



**EFFECT OF INVESTMENT CRITERIA ON FINANCIAL PERFORMANCE OF PRIVATE-EQUITY FIRMS IN KENYA**

**Muteti, E. N., & Kariuki, P.**

## EFFECT OF INVESTMENT CRITERIA ON FINANCIAL PERFORMANCE OF PRIVATE-EQUITY FIRMS IN KENYA

Muteti, E. N.,<sup>\*1</sup> & Kariuki, P.<sup>2</sup>

<sup>\*1</sup>Msc. Finance Candidate, Jomo Kenya University of Agriculture & Technology [JKUAT], Nairobi, Kenya

<sup>2</sup> Ph.D, Lecturer, University of Embu [UoEm], Kenya

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### ABSTRACT

*The purpose of this study was to identify the extent of the effect of investment criteria adopted by different Private-Equity firms in Kenya on their financial performance. The research employed a descriptive research design and census was applied whereby all the 62 private equity firms were selected. Primary data was collected using structured questionnaires which contained both open and closed ended questions and an interview guide. Pilot study was utilized for the purposes of ensuring that the data was both valid and reliable as well as eliminate any challenges in the data collection instrument that could hinder successful undertaking of the research. The primary data was analyzed for broader interpretations using descriptive statistical analysis and inferential data analysis. The regression analysis results indicated that 81.9% variability on financial performance of private equity firms could be accounted for by the target firm's team characteristics, target firm's market characteristics, target firm's products and services characteristics, and financial considerations of the target firm. The beta coefficients for target firm's team characteristics ( $B=0.356$ ), target firm products and services characteristics ( $B=0.146$ ), target firm's market characteristics ( $B=0.324$ ), and financial considerations of the target firm ( $B=0.192$ ) were statistically significant at 5% significance level. This results obtained from the study contributed to both policy development and practice improvement on the investment via private equity and their financial performance especially in the Kenyan context, where understanding of the application of private equity arrangement was important due to high risks that these firms faced hence limiting their access to adequate funding from commercial banks and therefore PE arrangement might be a better option. At a target firm level, the study recommended that they engage in familiar industry to reduce problem associated with information symmetry since it would allow them to screen the venture for high returns and low risk. The study contributed to investor decision making literature and policy making.*

**Key words:** Team Characteristics, Product and Services, Market Characteristics, Financial Consideration, Financial Performance

## INTRODUCTION

The private sector in any economy plays an important role in moving the developmental agenda of a country and consequently, its growth has been taken to be a benchmark of the overall economic growth in a country. Fairlie and Alicia (2012) are of the view that the public sector involvement in an economy should be limited to consumption of the goods and services that the private sector produce and the public sector intervention should be to regulate and provide a conducive environment to doing business. Financing of the private sector has been a challenge, especially in the developing world, and this has limited the capacity of private business owners to grow their businesses through investment (Ndirangu, 2017). The financing function of a private equity manager is often challenging because of the limited financial resources that the private business units access due to their risk level (Kaatz, 2011). The traditional way that has been used by investors to increase their funds has been through acquisition of shares in a company and this has led to the term private equity which is the practice of owning equity in a private company. However, as another avenue of raising funds, private equity has been concentrating to raise funds for small and medium enterprises so as to grow their firms and exit on getting the return on their investments.

Metrick and Yasuda (2013) describe a private equity as a financial intermediary that invests only in private companies through a process of taking an active role in monitoring and helping the companies in its portfolio. The primary aim of a private equity firm is to maximise its financial return by exiting investments through a sale or an initial public offering (IPO). Private equity investors are principally institutional investors such as endowments and pension funds. These investors, called Limited Partners (LPs), commit a certain amount of capital to private equity funds, which are run by General Partners (GPs). Lerner, Sorensen and Stromberg (2013) highlight that the GPs identify investments opportunities with high return and in

most of the cases start-up firms and then calls for funding from the limited partners. Apart from the financing role that PE play, Davila, Foster and Gupta (2016) highlight that the PEs play an important role in the economy, by boosting innovation and growth in promising start-ups or expanding firms, as well as by fostering the restructuring of mature companies. Apart from the critical role played by the PEs intermediaries in financial markets they provide capital to firms that might otherwise have difficulty attracting financing from alternative sources. These firms are mainly small and young, plagued by high levels of uncertainty and large differences between what entrepreneurs and investors (Gompers and Lerner 2011).

According to The City UK (2015), as at the 2014, private equity funds manage about \$3.2 trillion investment portfolio. Out of this, buyouts (BO) account for the majority of private equity investments by value and number of deals with some totalling to two thirds of the total investments in some markets. It is notable that private equity sector growth has been extraordinary such that growth in the last 15 years, increasing from \$120 billion in 1999 to the present day portfolio (Fenn and Liang 2016). The increase is attributed to the interest to the PE by institutional investors' portfolio allocation to private equity, which increased from 3% (2%) on average in 1999 to 12% (6%) in 2007 and 15% (8%) for large foundations (endowments). According to Puri and Zarutskie (2012) the industry has globalised in recent years, with China receiving the third highest investment after the USA and UK in 2008–2009, followed by France and India. Private equity financing has taken shape in East Africa and according to The Private Equity Sector Survey of East Africa (2016) conducted by Deloitte, it established that firms where PE Funds have bought stakes increased to 115 last year from 79 when the survey was last done in 2015. PE-backed deals during the period was valued at \$600 million (Sh62.02 billion). Further according to the report PE Funds, largely from the US and Europe were largely

involved and were drawn to the region because of the higher returns realised in the PE market that averaged 13.5% against a target of 22% in 2015.

Private Equity Confidence Survey(2016) shows that significant competition is rising in Kenya's private equity sector and fund managers were found to look for small and medium-sized enterprises (SMEs) for new deals. In the year 2015, Kenya drew 12 contracts of more than Sh12.6 billion, representing 46 per cent of the entire deals in East Africa. Rwanda was a second, closing five deals with a reported value of Sh6.6 billion. A total of 94 deals were completed in sub-Saharan Africa in 2013, with 46 of these reporting a total value of Sh328.1 billion.

Private equity investors are principally institutional investors such as endowments and pension funds. These investors, called Limited Partners (LPs), commit a certain amount of capital to private equity funds, which are run by General Partners (GPs). GPs search out investments and tend to specialize in either venture capital (VC) investments or buyout (BO) investments. In general, when a GP identifies an investment opportunity, it calls money from its LPs. When the investment is liquidated, the GP distributes the proceeds to its LPs. The current private equity funds in Kenya have their foundation in Development Finance Institutions (DFIs) that took root in Kenya in the 1970's and 1980's specifically Africa Development Bank and the CDC Group (Tuimising 2012).

### **Statement of the Problem**

Across the globe, the funds under the PE arrangement have continued to grow such that according to Learner et al., (2014), the total funds have grown from slightly over \$5 billion in 1980 to approximately \$1.125 billion in 2013 and cumulatively total over \$1.65 trillion over the last 40 years. This increase in the investment level is an indication of the growing interest in private equity as an alternative financing avenue. However, despite the growing interest in the PE funding, there has been a generally low returns being registered on the investment being undertaken

under the PE arrangement (Guo & Song, 2010). The situation is no different in Kenya and East African region at large because according to the Private Equity Sector Survey of East Africa (2016) undertaken by Deloitte, the annual returns of the PE firms in the region has been oscillating around 10-16% per annum with Kenya registering an average of 14.5%, a rate that is below the targeted rate of 22%. Considering that the private sector plays an important role in the national economy, it needs to attract funding from institutions and high net worth investors with surplus funds to invest. This can only happen if the private equity firms can generate adequate returns. Consequently, the PE should be able to identify and invest in sectors that generate high returns and this can be realised through establishment of an effective investment criteria that will assist the management in identifying profitable ventures.

Guo and Song (2010) laments that despite the growing importance of the PE in the financial intermediation, there has been less academic study on the venture capital industry than on other areas of finance. The most critical question is on how to screen successful ventures. MacMillian et al. (2005) found that capacity for sustained effort, demonstrating leadership, and track record in past ventures were essential factors allowing venture capitalists to identify and make investments in potentially successful ventures. Screening the venture is very difficult because of informational asymmetry. Alemany and Marti (2005) research on how venture capital backed firms affects the economy show that VC-backed firms have significantly higher revenues and employment growth rates than non-VC-backed firms. Chemmanur et al. (2011) researched on how venture capital financing improve efficiency in private firms and found that VC-backed firms have higher operating efficiency than non-VC-backed firms due to screening and monitoring. Puri and Zarutskie (2012) on their part researched on the life-cycle dynamics of venture-capital and non-venture capital-financed firms. They found that

there exist a financial performance gap between VC and non-VC financed firms. Bergstrom, Nilsson, and Wahlberg (2014) through their study on how PE-backed IPOs in London and Paris performs financially, found that PE-backed IPOs outperform other IPOs, and that both sets' display strong negative abnormal returns in the aftermarket for periods of up to 5 years. Consequently, it became important, on the basis of the limited studies that sought to establish investment processes of the PE firms to seek and establish the investment criteria adopted by the PE firms and how it affected their financial performance, especially in an emerging economy like Kenya.

### **Objectives of the Study**

The general objective of this study was to establish the effect of investment criteria on financial performance of Private-Equity firms in Kenya. The specific objectives were:-

- To determine the extent to which a target firm's team characteristics affects the financial performance of private-equity firms in Kenya
- To determine to what extent the target firm product and services characteristics influence financial performance of private-equity firms in Kenya
- To establish the effect of target firm market characteristics on private-equity firms' financial performance in Kenya
- To establish the level of influence of financial consideration of the target firms on private-equity firms' financial performance in Kenya

## **LITERATURE REVIEW**

### **Theoretical Framework**

#### **Resource Based Theory**

Resource Based Theory (RBT) as advanced by Wernerfelt (1984) and further refined by Barney (1991) is the most commonly used to explain firm financial performance. Resource based theory suggest that the basis of firm's competitive advantage is anchored on its ability to utilize internally available bundle of valuable resources.

These resources will include for example its human resource competence, products and services, technological prowess and partnership with other players in the market it is operating in. The RBT assert that a firms' idiosyncratic resources can be manifested in form of assets or capabilities, especially internal resources, that exist within an organisation (Lee et al., 2001). A firm resources and capabilities that are able to differentiate its operations from the competitors have the ability to achieve and sustain competitive advantage and improved financial performance. However, according to Barney (2001) for a resource to become a factor of competitive advantage, it should be valuable, scarce, imperfectly tradable and difficult to imitate. This means that top management characteristics in terms of qualification, experience and mastery of the local market will lead to improved financial performance.

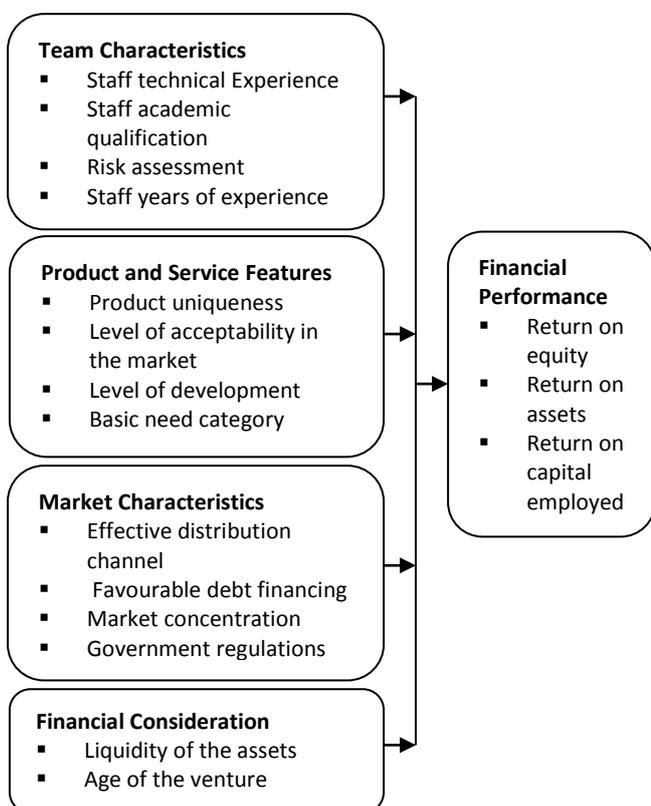
#### **Resource Dependency Theory**

Resource dependence theory provides a unified theory of power at the organizational level of analysis (Casciaro & Piskorski, 2005). It assumes that an organization's vulnerability to extra-organizational influence is partly determined by the level of dependence on certain types of exchanges for its operation with external environment. The exchanges could in form of goods and services such that if a firm is dependent on a single product or constitute a major proportion of income, then any demand fluctuation will affect the financial performance of the firm negatively. Thus, it creates uncertainty or instability which threatens the continued existence of the organizations. Gulati and Sytch (2007), for example, examined to what extent reliance asymmetry on the financial performance of two major U.S. auto manufacturers. They found that a manufacturer's dependence advantage was positively associated to its financial performance in the market, but on the other hand a supplier's dependence advantage was the opposite where it related negatively to the financial performance of the manufacturer in the market relationship.

## Market Based Theory

Market based view (MBV) is a group of a firm perspectives that focus a firm's strategy on the trends and nature that evolves in the industry's environment. Schendel (1994) that the competitive environment in which a firm operates determines its end product strategic position, but performing activities that are similar to other firms, but in ways that are very different. Therefore according to these group of theories, the structure and competitive dynamics of the industry within which the firm operates, determines a firm's profitability or financial performance.

## Conceptual Framework



**Independent Variables**                      **Dependent Variable**

**Figure 1: Conceptual Framework**

Source: Author (2018)

## Team Characteristics

Team characteristics is defined as the traits such as experience, motivation, tenure among others that

are considered necessary for the running of a firm and are attributed to the complexity and ambiguity of working environment (Jaw & Lin, 2009). The team characteristics relates to the personal traits and professional skills as well as attributes of equity firms' staff. The team characteristics will be measured as latent variable composed of seven composite indicators that is academic qualifications, reputation of the team, capacity for risk management, attention to details, team familiarity with the market, organization being familiar with venture team's reputation and requisite track record relevant to investments.

## Product and Service Features

Valérie Mathieu (2001) defines product and service features as the characteristics of a product or a service and differentiates it from others in terms of appearance, components and capabilities. Product and service features are responsible for attracting customer to the service or product. The product and services features relate to the attributes of the services that venture capitalists offer to their customers. This will be evaluated as a latent variable using five composite indicators of the variable that is market acceptance level of the product, capacity to protect product from market predictors, product having a functional prototype, technology aspect of the product and the category of such a product as to whether it would fall under the basic needs category.

## Market Characteristics

Market characteristics are the features of target market in terms responsiveness to demand and supply, accessibility and measurability. Market characteristics can be defined as the behaviours associated with a target market like price fluctuations, expansion among others (Kolter & Keller, 2008). The market characteristics relates to the attributes of the market that has the capacity to influence the financial performance of the venture capitalists products and services. This was evaluated through the examination of the target firm having access to well established distribution channel, stimulation levels of existing markets, capacity to create new markets, target firm lack of

significant competition in initial years, existing government regulations and target firm being in a familiar market.

### **Financial Considerations**

Financial considerations are features relating to the income, expenditure, or revenue of a firm and are used to measure the financial performance of the given firm. Ability to remain solvent is an indicator of desired financial characteristics (Allouche & Jausaud, 2008). The financial characteristic is concerned with money aspects relating to the private equity firms. These aspects to be measured using likert scale include PE entry into investment that could easily be made liquid, age of the target firm determining PE choice, PE not expected to make subsequent investments in the target firms and PE investment being always new to the segment

### **Financial Performance**

The financial performance relates the organizations extent of achievement of financial goals that it has set for itself or by the shareholders. There are diverse measures used for the measurement of the financial performance including Return on Equity (ROE), Return on Assets (ROA) and return on capital employed. The return on assets relates to the profitability of the firm relative to the assets in its possession. The return on equity refers to the ratio of the net income relative to the shareholders' equity. Finally, the return on capital employed refers to a financial ratio measuring a company's profitability and the efficiency with which its capital is employed

### **Empirical Studies**

Brav and Gompers (2002) found that there is a striking difference in financial performance across various groups of IPOs carried out by PE firms in terms of aftermarket financial performance. Using a sample of 934, they find that US VC-backed IPOs outperforms non-VC-backed IPOs, at least in equal-weighted returns. They attributed this to better management teams and corporate governance structures that exist in VC-backed organizations that help these companies to perform better in the

long run. Krishnan et al. (2009) provide further support by confirming that VC firms with better reputations invest in portfolio companies with better long-run post-IPO financial performance.

Rindermann (2004), while using a rather small sample of VC-backed IPOs in major EU countries namely; Germany, the United Kingdom, and France, finds evidence to support the under financial performance for VC-backed IPOs in Germany and the United Kingdom, but such differences were not statistically significant. Instead, he finds that a subgroup of internationally operating venture capitalists have a positive effect on both the operating and market financial performance of portfolio firms. Similar results were found by Hamao, Packer, and Ritter (2000) while using a sample of 355 Japanese IPO firms for the period 1989 to 1994. They found no evidence to exist to support the assertion that in the long-run, there is increased financial performance of VC-backed IPOs, except for firms backed by foreign-owned or independent venture capitalists.

In their study of 85 reverse leveraged buyouts (RLBOs), Mian and Rosenfeld (2005) report better aftermarket financial performance that appears to be driven by takeover activity. Such activity occurs during the second year, the time period in which the RLBOs appear to perform the best. The same findings were found by Cao and Lerner (2009) using a large sample of RLBOs from 1990 to 2002. They showed that there exist evidence of out-performance in the five years after the IPO when compared to other IPOs and various market benchmarks. This out performance was found to be consistent across different benchmarks, but high leverage is not affecting financial performance. A similar finding was found by Ritter (2010), in a recent website report for the period 1980 to 2006, demonstrates an average three-year buy-and-hold market-adjusted return for VC-backed IPOs of -12.9% and an equivalent return of 7.1% for their PE (buyout) counterparts

Oehler et al. (2007) analysed the factors that affect the European PE market. By employing a fixed and random effects models on a data set with 23

countries and for the period from 1995 to 2005 they concluded that among the factors that influence the PE market include GDP growth, the level of interest rate, stock market growth, PE divestments which was found to be significantly and positively associated with PE. In the case of IPO divestments, they concluded that the IPO divestments remain one of the strongest determinants for PE financings, or for PE investments. Similar results are observed for the trade sales divestments. In addition, they found that unemployment rate and the price /book ratio are relevant in the European PE markets.

Masulis and Nahata (2009) investigated venture capital conflicts of interest using firms that are venture backed in Singapore and found that investing is carried out through funds that have a life of mostly ten years. Extension of the contractual arrangement can only be made with the permission of the local partners. The capacity of a management team to set up new funds every three to five years and a good track record for timely exits as well as past financial performance are crucial to enhancing a firm's financial performance and future fundraising. Phalippou (2012) further opine that under such medium-term investment arrangement, the management team should be having appropriate track record that is relevant to the venture to be able make optimal. The researcher also found out that the management team characteristic that is critical is the need to be familiar with the market that the venture firm is operating in. Cumming and MacIntosh (2013) further suggest that the financial performance of a private equity firm will be influenced by the management team track record in dealing with private equity firms in the market. Harford and Kolasinsa (2013) in their study sought to determine whether private equity returns result from wealth transfers and short-termism further suggest that a PE team ability to assess the risk prevalence in a market and also capacity to discuss the venture in detail will affect the financial performance of PE operation.

Shivdasani and Wang (2011) findings on their research that sought to establish whether structured credit fuelled the LBO boom advocate that capital market conditions are the most vital determinant of the exit route for most PE firms and that these firms exploit the windows of opportunity that are present at different times and cite an example in which in 2006–07 period the unusual conditions in the credit market made probable the use of higher levels of debt in European buy-outs. Similarly, the huge amount of capital that was devoted to private equity before the financial crisis led to a shift in demand and taken together, these factors made private equity firms willing to pay more for portfolio companies, which improved their bargaining power compared to corporate acquirers, and resulted in a high amounts of secondary sales.

Axelsson et al. (2013) investigated determinants of leverage and pricing among the PE in UK for the period 2008 -2011 and found that in the quest of private equity firms to achieve the best exit price possible and capital market conditions may create different windows of opportunity. They found that higher availability of funds in the loan market or large amounts of capital committed but not yet invested in the private equity industry may make secondary buy-outs the most profitable exit route. Similarly, Axelsson et al. (2013) find that a higher availability of debt has a strong impact on the prices of deals as private equity firms borrow as much as they can for each deal.

Bonini (2015) investigated investment determinants of operating financial performance among the secondary buy-outs and found that the capacity of a PE investment to be liquidated positively influenced the financial performance of a PE firm. In addition, if the firm is not expected to make additional investment, then investors will be willing to acquire such an investment.

Phillipou and Zollo (2008) sought to investigate the drivers of private equities on both US and EU; and their underlying investments. The researchers first endeavoured to establish whether, the firms hedging properties justified their low financial

performance and also investigated the type of risks that the hedging firms are exposed. The researchers use panel data from both Treasury bill rate from the Federal Reserve and the venture capital financial performance was obtained from Thomson Venture Economics. The results were that the financial performance of the of private equity funds positively co-varies with the public securities exchange as well as the firm’s business cycle.

**METHODOLOGY**

The research employed a descriptive research design. Descriptive design is a formalized and typically structured with clearly stated hypotheses or investigative questions (Cooper & Schneider 2008). The population of the study comprised of sixty two (62) private equity firms in Kenya who

were registered and operational during the period under study (East Africa Venture Capital Association, 2017). The study used primary data which was collected using structured questionnaires and an interview guide. The questionnaire contained both open and closed ended questions. The study used primary data which were largely quantitative and descriptive in nature. The following regression equation was used;

$$Y = \beta_0 + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + \beta_4X_4 + \epsilon$$

- Where Y = Financial performance
- X<sub>1</sub> = Team Characteristics
- X<sub>2</sub> = Product and Services
- X<sub>3</sub> = Market Characteristics
- X<sub>4</sub> = Financial Considerations
- ε = Error

**RESULTS**

**Table 1: Descriptive Statistics for Target Firm’s Team Characteristics**

Statement	Very Low Extent %	Low Extent %	Mode	rate Extent %	Great Extent %	Very Great Extent %	Total	Mean	Std. Dev.
The team has necessary academic qualification and relevant trainings to operate in the industry.	2.0	8.2	30.6	46.9	12.2	3.59	0.888		
The team and the target organization as a whole have good reputation and was referred by a trustworthy source.	6.1	20.4	46.9	20.4	6.1	3.00	0.957		
The team is able to evaluate and react to risk well	2.0	8.2	30.6	44.9	14.3	3.61	0.909		
The team has attention to detail and is able to discuss the investment articulately	0.0	6.1	22.4	55.1	16.3	3.82	0.782		
The team has necessary familiarity with the market they operate in.	14.3	42.9	18.4	22.4	2.0	2.55	1.062		
The organization is familiar with the venture team's reputation	8.2	26.5	38.8	22.4	4.1	2.88	0.992		
The venture team has the requisite track record relevant to investments.	8.2	38.8	36.7	14.3	2.0	2.63	0.906		

Responses for all the statements for evaluating the target firm’s team characteristics except the team had necessary familiarity with the market they operate in, had standard deviations  $0.5 < \sigma_x \leq 1$ . The target firm’s team has necessary familiarity with the

market they operate in had standard deviation of 1.062 which indicated that there was lack of consensus ( $\sigma_x > 1$ ) on the team’s familiarity with the market of operation.

There was moderate consensus ( $0.5 < \sigma_x \leq 1$ ) amongst respondents on the target firm's team academic qualification and relevant trainings to operate in the industry ( $\sigma_x=0.888$ ), the team and the target organization's reputation and reference by a trustworthy source ( $\sigma_x=0.957$ ), the team's ability to evaluate and react to risk well ( $\sigma_x=0.909$ ),

and the team's attention to detail and ability to discuss the investment articulately ( $\sigma_x=0.782$ ). Similarly, there was moderate consensus ( $0.5 < \sigma_x \leq 1$ ) amongst respondents on the organization's familiarity with the venture team's reputation ( $\sigma_x=0.992$ ), and the venture team requisite track record relevant to investments ( $\sigma_x=0.906$ ).

**Table 2: Descriptive statistics for Product and Services Characteristics**

Statement	Very Low Extent	Low Extent	Moderate Extent	Great Extent	Very Great Extent	Total	
	%	%	%	%	%	Mean	Std. Dev.
The target firm invests in products that enjoy market acceptance	8.2	46.9	22.4	18.4	4.1	2.63	1.014
The target firm endeavour to protect the product from market predictors.	2.0	12.2	20.4	46.9	18.4	3.67	0.987
The product had been developed to the point of a functioning prototype.	4.1	30.6	38.8	18.4	8.2	2.96	0.999
The product invested by the firm most of the time is a high tech type	10.2	24.5	44.9	14.3	6.1	2.82	1.014
The product the target firm invests in has desirable components to attract customers	2.0	8.2	28.6	38.8	22.4	3.71	0.979
The target firm invest in services that have peak demand most of the time	12.2	30.6	26.5	20.4	10.2	2.86	1.190
The products and services offered by the target firm have a standard and stable price	16.3	28.6	32.7	16.3	6.1	2.67	1.125

Averagely respondents showed a trend in affirming that to a great extent ( $3.5 < \mu \leq 4.5$ ) the target firm strove to protect the product from market predictors ( $\mu=3.67$ ) and the product the target firm invested in had desired attributes to attract clientele ( $\mu=3.71$ ). Respondents on average confirmed that to a modest extent ( $2.5 < \mu \leq 3.5$ ) the target firm invested in products that were widely accepted in the market ( $\mu=2.63$ ). Respondents averagely asserted that to a moderate extent the product had been developed to the point of a operative prototype ( $\mu=2.96$ ) and that to a moderate extent the product invested in by the

firm was a high tech type most of the time ( $\mu=2.82$ ). Additionally, respondents on average acknowledged that to a moderate extent ( $2.5 < \mu \leq 3.5$ ) the target firm invested in services that have high demand most of the time ( $\mu=2.86$ ) and that the products and services offered by the target firm had typical and stable prices ( $\mu=2.67$ ). There was moderate consensus amongst respondents ( $0.5 < \sigma_x \leq 1$ ) on the target firm's endeavour to protect the product from market predictors ( $\sigma_x=0.987$ ), the product having been developed to the point of a functioning prototype ( $\sigma_x=0.999$ ), and desirability of components of the product that the target firm

invests in to attract customers ( $\sigma_x=0.979$ ). However, there was lack of consensus ( $\sigma_x >1$ ) amongst respondents on the target firm investment in products that enjoy market acceptance ( $\sigma_x=1.014$ ) as well as in services that have peak demand most of the time ( $\sigma_x=1.190$ ). Equally,

respondents lacked consent on the product invested by the firm most of the time being a high tech type ( $\sigma_x=1.014$ ) and the products and services offered by the target firm having a standard and stable price ( $\sigma_x=1.125$ ).

**Table 3: Descriptive Statistics for Target Firm Market Characteristics**

Statement	Very Low Extent	Low Extent	Moderate Extent	Great Extent	Very Great Extent	Total	
	%	%	%	%	%	Mean	Std. Dev.
The target firm has access to a well established distribution channel	4.1	24.5	42.9	20.4	8.2	3.04	0.978
At all times, the existing market would be stimulated.	10.2	26.5	32.7	24.5	6.1	2.90	1.085
Our investments have an existing well-established distribution channel.	10.2	24.5	34.7	26.5	4.1	2.90	1.046
The capacity of the target firm to create a new market is high.	2.0	30.6	49.0	8.2	10.2	2.94	0.944
The target firm invests in a market that has no significant competition in the initial years.	6.1	8.2	20.4	44.9	20.4	3.65	1.091
The target firm engages in an industry with which it is familiar with.	8.2	28.6	28.6	24.5	10.2	3.00	1.137

On average, respondents indicated a tendency to agree that to a moderate extent ( $2.5 < \mu \leq 3.5$ ) the target firm had access to a well-established distribution channel ( $\mu=3.04$ ), stimulation of the existing market at all times ( $\mu=2.90$ ), investments had an existing well-established distribution channel ( $\mu=2.90$ ), great ability of the target firm to form a new market ( $\mu=2.94$ ), and assignment of the target firm in an industry with which it is familiar with ( $\mu=3.00$ ). Respondents on average indicated a tendency to agree that to a great extent ( $3.5 < \mu \leq 4.5$ ) the target firm invested in a market that has no significant competition in the initial years ( $\mu=3.65$ ).

Respondents lacked consensus ( $\sigma_x >1$ ) on the stimulation of existing market at all times ( $\sigma_x=1.085$ ), existence of well-established distribution channel for the investments ( $\sigma_x=1.046$ ), target firm's investment in a market with no significant competition in the initial years ( $\sigma_x=1.091$ ), and the target firm's engagement in an industry with which it is familiar with ( $\sigma_x=1.137$ ). There was moderate consensus amongst respondents ( $0.5 < \sigma_x \leq 1$ ) on the target firm's access to a well-established distribution channel ( $\sigma_x=0.978$ ), and high capacity of the target firm to create a new market ( $\sigma_x=0.944$ ).

**Table 4: Descriptive Statistics for Financial Consideration**

Statement	Very Low Extent	Low Extent	Moderate Extent	Great Extent	Very Great Extent	Total	
	%	%	%	%	%	Mean	Std. Dev.

The PE enters into investment that could easily be made liquid	10.2	46.9	30.6	4.1	8.2	2.53	1.023
The age of the target firm determines the PE choice.	2.0	38.8	40.8	16.3	2.0	2.78	0.823
The PE invest in target firms whose expected return equal to at least 10 times its investment within five years	4.1	10.2	18.4	49.0	18.4	3.67	0.929
The PE is not expected to make subsequent investments in the target firms	10.2	28.6	40.8	16.3	4.1	2.76	0.990
PE investments are always new in the segment and we do not invest on the same venture twice	6.1	20.4	53.1	18.4	2.0	2.90	0.848
The PE engages in investments with low operation cost and generates high income	8.2	8.2	26.5	40.8	16.3	3.49	1.120
The PE enters into investments low risk and high return on investment (ROI).	4.1	16.3	34.7	30.6	14.3	3.41	1.059

On average, respondents indicated a tendency to agree that to a great extent ( $3.5 < \mu \leq 4.5$ ) the PE invests in target firms whose expected return equal to at least 10 times its investment within five years ( $\mu=3.67$ ). Respondents on average tended to agree to a moderate extent ( $2.5 < \mu \leq 3.5$ ) the PE enters in investment that could easily be made liquid ( $\mu=2.53$ ), the age of the target firm determines the PE choice ( $\mu=2.78$ ), and that the PE was not expected to make subsequent investments in the target firms ( $\mu=2.70$ ). Similarly, respondents on average tended to agree to a moderate extent that PE investments are always new in the segment and PE firm's do not invest on the same venture twice ( $\mu=2.90$ ), the PE engages in investments with low operation cost and high income generation ( $\mu=3.49$ ), and that the PE enters into investments with low risk and high return on investment (ROI) ( $\mu=3.41$ ).

There was lack of consensus amongst respondents ( $\sigma_x > 1$ ) on the extent of effect of PE firms entering into investment that could easily be made liquid ( $\sigma_x=1.023$ ), the PE engaging in investments with low operation cost and high income generation ( $\sigma_x=1.120$ ), and the PE entering into investments with low risk and high return on investment (ROI) ( $\sigma_x=1.059$ ). There was moderate consensus amongst respondents ( $0.5 < \sigma_x \leq 1$ ) on the extent of effect of the age of the target firm determining the PE choice ( $\sigma_x=0.823$ ), the PE investing in target firms whose expected return equal to at least 10 times its investment within five years ( $\sigma_x=0.929$ ), expectations for the PE not to make subsequent investments in the target firms ( $\sigma_x=0.990$ ), PE investments always being new in the segment and firm's not investing on the same venture twice ( $\sigma_x=0.848$ ).

**Table 5: Descriptive Statistics for Financial performance of PE Firms**

Statement	Very Low Extent	Low Extent	Moderate Extent	Great Extent	Very Great Extent	Total	
	%	%	%	%	%	Mean	Std. Dev.
The Private company has experienced high Return on equity	16.3	38.8	40.8	2.0	2.0	2.35	0.855

The Return on assets of the private equity firm has improved	12.2	28.6	36.7	18.4	4.1	2.73	1.036
There is high Return on capital employed in the private equity firm invested	28.6	30.6	26.5	8.2	6.1	2.33	0.962
There is increase in customer base in the private equity firm	10.2	32.7	38.8	18.4	0.0	2.65	0.903
The private equity enjoys increased profits in its operation	20.4	36.7	32.7	8.2	2.0	2.35	0.969

There was a lack of consensus amongst respondents ( $\sigma_x > 1$ ) on the target firm's team characteristics, target firm's market characteristics, target firm's products and services characteristics, and financial considerations on improvement of return on assets of the private equity firm ( $\sigma_x = 1.036$ ). there was moderate consensus ( $0.5 < \sigma_x \leq 1$ ) on the extent of effect of the target firm's team characteristics, target firm's market characteristics, target firm's products and services characteristics, and financial considerations of the target firm on high return on equity of the private company ( $\sigma_x = 0.855$ ), high return on capital employed in the private equity firm invested ( $\sigma_x = 0.962$ ), increase in customer base in the private equity firm ( $\sigma_x = 0.903$ ), and increased profits enjoyed by the private equity in its operation ( $\sigma_x = 0.969$ ).

**Table 6: Correlations Matrix**

		Team Characteristics	Products and Services	Market Characteristics	Financial Considerations	Financial Performance
Team Characteristics	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	49				
Products and Services	Pearson Correlation	0.489*	1			
	Sig. (2-tailed)	0.044				
	N	49	49			
Market Characteristics	Pearson Correlation	0.336*	0.619*	1		
	Sig. (2-tailed)	0.006	0.008			
	N	49	49	49		
Financial Market Characteristics	Pearson Correlation	0.454**	0.586*	0.729**	1	
	Sig. (2-tailed)	0.000	0.002	0.007		
	N	49	49	49	49	
Performance	Pearson Correlation	0.616**	0.400**	0.548**	0.707**	1
	Sig. (2-tailed)	0.000	0.004	0.000	0.000	
	N	49	49	49	49	49

\*. Correlation is significant at the 0.05 level (2-tailed).

\*\*. Correlation is significant at the 0.01 level (2-tailed).

The study established that there was an average and statistically significant relationship between team characteristics and products and services offered as indicated by a correlation coefficient of 0.489 and a p-value less than 0.05. The study further established that there was a weak relationship between team characteristics and market characteristics which was significance at 5% significance level as supported by correlation coefficient of 0.336 and a p-value less than 0.05. A correlation coefficient of 0.619 and a p-value less than 0.005 were obtained in correlating market characteristics and products and services offered, an indication that the correlating market

characteristics and products and services offered has a statistically significant relationship at 5% significance level. Financial Market Characteristics was found to be significantly related to Team Characteristics ( $r=0.454$ ,  $p<0.005$ ), Products and Services ( $r=0.586$ ,  $p<0.005$ ) and Market Characteristics ( $r=0.729$ ,  $p<0.005$ ). In regard to the independent variable of the study, it was established that Team Characteristics ( $r=0.616$ ,  $p<0.005$ ), Products and Services ( $r=0.400$ ,  $p<0.005$ ), Market Characteristics ( $r=0.548$ ,  $p<0.005$ ) and Financial Considerations ( $r=0.707$ ,  $p<0.005$ ) were significantly correlated to performance of firms.

**Table 7: Model Summary**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.905 <sup>a</sup>	.819	.802	.09481

a. Predictors: (Constant), Team Characteristics, Market Characteristics, Products and Services Characteristics, Financial Considerations

The R-value of 0.905 indicated a strong positive correlation between the independent variables and the dependent variable. The coefficient of determination (R Square) was used to establish the level of variability in the dependent variable that could be accounted for by the independent variables of the regression model. The results indicated the R Square was 0.819 which implied that 81.9% variability on performance of private equity firms could be accounted for by the target firm's team characteristics, target firm's market characteristics, target firm's products and services characteristics, and financial considerations of the target firm. Thus, there exists other factors which were not considered in the regression model of this study which have an 18.1% effect on the performance of private equity firms in Kenya.

The study sought to establish whether the regression model with target firm's team characteristics, target firm's market characteristics, target firm's products and services characteristics, and financial considerations of the target firm as independent variables and performance of private equity firms as the dependent variable was reliable. In this context, the analysis of variance (ANOVA) was undertaken and results presented in Table 8. The results gave a p value of 0.000 which was an indication that the regression model had no probability or likelihood (0.0%) of giving a wrong prediction since the test was done at a level of significance was 0.05. Thus since  $p < 0.05$  the study established that the regression model was reliable.

**Table 8: Analysis of Variance**

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	1.786	4	.446	49.666	.000 <sup>b</sup>
Residual	.396	44	.009		
Total	2.181	48			

a. Dependent Variable: Performance

b. Predictors: (Constant), Team Characteristics, Market Characteristics, Products and Services Characteristics, Financial Considerations

The coefficients of the independent variables were examined to determine the effect of the respective variable on the dependent variable with the other

independent variables held constant. The coefficients were displayed in Table 9.

**Table 9: Coefficients**

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.071	.233		-.305	.762
Team Characteristics	.356	.045	.528	7.859	.000
Products and Services	.146	.035	.292	4.111	.000
Market Characteristics	.324	.040	.530	8.024	.000
Financial Considerations	.192	.039	.331	4.931	.000

a. Dependent Variable: Performance

The coefficients were target firm’s team characteristics (B=0.356), target firm products and services characteristics (B=0.146), target firm’s market characteristics (B=0.324), and financial considerations of the target firm (B=0.192). This gave the following regression model;

$$\text{Performance of Private Equity Firms} = -0.071 + 0.356(\text{Team Characteristics}) + 0.146(\text{Products and Services}) + 0.324(\text{Market Characteristics}) + 0.192(\text{Financial Considerations})$$

From this regression model, the indication was that one-unit increase in target firm’s team characteristics while other factors are kept constant would result in a 0.356 increase in performance of private equity firms in Kenya. A one-unit increase in target firm products and services characteristics would result in a 0.146 increase in performance of private equity firms in Kenya with the other variables kept constant. A one-unit increase in target firm’s market characteristics would result in a 0.324 increase in performance of private equity firms in Kenya. Finally, a one-unit increase in financial considerations of the target firm would result in a 0.192 increase in performance of private equity firms in Kenya.

These findings showed that target firm’s team characteristics, target firm’s market characteristics, target firm’s products and services characteristics, and financial considerations of the target firm on their own had a positive influence on the performance of private equity firms in Kenya. The order of influence from the variable with greater influence on performance of private equity firms in Kenya to the least influential was target firm’s team

characteristics, target firm’s market characteristics, financial considerations of the target firm, and target firm’s products and services characteristics.

### FINDINGS

The study was aimed in establishing to what extent the target firm’s team characteristics influences financial performance of private-equity firms in Kenya. There exists a significant relationship (p=0.000) between target firm team characteristics and financial performance. This is an indication that team characteristics positively influence financial performance since one-unit increase in target firm’s team characteristics while other factors are kept constant would result in a 0.356 increase in financial performance of private equity firms in Kenya.

One specific objective of the study was to establish to what extent the target firm’s product and services characteristics influences financial performance of private-equity firms in Kenya. There exists a significant relationship (p=0.000) between target firm product and services and financial performance. This is an indication that the product and services positively influence financial performance since one-unit increase in target firm products and services characteristics would result in a 0.146 increase in financial performance of private equity firms in Kenya.

The study was aimed in establishing to what extent the target firm’s market characteristics influences financial performance of private-equity firms in Kenya. There exists a significant relationship (p=0.000) between target firm market

characteristics and financial performance which is an indication that market characteristics positively influence financial performance since one-unit increase in target firm's market characteristics while other factors are kept constant would result in a 0.192 increase in financial performance of private equity firms in Kenya.

The study was aimed in establishing to what extent the target firm's financial consideration influences financial performance of private-equity firms in Kenya. There exists a significant relationship ( $p=0.000$ ) between target firm financial consideration and financial performance which is an indication that financial consideration positively influence financial performance since one-unit increase in target firm's team characteristics while other factors are kept constant would result in a 0.324 increase in financial performance of private equity firms in Kenya.

## **CONCLUSION**

The study reached a conclusion that target firm's team characteristics on their own positively influence the financial performance of private equity firms in Kenya. A unit increase in the target firm's team characteristics result in increased financial performance of private equity firms in Kenya. In respect to the target firm's products and services characteristics, a conclusion was reached that they have positive effect on financial performance of private equity firms in Kenya. A unit increase in target firm's products and services characteristics results in increased financial performance of private equity firms in Kenya.

In regards to the target firm's market characteristics, the study concluded that for the PE firms in Kenya, they have a positive influence on their financial performance. If the target firm's market characteristics were to be increased by one unit, then it would lead to increased financial performance of the private equity firms in Kenya. The study also concluded that financial considerations equally have a positive influence on PE firms' financial performance in Kenya. In

conclusion, the target firm's market characteristics carry the greatest weight in influencing financial performance of the PE firms among the four variables followed by target firm's team characteristics, financial considerations of the target firm, and target firm's products and services characteristics in decreasing order of influence.

## **RECOMMENDATIONS**

The study recommended that target firms should constitute teams that give great attention to and has the ability to articulately discuss the investment. The team should understand the regulations for private equity in Kenya competently advice on the level of risk presented by an investment. This will ensure that their firms are able to attract adequate funding from investors.

In the context of the target team products and services characteristic, the study recommends that policy makers design policies and programs that will actively help in growing the private equity organisations in Kenya. In addition, the target firm should endeavour to protect the product from market predictors.

The study recommended that target firms engage in an industry with which it is familiar with since their information symmetry allows them to screen the venture and identify ventures with high returns and low risk. In addition, their record of accomplishment in past ventures enables them to highlight essential factors that help them identify and make investments in potentially successful ventures.

Finally, the study made recommendations to the target firms to put more emphasis on the selection of an appropriate investment that will result in higher return. This is informed by the higher mean score and low standard deviation generated from responses in regard to private equity firms' investment in target firms whose expected return equal to at least 10 times its investment within five years.

## **Suggestions for Further Studies**

The study focused on the effect of investment criteria on financial performance in Kenya. There is

however need for future researches to be done to establish the relationship between private equity financing and financial performance in Kenya. There were other factors not considered in the regression model of this study which had an 18.1% effect on

the financial performance of private equity firms in Kenya hence future studies could be geared towards establishing what other factors affect the financial performance of PE firms in Kenya.

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