THE EFFECT OF INVESTMENT STRATEGIES ON THE FINANCIAL PERFORMANCE OF PRIVATE EQUITY FUNDS INVESTING IN KENYA

BY

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DECLARATION

This Research Project is my original work and has not been presented for a degree in any other University.

Signed ____________________________ **Date**____________________

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This Research Project work has been submitted for examination with my approval as University Supervisor.

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DEDICATION

This research project is dedicated to my loving wife Stellah Kagendo and my wonderful daughter Nadiyah Njoki for being the source of my encouragement and support throughout the period of writing it. I love you two.

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LIST OF ABBREVIATIONS

AVCA – African Venture Capital Association.

BO – Buyouts

BRITAM – British American

CMA – Capital Markets Authority

GP – General Partnerships

IPO – Initial Public Offering

IRR – Internal Rate of Return

LBO – Leveraged Buyout

LP – Limited Partnerships

MPT – Modern Portfolio Theory

PE – Private Equity

PME – Public Market Equivalent

SPSS - Statistical Package for Social Sciences

UK – United Kingdom

VC – Venture Capital

ABSTRACT

Private equity investing (PE) has over the years experienced a rapid growth and has become a significant industry. Academic literature shows that there are many different strategies associated with private equity investments. The most common strategies include venture capital, leveraged buyouts, special situations and mezzanine financing. Managers who specialize in some of these strategies may also target the application of their investment money and expertise over a number of different points in a company's life cycle. Such points might include early seeding, start-up, expansion or replacement capital.

The objectives of this study were; to evaluate the investment strategies used by private equity fund investors in Kenya; to evaluate the performance of the private equity fund sector in Kenya and to evaluate the effects of investment strategies on the financial performance of private equity funds in Kenya. The study adopted a descriptive survey design in order to meet the objectives. The population of this study was the 20 licensed investment fund managers in Kenya. For the purposes of this study, both primary and secondary data were used. Primary data was collected through the use of a questionnaire structured based on the objectives of the study. Secondary data was sourced from the reports and websites of the various fund management companies as well as the CMA website and the NSE website. Data was analysed using descriptive statistics as well as linear regression.

The findings show that 45% of the companies adopted venture capital as a strategy, 33% adopted leveraged buyouts and 22% adopted mezzanine financing as an investment strategy. The results also showed that venture capital as an investment strategy had a significant positive effect on the performance of PE funds ($\beta = 1.727$). This effect was significant at 5% level of confidence. The study also found that leveraged buyouts as an investment strategy had a significant positive effect on performance of PE funds ($\beta = 1.947$). This effect was significant at 5% level of confidence. Finally, the results showed that mezzanine financing as an investment strategy had a significant positive effect on performance of PE funds ($\beta = 1.175$). This effect was significant at 5% level of confidence.

The study concluded that all the investment strategies had a positive and significant effect on the performance of PE fund investing in Kenya. The study recommends that PE fund

managers should adopt the strategies discussed above based on their expected returns. This will help ensure that the PE funds give maximum returns to their investors. The study also recommends that the PE funds structure their investments in portfolios of the investment strategies discussed as this will ensure maximum returns at lower risks. The study also recommends that the government should put up measures to ensure that the economic climate is conducive for the PE fund sector to grow. This will help spur growth in the financial sector and in the economy as a whole

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

Over the last few decades, private equity (PE) investing has evolved extensively to become a significant industry compared to the small niche market it used to be. Today, it is considered to play a crucial role in the economy, by boosting innovation and growth in promising startups or expanding firms, as well as by fostering the restructuring of mature companies (e.g., Davila et al., 2003; Cressy et al., 2007). It has been hailed as a new and efficient form of organisation that generates economic efficiencies through a superior governance framework. Private equity has become an increasingly important alternative asset class for institutional investors as it may offer return as well as diversification benefits relative to traditional stock and bond market investments. In fact, the market for private equity investments has grown dramatically over the 1998 to 2000 period. However, the economic downturn during 2001 to 2003 had a strong negative impact on the funds raised by the private equity industry. Nevertheless, it is common wisdom that private equity will again become an important source of corporate financing and, thereby, an important driver in economic prosperity.

Private equity is generally considered the most expensive source of finance, sought by firms that cannot support debt because of their high risk, and that have severe information problems and little track record to attract public equity. Such firms have difficulty raising capital because of the intensive need for due diligence by investors, and active management for a substantial period of time before returns are realized. These problems are solved in the private equity market by the limited partnership structure, the principal financial intermediary that is managed by investment professionals, such as venture capitalists and buyout investors, known as general partners. General partners are specialists that find, structure, and manage equity investments in closely-held private companies, and who gain their expertise by attaining a critical mass of investment activity that institutional investors could not attain on their own. Limited partnerships are among the largest and most active shareholders in their portfolio companies with significant means of both formal and informal control (Kaplan and Stromberg, 2009).

1.1.1 Private Equity Funds

Private equity fund has simply been defined as any type of equity investment into a business not quoted on a stock market. The investment may be used to develop new products and technologies, to expand working capital, to make acquisitions, to strengthen a company's balance sheet, or to buy out other shareholders. The formal PE market is usually split into two main sub-segments: buyout (BO) capital and venture capital (VC). A buyout is a transaction in which a business, business unit or company is acquired from other shareholders, typically applied to mature companies. A company that carries out buyout deals, manages and develops the entity after a buyout transaction has been made, and finally exits the investment is referred to as a buyout firm. In contrast, venture capital firms invest capital into early-stage companies with large growth potential or in firms that are in the expansion phase. Both types of PE investors are active owners, suggesting that they will not only bring capital but also relevant knowledge, business networks and certification to their investments. Other similarities between VC and BO investors are that they primarily invest third-party capital and have formal organizational structures for their investment activities. There are several types of PE firms, but the vast majority of them invest capital through fixed-life funds where portfolios of companies are built, developed and finally exited. Once one such fund has been closed, these PE firms need to raise new funds in order to stay in business (Diller and Kaserer, 2008).

The theoretical rationale for investing in an alternative asset class such as private equity is to improve the risk and reward characteristics of an investment portfolio, with the expectation that the asset will offer a higher absolute return whilst improving portfolio diversification (Bodie et al., 2005). In comparison with investing in more traditional securities such as public stocks or bonds, however, investing in PE funds is considered a complex task. This is due to their long-term and illiquid nature, as well as the noticeable lack of transparent and publically available information pertaining to PE funds (Tuck, 2003). Moreover, there are material variations in performance across PE funds, implying that while PE investing may generate excellent returns, investors could also face large losses (Kaplan and Schoar, 2005; Phalippou and Gottschalg, 2009). Hence, a PE fund investor needs to have the ability (or luck) to select funds with the potential to deliver attractive returns. However, deeper insights about which investment strategies have proven successful, and, more specifically, about how these strategies may differ across various investor types, seem to be missing from the literature. This is somewhat surprising given the large amounts of capital that private as well as public institutions devote to this particular asset class each year, as a broader understanding about performance determinants could improve investor returns.

From an economic point of view, one of the most important advantages of private equity compared to public equity is to overcome the free-rider problem in corporate control. While dispersed ownership as the typical ownership structure in public equity markets does not generate sufficient incentives to undertake costly control activities, private equity markets typically go along with concentrated ownership in portfolio companies. This is because the private equity investor normally holds a large part of equity in his portfolio company. For that reason he exercises a continuous monitoring activity. The private equity investor is typically by itself a fund where a given number of private or institutional investors, called limited partners, have paid in their capital. The fund is run by a management team called general partner. Of course, a conflict of interests between the general and the limited partners could arise. Normally, however, this problem will be avoided as the number of limited partners is not too high and the general partner has either invested his own money in the fund or is paid according to some purposeful incentive scheme. Whether these problems may become more serious in the case of a fund of funds construction, may be left open here. In such cases the outside investor has only a contractual relationship with the management team of the fund of funds; the allocation of capital to different private equity funds is made by the management team (Manigart et al., 2002).

From an investors point of view it is important to note that several empirical results, which are available particularly for venture capital as a special segment of private equity focused on financing high risk start-up firms, indicate that this kind of alternative investment may indeed offer desirable risk-return and particularly diversification characteristics. Despite these potential benefits it is important to point out that the lack of an organised secondary market for alternative investments comes along with low liquidity or even illiquidity in the transfer of alternative asset ownership. Hence, a major drawback of the private equity asset class is its liquidity risk. The latter can manifest itself with the impossibility to transact at a given point in time and/or with the occurrence of substantial transaction cost (Manigart et al., 2002).

It has already been mentioned that a private equity investment can be undertaken directly or indirectly via a so called private equity fund. Therefore, risk-/return characteristics of private equity investments can basically be defined from two different perspectives. Either one is interested in assessing the return distribution of an investment in a single company seeking for equity financing or in assessing the return distribution of an investment in a private equity fund. As far as risk management issues are concerned the first perspective is especially relevant from the viewpoint of a general partner, as he is supposed to make congruent decisions with respect to the allocation of capital provided by limited partners to portfolio firms. The second perspective is relevant for a private or institutional investor considering to act as a limited partner, i.e. to invest money in a private equity fund. Hence, when talking about return distributions one should make clear as to what kind of return processes he is referring to: returns generated at the level of a single portfolio firm, labelled as transaction level, or returns generated at the level of a private equity fund, labelled as the fund level (Peng, 2001).

1.1.2 Investment Strategies of Private Equity Funds

Academic literature shows that there are many different strategies associated with private equity investments. The most common strategies include leveraged buyouts, venture capital, special situations and mezzanine financing (Soderblom, 2011). Managers who specialize in some of these strategies may also target the application of their investment dollars and expertise over a number of different points in a company's life cycle. Such points might include early seeding, start-up, expansion or replacement capital.

Venture capital is one of the main investment strategies adopted by private equity funds. Venture capital describes early-stage investing, when a fund invests in small businesses or start-up companies that demonstrate above-average growth potential. Portfolio companies in a VC fund can often benefit from the specialized skill sets and managerial expertise of the VC fund's managers. This strategy involves investing in a company based on the belief that its value will go up due to a specific anticipated event related to the company. Such events may include shifting industry trends or changing government regulations (Kaplan and Stromberg, 2009).

Another strategy is the use of leveraged buyouts. A buyout occurs when a private equity fund or company takes control of another company's assets and/or operations by purchasing a majority of the voting stock of the target company. A "leveraged" buyout (LBO) occurs when a considerable amount of the proceeds used to make the purchase of the portfolio company's equity come from borrowed capital. In some cases, the acquiring body in an LBO may pledge the assets of the target company as collateral to secure the loan (Stromberg, 2007).

Sometimes referred to as "late-stage venture capital," Mezzanine financing is subordinate debt financing where the private equity fund would become a debt holder in a company and would typically have equity conversion features (for example, options, warrants or rights). Often viewed as the last sequence in financing before an IPO, mezzanine financers hope for capital appreciation resulting from a successful initial offering of the company's shares to the public (Soderblom, 2011).

1.1.3 Investment Strategies and Financial Performance of PE Funds

Research indicates that private equity generates significant improvements in financial performance and total factor productivity. Cumming, Siegel and Wright (2007) and

Kaplan and Stromberg (2009) provide useful surveys. In addition, recent work shows that employment appears to fall at first under private equity ownership, but a significant increase generally follows (Amess, Girma and Wright, 2008, and Davis et al., 2008). When it comes to asset-stripping, the popular charge is that private equity managers buy companies in order to break them up. In fact, “buy and build” or growth strategies are much more common. These involve making add-on acquisitions and injecting new equity into companies. Also, the average private equity holding period is more than four years (Lopez-de-Silanes et al., 2010, Stromberg, 2007), so their horizon does not appear particularly short.

Axelson, Strömberg and Weisbach (2009) highlight the pro-cyclical nature of the private equity industry, with a theoretical paper arguing that general partners have the incentive to invest in ‘bad deals’ in periods of loose credit conditions. A follow-up empirical paper by Axelson et al (2012) finds that variation in economy-wide credit conditions is the main determinant of leverage in buyouts, and that greater deal leverage is associated with higher deal values and lower investor returns.

In evidence from a UK population of firms over the period 1995–2010, Wilson et al (2012) find that private equity backed companies perform more strongly (higher return on assets, higher interest cover, higher gross margin) than a matched sample of private and listed companies both before and during the recent recession. They also found that bought-out companies have a higher failure rate than other companies, but this does not apply for deals completed after 2003. Andrade and Kaplan (1998), in a study of highly leveraged transactions that subsequently become financially distressed, find that the net effect of a highly leveraged buyout which subsequently becomes distressed is to leave the value of the company slightly higher. The evidence on private equity ownership and distress is therefore mixed. But more time is needed to get a full picture of the effects of the recent boom in leveraged buyouts.

1.1.4 Private Equity Fund Investing in Kenya

Kenya's private equity market has been on a happy growth curve since 2002. New funds here inspired by the success of private equity abroad are now welcoming international money, supplemented by a domestic effort that has been inspired by investment groups like Trans-century. Kenyan fund managers have never sounded more optimistic. They say the industry is growing, local money mobilising, and diaspora experts coming home (Deloitte, 2013).

Kenya is the most preferred market for private equity firms in Africa, according to the findings of a new survey, boosting the country's ambition of being a financial hub. The survey by Deloitte and Touché and research firm Africa Assets found that PE firms prefer Kenya to other African countries owing to its prospects of growth and open market policies with a high inclination to the financial sector. Seventy-four per cent of 39 PE funds that were reviewed by Deloitte released last week preferred Nairobi ahead of other sub-Sahara African nations like Uganda (70 per cent), Tanzania (67 per cent), Zambia (48 per cent), Ethiopia (41 per cent) and South Africa (37 per cent). Kenya has been seeking to attract funds to boost its economy in a bid to catch up with major economies in Africa such as South Africa, Egypt and Nigeria. "It is attributable to Kenya coming from a lower base than the South African market (Deloitte, 2013).

1.2 Research Problem

PE fund investing, similar to all types of alternative investments, is expected to generate better risk-return payoffs than traditional assets. Such investments are also expected to have low correlations with traditional instruments. In addition, private equity funds tend to have long investment horizons (Leitner et al., 2007), and thus are considered long-term and illiquid investments. As outlined, the lifetime of a private equity fund is normally set to ten years, and a LP cannot easily break from its obligations prematurely. Although a secondary market for limited partnership stakes is under development (Fraser-Sampson, 2007), a quick sell at a fair market value is still difficult to achieve and in some instances is not even permitted. Hence, one of the principal characteristics of this asset class is the liquidity risk (Bance, 2004). One challenge of selling partnership stakes during their lifetime is the issue of determining interim values. Since PE funds are not traded on a daily basis on a transparent market, interim valuations are typically subject to estimates made by GPs, which introduces noise and biases.

Over the years, a number of literature reviews of this empirical field have been published. Timmons and Bygrave (1986) presented one of the first overviews of venture capital investing and of existing research in the field, providing a holistic overview of the professional entrepreneurial financing industry. Following that, Sahlman (1990) published a widely cited paper on the structure and governance of US based VC organizations. In the early 1990s, Bygrave and Timmons (1992) released a popular book, Venture Capital at the Crossroads, which summarized the key characteristics of venture capital investing. One of the more comprehensive books about private equity was written by Gompers and Lerner (1999). Soderblom (2011) studied investment strategies, entry order and performance of private equity fund investing. One of the more interesting findings from this study is that there seem to be two significantly divergent investment strategies that lead to satisfactory performances when investing in PE funds: (i) to be a devoted, highly skilled and independent investor, or (ii) to copy the behaviours and decisions of other investors who are perceived as having high skills and thus have attained prominence in the market.

Private fund investing has not been given a lot of focus by researchers in Kenya. Most of the studies in this area have focused on the European market and the American Market. A search for empirical literature on investment strategies and performance of private equity fund investing in Kenya revealed several studies. Deloitte (2013) carried out a study on East Africa private equity confidence survey. Murithi (2012) assessed risk – return trade off among private equity firms in Kenya. Kiungu (2012) used BRITAM equity fund to investigate the influence of behavioural biases on the trading decisions of equity fund investors in Kenya. It is therefore evident that there is lack of adequate studies on the effects of investment strategies on the financial performance of private equity funds in Kenya. There is therefore a gap in literature as far as the study on the effects of investment strategies on the financial performance of private equity funds in Kenya is concerned. The following research question is therefore explored: What are the effects of investment strategies on the financial performance of private equity funds in Kenya?

1.3 Objectives of the study

1. To evaluate the investment strategies used by private equity fund investors in Kenya
2. To evaluate the performance of the private equity fund sector in Kenya
3. To evaluate the effects of investment strategies on the financial performance of private equity funds in Kenya

1.4 Value of the study

The findings of this study will be significant to the management of private equity fund investment companies in that they will get to understand the best investment strategies to use and their implication on fund performance.

The findings of this study will also be significant to private investors as they will be able to evaluate equity funds based on the investment strategies adopted and therefore be able to identify those that will offer maximum return to their investments.

The findings of this study will be significant to academicians in that it will add to the knowledge of the researchers in this field of study

The findings will also be significant to policymakers in that it will serve as a guide to them when making policies regarding private equity fund investing.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This chapter presents the literature review. First, a theoretical review is provided focusing on theories that explain issues to do with investment strategies and private equity fund investing. Secondly, an empirical review of the studies that have been done on the investment strategies and performance of private equity fund investing is carried out. A summary of the chapter is then provided.

2.2 Theoretical Review

This study is based on three main theories. These theories are Modern Portfolio theory, contingency theory and skills leadership theory.

2.2.1 Modern Portfolio Theory

Modern Portfolio Theory (MPT), a hypothesis put forth by Harry Markowitz in his paper "Portfolio Selection," (published in 1952 by the Journal of Finance) is an investment theory based on the idea that risk-averse investors can construct portfolios to optimize or maximize expected return based on a given level of market risk, emphasizing that risk is an inherent part of higher reward. It is one of the most important and influential economic theories dealing with finance and investment (Kaplan and Schoar, 2005).

Also called "portfolio theory" or "portfolio management theory," MPT suggests that it is possible to construct an "efficient frontier" of optimal portfolios, offering the maximum possible expected return for a given level of risk. It suggests that it is not enough to look at the expected risk and return of one particular stock. By investing in more than one stock, an investor can reap the benefits of diversification, particularly a reduction in the riskiness of the portfolio. MPT quantifies the benefits of diversification, also known as not putting all of your eggs in one basket (Kaplan and Schoar, 2005).

The theoretical rationale for investing in an alternative asset class such as private equity (guided by Modern Portfolio Theory) is to improve the risk and reward characteristics of an investment portfolio, with the expectation that the asset will offer a higher absolute return whilst improving portfolio diversification (Bodie et al., 2005). In comparison with investing in more traditional securities such as public stocks or bonds, however, investing in PE funds is considered a complex task. This is due to their long-term and illiquid nature, as well as the noticeable lack of transparent and publically available information pertaining to PE funds (Tuck, 2003). Moreover, there are material variations in performance across PE funds, implying that while PE investing may generate excellent returns, investors could also face large losses (Phalippou and Gottschalg, 2009). Hence, a PE fund investor needs to have the ability (or luck) to select funds with the potential to deliver attractive returns. However, deeper insights about which investment strategies have proven successful, and, more specifically, about how these strategies may differ across various investor types, seem to be missing from the literature. This is somewhat surprising given the large amounts of capital that private as well as public institutions devote to this particular asset class each year, as a broader understanding about performance determinants could improve investor returns.

2.2.2 Skills Leadership theory

Northouse (2006) summarized skill theory composition in three categories: (a) technical skills, (b) interpersonal skills, and (c) conceptual skills (p. 40-43). Baum &

Locke (2004) indicate that “entrepreneurs’ traits, skill, and motivation categories are significant direct or indirect predictors of venture growth for a period of six years following initial measurement”. Kim and Mauborgne (2003) frame “tipping point leadership” as being comprised of four skills. Two of the four skills are described as “rapid strategy reorientation.” Kim and Mauborgne discuss a cognitive hurdle that requires leaders to improve communications to engage stakeholders in problem solving. The other orientation point regards a resource hurdle. This compels leaders to allocate limited resources to address priorities. Kim and Mauborgne’s remaining two skills are described as “rapid strategy execution.” These are change management functions. One is a motivational hurdle to point the culture in the right direction. The other is a political hurdle to weed out antagonists.

Goleman (2004) discusses skills in relative terms. Whereas technical skills and IQ are prerequisites to effective leadership, Goleman confirms a more significant correlation with emotional intelligence, or EQ. Goleman continues that EQ has five components—three are self management skills and two are interpersonal skills. The self-management skills Goleman itemizes are (a) self-awareness, (b) self-regulation, and (c) motivation. The interpersonal skills are (a) empathy and (b) sociability. Kirkpatrick and Locke (1991) itemize distinguishable, differentiable attributes: (a) industry expertise, (b) intelligence, (c) self-assurance, (d) character, and (e) motivation.

With respect to private equity, skills theory may be summarized in terms requisite execution competencies. Knowing how creates value. Gilligan and Wright (2008) explain that consummating a transaction is highly technical. Investment professionals routinely complement their skills with supplemental subject matter experts, e.g., due diligence vendors. The ability to work with multiple stakeholders substantiates interpersonal skills. Creating an investment thesis draws upon conceptual skills. Portfolio company leaders have technical expertise in their market segment. Interpersonal skills are important with vendors and customers. Conceptual skills are substantiated by the enterprise value created to attract the private equity firm. Skills theory most assuredly applies to consultancy. Indeed, the engagement is precipitated by the skill possessed by the consultant that the private equity firm and its portfolio company require to solve a problem.

2.2.3 Contingency Theory

Contingency theory is a viable option within private equity. As the moniker implies, the leadership style is influenced by environmental conditions. Northouse (2006) explains that contingency theory operates on a continuum whose endpoints are task and people issues. For example, a "situations" private equity firm investing in distressed businesses may be expected to focus more on task, whereas a normal majority interest in a performing company may opt for an interpersonally-skewed approach.

Several considerations impact the efficacy of the task-people continuum. Schruijer and Vansina (2002) offer comments on the "soft" skills. They state that leadership development rests upon "increasing one's emotional intelligence, one's self-confidence, learning to win support, and overcoming resistance to change"). Schruijer and Vansina continue that "the concepts of leadership and management are theoretical constructs that are hard to distinguish in practice". The tenor of Schruijer and Vansina's comments suggest that leadership may be more associated with people whereas management may be more attuned to task.

Baum and Locke (2004) opine that leadership traits are less reliable performance indicators than comprehension of the growth vision by the team. Their studies substantiate superior performance when this is clear to the constituents. They also discovered that this rings more true in smaller rather than larger companies. This clarity induces predisposition on the task-people balance. The people-task continuum is another flexible opportunity for consultants. Indeed, it may be a simple means of communicating competencies to the private equity firm. For example, leadership development consultancy might involve the implementation of a performance management system. Task consultancy might entail the implementation of a new operating system.

2.3 Empirical Review

The focus of the earliest private equity studies was to a large extent placed on understanding more about this new type of investing. The research questions were typically oriented around how PE firms make selections, take decisions, work with their investee firms, and finally exit them. One of the more cited papers in this stream was written by Sahlman (1990), in which the author documents the organization of venture capital investing, the deal-making process, deal structuring, etc. The investment processes and selection criteria of VC firms, first modeled by Tyebee and Bruno (1984), garnered significant interest from scholars in the earlier PE research (Zacharakis and Shepherd, 2001; Dimov et al., 2007). In addition, investors' abilities to manage and control their investee companies is a common theme in this stream, with a focus on evaluating venture capitalists' as well as buyout firms' governance processes. Special interest is devoted to control mechanisms outlined in contractual agreements between PE firms and their investees, including staged financing, liquidation, and other control rights. The agency perspective on contracting is particularly popular in finance oriented papers, typically assuming that entrepreneurs (or executives in investee companies) are agents of the PE firm whereby conflicts of interest may occur (Hellmann, 1998; Kaplan and Stromberg, 2004).

Soderblom (2011) carried out a study on investment strategies, entry order and performance of private equity fund investing. Based on a comprehensive set of interviews with PE fund investors, in-depth insights about variances in motives for investing in the asset class, ways of working, and investment strategies were acquired. One of the more interesting findings from this study is that there seem to be two significantly divergent investment strategies that lead to satisfactory performances when investing in PE funds: (i) to be a devoted, highly skilled and independent investor, or (ii) to copy the behaviours and decisions of other investors who are perceived as having high skills and thus have attained prominence in the market. This, in turn, suggests that organization-specific characteristics determine which strategy will be the optimal choice for a certain investor. Amongst several novel results, the hypothesis-testing study indicated that the level of environmental uncertainty has a clear impact on which organization-specific factors explain entry order, as well as which factors impact the ability of an organization to take advantage of a chosen entry order. Furthermore, the study pointed at organizational reputation as an especially valuable asset in situations of uncertainty. While a good reputation does not directly lead to superior performance, it may be used in exchange for favourable entry order positions.

Cressya, Munarib & Malipieroc (2006) examined whether Private Equity (PE)-backed buyouts have higher post-buyout operating profitability than comparable companies ("The Jensen hypothesis") and whether relative investment specialisation provides the

PE firm with a competitive advantage over its peers (“The advantage-to-specialization hypothesis”). A sample of 122 UK buyouts over the period 1995-2000 and a matched sample of non-PE-backed UK companies are constructed to test the first hypothesis. Applying a new measure of relative PE firm specialization that identifies buyout-specialized and industry-specialised PE firms we test the second hypothesis on the subsample of PE-backed companies. The study finds that over the first 3 post-buyout years (i) operating profits of companies backed by PE firms are greater than those of comparable non-buyout companies by 4.5%, confirming the Jensen hypothesis; (ii) industry specialization of PE firms adds 8.5% to this profitability advantage, confirming the advantage-to-specialization hypothesis; (iii) buyout specialization has no effect on profitability but may provide a spur to growth. Finally, results show that profitability of the PE-backed company in the buyout year plays a major role in post-buyout profitability, suggesting that skill in investment selection and financial engineering techniques may play a more important role than managerial incentives in raising performance.

Azzi & Suchard (2013) examine the investing behaviour of foreign and domestic investors in PE funds that invest in China. The Chinese PE market can be considered to be a quasi-segmented market due to information constraints and legal barriers. It is also characterised by information asymmetries between domestic and foreign investors and differing investor risk appetites. The results show a clear distinction between the investment attitudes of domestic and foreign investors in PE funds in China. They found that offshore investors are more likely to invest with firms that are more experienced and not government affiliated. Foreigners are also more likely to invest in larger funds and funds that allocate a smaller portion of their commitments to China, which supports the view that they seek fund characteristics that lessen information asymmetry and provide additional diversification. They show that the size of an investor's commitment amount is determined by fund characteristics such as size, sequence and stage, but not by the location of the investor. In terms of performance, we find some evidence indicating that domestic investor backed PE funds exit a greater number of companies but that they do not realise these investments at higher exit multiples relative to PE funds supported by foreign investors.

Diller & Kaserer (2004) analyzes the determinants of returns generated by European private equity funds. It starts from the presumption that this asset class is characterized by illiquidity, stickiness and segmentation. As a consequence, Gompers and Lerner (2000) have shown that venture deal valuations are driven by overall fund inflows into the industry giving way to the so called 'money chasing deals' phenomenon. It is the aim of their paper to document that this phenomenon also explains a significant part of variation in private equity funds' returns. This is especially true for venture funds, as they are more affected by illiqudity and segmentation than buy-out funds. Actually, the paper presents a WLS-regression model that is able to explain up to 47% of variation in funds' returns. Apart from the importance of fund flows we can also show that market sentiment, the GPs' skills as well as the idiosyncratic risk of a fund have a significant impact on its returns. Moreover, they seem to be unrelated to stock market returns and negatively correlated with the development of the economy as a whole. According to a bootstrapping inference the results seem to be quite stable.

Aragon & Ferson (2006) provides a review of the methods for measuring portfolio performance and the evidence on the performance of professionally managed investment portfolios. Traditional performance measures, strongly influenced by the Capital Asset Pricing Model of Sharpe (1964), were developed prior to 1990. They discussed some of the properties and important problems associated with these measures. They then reviewed the more recent Conditional Performance Evaluation techniques, designed to allow for expected returns and risks that may vary over time, and thus addressing one major shortcoming of the traditional measures. They also discussed weight-based performance measures and the stochastic discount factor approach. They reviewed the evidence that these newer measures have produced on selectivity and market timing ability for professional managed investment funds. The evidence includes equity style mutual funds, pension funds, asset allocation style funds, fixed income funds and hedge funds.

Phalippou (2010) reviewed the literature on the risks and returns of private equity funds, comparing the different datasets used in academic research. Irrespective of the datasets used, average returns seem to be lower than public equity returns and, in any event, less spectacular than often conjectured. Buyout funds seem to bear a moderate market risk (beta is around unity), but their exposure to liquidity risk and distress risk is significant. The cost of capital of buyout is 18% (in excess of risk-free rate). The beta of venture capital seems much higher (around 3), implying a cost of capital of about 20% (in excess of risk-free rate and any venture capital liquidity risk premium). They conjecture on why industry benchmarks show different returns than those documented here. Finally, the study discusses fund selection. The study emphasizes the importance of a bottom-up approach when investing in private equity, show that top-quartile returns and evidence of performance persistence should be approached with some caveats in mind, and describe variables that have predicted returns.

Dijky (2009) developed a reinvestment strategy for private equity which aims to keep its portfolio weight equal to a desired strategic allocation, while taking into account the illiquid nature of private equity. Historical simulations (1980{2005) show that our dynamic strategy is capable of maintaining a stable investment level that is close to the target. This does not only hold for unrestricted portfolios, but also for investments limited to buy-out or venture capital, a specific region, or management experience. This finding is of great importance for investors, because private equity funds have a finite lifetime and uncertain cash flows.

See & Jusoh (2012) examined the fund characteristics that affect fund performance by studying 69 Malaysian equity mutual funds representing 44 conventional funds and 25 Islamic funds over the period of five years. The characteristics examined include Risk, Fund Size, Management Expense Ratio, Turnover Ratio and Fund Age. The hypotheses were tested using several regression analyses to see whether Risk, Fund Size, Management Expense Ratio, Turnover Ratio and Fund Age have significant relationships with Fund Performance. The results show that higher risk fund provides higher return. Those funds which spent more on research expenses give superior return compared to those that spent less. The findings also show that young funds performed better than old ones. However, Fund Size and Turnover Ratios were found to have no significant relationship with Fund Performance. Overall, the results indicate that investors should focus on young funds and select fund based on his/her preferred risk level. Fund managers should understand the characteristics that will affect fund performance and develop strategies on how to increase their funds performance.

Hsu, Reed, and Rocholl (2012) show that companies receiving private equity (PE) investments outperform their rivals, and we analyze the reasons for this outperformance. Specifically, they find that competitors experience a decrease in their stock price and operating performance around a rival's PE investment, whereas the withdrawal of a previously announced PE investment leads to the opposite outcome (an increase in competitors' stock prices). They identify the underlying sources of the decrease in competitiveness by analyzing the cross sectional differences in competitors' performance. They further find that PE specialization, corporate governance, technological innovation, managerial incentives, and operating efficiency are related to performance differences among competitors at the time of a PE investment. These results are robust to the inclusion of additional control variables and to a number of alternative explanations. Taken together, the findings support the view that performance differences are driven, at least in part, by the advantages conferred by PE investors.

Harris, Jenkinson & Kaplan (2013) evidence on the performance of nearly 1400 U.S. private equity (buyout and venture capital) funds using a new research-quality dataset from Burgiss, sourced from over 200 institutional investors. Using detailed cash-flow data, we compare buyout and venture capital returns to the returns produced by public markets. They find better buyout fund performance than has previously been documented. Average U.S. buyout fund performance has exceeded that of public markets for most vintages for a long period of time. The outperformance versus the S&P 500 averages 20% to 27% over the life of the fund and more than 3% per year. Average U.S. venture capital funds, on the other hand, outperformed public equities in the 1990s, but have underperformed public equities in the 2000s. the conclusions are robust to various controls for risk. We also compare the Burgiss evidence to that derived from other commercial datasets. Private equity performance in Cambridge Associates and Preqin is qualitatively similar to the performance in the Burgiss data. Consistent with Stucke's (2011) finding of a downward bias, buyout performance is markedly lower in the Venture Economics data.

Murithi (2012) assessed risk – return trade off among private equity firms in Kenya. The purpose of this study was to assess the risk and return trade off among private equity firms in Kenya. The study sought information from the AVCA data bank and various sources like publications journals, business magazines, websites of the firms under study and studies done by scholars in this field. The study adopted a descriptive research design which involved a census survey where secondary data was collected. This was a census study of the entire 14 private equity firms in Kenya. Before processing the data was checked for consistency. The data was analyzed using Fama and French model this model was used to measure risk and return and establish what relationship exist between these variables. The researcher also used NSE index to calculate the market return proxy. Risk free rate was calculated from the Treasury bill rates downloaded from central bank of Kenya data bank. Causal comparative research was used to explore relationships between variables. Descriptive statistical method was used to analyse data. The study revealed that the risk is very low for private equity firms in Kenya as the betas were negative. The study also found that the returns for the firms were quite impressive given the Treasury bill rate rose towards the end of the year 2011 and this contributed to negative beta for the firms. The study found that there is potential for higher returns given the high risk free rate of investment towards the end of 2011 and beginning of 2012. Firms with high return like centum investment had one of highest risk as compared to others. And a low return firm like the Acacia fund limited had one of the lowest risks, the principle of risk return trade off states that for a firm to get higher return it must be ready to take on higher risk.

Kiungu (2012) used BRITAM equity fund to investigate the influence of behavioural biases on the trading decisions of equity fund investors in Kenya. The objective of this study was to identify behavioral biases and phenomena present amongst investors in the equity fund market in Kenya and determine how these behavioral biases influence their trading decisions in terms of buying and selling of equity fund scheme shares. This study sought to identify if investors' selling behavior is influenced by the disposition effect and loss aversion and if investors are irrational in their purchasing decisions by irrationally buying shares with high prices or buying shares based on how old the fund is rather than the fund's performance. The study was an exploratory study. It focused on the British American equity fund scheme as it has been and it still is, the largest equity fund scheme in Kenya, with the most investors. The British American equity fund scheme has a current market share of 54%. Secondary data was collected from British American's equity fund data base and from their publicly available financial statements for the years 2008 to 2011. The data was analyzed using statistical tools such as charts and graphs and using regression analysis.

The study found that investors exhibited both rational behaviour and irrational behaviour in their trading decisions. It was found that there were a number of investors who were influenced by the disposition effect and by loss aversion in their selling/redemption decisions in that they sold fund shares quickly when prices increased slightly and held on to shares slightly longer when prices declined below the original fund share price of Kshs. 100. However, there were also a number of investors who retained their shares longer when prices were on an upward trend and sold them when prices had increased even further to higher levels, hence realizing more gains on redemption. With regard to purchasing decisions, the study found that investors were mostly rational, buying shares when prices declined. The study also found that investors purchased more shares in the fund when the performance of the fund improved i.e. when the fund made increased return/profits, which is also rational. It was noted however, that the number of fund shares issued decreased as the fund got older. This is in keeping with other studies that found that there is an irrational tendency of investors to purchase more shares from newer and younger equity fund schemes.

2.4 Private Equity funds

Despite the large increase in investments in private equity funds and the concomitant increase in academic and practitioner scrutiny, the historical performance of private equity (PE) remains uncertain, if not controversial. The uncertainty has been driven by the uneven disclosure of private equity returns and questions about the quality of the data that have been available for research. While several commercial enterprises collect performance data, they do not obtain information for all funds; they often do not disclose, or even collect, fund cash flows; and the source of the data is sometimes obscure, resulting in concerns about biases in the samples. Furthermore, some data are only periodically made available to academic researchers (Lerner 2000).

Private Equity (PE) as an asset class has experienced a dramatic growth over the last 20 years throughout the world and is now broadly accepted as established asset class (Bance 2002). In the US, PE funds investment grew from $5 billion in 1980 to $175 billion in 1999 (Lerner 2000). In Europe €121.7 billion was raised from 1996 to 2000 alone (Bance 2002). Investing into PE offers the investor the chance to generate higher absolute returns and at the same time improve the diversification of his portfolio (Bance 2002). It is expected that PE will continue to out-perform public equity benchmarks by 3% to 5 % (Maxwell 2002). However, notwithstanding the extraordinary development in the PE industry, disquiet has shown itself about declining returns, unknown performance and obscure fee structures. A recent study of AltAsset, a specialist UK PE research and publishing group, has revealed in a PE study that two-thirds of respondents consider the lack of transparency - in particular the lack of standardised and comparable data - to be the biggest obstacle to investing in PE (Campbell 2002).

Fund-of-funds investments, however, seem to be an attractive alternative to participating in PE without the concern of diversification and the need to have specific PE knowledge for selecting, managing and monitoring the investment. In 2001, fund of-funds, which accounted for 12% of the total, continued to be a major contributor to PE fundraising (EVCA 2002). During the last decade, Fund-of-Funds investing experienced the highest growth of all PE capital sources (Lerner and Hardymon 2002) and it seems that this trend is continuing. This development is also the reason why this research adopts a Fund-of-Funds perspective. Recently a paradoxical situation has arisen in which criticism (i.e. the transparency) of PE as an asset class among institutional investors is growing although the proportion of investments made in this asset class is significantly increasing (Tassel 2002).

As discussed, PE equity fund investing, similar to all types of alternative investments, is expected to generate better risk-return payoffs than traditional assets. Such investments are also expected to have low correlations with traditional instruments. In addition, private equity funds tend to have long investment horizons (Leitner et al., 2007), and thus are considered long-term and illiquid investments. As outlined, the lifetime of a private equity fund is normally set to ten years, and a LP cannot easily break from its obligations prematurely. Although a secondary market for limited partnership stakes is under development, a quick sell at a fair market value is still difficult to achieve and in some instances is not even permitted. Hence, one of the principal characteristics of this asset class is the liquidity risk (Bance, 2004). One challenge of selling partnership stakes during their lifetime is the issue of determining interim values. Since PE funds are not traded on a daily basis on a transparent market, interim valuations are typically subject to estimates made by GPs, which introduces noise and biases.

2.5 Summary of literature review

The review has evaluated the various theories that the study is based on. These theories are important in explaining the decisions to invest in private equity funds as well as the investment strategies adopted and their effects on the performance of these private equity pension funds. The literature review carried out above has also clearly shown that private equity fund investing has become a very attractive sector and a lot of academicians and researchers have been giving it a lot of attention. The literature shows that investment strategies adopted are different and this is due to the different motives of fund managers.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter presents the research methodology. First, a presentation of the research design is provided. This is followed by an explanation on the target population, description of research instruments, a description of data collection procedures and a description of data analysis procedures.

3.2 Research Design

The method of analysis that most captures the objectives of this study is descriptive analysis and the study design is therefore appropriately named a descriptive design. In this manner, the study was able to describe the relationship between the variables in the study. This was therefore considered the appropriate research design in this study. This study design was named based on the classification by method of analysis as espoused in Mugenda and Mugenda (2003).

3.3 Population and Sample

The study was a survey of the private equity fund investment management companies in Kenya. According to CMA (2013) there are 20 licensed investment fund managers in Kenya (Appendix 1). All of them were surveyed. The population of this study was therefore the 20 licensed investment fund managers in Kenya.

3.4 Data Collection

For the purposes of this study, both primary and secondary data were used. Primary data was collected through the use of a questionnaire structured based on the objectives of the study. The questions were both open and closed. The closed ended questions helped capture the results that can be quantified during analysis and were based on a likert scale. The open ended questions helped in eliciting responses that can be qualitatively analysed and helped capture the issues that are relevant to the study but cannot be captured by structured questions. The researcher dropped the questionnaires to the respondents and collected them after a period of one week in order to allow them to go through it at their own time and respond to the questions appropriately. Secondary data was sourced from the reports and websites of the various fund management companies as well as the CMA website and the NSE website.

The study used the following linear regression model

$Y = \alpha + \beta 1LBO + \beta_2 VC + \beta_3 MF + €$

Where

Y	Financial Performance measured in terms of Return on Investments (ROI)
LBO	Leveraged Buyouts measured by the means scores from the questionnaires.
VO	Venture Capital measured by the means scores from the questionnaires
MF	Mezzanine Financing measured by the means scores from the questionnaires
α	is the constant or intercept
€	is the error term

3.5 Data Analysis

After collection of data and testing for reliability, the questionnaires were coded and analyzed with the aid of the Statistical Package for Social Sciences (SPSS). Then, the study used descriptive statistics and inferential statistics to establish the relationship between the variables. The descriptive statistics here were the percentages, mean and standard deviations. Linear regression was also carried out to test the influence of the various investment strategies on the financial performance of the private equity funds. The model was tested for statistical significance at a level of significance of 95% and the results were interpreted using coefficients of variables, p-values, and R-squared statistics.

3.6 Data validity and Reliability

To establish the validity of the research instruments the researcher sought opinions of experts in the field of study especially the lecturers in the department of Finance and Accounting. This helped facilitate the necessary revision and modification of the research instrument thereby enhancing validity.

Further, the time between the test run and actual study was short enough to avoid historical effects. To ensure representatives of the sample with regard to the target population and the degree to which the findings can be generated to represent the population, given the number of licensed fund management firms, all the firms as per CMA were considered to be a fair representative of the population.

According to Walliman, Nicholas (2001), reliability refers to the consistency of measurement and is frequently assessed using the test–retest reliability method. To ensure reliability, the study adopted the test retest technique. This was achieved by testing the questionnaire to a sample of the population to test its consistency and adjust for any inconsistencies before the real field work begun.

CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

This chapter presents the results found from the data analysis. It therefore consists of the data analysis presentation and interpretation of findings. The objectives of this study were to evaluate the investment strategies used by private equity fund investors in Kenya, to evaluate the performance of the private equity funds in Kenya and to evaluate the effects of investment strategies on the financial performance of private equity funds in Kenya. Both the primary and secondary data that was used was based on the variables of the study and was intended to meet the objective of the study. The analysis was done as below.

4.2 Data Presentation

4.2.1 Duration Company has been in PE fund Management

It was necessary to find the duration the companies have been in the business of PE funds management in Kenya. The findings showed that 45% of the companies had operated for a period of over 10 years, 33% for a period of between 8 to 10 years, 11% had operated for a period of between 5-7 years and 11% had operated for a period of less than 2-4years.

Table 1: Duration of operation

Category	**Frequency**	**Percentage**
Less than 2 years	0	0
2-4 years	1	11
5-7 years	1	11
8-10 years	3	33
Over 10 years	4	45
Total	**9**	**100**

From the findings, it is evident that most of the PE fund management companies have been in operation for a period of over 10 years.

4.2.2 Investment Strategy Adopted

It was necessary to find out the investment strategies adopted by the firms in the investment of PE funds. The findings show that 45% of the companies adopted venture capital as a strategy, 33% adopted Leveraged buyouts, and 22% adopted Mezzanine Financing as an investment strategy.

Table 2: Strategy Adopted

Strategy	**Frequency**	**Percentage**
Venture capital	4	45
Leveraged Buyouts	3	33
Mezzanine Financing	2	22
Others	-	-
Total	**9**	**100**

4.2.3 Investment Strategy Returns

It was necessary to find out the returns of each investment strategy. The results show that mezzanine financing has the highest rate of return at 10.4 with a standard deviation of 1.6305. This was followed by Venture capital with a mean rate of return of 9.42 and a standard deviation of 0.7793. Last were leveraged buyouts which scored a mean of 9.1904 with a standard deviation of 1.6342.

Table 3: Investment Strategy Returns

Strategy	**Mean**	**STDEV**
Venture capital	9.42125	0.779287201
Leveraged Buyouts	9.190416667	1.634155586
Mezzanine Financing	10.42424107	1.630451044
Others	-	-

4.2.4 Extent Investment Strategy affects Financial Performance

The respondents were asked to indicate to what extent the investment strategies affected the performance of the PE fund. The answers were ranked on a 5 point likert scale where 1=Not at all, 2=Low extent, 3=Neutral extent, 4=Moderate extent and 5= High extent in order to show the extent of how the investment strategies affect the financial performance of PE funds. The results are shown in the table below.

Table 4: Effect on performance of PE funds

Statement	**Mean**	**STDEV**
Venture Capital	4.92	0.79024
Leveraged Buyouts	4.96	0.839714
Mezzanine Financing	4.92	0.769727
Average	**4.93**	**0.799894**

The results from the table above show that the respondents thought the investment strategies adopted strongly affected the performance of PE funds.

4.2.5 Correlation and Regression Results

Table 5 shows the results of correlation analysis. The correlation analysis was done for all the independent variables and the dependent variable in the study. The dependent variable was Return on Investment (ROI) while the independent variables were Venture Capital, Leveraged Buyouts and Mezzanine Financing. This analysis was carried out in order to determine whether there were serial correlations between the independent variables. As serial correlations are a problem when performing regression analysis, this preliminary test was carried out first.

Table 5: Correlation Matrix of Independent Variables

		Return on Investment	Venture Capital	Leveraged Buyouts	Mezzanine Financing
Return on Investment	Pearson Correlation	1	.546*	.220*	.449*
	Sig. (2-tailed)		.002	.001	.021
Venture Capital	Pearson Correlation		1	.612	.354
	Sig. (2-tailed)			.004	.012
Leveraged Buyouts	Pearson Correlation			1	.658
	Sig. (2-tailed)				.039
Mezzanine Financing	Pearson Correlation				1
	Sig. (2-tailed)				

The results show that there were low correlation between the independent variables and therefore no serial correlations between the variables. None of the correlations between the independent variables was significant. On the other hand, the independent variables all had significant effects on performance as measured by ROI. All the independent variables had positive correlations with the Dependent variable (ROI).

Table 6 shows the regression results for the effects of investment strategies on the performance of PE funds. Significance of the relationships is shown in parentheses.

Table 6: Effects of Investment Strategies on Performance of PE Funds

	Return on Investment
Constant	1.192
Venture Capital	1.727 (.002)
Leveraged Buyouts	1.947 (.001)
Mezzanine Financing	1.175 (.021)
R	.876
R^2	.853
F	2.536 (.002)

The study sought to determine the relationship between Venture Capital investing and performance of PE funds investing in Kenya. The results show that Venture Capital had a positive and significant effect on performance of PE funds (β = 1.727). This effect was significant at 5% level of confidence. What this means is that higher levels of venture capital investments lead to better performance of PE funds in Kenya.

The study sought to determine the relationship between Leveraged Buyouts investing and performance of PE funds investing in Kenya. The study found that Leveraged Buyouts had a positive and significant effect on performance of PE funds ($\beta = 1.947$). This effect was significant at 5% level of confidence. These results mean that higher levels of leveraged buyouts result in better performance of PE funds.

The study sought to determine the relationship between Mezzanine Financing investing and performance of PE funds investing in Kenya. From the regression analysis, the results show that Mezzanine Financing had a positive and significant effect on Performance of PE funds ($\beta = 1.175$). This effect was significant at 5% level of confidence. These results mean that higher levels of Mezzanine Financing result in better performance of PE funds.

The study found that the independent variables had a very high correlation with ROI ($R = 0.876$). The results also show that the variables accounted for 85.3% of the variance in ROI ($R^2 = 0.853$). ANOVA results show that the F statistic was significant at 5% level. Therefore, the model was fit to explain the relationships.

4.3 Summary and Interpretation of Findings

The study sought to determine the investment strategies adopted by firms in the investment and management of PE funds. The findings show that 45% of the companies adopted venture capital as a strategy, 33% adopted Leveraged buyouts, and 22% adopted Mezzanine Financing as an investment strategy. These results therefore indicate that the three strategies i.e. Venture Capital, Leveraged Buyouts and Mezzanine Financing are commonly used by Private Equity fund management firms in Kenya to invest their funds. This is attributed to the fact that these strategies have been known to give high returns and therefore the popularity. This is consistent with the findings of Kaplan and Stromberg (2009).

The study sought to evaluate the effects of the various investment strategies on the financial performance of private equity funds investing. The results show that all the strategies adopted had a positive and significant effect on financial performance with Leveraged Buyout strategy being the highest ($\beta = 1.947$). These results once again confirm the widely held assumption that success of PE fund investing is highly related to the mix of strategies which is consistent with the findings of Soderblom (2009).

The study sought to determine the relationship between Venture Capital investing and the performance of PE funds investing in Kenya. The results show that Venture Capital had a positive and significant effect on performance of PE funds ($\beta = 1.727$). This effect was significant at 5% level of confidence. Venture capital is a high performing but risky strategy mainly due to the fact that the strategy involves investing in a company based on the belief that its value will go up due to a specific anticipated event related to the company. Such events may include shifting industry trends or changing government regulations.

Venture Capital also refers to investment in start up or small companies, these are generally considered risky but with possibilities of high returns and therefore positive performance indicators. According to Cumming, Siegel and Wright (2007), Venture Capital greatly influences the performance of the PE funds and total factor productivity.

The study sought to determine the relationship between Leveraged Buyouts investing and performance of PE funds investing in Kenya. The study found that Leveraged Buyouts had a positive and significant effect on performance of PE funds ($\beta = 1.947$).

This effect was significant at 5% level of confidence. Axelson et al (2012) finds that variation in economy-wide credit conditions is the main determinant of leverage in buyouts, and that greater deal leverage is associated with higher deal values and lower investor returns. However, Andre and Kaplan (1998) had earlier indicated that the value of a firm involved in leveraged buyouts ends up being higher than initially.

In Leveraged Buyouts, the PE fund takes control of another company's assets and or operations by purchasing a majority of the voting stock of the target company. This could explain the reason why Leveraged Buyout strategy has the highest performance measure since the acquiring firm is in total control of the investee firm.

The study sought to determine the relationship between Mezzanine Financing investing and performance of PE funds investing in Kenya. From the regression analysis, the results show that Mezzanine Financing had a positive and significant effect on Performance of PE funds ($\beta = 1.175$). This effect was significant at 5% level of confidence. According to Soderblom (2011), mezzanine financiers hope for capital appreciation resulting from a successful initial offering of the company's shares to the public. This therefore means that Mezzanine financing is a long term strategy which eventually leads to higher returns for the investors.

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Private equity investing (PE) has over the years experienced rapid growth and has become a significant industry. Academic literature shows that there are many different strategies associated with private equity investments. The most common strategies include venture capital, leveraged buyouts, special situations and mezzanine financing. The objectives of this study were to evaluate the investment strategies used by private equity fund investors in Kenya; to evaluate the performance of the private equity fund sector in Kenya and to evaluate the effects of investment strategies on the financial performance of private equity funds in Kenya.

The study adopted a descriptive survey design in order to meet the objectives. The population of this study was the 20 licensed investment fund managers in Kenya. For the purposes of this study, both primary and secondary data were used. Primary data was collected through the use of a questionnaire structured based on the objectives of the study. Secondary data was sourced from the websites and reports of the various fund management companies as well as the CMA website and the NSE website. Data was analysed using descriptive statistics as well as linear regression.

The study found out that venture capital, leveraged buyouts and mezzanine financing are some of the strategies adopted by PE fund management companies.

The study also found out that there is a positive correlation between the investment strategy adopted and the financial performance of PE funds investing.

5.2 Conclusions

In order to fulfil the research objectives, attention was dedicated in order to provide a broader understanding about PE fund investing, with this, further attention was dedicated to PE fund investment strategies and performance determinants.

The study found that Venture Capital, Leveraged Buyouts and Mezzanine Financing were all used investment strategies by PE funds. The study therefore concludes that these strategies have the highest returns and are therefore the most popular.

The study found that Venture Capital had a positive and significant effect on performance of PE funds. The study therefore concludes that higher levels of venture capital investments lead to better performance of PE funds in Kenya.

The study found that Leveraged Buyouts had a positive and significant effect on performance of PE funds. The study therefore concludes that higher levels of leveraged buyouts result in better performance of PE funds.

The study found that Mezzanine Financing had a positive and significant effect on Performance of PE funds. The study therefore concludes that higher levels of Mezzanine Financing result in better performance of PE funds.

The above conforms to the findings of Wilson et al (2012) who found out that private equity backed firms perform strongly, that is, they have higher return on assets, higher interest cover and higher gross margin.

We can therefore conclude that, investment strategies have a positive effect on the financial performance of PE funds investing in Kenya.

5.3 Policy Recommendations

The study recommends that PE fund managers should adopt the strategies discussed above based on their expected returns. This will help ensure that PE funds whose one of the critical element is raising of funds give maximum returns to their investors taking into account the specific knowledge of the kind of returns to expect when funds are invested in a specific fund.

The study also recommends that the PE funds structure their investments in portfolios of the investment strategies discussed as this will ensure maximum returns at lower risks. This will ensure that with maximum returns, they can be able to attract more investors and thus facilitate their fund raising processes.

The study also recommends that the government should put up measures to ensure that the economic climate is conducive for the PE fund sector to grow. Policy makers could also obtain information from this study about investment areas that private investors have shied from and are thus in need of government support. This will help spur growth in the financial sector and in the economy as a whole.

The study is also useful to PE fund investors due to its practical implications. The study has been conducted in a manner which has helped expound further the understanding of the various components and strategies of private equity as an emerging asset class in today's financial markets. The study also confirms to PE fund investors that success from PE fund investing is directly related to the mix of funds in a firm.

5.4 Limitations of the Study

This study like all other empirical studies had its own limitations. However, the same may also be used for future investigations.

One major limitation of the study was the availability of yearly data per investment strategy for all the Private Equity funds management firms as this was the initial plan for the study. Since this was not possible, the researcher reverted to the use data from what was readily available.

Another limitation was on how performance was measured in the study. Two measurements are common in the private equity industry: IRR and multiples between returns and investments. In this study, the multiples performance measure was used. However, multiple ratios do not take into account timing factors and hence it would have been valuable to compare the results using IRR as the performance measure. Using multiple performance measures is however considered a rewarding way to pursue strategic management research in general, since performance is considered to be multidimensional (Venkatraman and Ramanujam, 1986).

Another key question that is applicable to most research is related to its generalizability to other contexts. There may be a risk that the findings of this study are only applicable to a particular industry, or even only to part of an industry. This study was specifically focused on Private Equity Fund investing.

Finally, there was limited peer reviewed literature regarding investment strategies of PE funds in Kenya. The researcher therefore relied more on literature from other countries.

5.5 Areas of Further Research

Researchers need to explore the relationship further by narrowing down to individual PE fund management firms' data to examine the effects of strategies on the performance of PE fund investing in Kenya. The present study was more focused on the general industry as the time did not allow the collection of specific individual company data and therefore future use of such may enhance the reliability of results.

Further, the specific industry in focus for this study was the private equity fund investing market. The research model as presented in this study is fairly general and may thus be transferred to other industries. In cases where similar conditions set out in the study are similar i.e a financial services industry with high risks, the conclusions are expected to be similar. Still, an empirical test of the model in other financial models would be a further area of research.

Further, studies should carry out more specific data analysis techniques in order to isolate the effects of other economic factors on the performance of PE funds in Kenya. Given that a large proportion of PE funding comes from most of us, at least indirectly, through our bank savings, insurance, taxes, e.t.c, an enhanced understanding about the phenomenon of PE investing ought to be of interest to many people since PE as an asset class is considered to be one of the less well understood segments of today's financial markets.

There is also need to incorporate other investment strategies in the regression models in order to determine their effects on the performance of PE funds in Kenya. This could provide a further area of research.

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APPENDICES

Appendix 1: Licensed Equity Fund Management Firms

1. Old Mutual Asset Managers (K) Limited

2. Old Mutual Investment Services (K) Limited

3. ICEA Lion Asset Management Limited

4. Pinebridge Investments East Africa Limited

5. Genesis (K) Investment Management Limited

6. British American Asset Managers Limited

7. Stanlib Kenya Limited

8. Sanlam Investment Management Kenya Limited

9. Standard Chartered Investment Services Limited

10. Co-optrust Investment Services Limited

11. CIC Asset Management Limited

12. Madison Asset Management Services Limited

13. Apollo Asset Management Company Limited

14. Dry Associates Limited

15. Canon Asset Managers Limited

16. Amana Capital Limited

17. Aureos (K) Managers Limited

18. FCB Capital Limited

19. Zimele Asset Management Company Limited

20. Fusion Capital Asset Management Limited

Appendix 2: Research Questionnaire

Section 1: General information

1. Please indicate your gender?

Male ( )

Female ( )

2. Please indicate your age category?

Below 25 years ( )

26-30 years ( )

31-35 years ( )

36-40 years ( )

41-45 years ( )

46 or above ( )

3. What is your designation?

…………………………………………………………………………………….

4. How long has your company been in business as a PE fund investment management firm?

Less than 2 years ( )

2-4 years ( )

5-7 years ( )

8-10 years ( )

Over 10 years ( )

5 What investment strategies does your firm adopt?

……………………………………………………………………………………
……………………………………………………………………………………
……………………………….

Section 2: Study Information

6. Which of the following strategies has your firm adopted in the investment of PE funds? *Tick as appropriate*

Venture Capital ( )

Leveraged Buyout ( )

Mezzanine Finance ( )

Other (Please specify) ( )

....
....

7. On a scale of 1-5, how would you rank the strategies from most important to the least important when it comes to making investment decisions?

1) Least Important 2) Not Important 3)Neutral

4) Important 5) Most Important

		1	2	3	4	5
	Venture Capital					
	Leveraged Buyout					
	Mezzanine Finance					
	Other					

8. On a scale of 1-5, Please indicate in each of the factors below the level of likelihood that will trigger your firm to consider another investment in case the one investment does not suit your performance evaluation criteria

1) Highly unlikely 2) Unlikely 3)Neutral

4) Likely 5) High likely

Factor	1	2	3	4	5
Management team of the investee firm					
Business Plan of the investee firm					
Size of the investee firm					
Exit plan for investors by investee firm					
Market positioning of the investee firm					

9. Do you think the investment strategy adopted affects the financial performance of the PE fund?

Yes ( )

No ( )

10. To what extent do you think the investment strategy adopted affects the financial performance of the PE fund?

High Extent ( )

Moderate Extent ( )

Neutral ( )

Low Extent ( )

11. Please use a scale of 1-4 to rank the following strategies from the one with highest returns to the one with the lowest returns.

Venture Capital ( )

Leveraged Buyout ( )

Mezzanine Finance ( )

Other (Please specify) ( )

12. What specialist support services do you offer your investee firms?

a...

b..

c..

d..

13. What parameters do you consider while investing your firm's funds?

a...

b..

c..

d..

e..

f..

14. What other factors affect the financial performance of PE funds?

a...

b..

c...

d...

e...

f...

The end