, but also enhances post entry growth of firms in sectors which are most dependent on external finance.

There is also some empirical evidence to suggest better access to finance leads to higher productivity within an economy. Butler and Cornaggia (2009) indicate access to finance has a positive impact on productivity as measured in agricultural crop yields in different US states.

## **CHAPTER THREE: RESEARCH METHODOLOGY**

### **3.1 INTRODUCTION**

This section presents the methods that were adopted by the researcher during the study. This included the research design, target population, sample design, data collection instruments, data analysis and presentation.

### **3.2 RESEARCH DESIGN**

According to Kerlinger (2004), a research design is a plan, structure and a strategy of investigation so conceived as to obtain answers to research questions or problems. This study adopted a descriptive research design. Gravetter and Forzano (2011) explain that descriptive research design involves the measurement of a variable or a set of variables as they naturally exist and that this design provides detailed information on the variables under study.

### **3.3 POPULATION**

Target population is that population to which the researcher wants to generalize the results of the study (Mugenda & Mugenda, 2003). There were 560 registered SMEs in Nanyuki town council from documents collected from the Revenue section of Town council (2011) classified as Retail shops, Hardware shops, Salons, Chemists, Restaurants Supper-markets and Cyber Cafes. From this population, the researcher sampled 56 SMEs for the study at a 10% sampling error. The target respondents were the proprietors or their HRs. Where applicable they were drawn from the active SMEs in Nanyuki town.

### 3.4 SAMPLING TECHNIQUE

A sample is a set of entities drawn from a population with the aim of estimating the characteristics of a population (Mugenda & Mugenda, 2003). To analyze the effectiveness of venture capital on performance of small and medium enterprises in Nanyuki Town Laikipia County, 10% of the owners and employees from selected SMEs were selected as respondents. To get the desired sample size, the researcher used systematic sampling by picking a representative sample from every category of SMEs. Systematic sampling according to Cohen et al. (2007), involves the division of the population into homogenous groups with each group containing subjects with similar characteristics. The study adopted the above said sampling selection and procedure since it was hard for the researcher to indentify the actual figure of SMEs on VCs. The sample size,  $x = 10\%$  of the population size (560) ,  $x = \frac{10}{100} \times 560 = 56$

**Figure 3.1 Non-proportionate Sampling**

<b>Strata/Group</b>	<b>Total Population</b>	<b>Sample Size</b>
Retail shops	170	17
Hardware shops	130	13
salons	70	7
restaurants	100	10
Cyber cafes	30	3
Chemists	50	5
Supermarkets	10	1
<b>Total</b>	<b>560</b>	<b>56</b>

**Source: Author (2013)**

### **3.5 DATA COLLECTION**

Axinn and Pearce (2006) explain that there are four data collection methods: questionnaires, interviews, observations and focus group discussions. In this study a questionnaire was used. Axinn and Pearce (2006) argue that questionnaires provide a high degree of data standardization and adoption of generalized information amongst any population. Cannoway and Powell (2010) add that questionnaires are advantageous since respondents are filled up by the respondents in their own comfort and facilitate the collection in large amounts of data in a relatively short time. They also tend to encourage accurate answers from the respondents hence eliminating bias. Questionnaires are further recommended by Kothari (2004), due to ease of administration and as less time consuming.

The questionnaire consisted of both open-ended and closed ended questions. Open ended questions are those that introduce a topic and allow participants to respond in their own words while closed-ended questions give answer options for the respondents to choose answers from (Gravetter & Forzano, 2011).

### **3.6 VALIDITY AND RELIABILITY**

Validity refers to the degree to which a study measures what it is intended to measure. In this case, content validity was applied to ensure that the questions in the questionnaire provide adequate coverage to the investigative questions. Content validity was tested by use of expert's opinion. The supervisor examined the instrument to ensure that the concepts are valid.

Reliability refers to the extent to which results of a study are consistent over time and accurate representation of the total population under study. To achieve reliability in this study, test-re-test method was used.

### **3.7 PRE-TESTING QUESTIONNAIRES**

To ensure validity and reliability of the data collection instruments, the questionnaires was pre-tested. Pre-testing is the administration of the data collection instrument with a small set of respondents from the population for the full scale survey (Mugenda & Mugenda, 2003). The purpose of pre-testing was to identify problems with the data collection instrument. Six questionnaires were pre-tested in Nanyuki. The responses were used to rectify the questionnaires to ensure that the questions could easily be understood by the respondents as intended by the researcher.

### **3.8 DATA ANALYSIS**

Data analysis was carried out on the data collected to a form that is suitable for use in drawing conclusions that reflect on interest, ideas and theories that initiated the inquiry, according to Babbie (2010). Further, data processing involves editing, coding, classifications and data entry (Kothari, 2004). Data will be analyzed using Statistical Predictive Analytical Software (PASW) formerly Statistical Package of Social Sciences (SPSS) and Excel. Inferential Correlation analysis will be used. Descriptive statistic will also be used, that is mean, and standard deviation. Cross tabulation will also be carried out to determine the relationship between variables. The output will be presented in tables and figures.

## **CHAPTER FOUR**

### **4.0 DATA ANALYSIS AND PRESENTATIONS.**

#### **4.1 INTRODUCTION**

In this chapter, the results and findings from the conducted study in Nanyuki town, are presented and discussed. The general objective was to analyze the effectiveness of venture capital on SME's in Nanyuki town. The specific objectives that guided the study were:

- i. To find out how effective venture capital is on SMEs' increase in sales in Nanyuki town.
- ii. To explore how effective venture capital has been on increase of assets of SMEs' in Nanyuki town.
- iii. To analyze the extent to which venture capital has influenced the increase of employees in SMEs' in Nanyuki town.
- iv. To establish how venture capital has influenced the increase in number of start-ups of SMEs' in Nanyuki town.

This chapter presents and analysis data collected using descriptive statistics. The questionnaire was the main method of data collection used. The data is interpreted in relation to the research questions and the results presented using tables, graphs and charts.

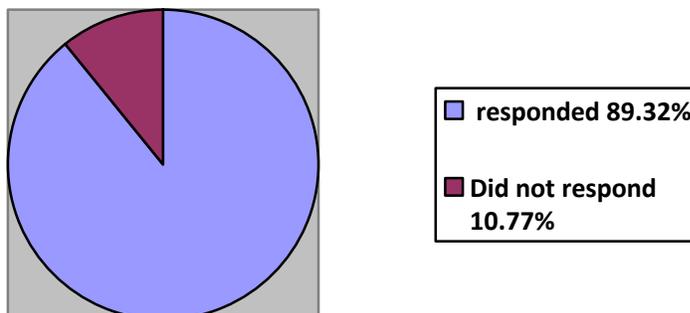
## 4.2 ANALYSIS OF RESPONSE RATE AND BACKGROUND INFORMATION

The study was carried out on the operators of small and medium enterprises in Nanyuki town who have venture capital in their businesses. These respondents were identified through random sampling. Out of 56 questionnaires administered to the respondents 50 were completed and returned, giving a response rate of 89.23%. Table 4.1 below summarizes the response rates.

### 4.2.1: RESPONSE RATE

A total of 50 small and medium enterprise operators responded by filling in data collection questionnaires, while 6 out of the 56 issued questionnaires were not returned. The researcher was able to gather enough information from the 89.23% who responded to the questionnaire. The respondents were classified in various groups according to the businesses they operate as shown in table 4.1.

**RESPONSE RATE**

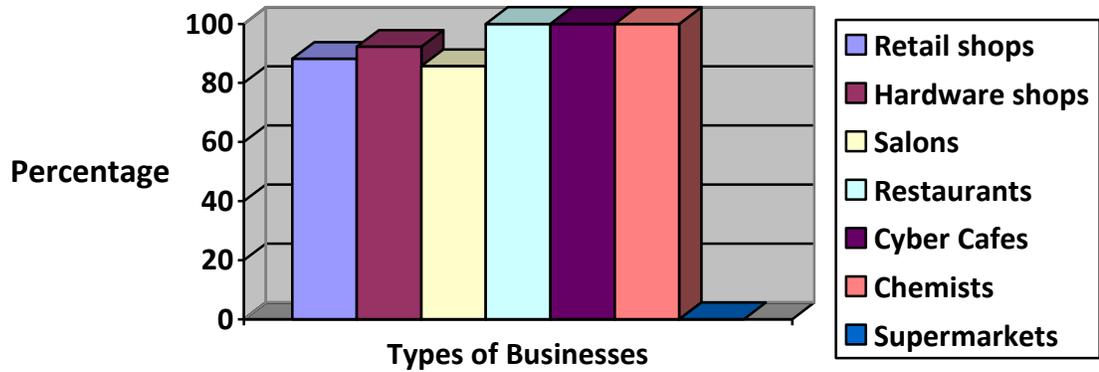


**Table 4.2.1 Analyses of response rates**

Type of business	Sample size	Number of respondents	Percentages
Retail shops	17	15	88.24
Hardware shops	13	12	92.31
Salons	7	6	85.71
Restaurants	10	10	100.00
Cyber Cafes	3	3	100.00
Chemists	5	4	100.00
Supermarkets	1	0	00.00
TOTAL	56	50	89.23

Source: Author 2014

## RESPONSE ANALYSIS



### 4.2.2 ANALYSIS OF BACKGROUND INFORMATION

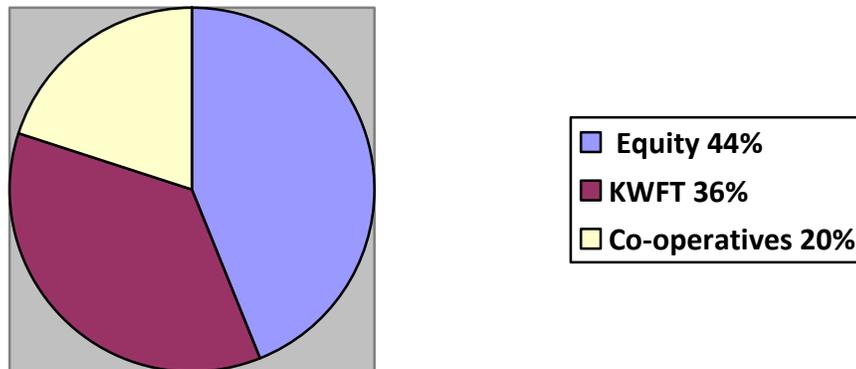
Questionnaires were only administered to businesses that have used venture capital. Random sampling was administered before the issuing of the questionnaires. According to the study the respondents used venture capital from local firms such as Kenya Women Finance Trust, Equity Bank, and cooperatives that are working with the Kenyan Government to empower women and youths economically. They provide women and youth fund. The table below shows the firms that provided venture capital to the respondents in the research.

**Table 4.2.2 Venture capital firms**

<b>Venture Capital Firm</b>	Frequency	Percentage
Equity Bank	22	44
Kenya Women Finance Trust	18	36
Cooperatives	10	20
<b>Total</b>	50	100

Source: Author 2014

### **VENTURE CAPITAL FIRMS**



### 4.2.3 INITIAL SOURCE OF FUNDING OF THE BUSINESSES

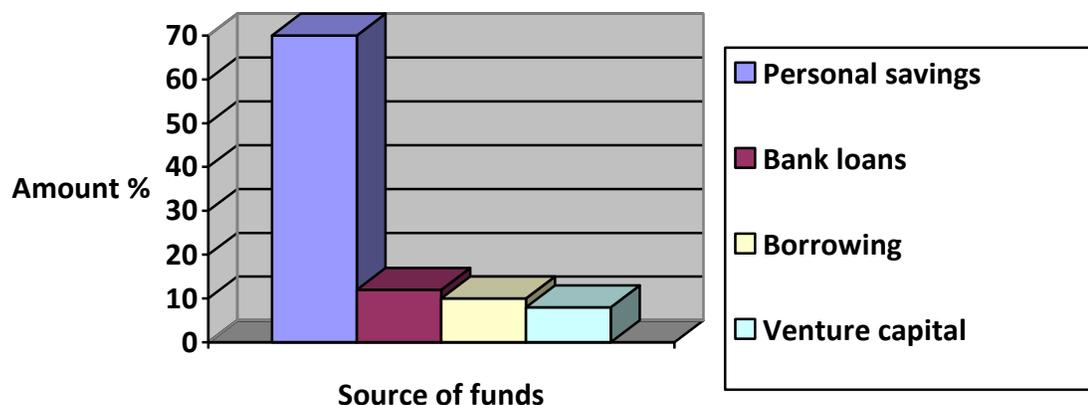
The study shows that although all the businesses are using venture capital, some of the respondents started their businesses by sourcing initial capital from other sources apart from venture capital. These include personal savings, loans from banks and borrowing from friends. Few businesses were initially funded by venture capital firms. This can be attributed to the fact that most of the venture firms do not fund start-ups but prefers established businesses that are promising. 70% were initially funded through personal savings, 12% through bank loans, 10% through borrowing from friends and 8% through venture capital. The table below shows how the businesses were initially funded.

**Table 4.2.3 Initial source of funding of the businesses**

<b>Source of initial funding</b>	Frequencies	Percentages
Personal savings	35	70
Bank loans	6	12
Borrowing	5	10
Venture capital	4	8
<b>Total</b>	50	100

Source: Author 2014

## INITIAL FUNDING



### 4.2.4. AGE OF THE BUSINESSES AND VENTURE CAPITAL FUNDING

After establishing the businesses the respondents desired to expand their businesses. One of the major constraints they were facing was lack of funds. In their search for funds, they came to know about venture capital through advertisements in the media, friends and relative. Though few new about venture capital even before they started the businesses. Majority were able to get VC funding during the initial stages of their businesses: that is within the first five years of establishment that accounts for 61%. 22% got VC funding between six to ten years, 14% got the funds between the eleventh and fifteenth year of establishment while 4% got the VC after the fifteenth year.

It was also noted that most of these business are less than ten years old. Putting in mind that 60% of new businesses die before or by the second year, VC can be attributed to the survival of the businesses in the study. The tables and the graphs below shows the age of the businesses and the time they have used venture capital.

**Table 4.2.4 1 Age of the Businesses**

Type of business	Age of the business			
	≤ 5years	6-10 years	11-15 years	16-20 years
Retail shops	12	3	1	0
Hardware shops	5	2	2	1
Salons	3	2	1	0
Restaurants	2	5	1	2
Chemists	1	1	2	1
Cyber Cafes	2	1	0	0
<b>Totals</b>	25	14	7	4
<b>PERCENTAGES</b>	<b>50</b>	<b>28</b>	<b>14</b>	<b>8</b>

Source: Author 2014

**Table 4.2.4.2 Life of Venture Capital Funding**

<b>Type of business</b>	<b>Life of Venture Capital Funding</b>			
	$\leq 5$ years	6-10 years	11-15 years	16-20 years
Retail shops	10	4	1	0
Hardware shops	6	3	2	1
Salons	4	1	1	0
Restaurants	5	2	2	1
Chemists	2	1	1	0
Cyber Cafes	3	0	0	0
<b>Totals</b>	30	11	7	2
<b>PERCENTAGES</b>	<b>60</b>	<b>22</b>	<b>14</b>	<b>4</b>

Source: Author 2014

#### **4.3 ANALYSIS OF THE EFFECTIVENES OF VENTURE CAPITAL ON ASSETS.**

Majority of the respondents started their businesses with less than thirty thousand shillings. However they have grown tremendously over the years after use of venture capital. They are valued over a hundred thousand Kenya shillings. The tables and graphs below show the assets growth rate from the initial capital to the current value or capital of the businesses after accessing venture capital funding.

Among the respondents 34% started with less than Ksh20,000, 24% between Ksh20,000-30,000, 16% between Ksh30.000-40,000, 10% between Ksh40,000-50,000 and only 16% of the respondents who started their businesses with more than Ksh50,000.

Currently, the businesses in the study 36% are valued less than Ksh100,000, 22% between Ksh100,000-200,000, 20% between Ksh200,000-300,000, 12% between Ksh300,000-400,000 while 10% are worth above Ksh500,0000.

It was also noted that apart from the money the venture capital led the businesses they also provided management skills to the entrepreneurs through training and monitoring the development of the businesses.

**Table 4.3.1 Initial capital**

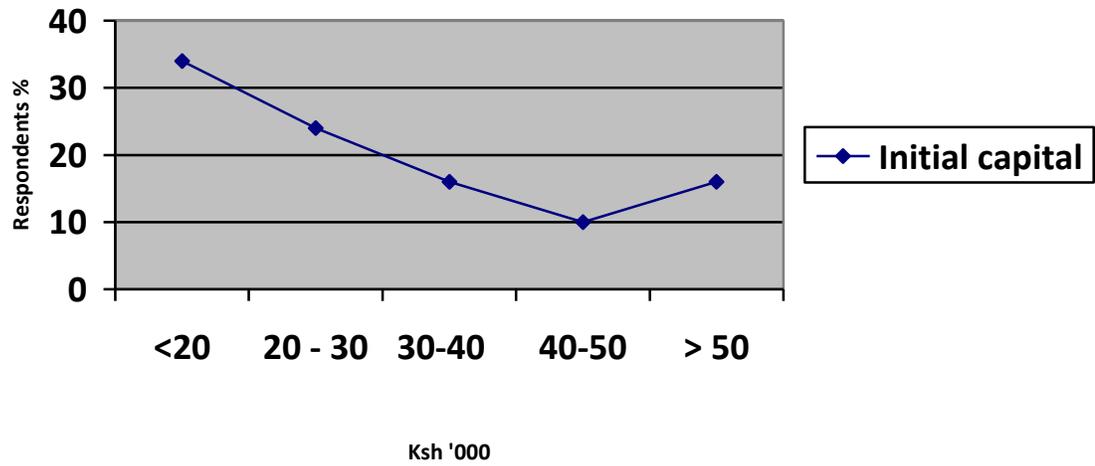
Type of business	Initial capital				
	Ksh000	Ksh000	Ksh000	Ksh000	Ksh000
	≤ 20,	20-30	30-40	40-50	≥ 50
Retail shops	8	4	2	1	
Hardware shops	2	3	2	2	3
Salons	4	1	1	0	
Restaurants	2	1	2	2	3
Chemists	0	1	1	0	2
Cyber Cafes	1	2	0	0	
<b>Totals</b>	<b>17</b>	<b>12</b>	<b>8</b>	<b>5</b>	<b>8</b>
<b>PERCENTAGES</b>	<b>34</b>	<b>24</b>	<b>16</b>	<b>10</b>	<b>16</b>

**Table 4.3.2 Current assets value.**

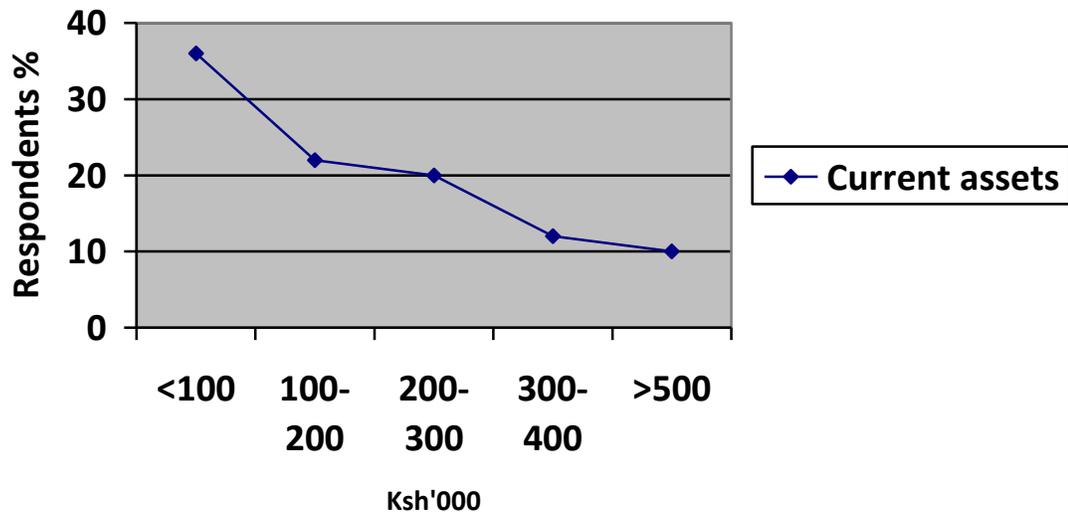
Type of business	Current capital				
	Ksh000	Ksh000	Ksh000	Ksh000	Ksh000
	≤ 100,	200-300	300-400	400-500	≥ 500
Retail shops	8	5	2	0	0
Hardware shops	2	1	3	4	2
Salons	4	2	0	0	0
Restaurants	1	2	3	2	2
Chemists	0	1	2	0	1
Cyber Cafes	3	0	0	0	
<b>Totals</b>	<b>18</b>	<b>11</b>	<b>10</b>	<b>6</b>	<b>5</b>
<b>PERCENTAGES</b>	<b>36</b>	<b>22</b>	<b>20</b>	<b>12</b>	<b>10</b>

Source: Author 2014

## INITIAL CAPITAL



## CURRENT ASSETS



#### 4.4 ANALYSIS OF THE EFFECTIVENES OF VENTURE CAPITAL ON SALES.

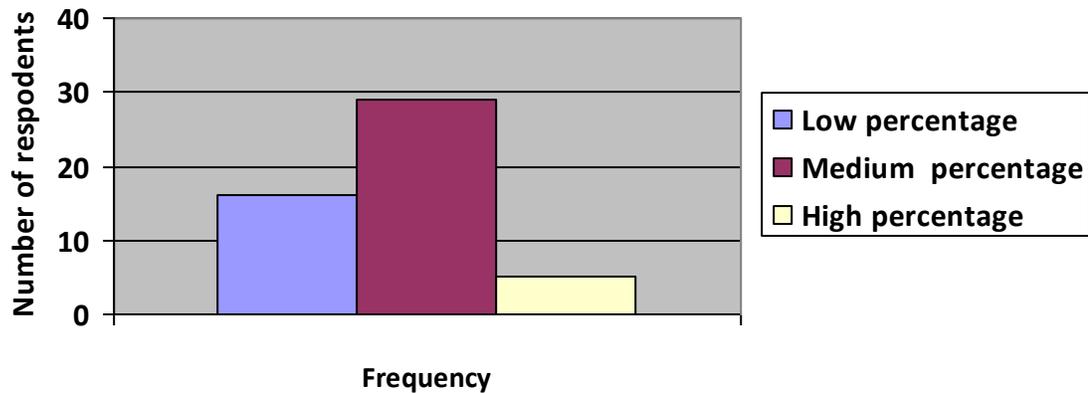
Majority of the respondents agreed that sales in their businesses increased as the businesses grew. The sales increased even more after use of venture capital. This is because they were able to add stock, advertise their businesses and got management skills of running the businesses. 58% of the respondents said that the sales increased at a medium percentage, 32% of the respondents said that the sales increased at a low percentage and 10% of the respondents said that sales increment was above average.

**Table 4.4.1 Effects of venture capital on sales.**

<b>Effects of VC on sales</b>	<b>Frequency</b>	<b>Percentage</b>
Low percentage	16	32
Medium percentage	29	58
High percentage	5	10
<b>Total</b>	<b>50</b>	<b>100</b>

Source: Author 2014

## EFFECTS OF VENTURE CAPITAL ON SALES



### 4.5 ANALYSIS OF THE EFFECTIVENES OF VENTURE CAPITAL ON JOB CREATION.

Most of the businesses started as sole proprietorships where the owners of the businesses were running the businesses all by themselves or with little assistant from the nuclear members of their families. In fact 58 % of the businesses had less than five employees, 32% between six to fifteen employees, while 10% had above fifteen employees before the use of venture capital.

Currently, after the use of venture capital, the number of employees generally increased in various businesses. Though the increment was small, it was noted that 90% of the businesses employed at least one employee. This can be attributed to the expansion of the businesses after use of venture capital. 48 % of the businesses have less than five employees, 32% between six to fifteen employees, while 20% have above fifteen employees.

**Table 4.5.1 Effects of venture capital on number of employees in a business.**

Number of employees	Before use of venture capital		After use of venture capital	
	Frequency	Percentage	Frequency	Percentage
Below five	29	58	24	48
Between six and fifteen	16	32	16	32
Above fifteen	4	10	10	20
Total	50	100	50	100

Source: Author 2014

#### **4.6 ANALYSIS OF THE EFFECTIVENES OF VENTURE CAPITAL ON NEW BUSINESSES.**

The study revealed that there has been an increasing situation of new businesses being started in Nanyuki town. 84% of the respondents said that about five new businesses are opened within their localities every year, 12% of the respondents talked about between six to ten new businesses and 4% talked of more than ten new businesses being opened in there localities every year. This can also be supported by the increasing new commercial buildings in Nanyuki town and its environs. Most of these businesses however, are closed within the first or the second year of their establishment.

Majority of the respondents were not sure if the businesses were as a result of the availability of venture capital funding in Nanyuki town. In fact 78% said they were not sure while 22% argued that the emerging businesses might be influenced by presence of VC in Nanyuki especially youth and women fund. It was noted that 8% of the businesses in the study were initially funded through VC funded through VC. The respondents said that some of the businesses were started with little capital and later. The increase of new businesses has led to high competition in various similar businesses.

**Table 4.6.1 Establishment of new businesses in Nanyuki town**

<b>New businesses</b>	<b>frequency</b>	<b>percentage</b>
Below five	42	84
Between six to ten	6	12
Above ten	2	4
<b>Total</b>	<b>50</b>	<b>100</b>

Source: Author 2014

**Table 4.6.2 Venture capital influence on start-up businesses.**

<b>VC influence of start-ups</b>	<b>frequency</b>	<b>percentage</b>
Not sure	39	78
Yes	11	22
No	0	0
<b>Total</b>	<b>50</b>	<b>100</b>

Source: Author 2014

## **4.7 CONCLUSION**

Majority of the respondents concluded that availability of venture capital have helped in the growth of their businesses and in turn helped improve their living. The respondents also agreed that Venture capital funding provided by the government together with other financial bodies such as Equity bank have helped in creation of new jobs to the youth and women in the society especially in the resent years. They cited youth and women fund as examples of public venture funding. To those entrepreneurs who have not accessed venture capital, the respondents encouraged to try since they have benefited a lot.

## **CHAPTER FIVE**

### **5.0 SUMMARIES, CONCLUSIONS AND RECOMMENDATIONS.**

#### **5.1 Introduction**

This chapter summarizes the findings of the study in relation to the objectives outlined in chapter one. Discussion, conclusions, recommendations, limitations and suggestions for further research have also been made from the study.

#### **5.2 Results and Discussion.**

A number of variables are considered to determine if use of venture capital by firms leads to growth of SMEs. They include, value of net assets, sales, profit, number of workers among others. In this study the variables that were used in the analysis of the effectiveness of venture capital on SMES in Nanyuki town includes: net assets ,sales, number of workers, new businesses among others. These variables were analyzed on a before and after venture capital basis.

##### **5.2.1 Effectiveness of venture capital on assets.**

Barnes (1990) observed that assets are particularly useful indicator of impact because their level does not fluctuate as greatly as others. Thus net assets are indicators of growth. Table 4.3.1 shows that assets of firms grew by a significant amount after use of venture capital. The maximum value of net assets/capital reported to have increased from around Ksh 100,000 to over Ksh 500,000. The minimum net assets/capital also increased from below Ksh 20,000 to over Ksh 100,000. This increase in value of net assets after use of venture capital is a worthy evidence to say that there is growth. Literature (Brigham and

Houston, 2001) confirms that growth in assets can be directly linked with availability of funds as the business expands. Since venture capital is equity capital to the business then net assets also increase.

### **5.2.2 Effectiveness of venture capital on sales.**

As Table 4.4.1 indicates, respondents in the study agreed that sales increased after using VC. 58% realised an average increase, 32% low increase while 10% had above average increase in sales. This finding is in conformity with the studies done by Memba, Gakure and Karanja (2012) in western Kenya. The minimum sales increased from Ksh 290,000 to Ksh 4,000,000. The maximum sales increased from Ksh 70, 800,000 to Ksh500, 000,000. The mean sales after use of venture capital were Ksh 139,043, 076 up from Ksh10, 349,661. Generally there was improvement in sales volume after use of venture capital. Steiner and Solem (1988), Cuba, et al (1983), Khan and Rocha(1982), and the United States Small Business Administration (1980) did studies which had used sales growth as a key indicator of small business success and overall performance. Their studies reported that there was substantial sales growth by firms that used venture capital. However, availability of finance is no guarantee to increase in sales. Cook (2000) observed that proper marketing strategy, pricing policy, research and development, proper management among others contribute to sales growth. The presence of venture capitalists in a firm provides guidance to all the above hence sales growth.

Also a number of factual evidence on the economic impact of venture capital has been published especially for the USA economy which supports the finding of this study. According to a study carried out by Astrid & Bruno (2004) on venture capital funded

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

### **5.2.3 Effectiveness of venture capital on employees.**

The study considered employees as a measure of economic growth of SMEs. This variable was also used by Gompers and Lerner (2001) in their study on the influence of venture capital on SMEs performance. From table 4.5.1, it can be observed that before the use of venture capital 58% of the businesses had below five employees, 32% between six and fifteen employees while 10% of the businesses had above fifteen employees. This may be due to lack of finance. Kauffmann (2005) and Saleemi (2009) confirms that SMEs in Africa have little access to finance, small local market and difficult business conditions which make expansion of both physical and human resource difficult. This is the environment that SMEs in Kenya face and hence the limited number of employment opportunities. After use of venture capital, the findings revealed that the businesses that had less than five employees reduced from 58% to 48% while those who had above 15 employees increased from 10% to 20%. The observation made is that the businesses that use venture capital contribute significantly to creation of employment opportunities.

#### **5.2.4 Effectiveness of venture capital on new businesses**

As table 4.2.4.2 indicates, venture capital funding was one of the sources of initial capital for businesses in the study. 8% of the businesses were initial funded through venture capital. Thi persentage is quite low, however it is a clear indicator that VC have a positive role towards establishment of new businesses

Table 4.6.1 shows that although 78% of the respondents were not sure if the new businesses in their locality were as a result of availability of venture capital, 22% thought that venture capital as a source of equity capital could have contributed to the increasing growth of new businesses coupled with other factors such as lack of employment, conducive environment and ready market among others. Swaab Attorneys (2012) stated that venture capitalists are higher risk investors and in accepting these higher risks, they desire a higher return on their investment. Therefore they investing together with firm managers for the establishment, development, or transformation of private firms that have a growing potential (Romain and Pottelsberghe, 2004; Wright and Robbie, 1998.)

A growing number of empirical investigations outlines the crucial importance of VC for high-tech start-up growth (Campbell, 2003), product marketing strategy [Hellman and Puri, 2002] and survival (Manigart, Baeyens and Van Hyfte, 2002).

### **5.3 Conclusions.**

The impact of venture capital on growth of SME is real and practical as established by this study. Venture capital study reaffirms the correlation between SME development and poverty alleviation. The study has demonstrated that use of venture capital have impact on both economic and social-economic factors. The economic impact of venture capital has been realized by SMEs in asset growth, sales growth, and the general growth of business. The social impact from venture capital perspective include the employment opportunities created which improve peoples lives and alleviated poverty among the employees. It is common sense that if a business is doing well interms of growth, profit increases as the main indicator of a business growth. The increased profits then imply revenue collection for government expenditure though collection of tax.

Also venture capitalists do not just provide funds but add value to SME, that is, they are not only involved in financing but also spur entrepreneurs who are responsible for economic growth. Venture capital 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. Venture capital not only assists SME in the provision of funds but also in the internal operations of the business especially in policy formulation. Therefore venture capital has demonstrated the business case for SME investment. Nurturing them at crucial junctures in their development and laying the foundation for an emerging generation of locally owned large enterprises.

## **5.4 Recommendations**

The following recommendations are made based on the results from the study: Venture capital firms are doing a good job in the establishment, development and sustaining of SME sector in the country. However this is less felt by many of the citizens. The researcher recommends that the firms need to do more advertisements of their product so as to inform more people and encourage more entrepreneurs to invest in the venture firms. This will in turn help improve the survival rate of SMEs and curb the 60% death rate in the first or second year of their establishment.

Venture capital firms should also organize training, seminars and public workshops to train the public on good business management skills and encourage them come up with new business ideas that will help develop new businesses or the existing ones into big enterprises or industries. This in turn will help improve both social and economic status.

The government should not only encourage the local but also the international venture capital investors to invest in the nation. This will provide a wide range of source of capital for small and medium enterprises that face difficulties in acquiring loans from the banks due to lack of collateral. It will also reduce the high risk of local venture capital firms collapsing because the risk will be shared with the international investors.

Entrepreneurs should also be encouraged to seek venture capital funding for their businesses. This is because apart from the financial support the venture capital firms offer they also give non financial assistance such as management skills, proper market strategies, and proper production strategies among others.

### **5.5 Limitations of the study**

Some respondents had difficulties comprehending the set of questions in the questionnaires. This made the researcher to spare more time to guide them in answering the questions. A few respondents did not return back the questionnaires but the researcher got enough information from those that were returned.

### **5.6 Suggestions for further research.**

The researcher suggests that more studies should be carried out in the following areas:

- To investigate on how venture capital firms indentify and choose the businesses they fund.
- To investigate on how venture capital firms monitor the businesses they have funded to ensure they are able to recover their money.
- To analysis the effectiveness of venture capital on growth of small and medium enterprises in rural areas.

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# **APPENDICES**

## **APPENDIX A: LETTER OF INTRODUCTION**

GACHAGUA ALICE,  
KENYATTA UNIVERSITY  
SCHOOL OF BUSINESS  
P.O. BOX  
NAIROBI

To the Entrepreneur,

**RE: ANALYSIS OF THE EFFECTIVENESS OF VENTURE CAPITAL ON  
GROWTH OF SMALL AND MEDIUM ENTERPRISES IN NANYUKI TOWN,  
LAIKIPIA EAST COUNTY**

I am a Post Graduate student at Kenyatta University pursuing a Masters Degree in Business Administration. I am conducting a final project research on the above mentioned topic in Nanyuki Town.

I'm kindly requesting you to respond to the questionnaire attached as honestly as possible. The questionnaires are meant for this research only and the response given will be treated with utmost confidentiality. To ensure this, no name of the respondent will be written on the questionnaire.

I look forward to your honest participation.

Thank you in anticipation.

Yours faithfully,

Alice Gachagua

**APPENDIX B: RESEARCH QUESTIONNAIRE**

Name of your enterprise .....

Type of your business .....

Position in the enterprise .....

1. a. Does your enterprise have a venture capital: Yes  No

b. If yes in 1(a), from which venture capitalist (kindly specify whether local or international) .....

2. When did you access a VC?

3. How old is your enterprise

<5 yrs  10-15yrs  16-20yrs  20yrs >

4. Which was the initial source of your capital? .....

5. How much did you start your enterprise with <Ksh 10,000

10,000- 20,000  20,000-30,000  30,000-40,000

40,000-50,000  Ksh 50,000>

6. How much capital do you have at the moment (Kindly indicate actual figures)

.....

7. Do you think this has increased as a result of accessing VC :

Yes  No

If yes above kindly explain how you think VC improved your assets

.....  
.....  
.....  
.....  
.....

8. Have you realized an increase in your businesses sales since you acquired the

finance: Yes  No

If yes above kindly indicate to what percentage increment

Low percentage  Medium percentage  High percentage

9. How many employees do you have currently <10  11—20

21-30  31-40  41-50 >

10. How many employees have you added after use of VC (indicate)

.....

11. How many employees did you have before use of VC

.....

12. How do you agree with the following statements

<b>Venture capital Effects</b>	Strongly agree	agree	neutral	disagree	Strongly disagree
Creates more opportunities within the enterprise					
Creates room for more jobs/employment					
Helps in creating more wealth					
Improves the social-economic lives of the community					

13. Within your business site have you noted increase in business start ups/new businesses

Yes  No

If yes indicate approximately how many have been opened within your locality

.....

14. Do you think this is a result of availability of VC: Yes  No

If no why do you think so

.....  
 .....  
 .....  
 .....

15. Through your experience and the years you have been here at Nanyuki Town did

you know you could access credit before :      Yes       No

16. When did you realize this .....

17. Who introduced you to VC

.....

18. Have you realized any business competition within Nanyuki town:

Yes       No

Is this as a result of new startups

.....

.....

19. How would you agree with the following statements

<b>Venture capital</b>	<b>SD</b>	<b>D</b>	<b>N</b>	<b>A</b>	<b>SD</b>
Increase stock					
Increase no of employees					
Increases no. of start ups					

20. In your own opinion what would you say about the VC in terms of your business growth

.....

.....

.....

.....

21. What would you say about VC in terms of the community especially with a crisis of unemployment

.....  
.....

.....

22. Again what would you say to those entrepreneurs who have not accessed VC

.....  
.....  
.....

**APPENDIX C: RESEARCH TIME FRAME**

S/NO	Activity	Time															
		Mar 2013	Apr 2013	May 2013	Jun 2013	Jul 2013	Aug 2013	Sep 2013	Oct 2013	Nov 2013	Dec 2013	Jan 2014	Feb 2014	Mar 2014	Apr 2014	May 2014	Jun 2014
1.	Start of proposal development																
2.	Submission of draft proposal and allocation of supervisor																
3.	Proposal development																
4.	Revising the proposal																
5.	Data collection and analysis																
6.	Drafting and submission of research project report																
7.	Make correction to draft project report																
8.	Submit final research project report																

Source: Author 2014

## APPENDIX D: BUDGET

<b>Item Description</b>	<b>Cost(Kshs)</b>
Typing and computer services	33,000
Research Assistants Allowances	20,000
Traveling expenses	8,500
Printing, stationary, and photocopying expenses	20,000
Binding of six(6) copies of research proposals	900
Binding of three(3) copies of correction research proposals	500
Data analysis expenses	10,000
Hard binding of six(6) copies of final research project report	2700
Other miscellaneous expenses	8,000
<b>Estimated Budget total (kshs)</b>	<b>103,600</b>

Source: Author 2014