Venture capital and the finance gap in emerging markets: An institutional perspective on the case of Kenya.

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- Business & Development Studies -

Mads Emil Vestergaard Robdrup, 92173

Carl Henric Emanuel Hansson, 125510

Supervisor: Michael W. Hansen

"Africa is sexy for venture capital, because it's got the youngest population of any continent; the middle class is growing faster than in any other continent, government and infrastructure is changing frequently. It's arguable that the African economy is growing, at an exponential rate. So good funds will be turned on to this in, any case."

(Interviewee 2 from VC 3, 2020)

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Abstract

This thesis takes departure in the premise of a finance gap in emerging markets, hindering SME growth and economic development, through an investigation of the rapidly growing venture capital (VC) industry in Kenya, known as the "Silicon Savannah". Drawing on the institutional approach to business strategy in emerging markets, this thesis set out to explore the barriers to venture capital found in the institutional environment and the strategies used by VC firms to overcome these. By combining deductive and inductive approaches, this paper presents a multiple-case study of VC firms and other relevant actors in the industry. We find that the institutional barriers to VC relate to regulatory uncertainties mainly due to political fluctuations, a lack of underlying shareholder protection, and inadequate governance and reporting regulation. Further, local founders face challenges relating to liability of outsidership as a result of foreign networks of capital. In effect, VC firms may suffer from liability of foreignness as their portfolio ventures struggle to navigate the local business context. Moreover, we find that the VC industry suffers from a lack of supportive industries, particularly inadequate or lacking information providers, early stage technical and financial intermediators, and exit opportunities. To overcome these institutional barriers, we identify four coping strategies used by VC firms. Firstly, governance strategies relate to supporting the portfolio ventures' governance processes. Secondly, firms may adopt local knowledge-capturing strategies to overcome liability of foreignness. Thirdly, diversification strategies refer to risk-averse investments, spread over industries and countries in the region. Lastly, in institutional avoidance strategies VC firms pursue investments in foreign entrepreneurs who they perceive as less affected by the institutional barriers. Thus, our findings show that the VC industry is indeed thriving despite facing some institutional challenges, typical for emerging markets. With regards to the finance gap, our findings indicate that this specifically relates to local founders and their ventures. We suggest that future research and policy should consider the institutions which can support this part of the industry to prevent the development of an enclave economy.

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List of Abbreviations

ABAN	African Business Angels Network
ADB	Asian Development Bank
AFDB	African Development Bank
BA	Business Angel
BoP	Bottom of the Pyramid
CB	Crunchbase
CDC	Commonwealth Development Corporation
CFI	Corporate Finance Institute
DFI	Development finance institution
EAVCA	East-African private equity and venture capital association
EIB	European Investment Bank
EU	European Union
FDI	Foreign direct investment
GP	General partner
IB	International Business
ICDC	Industrial & Commercial Development Corporation
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFU	Danish Investment Fund for Developing Countries
IMF	International Monetary Fund
IPO	Initial public offering
ISDB	Islamic Development Bank
I3N	Intellecap Impact Investment Network
LP	Limited partner
MSME	Micro-, small- and medium-sized enterprises
NSSF	National Social Security Fund
OECD	Organisation for Economic Co-operation and Development
PE	Private equity
POCD	People, opportunity, context and deal
SME	Small- and medium-sized enterprises
SSA	Sub-Saharan Africa
UN	United Nations
VC	Venture capital
VCs	Venture capitalists
VC4A	Venture capital 4 Africa

1 Introduction

1.1 Introduction

In the 2000's, entrepreneurship and private sector development has seen an increasing appraisal from the development community for its role in ensuring economic prosperity of developing countries (Gambetta *et al.*, 2019). In particular, the success of small and medium sized companies (SMEs) has been considered crucial for economic development. In emerging markets, formal SMEs contribute up to 60% of total employment and up to 40% of national income and it is estimated that these figures would increase, taking informal SMEs in account (Ndiaye *et al.*, 2018). For such entities, the lack of finance is considered one of the largest challenges, hindering small firms to scale, internationalize and become substantial contributors to economic development of the country. The World Bank estimates an unmet demand for $1.2tn from formal SMEs in developing countries, and another $1tn for informal enterprises. In particular, SMEs requiring between $100,000 and $2m in capital are facing the issue, falling into the "missing middle" (Sultan, 2019).

Named the "the hopeless continent" in an article from The Economist (2000), parts of Africa were for a long time perceived as incapable of lifting itself out of poverty. A decade later, that perception changed to "Africa rising: a hopeful continent" (The Economist, 2013). While almost non-existent in the early years of private capital, low-income countries in Sub-Saharan Africa (SSA) nowadays account for a growing amount of international private equity (PE) and venture capital (VC) investments (Hain & Jurowetzki, 2018). Particularly through improvements in IT infrastructure, IT-competence and the development of innovative tech-solutions, countries such as Kenya and Nigeria have been called the "new emerging markets" (Hain & Jurowetzki, 2018). In the last decade, Kenya has been rising as the top pillar for start-up growth in Eastern Africa. With success stories of ventures such as M-Pesa, M-Kopa, BRCK, and Twiga Foods, the country has built a global reputation as a rich start-up hub known as the *Silicon Savannah* (Pilling, 2019).

The VC financing model has been suggested as a viable mechanism to spur innovative SME growth. The efficient flow of risk finance, which VC firms bring, is considered to contribute significantly to entrepreneurial prosperity and business development, supporting the wider economy, particularly as innovative businesses are major job and income generators (Lerner, 2010). Besides, innovative businesses without trading track records tend to face information asymmetries for which effective due diligence is prohibitively expensive for larger financiers such as banks and other PE models to undertake and invest. This applies particularly in emerging market contexts where the requirement of formal reporting and corporate governance has shown to be insufficient (Carpenter & Peterson 2002).

The independent market analyst organisation, Briter Bridges (2020) presents in their latest report that private capital investments in Africa accumulates to $1.5 bn. Leading African news media on entrepreneurship, Weetracker (2020), shows in their report that Kenyan startups raised $428.91 million in 2019. This places Kenya second in the amount received during the year in Africa, following Nigeria, at a nearly 300% rise in investment volume from 2018. Their reports showed additionally that the gross escalation is largely attributed to big-ticket deals of more than $40 million, where companies in Fintech, E-commerce and Agritech tops the charters (WeeTracker, 2020; Briter Bridges, 2020). Kenya has been praised for its regulatory stability, sophistication of its business environment and private-sector led economy (Divakaran *et al.*, 2018). In addition, the country hosts a strong entrepreneurial class and benefits from a good supply of human capital, both local and international. As such Kenya has captured a disproportionate share of the activity, both in terms of deal flow and funds compared to other East-African countries, and the country's current standing in the alternative investment industry in Africa is notable (ibid). While most business and economic development literature on international finance flows toward SSA mainly focuses on the drivers and impact of foreign direct investments (FDI), VC in SSA is yet an unstudied phenomenon albeit its potential implications for economic development (Hain & Jurowetzki, 2018). As such, Kenya is an interesting case for looking at VC in emerging markets and the possibilities for economic development.

1.2 Problem Formulation

Despite its rapid growth and large success, the Kenyan VC ecosystem is still young. As such it carries a number of implications and differences to developed economies with a longer history of early stage financing (Hain & Jurowetzki, 2018). In mature VC systems, investors have been heavily reliant on institutional stability, such as rule of law, minimal corruption, corporate control and capital, which arguably is often lacking in emerging markets (Ahlstrom & Bruton, 2006). Generally, East-Africa has shown a high cost of operating a VC fund in the region, much due to the length of time it takes to find, evaluate, and make investments (Gugu & Mworia, 2016). The struggle of deal-sourcing has been attributed to underdeveloped deal intermediaries such as incubator- and accelerator programs whilst the lack of exit opportunities is due to poor private liquidity options and underdeveloped financial markets, making initial public offerings (IPOs), a rare occurrence (Gugu & Mworia, 2016). In an extensive report by the World Bank, the lack of information available to investors was further highlighted as a major factor, hindering investments in SMEs. The lack of knowledge on formal reporting mechanisms, corporate governance and financial capacity to navigate the information required by VC firms make due diligence processes lengthy and costly. As such, navigating the local institutional context is crucial for making good VC investments (Divakaran *et al.*, 2018).

Peng (2002) describes these issues relating to regulatory uncertainties as typical for emerging markets, while Khanna and Palepu (2010), in addition, coin the term "institutional voids", referring to the lack of formal institutions such as intermediary agencies and credit rating systems, arguing that in countries where formal institutions are weak, informal institutions and networks fill their place. As such cultural differences and the liability of foreignness have been emphasized as imperative for firms operating in emerging markets (Marquis & Reynard, 2018). This poses some barriers related to the institutional context and creates implications for the VC firm's strategy, which arguably need to be changed in accordance to the institutional framework. We find that institutional theory has not yet been applied to VC industries in emerging markets, and therefore there is a need for research within this field.

1.3 Purpose statement

This paper takes a departure in the notion of a finance gap within emerging markets and developing countries as commonly proclaimed by The World Bank and other major global development institutions. Highlighting the functions of institutions in unlocking finance in emerging markets, particularly through the flow of VC, we further seek to investigate whether there is a finance gap and how the institutional context creates implications for VC in terms of reaching the entrepreneurs. As such we aim to apply the institutional perspective to approach business strategy on VC in the Kenyan context. Kenya is chosen as the country of analysis due to its growing reputation as the *Silicon Savannah*, attracting investments into a growing startup ecosystem. By exploring the implications of the institutional environment specific to Kenya we aim to understand how this affects the VC industry. Through our assessment of the literature on business strategies in emerging markets, we find some general emerging market characteristics, what we call institutional barriers. A large focus of this paper is to truly investigate the validity and replicability of these institutional barriers in the context of VC in Kenya, as a case for VC in emerging markets. Additionally, we seek to explore the strategies adopted by VCs for successfully navigating the context. Although literature on institutional challenges for VC exists (Ahlstrom & Bruton, 2006; Ekanem *et al.*, 2019), we seek to further enrich the notion of institutions in the emerging market context, particularly for the VC industry, through the case study of the Kenyan context. Hence, we have a two-fold research purpose in terms of exploring the institutional barriers for VC in emerging markets and exploring the strategic implications for VC firms.

1.3.1 Research Question

Based on current literature on business strategies in emerging markets, this research project aims to evaluate and explore two spectrums relating to early-stage investments in Kenya. First, we seek to evaluate the applicability of the barriers implied by the 'weak' institutional framework and market failures, specifically in relation to the venture capital industry in Kenya. Considering one of the most commonly noted differences between developed- and emerging markets amongst major business scholars relates to the formal institutional environments, our paper will take departure in the institutional theory. Secondly, we aim to explore the strategies that VC firms are adopting in order to navigate the institutional challenges in Kenya. As such, our research question follows:

What are the institutional barriers to venture capital in emerging markets, present in the case of Kenya, and what strategies do venture capital firms use to overcome these?

2 Methods Section

2.1 Research Design

This section describes the research design, including the approaches and strategies we have taken and what methodological decisions we have made to best answer our research question. These approaches and decisions are based in our ontological and epistemological beliefs, which can be categorised as the philosophical assumption of *pragmatism*. Our research design is a general plan of how we are going to answer the research question. Our two-fold research question embodies a two-fold research purpose. First, we aim to understand the institutional barriers for venture capital (VC) firms that operate in Kenya in a *descriptive* and *confirmatory* way. Second, we aim to understand the strategic implications that such barriers have on the VC firms in an *exploratory* way. As exploratory research is particularly useful to clarify the understanding of a problem, when the precise nature of the problem is uncertain (Saunders *et al.*, 2009), the overall purpose of our research is exploratory. As presented in depth below, we seek to move from one research purpose to the other.

As the section sheds light on the research approaches, the methodological decisions and the pragmatic reasons behind our choices. The headlines include: philosophical assumption, research strategy, research approach, methodology and data collection, and credibility. While presented in the same order as listed, a summary of the research design can be found in the table below.

Philosophical Assumption:	Pragmatism
Research Design:	Exploratory, multiple-case study
Research Approach:	First part deductive, second part inductive
Methodology for Data Collection:	Qualitative, semi-structured interviews
Credibility:	Validity through triangulation, case selection, & Multiple coding of data

Table 1: Research design: summary of methodological approaches and decisions.

The research project's time horizon is an important aspect to consider when creating the research design. The time horizon is defined by the research question and the research purpose, but also influenced by the amount of time and other resources available to the researchers (Sanders *et al.,* 2009). As the phenomenon of VC is recent and and the perceived institutional barriers for VC firms are contemporary, the time horizon of this research resembles what Saunders *et al.* (2009) term *cross-sectional,* which is a snapshot, rather than *longitudinal*, and showcases change and development over time. As this research project has an end date, culminating with a hand-in of the project for our final exam, the time for this study has been limited to 3 months. Consequently, the time horizon impacts the research strategy and the choice of methods used for data collection.

2.2 Philosophical assumption

Research philosophies consider the underlying assumptions to what constitutes knowledge and how new knowledge can be developed (Saunders *et al.*, 2009). The four main research philosophies are: positivism, interpretivism, realism, and pragmatism. *Positivism* reflects the philosophical stance of an objective worldview focusing on observable data. On the other side of the spectrum, *interpretivism* considers the importance of the subjective understanding of the researcher and provides a larger acceptance for different interpretations among social actors. Similar to positivism, *Realism* adopts an approach, which relies heavily on observable data but acknowledges the contextual impact and the perceptions of social actors. Finally, *Pragmatism* suggests that there are several different ways to view knowledge. The pragmatic approach considers that multiple perspectives will most probably enrich the study. As a result, pragmatists can integrate several research approaches and strategies in the same study, for example by mixing qualitative and quantitative data (Wahyuni, 2012; Saunders *et al.*, 2009). This study acknowledges different research approaches as well as research objects with varying perceptions, as such a pragmatic research philosophy is appropriate. Taking a pragmatic approach to the research, we find ourselves developing the research design, choosing methodologies and choosing the theoretical foundations based on our research question. The adopted pragmatic research philosophy is a result of our different ontological, epistemological and axiological views. In the sections below, we describe the main philosophical dimensions, *ontology* and *epistemology*, and the views applied in this research project.

Ontology refers to "*how one perceives knowledge*" (Wahyuni, 2012: 69). The two aspects of ontology, *objectivism* and *subjectivism*, both common in business and management research. From a pragmatic standpoint, it is assumed that reality is external, multiple and complex, and the view that best enables the researcher to answer the research question should be adopted (Saunders *et al.*, 2009). It is our ontological belief that knowledge is not only acceptable if the phenomena observed can provide hard data, details or facts, but that subjective meanings about social phenomena certainly generate acceptable knowledge.

The other philosophical dimension, *epistemology*, refers to the *"beliefs on the way to generate, understand and use the knowledge that are deemed to be acceptable and valid"* (Wahyuni, 2012: 69). From a pragmatic view, both observable phenomenon and subjective meanings are considered acceptable knowledge if it contributes to answering the research question. Hence, we accept that there is a reality behind the details, as subjective meanings motivate actions and impact strategic decisions, and in the case of developing findings in this research project, we use subjective meanings as valid data for our own reasoning to develop acceptable knowledge.

Furthermore, in terms of our *axiological* belief, which is "*concerned with ethics, encompassing the roles of values in the research and the researcher's stance in relation to the subject studied"* (Wuhyani, 2012: 69-70), we see ourselves as *etic* to the observed context. As we are full-time master's students and do not work with VC or live in Kenya, our research on the topic is outside-in. In addition, we acknowledge that we have value-laden interpretation of the results, as we cannot argue to be completely independent of the data, but most likely adopt objective as well as subjective points of view along the way.

As the nature of our master's thesis relates to some particular context-dependent challenges for organisations operating in the Kenyan industry for VC, we perceive the reality as objective and that it exists independently of human thoughts and beliefs or knowledge of its existence. Nevertheless, it is our understanding that despite reality being objective, it is interpreted through social conditioning and therefore presents itself differently in each individual's perception. As our ontological and epistemological fundamental beliefs do not fall into either one paradigm or the other, we reasonably categorise our research paradigm as *pragmatism*.

2.3 Research strategy

The choice of a research strategy should be guided by the research question and the research purpose (Saunders *et al.,* 2009). As for the research question and the research purpose, we found it most suitable to make the exploration of VC in Kenya as a case study. Wahyuni (2012) advocates for the case study, as it *"facilitates a deep investigation of a real-life contemporary phenomenon in its natural context*" (p. 72). Furthermore, as highlighted by Yin (1994), the boundary between the phenomenon being studied and the context within which it is being studied is not clearly evident, meaning that an uncontrolled context is not problematic and that the study is not limited by the number of variables for which data can be collected.

A case study can either be a single-case study or a multiple-case study. Single case studies can be holistic or embedded, depending on the unit(s) of analysis. In a multiple-case study, the researcher examines several cases to understand the similarities and differences between the cases (Baxter & Jack, 2008). As we seek to establish whether the findings occur across the cases in order to produce generalisations across the VC firms under the scope we decided to include a number of different cases. Thus enabling us to get a representative and more general understanding of the institutional barriers to VC and the coping strategies used by VC firms. As such we adopt the multiple-case study approach, inspired by Yin (1994), where we perceive our multiple-case study as a rich, empirical description of particular instances of a phenomenon that is based on a variety of data sources.

In his review of the case study methodology, Rolf Johansson (2007: 2) presents three points about the "case" in case studies, which most researchers seem to agree upon. The "case" should: be a complex functioning unit, be investigated in its natural context with a multitude of methods, and be contemporary. While Stake (1998), emphasizes that crucial to case study research is the interest in individual cases, Yin (1994) places more emphasis on the methods and the techniques that constitute a case study (Johansson, 2007). In addition we find that as the number of cases in the multiple case study increases, the less relevant a detailed and in-debt description of each individual case becomes (Eisenhardt & Graebner, 2007). Although acknowledging Stake's (2013) argument of treating every single case in the multiple-case study as an entity and a case study of its own, we adhere to Eisenhardt & Graebner's (2007) argument of reducing the efforts to present each case with an 'unbroken' description. Thus we seek to combine Stake's (1998) individual case perspective and Yin's (1994) emphasis on techniques and method.

2.3.1 Selection of cases

The phenomenon and main focus of our multiple-case study is investment of VC in emerging markets. As explained in the introduction, we look at the phenomenon as it occurs in Kenya, due to its development of the VC scene, which in recent time is gaining a lot of interest from foreign investors. As we decide to look at various actors and organisations in the VC landscape, it makes sense to choose the cases as *entities* (Stake, 2013). The cases have not been randomly selected, but selected carefully to provide a comprehensive, wide-ranging coverage of the challenges in the Kenyan VC industry and coping strategies that VC firms use to overcome these challenges. This corresponds to Flyvbjerg (2006: 230) *information oriented selection*, where we aim to include maximum variation cases to *"obtain information about the significance of various circumstances for case process and outcome"*. To get a representative understanding, we have included five VC firms as entities to be investigated as cases. These five cases vary in their origin, time in the market, composition of staff, and investment focus such as industry and stage, however, they all have that in common that they have offices and staff in Kenya. The cases have been selected out of a great population of foreign as well as domestic VC firms that operate in Kenya. These five cases will count as the primary cases of analysis in our quest to answer the second part of the research question, while the following cases contribute in understanding the greater picture of institutional barriers.

Additionally, as a sixth case we have included an industry organisation for PE and VC, due to its importance in the industry. We additionally include an accelerator program, which is a capacity building organisation for equity seeking companies, to shed light on the financing of start-ups and SMEs from another perspective. The accelerator program has been selected based on our perception of it as a critical case, with important differences from other accelerators. Lastly, we include an entrepreneur who represents the opposite side of the table, seeking investments for his venture. The presentation of cases will take place in the second part of presentation of the case study and will not be presented further in this section.

2.4 Research purpose and approach

2.4.1 Deductive and inductive approaches

There are generally three research purposes in social science: *descriptive, explanatory,* and *exploratory* (Saunders *et al.,* 2009). The purpose of the research defines the approaches that the researchers need to take in order to answer the research question. Descriptive research aims to portray an accurate profile of persons, events or situations and can often be a forerunner for exploratory research or combined with explanatory research. Explanatory research includes studies that establish causal relationships between variables. Exploratory research is particularly useful to clarify the understanding of a problem, when the precise nature of the problem is uncertain (Saunders *et al.*, 2009). In relation to the framework suggested by Saunders et al (2009), our overall research purpose is exploratory. In addition, Reiter (2017) separates exploratory research into confirmatory and exploratory. As such *confirmatory research "allows for a clear formulation of a theory to be tested in its application, commonly formulated as hypotheses"* (p. 131). As outlined above, we approach our research in a way that we perceive best fit to answer the research question. The essence of this research project is an exploration of whether certain emerging market characteristics are present in the VC industry in Kenya and if so, what coping strategies VC firms use to overcome these. As the research question is twofold and there are two purposes for the research project, there is accordingly a need for two unique research approaches.

The first part seeks to investigate whether some general characteristics about markets and industries in emerging economies, which are taken-for-granted in numerous studies in the international business management academia, are prevalent and recognised as real challenges in the Kenyan VC market. In doing so, we go through the financial literature on VC and the literature on institutional theory, as implied in emerging market contexts. From the literature, we create a theoretical framework combining the two strands of literature, from which we develop 3 main propositions about institutional barriers for VC in emerging markets. As this section takes a deductive approach, it conforms to what Reiter (2017) calls confirmatory research. Our understanding of reality and understanding of knowledge of reality, makes it purposeful for us to analyse the data in relation to these propositions. Hence, we make qualitative analyses of our primary data and explore what institutional barriers our interviewees from all eight case entities experience. The figure below shows how we go from the premise of a finance gap for startups and SMEs in emerging markets to a literature review and theoretical framework to the creation of the propositions, and how we explore the institutional barriers to VC deductively in our case study and the coping strategies inductively.

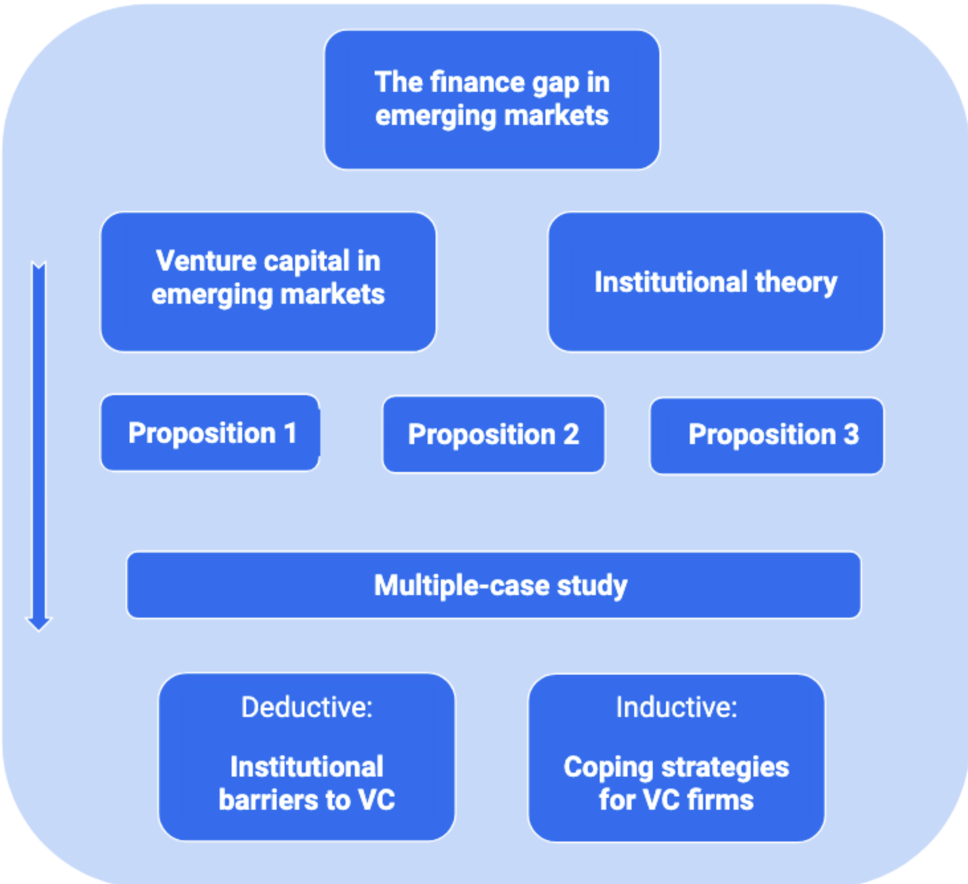

Figure 1: Research approach and process from theory to generalisations.

The second part takes an inductive approach and seeks to explore the coping strategies, which VC firms use in order to work around the challenges, which have proven to be present. The purpose here is to understand how the challenges affect the strategic decisions of the VC firms and to provide students, academics, professionals and other stakeholders to the Kenyan private equity market with an exploration of the conducts in the industry. In the second we therefore adhere to using only the data from the VC firm case entities, as well as we limit our use of theory. As Stebbins (2001: 6) argues, *"the main goal of exploratory research is the production of inductively derived generalizations about the group, activity, process, or situation under study"*.

The figure below shows Perry's (1998) conception of theory building from case study research, where the number of cases and the theory used in analysis correspond to the exploratory or confirmatory nature of the research. Where the left-hand side is inductive and the right-hand side is deductive, the dotted line in the centre of the horizontal axis marks what Perry denotes as the preferred position of induction and deduction. As argued, we pursue the first part of the research to be deductive and confirmatory, whereas the second part is inductive and exploratory by building on the first part through investigating the strategies adopted by the VC firms. Therefore, we move from the green circle to the right of the dotted line towards the green circle to the left of the dotted line.

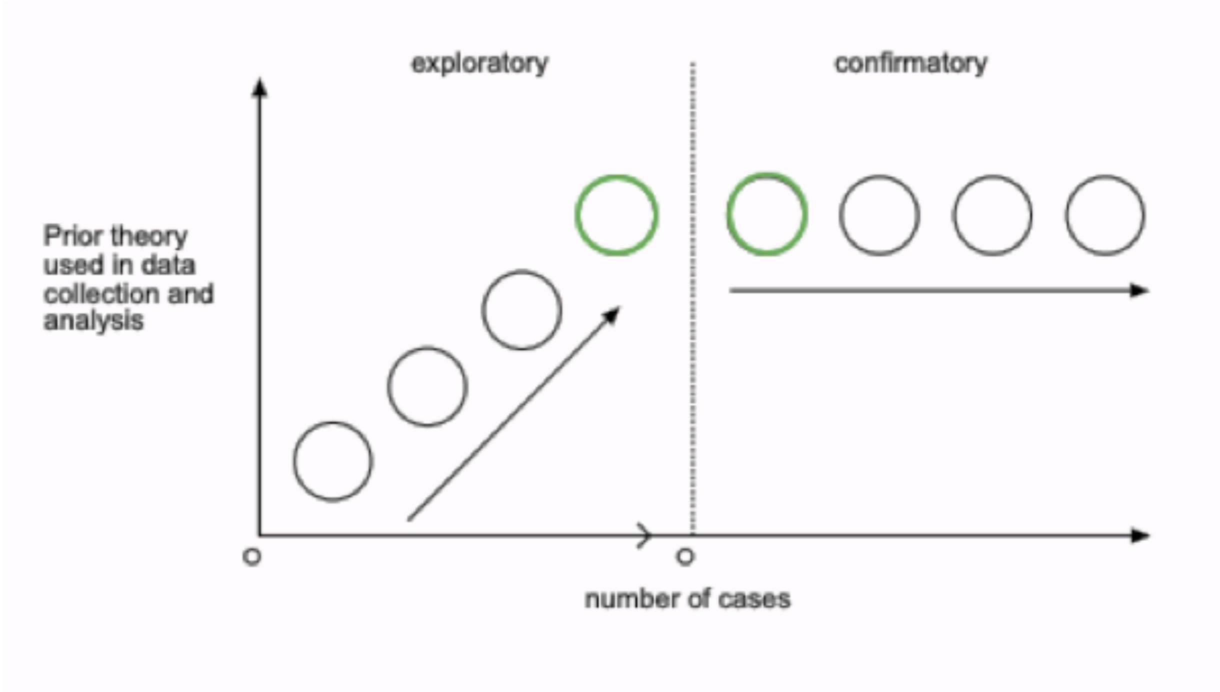

Figure 2: comparison of two case study research positions: inductive (left hand side) and deductive (right hand side). The center marks the preferred position (a blend of left hand and right hand sides. *Adopted from Perry (1998: 789).*

2.5 Methodology for empirical research

A research *methodology* refers to *"a model to conduct research within the context of a particular paradigm. It comprises the underlying sets of beliefs that guide the researcher to choose one set of research methods over another"* (Wahyuni, 2012: 72). The decision to choose one methodology is often highly based on the philosophical paradigm applied in the research. As such, positivism often leads to quantitative methods and interpretivism often leads to qualitative methods (Saunders *et al.,* 2009). As our philosophical paradigm is that of pragmatism, neither one methodology or another is given as the fundamental beliefs of knowledge. As we perceive knowledge to be interpreted differently through social conditioning in each individual's perception, as given in our ontological and epistemological beliefs, the most appropriate methods are found in the qualitative methodology.

2.5.1 Types of Data

This case study makes use of both primary and secondary data. Secondary data can work as the only source of data of a study or it can be used as a complement to primary data. (Saunders et al., 2009). Different types of secondary data include raw data or compiled data, such as industry statistics and reports, surveys and government publications, and it can be quantitative as well as qualitative (ibid.). In our presentation of the developments and trends in the private equity and VC markets across East Africa and in Kenya especially, we use secondary data sources. These include publications from industry analysts such as WeeTracker (2020) and Briter Bridges (2020), a policy research working paper from the World Bank (Divakaran *et al.,* 2018), and various news articles. These sources contain both quantitative and qualitative data.

Primary data, on the contrary, is data produced by the researchers for the purpose of the research project. For this multiple-case study, we apprehend primary data from professionals and employees working at the VC firms, which are our entities of analysis. As Reiter (2017) argues, *"there no longer is a legitimate justification for 'playing the God trick' and pretending that one can do research from nowhere, without a specific interest, while seeing everything"* (p. 130), and we arguably cannot rely on secondary data and Google searches alone. This complies with Wahyuni's (2012) recommendation, that "*qualitative researchers should get involved in a communication with the practitioners in the organisational coal-face in order to better understand the current state of real-world practices"* (p. 73). We have been directly engaged with the companies which we study, and been able to collect comprehensive qualitative data from primary sources. A discussion of the validity and credibility follows in the subsequent section.

2.5.2 Methods for data collection

As we have adopted a qualitative methodology for data collection to get the results that best relate to our research question, we dive into the *toolbox* of this methodological foundation. The qualitative data collection methods most commonly used for case studies are *interview* and *observations* (Saunders *et al.,* 2009). An interview is a purposeful conversation where the interviewer asks the interviewee some questions about the research topic. As the data, we perceive is valid, is generated in the individual's perception, asking questions and getting answers are more meaningful to us than looking at 'hard' data alone.

Interviews can vary from highly standardised to highly informal talks. Many guidelines on conducting interviews concern maximizing the flow of valid, reliable information while minimizing distortions of what the interviewer already knows. According to Yin (1994) one of the jobs of the interviewer is to ask actual conversational questions in an unbiased manner. Silverman (2004) adds, that as the interviewer is supposed to be neutral, a main challenge lies in extracting information as directly as possible, without contaminating it. He furthermore argues that the interview is framed as *"a potential source of bias, error, misunderstanding, or misdirection; it is a persistent set of problems to be minimized. The corrective is simple: if the interviewer asks questions properly and the interview situation is propitious, the respondent will automatically convey the desired information. In this conventional view, the interview conversation is a pipeline for transporting knowledge"* (Silverman, 2004: 141). As such, it is important to realize how to ask questions, the kind of questions not to ask, and the order in which they should be asked. 'Why' questions could often create defensiveness on the informant's part, in contrast to posing a 'how' question (Yin, 1994.).

Initially, in our process of tuning in on the research topic and getting to know more about the nature of the VC landscape in Kenya, we conducted two unstructured interviews with industry experts and professionals. The first interview was conducted with an executive director and partner of a leading accelerator program in Kenya, Growth Africa. The second interview was conducted with an analyst at Helios Capital, a private equity firm that does not fall into our category VC investors, due to the high ticket sizes. Both interviews helped us understand the dynamics of the VC industry in Kenya and how it works. This highly affected our research purpose and our research question. Besides the initial interviews, we used the interview method to gather data from our cases to answer the research question. We had intended to spend three weeks in Kenya to collect our data as we perceived this to improve our chances of getting to interview the companies and the people, we were most interested in. However, as of the outbreak of COVID-19, the pandemic coronavirus that made implications for global mobility, we had to cancel this trip. After informing the interviewees of this, 8 out of 9 understood our decision and remained willing to contribute our research with their insights. Hence, due to the geographical distance between the participating firms and us, interviews are conducted online in a virtual conference room. The interviews were recorded and note taking was carried out too.

These interviews were semi-structured, and we used an interview guide to lead us through the interviews. As we set out to get information about the VC firms' perception of institutional barriers and their corresponding coping strategies, the interview guide has logically been structured around the three propositions. In that way, the interviewees have given us insights to how he/she perceives the various institutional barriers to VC in Kenya, which we have predetermined from the theoretical framework as propositions. With regards to the second part of our research question, an identified solution for asking about the interviewees' and the case companies' strategies for operating in the environment is through the technique of probing. For our interview strategy we used the probing technique in a predetermined as well as in a spontaneous way. Probing questions can be used to explore responses that are of significance to the research topic (Saunders *et al.,* 2009). This means that prior to conducting the interviews we identified various ways, in which we could probe, while these questions were supplemented with more intuitive questions by the interviewer. Regarding the roles during the interviews, we decided that the one, who had established the connection to the interviewees and case companies, should begin with an introduction, whereas the other one should carry out the interview as the interviewer.

While Yin (1994) highlights that the choice of methods and techniques is important in case studies, Wahyuni (2012) states that case studies should often use more than one method. With regards to the collection of primary data, we had intended to meet with professionals and if possible take part in some interaction between entrepreneurs, accelerator programs, business angels and VC firms. However, with the outbreak of COVID-19, we had to cancel our three-weeks field trip to Nairobi, and conducting observations became impossible. Instead, we must rely on the interview as our only method for primary data collection. Nevertheless, when it comes to secondary data, we used the Internet to get various data sources, mentioned in the previous section.

2.5.3 Data analysis

As the interviews were recorded, we were able to make wordly and accurate transcriptions. To ease the work, we used an online transcription service called Otter.ai, which made an initial transcription. It is then possible to read through while listening and correcting any mistakes. Before the analysis of our primary data, we used coding methods. To ease this process, we used a software for treatment of qualitative data, called NVivo. Here we created a masterfile with all the transcriptions and we created four codes, three of which refer to the three propositions and one generic code referring to strategies adopted by VC firms to circumvent these barriers. Then we distributed copies between us and both coded the entire data set. Upon merging the two copies into a new masterfile, we could compare the results of our coding process, and where different codes had been assigned, a fruitful discussion about the meaning of the given quote would follow. As such, an analysis of our data continued and was elaborated in this process. Having coded the interviews, we begin gathering the codes into sections, while comparing how each VC firm experiences the prevalence of the institutional barriers and their impact on strategy.

2.5.4 Research ethics

At the beginning of the interviews, the purpose of the study is once again presented and a brief outline of the interview is introduced. Interviewees are asked for permission to record the interviews and if they would prefer being quoted directly or anonymously. All interviewees agreed to being quoted, although some said that their views were personal and not reflecting the company they worked for. Despite some interviewees proclaiming that their views are personal, we consider their professionalism and expertise on the research topic as the most important factor concerning the data validity. We are aware of the fact that the research should not put any of our participants in a bad stand in any way, and it is our responsibility to protect the participants from any harassment related to their views, as presented here. Towards the end of the interview, we asked the interviewees if they felt we missed some important points or topics in our questions or had anything to add about the challenges and constraints to VC in Kenya. Furthermore, we asked if the interviewees had any questions for us. Common to all was the interest in getting the findings of our study, which we agreed to give them. In that regard, we are very interested in seeing whether the participants can benefit from our findings and their implications for practice or whether our findings are more beneficial to new entrants to the Kenyan VC market, such as international PE and VC firms or entrepreneurs in Kenya in search of capital.

2.6 Credibility

This section seeks to validate the process of going from theory to propositions and from interviews to generalisations as well as arguing for the reliability of our scientific method and data sample. Hence, we seek to work on the concepts of reliability and validity. In this regard, Reiter (2017) argues that there will always be some sort of a paradox: *"The more reliable scientific methods, the less valid their findings"* (p. 135). In terms of working on credibility, Silverman (2001) argues that *""we should not be all that impressed if a researcher makes very much of their 'intensive personal involvement' with their subjects"* (p. 221), indicating that perhaps there exist some motivation for us in terms of making the research project appear more valid and reliable than it really is. Throughout this section, we aim to consider this bias in particular.

2.6.1 Reliability

In this discussion on reliability of our research, we adhere to the framework proposed by Saunders *et al.* (2009: 156-159). Reliability refers to *"the extent to which your data collection techniques or analysis procedures will yield consistent findings"* (Saunders *et al.,* 2009: 156). Thus we need to consider the research strategy, the selection of cases, and the research method for the first part, and our analysis of the data for the second part.

The framework consists of four *threats* to reliability: participant error, participant bias, researcher error, and researcher bias.

The first threat to reliability is concerned with *participant error*. To begin with, we need to evaluate the case companies that have been chosen as entities for our multiple-case study, and the representatives from the companies, with whom conducted the interview. Regarding the selection of cases, we have chosen them based on the perspective of maximum deviation, as described earlier. The main reason for that is reliability. It is our belief that the more variation we find in the VC firms, the more will the views and opinions be representative for the general population. Nevertheless, our evaluation of and selection of VC firms is not necessarily perfect, and future research following the same criteria may select different case companies, threatening the reliability of our study. Participant error may also exist, when it comes to the specific individuals that participated in our interviews. In three out five primary cases, we had the opportunity to speak with the persons which we initially considered were fitting for the study best, while in the other two cases, employees were assigned by their superiors to participate. It is our belief that the bosses assigned individuals, who they believed could benefit our study the most, however they might not have been fully aware of our research purpose before taking that decision. Nevertheless, the variety of the participants' profession gives us insights to the various strategic and operational decisions taken on different levels of the VC firm. The strength of interviewing Kenyan professionals lies indeed in their particular knowledge about the industry and the institutional environment of the country.

The second threat to reliability is *participant bias*. In terms of the participant bias, interviewees may have said something they thought we or their bosses (in case they would see the research project) wanted to hear, or they would restrain themselves from saying something because they were afraid of the consequences if the wrong people heard their views. In this regard, one topic that seemed to be sensitive for some interviewees was the influence of the Kenyan government on facilitating investments in the VC industry. In one interview, the interviewees directly said that they would prefer not to answer that question.

A third threat to reliability is *researcher/observer error*. In relation to conducting the interviews, the two of us, researchers conducting this study would obviously have two different ways of conducting the interviews. Therefore, as described earlier, we agreed on specific questions to be included in our well-structured interview guide and agreed to ask the questions as precisely as they were written while allowing for some flexibility in terms of the order in which the questions were asked. To keep consistency in how questions were asked, we used the same interviewer for all the interviews. In future replicative studies, where researchers base their research on similar theoretical foundations, it might as well be that propositions are created differently and that the interview guide and questions consequently are different too. Hence, we try to be transparent about our research methods, our approaches and describe the reasons behind the choices we make.

The last threat to reliability concerns *researcher/observer bias*. This largely refers to how the observers understand the answers and how the researchers analyse the responses. We must acknowledge that some uncertainty exists in the way questions have been understood by the interviewers. One particular challenge lies in conducting the interviews online, but the general conception of misunderstandings based on socio-cultural differences is considered. To limit this bias, we allowed the second researcher, the one who did not carry out the interview, to ask probing questions at the end of each interview. This seemed particularly helpful at several occasions, where the researchers had understood something differently or when the second researcher was interested in probing into something the interviewee had said. With regards to the reliability of the research methods, we find it to be a strength that both of us took part in the process. This is also the case for the data analysis, where we used multiple coding and discussed the interviews in relation to the coding process. In that way, we were able to question each other's understanding.

2.6.2 Validity

According to Silverman (2001:232), validity is *"truth: interpreted as the extent to which an account accurately represents the social phenomena to which it refers"*. In terms of validating the research, we emphasize the triangulation of data by using both our primary data from the interviews and the secondary data about the VC industry in Kenya. As stated earlier, the use of an additional method for data collection would have benefitted the validity of our research, as we would have been able to compare two sets of primary data. However, we see it as a strength, that relevant secondary data exists, which we can use instead. Validity and reliability strongly affect the ability to generalise from the findings, and hence the arguments presented in this section should aim to justify that the generalisations and conclusions of the analysis responds to the research purpose in a satisfactory way.

2.7 Delimitations

As a final paragraph in this section, we will present some of the delimitations we have made as a result of narrowing down the focus of our thesis. Most importantly, we decided to limit our focus of private capital investments to early-stage investments into startups and SMEs. Hence, we do not include private equity such as those directed towards infrastructure development projects. This also means that, although we found it interesting along the way, investment projects and the entire investment agenda for economic development related to development finance institutions (DFIs), such as the Danish IFU, were left out of our scope. With regards to the number of cases, we acknowledge that interviewing twice as many VC firms would have increased the reliability of our findings, but due to the selection of cases, we evaluate the data as sufficient. As this study assumes VC firms as the main providers of early stage venture financing, it does not investigate the specific institutions affecting alternative sources of early stage investments such as business angels, peer to peer lending and crowdfunding.

Furthermore as our theoretical focus lies within the scope of institutional perspective, it is not within the scope of this research to consider the nature of the investments made by VCs. As such, this study will not consider the internal processes such as knowledge transfer found within VC firms and the ventures they invest in. Although we recognise that some business strategies related to institutional barriers in emerging markets already exist, it is not our intention to test the applicability of these. Due to our inductive approach we instead seek to find patterns in the empirical data to form generic strategies for VC firms. Furthermore, although the focus of this paper revolves around the common notion of a finance gap preventing socio-economic development in emerging markets and socioeconomic long-term development, we do not seek to provide specific assessments around the political economy or any in depth policy analysis. Lastly, this paper does not seek to provide specific strategies for VC firms, but rather areas of consideration which are highlighted in the findings of our research.

Summary of section 2:

In the method section we have defined and described the research design, research strategy, research purposes and research approaches of this thesis. As such, we have highlighted that the research question calls for an exploratory purpose, which we further divide into a confirmatory purpose and an exploratory purpose. Furthermore, each of these purposes is related to a deductive approach and an inductive approach, respectively. For the deductive part, we use a theoretical framework, which we have constructed by combining the relevant financial literature on venture capital and the literature on the institutional perspective on business strategies in emerging markets. This theoretical framework has produced three propositions, which guide us through the first parts of the analysis. Through a multiple-case study, semi-structured interviews have been conducted with professionals in the VC industry in Kenya, which have been selected through the maximum deviation selection criteria.

3 Literature Review

In the following section, literature constituting the foundation for the study is outlined. The first part introduces the key concepts relating to the venture capital (VC) landscape and entrepreneurial finance to show some of the challenges and strategic implications facing the VC firm. Subsequently, we present the institutional theory and its contributions to business strategy in emerging markets. The third section presents earlier contributions to institutional theory as applied to VC firms in emerging markets. Based on this literature, the last section includes the theoretical framework and 3 propositions, which will be employed for the analysis in order to answer the research question.

3.1 Venture capital and financial literature

In this chapter we aim to present the relevant financial literature on VC as a vehicle for early stage investments for startups and SMEs. As such, we aim to explore the key concepts and main actors, which impact the operations of the VC firm, and the activities in relation to the VC fund cycle.

3.1.1 Globalisation of private capital

Since the 1980's private capital markets have been on the rise. Jensen (1999) described the phenomenon as the "privatization of public equity" referring to the influx of investments through private equity (PE) funds, venture capital (VC) funds, buy-out funds, family offices, infrastructure funds, real estate funds, business angels (BAs). The private markets differ to public markets mainly in that while the public markets of asset classes such as stocks and bonds include transactions involving the general population, the private capital markets involve transactions of equity and debt between professional investors (Jensen, 1999). We adopt Gompers & Lerner's definition of VC as "*independent, professionally managed, dedicated pools of capital that focus on equity or equity-linked* *investments in privately held, high growth companies"* (2001: 146). The last decades of technological advancements and digital business emergence, hubs such as Silicon Valley, have brought an increasing amount of capital towards VC firms (Fazekas & Becsky-Nagy, 2015). Thus, the VC market provides a unique link between finance and innovation, providing early stage firms with capital market access, that is tailored to the special task of financing these high-risk, high-return activities (Gilson, 2003). As the presence is increasingly global, the number of VC-backed startups and small businesses has seen a sharp increase throughout emerging markets (McKinsey & Company, 2019). Through the successful development of the VC industry in China, India and Brazil, combined with the increasing perception of VC as a key determinant for economic development, investors are increasingly turning their eyes towards other emerging markets around the world (Breuer & Pinkwart, 2018).

3.1.2 Startups and SMEs: the 'ventures'

It is imperative to take into account the groups of organisations and individuals who receive VC: the investee companies. Hence, in this section we seek to define SMEs and startups, which are the actors referred to interchangeably throughout this paper as *ventures*. Micro-, small- and medium-sized enterprises (MSMEs) are acknowledged worldwide as important drivers of socio-economic development due to their important role in GDP growth, new job creation and entrepreneurship (Karadag, 2016). Their role has been considered particularly crucial in developing economies with a comparably lower number of large corporations (Narteh, 2013). The OECD's definition of SMEs is wide in terms of age, size, business model and aspiration of entrepreneurs, varying in their characteristics and performance (OECD, 2019). In addition, the World Bank (2020) stresses the importance of formal SMEs as they contribute up to 40% of gross domestic product (GDP) in emerging economies, emphasizing that these numbers are significantly higher when informal SMEs are included. Although acknowledging that all countries may define SMEs differently, the World Bank (2008) has categorized all companies with a maximum of 300 employees, and a yearly revenue of up to $15 million, to belong to the category. Within the category of SMEs, micro-sized enterprises hold a maximum of 10 employees and sales of $100.000; small-sized enterprises hold between 10-50 employees with total sales between $100.000 to $3 million; while medium-sized enterprises employ between 50-300 employees with revenues between $3- $15 million (The World Bank, 2008). Startups serve part in this categorization as they are generally known as newly formed ventures, preparing some minimum viable product, having higher entrepreneurial risk in establishing itself on a market, and is striving for fast growth. For such firms, the provision of sufficient funds to foster growth is the key factor of successful business development Bednár & Tarišková (2017).

Hudson & Khazragui (2013) coined the phrase "startup's valley of death" referring to the early stage of development where startups encounter the financial gap which limits the companies' abilities to innovate and to commercialise its products. Limited human capital, high uncertainty in terms of product and market, volatile development process and weak partnership ties are considered traditional barriers, which impedes successful startup growth, causing a high number of startups to fail within their first years of operation (Fielden *et al.*, 2000). These firms are thus often considered too risky for commercial loans and too underdeveloped for public markets (Herciu, 2017). As the risk of failure is very high, the VC firms are considered one of the most relevant sources of funding for new ventures (Li and Zahra 2012).

3.1.3 Venture capital for early-stage financing

The main function of VC firms is to invest in a company's balance sheet and infrastructure through equity or debt until it reaches a sufficient size and credibility for an exit (Hall & Lerner, 2010). General difficulties related to investing in startups and early stage companies include lack of internal cash flows and collaterals, asymmetric information and agency problems, bringing high risks, pressuring the VC to make high returns on successful investments (ibid.). In essence, the VC firms buy a stake in an entrepreneur's idea, nurture it for a short period of time, and exit at a high return if the business is successful (Gompers *et al.*, 2015). The most common structure for a VC fund is a limited partnership arrangement. Under the limited partnership arrangement, individual private investors (LPs) purchase a limited interest in a VC fund, which is managed by a group of venture capitalists (VCs). Those VCs are the general partners (GPs) in the VC fund, as well as the principals, associates and investment analysts, and they charge a management fee plus a share of the capital gains to run the fund (Baker & Filbeck, 2013).

Kaplan & Lerner (2010) highlight that despite the fact that the numbers of ventures actually receiving VC funding in the US is much less than 1%, it is considered well suited to stimulate the development of innovative fast growing businesses. Breuer & Pinkwart (2018) further emphasize the importance of VC to the wider economy, adding the importance of PE in their review of current financial literature in emerging markets. They argue that although PE funds and VC funds are both seen as important contributors to the economy, their differences become crystal clear once one takes a closer look on the two different types of funds (Breuer & Pinkwart, 2018).

While VC has proven to be one of the most relevant sources of funding for new ventures, PE funds represent a natural financing source for firms pursuing capital-intensive and risky investment strategies, usually in maturing industries. While VC enables founders to establish young, often tech-related ventures in immature markets, PE funds typically buy firms seeking additional capital in maturing markets, e.g. through a leveraged buyout. Furthermore, Breuer & Pinkwart (2018) discuss that while VC has been seen as a supportive factor to entrepreneurship and SME growth, PE firms have been criticized for loading companies up with debt, exploiting regulatory loopholes as their investments result in highly levered firms. Others claim however that firms financed by PE funds increased their performance due to an enhanced financial scope. The fact of the matter is that PE firms tend to enter at later investment stages, and usually buy a majority stake in the ventures they invest in (Breuer & Pinkwart, 2018).

Moreover, by actively supporting the venture's management, corporate governance, and reporting, VC firms have been considered particularly suiting to contribute to the professionalization of startups (Hellmann & Puri, 2002), enabling innovative products or services to be rapidly brought to market (Black & Gilson, 1998). As Sorenson and Stuart (2001) point out, the selection criteria and industry focus for the VC firm can vary highly depending on the industry criteria and the environment. If the GPs have experience from a specific industry, the fund can be industry specific, in other cases it can be industry agnostic, meaning the firm will seek investments across industries. Similarly, Mayer *et al.* (2005) argue that some VC firms enter at earlier stages where investment rounds are smaller and others focus on later stages where investment rounds are larger. According to the online startup tracker and information tool for many VC, Crunchbase (CB) (2020), the most common funding rounds are categorized as pre-seed, seed, Series A, Series B, Series C, and Series D. Below follows an illustration of the startup financing rounds. The amount of the rounds are not fixed, nor is the order chronological, as ventures may need additional financing that does not correspond to the subsequent round provided by the model below. However this model is used to provide an overview of the investment amounts and the financing actors that correspond to these.

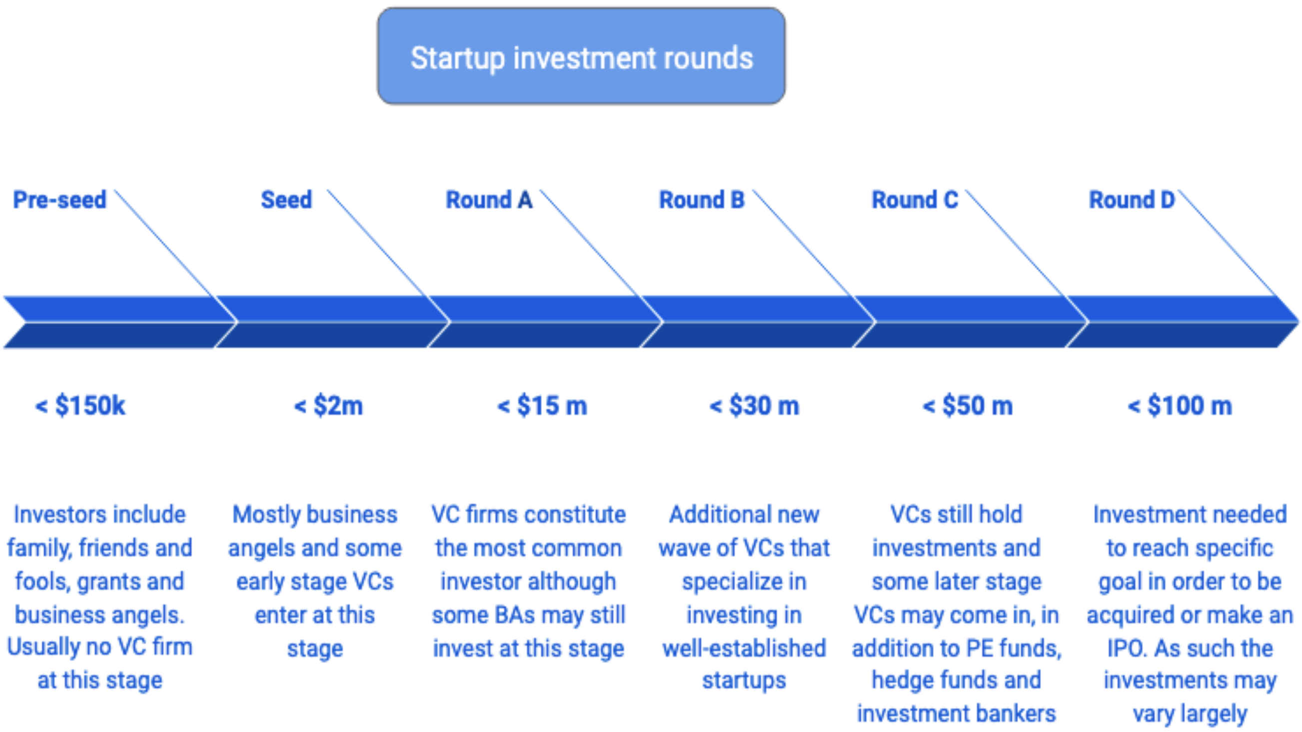

Figure 3: Startup investment rounds. Own construction. Source: Crunchbase (2020)

Pre-seed is the startup phase of the venture, where founders rely on informal capital to test the viability of their business idea. At this stage, the venture has no institutional investors and the capital invested is often a very low amount, often below $150k (Crunchbase, 2020). In this earliest phase, the entrepreneur is mostly relying on financial support from family and friends as well as grant funding. At the second stage, *the seed funding*, the venture gets capital to fund costs of product launch, early traction, bring in their first revenue, initiate important hiring and further market research for product-market fit (Riding, 2008). At this stage, Business Angels (BAs) serve the most important part of financing the ventures although some VCs enter already at this stage. Investment sizes range between $10k–$2M at the seed stage according to CB (2020), who reports that larger seed rounds have become more common in recent years.

Traditionally, *Series A* is the first round of VC financing and at this stage the venture should have developed a product and a customer base with consistent revenue flow, as the investments at the Series A round focus heavily on scaling up and reaching significant recurring revenue increases. According to CB (2020) Ventures at this stage may raise up to $15 million at this funding stage. The *Series B* funding stage focuses heavily on the ventures ability to meet the various demands of their customers and compete in tight markets in terms of competition. Here, ventures can raise approximately $30 million during the Series B funding round (*ibid.*). The Series B funding stage may appear similar to the former funding stage in terms of processes and key players, however, the major difference is usually the addition of a new wave of VCs that specialize in investing in well-established startups so that they can further exceed expectations.

Generally, ventures that make it to the *Series C* funding look for funding to build new products, reach new markets, and even acquire other under-performing startups of the similar industry. As the venture's operations have become less risky at this stage, other institutional investors than VCs are coming into play. Apart from PE firms, which are very active at this stage, hedge funds and investment banks invest in ventures during the Series C stage. Ventures with good business growth, valuing up to $100 million, may be able to raise approximately $50 million during the Series C funding stage (*ibid.*).

Subsequent to the Series C stage, some ventures additionally go through a *Series D* funding stage, which allows entrepreneurs to raise funds for a special situation, for instance a merger. A venture may consider series D funding, or bridge-financing, if it has not gone public or been acquired yet, but is contemplating a merger, and needs some runway to reach their targets. In addition to PE firms, investment banks and hedge funds, some late stage-VCs are still active investors at this stage. Startups in this stage may raise up towards $100 million (*ibid.*).

	Business Angels	**Venture Capital**	**Private Equity**
Ticket Size *	$10.000 - $500.000	$0.5 - $20 million, although increasing	Wide range: from $ millions to billions
Investment stage (of business) *	Founding, startup, pre-revenue; Pre-seed stage, seed stage, A-round	Early stage, pre-profitability; Mainly A-round, B-round and C round, sometimes also D-round and bridge financing	Mature cash flow, often deteriorating due to inefficiencies; B round, C round and D-round
Type of investment	Equity	Equity, convertible debt	Equity with leverage
Level of risk and return *	Extreme risk and return (100x return target)	High risk and high return (10x return target)	Moderate risk and moderate return (15% IRR)
Investment screening	Founders, market share potential, virality, # of users	Founders, market share potential, revenue, margins, growth rate	EBITDA, cash flow, IRR, financial engineering
Ownership	Small equity, own capital invested.	Below 50%, invest on behalf of LPs	Above 50%, on behalf of LPs
Purpose	High involvement in management, professionalization, go to market strategy.	Mentoring, professionalization, growth. Sell stake for profit through exit.	Create economic efficiency and growth. Leveraged buyout (LBO).
Investment focus	Invest in small number of ventures	Hockey stick ventures, often within state of art technology or novel product-market fit	Traditional industries or firms with well tested business models and good traction

Table 2: Difference between BA, VC and PE: characteristics in spectrum of risk/return and stage of investment. Own construction based on: Aylward (1998); Gompers et al., (2015); Monika, & Sharma (2015); Baum & Silverman (2004); Hall & Lerner (2010); CFI (n/d); CB (2020); Hellmann & Puri (2002); Black & Gilson (1998); Sagari & Guidotti (1992); Ramadani (2009); Teker & Teker (2016). **The figures provided should be considered as general points of reference to distinguish between the types of investor. The investor types, as explained in the paragraphs below, are constantly evolving and there is no definition that can account for all the variations.*

3.1.4 Business Angels and other early stage financiers

Business Angels (BA), which usually constitute wealthy individuals with large business experience, and family and friends of the entrepreneurs ('love money') make up the informal capital market for early stage ventures. Together with the VC firms they are considered an important source of capital for SMEs and a vital cornerstone in the early financing stages (Riding, 2008). As such they serve a crucial financial role to bridge the gap between the founders and larger institutional investors. Apart from their contributions through the financial investments, BAs tend to have a high involvement in supporting the management of the ventures they invest in. As BAs usually have an entrepreneurial background either by succeeding with their own venture or by having done very well in the industry, they have the financial means and experience to contribute with (Ramadani, 2009). The last couple of years have seen an increasing trend of BAs coming together under *Angel networks.* In such syndicates, as a group BAs can provide higher amounts of financing than individual BA investors (Croce *et al.*, 2016).

Other models of early stage venture financing includes *crowdfunding*, which is an umbrella term used to describe diverse forms of fundraising, typically via platforms over the internet, whereby groups of people pool money to support a particular goal (Ahlers *et al.*, 2015). Furthermore, family offices that serve as intermediaries to manage wealth is yet another model. Instead of owning the firm directly, the family bundles its ownership shares into a family office and only has an indirect ownership share in the firm (Zellweger & Kammerlander, 2015). Such family offices increasingly invest in growth ventures and have evolved into an important player in the market. These emerging models add heterogeneity to the rapidly changing landscape of entrepreneurial finance (Block *et al.*, 2018).

Perhaps the most notable addition to the early stage financing landscape is the rapid evolution of accelerators and incubators appearing all over the globe. These are organisations that support the ventures by mitigating risk and increase the probability for success by implementing targeted operational improvements at investee companies. Such efforts include financial literacy training, business plan development, marketing support, strategic planning, legal support, operational and process improvement, facilitating access to international supply chains, and information technology support. Additionally, accelerators and incubators seek to support start-ups in their growth through network access and in addition to co-working space (Divakaran *et al.*, 2018).

While scholars and practitioners commonly use the terms incubator and accelerator interchangeably, incubators have been around for a much longer time and their scope has been considered much wider, including all support relating to projects, tools, facilities, buildings, enterprises, organizations which may facilitate the business startup process. Accelerators, on the other hand, are usually fixed-term, cohort-based programs providing education, monitoring, and mentoring to the entrepreneurs, and connecting them with VC firms and BAs amongst others (Hausberg & Korreck, 2020). Although some accelerators are increasingly providing financial support through loans, convertible notes and equity at pre-seed stage, their role in the larger scheme of early-stage funding tends to lay around preparing the ventures and connecting them with investors, and hence they can be seen as an intermediary actor (Hallen *et al.*, 2016). In comparison to the alternative models of financing, VCs have been considered as a better fitting investment vehicle to foster the interest of larger institutions such as pensions funds, and lately even development banks in their surge for unlocking capital in emerging markets through investments in early stage ventures (UNCTAD, 2017; Barger *et al.*, 1996),

3.1.5 The cycle of venture capital funds

The cycle of VC funds, as shown in the figure below, includes funding, screening, investing, monitoring and exiting (Rajan, 2010). The funds which the VC firm is running are usually closed-ended and reach maturity, normally at 10-12 years, after which investments should have been exited and returns distributed (Cremades, 2018). The first step, *funding,* includes finding the investors who will fund the VC itself. The GPs of the VC firm are usually experienced investors who will seek external funding to run a fund for a specific period of time. Experienced GPs may run multiple funds with different investors and portfolios simultaneously. These investors, the LPs, include amongst others endowments, corporate pension funds, sovereign wealth funds, wealthy individuals and families, and funds of funds (Rajan, 2010; Patricof & Sunderland, 2005).

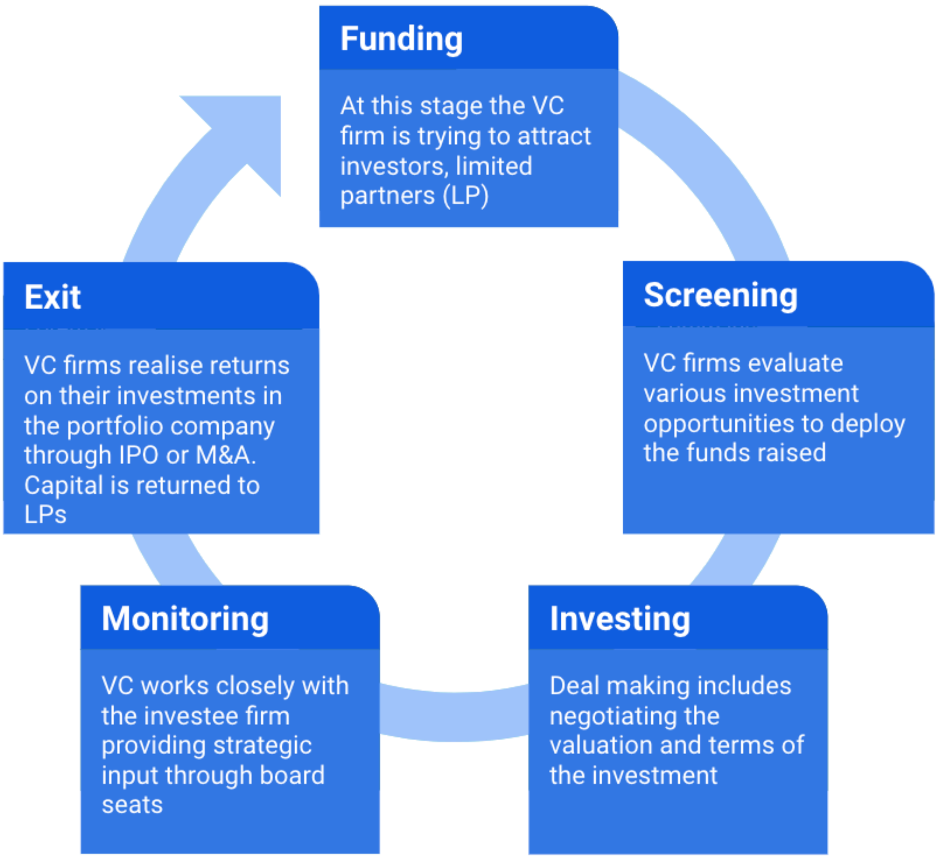

Figure 4: The VC fund cycle. Own construction based on Rajan (2010).

The second stage in the VC firms fund is *screening*. The analysts of the VC firm usually collect market research and information on potential investment objects. Together with more senior employees, associates, the analysts serve a key role in the firm's screening and deal-sourcing (Rajan, 2010). Scraping various market intelligence sites for popular deals and keeping a close relation to the intermediary actors such as accelerators and other network parties who may provide deals is a vital part of the analysts and associates contributions to the VC firm. Although the final investment decision is often taken by the GPs, the analysts and associates provide a crucial role in providing necessary information for developing the right criteria, KPIs and ultimately investment decision (Landström, 2007). Multiple phases of screening and evaluation is needed to understand the industry- and firm specific conditions prior to investing in the venture (Fried & Hisrich, 1994). Although the investment criteria may differ largely from firm to firm, the people, opportunity, context and deal (POCD) framework developed by scholars at Harvard Business School usually presents some overarching categories which VCs tend to include when forming their own criteria. *People* refer to the capacity and track record of the founders, management and employees. *Opportunity* refers to the economics of the business and usually includes cash flow estimates or other potential market opportunities that may arise. *Context* refers to the external factors potentially affecting the business such as shifts in the political landscape. Lastly, *deal* refers to the relationships between the involved parties, including contracts, compensation, and incentives (Amis & Stevenson, 2001).

When the firm has found ventures which fit their criteria they will proceed with the third stage, *investing.* In a typical start-up deal the investments are made in preferred-equity ownership position, which implies downside protection. For instance, the VC firm receives a liquidation preference which ensures their investment is repaid before other shareholders. In other words, should the venture fail, they are given the first claim to all the company's assets and technology. In addition, the deal often includes blocking rights or disproportional voting rights over key decisions, including the sale of the company or the timing of an initial public offering (IPO), referring to offering corporate shares to the general public (Rajan, 2010; Zider, 1998). In most cases, VCs invest in the company through multiple funding rounds, since staging of capital infusions allows VCs to gather information, monitor the progress of firms, and gives the option of abandoning those projects that are not doing well (Gompers, 1995). As described above, the funding rounds are often categorised as pre-seed, seed, series A, series B, series C and sometimes even series D before a venture is viable for an exit.

The fourth step in the investment cycle is the *monitoring* process along the venture's growth journey. Many studies show that VC-backed ventures are more likely to succeed than ventures who are not backed by VC firms (Cumming, *et al.* 2005). This is supported by the fact that GPs tend to have a highly active role in the ventures they invest in, holding board seats and acting as strategic partners in many high level decision-making processes. VCs use their specific industrial knowledge, expertise, and contacts to assist their portfolio firms in various areas such as strategic and operational planning (MacMillan *et al.*, 1989; Sagari & Guidotti, 1992).

The last step of an investment is the *exit*. Since VC funds are generally structured as close ended funds, the VCs have to liquidate their investments after a certain period to distribute the profits to the limited partners. The common routes of exit are through IPO, acquisition by another company, repurchase of VC firm's shares by the investee company, or secondary purchase of VC firm's shares by a third party (Sagari & Guidotti, 1992; Rajan, 2010). Studies suggest that longer investment periods are correlated to lower returns on investments, indicating that early exit routes are preferred (Aylward, 1998). Additionally, Schwienbacher (2008) highlights the agency issues resulting from the conflict of interest between the investors and the founders of the venture, when deciding routes for the exit. Seeing an IPO often allows the entrepreneurs to keep control after the VC firms exit, this may conflict the interest of the investors who at this stage will look for the most lucrative offer for their share in the company. As a result, most startup deals include provisions, which allow the investors to have veto rights on the exit route decisions (Schwienbacher, 2008). This could in effect answer why the majority of exits are made through acquisitions (Gompers, 1995).

3.1.6 Emerging Markets

Multilateral organizations each employ their own classification of countries, varying with the purpose of the organization. The World Bank classifies countries in four categories based on the per capita income as *low income*, *lower-middle income*, *upper-middle-income*, and *high-income*. Countries with an income exceeding $ 1,025 = lower middle income; over $4,035 = upper middle income; over $12,475 = high-income economies. Kenya thus classifies as a lower middle-income country (Fantom & Serajuddin, 2016). The International Monetary Fund (IMF) uses a similar classification, but adjusts for example for members of the Eurozone, which are considered as *advanced*. The United Nations (UN) categorizes countries in three categories, *developed*, *developing* and *transition*. Apart from countries that joined the EU which are automatically classified as *developed*, the UN´s classification has not been updated to reflect the economic evolution of the past 25 years (Meyer & Grosse, 2018).

Management scholars have taken a more pragmatic approach to the classification of countries. Emerging markets have been defined as *"those economies that have high growth or growth potential, but do not have the same sophistication of the institutional framework as Western Europe or North America"* (Meyer & Tran, 2004: 6). Management studies additionally emphasize differences between emerging markets. One of the biggest differences made by management scholars is between developing countries and transition economies. Although neither the Organisation for Economic Co-operation and Development (OECD), the World Trade Organisation (WTO) nor the World Bank operate with definitions for developing countries, development studies and, increasingly, business studies are dealing with the term. Mutual research themes on developing countries have been identified such as market failure, institutions, entrepreneurship and firm internationalisation (Hansen & Schaumburg-Müller, 2010). While the term *developing countries* is usually used for countries in Asia, Latin America, Africa, and the Middle East, *transition economies* is used for countries in the former Soviet Union, Eastern Europe and East Asia. Transition economies are facing a change from a centrally planned economy to a market economy through increased privatization, a changing role of government, and legal and institutional reforms. Apart from these differences, emerging markets differ in their level of industrial development, the extent of market liberalization, the degree of integration into the global economy, and the rate of economic development and growth (Marquis and Raynard, 2015). Despite these differences, emerging markets share a number of characteristics that not only differentiate them from traditionally studied developed markets, but also create a set of general challenges for navigating their business environments (Khanna & Palepu, 2010). Kenya has in the last decade been the subject of several studies, focusing on business strategies in emerging market contexts. As such, Sudhir *et al.* (2015) study the application of emerging market literature relating to consumer preferences and marketing using the Kenyan context as the subject of the research. Similarly, Drouillard (2017) uses Kenya as the country of analysis for his study on how digital platforms can help overcome salient market inefficiencies stemming from institutional voids in emerging markets. Investigating the VC industry in Kenya, Hain & Jurowetzki (2018) additionally comment that the recent flow of investments into Sub-Saharan Africa signals "*there exist young companies with innovative products, services, or business models which are potentially fit for international or even global markets. This picture fits well with the arising speculations about countries such as Kenya and Nigeria becoming the 'new emerging' markets who may follow the development path of the BRICS countries*" (p. 451). As such we perceive Kenya, as the country of analysis, to be a representative case for the VC industry in emerging markets.

3.1.7 Venture Capital in Emerging Markets

Throughout the past decades, cross-border VC investments have increased substantially in terms of number of deals, amount of capital invested, and geographical reach (Aizenman & Kendall, 2012). In 1992, the World Bank issued a discussion paper on the possibilities for VC investments as a solution to provide financial support to develop the productive sectors in developing countries (Sagari & Guidotti, 1992). Although recognising that traditionally conceived VC firms might face challenges related to business environment, such as the size and the purchasing power of the domestic markets, the supply of skills, entrepreneurs' attitudes towards sharing control, and exit mechanisms, the paper suggests that lessons learned from the developed world can be used in emerging markets (Sagari & Guidotti, 1992). The pattern of VC globalisation has been explained mainly by market attractiveness. This is an exogenous country-level factor to which VC investments gravitate, and empirical studies show that VC investments tend to flow to countries with some key economic features such as high economic growth (Schertler and Tykvová, 2009; 2010). Explaining the cross-border VC flows, Guler and Guillén (2010) emphasize the role of institutional factors and conclude that VC firms prefer to invest in countries with technological -, legal -, financial -, and political institutions that create innovative opportunities, which they consider defined by the level of scientific knowledge and technology. Ahlstrom and Bruton (2006) argue that over the last decades, some emerging economies such as Brazil, Taiwan, India, and China have however succeeded to attract substantial amounts of foreign VC investments. The number of cross-border VC investments into emerging economies increased from 8.7 percent of the total VC investments in 1991 to 56 percent in 2008 (Chemmanur *et al.*, 2016). Financial data provider, Preqin (2018), showed in their report from 2018 that funds from emerging markets have collectively posted the strongest returns for both 2010-2012 and 2013-2015 vintage funds compared to North America- and Europe based VC funds. The report additionally showed that the majority of the VC investments in emerging markets are made in Asia, where Singapore is the hub, however, the regions with the largest proportion of newly registered VC firms is Latin America (30%), followed by firms based in Sub-Saharan Africa (26%) (Preqin, 2018).

Although, there is an emergence of dynamic startup ecosystems and rapidly growing domestic markets in these countries they are also characterized by a high degree of political and market instability, underdeveloped investor and property protection (Peng, 2001), corruption (Johan and Najar, 2010), weak security and basic infrastructure as well as vastly diverging business models, ethics, and practices (Ahlstrom and Bruton, 2006). As a consequence of the high levels of uncertainty, investments into these countries represent a challenge for VC investors, requiring them to adjust their routines regarding deal selection, structure, monitoring, and providing managerial support (Dai *et al.*, 2012; Khavul & Deeds, 2016).

Summary of chapter 3.1

In this part of the literature review, we have explored the concept and phenomenon of VC. We have further emphasized the globalization of VC and its recent expansion into emerging markets. The chapter has additionally presented VC as a suitable financial vehicle for development of startups and SMEs (the ventures) and that VC integrates into a process of financial mechanisms together with BAs and PE funds, which appear at different stages of the ventures development. Lastly, we have explored the stages of a VC fund's cycle, at which different activities take place. These stages include funding, screening, investing, monitoring and exiting.

3.2 Institutional theory and firm strategy in emerging markets

In this chapter we aim at exploring the literature that has evolved around business strategies in emerging markets by highlighting the arrival of institutional theory, as a perspective that takes into account the external factors to the firm. Thus, exploring the origins of institutional theory, the literature review furthermore presents the quality of the institutional setting as commonly characterised in emerging markets.

3.2.1 Business strategy in emerging markets

Until the 2000's, business strategy literature largely focused on Porter's (1980) industry perspective, Barney's (1991) resource-based view and to some extent, the knowledge based perspective presented by Teece (1997). Porter (1980) suggested that the firm's competitive advantage is a matter of cost leadership or differentiation, relating the firm strategy to its position against other industry actors. Barney (1991) considered the firm's success as a matter of internal resources and capabilities with a particular focus on their advantage-value, rareness, imitability, and substitutability. Following his ideas, the knowledge-based perspective (Teece, 1997) emphasized the firm's internal resources in terms of knowledge, transfer of knowledge and the protection of such resources. Although scholars such as Oliver (1997) suggested that firms need to adjust for wider influences from the state and society, the above mentioned theoretical strands have been criticized for lacking applicability outside developed countries, where the societal influences on the firm is subject to rapid change, affecting the firm's strategy (Garrido *et al.*, 2014).

In the light of this, it has further been argued that the three most appropriate theories to explain the relationships between the firm and its surroundings are resource dependency theory, population ecology, and institutional theory (Hatch, 1997; Pfeffer & Salancik, 2003). Further, Hoskisson *et al.* (2000) argue that particularly institutional theory suits organizations operating in emerging markets due to its ability to capture the nature of the regulatory bodies and their impact on organisational behaviour, as well as the significance of culture. As government- and societal influences are stronger in emerging markets than in developed economies, Hoskisson *et al.* (2000) consider the institutional theory as preeminent in explaining how this will affect the firm's strategy, arguing for a combination of institutional theory, resource based theory and transaction cost economics for strategy formulation in emerging markets. Hoskisson *et al.* (2000) declare the role of institutions in an economy to reduce transaction- and information costs by limiting uncertainty and establishing a stable structure that facilitates interactions between societal actors. Hoskisson et al, (2000) further meant that transaction cost is related to institutional enforcement such as the rule of law. When institutions fail to support such interaction, the setting will give rise to opportunistic behaviour, implying higher transaction costs for the firms (Hoskisson *et al*, 2000). Peng (2002) emphasizes that although the resource based view and the industry perspective paid attention to the "external environment", their considerations have been limited to primarily economic factors such as technology and demand. He additionally highlights that the institutional underpinnings, which form the context of competition and the firms, have been ignored as an effect on research on firms, competition and strategy in the US. Hence, taking into account the wider societal influences should no longer be ignored. These influences are broadly considered as institutional frameworks (North, 1990; Scott, 1995).

In business strategy research, this perspective has been called the institution-based view (Peng, 2002). Thus, Mike Peng (2008) proposes the "strategy tripod", which considers strategic choices as driven by industry conditions, firm capabilities, and an important reflection of the constraints of a particular institutional framework. Treating institutions as independent variables, the institution-based view of strategy thus focuses on the dynamic interaction between institutions and organizations, and considers strategic choices as the outcome of such an interaction (Peng, 2008). Furthermore, institutional theory considers the implication of networks and culture on firm strategy as Marquis and Raynard (2015: 2) add to this approach by defining institutional strategies as "*the comprehensive set of plans and actions directed at strategically leveraging the socio-political and cultural institutions within an organization's external environment*". Some firms further utilize social networks as a strategic mechanism to overcome disadvantages related to the institutional environment (Peng 2008, Hoskisson *et al.,* 2010). In their revisited version of the Uppsala model, Johanson & Vahlne (2009) highlight that networks and mutual commitment play a large role in the internationalisation of a company, whereas the nature of informal relationships creates an effect of liability of foreignness.

The term liability of foreignness was first coined by Zaheer (1995) to explain the additional costs that firms operating internationally experience in relation to local firms. Khanna and Paleppu (2010) have used the concept to explain numerous implications for business strategy relating to emerging markets such as local product adaptation and marketing strategies. Moreover Johanson & Vahlne (2009) argue that a firm's international success requires that it be established in one or more networks, in which the firm becomes an *insider*. If the firm does not possess such a position in the local network, it is considered an *outsider* and suffers from the *liability of outsidership* (ibid.). If the firm attempts to enter a new market without having established relationships and networks, it will suffer from both liability of foreignness, i.e. the socio-cultural understanding of local market environment (Marquis & Raynard, 2015), and liability of outsidership, which makes it impossible to develop a business (Johanson & Vahlne, 2009). Hence, as the business environment is viewed as a web of relationships, more than the psychic distance, outsidership is a root of uncertainty (ibid.).

3.2.2 Institutional Theory

Kostova & Marano (2019) distinguish between two strands of institutional theory: the institutional economics and the organisational institutionalism (Kostova & Marano, 2019). Firstly, the institutional economics strand of institutional perspective, as in the work of North (1990), emphasizes the institutional quality in an industry or country and the salience and role of the institutions (as applied in e.g. Khanna & Palepu, 1997, 2010; Meyer & Peng, 2005, 2016; Xu & Meyer, 2013). Secondly, the organisational institutionalist strand, which was first developed by DiMaggio & Powell (1983) and later elaborated by Scott (1995), focuses on how organisational arrangements impact other organisations (as applied in e.g. Ahlstrom & Bruton, 2003; 2006; 2010). Together, the institutional economic strand combined with the organizational institutionalism strand serve crucial cornerstones in the understanding of institutions as social structures and their impact on the firm.

In institutional economics, institutions are perceived as *"those humanly devised constraints that help reduce uncertainty among transacting economic actors" (*Kostova & Marano, 2019: 101). Hence, firms' actions are explained through the logics of economic efficiency and rationality within the constraints of the institutional environment. North's framework (1990) embodies a conception of the different dimensions of institutions, defining them as the "rules of the game". The formal dimension includes laws and formal rules, while cultural norms and tacit codes of behaviour are embodied in the informal dimension (Ahlstrom & Bruton, 2006; Grilli *et al.*, 2019). Hofstede (2007) additionally emphasizes the importance of culture as the foundational layer of institutional arrangements. Institutional economics further suggests that, in situations where formal institutional constraints fail, the informal constraints will come into play to reduce uncertainty and provide consistency to organisations (North, 1990; Peng, 2002).

Organisational institutionalism is concerned with how and what social constructs influence the arrangements of organisations (Kostova & Marano, 2019). These institutional forces that make organisations look quite similar are identified as institutional isomorphic change (Alsharif, 2015). DiMaggio & Powell (1983) identified three mechanisms for this isomorphism: the coercive isomorphism that stems from political influence and the problem of legitimacy, the mimetic isomorphism which results from standard responses to uncertainty, and the normative isomorphism that is associated with professionalization. In addition, Scott (1995) builds on North's concepts of formal and informal institutions and incorporates the categorisation of DiMaggio & Powell's three mechanisms (Ahlstrom & Bruton, 2006). Scott (1995) categorises the institutional mechanisms as regulatory, normative and cognitive. The regulatory institutions are the most formal and represent the rules, laws, regulations, and other sanctions. The normative forces include the norms and values in a society, often manifested through accepted authority systems such as accounting. These can be codified, and other times they are the tacitly understood practices of a profession or work function. Finally, the cognitive forces are the most informal and reflect the cultural dimension of a society. They guide the behaviour through taken-for-granted rules and beliefs, which are established among individuals through social interactions. The cognitive and less formal normative institutions influence a society through the culture of a community (Ahlstrom & Bruton, 2006; Scott, 1995).

3.2.3 The institutional setting in emerging markets

The institution-based view on strategy has produced a rich explanation of the contextual environment of emerging markets. Scholars such as Meyer & Peng (2005; 2016), Xu & Meyer (2013) and Khanna and Palepu (1997, 2010) emphasize certain constraints relating to the institutional setting of emerging market context. At different levels of the spectre: the institutional arrangements can be "strong" if they support effective market mechanisms, and they can be "weak" if they fail to ensure an effective market. Khanna and Palepu (1997) coin the term 'institutional voids' referring to the imperfections in the institutional framework which commonly colour emerging markets, such as if the national environment lacks formal institutions that support effective functioning markets, such as prevention of corruption, protection of property rights, ensuring the rule of law, and provision of public investments and infrastructure (Khanna & Palepu, 2010; Kostova & Marano, 2019). Hence, these scholars emphasize the role and level of quality of the formal institutions, particularly the government-related entities, and the importance of the informal institutions such as social norms and cultures as the counterbalance.

In addition, Meyer & Tran (2004) builds on this notion, highlighting that emerging markets are highly volatile because of frequent changes in institutions, industrial structures and the macro-economy. Despite this, the economic context of emerging markets tends to be coloured by a rapid GDP growth, an increasing consumer purchasing power, a growing middle class, a high proportion of manufacturing, labour-intensive industries, and large-scale heavy industrial sectors (Sit & Liu, 2000). The rapid and widespread adoption of market-based policies is common amongst emerging economy governments and, additionally, raises important issues for the strategies adopted by private enterprises in emerging markets (Hoskisson *et al.,* 2000).

When comparing institutional frameworks between nations, there are often certain institutions that are perceived as each others' equivalent. Nevertheless, the institutions common to an industry in one country will not be similar to the corresponding institutions common to an industry in another country. This is because organisations in general are embedded not only in the institutional arrangements in their industry, but in the country-specific institutional setting as well, including the historic development of a nation's rules and laws, business norms, and commercial traditions (North, 1990; Busenitz *et al*., 2000; Kostova, 1997). Xu & Shenkar (2002) have used the concept of institutional distance, to explain this phenomenon. For foreign firms operating in emerging markets, the institutional theory concepts such as institutional quality, institutional voids, and institutional distance are particularly relevant (Kostova & Marano, 2019). This is especially insightful concerning emerging markets, as it allows us to understand the distinctiveness of the market and the uniqueness of managerial and strategic challenges for the firms (Kostova & Marano, 2019). As emerging markets are by definition undergoing societal and economical development, they provide a rapidly changing environment for organizations to evolve within (Hoskisson *et al.*, 2000). As such it becomes pertinent to understand the influence of institutions on the firm's strategy, which as it faces strong environmental pressures for change (Peng, 2003). Specifically, scholars have highlighted issues relating to increased transaction costs, market vulnerabilities and macroeconomic- and political instabilities as well as underdeveloped and missing infrastructures (Mair & Marti, 2009), and rampant opportunistic behaviour, bribery, and corruption (Hoskisson *et al*., 2000). On a practical level, the institutional perspective thus offers an approach to strategic decision-making, which will help organizations navigate the complex challenges specific to emerging market contexts.

Summary of chapter 3.2

In chapter 3.2 we have introduced the institutional approach to business strategy in emerging markets. Hoskisson *et al.* (2000), Peng (2001), and Khanna & Palepu (2010) amongst others have highlighted the applicability of the institutional theory within business strategy in emerging markets. Exploring the roots of institutional theory, this chapter presents North's (1990) work on institutional economics and the organisational institutionalism, as developed by DiMaggio & Powell (1983) and later elaborated by Scott (1995), defining the rules of the game. Investigating the institutional setting in emerging markets, we find that a common characteristic of emerging markets is inadequate or lacking formal institutions, described as a weak institutional environment and institutional voids, informal institutions tend to take crucial functions otherwise provided by formal institutions. As such, informal institutions, such as networks and the cultures they are embedded in, are critical components for firms to navigate the local context.

3.3 Theoretical Framework: institutional theory and venture capital in emerging markets

Relating the previous chapters of the literature review, we combine the financial literature on venture capital and the literature on institutional perspective on business strategy in emerging markets into a unique theoretical framework.

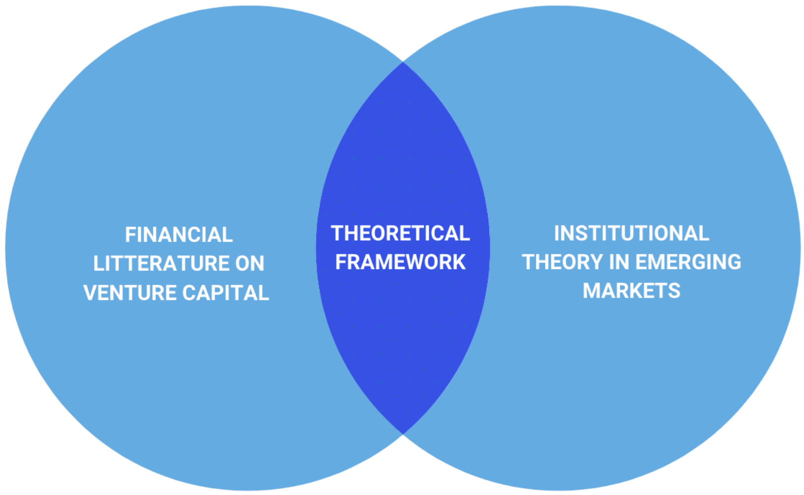

Figure 5: Illustration of the theoretical framework as a combination of the financial literature on VC and the literature on institutional theory in emerging markets.

This paper is aimed at assessing characteristics of the institutional setting which may propose barriers to VC firms face in Kenya and what coping strategies firms adopt to circumvent these barriers. As such the theoretical framework, which will be applied to answer the first part of our research question, draws heavily on the contributions from Peng, (2002; 2008) and Hoskisson *et al.* (2000) under the institutional approach, considering the firm's strategy as an outcome of the dynamic interaction between the firm and the external environment. This encompasses the emerging market characteristics, the market failures, and the institutional surroundings (Marquis & Raynard, 2015). As Peng (2008) suggests under the institutional approach to strategy, we will assume the institutional environment as an independent variable. Hoskisson *et al.* (2000) further emphasize the institutional environment as a key influencer in opportunistic behaviour, agency, and ultimately transaction cost, suggesting that this is particularly the case for emerging markets where formal institutions may be weak or absent. We aim to take departure in this notion in our study, using North's (1990) and Scott's (1995) categorizations of institutions to create an understanding of how the institutional setting in Kenya is affecting the VC firm's business strategy. The lack of formal institutions in emerging markets is considered to have significant implications for firms (Peng, 2008; Hoskisson *et al.*, 2000; Khanna & Palepu 2010; Ahlstrom and Bruton, 2006). More specifically, government intervention and regulatory uncertainties (Marquis & Raaynard, 2015), liability of foreignness, socio-cultural differences, and liability of outsidership (Khanna & Palepu, 2010; Johanson & Vahlne, 2009), and underdeveloped supportive industries, technological challenges, and weak infrastructure (Arregle & Borza, 2000; Khanna & Palepu, 2010) have been emphasized as particular challenges relating to the institutional barriers that firms face in emerging markets. We particularly consider VC firms as important providers of finance for young innovative firms, as suggested by Hall & Lerner (2010), among others, where the main strategic considerations lie within funding, screening, monitoring, and finally exiting the ventures they invest in (Rajan, 2010).

Institutional theory has been applied in emerging market contexts to explain the VC firms' strategic decisions and ways to operate (e.g. Ahlstrom & Bruton, 2006; Lingelbach, 2015; Li & Zahra, 2012). However, the effect of changing institutional environments of emerging markets on the VC development process has only just begun to be addressed (Ekanem *et al*., 2019). As proposed in the VC investment decision model (Fried & Hisrich, 1994), there would often be certain institutions that are common to the industry that will lead to uniformity among the VC firms' behaviour. However, firms should acknowledge that these institutions do not shape the industries in similar ways once compared across countries (Busenitz *et al*., 2000; Kostova, 1997; Xu & Shenkar, 2002). If the institutional differences in emerging markets make VC firms' decision process different, the traditional VC mechanisms may have to be modified (Ahlstrom & Bruton, 2003; 2006). According to Ahlstrom & Bruton (2006), the past understanding of the VC industry has primarily built on agency theory and stewardship theory, and highlight that these approaches seem only to have been fit for developed country contexts. The geographical-, cultural- and institutional distance between the VC firm's home country and the host country has been considered to negatively affect cross-border investments (Li & Zahra, 2012). In addition, the concept of institutional trust is important as it reflects the need for foreign firms to build up relational trust. This is mostly reflected in the businesses' or population's trust in the institutions, and if this is low there is a need for more proximity and engagement with local partners (ibid.). Hence, high levels of institutional trust have a positive impact on cross-border VC flows from developed to emerging economies (Hain *et al.*, 2016).

Li & Zahra (2012) show a positive correlation between VC investments across countries and the development of formal institutions. Hence, they argue that stimulating the VC activity by developing the regulatory frameworks of formal institutions is beneficial as a means for promoting entrepreneurship. However, their results suggest that both formal and informal institutions are important determinants of the cross-border VC activity. The effects of formal institutions depend on informal but powerful cultural constraints, as uncertainty avoidance and collectivism reduce VC firms' sensitivity to the incentives provided by formal institutions (Li & Zahra, 2012). These findings support the view of North (1990) and Xu & Shenkar (2002). Also Ahlstrom & Bruton (2003) have called attention to informal institutions such as culture and norms that can substitute for potential VC unfriendly formal institutions. Local bias is considered inherent in financial intermediary activity, as there is a strong need for spatial proximity and heavy reliance on local expertise to mitigate agency problems, especially as investment in innovative activities involves considerable uncertainty and is characterized by asymmetric information at the outset and agency problems during the investment process (Hain *et al.*, 2016).

For international VC firms to consider investments in developing countries and emerging markets, the institutional conditions as well as the characteristics of the market in general are vital considerations. Due to the chronically poor IT infrastructure, particularly related to many Sub-Sahara African (SSA) countries, investments in technology-related applications and ventures, where most investments go, calls for attention with regards to the applicability of these innovations in society, e.g. through integrating local perspective and bottom of the pyramid (BoP) approach (Hain & Jurowetzki, 2018). Nevertheless, new establishments in internet and mobile infrastructures are improving tech-competence and potential for domestically developed technology-intensive solutions (Hain & Jurowetzki, 2018).

Generally, East-Africa has shown a high cost of operating a fund in the region, much due to the length of time it takes to find, evaluate, and make investments (Gugu & Mworia, 2016). Additionally, lack of experience and knowledge around rapid scale-up, which tend to characterize ventures under the loop of VCs, are forcing fund managers in the region to take on roles that are not typical of conventional fund management. Furthermore, challenges related to screening and exit have also been highlighted as an inherent part of the current VC ecosystem. The struggle of screening, or deal-sourcing has been attributed to underdeveloped deal intermediaries such as incubator- and accelerator programs, whilst the lack of exit opportunities relates to the poor private liquidity options and underdeveloped financial markets, making IPOs a rare occurrence (Gugu & Mworia, 2016). In an extensive report by The World Bank on PE in Kenya from 2018, the lack of information available to investors was further highlighted as a major factor, hindering investments in SMEs. The lack of knowledge on formal reporting mechanisms, corporate governance and financial capacity to navigate the information required by VC firms, make due diligence processes lengthy and costly. As such, navigating the local context is crucial for making good VC investments (Divakaran *et al.*, 2018).

3.3.1 Propositions

By combining the institutional approach to business strategies in emerging markets with financial literature we have developed three propositions which will be analysed through our findings. The propositions concern institutional barriers which the literature in general perceives as challenging for firms in emerging markets. Hence, the institutional barriers hinder the VC firms from pursuing investments in emerging markets. Through these propositions, we seek to answer the first part of the research question: *"What are the institutional barriers to venture capital in emerging markets"*. The section below provides an outline to these propositions and the logic behind them.

1. Regulatory uncertainties are institutional barriers to venture capital in emerging markets.

Emerging market countries have been considered to include less developed regulatory infrastructures, which has been categorised as regulatory uncertainties, including inadequate or missing market regulation, corporate governance, transparency, accounting standards, and intellectual property protection (Khanna & Palepu, 2010). Corruption and opportunistic behaviour has particularly been considered as challenges for the firms, causing high monitoring costs and making legal contracts difficult to enforce (Peng, 2001; Khanna & Palepu, 2010; Marquis & Qian, 2014). Especially the effectiveness of regulations and the legal system regarding investor protection, reporting and accounting standards have been highlighted as important for VC activity (Grilli *et al.,* 2019). Imprecise descriptions of regulation of reporting standards, and inadequate enforcement of such, create challenges for VC firms upon the collection of valid financial information on the investee companies. Gugu and Mworia (2016) argue that corporate governance and reporting have particularly challenged the VC firms operating in such a context. Ahlstrom and Bruton (2006) further highlight that such institutional settings are typical for emerging markets and result in unattractive markets for VC investors, who typically are heavily reliant on the rule of law. Furthermore the political environment is considered as particularly challenging to navigate, as emerging market governments have been noted as more susceptible to external conflicts, coups, internal tensions and political instability (Hiatt & Sine, 2014; Hain & Jurowetzki, 2018). Lingelbach (2015) additionally emphasizes the impact of rapidly changing formal institutions, such as laws and regulations, related to the government's effort to make substantial reforms on the VC development process.

2. Liability of outsidership and liability of foreignness are institutional barriers to venture capital in emerging markets.

The lack of institutional market knowledge, such as knowledge about the language, laws and rules has been highlighted as a *liability of foreignness* (Johanson & Vahlne, 2009).

The term refers to the additional costs that firms operating internationally experience in relation to local firms (Zaheer, 1995). Khanna and Paleppu (2010) have used liability of foreignness to explain numerous implications for business strategy relating to emerging markets such as local product adaptation and marketing strategies. In addition, Johanson & Vahlne (2009) argue that if the firm is not established in a network of other businesses and institutions in the industry, the firm is considered an *outsider* and suffers from the *liability of outsidership*. This can be related to the term of local bias, which is of particular concern in terms of agency problems and information asymmetry in emerging markets (Hain *et al.*, 2016). In relation to that, as emerging markets are often characterised by lower institutional trust, there is a need for VC firms to get established and get geographical proximity to the investee firms (ibid.). Ahlstrom and Bruton (2006) further suggest that networks and the knowledge possessed in networks on the local markets are necessary in bringing value to the ventures, in which the VC firm holds investments. They argue that such relations are cultural-cognitive dependent, highlighting the need for VC firms to possess local cultural understanding. In particular, the cultural distance between emerging markets and developed economies creates differences on the business ethics inherent to the local setting (Ahlstrom & Bruton, 2006). Furthermore, as the socio-cultural environments in emerging economies are especially characterized by a younger population, an expanding workforce, and rapid urbanization they tend to differ largely from advanced economies, (Marquis & Raynard, 2015).

3. <u>Underdeveloped supportive industries are institutional barriers to venture capital in emerging markets.</u>

Underdeveloped supportive industries seen as market failures in emerging markets have been resulting in weak provision of assisting technological infrastructure for the VC industry. Key financial intermediaries such as accounting firms, credit rating systems and financial analysts are typically either absent or only marginally present, creating information asymmetries within the markets (Peng & Heath, 1996; Lerner, 2010). In relation to these institutions, Mason and Owen (2017) recognize that in developed markets successful nurturing of VC markets requires a holistic approach, which includes the entrepreneurial finance escalator, including pipeline development of new businesses. Supportive market institutions, as such, are often underdeveloped in emerging markets (Khanna & Palepu, 2010). In this notion, assisting intermediary institutions include the accelerators and incubators, but also complementary financial providers such as BAs, which serve to provide the VC market with a pipeline of investable ventures (Ekanem *et al.,* 2019). With regards to the financial markets, Grili *et al.* (2019) further emphasize the correlation between higher intensity and returns on exits on VC funding with a high stock market capitalization/GDP ratio, highlighting the importance of a developed stock market for VC development. Apart from an active IPO market for the development of VC activity, an active market for Mergers & Acquisitions (M&As) has been stressed as an expected determinant that may stimulate VC markets and optimise portfolio company exit value and recycling of returns into new investments (ibid.). Such supportive industries are often underdeveloped in emerging markets, affecting potential exit opportunities for VC firms (Ahlstrom & Bruton, 2006).

Other market failures have been further noted by Khanna and Palepu (2010) as the result of a lack of hard infrastructure, i.e. roads and ports, and soft infrastructure, i.e. the market institutions. Institutional voids, as the lack of developed infrastructures and formal market institutions that enable efficient business operations and effective functioning markets, forming barriers for firms operating in emerging markets (Khanna & Palepu, 1997; 2010). Additionally, emerging markets typically have less developed or inadequate technological and physical infrastructures as compared to developed economies causing specific issues for VC firms. Inadequate information and communications technology (ICT), commercial and transportation infrastructures, power generation capabilities, distribution channels, and low levels of education has specifically been highlighted as constraints to the firm's investment ambitions in these contexts (Arregle & Borza, 2000; Hain & Jurowetzki, 2018; Marquis & Raynard, 2015).

Summary of chapter 3.3

This chapter presents a literature review on financial theory of VC and institutional theory in emerging markets, and created a theoretical framework, in which we combine these strands of literature. Additionally, the theoretical framework is composed of three overarching propositions about emerging market characteristics and challenges that have been highlighted in the literature. In our theoretical framework, this is referred to as institutional barriers to VC in emerging markets. The three propositions, show in the figure below, will be used to assess the findings of this research, relate to the concepts of regulatory uncertainties, liability of outsidership and liability foreignness as well as underdeveloped supportive industries. For the first part, the deductive part, of our research question, we aim at exploring these propositions in relation to the empirical data to understand the impact of the institutional environment on VC and assess whether the literature of institutional theory really is applicable on the VC industry.

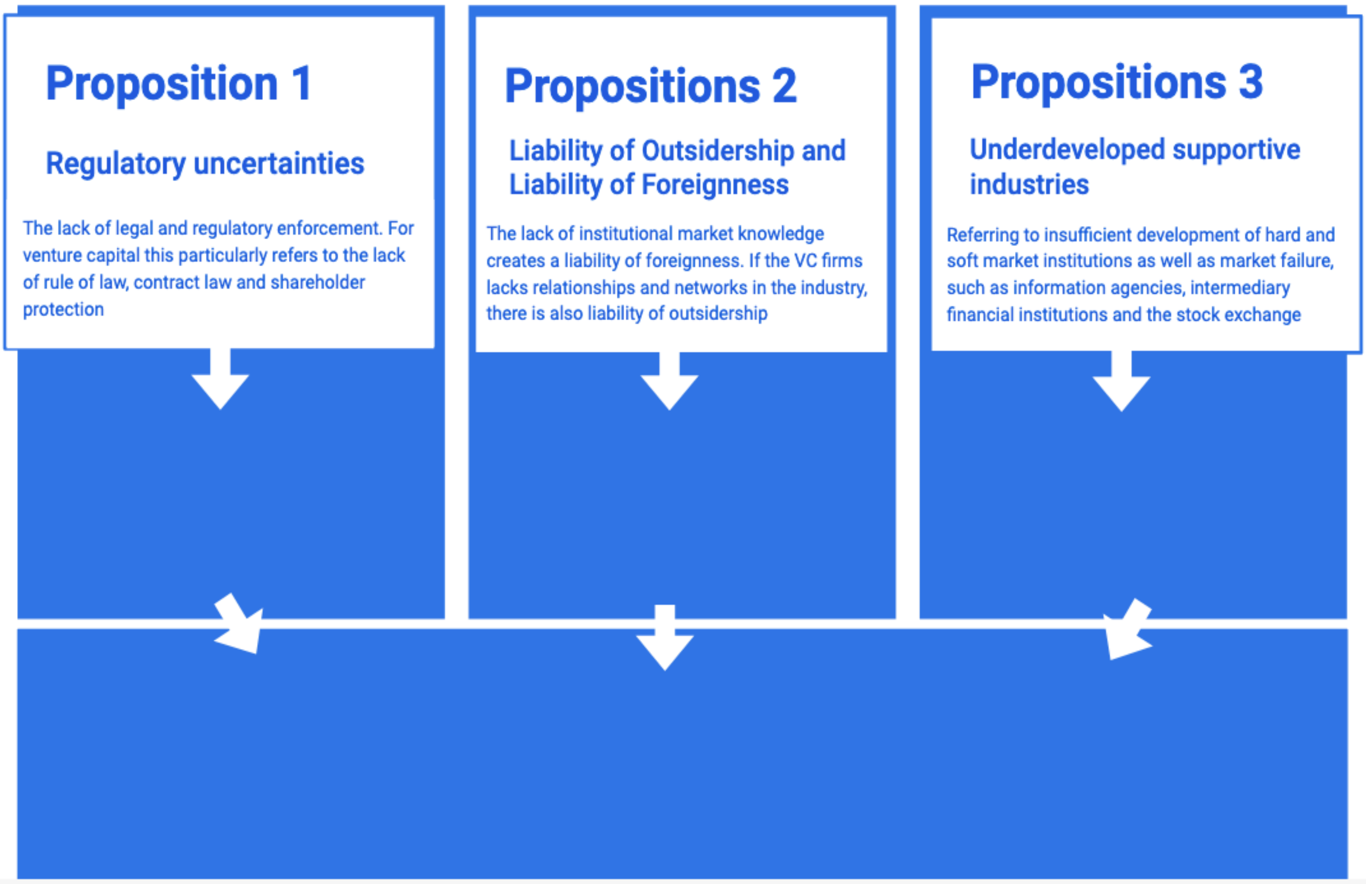

Figure 6: Illustration of the deductive process from proposition generation to empirical findings.

4 Introduction to the case study

The following section presents an overview of the venture capital industry in Kenya and the last decade's development. As such, we present the emergence of venture capital in Kenya, followed by an outline of the actors and recent changes in the venture capital ecosystem. Subsequently we present the case entities that constitute our multiple-case study.

4.1 Private Equity and Venture Capital in East-Africa and Kenya

4.1.1 Venture funding for digital lions

In the last decade Sub-Saharan Africa has seen a rapid upsurge in VC investments (Gugu & Mworia, 2016). From 2008 to 2010, nearly 60 per cent of investment in Sub-Saharan Africa was destined for South Africa. Regional hubs in Nigeria and Kenya were trailing far behind in terms of market share. In the aftermath of the 2008 global financial crisis, the region's growth story attracted an influx of private equity investors to Africa. The influx of foreign VC in emerging markets with limited indigenous VC firms drove an upsurge of growth-oriented, technology firms in these regions (Meuleman *et al.*, 2017).

Within the context of East Africa, Kenya became an increasingly important destination for private equity investors. New entrants into the African private equity scene looked beyond the increasingly crowded South African market, to explore other countries on the continent. Between 2013-2015, PE funds invested more than $750 million across nearly 50 deals based in Kenya. Thus, gaining some 15.5% of total Sub-Saharan PE investments, just behind Nigeria at 19.5% and South Africa at 28.2% (Divakaran *et al*, 2018).

	2013		2014		2015		Total		Total	
	# of Deal	Capital Invested (US$M)	# of Deals	Capital Invested (US$M)	# of Deals	Capital Invested (US$M)	# of Deals	%	Capital Invested (US$M)	%
South Africa	24	368	22	418	25	586	71	21.3%	1,372	28.2%
Nigeria	14	176	17	614	20	159	51	15.3%	949	19.5%
Kenya	**15**	**629**	**22**	**22**	**11**	**104**	**48**	**14.4%**	**755**	**15.5%**
Ghana	7	25	15	179	8	6	30	9.0%	210	4.3%
Cote d'Ivoire	7	14	4	38	2	N/A	13	3.9%	52	1.1%
Other	43	715	45	631	33	187	121	36.2%	1,533	31.5%
Total	110	1,927	125	1,902	99	1,042	334	100.0%	4,871	100.0%

Figure 7: VC investments into SSA 2013-2015. Adopted from Divakaran *et al.* (2018)

Briter Bridges (2020), an independent body that collects data on African investments, shows in their latest report that private capital investments in Africa in 2019 accumulates to $1.5 billion. More specifically on Kenya, leading African news media on entrepreneurship, Weetracker (2020) shows in their report from 2020 that Kenyan startups raised $428.91 million in 2019, placing Kenya as second to Nigeria in the amount received during the year in Africa, at a nearly 300% rise in investment volume from 2018. While almost nonexistent in the early years of private capital, low-income countries in Sub-Saharan Africa (SSA) nowadays account for a growing amount of international venture capital (VC) investments (Hain & Jurowetzki, 2018). The opportunities for African digital development has been popularized through epithets such as 'Lions go digital', suggesting that the huge generation of young, technology-savvy Africans could grow Africa's economy (McKinsey Global Institute, 2013., FT, 2018). Additionally countries such as Kenya and Nigeria have been proclaimed as the 'new emerging markets', particularly through the recent improvements in IT-infrastructure, IT-competence and the development of innovative tech-solutions, (Hain & Jurowetzki, 2018). The gross escalation is largely attributed to big-ticket deals of more than $40 million, where companies in Fintech, E-commerce, and Agritech top the charters (WeeTracker, 2020). Overall, the increased investments in Africa has been as the result of an increasingly positive outlook for African business environment (Roxburgh, 2010).

4.1.2 First there was M-Pesa

Over the last decade, Kenya has been rising as the top pillar for start-up growth in Eastern Africa. Platforms such as M-PESA, the mobile phone-based money transfer platform from 2007, have been described as stimulating a butterfly effect, acting as the *"the trigger and driver of a new ecosystem of mobile technological innovations"* (Manske, 2015: 14). Through other success stories of ventures such M-Kopa and Twiga Foods, the country has built a global reputation as a rich start-up hub, which has come to be known as the *Silicon Savannah* (Financial Times, 2019). As one of our interviewees puts it: *"We've seen a huge growth in software and tech businesses and then here in East Africa, Kenya has been the hub and is primarily been driven by strong infrastructure and mobile money, right? So mobile money to Kenya so you can see it in the trends right. FinTech is something that's done really, really well in Africa. And that's because more and more people have access to mobile money"* (interviewee 2 from VC 3, 2020).

Since 2010, several hubs for information sharing between innovative tech-entrepreneurs have been founded in Nairobi, Kenya, which later developed into numerous accelerators and incubator programs and gave rise to the technological ecosystem claimed to be the centre of African technological innovations (Manske, 2015). Following these developments, some of the largest tech-Multinationals such as Google, Microsoft, Nokia and IBM have opened branches and research centres in the capital (ibid). The illustration below has been adopted from a Vodafone report made in 2015, and although changes have occured since, it firmly illustrates the strong existence of accelerators and tech-hubs in the entrepreneurial ecosystem in Nairobi. And as many foreign VC firms set up regional offices in Nairobi, one interviewee expresses his impression of the development of the VC landscape: *"The ecosystem is quite rich and is quite interconnected, so you can meet people easily"* (interviewee from VC 2, 2020).

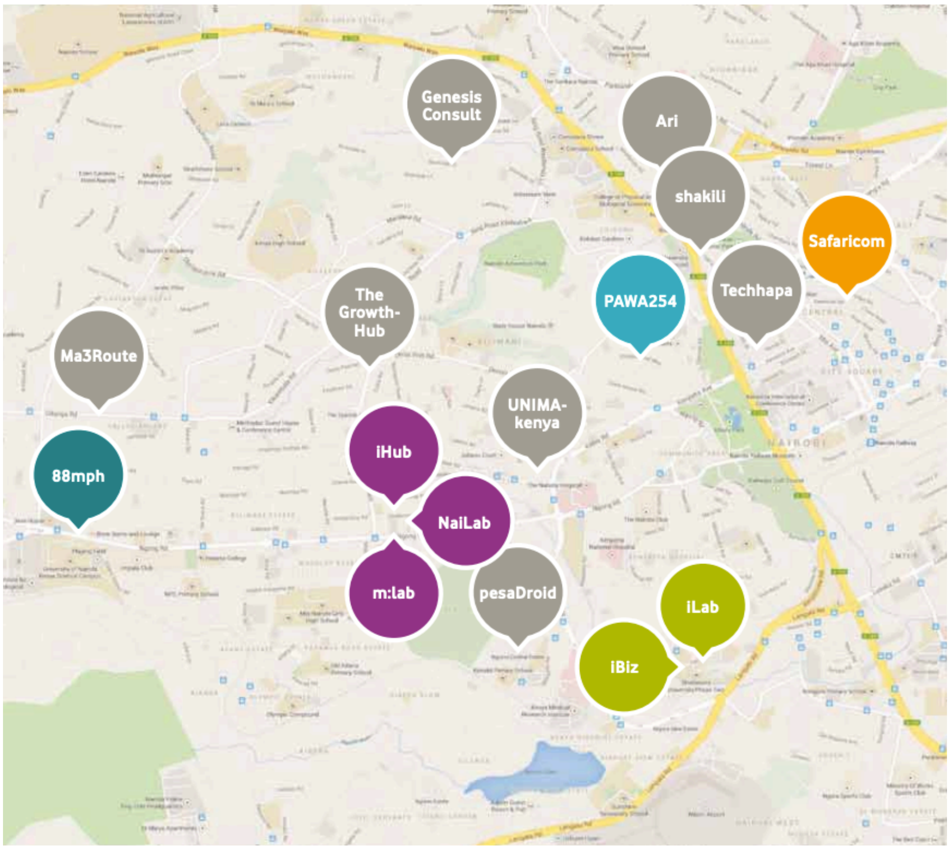

Figure 8: The rise of a technological ecosystem in Nairobi. Adopted from Manske (2015: 13).

Although 42 percent of the Kenyan population is officially unemployed, informal enterprises with innovative solutions for managing everyday problems are germinating everywhere (Manske, 2015). The combination of this constructive attitude, known as Jua Kali ("under the hot sun"), combined with the competences of the increasing number of local and foreign developers and technology experts that come out of Kenyan universities, creates a potential for creative business ideas, as mobile technologies open up new ways of solving numerous challenges (Manske, 2015). Hence, the reputation of Kenya as a global ICT-hub, holding a strong entrepreneurial class and good supply of human capital within the sphere has helped contribute to the hype of the Kenyan tech-scene (Ndemo & Weiss, 2017). As one of the interviewees stated: *"Foreign VCs are getting more and more turned on to the space [...] Africa is sexy for venture capital, because it's got the youngest population of any continent, the middle class is growing* *faster than in any other continent, governments and infrastructure is changing frequently. It's arguable that the African economy is growing, at an exponential rate. So good funds will be turned on to this [...] especially because a lot of high net worth individuals also want to start making a positive impact"* (interviewee 2 from VC 3, 2020).

4.1.3 Institutional Stability

Kenya has shown stability over the past couple of years. Recently, a much-hyped handshake between the President Uhuru Kenyatta and the leader of the opposition Raila Odinga in March 2018 has given an additional boost to the hope about the political stability of the country (Wilson, 2019). The growing economic development in the country reaches a GDP per capita of USD 2,127.42 in 2019, responding to a GDP growth of 6.62% (KNBS, 2020). Accordingly, this has increased the interest for foreign investors to enter the country (Chambers, 2019). Kenya's newly formed policies around protection of minority investors, online tax-system and strengthened access to credit by introducing online registration, modification and cancellation of security interests ranked Kenya 56th on the World Bank's Ease of doing business rankings in 2020 (The World Bank, 2020). Beyond offering relative regulatory stability, Kenya has long been known for its private sector-led economy, which has gained strong political support, both in an absolute sense, but particularly relative to the other economies of East Africa (Tyce, 2020). Additionally, The World Bank (n.d.) reports strong efficiency gains due to the online systems for tax filing and payments. Further, Kenya scores high in protecting minority investors in the 'extent of director liability index' by requiring shareholders to approve the election and dismissal of an external auditor (World Bank, 2020).

To promote investment in Kenya, the Government made substantial changes to Kenya's licensing regime in 2006, and reduced the number of licences required to do business, while making licensing regimes simpler and more transparent. Furthermore, in 2008, the Government reduced the number of licences required to set up a business from 300 to 11 (Africa Legal Network, 2015). Following Kenya's Constitution Article 40(5), the state is required to support, promote and protect intellectual property rights, whereas enacted legislations that protect the intellectual property rights include the Trademarks Act (Chapter 506), the Copyright Act (Chapter 130), and the Industrial Property Act (2001), which relates to patents, industrial designs and utility models. Internationally, Kenya is a member of the African Regional Intellectual Property Organisation and the World Intellectual Property Organisation (ibid.). Additionally, the Competition Authority of Kenya (CAK) is mandated to promote and protect effective competition in markets and to prevent misleading market conduct throughout Kenya (Chambers, 2019). Thus, showing that the Kenyan government bodies are focusing their efforts by putting several acts in place to protect foreign investors.

Other institutions that govern and support the investment scene include the Kenya Investment Authority (KenInvest), which is a corporate body established by the state to implement the legislations from the Investment Promotion Act, 2004. As such, it decides whether a foreign investor can become certified for investments in Kenya, and in 2015, this encompassed an investment size of at least $100,000 and an evaluation of *"the extent to which the investment will contribute to the Kenyan economy by increasing the number and quality of jobs in Kenya, training Kenyans in new skills or technology, encouraging economic development, allowing the transfer of technology, adding to tax revenue or affecting foreign exchange"* (Africa Legal Network, 2015: 9). In that regard, one of the interviewees further notes that recent changes made by the CAK encompass an exemption to the VC transactions from competition pilots, so they don't have to get regulatory approval to do investments that are less than $100,000, and hence are able to deploy without spending more money for regulatory filings (interviewee from the industry organisation, 2020).

Kenya's vibrant investment environment is centred around the Nairobi Securities Exchange (NSE). As of May 2020, the NSE had 67 companies listed in the stock market, showing little growth in terms of companies listing on the stock market through IPOs (NSE, n.d. a). However in January 2013, the NSE launched its Growth Enterprise Market Segment (GEMS), a new market which SMEs to raise on-going capital. The NSE included incentives for SMEs to list such as reduced requirements for listing, reduced listing fees, and reduced corporate taxes for listed companies (NSE, n.d. b) As of 2018, there are five companies listed on the GEMS, which are Atlas, Home Afrika, Nairobi Business Ventures, Flame Tree, and Kurwitu, showing a relative positive growth in terms of listings (Mbogo, 2018).

In relation to the government's efforts to attract more foreign investors to the country, a variety of legal and institutional changes have been made. Over the past years, some of the most notable regulatory changes to the VC industry include a regulation from 2015 that allows local pension funds to invest in private equity and venture capital, as such the first investment from pension plans in private equity took place in 2018 in an infrastructure project (Jacobius, 2018). As such it can be seen that the government has focused its attention in the last decade on promoting the regulatory environment and ease of doing business, particularly for private capital investors.

4.1.4 Actors in the Kenyan Venture Capital Landscape

The funds that constitute the private capital industries can be divided into distinct groups. First, there are private equity funds. Private equity funds invest in businesses ranging from SMEs and family-owned businesses to large pan-regional businesses that operate in Kenya, in East Africa, or across the continent. Such investments may include globally governed funds with dedicated regional teams for Africa and Kenya (Divakaran *et al.,* 2018). Other funds are regionally invested, focusing on firms within East Africa. At present, there are no PE funds that operate solely in Kenya. Second, beyond the set of traditional private equity funds, Development Finance Institutions (DFIs) are somewhat also competing for the same dealflow as the PE funds. A number of these institutions include large players such as the Commonwealth Development Corporation (CDC), the International Finance Corporation (IFC), the Danish Investment Fund for Developing Countries (IFU), the African Development Bank (AFDB), the Asian Development Bank (ADB), the European Investment Bank (EIB), the Islamic Development Bank (ISDB). The strong participation by DFIs in the market is not surprising; DFIs have often been among the earliest investors in private equity in emerging markets worldwide and have been crucial to providing a demonstration effect for the industry. They also provide governance, environmental and social best practices and serve as a training ground for the human capital that is required to start and manage successful investment firms (Divakaran *et al*., 2018).

As foreign VC firms are increasingly finding the industry attractive, the number of VC firms that invest in Kenya is growing. Our primary and secondary research shows that there are more than 40 VC firms investing in Kenya. Some of the most active VC firms in Kenya include: Acumen, DOB Equity, AE Ventures, AHL Ventures, Novastar Ventures, and TBL Mirror Fund. The few domestic VC firms that exist are: Grey Elephant Ventures and Savannah Fund.

Moreover, some of the most prolific accelerator and incubator programs include iHub co-working space, NaiLab accelerator, GrowthAfrica accelerator, Safaricom Spark Venture accelerator, Pangea accelerator, Antler global accelerator among others. In addition, AfriLab is a pan-African organisation that helps the accelerator programs and innovation hubs through knowledge sharing and capacity building (Afrilab, n.d.). Furthermore, aiming to build up Africa's startup community, VC4A was established in 2007 to create a platform for gathering the knowledge, capital and network that startups need to succeed (VC4A, n.d.). On their platform, entrepreneurs can gain access to the VC4A Startup Academy, mentorship opportunities and the ability to raise capital. Furthermore, the Baobab Network is highlighted by many interviewees as a promising new platform for gaining knowledge about what is going on in the VC landscape, as the platform publishes information on ventures, sectors and markets to its members, while also being and accelerator which provides capital to the startups in its cohorts (Baobab Network, n.d.). About the increasing amount of accelerator programs, interviewee 2 from VC 3 emphasizes that the environment is growing very rapidly. In fact, the growth might even contemplate the proximity and relatedness of the different actors in the VC landscape: *"there are so many accelerations that I just hear about, and I don't know about them. In theory, they should know about us, and we should know about them."*

In addition, there is a growing number of BAs in Kenya. The African Business Angel Network (ABAN) is a pan-African non-profit organisation that supports the deployment of early stage capital in startups across Africa. Since the launch in 2015, the number of

BA networks has grown to over 80 across Africa. BA networks seated in Kenya include Viktoria Business Angel Network, Intellecap Impact Investment Network (I3N), and 1000 Alternatives (ABAN, n.d.).

Summary of chapter 4.1:

In this chapter 4.1, we have shown that VC inflows have increased in East Africa, and that the VC industry in Kenya has seen some rapid changes over the past two decades. As such, the success stories of technology startups have spurred the development and gained international attention. We have showcased the main governing institutions to the Kenyan VC industry and highlighted the institutional stability that is increasingly being associated with it. As such the number of supporting actors within the VC industry has been flourishing in the last decade, including VC firms, accelerator programs and BAs.

4.2 Presentation of case companies

To get a representative understanding of the institutional barriers in the Kenyan venture capital industry and to get an awareness of how strategies can be used by the VC firms to overcome these challenges, different companies and organisations in the Kenyan VC landscape have been selected as case entities for our multiple-case study. As argued in the methodology section, we aim to get a representative sample of the population of VC firms through a selection strategy of maximum deviation. A total of eight cases have been included of which five cases are VC firms. Of the remaining three cases, one case is an accelerator, one case is a VC industry association, and one case is an entrepreneur with a startup in Kenya. Following the argumentation in the methodology section, the high number of cases implicates a thorough and descriptive presentation of each case. In this section we aim to give an overview of each case, their relation to the Kenyan VC industry, and an argumentation for including each particular case. See Appendix A for a summary of the case entities.

4.2.2 Venture Capital firms

Enza Capital, VC 1

Enza Capital is a Kenyan-based private investor in early-stage African technology companies. As a VC fund, Enza Capital is backed by private capital which specifically targets tech-enabled businesses that are "*trying to solve large and meaningful problems on the continent"* (interviewee from VC 1, 2020), as they look *"for solutions that can lead to positive social or environmental outcomes for Africa and our growing populations"* (Enza Capital, n.d.). The limited partners of Enza Capital are all foreign to Kenya, based in Europe and the US. While the capital that is invested is foreign, the team of investors are all local Kenyans and consists of a chairman, a CEO, and an analyst. We interviewed Anthony Kimani, the investment analyst, who mainly handles deal pipeline, screening and analysis, deal structuring, and in the event of investment, portfolio management and reporting. Although Anthony has agreed to be quoted, we will so forth refer to him as "interviewee from VC 1".

Set up in May 2019, it is the most recently registered VC fund out of our interviewees. Today, the portfolio already includes five investments of which four are Kenyan-based ventures and one is in Nigeria. Their ticket sizes range from $50,000 to 1 million dollar ranging from pre-seed to Series A. Their investments include Flair, an emergency response business focusing on logistics within healthcare supply, the startup Link, which provides a platform that connects informal sector workers to people in need of their services, Sendy, which is a quite popular logistics company in Africa, Tuteria, a net tech business based in Lagos, Nigeria, which connects tutors to students in need of tutors, and lastly Safi Analytics, which is a business that provides industry 4.0 solutions to manufacturing companies to help them improve their efficiency and efficient energy use. So while technology is a main investment focus, Enza Capital has investments in Logistics, Ed-tech, Healthcare-tech, and smart factory technology (interviewee from VC1, 2020).

Saviu Ventures, VC 2

Saviu Ventures is registered as a holding company that raises capital funding from external investors such as wealthy individuals, family offices and private equity firms. Within this structure all the capital is gathered under one 'umbrella', unlike traditional VC firms, which have closed-end funds and are supported by institutional investors as LPs. In Saviu Ventures there are no general partners but employees who run the various functions from deal sourcing to portfolio management. According to the interviewee from Saviu Ventures, who will so forth be referred to as "interviewee from VC 2", their structure gives them more flexibility and the ability to proceed with investments faster than an average fund, due to the lesser bureaucracy related to the investments. Additionally, the umbrella structure allows Saviu Ventures to exit the investment when it suits best, as the VC firm is not restricted by the certain number of years of a traditional fund cycle. Although their structure gives more flexibility, the VC firm has to raise capital from their investors almost on a yearly basis (interviewee from VC 2). The staff is from Europe and does not have a background within the financial world. While Saviu Ventures initially had their focus on Francophone Africa, the VC firm recently moved its focus to East Africa as they were *"tired of being the only ones doing venture capital over there"* and wanted to *"find some follow on investors that will join us in the adventure"* (interviewee from VC 2). Today they have offices in France, Mauritius and their main office in Kenya.

Saviu Ventures focuses on tech-startups but has through investments in Francophone Africa adopted an approach, which they describe as 'offline'. Instead of purely investing in tech startups, the VC firm perceives 'tech' as a long-term process or a 'mindset', as they look for startups that also are able to do things offline. According to their website, Saviu Ventures do not look for 'unicorns' but for 'gorillas', which they define as *"ambitious entrepreneurs who are building category-defining companies with solid foundations"*, including local roots but regional ambitions, B2B business models, post revenue companies, and strong unit economics (Saviu Ventures, n.d.). Over the years, Saviu Ventures has made eight investments and is now closing their ninth investment, which will be the fourth investment in Kenya. They invest at pre-seed and seed stages and hence focus on very early stage startups. Previously, they invested pre-revenue, but as the inflow of investable ventures have grown they invest in ventures with at least a few thousand USD of revenue per month. The ticket sizes of the first investments range from $50.000 to $800.000 but increase for the follow-up/bridging investments. Saviu's investments in Kenya include Swyft, which is a logistics platform that enables African brands to reach their end-consumers, and Lapaire Glasses, which is an eyewear provider for the African urban middle-class.

Chandaria Capital, VC 3

Chandaria Capital is a VC firm, which is part of the Chandaria Group owned by the high net worth family with the same name. As such, the VC firm can be categorised as 'family investment office'. Chandaria Group has been operational in Kenya and Eastern Africa for 60 years mainly through their primary business, Chandaria Industries which sells hygiene and tissue products. Today, they are one of the biggest producers of tissue and hygiene products in terms of market share within the Sub-Saharan region. Apart from Chandaria Capital, the group includes a separate entity for more mature investments, Chandaria Ventures, as well as an entity for property investments. Chandaria Capital stands out as the only VC firm amongst the interviewees with local LPs through the Chandaria family office. The VC firm has been operating in Kenya since 2018 and is composed of a team of nine venture capitalists, of which three are from the Chandaria family. The interviewees for this research was Bruce Nsereko-Lule, the investment principal, who will so forth be referred to as "interviewee 1 from VC 3", and Hamza Butt, an associate, who will so forth be referred to as "interviewee 2 from VC 3".

The VC firm's ticket size range from $150,000 to $500,000 and has an industry agnostic focus but aims at sectors with high entry barriers. Most importantly is the scalability of the firm as they make pre-series A investments. Their portfolio includes Cobo360, a logistics company that provides services for trucks to optimize transportation, SokoWatch, an FMCG distribution platform for small scale vendors, Safi Analytics, described earlier, the Savannah Brands, which produce snacks and drinks "*with a truly Kenyan kick*", and Mobius Motors, a car manufacturer for the African mass-market

(Chandaria Capital, n.d.). As a conglomerate, Chandaria Capital can test and scale up the investee's solutions in their own businesses entities as well as referring them to businesses in their networks, which *"proves to be very useful to a lot of companies that need business contracts and suppliers to provide them goods at subsidized rates and so on"* (interviewee 1 from VC 3, 2020).

Pearl Capital Partners, VC4

Pearl Capital is a pan-African VC firm, started as a holding company, that is currently running its fourth fund since its launch in 2005. The firm is categorised as an impact fund as investments are valued not only on financial returns, but also on socio-economic returns. All the funds have run across Africa focusing on social-, cultural- and financial inclusion. Focusing on SME-investments within the agribusiness industry, the fund's investors include the International Fund for Agricultural Development (IFAD), Soros Economic Development fund, the EU, and NSSF Uganda. Although Pearl Capital's currently running fund only holds investments in Uganda, the firm has in recent years invested in agribusiness ventures in Malawi, Mozambique, Ethiopia and Kenya, where they also host their second office. The ticket sizes range between $500,000 - $2.5 million, but increasingly the funds have focused on more scalable companies in the agribusiness, such as those in logistics services and cold chain facilities. Due to the high management costs related to each investment, Pearl Capital is focusing on making fewer investments to ensure a manageable portfolio of companies.

As the firm focuses on impact ventures, a vital part of their screening process includes an assessment specifically for this dimension. Some of the KPIs they look for therefore include the increase in household investment per dollar investment and the increase in growth earnings per dollar investments, in addition to a number of ESG criteria (Pearl Capital, n.d.). These criteria limit the number of opportunities, Pearl Capital can pick. Through the second and the third fund, Pearl Capital invested in 24 ventures across East Africa. One of the investments included Real IPM in Uganda, a company providing services for farmers to grow their crops without pesticides, and thus also improving their environmental impact.

The interviewee at Pearl Capital is Hiram Githuku, an investment Analyst, who has been with the VC firm for years and participated in previous funds across East Africa. So forth he will be referred to as "interviewee from VC 4". His responsibilities include deal sourcing, pipeline generation, screening, and portfolio management. The interviewee is located in the Kenyan office, but most of the team sits in the Kampala office, which constitutes the administration and the finance department, totalling around 15 employees.

Goodwell Capital , VC 5

Goodwell Capital is an international VC firm with a relatively long history of investing in emerging markets. Starting off focusing their investments in India before turning their focus to Africa, Goodwell Capital hosts their main office in the Netherlands and today has regional offices in Kenya and South Africa. The capital is sourced from LPs around Europe. The firm's GPs are based in the Netherlands while the employees in Kenya are associates and investment analysts. The venture capitalist, who participated in our interview is Joel Wanjohi, who sits as an associate. He has previously worked in the Kenyan DFI, Industrial & Commercial Development Corporation (ICDC). So forth he will be referred to as "interviewee from VC 5". Goodwell capital is currently running their fourth fund, which has a pan-African focus: from South to East to West. The first fund was launched in 2008 in India, focusing on investments in financial inclusion- and microfinance solutions. The second fund additionally aimed at investments in India. While the third fund was deployed across West Africa and South Africa. Goodwell Capital's office in Nairobi overlooks investment opportunities and portfolio management in Kenya, Tanzania, Uganda, Rwanda and potentially Ethiopia.

While the first and the second fund were predominantly focused at financial inclusion type of investment, the two latter ones have been presented as 'access funds'. This means that the ventures they are focused on are offering access to basic goods and services to the bottom of the pyramid (BoP). Apart from financial inclusion, this also includes agribusiness, mobility and retail and distribution. As Goodwell Capital usually invests at Series A and Series B, their investment amounts are larger than the other interviewees, ranging between $1 to $5 million, and the investee ventures are usually more established. Of notable investments in Kenya, the interviewee from VC 5 highlights Sendy, which has been presented earlier, and Copia, a shipping and delivery service provider for the BoP customers in Africa.

4.2.3 Industry Association

East African Private Equity and Venture Capital Association (EAVCA)

The East African private equity and venture capital Association (EAVCA), founded in 2013, is a business membership organization for private equity and venture capital funds that invest in East Africa. Their primary mandate is twofold. One is to showcase the investment opportunities of East Africa, presenting the region as an attractive destination for private capital. The second mandate is to create awareness of private capital and how it works. This is done across Kenya Uganda, Tanzania, Rwanda, and Ethiopia. EAVCA has about 100 members and their work consists of carrying out training around the functions of private capital works to the public sector, policy makers as well as entrepreneurs. As such the EAVCA is perceived as an official voice for the members, lobbying the state agencies that govern and support the VC industry in order to create awareness of issues experienced by the professionals. Hence, the industry association works as an interface between the region's stakeholders, the general public and the investors. In addition, EAVCA conducts industry specific research to be used for investors. Our interviewee at EAVCA is Eva Warigia, who is the Executive Director of the industry association. So forth she will be referred to as the "interviewee from the industry association". According to the interviewee 1 from VC 3, EAVCA is perceived as a useful instrument and media for affecting the law makers: "*I think the EAVCA is actually a very useful institution in the ecosystem because they look to do a wide range of activities and it's really to support the venture capital and private equity within these ecosystems.*"

4.2.4 Accelerator

Pangea Accelerator

Pangea is a business accelerator in Nairobi, funded by the Norwegian DFI, Norfund. Through its accelerator programs, Pangea provides technical support to startups. The accelerator ran its first program in 2018 and according to the website, more than 15 startups have successfully been through the cohorts (Pangea, n.d. a). Unique to its category in the region is that Pangea provides capital to the startups in the form of convertible loans, which can be converted to equity or debt after three years. Being aware of the investment gap that exists for local entrepreneurs in particular, the accelerator also hosts an investor program, which aims at educating foreign and local high net worth individuals in becoming angel investors. The investors are required to contribute with at least $13,000 in order to participate (Pangea, n.d. b). As the programs run simultaneously the investors will get first hand experience from mentoring and interacting with entrepreneurs, while the startups get additional mentoring from engaging with potential investors. As such, the investment platform connects the entrepreneurs with potential business angels.

At Pangea Accelerator we interviewed Anne Lawi, who is the country director in Kenya. So forth, we will refer to her as "the interviewee from the accelerator". The interviewee from the accelerator describes the need for exactly such a model: *"What we do is to provide information and create knowledge, a dissemination mechanism to the investors for them to understand why they need to invest as early as the business starts."* As presented in section 4.1.4, there are many accelerators and incubators appearing in the Kenyan VC landscape. A number of these accelerators are supported by foreign institutions, as Pangea is, and increasingly begin to co-invest in the startups, together with business angels, and provide grants to the startups, as Pangea does. Hence, the Pangea accelerator represents the population of other accelerators in Kenya on many parameters.

4.2.5 Startup

Social Bites

Social Bites was founded in 2017 by Johannes Traerup from Denmark, who is our last interviewee for the case entity in the multiple-case study. So forth he will be referred to as "the interviewee from the startup". The startup, Social Bites, is a dairy company that sells frozen dairy products called *milk pop* to the low-income earners. Locals join Social Bites as vendors, whereby they are being provided with the means to sell and the products on credit. Having sold the products, they return to the sales depot and are reconciled. The products are produced and packed in Nairobi and sold in the warmer climates in Mombasa, Kenya's second largest city.

The founder built the concept after having worked for many years with similar products in West Africa. In 2018, he was seeking his first official round of funding and went to pitch his business model for many VC firms in Nairobi, but eventually found that Social Bites was at a too early-stage for VC funds to enter. Consequently, he decided to look for BAs, and as this search took him back to his origins, he found three investors, two from Denmark and one from the United Kingdom. The investors came in over two rounds, the first one in July, 2018, and then the second one in July, 2019 at undisclosed amounts.

Summary of chapter 4.2

Chapter 4.2 presents the 5 VC firms, the industry association, EAVCA, Pangea accelerator and the startup, Social Bites, constituting the entities used for the multiple case study of this research. Each case holds unique characteristics, angles and insights, and together they provide a holistic view of the institutional challenges pertaining to the VC industry and the general process of early stage venture financing.

5 Analysis

Having presented the developments of the VC industry in Kenya as well as the case entities that have been selected for the multiple-case study, the following section contains the analysis and the presentation of our findings.

In the first part of the presentation of the empirical findings, we will answer the first part of the research question. As outlined in the research purpose and the research approach sections, this encompasses a confirmatory approach where the propositions are compared to the empirical data. Hence, the aim is to test whether the general assumptions about emerging market characteristics, referred to as institutional barriers, are applicable to VC in the case of Kenya. Moving forward in a deductive, confirmatory approach, we aim at examining the three propositions one by one, starting with *5.1 Regulatory Uncertainties*, followed by *5.2 Liability of Outsidership and Liability of Foreignness*, and lastly *5.3 Underdeveloped Supportive Industries*. In this deductive part, we take a point of departure in the literature as we structure the analysis around our propositions. We further use our primary data, which is constituted by the semi-structured interviews which have been coded and structured. As we present the data in the form of citations, we make references to data sources by referring to the interviewees according to their VC firm. An example is "interviewee from VC 1", which then refers to the interviewee from VC 1, as labelled in the presentation of cases-section. At the end of the first part, we present the findings in a summary table of the firms' perceptions of the institutional barriers in Kenya. In section *5.4 Qualification of findings*, we address the institutional barriers in relation to the severity, how they affect the VC firms differently, and at what stage in the fund's investment cycle they occur.

Thereafter, in section *5.5 Coping Strategies*, we take an inductive approach to the data, as we aim to explore what strategic implications these institutional barriers have had for the VC firms in Kenya. Hence we seek to answer the second part of our research question. In this inductive section, we look for patterns in the ways the interviewees express their operations and their strategic considerations. As such, we find it purposeful to include the data extensively to discover these patterns. These patterns are then presented as coping strategies to the institutional barriers found in the deductive part of the study. The inductive approach implies that we are not driven by any literature or existing theory, but are data-driven. We aim to see whether these coping strategies can be perceived as generalisations in a broader perspective.

The table below contains a summary of the institutional barriers to VC in Kenya as perceived by our interviewees, structured in accordance to the proposition and to each of the cases.

Inter-viewee	P1 Regulatory uncertainties	P2 Liability of outsidership & -foreignness	P3 Underdeveloped supportive industries
VC 1	Challenges related to political cycles, positive view on government's efforts to ease tax pressure and improve exit opportunities for private investments. Untrustworthy financial reporting.	Lack of investments in ventures founded by locals which ultimately implies that many ventures lack understanding of the local regulatory - and market specifics. Challenging due diligence processes if no local networks or local team.	Inadequate information sources, particularly in less popular industries. Insufficient grants and other early stage financial supporting mechanisms. More exit possibilities coming into place through supportive stock market regulations.
VC 2	n/a	VCs are heavily reliant on foreign networks that ultimately affect the later investment rounds and exit opportunities where less foreign networks exist. Challenge relating to local adaption of the ventures.	A lack of seed investors such as BAs. Lack of family friends and fools. Accelerators are not really sufficient. Not really aware of the accelerators. No opportunity for exits.
VC 3	Unsupportive legislative environment	Lack of technology skills and international best practices are constraining VC investments in local founders.	Sufficient information sources are being established. Insufficient accelerators, but improving. Not really aware of the accelerators. More education on venture capital is needed.

VC 4	Challenges related to election cycles. Tax regulation is beneficiary. Lack of governance, accounting standard and trustworthy reporting.	Disconnection between many entrepreneurs and foreign networks. Challenges relating to lack of local knowledge amongst foreign led investees. Lack of technological skills amongst the local Kenyan ventures.	Many information sources but coverage is not sufficient. Accelerators are supportive for deal sourcing as they reduce cost and time for conducting due diligence.
VC 5	Generally supportive government interventions. Challenges related to governance and reporting.	Challenges related to foreign ventures who lack local market knowledge. Ventures with local founders are disadvantaged even in relation to angel networks and donor funding.	Information from agencies is not sufficient. Lack of local LPs who can invest in VC. Limited options for exits.
Industry Association	Challenges relating to currency fluctuation due to political uncertainties. Opportunities relating to new tax benefits and less regulation for investors. Challenges related to enforcement of shareholder protection	Cultural differences are enforcing network barriers. Lack of local presence and local knowledge hinders the creation of adequate investment criteria	Lack of BAs. More local LPs are coming in to support private capital markets. Challenge with an information gap.
Accelerator	n/a	Need for local solutions and frameworks both from investors and ventures.	Lack of BAs. Describing how they are trying to solve this by offering education to investors.
Startup	n/a	Getting access to foreign networks will increase chances that you get referred to other investors. Lack of local knowledge can significantly hinder the scale-up process of ventures, in particular during the recruitment process.	Lack of BAs.

Table 3: List of institutional barriers from our findings as divided into the case entities.

5.1 Regulatory uncertainties

The first proposition derived from the literature as an institutional barrier to venture capital is summed by our concept of regulatory uncertainties. The proposition reads:

1. Regulatory uncertainties are institutional barriers to venture capital in emerging markets.

From the coding of our empirical data, we find three main topics relating to regulatory uncertainties. These include: 1) political uncertainties, 2) regulation and tax, 3) and corporate governance. In this section, we will analyse our empirical data in accordance to the categories listed above and investigate how the interviewees perceive these challenges.

5.1.1 Political uncertainties

The Kenyan VC industry is repeatedly described as affected by the political fluctuations in the country. Many interviewees emphasize this as a significant barrier to the flow of VC investments. This is because the life cycle of a VC fund of above 10 years potentially exists over several political regimes. The Interviewee from VC 4 emphasizes this issue, specifically highlighting the uncertainties relating to election times, mentioning, *"In Kenya, we are quite sensitive with the election cycles. Whenever we have general elections, VCs tend to shy away for that period."* As the effects of such political uncertainties can cause currency fluctuations, the interviewee from the industry association describes this as a barrier for the flow of VC investments in Kenya, stating, *"the returns will not be generated in hard currency. They are earning in local currency, and currency fluctuates all the time for developing countries like Kenya and will always be at a lower position than the hard currency".* Therefore, besides potential negative effects on the domestic markets, the uncertainty is also related to currency fluctuations. Hence, the political reforms are also highlighted as risky factors, forming institutional barriers to the venture capital industry.

5.1.2 Regulation and tax

In spite of some of the barriers relating to the political uncertainty, many interviewees express that the regulatory environment concerning tax is evolving positively. Regarding the current regulatory frameworks, most of the interviewees highlight a number of regulations and government interventions coming into effect to harmonize private capital markets. The interviewee from VC 5 expresses that *"If venture capitalists knock on their door and go to them, the government will be able to listen to them.* [...] *I think what Kenya is known for in the region is that the government doesn't really interfere with the private business, they work as hard as possible to attract any entrepreneurs and investors, which is also provided through the tax holidays and all those aspects of business."* Showing that the efforts from the Kenyan government set a good environment for VC firms to enter into the market.

The interviewee from the industry association highlights, in relation to their own work in lobbying the government, that one of the major successes includes the Competition Authority of Kenya's (CAK) exemption of regulatory approval requirements for VC transactions. In relation to the M&As, she further explains that another law exemption will decrease transaction costs for VC firms, "*then the outcome is that the time for the VC deal is shortened because you don't have to wait for a regulator to give you the 'go ahead'.*" The perception of the government as a supporter of private capital markets is thus gradually evolving as the government is introducing regulations which will decrease the transaction costs involved with VC, improving the ease of doing business within the sector.

Furthermore, many interviewees emphasized the tax exemptions which the Kenyan government has introduced have shown positive effects on the industry, in particular for facilitating stock market participation. The interviewee from VC 1 states, "*this is not just to encourage venture capital funds to participate because they have an exit route, but also for local investors to start participating as angel investors."* Showing that there is a general perception that the government is providing regulations, which seek to assist the VC industry, in this case related to exit opportunities and business angel investors. In addition, it is emphasized by the interviewee from VC 4 that the government is trying to make it feasible for the VC firms to register their funds in Kenya. He states that *"we have been exploring the option of instead of registering funds in tax haven countries, which end up increasing the administration cost of the fund, just to set up here. We have tried to use local holding companies. Then the government can provide concessional periods or tax holidays on investments."* As such, the interviewee shows that their fund is already reaping the benefits from some of these exemptions. In relation to the regulations in place and the tax exemptions given by the government, the interviewee from the industry association states, *"you can give them tax breaks, but if the underlying shareholder is not protected, not many people will be willing to take that risk."* Thus, she highlights that although the government is working to introduce a beneficial regulatory environment for the investors, there is still an issue around regulation and enforcement of the shareholders protection prevailing in the country.

In summary, although there appears to be diverging perceptions around the effectiveness of the financial markets, most interviewees perceive the efforts of the Kenyan government bodies to have a positive effect, enabling VC firms to operate more effectively in the market. Such as by decreasing the bureaucracy and the facilitation fees, creating options for domestic fund registration, making tax benefits, and improving the financial markets.

5.1.3 Corporate governance

Corporate governance is the effect of the regulations of a country around distribution of rights and responsibilities among different stakeholders such as the board, managers or shareholders, spelling out the rules for decision-making in corporate affairs. We find that most VCs highlight barriers relating to the governance as well as formal reporting mechanisms of the ventures. It is further perceived that this is an effect of inadequate institutional and legal requirements around financial reporting and structuring of the firm. The interviewee from VC 5 mentions that *"for the few [local] businesses you come across the big challenge is always in their corporate governance. [...] people are not accountable, they have some integrity issues which is a big problem for local businesses."* Similarly, the interviewee from VC 4 mentions the lack of governance in relation to why many VC firms end up investing in ventures with foreign founders. He states "*the issue of corporate governance makes people fear a lot of the ventures which are started by the locals",* highlighting that this is particularly a challenge when investing in Kenyan founded ventures. The interviewee from VC 2 further notes that the lack of formal reporting requirements is hindering proper due diligence processes and thus proceeding investments in local firms. As such, he asserts that "*a lot of them have data rooms, but most of them have a lot of information missing in that data room."* The interviewee from VC 4 further highlights this issue and its complications for the due diligence process, as some completely lack coherent reporting and accounting standards, noting that *"sometimes you will find that you know a founder who is approaching a venture capital with a few sets of accounts, which he prepared for the fundraising. Then they have another set of accounts which they prepared for the tax man, and a third one which reflects the actual position of the business."* He further argues that *"it's one of the challenges that we've been experiencing in the industry, someone shows the books just to impress you, but then if you dive into the business and you make a simple analysis of the value chain, then you will understand."* Hence, it is acknowledged to be a serious issue with integrity, transparency and reliability in some of the ventures' reporting and governance mechanisms.

Summary of chapter 5.1:

To sum up, we find a number of issues having an effect on the VCs relating the institutional barriers relating to regulatory uncertainties. Firstly, political uncertainties related to the election cycles create risks associated with VC investments in Kenya and uncertainty about the future market conditions. Secondly, shareholder protection was described as inadequate in the country. Despite this, many newly introduced regulations, in particular related to tax benefits, are perceived as favourable to the VC industry. Thirdly, a lack of formal governance requirements is causing issues related to reporting and accounting, particularly for local founders, thus becoming an integrity issue. This challenges the due diligence process for many VCs, as the information provided from the startups is not sufficient.

5.2 Liability of outsidership and liability of foreignness

The second proposition derived from the literature as a general institutional barrier relates to liability of outsidership and liability of foreignness. The proposition reads:

2. Liability of outsidership and liability of foreignness are institutional barriers to venture capital in emerging markets.

From our research, we find that most capital that goes into the VCs stem from Europe or the US. Additionally, most ventures that receive VC investments are founded by foreigners. As such the foreign networks are crucial to gain access to deals as well as to investors. We find tendencies that show that this becomes a constraining factor for the entire VC industry, as the lack of local knowledge infused in the industry affects the success of the ventures negatively. In addition, only a limited investment flow reaches locally founded ventures. Based on our findings we further separate this section into 1) liability of outsidership, where we explain the dynamics of these networks and challenges which arises due to lack of belonging 2) liability of foreignness, where we portray our findings in relation to the lack of knowledge on the local setting. The issue of liability of foreignness can be seen on two levels: whether the investor understands the local context, and whether the investee understands the local context. As such, much of this analysis will be focusing on the entrepreneurs as well as the VC firms in terms of liability of outsidership and liability of foreignness.

5.2.1 Liability of outsidership

It is evident that most of the VC firms in Kenya are funded by foreign LPs, or are run by foreign GPs, often from Europe or the US. As such, the VC industry is at large described as heavily dependent on foreign networks that invest in foreign-led founders. Although it is perceived that without the influx of foreign capital the VC investments are very limited, some interviewees highlight issues relating to this phenomenon.

In particular, gaining access to the foreign VCs is highlighted as a major threshold for local ventures. The interviewee from VC 1 states that "*local founders are disadvantaged to some extent by virtue of one not having these networks that most foreign founders have built from going to certain universities and educational institutions or working somewhere like Silicon Valley or just having friends. [...] For most local founders, raising capital is a challenge. Because generally Africa does not have a lot of local capital."* Thus, he explains that many investments are made into foreign-led ventures as an effect of their networks from their home countries, through educational and professional backgrounds whereas local entrepreneurs are facing challenges related to the liability of outsidership. In a similar fashion, it is acknowledged that local entrepreneurs have difficulties in gaining access to the networks of early-stage investors such as angels or donor agencies, the interviewee from VC 5 states *"What we are seeing is that the entrepreneurs, who are from the origin of either America or Europe, have good access to angel investors and some of these donors, but the local entrepreneur does not have the access to that. So there's a gap for that."* Additionally, the interviewee from VC 2 highlights that foreign founders are good at raising funds as "*they can sell the whole African story and then everybody gets excited."* Hence, it is prevalent that the gap for investments at an early stage, prior to venture capital investments, mainly pertains to locally founded ventures.

The interviewee from the startup additionally describes the way the foreign investor networks share information and investment opportunities, *"When you have a meeting with the VC firm and, they like you but they can't invest in you, they'll always try to refer you to someone else."* This suggests that referrals form a major benefit to those who can access the foreign VC networks. This again highlights that there is a network of investors and ventures, where foreign money is being invested into foreign solutions, and those outside the networks are in fact the local Kenyan entrepreneurs. The interviewee from the accelerator explains this phenomenon as culturally embedded, saying that *"If I'm being honest, familiarity attracts familiarity, and white VCs find it easier to give money to white founders."* The interviewee from the startup additionally emphasizes the importance of education, considering the fact that many foreign VCs only reach foreign ventures due to the quality of Kenyan education and the skill sets possessed by local entrepreneurs. He states *"I also think that it may come down to skill set. I mean, if you* *have a European education, you know, you've worked in Europe, you have the upper hand compared to someone who took the Kenyan education."* Hence, he explains that foreign founded firms are more likely to attract foreign investors as a result of their educational and professional background.

It is however highlighted that the foreign networks only extend to certain stages of the investment rounds, suggesting that this may limit the benefit of gaining access to such networks, in particular relating to exit opportunities on the investments. The interviewee from VC 2 states, "*but at some point, like when you become so big that no local African specialist funds can get into the rounds that you're organizing and your valuation is one of Silicon Valley, you're gonna get screwed."* This emphasizes a point about the risk of dependency on foreign investor networks, as these networks often do not provide exit opportunities in Kenya. Furthermore, it appears that an effect of the separation between local ventures and foreign investor networks is that VCs often end up lacking the necessary connections to gain information on the local market and local ventures to pursue due diligence. The interviewee from VC 1 states that *"and in areas where you do not necessarily have networks in those particular sectors, it becomes even more difficult to get access to this information."* Although most of the VC firms have employed locals in the investment teams as associates and analysts, the nature of the VC networks are rather foreign focused, and thus limited in information on the local setting.

5.2.2. Liability of foreignness

The fact that the majority of the VC investments are made in foreign founded businesses is repeatedly described as an issue for the VCs. Many of the interviewees highlight that the fact that most ventures are foreign founded is a topic of a heated societal debate. The interviewee from VC 4 states, *"people were worried if, as they are coming, are they coming in to kill the local entrepreneurs? Or are they coming in to promote local entrepreneurs? And, what are some of the synergies that we exploit from the process?"* As various interviewees are highlighting this on-going debate, we find it to be a symbol of the scepticism that still surrounds the VC scene. Although another interviewee highlights that there is generally being made more effort today in finding locally born ventures, many of our interviewees state that they do not have any particular strategy or interest in finding ventures with local founders. In that regard, the interviewee from the accelerator program highlights that, in order to find locally born ventures, VC firms must come up with different strategies for screening and deal sourcing, specifically in relation to the lack of the knowledge of the local market, *"It's not a cut and paste. Just because other things, other investor tools, and the way of doing things work in Europe or in Silicon Valley doesn't mean it will work in Kenya, or in Africa. We have very different market segments, and different nuances and you have to adapt and put in consideration those markets and nuances that come with this market."* As such, the lack of knowledge on the local markets in the foreign networks, gives rise to certain liability of foreignness, particularly for the foreign founded ventures where the lack of market specific knowledge is constraining the traction and scale-up of the VC firms investments.

It is argued that foreign entrepreneurs lack knowledge about the local markets and consequently try to sell some products or services or apply business models which do not match with the local context. The interviewee from VC 5 states, *"It's a challenge in one way or the other because sometimes when these foreigners come in, they try to come up with solutions which are Western, but the problems are here. Sometimes many of these fail, because they lack that local nuance".* This shows that foreign founders, who constitute the majority of the founders receiving venture capital, are facing challenges related to liability of foreignness.

In particular, it was shown that many of the solutions that the ventures are providing, are not fit for the local setting. The interviewee from VC1 stresses that foreign founded ventures often face issues specifically relating to the preferences of the local consumers, hindering the growth and success of their ventures. He states in relation to one of their portfolio companies that *"One thing they came to realise is that there's a certain standard of quality that's expected from the middle class in the country."* As such, the lack of understanding of the preferred quality amongst consumers hindered the initial success of the venture.

The interviewee from VC 4 additionally emphasizes the need for knowledge of the local setting, referring specifically to supply chains and business partners amongst the founders who the VC firms invest in. He states, "*You have to relate well with the value chain whether you're sourcing products from the farmers, you have to be able to relate well.*" Further emphasizing exposure to the local market and building trust amongst various business partners as important elements to navigate the local context. The interviewee from VC 1 additionally notes that some of the ventures they have invested in, have been facing this particular challenge. Telling the story of one American entrepreneur whose business they had invested in, "*He didn't have a good understanding of the local context, the local farmers, the local framework, the policies around land, policies around farming. He had good business acumen, but the lack of understanding the local market made the business drastically underperform within the first few years until we brought on board professionals who had good understanding of the local market.*" Showing that the lack of understanding extends merely market knowledge and includes how to navigate the regulatory environment, ultimately creating a liability of foreignness, forcing the VC firm to bring in external managerial support with local knowledge.

Additionally, the interviewee from the startup mentions that the level of local understanding will also affect the scale-up process of the ventures, which VC firms invest in, particularly during the recruitment process. He states, *"that means that there's no structures in place, there are no processes in place regarding how things should be carried out. That means that you get people who are not empowered."* Thus, he explains that staffing is another liability to foreignness facing the investee venture, in particular as many foreign-led ventures receive investments to staff a lot while scaling up rapidly. The lack of understanding of training and local recruitment obstacles is thus particularly constraining the success of the ventures. Furthermore, the level of digital and technological development in Kenya was noted as an area where VCs suffered from a wrongful perception of the local context. The interviewee from VC 2 mentions that "*We've seen some examples, even in our portfolio, where we made some wrong decisions, assuming that taking a digital approach would work and the market would adapt. It's not that easy. [...] We did lack local knowledge as investors about the fully digital approach* *and what you think the market is able to integrate when in reality it's not."* Hence, the challenges regarding local knowledge are not only pertaining to entrepreneurs but also to VC firms, who face barriers relating to the liability of foreignness in relation to understanding the level of digitalisation in the market.

The knowledge of the Kenyan market is additionally perceived as a major barrier to the investors in terms of building a well-informed criteria framework for their investments. The interviewee from the accelerator specifically highlights differences related to the level of information and understanding of the local business landscape. She mentions that this becomes particularly problematic when investors lack local presence and understanding of the market dynamics, stating that "*This happens if you're dealing with diaspora investors, because they are not in this market. They may have the business know-how and they may understand the principles of building a business, but they can't contextualize the dynamic of this market.*" The interviewee from VC 1 additionally stresses the importance of building local knowledge to support the creation of relevant investment criteria, stating that *"It is crucial to be able to build research on the different problems that the continent is facing and then you look at those businesses in that context".* Therefore, it can be said that the foreign-led networks creates benefits for the foreign founded firms who can more easily get access to investments through these networks. However, as many of these ventures face challenges relating to their lack of understanding of the local context, the VCs face barriers relating to monitoring and supporting their ventures. Additionally the VC firms seem to struggle gaining information on the local markets and regulations as an effect of being heavily centralized around foreigners who lack this particular knowledge.

Summary of chapter 5.2:

In relation to the liability of outsidership it can be said that most VCs constitute the epicentre of the networks and do not seem to be facing direct barriers related to the liability of outsidership. These networks are to a large extent constructed around foreign funded VCs and foreign founded-ventures and it can thus be said that the liability of outsidership seems to pertain with locally founded ventures who struggle gaining access to venture capital. An effect of this is that most ventures who receive venture capital are led by foreigners who lack knowledge of the local setting. Such liability of foreignness particularly relates to understanding the local consumers, business partners and regulatory framework, ultimately hindering the growth of the ventures, constraining the success of the VC firms' investments. Additionally, the VC firms, particularly the ones with limited local presence, face challenges related to gaining information on the local markets and ventures.

5.3 Underdeveloped supportive industries

Our third proposition deducted from the literature on institutional theory and venture capital in emerging markets concerns the lack of supportive industries and reads:

3. Underdeveloped supportive industries are institutional barriers to venture capital in emerging markets

From our study, we find that within this institutional barrier, there are four main categories relating to underdeveloped supportive industries. These include: 1) Information agencies, 2) intermediary financing mechanisms, 3) accelerator programs for pipeline development, and 4) exit opportunities. These barriers are ultimately affecting the amount of investable ventures and limiting the possibilities for exiting the investments, which are considered constraining factors to the VC firms. In this section, we will analyse our empirical data in accordance to the categories listed above and investigate how the interviewees perceive these challenges.

5.3.1 Information Agencies

Information agencies include private and public market institutions that provide information about new investable ventures, markets, and sectors. These institutions have an impact on the due diligence process conducted, in which the VC firm makes an assessment of the investee's business plan, its track record and the growth potential of the venture, providing industry benchmarks, trend reports and market insights. Between all our cases there is agreement that the level of information is not sufficient in terms of coverage of sectors. Additionally, interviewees highlight that there are various sources of information, but that these sources are inadequate, in particular relating to novel sectors. Nevertheless, many interviewees emphasize that new platforms could be changing that in the near future.

A number of interviewees highlight that there is an increasing number of platforms, such as the Baobab Network and Venture Capital 4 Africa (VC4A) are emerging. However the information from these sources is perceived as limited to those sectors, which have been the primary target for VC investments, and other novel sectors are rather uncovered. As the interviewee from VC 1 describes, "*You will find that if a sector is not popular, you will not find research on it generally. So, like FinTech EdTech, HealthTech, there's a lot of information on it, [...] but for novel sectors, or sectors that are just coming up, or solutions to problems that have not been thought of extensively you have to do primary research."* As such, he highlights the issue of intermediary agencies providing inadequate information on the industries that are not considered trendy, thus creating a barrier for the VC firms. In addition, we found that the reliability of the information provided through these platforms has been questioned. The interviewee from VC 5 claims that he has to use his own market intelligence to confirm the information he extracts from these platforms due to their private nature. As such he states, *"Can you rely on such information? And by this I mean, whatever piece of information you come across, you really need to use your market intelligence to see whether it's true or not. [...] it would make the due diligence easier and probably take a shorter period and be able to validate this information if we had a forum where all this had been gathered."* Hence, the reliability and the outreach of the information is an issue.

When the VCs are doing their due diligence on ventures that operate in sectors that are new, or rather unknown to the VC firms, they can to some degree use government bodies or donor funded projects from international organisations to acquire additional market information. The interviewee from VC 4 gives an example from an investment in seed oil in Uganda, where he would reach out to the UN agency, International Fund for Agricultural Development (IFAD), *"I am expecting that they would have access to some level of research that we probably don't have. So we would rely on the research that they have, since they are mandated to promote the seed oil industry and to catalyse the industry."* In that way, these institutions can be perceived as another information source. The interviewee elaborates *"So sometimes you work hand-in-hand with donor funded projects to get expertise from those who are doing research in the local market, and the government bodies come in handy around regulatory framework."* However, it is again emphasized that this information is not sufficient, in particular, as some industries are not covered in the current information mechanisms.

Although many different information agencies are established or currently being developed, many VCs perceive these sources of information to be insufficient to fully leverage the information for their investments. Hence, the information provided from these sources is not considered adequate and the VCs have to use their own sources of market intelligence to test the validity of the information. As we find this to be the case for many of the interviewees, we perceive the information level provided by various agencies as insufficient, creating barriers for VC in Kenya.

5.3.2 Intermediary financing mechanisms

Several interviewees describe that there is a need for more capital as well as intermediary financiers for the ventures that are in the pre-seed and seed stages. This is particularly important for ventures, as they need working capital to test their business model and get traction, as a matter of making ventures investor ready. The interviewee from VC 2 describes the need, as people with business ideas enter the scene knowing that they will not earn an income for a long period, *"so I guess in order to get more of* *those [entrepreneurs], we need seed investors. We need people who can write $50,000 checks."* The actors who could support the entrepreneurs at this stage are the 'love money', grant or investments by accelerators, other types of grants, and BAs. We find that there are challenges related to all types of early stage intermediary investors, particularly for the local entrepreneurs, which indeed create institutional barriers for VC.

Among our interviewees, there is a common notion pertaining to African entrepreneurs facing difficulties finding 'love money', otherwise perceived as a crucial financing mechanism for early stage ventures. Additionally, we find that most interviewees explain that this relates to the demographic and economic status on one hand, and a mindset, which is not culturally wired towards venture investments on the other hand. By this they refer to the lack of willingness to pursue investments in alternative asset classes, as traditional assets such as land and farming are perceived as more attractive. This in fact creates a difference on the level of opportunities between local founders and foreign founders, as the foreign founders usually have easier access to 'love money'. The interviewee from the accelerator states *"We don't have family, friends or a fool group where you can get investment because of the country and the demographic and economic status."* This notion is supported by several interviewees from VC firms.

As an alternative to 'love money', several interviewees state that more startups should turn their attention towards impact funding or grants as a solution to the investment gap. However, the interviewees also acknowledge that many entrepreneurs will not have access to these, and hence the grants are not perceived as sufficient to spur early stage financing, as they are currently being provided. The interviewee from VC 5 comments on the lacking effect of grants, as they to a high degree are sector-based, *"Yeah, there are some who have access to grants, but it depends on the sector, and who is trying to promote that sector. Not everyone has access to grants."* It is perceived that those grants should be provided more extensively to the early stage ventures in the pre-seed stage. Hence, the grants are not supporting entrepreneurs sufficiently as early stage financing as they are working in the industry today.

Even though both Pangea Accelerator and the international accelerator, Antler provide early stage financing to their incubees, many interviewees express an additional need for early stage financial support from accelerators which is not currently provided throughout the sector today. Interviewee 2 from accelerator 3 highlights Antler, hoping that more and more accelerators will begin to follow their example and provide the startups with a possibility to get capital: *"So when Antler is actually providing that money they give them some runway to go and raise money elsewhere and understand the value of using this money, cash burn, etc. And it's just bringing in good practice."* As such, it would appear that there is a need for this alternative of early stage financing to stimulate the VC industry.

Although BAs are traditionally the most common vehicle for early stage investments for startups, it is perceived by many interviewees that BAs do not provide sufficient financial support in relation to the financing gap in the Kenyan VC industry. In that regard, the interviewee from the industry association states that there are not many active BAs in Kenya nor in Africa in general, *"We do not have a very prevalent Angel community here. We do not have a lot of individuals that are angels on this part of the continent, pretty much most of Africa."* As presented in section 4.1.4, there are a few angel networks that are being established, but according to the interviewees, they do not appear to be very active yet.

In terms of getting the BAs more active, interviewee 2 from VC3 states that more education is needed as well as success stories to give high net worth individuals confidence to make investments into startups and SME instead of the traditional investments in real estate, general securities, government bonds etc. He states that "*There is money here. There are people here who can write Angel tickets, and who can deploy that money. It is just about investor education and experience."* Hence, more education on investing in the local context and creation of success stories seem to be what is expected before BAs become more active. According to the interviewee from the industry association, the EAVCA appears to work on aligning the investors with the expectations of what is required and getting a grasp of the reality for the startups. As such, the interviewee from the industry association argues that *"oftentimes the 'money* *people' may not know where the business side is sitting and the business side does not know where to find the 'money people'."* As such it can be seen that although there is currently a lack of early stage business angels, there are a number of facilitative mechanisms occurring in the industry.

Additionally, there is a specific program to educate BAs taking place at Pangea Accelerator. The investor program is intended to eliminate the investment gap for early stage ventures, as wealthy individuals can get training in becoming a BA investor. As such, local as well as foreign investors participate in a program that runs simultaneously with the accelerator program, where investors at the end of the program are presented with investment opportunities in the incube ventures. About the investor program, the interviewee from the accelerator explains "*What that does is it provides a better understanding of these businesses, their areas of weaknesses and how they can support them as investors."* A similar thing is taking place at one of the universities in Nairobi, Strathmore Business School, where VC is becoming a subject of research and has been added to the curriculum for some business programs. Interviewee 2 from VC 3 explains that *"there's a lot of other people who are taking action so for example Strathmore business school is trying a program where they are educating people on what this whole new asset class, the venture capital asset class."* Hence, we find that although initiatives are taken, such as the investor program, there is an institutional barrier with regards to intermediary financial mechanisms, in particular BAs. As the VC industry is still young and developing, there is hope and confidence that the market will accommodate the needs and that actors will come in and fill the institutional voids with different solutions.

Ultimately, the effect of a lack of intermediary financing mechanisms is reflected in the small number of ventures that are ready to receive a VC investment, particularly concerning the ventures and startups with local, Kenyan founders. Hence, this aspect is indeed perceived by the interviewees as a challenge, why it conforms with our proposition of intermediary financing is an underdeveloped supportive industry and an institutional barrier to venture capital in Kenya. The interviewee from VC 1 firmly describes the issue, "*There are a good number of startups, but a very small proportion of* *them are investable and again, it comes back to the limitations faced by the local founders. So the question you end up in is you have a very large pool of funds chasing a very small number of deals."* Hence, we highlight that there is an important institutional barrier related to the early-stage financing, which is underdeveloped in terms of growing the startups and making them more attractive for VC investments. It is highlighted that this lack of intermediary financing mechanisms is most severe for local entrepreneurs.

5.3.3 Accelerator programs for pipeline development

In general, not many VC firms use the incubators or accelerators for creating a pipeline of investable opportunities and sourcing their deals. This has mostly to do with the fact that the VCs do not perceive the ventures that come out of the accelerator programs to be investment ready as their business models and markets are not scalable enough to be attractive for a VC investor. Hence it is perceived that the accelerators do not seem to provide ventures with enough traction, revenue and growth potential within fitting industries to the VC firms. Using the analogy of the hockey stick growth, the interviewee 1 from VC 3 explains how exponential growth is often lacking among the ventures that have gone through the accelerators. He states, *"not every business that exists is a venture capital kind of investment. Not every business is gonna have a hockey stick."* As such, the interviewee continues to conclude that accelerators have not been perceived as fitting mechanisms for VC pipeline generation, *"So I think that's why they have so far proven not to be a necessary, good mechanism. [...] We are venture capital investors, so we are really looking for those scalable business models, and that kind of hockey stick kind of stuff. Unfortunately, that's not what kind of pipeline we have been getting from the accelerators."* The interviewee from VC 5 states that it particularly relates to the capacity of the entrepreneurs, *"I think there are too few opportunities in Kenya in relation to a number of investments in the region. And as I say, this is mainly because of the quality of entrepreneurs available in the country."* The interviewee 2 from VC 3 additionally highlights this issue, arguing that there is a lack of international best practices amongst the local ventures. Particularly, he argues that accelerators have not been good enough at providing these international best practices, hence, enabling knowledge transfers. He states that “*Some of the people that were running these accelerator programs were not as experienced or were not bringing international best practices, which is obviously super helpful for companies that are going to raise money from international funds in the future.“* As such, this knowledge is particularly highlighted as being useful for the ventures upon raising foreign capital. Based on our interviews, it is a common perception that the accelerators do not provide the VC firms with the right type of startups.

Nevertheless, some interviewees also highlight that there are improvements and positive aspects on various topics relating to the accelerators. As such it is highlighted from various sources that the accelerators help professionalise the startups. One example is the interviewee from VC 4, who states that he and his team have realised a benefit from using the accelerator programs for screening and deal sourcing, as they can reduce the time for carrying out the due diligence. This is because the accelerator has been able help the startup in reporting and become more professional, *“What we have come to realize is that sometimes it becomes much easier for us, as an investment team, to close deals which have come directly from an accelerator. If you look at the period of time we spend in a particular deal. It takes less time to close a deal that has come directly from an accelerator program.”* Thus, he argues that the accelerators have some resources available, which nevertheless assist the VCs in their due diligence process.

Even though our research has shown that the number of incubators and accelerators in Kenya is growing, not all venture capital firms seem to be aware of them. Many of the interviewees expressed their relationship with the local accelerators as inadequate, often stating that they do not know about them. The interviewee 2 from VC 3 highlights this issue, *“There are so many accelerations that I just hear about, and I don't know about them. In theory, they should know about us, and we should know about them.”* He consequently describes a lack of awareness about the operations of the accelerators, which quite obviously is a prerequisite for establishing a supportive and mutually beneficial relationship.

In summary, as we find that although there are some benefits related to using the accelerator programs in terms of shortening the due diligence, the accelerators are not perceived sufficient for pipeline generation, this supportive industry is underdeveloped and functions inadequately for the VC firms, and can therefore be perceived as an institutional barrier.

5.3.4 Exit opportunities

As we find that most VC firms operating in Kenya have foreign invests, most capital invested in the VC firms comes from developed countries and foreign DFIs. It is perceived that this capital has so far not been able to provide a sufficient amount of exit opportunities through acquisitions. It is acknowledged that the pension funds and other PE investors are currently not perceived as supporting the VC industry sufficiently to create opportunities for exits. Additionally, IPOs in Kenya are currently highly limited as an effect of an underdeveloped stock market. As a result, the exit opportunities are few, and the interviewee from VC 2 even claims, *"No, I found out that there are none."* However, as highlighted earlier, new regulations are enacted to facilitate the inflow of domestic capital to the industry and interviewees have some confidence that with time there will be more exit opportunities.

Reinforcing that the Kenyan VC industry is still too young to see the real picture of the opportunities of making an exit from investments, the interviewee from VC 5 argues *"When we look at VC in the region, it is barely eight years old, meaning probably you're starting to see the first type of exits coming in from this year going on. [...] The investment period is for most VCs between five to 10 years. So I think that time will be the best healer. I know as time moves on, to give us an opportunity to have more exit happening in the region and people making money from these VCs."* In an equal manner, the interviewee from the industry association is rather positive about the development of local LPs in the Kenyan private capital industry, as investments are beginning to come into PE funds. Referring to the law from 2016, she notes that *"We have been able to mobilize some local pension funds and insurance funds to invest in private equity as LPs."* As such, pension funds are increasingly looking into private capital markets. This may have a positive effect on the entire industry, as venture funds may find it more common to experience exits from their investments, as their shares in the investee companies could be bought by a local PE fund, in addition to other acquisitions.

In terms of exiting investments through an initial public offering (IPO), we find that this supportive industry is also highly underdeveloped and does not support the VC industry sufficiently. Looking at the investments that have been made in Kenya over the years, our secondary data does not seem to confirm any startup exits through IPOs. This has to do with the development of the public stock markets. This has been an issue for the VC industry associations across Africa. As such, the interviewee from VC 1 refers to EAVCA, stating that *"Some of the measures that the venture capital associations in the different countries are trying to promote are related to exits, which are a big problem in Africa, generally. Not many venture capital funds have managed to exit."* In particular, interviewees express little confidence for the development of a public stock market which could enable IPOs as the public does not have much trust in the stock markets. Referring to some IPOs that happened in the past, the interviewee from VC 5 states, *"People probably feel the information flow is kind of sometimes interfered with. [...] and we did see one or two IPO kind of crashing down from the price they started on and it crashed almost like a half price. So that kind of generated some fear in the public."* As such, the public markets are not working well in terms of providing exit opportunities for VC firms. However, several interviewees refer to a recent modification of the Kenyan stock market, the NSE, concerning a new segment called the growth enterprise market segment (GEMS) for SMEs with a book value of at least $100,000. This indicates that measures have been taken to make it more attractive to become listed, and supposedly that could lead to more information being distributed and increase the public's trust in the financial market.

Summary of chapter 5.3:

The industries and market institutions that support VC investments in Kenya are to a high degree underdeveloped and constitute an institutional barrier for VC investments. This concerns the insufficient information agencies, where the VC cannot get enough widespread and reliable data. Additionally, the lack of intermediary funding for startup financing rounds prior to VC investments, where especially BA investments and 'love money' serves a vital role, are highlighted as problematic for ventures with local founders. Moreover, the lack of exit opportunities, reflected in a poor public market and a low degree of pension funds investing in PE were perceived as an institutional barrier relating to underdeveloped supportive industries. The figure below illustrates the findings in relation to the propositions.

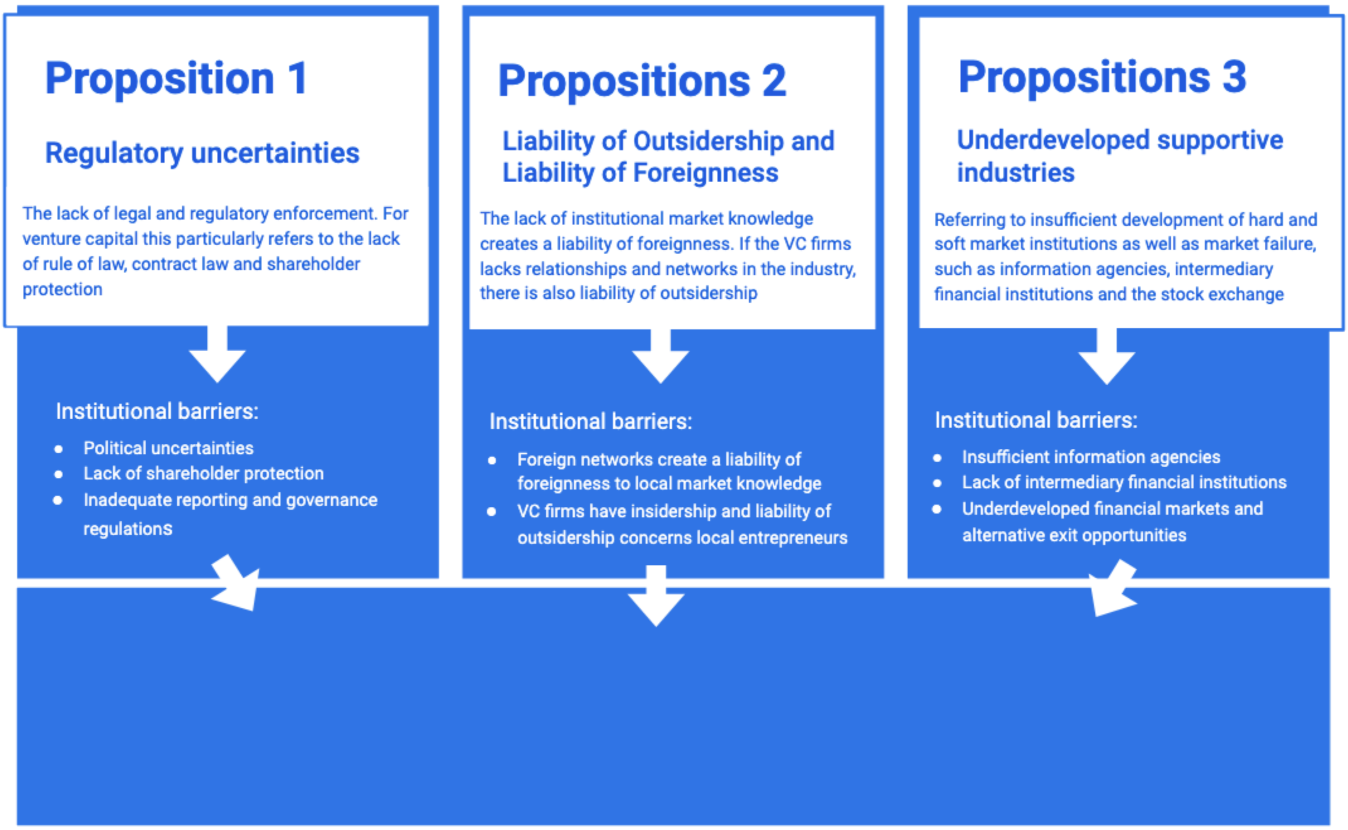

Figure 9: Illustration of the institutional barriers perceived by the interviewees. The figure illustrates the deductive approach to which we explore the institutional challenges to VC in emerging markets, in the context on Kenya.

5.4 Qualification of findings

The findings show that all VC firms, independent of fund structure and type of limited partners, face institutional barriers to some degree. These barriers were perceived as challenging for VC firms funded by family offices with long presences in the country, as for newly founded VC firms with foreign investors, as well as for impact focused VC firms receiving funding from large development banks. Thus, it is shown that the institutional barriers are widespread, causing challenges for all actors in the industry. We found however that these barriers pertain to the various stages of the VC fund cycle and that these barriers additionally cause varying degrees of severity to the VC firms depending on which stage in the funding cycle they occur. For example, the VC firms face the barriers relating to financial reporting and accounting standards particularly during the screening and deal sourcing stage. At this stage many VCs struggle with the reliability of information provided by the ventures, particularly local businesses that may stem out of family businesses or more informal business setups. Furthermore, a lack of governance and formal reporting mechanisms was also perceived as an issue of integrity during the screening and deal sourcing stage as well as during the monitoring and supporting stage.

Additionally our findings show that although there is a growing amount of intermediary information providers, most VCs do not perceive these to provide adequate information on the industry. Further, some VCs perceived the regulatory uncertainty, specifically relating to election cycles as a challenging factor. In particular the funding stages but also the investing stage of the venture may be complicated due to worries regarding stability in the country as well as lack of regulatory enforcing mechanisms. Moreover, our findings show that the lack of intermediary supportive actors such as business angels and accelerators are significantly hindering the development of early stage ventures, thus limiting the amount of investable ventures available for VC firms during the screening and deal sourcing stage. Apart from the financial aspect, our findings show that the lack of international business practices and technical skills is further limiting the effectiveness of these accelerators. Furthermore, exit opportunities were perceived as one of the greatest challenges to the VC industry in Kenya. Limited opportunities for

IPO, as well as larger PEs and other actors who could enable exits through acquisitions was additionally perceived as a barrier relating to the lack of supportive industries. As a result of these institutional uncertainties many VCs turn to foreign founded ventures who they perceive as better prepared in terms of providing accurate reporting, contractual obligations and overall higher degree of startup experience. Hence, the Kenyan VC industry is largely focused around networks of foreign founded ventures, causing liability of outsidership mainly to pertain to local founded ventures. Although the Kenyan VC industry is very young, our findings show that many VCs have struggled seeing their investments come through as foreign founders tend to lack knowledge on the local market dynamics and regulatory setting, ultimately constraining the scale-up and success of the venture, thus facing issues relating to the liability of foreignness. Although our interviewees did not seem to perceive the lack of investable opportunities as particularly challenging, many did see the lack of knowledge of the local market dynamics as constraining, forcing the VCs to support the ventures in getting their business models, products and services to fit the Kenyan market. Finally, although there is a lack of investable ventures founded by Kenyans, networks around foreign founders present an adequate amount of investable opportunities for VC firms.

5.5 Coping Strategies

Having answered the first part of the research question related to the institutional barriers to venture capital in emerging markets, this section answers the second part of the research question, "*and what strategies do venture capital firms use to overcome these?*" Based on our analysis of primary data, we find patterns from the VC firms that pertain to how they cope with some of the institutional challenges. As such, to discover these patterns, we find it purposeful to include the data extensively and present multiple quotes in the analysis. We have found four strategies, which VC firms use to circumvent the issues relating to institutional barriers. The section below starts by outlining the institutional avoidance strategies which includes strategies where the VC firm seeks to avoid dealing with the local institution. Secondly we proceed with the local knowledge-capturing strategies, which includes the strategies that firms adopt to gain local knowledge and circumvent issues mainly relating to the liability of foreignness. The third type of strategy we call diversification strategies, including strategies that firms may adopt to spread the risk related to political uncertainties. The last strategy includes strategies specifically focusing on overcoming the issue of lack of governance and formal reporting. Combined we find these strategies to deal with specific institutional issues relating to the VC fund cycle.

5.5.1 Institutional avoidance strategies

We found that as a result of the institutional barriers such as the lack of reporting standards, inadequate supportive industries and regulatory uncertainties, many VC firms turn their investments to foreign founded ventures. It is perceived that foreign founded ventures are not as heavily affected by the institutional barriers and are thus better structured in terms of governance and formal reporting and hold an overall better preparedness in terms of professionalizing and scaling startups. As such, foreign networks are crucial to take part in in order to cope with institutional barriers. Such networks were perceived as particularly important during the screening and deal sourcing stage of the VC firm. Interviewee 2 from VC 3 explains that *"Primarily we will get them [the deals] through our networks, because we have extremely strong networks between the three of us [...]. We have really, really strong networks."* He therefore emphasizes the need for networks in the Kenyan VC industry. Leveraging networks to overcome the issue of inadequate information was particularly highlighted in relation to screening and deal sourcing. The interviewee from VC 1 states that "*You have so many other related venture capital funds who have done due diligence and they have shared this information with co-investors and so details of this particular sector in different countries is known."* Describing how their screening and deal sourcing process is facilitated largely through the information they get from their network belonging. This notion was additionally highlighted by the interviewee 2 from VC 3, who explains, *"Networks are fundamental. I mean, you can't find deals without a network. To look at ourselves, we're a* *generalist fund, we are sector agnostic, so we have to build a network. It would have been pointless to be a generalist fund and not have a network of people across sectors."* As such, it is emphasized that the need for networks to overcome the information gaps is particularly important for industry agnostic firms. The interviewee from VC 5 explains that their own due diligence process is heavily reliant on their networks for trustworthy information, stating in relation to the issue of lack of corporate governance and reporting that *"Yeah. It does affect due diligence, and that's why probably before we do the due diligence, we really have to look at a number of sources of information from the experts point of view, (..) which is why we try to gather as much as possible through our network."* He emphasizes the importance of networks and the information they may provide in order to overcome the challenges related to faulty reporting and information on the ventures performance.

Apart from providing information, networks are also described as direct sources for discovering deals. If one investor is approached by a VC but may not have the possibility to invest at that particular time, he/she may refer the venture to another VC within their network. The interviewee from VC 4 highlights that connections and relations to other investors is the most useful method for screening and deal-sourcing, *"Referral comes in handy, investor conferences, subsector marketing, you map out and identify some of the companies operating in a particular sector and then, you know, you pay a visit. The fact that we've been in the industry for more than 15 years, also gives us an edge when it comes to sourcing deals. I mean, we've created a good name, within the networks."* As such, we find the network amongst VC firms as crucial. The networks of founders were additionally highlighted as important sources for deals. The interviewee from VC 1 states that *"Our approach to generating deals and originating them is basically building this network with the founders."* Consequently, he highlights the importance of networks, not only between the VC firms but also amongst founders. In relation to screening and deal sourcing foreign founders networks are crucial, as most VC firms perceive these ventures to be less affected by institutional challenges, thus avoiding these by focusing on foreign founders. The interviewee from VC 1 states, "*One way to do it is to take a proactive approach. So you trace back, basically how these businesses are started. And you will realize most of these businesses are actually started by foreign founders. So you can* *either start by building a network of other founders who have actually already built businesses in Africa or building a very good relationship with some of the top venture capital funds in the market. And so you can always follow up on any investments or get wind of a deal from some of the founders before it blows up and is quite popular."* He thus states that as many of the ventures in Kenya are foreign founded, these networks and connections are crucial for finding investment opportunities. Getting into the networks of the successful founders is highlighted to be quite feasible, as the VC would get to know about future investment rounds directly from the founders.

The key to join such networks is perceived to include long experience in the industry. The interviewee from VC 5 states that *"Like myself, having worked in the sector for long, I'm looking at a particular VC, which is in a certain area, I probably have a couple of guys who I might reach out to, and try to gather information for the sector, their expertise and all that."* Thus, he stresses the need for experience within the sector. It could therefore be a particular strategy for VC firms to recruit local staff with experience in the industry, to gain access to these networks. Furthermore, networks were also considered as a vital source of agency against regulatory bodies and the government. In relation to the importance of networks in influencing the policy makers and regulation, the interviewee from the industry association states, "*Relationships are what makes the VC ecosystem work. People invest into other people based on the relationships they hold. So If you can get relations with the policymakers or the regulators, it is just one other measure that helps you to do your business more effectively in terms of, you know, the right person to call to get things done."* Hence, the importance of connections with local government agencies to ensure a smooth regulatory environment is emphasized. The collaboration between these network partners extends purely information advantageous to include cooperative efforts to spread risks. Moreover, the interviewee from the industry association highlights the benefit of co-investing with other VCs as a strategy to spread the risk stating that "*Most of them will do club deals to spread the risk."* Hence, club deals between two or more VCs from the networks are suggested as an appropriate way to deal with the risky environment.

5.5.2 Local knowledge-capturing strategies

It was perceived as necessary to recruit locals to the investment teams of the VCs to gain access to local market intel and understand the challenges facing the Kenyan market. The interviewee from VC 5 states *"VCs who don't have a consistent presence in Kenya and are still [investing] remotely from Silicon Valley are failing because the problem was probably that the solution was not a local solution. So something is working either in Silicon Valley or somewhere in Europe, which they are trying to plug into Kenya(..). We are quite careful on that, and that's why we have a local team."* Thus, having a local team is considered crucial for investors to navigate the local setting. In light of the benefit of local knowledge, the interviewee from the accelerator additionally states "*If you're an investor, and you're guided by someone who understands the market, then you're able to see the business opportunity, you're able to clearly see that business model and how they can sustain themselves and how they can scale to other markets."* Which refers to the advantage of having staff who understands the local environment. The interviewee from VC 4 further states, in relation to the importance of having a local team that "*One of the reasons why we see ourselves as competitive and that we have an edge is because our team is local. We understand the local environment, we understand the local challenges of these entrepreneurs."* This was particularly highlighted as a necessary strategy to adopt, relating to the screening and deal sourcing process of the VC. The interviewee from the industry association additionally mentions, "*the LPs will be foreign but the boots on the ground will a lot of the time be locals. Again, for the same assumption that you know where to go to get deals as a local you know, how to understand how the markets work as a local, and how to evaluate the product or service in the market to realize the potential returns of the investment. [...] In particular, they want to use the club's deal space to also learn about how to do business in the region."* relating to the importance of recruiting locals for the investment team.

Considering one of the most common pitfalls of VCs and the ventures they invest in is the knowledge of the Kenyan market context, gaining such knowledge is considered crucial. In relation to this, it was widely acknowledged that in order to circumvent some of the local challenges and understand the local setting, VCs need to invest in local firms. The interviewee from VC 2 states, "*My feeling is that if you want to be relevant, you want* *to invest in local founders because they just know the place. You know, I wouldn't trust a Kenyan guy to build a venture for French people. I guess it is the same way the other way around. Even though, of course, if you have lived over there, you have experienced the people and their habits. It makes you more and more relevant throughout the years."* He further argues that *"I've met a lot of foreigners that were not giving us a good feeling and I met a lot of local people that were not giving us a good feeling. In our portfolio we have a mix."* He thus highlights the need to include both foreign and local ventures in the portfolio to spread the risk of liability of foreignness. The interviewee from VC 4 added to the importance of including both foreign ventures and local ventures that, *"we leverage a lot on their understanding of the international market and if the foreign founders get to meet with local entrepreneurs who have a good understanding of the local environment then it's always a very impactful partnership."* Thus, the need for investing in local ventures that hold specific knowledge on the Kenyan market is emphasized. In relation to overcoming the challenges related to retrieving information about the markets and sectors, interviewee 1 from VC 3 states that *"I think you have to be a bit proactive to get it. Like I can't go to a government desk today to ask [...] but if you get into the right networks and meet the right people."* Hence networks and the intel they may provide can help VC firms overcome institutional barriers relating to information asymmetry. Apart from VC networks and founder networks, connections to industry experts were also perceived as an important strategy for overcoming the challenges related to the lack of information on the industries.

5.5.3 Diversification strategies

In order to spread the risks associated with investing in Kenya many interviewees highlight the need for investment diversification. To diversify risk and not being too vulnerable upon a single market, the interviewee from VC 4 emphasize the importance of being risk averse in terms of diversifying investments across industries and countries in the region stating that "*If I were to advise on developing or raising funds within East Africa, then it would be ideal to have a multiple country focus, it would also be ideal to not to limit yourself into one sector. It would make more sense in terms of the de-risk profile and also diversifying your portfolio*." Accordingly, he proposes that spreading risks over not only industries but also countries is necessary to overcome the challenge related to institutional risk. The interviewee from VC 4 particularly highlights the importance of such diversification in relation to the uncertainty in the region stemming from the election cycles, arguing, "*It's always uncertain what will happen. We are trying to overcome that through investments in diversified geographies. You know, having some investment in Kenya, Uganda, Rwanda, Tanzania, which have different election cycles."* Highlighting the political cycles as particularly challenging, and investing in various countries as a particular strategy to adopt to overcome this challenge.

5.5.4 Governance strategies

One of the most evident challenges facing the VC firms is relating to the governance and reporting of the ventures, particularly during the due diligence and screening stage. We found a number of measures that the VCs are taking to overcome these challenges. Relating to the issues of governance, the interviewee from the industry association emphasize the importance of training the entrepreneurs, stating their own involvement in this as focusing on *"carrying out training to the communities around how private capital works or specific fractions of private capital like how to build structures such as due diligence."* Such training is additionally required from the VC firms. As many ventures are lacking routine in relation to reporting and their financial information some VC firms are forced to take on a supportive role, which extends their otherwise strategic support. The interviewee from VC 5 states that "*Even if we try to look at it from a strategic point of view, we often get in touch with these ventures almost on a weekly basis, where we'd be meeting and brainstorming on the best way to handle such procedures.*" Thus, the importance of taking an active role in the ventures to ensure coherent and professional reporting procedures is emphasized. Additionally the interviewee from VC 4 highlights the need for the VCs to take an active role in the companies stating that, "*these are integrity issues so you have to raise it with the management."* Further he mentions that the key to success is the founders' acceptance on such involvement from the investors, suggesting a careful approach to training the founders on these matters. He further emphasized the need to build trust to overcome this challenge, stating, *"You have to earn their trust to access the real original books of* *accounts, which speaks to the business performance, because that's the only way you're going to have a viable investment decision."* As such, it is shown that trust is an important cornerstone in the relationship and cooperation between the VC firms and their portfolio ventures.

Summary of chapter 5.5:

In this chapter we have explored the coping strategies used by the VC firms to overcome the institutional barriers in the industry. In doing so, we took an inductive approach to the empirical data, as we looked for patterns in how the VC firms were operating, based on the interviewees' considerations and statements. Through this process, we identified strategic and operational implications, which we have summed under four main types of strategies. These are Institutional avoidance strategies, Local knowledge-capturing strategies, Diversification strategies, and Governance strategies.

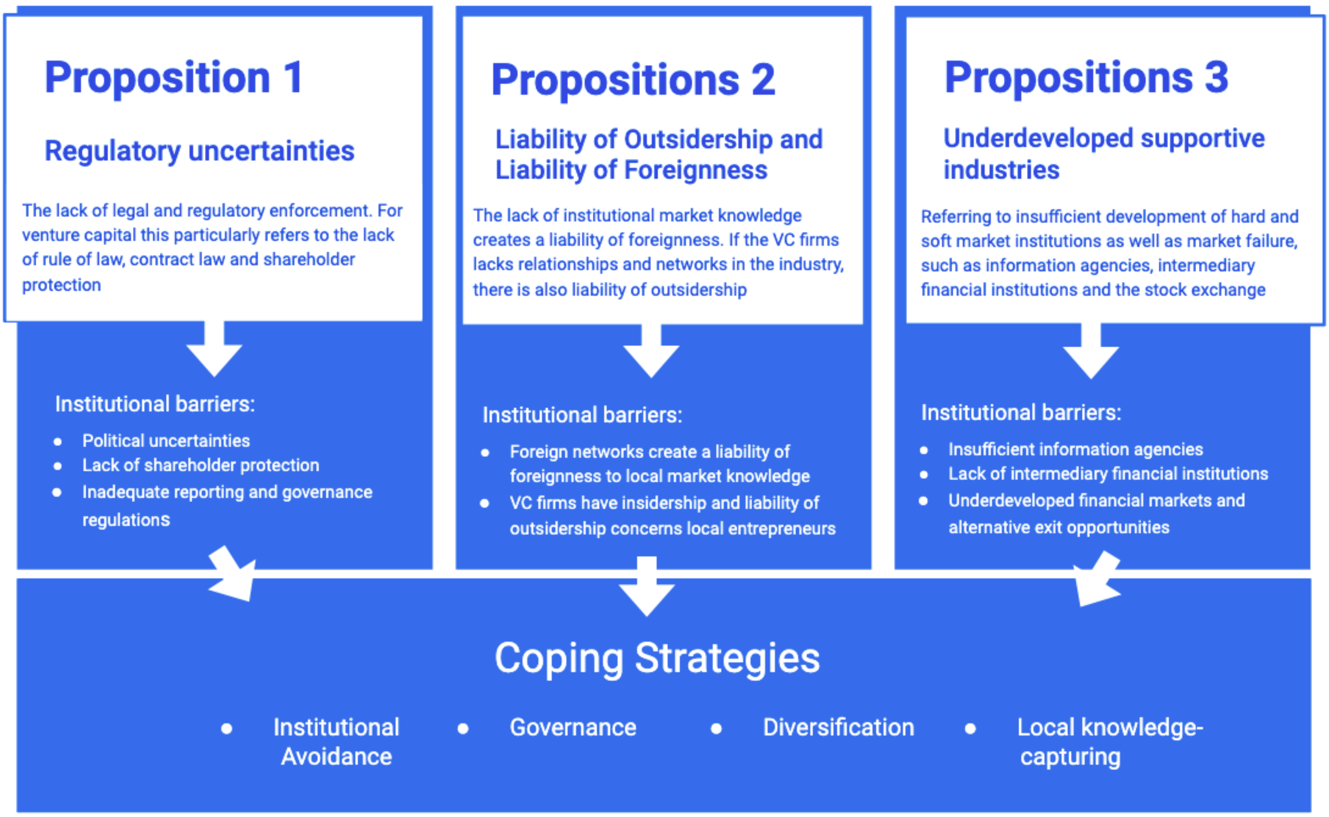

Figure 10: Inductive approach from barriers to strategies. An illustration of how our deductive approach to institutional barriers in emerging markets has been followed by an inductive approach to exploring the coping strategies used by VC firms.

6 Discussion

The theoretical and strategic implications and contributions of the findings is discussed in the following sections. How the study contributes to knowledge on institutions in emerging markets and their implications for the VC industry is delineated, followed by insights on how the findings can be translated into focus areas for policy development. Subsequently we provide a critical assessment of our research method and approach.

6.1 Empirical Generalisations

6.1.1 The lack of capital in emerging markets

With regards to the underlying premise of this research, that there is *a* lack of capital hindering the flow of investments and the growth of SMEs in emerging markets, our primary data raises questions around this premise. In particular, our research highlights the importance of acknowledging the complexity and the roles of institutions in the discussion around unlocking capital in emerging markets. In relation to venture capital, we find that there is an abundance of capital and that the number of VC firms in the industry is reaching saturation in relation to the amount of investable ventures in Kenya. Hence, our findings show that there is a lack of investable ventures, particularly ventures tied to the local population through local founders or managers. It is shown in our findings that these ventures suffer particularly from the liability of outsidership as an effect of institutional barriers such as lack of reporting standards, early stage financiers and adequate technological support. Thus, it is our finding that the appraisal of Kenya as the startup hub, *Silicon Savannah,* mainly points to the development of foreign founded ventures. Despite also facing particular challenges related to liability of foreignness it is emphasized in our findings that such ventures have the capacity of circumventing institutional barriers in Kenya much due to the effects of institutional stability in their home countries; relating to their overall governance and reporting standards, early stage financing support through business angels and well established accelerator programs, in addition to their strong networks stemming from educational and professional backgrounds.

Therefore, our findings show that the perception of a lack of capital, as the overarching challenge to SME growth and economic development, requires further investigation. in particular around the institutions which support this development. Acknowledging that the issues surrounding VC investments in developing countries and emerging markets are complex, we see our findings to be an important contribution. As in fact many international organisations and development programs take their point of departure in the very same premise about a lack of capital, this finding from our empirical analysis is an important contribution to academia and to the public debate about the correlation between early stage investments and economic development in developing countries and emerging markets.

6.1.2 Institutional barriers and strategic implications

By assessing the validity of our propositions, we bring forward unique empirical findings, which connect previous contributions to institutional theory in emerging markets with challenges facing the actors in the VC industry. Additionally, our research discloses aspects of previous contributions to institutional theory, which our findings have revealed as less prevalent in the context. As such, we highlight that some institutional challenges are more significant than others in relation to the VC funds life cycle. The lack of capacity around acquisitions and IPOs heavily influences the VC firms' ability to exit their investments. As such, the exit opportunities currently held by foreign VC networks are portrayed as limited. Despite positive attitudes among the VCs on the recent tax reformations, political fluctuations and regulatory uncertainty is increasing the perceived risk to invest in ventures in Kenya. Particularly, inadequate governance and reporting requirements and capacity building organisations as well as the lack of early stage financiers such as business angels are barriers to proceeding investments in local ventures. To cope with these challenges we find that VCs seek to diversify their risk by investing in numerous industries and countries. Additionally, our findings show that

VCs are increasingly investing in foreign founded ventures, perceived to be less affected by institutional barriers. Although this may give rise to some initial liability of foreignness, many VCs cope with this by inserting local teams with the capacity to support their ventures in navigating the local context. We do find that the sustainability of proceeding with an investment strategy that largely focuses on foreign ventures was questioned. Not only because of the societal debate, which this phenomena pertains to, but also the capacity of long term business success these ventures may achieve considering the liability of foreignness, which the founders are facing in relation to product-market fit.

Furthermore, we perceive our findings to contribute to the discussion about venture capital as a supporting mechanism to entrepreneurship and SME growth. In relation to the notion highlighted by Lerner (2010), that the VC firms support and professionalize ventures, our research shows limited proof of this. As our findings show that most VCs pursue investments in ventures with foreign founders who have proven business acumen, the capacity of the VC to contribute to the entrepreneurial development in Kenya is questionable. Looking at the entire VC industry, we find indications highlighting a risk of economic enclaves where foreign capital is being strategically invested by foreign investors into foreign entrepreneurs.

Furthermore, we perceive our findings to confirm previous issues related to the business context of emerging markets as suggested by Peng (2001), Hoskisson *et al.* (2000) and Khanna and Palepu (1996). As such it is our belief that the findings from this research may to a large extent be generalized when considering facilitative mechanisms for VC investments in other emerging markets.

6.1.3 Can we generalise from the empirical findings?

Given our research approach, this thesis generates important, in-depth knowledge about the empirical world of venture capital in developing countries and emerging markets. Through the multiple-case study strategy, we are furthermore able to compare and see whether the observations made in one case also occur in other cases. Hence, as our cases are different in their nature, *i.e.* the type of VC firm, composition of staff and investment focus, the maximum deviation selection criteria implies that our findings are based on representative and reliable foundations for generalisations across investment firms that operate in Kenya. This relates to the fact that the VC firms experience almost the exact same institutional barriers, despite their organisational and structural differences. Since we can confirm many of the barriers highlighted in the IB literature on institutional theory in emerging markets to be present in our case study of Kenya, it is our perception that these findings can to a large extent be generalised across VC industries, not only in sub-Saharan Africa but in developing countries and emerging markets in general. Additionally, we find that the coping strategies related to these institutional barriers can be used to explain how VC firms operate in emerging markets in general.

The topic of VC in emerging markets has been highlighted by other scholars to be an under-researched topic (Hain & Jurowetzki, 2018). As such, this is particularly interesting as publications about venture capital in emerging markets mostly focus on VC investments in China and India (Dossani & Kenney, 2002; Ahlstrom & Bruton, 2006; Dai *et al.*, 2012). Additionally, the specific industry focus on Kenya is a contribution to the exploratory reports and publications on economic and institutional development of Kenya.

6.2 Theoretical Contributions

The institutional approach to venture capital in emerging markets

By assessing the venture capital industry in emerging markets from an institutional perspective, we have constructed a theoretical framework in which we combine financial theory with institutional theory. As such, we have developed a theoretical framework to understand the interaction between emerging market institutions and venture capital. The international business literature that investigates strategy in emerging markets from an institutional perspective commonly considers internationalisation strategy for multinational companies. We find however that previous contributions by scholars such as Hoskisson *et al.* (2000), Peng (2001), Khanna

& Palepu (1997, 2010), Marquis & Raynard (2015), can be applied to the VC industry in emerging markets as well. Likewise, financial theory on venture capital in developed markets (Gilson, 2003; Rajan, 2010; Hall & Lerner, 2010; Breuer & Pinkwart, 2018) as well as in emerging markets (Dossani & Kenney, 2002; Gugu & Mworia, 2016; Hain & Jurovetzki, 2018) have to a large extent avoided the institutional theory. As such, our findings have shown new applicability to the institutional approach by combining financial literature on private equity and venture capital with the literature on emerging market strategy and institutional theory.

As we perceive the financial literature to shed light on the underlying mechanisms and strategic decisions and processes under the VC fund life cycle, combining these insights with the particular focus on institutions as the "rules of the game" provides a novel understanding of the nature of venture capital in emerging markets. Although we find a number of publications, which also approach venture capital in emerging markets with institutional theory, including Ahlstrom & Bruton (2003, 2006, 2010), Lingelbach (2015), Li & Zahra (2012), Hain *et al.* (2016), Ekanem *et al.* (2019), it is our view that this research paper has taken a unique focus on the specific institutional challenges as well as the coping strategies deployed by VC firms in emerging markets. Thus, this thesis provides further depth on the importance of institutional quality and consideration of the institutional context for academia around business strategy in the VC industry in emerging markets.

6.3 Implications for practice

6.3.1 Implications for VC firms

As we explore the institutional barriers to VC in emerging markets, we shred light on the most prevalent challenges for VC firms from an institutional perspective. As highlighted earlier, we find these challenges to be generic and thus VC firms should be aware of these upon entering less developed VC industries in emerging markets. Furthermore, as we highlight some of the coping strategies that VC firms use to overcome these barriers, we are able to make generalisations and suggestions for best practices in emerging markets. Furthermore, we found that VC firms may circumvent some of the risks relating to the institutional barriers by diversifying their portfolio through various industries and countries in the region, thus adopting diversification strategies.

With regards to the institutional barriers concerning lack of information agencies and intermediary actors for pipeline generations, VCs may rely on professional networks and relationships with colleagues in the industry, as they can share information about new investment opportunities, relating to aspects of the institutional avoidance strategies. Concerning the lack of knowledge about the local market, VC firms can benefit from creating proximity by establishing a local office and hiring local staff, who can assess the product-market fit of investment opportunities, relating to the local-knowledge capturing strategies.

Lastly, we find that in order to overcome institutional barriers related to the lack of professionalisation of local ventures' corporate governance and reporting standards, VC firms may need to engage operationally with the ventures and improve their structures and procedures through education, relating to the governance strategies. Additionally, we find that VC firms may invest in ventures established by foreign founders; as such they can avoid some of these local, institutional barriers, as in the other aspects of the institutional avoidance strategy. However, we do not find this strategy sustainable in relation to supporting the local economy and integrating local innovations and entrepreneurs in the industry.

6.3.2 Policy consideration

Relating to the premise of the lack of capital as the main constraining factor to SME growth in emerging markets, our research suggests the need for a holistic market approach to guide policy makers and efforts from the global development community. Based on our empirical analysis, our research provides a number of areas of consideration for future policy development on the topic of unlocking capital in emerging markets through private capital.

Our findings show that future policies and initiatives should focus on the facilitation of early stage investments. This may include, but is not limited to, early stage financing through grants or additional tax breaks and benefits for business angels, particularly relating to the institutions which serve local entrepreneurs. Furthermore, it is our finding that efforts should be made to support the creation of nuanced and reliable databases of information about various sectors, which can be easily accessed. Additionally, domestic regulation policy should focus on improving the general reporting and governance standards to get more coherent financial reporting mechanisms. Moreover focus must be put on strengthening the legal enforcement around commercial law and shareholder protection. Lastly, policy development should facilitate VC investments in terms of limiting the bureaucracy and costs associated with investing.

Such policy development must however consider the risks of the VC industry becoming extractive, showing tendencies of economic enclave. As such it is further highlighted that future policy should consider the spill-over effects and linkages which the investments are contributing with, in particular relating to the participation of foreign investors in the local markets.

6.4 Evaluation of research strategy and methods

In this section, we aim at evaluating and discussing the limitations of our research in terms of answering the research question: *What are the institutional barriers to venture capital in emerging markets, present in the case of Kenya, and what strategies do venture capital firms use to overcome these?* We evaluate the applicability of the chosen method and assess the usefulness of the research strategy and design in general in the light of the overall philosophy of science. Furthermore we provide some of the considerations in terms of the selection of cases.

Having analysed the data and discussed the findings, we conclude that the research strategy of a multiple-case study has fulfilled the goal of supplying useful and appropriate information about the institutional barriers to VC in Kenya. Further, the combination of deductive and inductive approach has enabled us to both compare the perceptions of the institutional environment across cases and observe patterns in the interviewees' statements about how they cope with these barriers. Looking in retrospect, we find that more cases could have provided further depth to the study. This includes amongst others VC firms without an office in Nairobi, local entrepreneurs and entrepreneurs that have received VC investments, other accelerator programs, and other actors in the industry such as the business angels. However, as highlighted in the Method section, we find that there is a trade-off between a high number of cases and the richness of data from each case. As such, we are aware that we are missing out on some perspectives on VC within the industry, but as we focus on the institutional barriers from a VC firm perspective, we evaluate the relevance of our data as sufficient. Nevertheless, other methods could have been included to provide additional perspectives and more richness to the data. As such, observations would have been a matchless method to accompany the semi-structured interviews, although impossible due to the on-going pandemic.

Furthermore, other research methods focusing on triangulation of the data could have been applied to improve the validity of our findings. One example is by combining qualitative and quantitative methods, where we in addition to the semi-structured interviews could have done a survey, focusing on different aspects of the institutional barriers. Although such research strategy would rather resemble a mixed-methods approach, it could provide data for a more complex analysis. However, we did not use this method because of our philosophy of science position, in which we are mostly interested in qualitative data to create reasoning about the institutional barriers that VC firms experience in emerging markets. Additionally, as we find that VC firms experience more or less the same institutional barriers, we have assessed our research strategy of a multiple-case study and find that also a single-case study could provide valuable insights. Through a single-case study, the research could have included a study of the VC firm's portfolio to actually determine the extent of the impact of barriers such as liability of foreignness, governance and reporting. Yet we find that our qualitative multiple-case study fulfilled the necessary insights in terms of answering our research. However, as the research on the roles of institutions in the VC industry in emerging markets is rather unexplored, we see a large potential for other approaches and methods to provide new insights which can enrich both academia and praxis on the matter. Since our conclusions are rather related to economic, and policy focused- different type of study is needed to confirm the validity of these findings

6.5 Suggestions for future research

This paper takes its departure in the notion of a finance gap prevailing in emerging markets, commonly proclaimed by The World Bank and other development organizations. The finance gap has particularly shown to be a hindering factor to the growth of SMEs, otherwise praised for their role in contributing to economic development and prosperity in emerging markets. Our findings show that although the Kenyan startup ecosystem is growing at a rapid pace in terms of investments, it is unclear how this contributes to knowledge spillovers and overall socio-economic development. As such, we believe that future research should investigate the effects of the investments and ventures pertaining to linkages and knowledge spillovers. Particularly this research should focus on creating a facilitative environment for such knowledge spillovers. Furthermore, through the lense of development and economic prosperity, further research should include a thorough investigation on the impact of venture capital on the important societal functions in the communities they affect. We believe this particular research focus to be of much need to provide a nuanced input on the creation of frameworks under the emerging investment type commonly noted as "impact investing".

Moreover, as this research shows, we find it requisite within the stream of financial literature to further the depth of the role of institutions in strategy formulation. We believe this to be particularly important as investments into emerging markets and developing countries are on the rise. Especially, as different actors ranging from business angels and accelerators to investment banks and pension funds are widening their geographic scope, future research should investigate the institutional setting and strategic implications they face.

Additionally, our study leaves little room for novel financial solutions to startups such as crowdfunding or peer-to-peer lending. Future research should therefore focus on alternatives to VC funding to spur local innovative MSME growth.

Moreover, as the study focuses largely on the institutional barriers for the firms, further research should consider the effectiveness of capacity-building efforts for the institutions that dictate the success of the venture capital industry. As our study is limited to insights concerning barriers and coping strategies from the VC firms perspective, future research should consider the actors involved in facilitating a strong institutional support for the VC and local SME development. This includes amongst others, educational institutions, accelerators, entrepreneurs and other early stage financiers. This particularly pertains to research focusing on areas of policy which may contribute to the creation of strong and effective institutions that can support the private and public capital markets.

7 Conclusion

Due to increasing focus on venture capital as a vehicle to spur SME growth and economic development in emerging markets, several international organisations are focusing their attention on facilitating foreign capital directed towards startups and SMEs in emerging markets. As such, we take our point of departure in the premise that local entrepreneurship is lacking capital in order to grow, create jobs and foster economic development. Further, this study has focused on Kenya as the country of analysis, much due to its recent reputation as the *Silicon Savannah*, attracting capital to a growing startup ecosystem. Through a literature review of financial theory on venture capital and institutional theory in emerging markets as provided by Peng (2001), Hoskisson *et al.* (2000) and Khanna & Palepu (2010), we formed the theoretical framework used for this research. Combining these strands of literature, we further constructed three propositions, used to assess the institutional environment pertaining to the Kenyan VC industry.

In our analysis we find that, firstly, there are some institutional barriers that affect the VC firms in Kenya more than others. In relation to regulatory uncertainties we find that the political uncertainties stemming from the country's election cycles provide a risky environment, in particular around the fund-raising stage of the VC firm. Furthermore, we found issues relating to governance and reporting regulations are providing challenges for VC firms during the screening phase, specifically pertaining to assessing the locally founded ventures. Despite this, we also found a positive attitude towards government initiatives as newly introduced regulations concerning tax breaks and transaction requirements are providing benefits to the VC firms. Secondly, our research shows that VC firms often invest in foreign founded ventures, as opposed to the local ventures, which they perceive as constrained by the institutional challenges. Such foreign founders may however struggle with the liability of foreignness stemming from their lack of knowledge around context contingent specifics such as consumer preferences and regulatory environment, thus affecting the VC firms in monitoring and supporting their portfolio ventures. Lastly, we find a number of challenges for VC firms in Kenya relating to underdeveloped supportive industries. Inadequate information agencies and unreliable sources are hindering the screening and deal sourcing phase for many VCs. Furthermore, the lack of early stage financing mechanisms, such as business angels, and inadequate technical intermediaries, such as accelerators who can support the ventures in becoming investable opportunities, are halting the deal sourcing process for ventures. Additionally an inadequate public stock market and the lack of PE funds and other actors capable of pursuing acquisitions are limiting the exit opportunities for VC firms.

To circumvent these challenges we find that VC firms adopt four different coping strategies: diversification strategies, governance strategies, local-knowledge capturing strategies, and institutional avoidance strategies. Diversification strategies refer to the strategy of the VC firm's investments. We find that many VCs perceive the risks relating to the country's election cycles as high. Therefore, VC firms seek to spread their risk by investing in several countries in the region, in addition to spreading their investments throughout several industries, thus diversifying their portfolio. Governance strategies refer to the VC firm's need to work proactively to circumvent issues relating to reporting and corporate governance. This includes taking a hands-on approach with the ventures, which extends the otherwise purely strategic role of the VC during the monitoring and supporting phase of their investments. Local-knowledge capturing strategies refer to the fact that many VCs firms have regional offices and employ local staff with connections across various sectors. As such, the VC firms cope with the lack of information agencies and the liability of foreignness. Lastly we find that VC firms invest in foreign founded ventures, which they perceive as less affected by institutional setting, thus avoiding the institutional barriers in Kenya. We find that institutional avoidance strategies are widespread within the VC firms in Kenya.

As our research shows that the majority of VC firms are investing in foreign founded ventures, we find that the VC industry is constructed around foreign international networks. Due to the nature of these networks we further find that locally founded ventures suffer from the liability of outsidership. As such the appraisal of Kenya as the *Silicon Savannah* mainly pertains to foreign funded VCs investing in foreign founded ventures. To conclude on our findings, we find little evidence that proves the capacity of VC firms to contribute to the professionalization, knowledge spill-overs and thus entrepreneurial improvement of locally founded startups. We further conclude that although there indeed is a gap of investments into local SMEs, approaching the issue of the finance gap in emerging markets requires a holistic approach, highlighting the importance of creating supportive institutions to avoid the risk of extraction and the development of enclave economies in emerging markets.

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Appendices

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APPENDIX A. Summary of Cases

Summary of the VC firm case entities

Name of VC	Focus/sectors	Ticket sizes / stages of investment	Characteristics
VC 1 Enza Capital	Tech-related innovations with triple bottom-line impact; In Kenya mainly.	$50,000 to 1 million; First investments range from pre-seed to series A.	Small team of investors based in Kenya that invests capital from LPs in the US and Europe. Launched in 2019, Enza has already invested in five startups.
VC 2 Saviu Ventures	Tech-focused, but sees tech as a long-term process. Invests across Francophone Africa to East-Africa.	$50,000 to $800,000; First investments from pre-seed to seed stages.	Not a VC firm with a traditional fund cycle but a Holding Company; Staff are from Europe.
VC 3 Chandaria Capital	Industry agnostic; Mainly concerned with scalable, hockey-stick growth potential firms in the region.	Ticket sizes range from $150,000 to $500,000. First investments are aimed for pre-series A.	The VC firm is part of a family-owned conglomerate, Chandaria Industries, and hence it is one of the only wholly Kenyan VC firms. Benefits from conglomerate through testing and scaling of portfolio ventures.
VC 4 Pearl Capital Partners	Focus on impact ventures with socio-economic mission, mainly in the agribusiness value chain; Pan-African focus	The ticket sizes range between $500,000 - $2.5 million	Started in 2005 as a holding company; currently running its fourth fund, which is based in Uganda and raised in 2017; LPs include IFAD, the EU, and NSSF Uganda
VC 5 Goodwell Capital	Industry agnostic 'access' fund that focuses on improving access to basic goods for the BoP segment; pan-African focus.	Ticket sizes range from $1million to $5 million; Goodwell Capital usually invests at A rounds and B rounds.	As the LPs are from Europe and the main office is in the Netherlands, Goodwell is a large VC firm that invests across Africa. The first two funds focused on financial inclusion in India.

Summary of the case entities other than VC firms

Company Name	Place in industry	Impact on VC	Characteristic
EAVCA	Industry association for PE and VC firms	Works on promoting investments in the region by attracting investors and lobbying authorities in order to make a more efficient market	Founded in 2013, EAVCA is an organisation with more than 100 members across East-Africa.
Pangea Accelerator	Accelerator program	As an accelerator, Pangea professionalises startups through development programs and provides the startups with initial funding.	Besides the acceleration of ventures, Pangea has an investor program, which educates high-net-worth individuals in becoming BAs.
Social Bites	Startup	As a startup, Social Bites is on the receiving side in terms of the investments.	In 2018, the founder aimed for taking in investors in Kenya, but ended up with a few BAs from Denmark and the UK.

APPENDIX B. Interview Guide

First part

- Introductions: Who are we? What is the purpose of our thesis? How can it contribute to your VC firm?
- To increase the validity of our data, we would prefer to record the interview. Anonymity.
- What are we going through in this interview - present the parts.
- This is a university project and is not to be published in any journal and magazine.

Second part

- **Nature of their operations**
- **Can you describe your fund and what kind of investments you are making?**
    - Industries, what kind of ventures?
    - What size of investments?
    - Required return of investment?
    - How many employees?
    - Organizational structure with limited partners etc?
    - How long has it been operating in Kenya?
    - Any success stories you want to share?

Third part - Challenges

To begin with we have some questions regarding the challenges that you (VC firms) may encounter in the Kenyan industry. They are based on the literature that we have read prior to this interview. We will also be asking some more open ended questions.

- Note to ourselves: "Challenge" followed by "Coping Strategy"

1. What is your perception of the amount of investable ventures in the Kenyan industry? Is there a good fit? Would you say that there are too few ventures?

2. Are you using the accelerator programs in Nairobi to discover viable firms for investments? If so, how?

    - *Coping strategy:*
    - *Do you engage in the development of their pipelines?*
    - *Are you using any other type of pipeline? How does it work? What are the advantages?*
    - *Social network - connections?*

3. What is the level of information available about the ventures and the markets they operate in? Is it sufficient?

- *Coping strategy: If there is a lack of information, how do you deal with it? Other strategies for finding information about the ventures?*
- *How does this impact your performance of due diligence on the firm?*

4. What is your current process for finding locally born ventures?

- *Coping strategy: Employment of staff with local knowledge?*
- *If not, what is your process to find good ventures?*
- *How do you see the function of social networks to do so?*
- *Never really asked yourself the question. Met with a-lot of foreginers, met with a-lot of foreigner because they lived. If you want to be relevant, you wan't to invest in local founders. Lacked the local knowledge, fully digital approach. Foreign founders, they can sell the African story and everyone get's excited. But people can learn.*

5. Are you working operationally in the companies you invest in?

- *Coping strategy: If so, why and how?*

6. In comparison to other parts of the world, such as Silicon Valley, where VCs have been around for a much longer time, what would you say is the biggest difference in the ventures you find in Kenya?

- *Coping strategies: Is there a need to compromise some of the investment criteria in order to find viable ventures to invest in? (lower investment size, rate of return, exit strategy, industry)?*

7. How do you see the government is currently influencing the VC industry? In what way?

- *Coping strategies: What kind of supportive mechanisms exist?*
- *In what ways does the legal framework support or oppose your work?*

If there is time:

8. What other kind of challenges are you facing and how are you overcoming these?

9. In relation to our first question about the lack of capital or lack of investable ventures, do you think that there is an issue regarding the types of capital that are available in the market?

- Would there be some financial gaps e.g. investment sizes, growth rates? Any imbalance between supply and demand?

APPENDIX C. Interview with interviewee from VC 1

Transcript of Interview. Interviewee from VC 1, Enza Capital

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee: Anthony Kimani
Time: 57:16

Henric Hansson 0:00
I hope we will be able to keep it within one hour. And first of all, I would just like to ask you, if you can describe sort of Enza Capital as a fund and what kind of investments that you're making in general.

Anthony Kimani 0:21
Okay, so Enza capital is a VC tech fund, backed by private capital. And we specifically target tech enabled businesses that are trying to solve large and meaningful problems on the continent. We have ticket size, our ticket size ranges from between $50,000 to to a million dollars.

Henric Hansson 0:54
Okay, and are there maybe just what are your main responsibilities at the fund?

Anthony Kimani 1:31
Okay. So at Enza I basically handle four things. So my main function is deal pipeline, looking at companies that you can potentially invest in, running an analysis on them, doing a bit of structuring. In the event we do invest, a bit of portfolio management and reporting.

Henric Hansson 2:07
Okay. And do you have any particular focus in terms of industry?

Anthony Kimani 2:19
So far we've invested in five different entities. I will just list the amount for you and then briefly just talk about them for you to understand how we are operating. So the first one you have is Sendy, a business called Sendy. It's quite popular in Africa and they do logistics. Second, we have a business called Flair. It's a solutions business that provides emergency response services. So sending in logistics flies in health tech in some way. You have a business called Link, which basically is a platform that connects informal sector workers to people in need of their services. Then we have a business called Tuteria, which we recently closed a transaction on. It's a net tech business based in Lagos, Nigeria. So basically the business connects tutors to students in need of tutors in Nigeria. The fifth investment is Safi Analytics, a business that provides services to manufacturing companies basically providing solutions to help them improve their efficiency and efficient energy use. So, so far we in a nutshell, have investments in Logistics, Ed-tech, Healthcare tech, and now Safi Analytics.

Henric Hansson 4:31
Yeah, yeah. So it's rather industry agnostic, I guess. But are most of these investments in Kenya? Or is it sort of spread out? You said that one of the businesses was based in Lagos or the other based in Kenya or is it spread out?

Anthony Kimani 4:52

all, sorry, you disappeared for a bit there. Can I make a suggestion Can we try switching to just audio, to see whether it helps with the new boundaries. Is that okay with you?

Anthony Kimani 5:30
So, other than Tuteria, all the other four businesses are based in Kenya.

Henric Hansson 5:38
okay. And so, you said that the ticket sizes are basically from $50,000 to 1 million. So, at what stage Would you say that you go in, in businesses is it early stage, is pre-seed, seed or at what stage in general to you enter the businesses?

Anthony Kimani 6:01
So in this different businesses we have invested in, in seed in series A and did bridge financing on different points of the fundraising cycle. But generally we do target pre-seed, seed and series A. But in the investments we do we intend to follow up. So that means, consequently participating in Series B potentially in some of the investments we make in the previous funding rounds.

Henric Hansson 6:41
Okay. Yeah. And how long has the company been operating in Kenya?

Anthony Kimani 6:52
So, we two, three It started in May May last year 2019 and In the same month is when we closed our first transaction, which was Sendy.

Henric Hansson 7:05
Okay, okay. It's very new. And how many employees are you?

Anthony Kimani 7:19
So currently in terms of the active, the active team members, we are three. So there's myself. There's Mike Mompi, who's the CEO. And then there's John Lazar, who's our chairman and also our limited partner in the fund. We have other limited partners. One of the limited partners is a member of the Investment Committee. So more or less, we just three in terms of those who are running the fund.

Henric Hansson 7:52
Okay, so it's sort of three operational people in charge of operations. And then you said there were a couple of limited partners as well, or?

Anthony Kimani 8:06
Yes, we are backed by private capital. so far. We have, I think currently we have three. I think we have three limited partners. We intend to make our second close by the end of April of May this year, and so that number may go up, but essentially we are backed by private capital. Mostly high net worth individuals. Yeah, well, even the number of LPs will most likely go past five or six.

Henric Hansson 8:45
Okay. And are those also based in Kenya or is it sort of foreign foreign private equity?

Anthony Kimani 8:56
So it's, it's basically foreign. People from Europe, from the US and we have others from South Africa.

Henric Hansson 9:11
And so I know that you're, you're rather new on the market and stuff like that. But are there any particular, you know, success stories that you've seen so far in terms ofanything that has surprised you sort of

Anthony Kimani 9:30
Generally in the venture capital space, or? Generally in the venture capital space, or just private markets, or I mentioned to the specific plane tech?

Henric Hansson 9:50
Yeah, yeah, I meant more in your investments. Are there any ventures that have been for example, performing abnormally well or something that you've seen is panning out to be a good investment.

Anthony Kimani 10:06
Yes. So Sendy, which is the first investment we made, is a very attractive business , it has very strong fundamentals. Not at the point where it is profitable, but it is quickly heading towards that point. So we entered a bridge round in May. The business has been growing quite aggressively by December, they did another fundraiser where they raised $20 million, which is one of the larger funding rounds in the market, at least for last year. And so we are impressed with the general direction of the business and basically what they are trying to do in the space it's operating. So I would, I would call that a success story.

Henric Hansson 10:59
Has anyone at Enza capital been operating in that venture as well? or supporting them with business advice in any sense?

Anthony Kimani 11:26
Well, one of the value propositions we have for companies we invest in or potentially invest in is basically being able to offer strategic and business advice to risk businesses. We pride ourselves in being entrepreneurs so it's a fund that is being run by entrepreneurs. have a bit of a background in investment banking, private equity, entrepreneurship. So does Mike and then John, our chairman as well. He was a CEO of a business in the UK called Metaswitch, I don't know whether you've heard of it.

Henric Hansson 12:10
No, I haven't.

Anthony Kimani 12:13
Yeah, he was the CEO there for I think 14 or 16 years. And then he quit and then just came into the venture capital space. So having that combination of skill sets, we believe we're very well positioned to offer strategic localized advice to these entities. And so we regularly tend to have meetings with the founders and the teams just to understand what pain points they have, what difficulties are they facing and then we try to see how either we can help them or how we can reach out to our networks to help them. Because all things considered that that's okay. The best way to help this entity is, given that in venture capital, you also don't have a lot of say in the direction of the business by virtue of having a very small stake in the business.

Henric Hansson 13:20
Sounds like a really good proposal. But you're not operating like none of you're sitting physically, with the companies. It's more of a strategic focus?

Anthony Kimani 13:37
So for businesses that do require our help, we have always offered to step in the input as some of us in the team have an expertise in it and we do try to help. For most startups, at least in my experience with dealing with companies, they tend to be very good in terms of structuring fundraising and building models and such things. And so anytime we come into a business and we do decide to invest, those are some of the things we help them with, how they can improve their reporting, how they can improve their bookkeeping in preparation for them to be ready for subsequent funding rounds. So we do sometimes go to the operations of the business, but it has to be in a way also that we don't undermine the team itself.

Henric Hansson 14:47
Yeah, yeah, I understand. You can't step on many toes, I guess.

Anthony Kimani 14:53
Yes. Maybe it has to be that they actually see that sense in us helping them and they do need that help. Otherwise, it would just be us forcing ourselves on the company and that doesn't necessarily lead to a long term sustainable relationship between us and them.

Henric Hansson 15:16
No, no, I understand. Apart from the company in Lagos, are the companies based in Kenya, are they founded by Kenyan founders or is it mostly foreign founders?

Anthony Kimani 15:35
Some of them do have foreign founders, some have both local and foreign. So for a company like Sendy, it has a group of founders which close to half of them are local. And then for the other ones, you basically have foreign as well. Coming to Kenya and they've more or less decided to go to live in Kenya. And so we support them on that basis for one of the companies, which is Safi Analytics. The founder is married to a Kenyan. And so as far as we are concerned, they are citizens by virtue of being married to a Kenyan and have set up roots here. I think the biggest concern we have even more venture capital firms have is the risk that someone will come set up an entity and they don't necessarily have long term prospects. And so in our efforts to try to support businesses that are solving large and meaningful problems for these businesses to be sustainable, they also have to be run by the people who are actually experiencing these problems. And so it makes sense for you to have locals or people who have permanence in the region.

Henric Hansson 17:13
Yeah, yeah. But that's also what I've heard before, but I was just wondering, are there any particular challenges that you think that those with foreign founders are facing? Like, do you see some specific challenges that foreign founders are facing that perhaps local founders are not facing?

Anthony Kimani 17:41
I would actually argue that it's the other way around. You have more challenges facing the local founders as opposed to the foreign founders. If you look at it in the context of the problems faced by startups were the main one being running on out of cash and basically being able to attract really talented people to join the team and build the business. You'll find local founders are disadvantaged to some extent by virtue of one not having this networks that most foreign founders have or have built from going to certain universities and educational institutions or working in somewhere like Silicon Valley or just having friends in that region and then to not having worked in places where they're able to build networks with talented people who eventually can join them in that entrepreneurial journey. So you find for most local founders, raising capital is a challenge. Because generally Africa does not have a lot of local capital. And so most of the capital that is attracted to the VC space tends to come from developed markets. And then too,

by virtue of not having networks, they're not able to attract really talented people to join the business. And so this creates a loop where the business does not have cash and it cannot scale and it also doesn't have a good team. So the business cannot grow to a decent size to attract more capital, and that limits them.

Henric Hansson 19:31
Okay. So in terms of finding capital and finding the network that holds the capital, foreign firms are actually usually better off because they already have that network. But I was thinking a little bit about operationally when the startup or a smaller venture operation or has their operations in Kenya, is it the other way around, are they sometimes more reliant on you know, local networks and local knowledge In some sense, would you say?

Anthony Kimani 20:03
To some extent, yes, especially if the problem problem that the business is trying to solve is highly local, you will find that local funders have an advantage in that they have grown up with these problems and so they understand firsthand what it means for for the, for the for the problem to be solved, they have decent experience in understanding how previous businesses or even the government has tried solving these problems. So, they have a very good idea of what can work, what cannot work and basically the fastest way to get to there in terms of using the resources that are around them. So, they have a very deep knowledge of basically regulations, how business works, where do I go if I need to find ABCD, which is something foreign founders struggled with initially. But you find after all, then that, that that ceases to be an advantage.

Henric Hansson 21:15
Okay, understand, and.. Sorry, I lost myself a little bit.. Oh, yeah, I wanted to ask you; Have you seen some startups struggle with limited local knowledge or these kinds of things?

Anthony Kimani 21:58
For some of them, yes. During discussions with some of the founders, we have found some of their foreign founders admitting to the fact that they were on a learning experience where they had a certain view of the market they're operating in, and then they got into it. And then they realize things are very, very different. And a good example is Link in the business, that's a platform that is providing services for informal workers or connecting informal workers to people in need of their services. One thing they came to realize is there's a certain standard of quality that's expected from the middle class in the country because initially restructure the platform for informal workers to provide services to the middle class in a way that the quality can be controlled. Yeah. So what happened was initially when they started the business, they just offered the platform, but then they realized the uptake was not as fast. And when tracing some of the main complaints that the clients had with a business the quality being offered by the workers is not to our standard. So the business was faced with two options, either they somehow managed to get our costs to a certain level or bring down the quality of their services. And so the, they sort of had to backward integrate and, and come up with sort of an academy that teaches informal workers and so sort of both their the quality of the work they do for that to matchthe client.

Henric Hansson 23:54
Yeah, I understand. Thank you so much for telling us about Enza capital, and some of your investments. I just wanted to know. Furthermore, we had some more general questions, so I'll just jump straight into them. What is your perception of the amount of all ventures in the Kenyan industry? Is there a good fit? Or would you say that there are too few ventures or too many ventures in comparison to VCs?

Anthony Kimani 24:27
Okay, by ventures You mean like the VC funds themselves or startups?

Henric Hansson 24:36
So, so I meant the startups like would you say that there are enough investable opportunities

Anthony Kimani 24:46
There are a good number of startups, but a very small proportion of them are investable and again, it comes back to the limitations faced by the local founders. So the question you end up in is you have a very large pool of funds chasing a very small number of deals. Yeah.

Henric Hansson 25:19
And what kind of strategy can you adopt to still find these, these ventures these investable ventures?

Anthony Kimani 25:32
One one way to do it is to take a proactive approach. So you trace back, basically how these businesses are started. And you will realize most of these businesses actually started by foreign founders. So you can either start by building a network of other founders who have actually already built businesses in Africa or building a very good relationship with some of the top venture capital funds in the market. And so you can always follow up on any investments or get wind of a deal from some of the founders before it blows up and is quite popular. And another option is to use incubators, but there are so many incubators but very few actually have output that is actually attractive to the market.

Henric Hansson 26:41
Okay. And are you currently using any accelerator programs or or incubator programs?

Anthony Kimani 26:49
No, currently we're not engaged with any incubators or accelerators. Our approach to generating deals and originating them is basically building this network with the founders. Our strategy personally in Enza is slightly different from the typical funds, you see, because we are targeting businesses that have an Africa focus and are trying to follow like businesses generally that are solving problems that are quite pressing in on the continent. And so our approach to origination comes from the problems. And that's proactive in the sense what are the major problems that are being faced in the continent now you have access to financing, access to health care, access to cheaper education, and so you you move down that funnel basically looking at these businesses until you find a business that is the best in terms of how they approach solving that problem.

Henric Hansson 28:10
Yeah. But I just wanted to go back to accelerate the programs. What do you think is the main issue with the firms that go through the accelerator programs? Why can't you really invest in them?

Anthony Kimani 28:25
One of the biggest issues is valuation. So, there exists a conflict of interest for the accelerator programs themselves. Because you want your graduates or the businesses that come out of the accelerator to actually get funding at the same time you also judged on the basis of just how much of a valuation you can get for the businesses that actually graduate from the accelerator programs. You will find those to conflict because the people you're selling the business to wants to come in at a lower price. And you want to come in at a at a higher price. And so that discourages venture capital funds.

Henric Hansson 29:16
Okay. And are you sort of engaging in the development of any other pipelines to find early stage startups?

Anthony Kimani 29:29
Yes, you're always trying to come up with

Henric Hansson 29:34
Pardon? Are you using any other type of pipeline

Anthony Kimani 29:41
Those are our main ones. But we're currently trying to come up with ways, proactive ways at least or beefing up the deal pipeline, but more or less, that's what we rely on mostly relationships and our proactive approach to deal origination.

Henric Hansson 30:01
And when you say you're mostly reliant on relationships, so you kind of meet someone on the ground with relationships there to actually find the deals.

Anthony Kimani 30:13
Not necessarily because like in Kenya, so I have worked in the private capital markets for some time and the private equity and venture capital space for some time. So, between Mike, myself and John, we have developed quite deep networks into the continent and personally for me in eastern Africa, so I do not necessarily find it a challenge to reach out to anyone. If a business is attractive, we will quite easily find a way to get to them.

Henric Hansson 30:55
Yeah, and And what about information? What would you say is the level information available about these ventures and the markets they operate in. Is it sufficient?

Anthony Kimani 31:07
Definitely, it's not sufficient (information). But we see that as an issue with how funds basically approach origination. So some funds do their own research and due diligence in particular sectors. And so anytime they target a business and look at it in the context of that knowledge, which is something we also do. Basically being able to build research on the different problems that the continent is facing and then you look at those businesses in that context. But the businesses themselves, understandably, are incentivized to give you information that paints the sector or their business in a good light. For if sector is not doing so well and the business is trying to solve a problem in that sector, it is very difficult for them to come in tell you growth in this sector is actually decelerating, tough regulations are coming etc. You will never see that on a pitch deck. So, we always try to form an independent view that is different from what the company is telling us about the sector because given the space they are in, you can understand why they would suffer from a confirmation bias when looking for information and building a business case.

Henric Hansson 32:39
Yeah, naturally, but, so, how would you say that this lack of information is impacting your performance of due diligence on firms?

Anthony Kimani 32:51
It makes due diligence much more difficult because you have to go in basically do primary research yourself or as a group of investors, if you're going in as co investors. You have to put in a lot of resources

into preparing a due diligence report, which can be costly and time consuming. And in areas where you do not necessarily have networks in those particular sectors, it becomes even more difficult to get access to this information.

Henric Hansson 33:31
So, you said that sometimes you have to do the research yourself. How does that work?

Anthony Kimani 33:41
So, basically, you would if you're looking at a business in any country, let's say in Botswana, the first thing you would do is basically try get a list of contacts from the company about who they think in that space understands that business. So basically kind of like what you've done the way you reached out to Enza, to try to find out our view in the market we more or less do the same thing with sector experts and basically get some insight from them and if they know anyone else who can assist us also interview them, and then we slowly start to form a view of the sector and check whether that actually is reflected in what the business is telling.

Henric Hansson 34:34
Yeah, so from what I know, in Europe, sometimes people use for example, TechCrunch, which is an online platform where you can find a lot of data about companies, do you have to do something similar or are you also using TechCrunch?

Anthony Kimani 34:49
So, there are some solutions that are currently being built. You have, there's an entity called the Baobab Network, which is basically trying to build a database of information on startups in Africa. You have Venture Capital 4 Africa, which is a platform also providing data on some of these startups. So we tend to use some of this, but then again, they suffer from the same challenges that we have when going into a business, because for most of these businesses, you will find that if a sector is not popular, you will not find research on it generally. So, like FinTech EdTech, HealthTech, there's a lot of information on it. So you have so many other related venture capital funds who have done due diligence and they have shared this information with CO investors and so details of this particular sector in different countries is known. But for novel sectors or sectors that are just coming up or solutions to problems that have not been thought of extensively. And for those ones you have to do primary research.

Henric Hansson 36:22
Okay. And I just wanted to we talked a little bit before about, you know, local ventures and foreign ventures and local founders and foreign founders and these kinds of things. Yeah, do you have a current process for finding locally born ventures with local founders?

Anthony Kimani 36:41
Currently, we use the same process we have. But the challenge you will end up with is that eventually you will find that the system or the final number or potential deals you end up with will have more foreign founders. Again, for these businesses to attract capital, they need money. And these foreign founders have access to money. And so for local founders, some of the things we're trying to work around, at least in the course of this year is to look at businesses that potentially we can go in at an earlier stage. And one of them was actually Tuteria. So Tuteria, is founded by two Nigerians born and raised in Nigeria. And our thesis behind the investment was the business may not be at a level where it attracts large funds and is quite popular. But you have a very strong team that is dedicated, that has a lot of integrity, and who actually believe in what they're trying to do. They just need some direction to get to a point where business can be compared to a business that has a foreign founder.

Henric Hansson 38:04
Yeah. And did you do anything differently in terms of your investment for Tuteria?

Anthony Kimani 38:15
No, no, not really. We judge them on the same basis. Are you trying to solve a problem? Is the business sustainable? And basically also looking at the team. So we encourage or we tend to prefer businesses that, even if the founder is foreign, has a very large portion of the team that is local.

Henric Hansson 38:40
Yeah, yeah, I understand. But did you do any? What do you call it? group investments in the in this in relation to Tuteria or did you? Did you lower your investment ticket or anything like that? Since they were no edge?

Anthony Kimani 38:57
No, no because it fits well in our investment range. So our investment range is quite wide. I mean, you know, from 50,000 to a million dollar USD, I mean, it accommodates a good number of businesses. For today, we put in $250,000, which is the amount they needed to, to get to the subsequent funding round. So we did we did not necessarily increase or decrease our ticket size on the based on where the founder comes from.

Henric Hansson 39:34
Yeah, I understand. I just wanted to know, switch topic a little bit, but how do you think the government is currently influencing the VC industry?

Anthony Kimani 39:48
Some of the measures that the venture capital associations in the different countries are trying to promote are related to exits, which are a big problem in Africa, generally. Not many venture capital funds have managed to exit. And so one thing they're trying to push for is for investment into venture capital to be sustainable on the continent. Funds have to be able to exit and redeploy this capital in other businesses.

Anthony Kimani 40:19
And so, associations and even funds are lobbying the government to make it quite easy for businesses to list on stock market. In general, you also give them incentives for them to be able to operate or at least cushion them from some of the challenges that would otherwise affect the performance of his businesses. So currently, Kenya is one of the countries that has tried to make strides on this. So there is a segment of the stock market called the gems. It is the growth enterprise market segment on the Nairobi Securities Exchange where a business has to have at least a book value of $100,000, to be able to list, they don't have to be profitable, and for the first three years, they get a tax break on corporate tax. And so this is just to encourage not just venture capital funds to participate because they have an exit route, but also for local investors to start participating either as angel investors are generally just streaming in this businesses to increase liquidity for anyone who is investing in the smaller projects.

Henric Hansson 41:44
So when you say that the individual VCs and and other type of investors are kind of reliant on on this sort of lobbying relationship with the government with the local government

Anthony Kimani 41:59

Yes. Because it has to it has to be done through these associations because they represent a much larger number of people so you have a consolidated voice when going to regulators and the government.

Henric Hansson 42:12
Okay. And how do you see that? foreign VCs? I mean, they probably don't know about these associations.

Anthony Kimani 42:23
So , they do and most of them are like for the East Africa venture capital Association. You have most of the funds actually not from from East Africa. What's normally required is not East Africa is one of your investment areas. So that basically makes you a stakeholder because you will be affected. Any regulations that affect the private capital space in these countries will in one way or another affect how you choose to invest.

Henric Hansson 43:03
Understand, yeah. But so, so foreign foreign firms are kind of reliant on these relationships with the local authorities. okay, understand? I just like to know as well, if we take this on a very broad perspective, if we compare to other parts of the world like Silicon Valley where VC has been around for a much longer time, maybe 30 years and other parts of the world, as you know, caught up much later. What would you say is the biggest difference in the ventures you find in Kenya

Anthony Kimani 43:52
in comparison to developed markets or, or other African countries

Henric Hansson 43:57
Yeah. Especially in maybe developed VC industries, if we see that, for example, venture capital has been around for 30 or 40 years. Yeah, in in Silicon Valley. What would you say is the biggest difference in the in the actual ventures?

Anthony Kimani 44:17
I think, generally, an understanding of the VC culture. In these markets (developed), people understand how VC works. They understand funds need to invest and also exit. In Kenya, most funders don't necessarily have an appreciation for that because they don't understand how private equity fund structure works. So there are some that you will find seeking capital that ideally should be long term, but go to someone who has a very long term view. And so you have that conflict in terms of how long the capital should stay in the business. Second one is expectations in terms of reporting, and generally structuring the business. So in developed markets, you have people who understand how to structure their business, basically how to do fundraising, how to be able to attract people and just plug them into a team quite fast. For African entities, you have a challenge with that. Because also attracting talent is a limitation in itself. Over and above, knowing how to deploy it.

Henric Hansson 45:45
Yeah, but do you think? Do you think that the VCs also have various stuff we talked about that for example you have some companies like Tuteria, that was quite early stage and perhaps traditionally, you would not have invested in them. Is there sort of a need for VCs in general to compromise some of the investment criteria? Perhaps, I don't know, lower required return more patients in terms of expiration until exit or perhaps that you could do smaller investment sizes. What is your opinion on that?

Anthony Kimani 46:35

Personally, having operated in the different private markets in eastern Africa, I can say the model needs to change. For entities in Africa, they need more patient capital. So you have a fund structure that is, for most of them, it's 10 years with a two year extension plus one plus one. And you'll find for most of these businesses, they are affected by political cycles, which is not something that you see in developed markets. So even generally scaling and purchasing power of the customers of this businesses is not the same as you have in developed markets. And so it will take a much longer period for this such businesses to scale and so they require capital that is that patient and so, they may not necessarily require permanent capital or permanent investment vehicles to come in, but longer term funds will be more appropriate for such businesses.

Henric Hansson 47:51
Yeah, yeah, understand, and because it seems like there, as we talked about before, with accelerators and incubators that there are a lot of firms that perhaps are at the too early stage to seek VC funding. Do you still think that there's some sort of investment that VCs or perhaps another type of investors can, can do in terms of filling this gap?

Anthony Kimani 48:21
They can, they can. So what is needed to a large extent is more players in the pre-seed and seed side of the funding cycle. And these need to be people who are ready to take on way more risk than people that are in different segments of the funding cycle. Grant funding also needs to be directed towards that end of the growth curve. Because once these businesses able to prove product market fit, and in a position where they can scale, then they're in a position to take on more capital, capital that is commercial in nature. And on that end, I would say you'd require more impact funding and grant funding, basically.

Henric Hansson 49:27
Understand? Well, I think I had all my questions on my sheet and I've asked them, thank you so much for that. I don't know, Mads, you have any follow up questions. I'm sure you do.

Mads Robdrup 49:42
Yeah. Hi, again, Anthony and Henrik.

Mads Robdrup 49:46
No, I think actually, what you've been around throughout this interview is pretty much what we would have thought about them prior to the interview Anthony. So actually no additional questions from my side.

Henric Hansson 50:08
That's nice to hear. Do you have any questions for us in regarding this topic, this thesis or anything else?

Anthony Kimani 50:19
Really, but I would be curious to to finally see your findings. I don't know whether you guys will commission a report or you're allowed to share your, your thesis once you're done.

Henric Hansson 50:33
Yeah, we are allowed to share it and we will do so. It will probably be a long report. Hmm.

Mads Robdrup 50:44
What we can share is an abstract of the report, and where you get the main findings as well as our our research strategy and so on. And of course we we would like to share that with you.

Anthony Kimani 51:09
Yeah, whenever you can, you can only share it we also generally just quite curious to understand how we can help these these businesses. Yeah. In your thesis, are you talking to intrapreneurs?

Henric Hansson 51:28
as of now, we're mostly talking to various type of investors. We also spoke to the East African private equity Association this morning, that we will mostly actually be the investors site and various accelerators and these kind of things. But if we get in contact with the with some of the startups that would of course be very interesting. I don't know if it would it be possible to talk to some of your entrepreneurs, you think?

Anthony Kimani 52:01
Yes, we would be very much willing to connect you with them if it helps you with your thesis. Yeah, like a good example. So the founder of, Tuteria. The Nigerian, I previously mentioned is is he is a local founder and it would be interesting for you to please also understand his view the challenges he has faced in trying to raise capital as a local founder. He would be someone quite interesting for you to talk to.

Mads Robdrup 52:48
I think we are experiencing a bit of a lag also with the Internet, and now. Yeah, of course the as Henric says that would be interesting for us, but Yeah, in fact, we are mostly focusing on the industry in Kenya. So, this this investment was in terms of their expansion into the Kenyan market, or did you perform the investment in Nigeria?

Anthony Kimani 53:16
Okay, perform the investment in Nigeria. For now, they don't necessarily tend to go outside Nigeria for them to strengthen their presence in Nigeria basically then subsequent funding rounds we can consider them moving to other markets.

Mads Robdrup 53:38
In that case, I think it will be a bit out of scope as we are trying to focus on only one venture capital industry.

Henric Hansson 55:55
okay, but yeah, I wish you all the best and and let's think Like

Anthony Kimani 56:01
Okay, okay sure. You to take care

Transcribed by https://otter.ai
Edited by Mads Robdrup

APPENDIX D. Interview with interviewee from VC 2

Transcript of Interview. Interviewee from VC 2, Saviu Ventures

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee: Arthur Thuet
Time: 42:45

Henric Hansson 0:00
is not going to be published in any external journals or anything like this. But we're, we're still happy to send you the results, if that's of interest.

Arthur Thuet 0:08
Oh, yeah, that is I work in, I work in that area. So if anything interesting comes up, you know, happy to have a look.

Henric Hansson 0:15
Yeah, that's what I thought. Okay, so maybe we can just jump straight into it. And I just want to ask you a little bit about, about your fund and and maybe you can just comment in general how is it structured and what kind of investments you're doing.

Arthur Thuet 0:36
So, I'm so sorry, I didn't get the first part of the sentence how what is structure the, the, the, the fund Saviu Ventures or the industry or the sector in in Kenya or in East Africa is

Henric Hansson 0:53
just just the fund. How is how is it structured? Well,

Arthur Thuet 0:57
We are not a fund. We were more like We are an investment holding. So we don't have the same compliance as a fund even though we have some compliances of course, but it's more like any type of business that receives funding from external investors. But everything is gathered under one, one umbrella which is Saviu ventures and there is not a GP company and then a fund that is fueled by by institutional investors. So we gather family offices, European and African family offices, European with the entrepreneurs and the private equity fund from Mauritius that wanted to either discover the tech industry in Africa because they have interests on the continent, or, you know, like people that were purely interested in exploring a new area that they don't know about. It's just like they believed what we told them. And, and they, they, they just bought what we had to what we had to offer because they they thought it would be a good a good investment.

Arthur Thuet 2:32
So that's why like it gives us maybe a bit more flexibility and we are able to go faster than the average fund, which has to do a certain amount of things. It doesn't mean that we don't do due diligence properly, but I guess our internal processes are a bit less heavy than some of those guys out there.

Arthur Thuet 3:04
It also means that we, we raise capital every year. So usually like closed end funds because they do the first one, then they have, you know, 10 years ahead of them, and they they raise another another fund

during that time. We don't do that every year we raise new new capital from existing investors or new investors that we convinced to invest during the next round. And it's, it's kind of, it's less comfortable, I guess, for us, because like, we need to fundraise. Same way as entrepreneurs do, and at the same time, deal with the existing portfolio, look for new opportunities, analyze interesting startups and run due diligence. So All that at the same time. But on the other hand you know, I guess that was the only way for us to do so. Because it's, it's really hard to raise venture capital fund, especially as my partner and I are not necessarily investors. But so we don't have like the background that would allow us to say, okay, we raised 50 or 15 million dollar fund, and we're gonna raise cash with the DFIs or with like, big corporates or with the funds of funds, because those guys just don't give money to people like us. So we had to find a way around that and, and the only way was to find people that have interests in that particular area. And that, you know, like, understand that the profiles that we have is not necessarily a bad profile when it comes to investing in startups, wherever in the world, but yeah, in Africa as well.

Henric Hansson 5:16
And you mentioned that it's, the Tech is sort of your niche market

Arthur Thuet 5:22
Yeah. But yeah, so we invest in startups and tech, it's always like a, you know, I can say like, you're right now, the number of pure tech companies that we have in the portfolio is not it's not that high. Tech is more of a long term process. And kind of, it's more like a mindset. So we know that we're going to get there. But we know that in order to get there, you want to do things offline. Otherwise, like, it's just it's not gonna work. And we've seen some examples. Even in our portfolio, just like we, we took some wrong decisions, assuming that taking a digital approach would work and the market would adapt. It's not that easy. So, yeah, I'd say like, we we keep that in mind all the time, that realities have been different.

Henric Hansson 6:34
Yeah. Sorry. Is that something you found out along the way?

Arthur Thuet 6:40
Yeah, yeah, definitely. And then I guess the situation's are very different depending on the countries. A tech entrepreneur in Kenya is going to have much more can we say facilities in English I don't know is going to have an easy and easier life than the guy in, in in Francophone Africa because of the habits of different people people in Nairobi or even in rural areas are used to certain things that people in rural Ivory Coast or rural Benin are not used to. So you probably have a higher reach and a lot more digital habits. I'm not saying that they are like 10 years ahead, but probably a few years. So it's definitely gonna come in the other parts of Africa but for now, it's not like that. So there are a lot of differences depending on the countries and I guess a lot of differences between Nigeria and Kenya and maybe Ghana and the rest of the countries. It's always like we speak about English speaking Africa being super ahead in terms of VC and Tech. But no, that's both Nigeria, Kenya and South Africa. Otherwise, like a while maybe Uganda is but I'm not even sure. I don't know Uganda very well. I mean, there are a couple of times but only in Kampala, so I can't talk about that. But if you go to other countries, it's not that it's beautiful.

Arthur Thuet 8:47
I think basically, if you want to build something fully digital now you need to do that in the Capital City otherwise it will require a lot of OPEX, which is fine, honestly, we just need to find entrepreneurs that know about that, who are not gonna just to try to execute on a fully digital approach. We've learned that of course, like ourselves, we've made some small mistakes, assuming that it would work and it did not so now we try to be careful with that. Nonetheless, I guess it's the right time to push for those services and it is the right time to invest money on the conversion of your customers from an offline approach towards

an online one. Especially, during those hard times, where we're going to have some time to communicate with our customers, and try to get them to learn how to use the digital platforms that we've created and see how they react and how they give us feedbacks. So yeah, right timing, but long, long process.

Henric Hansson 10:21
Yeah. Yeah. But but so it's mostly tech startups. And is that an early stage or what?

Arthur Thuet 10:30
We've done from very, very early, we've even created a company. So more like on a startup studio mode. And all the way we've done all the way from pre-revenue. We've never done the pre-series A as first investment, we've done pre series as follow on investments, but otherwise, all of the investments were early stage, seed or pre-seed. We have stopped doing pre-revenue for a simple reason that I think if you do if you do pre-revenue it must be some kind of a business model as a fund, and you need to know them in order to succeed. Kind of like an industrial approach to investment where you can do five investments per month. And we don't have, we didn't take that path. We want to have a small portfolio with companies that we really like and that we really believe in. We would rather have like 10 companies that we can support throughout their investment life than you know 40-50 companies in the portfolio, where we don't even know who the founders are, and we were not able to communicate with them. And where we will just wait for those who will die to die and those who will succeed to succeed, and then we'll be able to spend some time with the company. I mean, it's not that it wouldn't be interesting, but that's not what we want. So now we do companies that have a few thousands of dollars of revenue per month when we invest. So from, I guess the smallest or the smallest was zero, but now we start the smallest was like 5 K and the biggest revenue at investment was around 20 k a month.

Henric Hansson 13:00
And sort of where does this leave you in terms of ticket sizes?

Arthur Thuet 13:06
We've done between $50,000 and $800,000 as first ticket, and then with the follow ons. We were able to put more money in each of those companies if we, if we believe in it.

Henric Hansson 13:28
Yeah, I see. And how long have you been operating in Kenya?

Arthur Thuet 13:34
So in Kenya, our first investment happened in September 2018. It was investment at Lapierre glasses, which is an eye care company, and now we have three portfolio companies in Kenya. We are closing on the fourth one right now. So approximately half of our portfolio will be in Kenya once we're done with that new investment.

Henric Hansson 14:02
Okay, so the other companies are in other parts of Africa?

Arthur Thuet 14:05
Yeah, the other companies are in Francophone Africa. Rico, Senegal. We'll set some subsidiaries in Mali in now. Okay, that's it. And now we tried to stop doing Francophone Africa because we're tired of being the only ones doing venture capital over there. And so we want to mitigate or resolve a little bit. So we'd rather you know, make a few investments in Kenya as it's an area where we know we can find we know

for sure that in the company's teens, we can find some some some some follow on investors that that will join us in the in the adventure.

Henric Hansson 14:53
Yeah, yeah, I see. And in Kenya, are there any like success stories and ventures that you've been there fairly for a fairly short time, but still, are there any success stories or?

Arthur Thuet 15:06
Yeah, yeah, definitely. That glass, that glasses company when we invested it was, like five months old. It was only operating in Kenya doing $4,000 revenue per month. Really, you know, really, really young company. Very, very early stages of its life and now it's in five countries in both English and French speaking Africa. It's doing like around $60,000 of revenue per month, profitable. You know, kind of like pioneering the new way to sell eyeglasses, prescription eyeglasses in Africa in an affordable way. So it's a good story. Good, good human story, I guess. And and it's also like financially it's been quite impressive, how they used our money to just increase the footprint and also dramatically increase the revenue you while staying near profitability. So, and this is really some the kind of companies that we are looking for. We're not looking for the ones burning hundreds of thousands of dollars per month. We don't feel very comfortable with that for two reasons. The first one is that, okay, it's our not very deep on service side. Our fund is quite small, we need to raise capital every year. So we don't have that kind of mattress where if one intrapreneur comes and say - Hey, I'm in deep shit, my numbers are not looking good. I need 200 K - we don't know if we're going to be able to do that, because it can depend on the timing that we have for our own fundraising. And the other reason is actually quite relevant right now, as we never know what was going to happen.

Arthur Thuet 17:36
I wouldn't have said that about viruses a few weeks ago, but more like on the funding cycles and, and it's never easy to find money anywhere in the world. Of course, it's easier if you have a good project, but you can take longer time than expected. It's just like it depends on the random encounters, how big your network is, do you meet with the right people at the right time? So, you know, like you can have a delta of of six months I guess for fundraising. So, you want to make sure that your companies are not like you know burning too much otherwise those could be complicated curves. So now with the COVID that is same same kind of explanation, I wouldn't like to have or to be running a company that is burning 200 k per month because revenue are basically gonna go down to zero. So then what do you do? We have a lot more, a lot more people to fire than the guys who try to be a bit more balanced in their development. And I think that a company like the eyeglasses has a good personnel for the explaining type of company that we try to find.

Henric Hansson 19:14
I see. And in general, what is your perception about the amount of investable ventures in the Kenyan industry? Is there sort of a good fit? Or would you say that there are too few ventures like the ones you just explained? Think compared to more developed industries.

Arthur Thuet 19:35
I don't know, because like, I've never done VC in in other parts of the world. But I guess it's either like Kenya is a bit different. You can see more and more entrepreneurs, more and more people who just quit their jobs to start a venture, even though they know that they're not going to make money for for a few months. So I guess in order to get more more of those, we need seed investors. We need people who can write $50,000 checks. We need incubators who are able to just give them 20k or 30k to do the first hirings. And as long as you don't have that, as we might have in western countries, and trouble finding love money,

as African people usually don't have love money, so we have to rely on the smaller structure to be able to write smaller checks.

Arthur Thuet 20:47
A lot of people won't be able to to create companies that can put food on the table. You don't necessarily want to take the risk or is going to wait a bit more, a bit more a bit more. And at the end of the day, that's what's really matters, I guess. And minimizing the number of startups that could exist on the on that market. But honestly, we receive a lot of deal flow, and we are not lacking investment opportunities. We don't have time to review everything so that's why now we get to be picky on revenue or stuff like that. I don't see, especially not in Kenya, I don't see the deal flow as a problem. There are many and the ecosystem is quite rich and is quite interconnected, so you can meet people easily. It is really unique, I guess, and I don't know Nigeria quite well. But Kenya is a bit unique in the sense that it's always been quite livable, and small and quite nice. You have the few tech hubs that everybody knows about. Everybody is like moving around and investors all have an office in Nairobi. So it's also like a good way to share good opportunities and share the thoughts with people doing the same job on the market or on the the entrepreneurs that we get to meet. At the end of the day, if you had, you know, like all those funds around they all say that we can write $50,000 checks is, or even like 200 or 300 or 500. But the truth is that investors mainly work on it for big funds, they mainly work on, you know, multi million dollar deals because they just need to use it to invest their cash. Today, they might be able to take some smaller bits just because they, they can tick all the boxes and say like, it's a super team. The market is great, the product is great. The momentum is great. We don't have a lot of work right now a lot of good deals. So okay, we're going to be able to execute on a 500 k dollar deal.

Arthur Thuet 23:52
But if you have 100 million in the bank, you're not gonna you can't focus on such deals and I'd say like even even smaller investors, I can see a trend. And that's quite interesting honestly. And if we can find some opportunity like that we'd be happy to get them. What's the best way to get because at the end of the day, your job is to get money back to your investors. In order to get money back to your investors, of course, you need to do an exit. And, and my question and maybe you have an opinion on that, but my in opinion it is easier to get money back to to your investors if you own 40 plus percent or 30 plus percent of significant startups you know, kind of be like series A startups doing rounds above a million dollars doing revenue above a million dollars every year. But you own 40% of it? Or is it easier if you own 3% of a huge deal startup valued above $50 million, that's gonna have some new rounds of funding in the coming months. And as a small investor, you're like, Okay, yeah, I've been there for for two years, I want to cash out. I can do a good deal good discount on the price on the underround price. And so we can even see like some smaller seed fund trying to focus on those series A deals that they know are going to go to Series B or series C. And at series C, they're gonna raise the flag and say, I want out. But I guess if you really try to do seed investment, you could get stuck, because no one is going to buy you out, no one is going to buy 40% of compound shares in series A. that is that's just not what they want to do with cash, they want cash to be injected in the company, they want it to actually create value, and they don't want to give money back to Saviu so that Saviu can please their investors.

Henric Hansson 26:26
So there are not really any opportunities of doing exits, actually?

Arthur Thuet 26:30
Mm hmm. Yeah. No, I found out that there are none. And this is why I believe that those smaller micro VCs are maybe making making the right decision. Now because the it's probably a better way to a more secure way to do an exit than just investing big tickets in future big startups. So of course, like you can you could

cash out a little bit, you know, like, one quarter of your investment. And there are always some possibilities. Myself, if I invest in a series A startup, I'm gonna be like, I don't want anyone to go out right now, because I don't want my money to be used for that. The most I can do is to buy out some shares from the founders because I know that they are paid like 1500 dollars per month, and they want a bit of cash. So I could do that. Buying out the business angels that have been there for a year would be like a pain in the ass. So yeah, I get everybody's point on that topic. But it's a tricky thing to handle. And I guess I'm not saying that we're going to get stuck in five years. We are quite flexible. As I was saying, we don't have a clear timeline, we can stay as long as we want, and we even put that in our thesis, saying that we do all the hard work with the entrepreneurs for the first years that are shaky. Whether it's about finding the customers, trying to secure them, trying to grow the company to make it profitable. Why would we force ourselves to just sell our shares once they get above that threshold where it's now starting to be a big company that has a reputation and all that? Why shouldn't we say so, and I guess our investors are quite happy with that state of mind. But for other funds that are closed then, I'm curious to see how they're gonna handle the situation in five years, because we see a lot of closed-end funds that are going to have to give money back to the investors, and I'm curious to see how they manage to get that cash.

Henric Hansson 29:11
Yeah. So there's a bit of a sort of liquidation issue there.

Arthur Thuet 29:16
Yeah, either they're gonna give some huge discount, or they're going to extend their extended funds. anyway they don't have much of a choice.

Henric Hansson 29:26
Yeah, I get your point. I was just a little bit curious. You just said before that. You industry in general. No, you're kidding. The lack of hope. So yeah. Sorry. Okay. So I was just wondering, are you using accelerator programs to a large extent, to discover viable firms for investment?

Arthur Thuet 29:58
No, not at all.

Henric Hansson 30:01
Not at all. And how is that?

Arthur Thuet 30:06
How is that? How do I find that when we find the deals that we do, or why don't we use accelerators?

Henric Hansson 30:14
Yeah, maybe why don't you use the accelerator?

Arthur Thuet 30:19
Because? I don't know. That's a good question. We haven't felt we needed to use them [the accelerators] in order to find good opportunities. Like I was saying, We have plenty of deals on the floor. For most of the investments that we have done, we received the opportunities through our network. So there was validation from people that we trust that it is a good opportunity, and then it was confirmed during the due diligence period. So we don't really feel the need. And again, we don't do 10 investments per year, we do two to three new investments and then all the rest is follow on. So if I was speaking to all the accelerators in that in that area, and I would receive like 20 opportunities per month from different source, and I would have to lie all the time saying, yeah, please send your deal flow, send your info and

never executing on a single deal, which I guess would put me in a bad position on the market. So first of all, we want to be honest with what we are able to do, we try not to oversell Saviu as a very active [investment company]. We are probably one of the most active seed funds but not necessarily in terms of volume of new investments. But as we are able to reinvest every year in our companies, we still have some pretty strong activity compared to the other people in the market for seed and pre seed companies. But I wouldn't like to have my inbox filled with new opportunities every week. And also like when you speak about accelerators like I know a few of them like Growth Africa, Katapult but it's more in Northern Europe, but they have some African ventures. There is also one in England, Founder's Factory. But otherwise, I guess there are not that many. There are not that many. I just speak with them. And when we speak with them, for example, if I can remember when I talked to the Growth Africa guys, we made it clear what our criteria were. So that we, you know, we just make sure that they send us relevant, relevant cases, and not just all the things that they have in the pipeline. Now, the main reason is that we don't need to have such a high number of deal flow.

Henric Hansson 33:44
Yeah. And you were talking a little bit about the network's there. Is that something you had going into Kenya or is that something you've had to build? build on it?

Arthur Thuet 33:55
No, no, we had to build it. So we had more of an operational network for potential customers, former companies, but otherwise it was a it was we had to build that.

Henric Hansson 34:09
Okay, and what would you say in general? Is the level of information available about the ventures and the markets they operate in? Is it sufficient? Or how do you get it information?

Arthur Thuet 34:20
What do you mean the level of information about the ventures? It's quite confidential. And we I mean, you mean before we speak to the to the entrepreneurs?

Henric Hansson 34:30
Yeah. I was thinking more in general. Perhaps VC firms in Europe are operating a lot on TechCrunch or using these sort of?

Arthur Thuet 34:44
We read all that. It's interesting to read about it because you need to know about the market and you need to know people to know names. So it's kind of mandatory. But we don't do cold sourcing either. I'm not looking at TechCrunch Africa every morning and sending out emails to meet with the founders that they talk about. Because they don't have time and we don't have time to do that. We are a small team and we don't do much new investments every year. It's just like having an overview of what's happening and what investors are investing and making some deals. So we use Disrupt Africa, Qvartz, Jeune Afrique and TechCrunch.

Arthur Thuet 35:46
But more like in a kind of a sporadic way.

Henric Hansson 35:50

And is that affecting sort of, I'm thinking now more about the information you actually receive. Once you have initiated a relationship with the venture Is that sort of slowing down your due diligence process? Or have you noticed any sort of difference in?

Arthur Thuet 36:06
A lot of them [the startups] are not prepared, and they don't know what it takes to raise capital. A lot of them have data rooms, but most of them have a lot of information missing in that data room. So this is something that we try to transmit to our portfolio companies, helping them to actually be investment ready. And that makes such a big difference for the first conversations that you have with an entrepreneur, if everything is well organized, all the documents are there. Then you always have some additional information that you require. When you know 90% of it is already there, it just gives such a good impression on the company. It's very important.

Henric Hansson 37:15
Yeah. And another thing we've seen a lot in the literature is sort of there seems to be somewhat of a debate between locally born ventures and you know, foreign founded ventures. And do you see any difference in the way you sort of find the locally born ventures in relation to the ones that are foreign?

Arthur Thuet 37:43
Honestly, we've never really asked ourselves the question. We invest in people, because we do see something in them. I've met a lot of foreigners that were not giving us a good feeling and I met a lot of local people that were not giving us a good feeling. In our portfolio we have a mix. We have 60-70% of local founders and the rest are foreigners that just wanted to create a company in Africa, because they have lived over there. Usually, it's because they have lived over there. We don't really make any difference. My feeling is that if you want to be relevant and you want to invest in local founders because they just know the place. You know, I wouldn't trust a Kenyan guy to build a venture for French people. I guess it is the same way the other way around. Even though, of course, if you have lived over there, you have experienced the people and their habits. It makes you more and more relevant throughout the years. But yeah, no. A Kenyan guy coming to Paris to build something there for the first time, I'm not going to risk my money there.

Henric Hansson 39:18
Start making French crèpes. No, but I see your point. But have you seen also that there are some some challenges that I mean, you thought you talked a bit about this local knowledge? Have you seen foreigners founding companies who have left that sort of local knowledge?

Arthur Thuet 39:40
Yeah. And we did lack local knowledge as well as investors. As I was saying before about the fully digital approach and what you think the market is able to integrate and when it's not. Definitely we've seen it. We've also seen like some, you know, I think that maybe foreigners are more used to venture capital and startups so they come to Africa, they launch a startup, they raise capital more easily than local founders. They reach very high valuations that are not sustainable and not necessarily justified by strong revenue growth. Just because you know, they find capital all over the place, in the US or in Europe. And they speak well, and they can sell the whole African story and then everybody gets excited. But at some point, like when you become so big that no local Africans, Africa specialist funds can get into the rounds that you're organizing. And your valuation is one of Silicon Valley, you're gonna get screwed. So I guess that's maybe a bigger issue than people might think.

Arthur Thuet 41:13

For foreigners, it's like they are trying to replicate the scheme that they have seen in their home countries or home continents in Africa, while like, you know, things are not stable yet as it could be in western countries in terms of VC. I'd be careful about that with foreigners. And then yeah, local context. Yeah, habits and stuff, but people can learn. And I mean, of course, so after a few months or a few years ago, you're totally, not totally but you were more able to create a local local startup as a foreigner. For example we made these mistakes.

Arthur Thuet 42:13
Guys. I hope you don't mind, I have a call starting in two minutes. Maybe I don't if you have other questions. Sorry to interrupt that.

Henric Hansson 42:21
no, no.

Arthur Thuet 42:23
I am able to have another chat whenever you want.

Henric Hansson 42:26
Yeah.

Arthur Thuet 42:28
I can't miss that one.

Henric Hansson 42:29
Perfect. Of course. Thank you so much for taking your time and we will let you know once we're done with this report.

Transcribed by https://otter.ai
Edited by Mads Robdrup

APPENDIX E. Interview with interviewee 1 and 2 from VC 3

Transcript of Interview. Interviewees from VC 3, Chandaria Capital

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee 1: Bruce Lule (Principal)
Interviewee 2: Hamza Butt (Associate)
Time: 1:09:51

Hamza Butt 0:09
I think probably we go through Chandaria capital, who we are and how we were formed and then we just take it from there and see how we can help these guys out as much as we can. Take any questions if we need to. I guess they have questions that they're already prepared in advance. So we can probably jump into that and then just see how the conversation goes. So do you want to do the introduction? Or do you want me to the introduction?

Bruce Lule 0:36
I'll do the intro, and then you add in, sound good? Yeah, great. So effectively, Chandaria capital. We're a venture capital fund for a high net worth family and a group of companies. So the Group of Companies are called the Chandaria group of companies and have really been operational within the region for up to 60 years through their primary business, Chandaria Industries. Chandaria Industries sells hygiene and tissue products. So they've been doing this effectively for 60 years. And have grown to be one of the biggest producers of tissue and hygiene products in terms of market share within the Sub-Saharan region and in doing so have developed a lot of business links and business networks. Yeah, and I guess through developing all of these business links and business networks and seeing the opportunity for other businesses, within the Chandaria group, they formed various entities to take advantage of various business opportunities in Africa. So the group also has an entity called Chandaria ventures. Chandaria ventures invest in more mature companies and has made investments in banks, insurers holding significant positions within them. And then they have another entity considering properties which sells and leases properties within Africa, UAE and Europe and then effectively us, Chandaria capital. So to just give a broad understanding, the Chandaria group is owned by a high networth family, called the Chandarias, which are in various kinds of business interests, as I've described as a whole family, even greater than this family that owns the Chandaria group, in particular. So effectively two and a half years ago, Myself and the Chandaria group, formed this venture capital fund, Chandaria capital to effectively invest in early stage businesses that we believed could confidently scale across Africa. So I'm sure that Hamza has explained what we believe are those kinds of companies.

Hamza Butt 3:21
Actually I wasn't so maybe you can just touch upon that.

Bruce Lule 3:31
Okay, so with regards to these companies that we believe can confidently scale, obviously, they must be running a business model that is scalable. So in terms of being scalable, it can be offered to a wide range of customers, we see, can continually be increasing, and basically can be customized across the continent. We wanted to invest in business models, where we see that they have very strong barriers to entry and competitive advantage. So that as the business takes on more customers and so on, competitors wouldn't necessarily come in and take their market share easily. We want to invest in companies led by teams that really understand how to operate a business efficiently and have developed what we believe are strong

ideas in terms of scaling it across Africa, and that we can use the expertise from our group of companies to verify and check if they're thinking in the right kind of way. And then, lastly, is we wanted to invest in companies where they provide an impact to the broader ecosystem. Being helping people get employment, improve their standards of living, and so that there is a general positive impact from the services that we're providing. Now, another part of our thesis is we like to invest in early stage companies. But we like to invest in early stage companies that have a proven track record. So in terms of us looking at these, basically four elements, we want to see that businesses are so actually having a scalable business model. So traction to us is very key

Henric Hansson 5:50
sorry if I'm interrupting you, I was just a little bit curious there. What does that mean for for your ticket sizes? What are your ticket sizes, typically?

Bruce Lule 5:59
Okay, cool, I'll get into that. Yeah, I'll get into that. I'll just finish this point and get right into it. So in terms of traction, we really need a business to prove that A; it's providing a product to an underserved market that's willing to pay a premium for it and that more and more customers are attracted to that. So that's, that's, that's really the key thing. So really proving the business concept, and really proving that there is a market. So effectively, we're a pre-series A investor. Our ticket sizes basically range from, I'd say $150 K to $500 k we previously used to invest from $50k but we've seen that there is a need for bigger tickets. Even within this pre series a space. We follow on in companies that we invest in. If it makes sense in terms of economics, we invest up to 150 K to 500 k in a company and we're sector agnostic. So, we really across sectors as long as we really believe that it's in line with our thesis, and not particularly sectors. And really what's the key thing that's important to us and to our investors is that we use the expertise or experience of our group of companies to help these companies.

Bruce Lule 7:57
That is quite unique to us. We play a role as we do invest money, and capital, but we really use the expertise that we have from ourselves as team members, because we are all actually quite knowledgeable on the African context and actually have strong network, but then also use our group of companies to help these companies scale. Yeah. And that proves to be very useful to a lot of companies that need business contracts and suppliers to provide them goods at subsidized rates and so on. Hamza is there anything else to add on to that?

Hamza Butt 8:43
I wouldn't necessarily add on, but maybe just add a little bit of color, I suppose, on what Bruce is saying. So, you know, Bruce has already touched on the requirements that we would need to see in companies that we're investing in. So that's traction, product-market fit, strong team, clear barriers to entry and ability to continue to develop defensibility. Those are all really important to us. And on the value add side, you know, typically, because of the types of entrepreneurs we decide to back, these are the entrepreneurs that need hand-holding every day. These are entrepreneurs who just need strategic support and advice and also the things that we can really add on to. So typically, as Bruce is saying, that tends to be networks, that tends to be strategy development, and that tends to be brand building, and just overall business development. And basically, just navigation through both the business and political side. I think we started in pretty well, um, I don't think there's much more to add on that. Yeah.

Bruce Lule 9:42
Okay. I guess maybe just a quick background on our team. So we have a managing partner who is the group CEO. He has led Chandaria industries from 2012, really scaling that company into one of the biggest

tissue and hygiene product manufacturers here in eastern central Africa. Then you have myself, I am born and brought up here in Kenya. I studied abroad in the UK, economics and politics, worked at Credit Suisse where I assisted in the management and setup of investment banking businesses in emerging markets. That's effectively my background, did an MBA and then came and helped set up this venture capital fund, and then maybe Hamza can you just give a quick background on yourself.

Hamza Butt 10:48
Sure. So similarly, born and raised in Kenya, I studied in the UK. I did my undergrad international business and I did a Master's at King's College in international management. Then I took another master's degree in energy trade and finance. After that I came back here to Kenya, I didn't end up working in finance, I ended up working in operations because I had an operations background and management background. So I ended up being the head of operations at a group of healthcare companies, we were setting up seven hospitals across the country. So oversaw the setting up of hospitals across the country. I really didn't like being in healthcare, it's not something I'd grown up wanting to do. It's not something that I felt like I had the emotional capacity to deal with because it's quite challenging, as you can imagine. So I took a step back, I'd always wanted to get back into investing, and it's what I'd studied. But given that I had help set up to early stage companies and then essentially grow them and take them to a certain point of operational capacity, I really wanted to get into the venture side more than the private equity side and really just get involved in you know, helping grow businesses, helping scale businesses. Leveraging a strong operational background to my understanding of businesses, and combining that a little bit with finance, so then I ended up joining the team. I've been with them for about two years now. So yeah, that's me, that's Bruce, that's passion, and that's Chandaria capital. So happy to jump into your questions now.

Henric Hansson 12:18
Thank you. Thank you so much. You ticked all the boxes for our background questions. So, thanks for being so prepared for that. One thing I was wondering is just if you have any sort of success stories in terms of investments? You've only been operational for two and a half years but but maybe you've already seen some of your ventures that have outperformed others?

Bruce Lule 13:00
So effectively, I think, you know, we have had a lot of successes on our portfolio already. I'd like to potentially highlight 2, and then maybe Hamza can take over from there. So, in two and a half years, we've actually invested in 12 companies. So our portfolio has grown quite proactively, and I believe it's, it's not been equal in terms of year on year, I think it was something like 3,5,6 or something of that sort, something more like that. So so as as we have been in the industry, as our name has grown and so on, we've taken on more each year. But yeah, just to go over our, our successes. I think one of our clear successes is Cobo 360. Cobo 360 is a company that is optimizing logistics in terms of trucking services. So effectively it's almost like an Uber for trucks. Fleet owners can basically put their fleets on this platform and businesses can order trucking services to pick up and deliver goods. They also provide additional value add services, such as sorting out the goods that are being transported and providing financing for drivers who actually do these trips, so that they can have financing to pay for, kids school fees and so on. They alsop have subsidized rates for fleet owners on fuel. Also they optimize payments. So typically in this kind of industry, payments between firms tend to take 60-90 days. Through their platform, they're optimizing it so ensuring that its owners get payments. The company has grown relatively well. We invested in them about two years ago now when they were only operational in Nigeria and they were at a valuation that was just getting double digits and effectively the last valuation on that company has been a triple digit number in USD. Goldman Sachs has invested in it. Shortly after we invested, IFC invested in the company. The company is now operational in several countries in Africa. It's operational in Kenya, in Uganda and Togo. So in several companies in Africa. Therefore it is employing a lot of people and really

optimizing logistics, delivery, and really providing a strong service. What I really like about Cobo 360 is that it's really proven that our investment thesis is viable. There are companies that you can invest in at a relatively early stage, scale them and prove that they have competitive advantages through the services that they provide. And yes, as an investor, we also get the additional benefit that we have made a considerable return. If you think of the difference between the valuation we entered, and the valuation that we are in at the moment, we are already looking at 7-8X on our money, so we're quite happy about that particular investment.

Henric Hansson 17:35
Okay, I would just like to ask you, in general, what is your perception of the amount of investable ventures in the Kenyan industry? Do you think there's a good fit for these sort of Ventures that you just mentioned or sort of too few in comparison to available investors?

Hamza Butt 18:08
Yeah, I'd like to answer that as it's something that we've been speaking about quite a bit and doing a little bit of reading on recently as well. So look, I think it's important to note that as an overall the whole venture industry in Africa is young, right? It's less than 10 years old, across the continent, maybe it's touching 10 years, if you really factor in how solar companies grew, and how they raised money in the past, especially, DFI's and non commercial funds, essentially. So it's a very young industry. The amount of investable is probably not like what you'd see in the West, it's obviously in comparison to Silicon Valley or when you compare to Southeast Asia, it's not that high. But a lot of that will change as the industry gains a little bit more experience as the industry gets a little bit more success stories. You know, the more kinds of deals that are like Cobo 360 will encourage entrepreneurs and entrepreneurship . This will take people from corporate jobs and move into entrepreneurship similarly. Already there's a good amount of funds coming in, right but it will probably not reached a point of saturation. Because the venture scene is very split in terms of North, West, East and South Africa. So your North Africa deals which typically tend to get funds from MENA based funds. So Middle East and North African funds. The West African market was a little bit more developed because Nigeria is just such a huge population. It's got such a young population, and it's got a very high number of engineers and software engineers. We've seen a huge growth in software and tech businesses and then here in East Africa, Kenya has been the hub and is primarily been driven by strong infrastructure and mobile money, right? So mobile money to Kenya so you can see it in the trends right. FinTech is something that's done really, really well in Africa. And that's because more and more people have access to mobile money. In East Africa, in particular, you see Branch and Tala doing extremely well in the past. You look in West Africa ,in mobile money, you have guys like Flutterwave, they've just, you know, raised $25 million from visa alone and they are almost hitting unicorn level. Right? So, look, there's more and more opportunity. There's actually been on, South African ed tech startup and they did a full exit driving huge returns to the investor. So their deals right. But, you know, the industry is growing, it needs to grow, it will grow. We will see more startups coming in and it will just justify the funds. Right. And, you know, I know it s a lot of implications already at the moment, you know, more money, more monies Less startups meaning it has an impact on valuations especially right. So sometimes it can distort valuations as purely a demand and supply thing.

Hamza Butt 21:11
So, yeah it's an interesting question. There's room, right. And it's actually part of why we are investing in this space that we are investing in. Typically there's been very little capital available to startups between seed and series A. There's a lot of risk for funds to take on, especially funds who didn't have local context. So the fact that there are more and more funds setting up with local context, local LP's, local GP's, and local teams, or foreign funds are coming in and getting in local GP'S and local teams is really helping to drive a lot of context. But also that by investing in the space that we invest in we are likely to see more returns

because there's already funds that are there that do series A, series B ,Series C investments than private equity, right? The stage that we play in almost presents a bit of an arbitrage opportunity to make some money, because A; nobody's coming into the space, and B; ticket sizes at A and B round a bigger so it's less and less likely that people will buy each other out at that particular stage especially because funds have similar ticket size based at that point. Therefore it also gives us an opportunity down the road with more exit opportunities, it will see more funds, allocate some attention towards this space and it'll bring more startups into the system. We have a lot of good international players coming into the space like Antler which is now here in Kenya and they're doing really well. They will also help grow the quality of startups and entrepreneurs in general. I think it's important to add to the context, that it's an early industry.

Henric Hansson 23:00
That sounds a bit like you're you're sort of winning strategy here is to hit that sweet spot between seed and series A is that true?

Hamza Butt 23:09
Its a win-win situation as it's beneficial to us and also to start-ups because we're actually providing really critical capital.

Bruce Lule 23:18
Maybe just to add on to that, what we're beginning to find is that, with the very successful entrepreneurs here, that maybe started startups that have grown from about 2014 and 2015 there's starting to now come up with ideas for new for new startups given what they have learned given that the companies have scaled. So even though we typically look at pre-series A, we are starting to dabble with one or two seed series from proven entrepreneurs. As Hamza sums perfectly put, effectively there is little funding towards the beginning within. There's a lot of more later stage VC, and later kind of money. So what we're doing is efficient to the whole ecosystem because we're really helping to build these companies at that early stage. And it's great for us because then we have exit opportunities.

Henric Hansson 24:26
That's super interesting. I'd just like to ask you a little bit about how you're actually finding your ventures?

Bruce Lule 24:32
Yeh before that, Hamza do you want to talk about Soko Watch, which another great company that we're quite proud of?

Hamza Butt 24:47
Soko watch is very interesting deal. Soko watch is an on demand delivery distribution system platform, and they basically deliver goods to informal retailers, small informal retailers. Now, by profile these retailers are, people living at the bottom of the pyramid themselves, they are entrepreneurial themselves, but they have cash cycle problems, their businesses turnover very little money in a day. So they're selling FCMG goods from the side of the road. I don't know whether you guys are familiar with kiosks but they are essentially kiosks here. Soko watch is able to deliver to the goods that they would normally distribute within two to 2-24 hours with a fleet of delivery tuk-tuks and thus eliminating the need for these guys to go early mornings into the center of town and, take a pull cart with them at five o'clock in the morning. to get some goods. Soko grew organically. And I mean, they grew really well. When we invested in Soko watch, they were doing very small revenues and now they're doing you know huge amounts. When we invested in them they were doing in the thousands of revenue per month and now they're hitting in the millions USD range per month in revenue. By doing that they've been able to grow their gross margin so on and so forth and naturally. This is the kind of success we're talking about, not just based on paper

returns or gross value of the equity value of the company but seeing this company grow from a tiny fleet of like 20 TukTuks, servicing a 200-300 kiosks, to now servicing over 15,000 kiosks in the region with a fleet of over 500 TukTuks, growing the monthly revenue so significantly and then pivoting into a very interesting sector. Because they have been able to build up enough data on the customers who were buying from them, they have developed trust, etc, etc, and introduced credit. This is something that has never been available to this particular consumer right, to be able to get these goods and pay for them seven days later, rather than pay for them immediately, right? So it's giving them a little bit of cash reserves, helping them buy more goods and sell more goods. So, the successes are different. Similarly with Soko watch, we invested in them at a very early stage, we invested at a sub $10 million valuation, and the valuation that is now in a significant range. They've done really well.

Hamza Butt 25:09
They're above $50 million.

Hamza Butt 25:34
Yeah, above $50 million within one and a half years. Well, two years. They've grown the valuation from sub 10 to a $50 million plus valuation. So that's a success. Similarly across our portfolio, we have other portfolio companies that started off with in one particular place, Coco networks is another really good example. So Coco networks is a is a tech company that has both hardware and software solutions aimed at the urban retail market. And essentially, their first product is a gas cooker that uses ethanol fuel, and they built ATMs that actually dispense this fuel. So you just go to the ATM and you dispense a new fuel canister with ethanol. They have really strong partnerships with the main supply of that here which is Vivo energy. These cookers are better than you know kerosene and charcoal and they were doing good stuff with it, but success for them has as has also changed a little bit because now they also sell carbon emission credits to these huge carbon emission marketplaces across the world, because of reducing the amount of carbon emissions so they get certain tokens, they can then sell them into exchanges. So this business went and built a multi million dollar revenue line as an add on, and that's something that was just from the strength of the entrepreneurs, the knowledge of the entrepreneurs and the network of the entrepreneurs to go and build out something like that. So success for us is both paper based but also you know, invalidation of business models and growth of business models, and you know, also just in general in technical stuff that they're doing.

Henric Hansson 29:42
Yeah, that's super interesting. I'd just like to know a little bit about how are you finding these ventures? Are you using accelerator programs?

Hamza Butt 29:53
Primarily we will get them through our networks, because we have extremely strong networks between the three of us Dash, Bruce and myself. We have really, really strong networks. We have a co-investor pipeline of almost 80 funds across the world. So we share deals, we talk about deals, we share stuff that's hard. Similarly, we have a really good reputation and relationship with entrepreneurs. So entrepreneurs tend to refer their colleagues to us. Accelerators less and less so. A little bit of that comes down to the fact that accelerators here have a bit of a different approach and have not necessarily had the best track record yet but then you know actors like Antler and Baobab networks and they have different approaches. These accelerators are also putting their own money into the businesses and actually have skin in the game. So Antler and Baobab are definitely going to be future sources of pipeline for us, I can see that. See that.

Bruce Lule 30:59

I totally I totally agree with what you're saying, I think with regards to the accelerators, we've had accelerators that teach good business practice, which is great. And it really helped people to manage businesses well, however, we are venture capital investors. So we are really looking for those scalable business models, and that kind of hockey stick kind of stuff. Unfortunately, that's not what kind of pipeline we have been getting from the accelerators. However, with with one or two new accelerators, we see that we will probably get more hockey stick kind of growth companies. Yeah, so our best things come from is VC networks, or personal networks. We're all born and brought up here. We all went to good schools. So we know a lot of entrepreneurs personally. And yes, the entrepreneurs that we've invested in and that interact with us will give references.

Hamza Butt 32:08
We get approached as well. A lot of good startups will approach us and then if we haven't heard of them, you know, we'll get a message from them saying they're raising capital so on and so forth.

Bruce Lule 32:22
In the beginning of the fund, I always thought that it was very important that we established a very visible track record so that in the long run people would be coming to us and it seems to be like

Henric Hansson 32:41
I just like to ask you what do you think is the is the main issues with accelerators isn't that they are not providing large enough sort of tickets sizes? Or what is sort of hindering you from actually going there and finding your investments there?

Bruce Lule 33:06
I think what the accelerators are helping to solve a problem. That is around how we professionalize our businesses so that any form of investor or financier would come in and help those businesses grow. Fair enough, that's what they have done. But you know, there's always two ways to look at it. Not every business that exists is a venture capital kind of investment. Business, not every business is gonna have a hockey stick. So they were dealing with a lot of businesses that are just not particularly venture capital businesses. Further on that, the course material is not really providing what is needed to be a venture capital business. It's more just about professionalizing the business. So I think that's why they have so far proven to be not necessarily good mechanism.

Hamza Butt 34:25
I also think, you know, locally, again, I'll go back to the experience of the general industry, right. Locally in Kenya, there was the whole wave of tech businesses, in general of these startups and people wanting to enter into entrepreneurship and stuff. So some of the people that were running these accelerator programs were not as experienced or whatnot and were not bringing international best practices, which is obviously super helpful for companies that are going to go and raise money from international funds in the future. So I think it was just a little bit about a learning curve for some of the accelerators as well. And it's something that they're doing. They're developing, they're iterating. One thing that is quite interesting is actors like Antler and Baobab, they put their money where their mouth is. They don't just take you through the program, they will take you through the program and you'll either fall out of the program or you go through the program and actually get money into the business.

Hamza Butt 35:27
So these businesses will need money at that early stage super early no matter what right? So when Antler is actually providing that money they give them some runway to go and raise money elsewhere and understand the value of using this money, cash burn, etc, etc. And it's just bringing in good practice. More

and more people will do it. And I think you know, we'll see a situation where accelerators are bringing out good quality deals in the future. But I think it'll take again, some more success stories, understanding best practices and building the right types of networks. I mean for example, some of the local accelerators here have never even approached us. And maybe that's not their own fault. Maybe it's just a capacity issue where they're working with startups and don't have the capacity to have people working on the fundraise side as well. But there's so many accelerates that I just hear about, and I dont know about them. In theory, they should know about us, and we should know about them. But you know, I don't necessarily want the sector down because there's some really good people there. There's some really smart people there. There's some really hard working people, then there's people that are going to make a difference. But like I said earlier, the industry needs to grow experience in general.

Henric Hansson 36:51
But it sounds a bit like you believe that the key factor for these accelerators is to provide this pre-seed funding?

Hamza Butt 37:00
Maybe that's not anyone else's opinion or the fund's opinion as an overall but for me personally, I believe in it and the reason why I personally believe in it. I think these businesses need money right. At the end of the day if you don't have money, you don't know you can't keep the lights on. You can't pay your employees, you can't scale, you can't sell and business will die, right. It takes a while to raise money. It's not a one or two week process. It can sometime take a year to raise money, right? Some will fundraise for two years. Eventually they raise their money but these are companies who are raising much larger tickets. But can you imagine for a small company that's going through an accelerator program that is super young, they have no capacity and no runway to be able to be engaging in a super long fundraising process, right? Especially if the funds that are going to look at them are going to ask them for traction. So it's a weird dichotomy between the startup in terms of what do we do with the money? Do we have money to do stuff? And without that money to do stuff we can actually go to? You know, it's kind of like with uni students, right? The employers like, "do you have work experience?" And you're like, "No, I'm trying to get work experience to get a job" So it's something similar to that. I think it's a bit of an interesting space. So if companies have a little bit of money, where they can go and get traction, like bruce was saying, right, the beginning traction is important, especially when it's competitive.

Henric Hansson 39:23
Now, can I just ask. Do you think this initial funding gap, that seems so so necessary? Do you think there is a way for VCs to fill that gap?

Hamza Butt 39:39
I wait for more angel investors to fill the gap. Typically that would be the process in most venture economies. People would raise that money from angels or from friends and family right? But again, you know it comes back to the use of the industry as an overall. There is money here. There are people here who can write Angel tickets, and who can deploy that money. It's just about investor education and experience, right? Because these investors have traditionally been used to traditional investment. Real estate, general securities, government bonds and so on, so forth. They are used to that kind of stuff. So, more and more people need to prove out that there's an opportunity for angels in this space to make a little bit of money and convert them and get them thinking about the space. And we've seen it, we've seen groups of high networth individuals come together and set up in informal SPVs to make these investments. We've seen an increase, especially over the last year, of angel investors, and I think there is where there's going to be growth for these companies to get these money and how they reach these angel investors will be important.

Bruce Lule 41:02
So effectively I agree with Hamza. I think it's really a place for angel investors to really become more active and really help support the ecosystem's growth. I think it's a challenge as there's a lot of talk here about various groups, finding it easier to raise. And typically what we are beginning to find as a trend is that a lot of entrepreneurs who are struggling to raise money is because they are finding it difficult to unlock an angel network that will enable them to effectively start up the business and grow. In terms of venture capital, capitalist, maybe even later stage funds playing a part in that. I don't know we could all dedicate maybe percentage of our portfolio to early stage, like seed stage, but you have to think of a very bespoke model, given the economics of doing so in terms of a fund is very difficult to justify. So, yeah, getting back to it, it's really about getting our angels active. And I feel if we do get our angels active, you will see a lot more homegrown businesses scaling.

Henric Hansson 42:27
And just relating to that. You talked a little bit about getting the investors trained and the knowledge and these kind of things. What do you think about the information available about ventures today? And also the markets that ventures operate in? Is it sufficient, is it easy to gain this information and how do you deal with it?

Hamza Butt 42:53
If you are in space, you know where the information is.

Bruce Lule 42:57
Yeah, I agree. (on the level of information)But I think you have to be a bit proactive to get it. Like I can't go to a government desk today ask, what is venture capital? How do I invest? What structure should I use? But if you get into the right networks and meet the right people, you need to be quite ambitious. And probably there is room for more information to be made more readily available to local investors. Local investors can go onto the internet and get this; it's quite available worldwide.

Hamza Butt 43:48
I mean, you know, you can use databases like TechCrunch, Disrupt Africa also Baobab have built an incredible platform where you can find out a lot of stuff about what's going on in the venture capital space here. If you're signed up to play you know, resources like pitch book, you get a lot of information on the global scene. One way that it will likely happen is again on success stories right? For example ours is a bit of an interesting situation because we were a angel investor turned into a venture capital fund. Someone like Darshan, our Managing Partner obviously, you know, their family is exposed to a lot of other high net worth individuals. Similarly, you know, we are exposed to the high networth individuals so you get to talking, you get to speaking, you get to explaining the type of risk profile of the deals and then subsequently the type of return profile on the deal right. So the more success stories that will come, it becomes an easier conversation, you know, people will have a drink over a glass of wine and talk about the stuff so it'll happen but it is a gradual process. Similarly, there's a lot of other people who are taking action so for example Strathmore business school are trying a program were they are educating people on what this whole new asset class is, the venture capital asset class. Everyone knows private equity, everyone knows, pension funds and government bonds and stuff. So people are now trying to get people talking, but you know, then it'll come back to are the quality of the people who are coming for these things. So I think it'll happen over time driven by success stories.

Henric Hansson 45:41

So it sounds a bit like since you have the boots on the ground, and you've had that you've both grown up in Kenya and sort of have the networks. It feels like you can get some, some sort of, I don't know you can get more knowledge out of your actual networks. How do you think it works for foreign VCs for example, how did they get this information?

Hamza Butt 46:05
Foreign VCs are getting more and more turned on to the space in general, because I mean, everybody knows Africa's and there's all the good things a venture capital fund would be looking at when they're looking at emerging markets. So Africa is sexy for venture capital, because it's got the youngest population of any continent, the middle class is growing faster than in any other continent, government and infrastructure is changing frequently. It's arguable that the African economy is growing, at an exponential rate. So good funds will be turned on to this in, any case. This is information that they'd be aware of this information and that they'd be looking to factor into their decision making, especially because a lot of high net worth individuals also want to start making positive impact. So you see people from abroad, who are looking at what they can do to make an impact, but also make commercial returns. It's happening, and it's hard to ignore the data that the continent is providing.

Henric Hansson 47:12
Okay. And what is your current process for finding locally born ventures?

Bruce Lule 47:27
I think it's the same as what we had mentioned before. So it's really through networks, raw venture capital networks, to the networks that we have established on the ground through us growing up here and knowing entrepreneurs here, through entrepreneurs that we've invested in and interacted with that had a positive experience with us. I don't think it doesn't really change between whether the business is locally grown per se, or has been grown foreignly and then brought here or by foreigners, it's the same.

Hamza Butt 48:14
How would we look at it is if, Company A is solving a valuable problem with a real solution? Right. And if they are, then we look at them. Typically, I mean, if you see our portfolio, these are these are all African problems that are being solved by African type solutions. So there is product-market fit, these are African solutions for African problems at the moment. Yeah.

Henric Hansson 48:51
Yeah, the reason why I'm asking about this is that you often read about that, you know, one of the strategies for finding ventures is through networks in Kenya. And and I think where the literature has been divided is that some people talk a lot about that you find this through the networks. And if you have a lot of local networks, that's where you find the ventures. And if you've studied abroad, like both you and Bruce have done, that's usually where you get your networks from. So I'm just wondering, do you think there's any truth to that argument?

Hamza Butt 49:36
In any case, it's true. I mean, if I just flip it a little bit, one of the things we look at when we look at our entrepreneurs, when we make our decision to invest in them, we look at their ability to raise capital without us. People come to funds and they're like, Oh, hey, I'm raising funds, Can you make a few introductions? Then good entrepreneurs have a pipeline of who they should be talking to, and are approaching them themselves. So we look at their ability to have their own network as entrepreneurs, but then to flip it onto the investor side. Networks are fundamental. I mean, you can't find deals without network. To look at ourselves, we're a generalist fund, we are sector agnostic. So we have to build a

network, it would have been pointless to be a generalist fund and not have a network of people across sectors, right. So for instance, if we want to know what's happening in the healthcare sector, naturally, we would need to know investors in the healthcare sector who are looking specifically at the healthcare sector, right. So by going to them them we are able to understand what's happening in that sector. Because the ecosystem is much smaller here. And you've already touched on earlier in terms of the availability of deals locally, or in Africa, in general, you're aware, okay, you can't do all the deals. You're never gonna know all the deals, right? It's difficult to know all the deals. But you if you stay alert, just yesterday, for example, we were having a conversation with a venture capital fund based in Silicon Valley, but they're funded by North African LPs primarily. I was speaking to him, and he pointed out that there's a very interesting healthcare deal in Nigeria that we had never heard of and that's why the network drive to know to be speaking to and you're lucky sometimes to hear about really good deals, and that's how you find them. So network is fundamental to the venture space.

Henric Hansson 51:56
That's really interesting, and I just wanted to know you mentioned that you provide this strategic services to to your ventures, or to the ventures that you invest in as well. Are you working operationally in companies you invest in as well?

Hamza Butt 52:12
So that's interesting. What we do is slightly unique to the continent, and there are very few other people who can do what we do. We're part of a larger group of operating companies, right? We can even test products by plugging them in. So for example, Cobo 360 they are essentially, you know, providing the super truck security solution. So we can test them, we can use them, we can reference them, we can do anything we want to to understand there business. Similarly, one of our other investments is in a company called Satfi analytics and they're basically built a piece of a very clever hardware and software, which is like a Fitbit but for machines. So it gives you areal time data on the performance of these machines. And it's basically helps companies with their operational engineering efficiency, or basically just efficiency, right. We can test that. We can literally take that piece of hardware, connect into our factories, and then basically get that information real time to see if this is valuable? And then, in the case of Safi analytics, where we've invested in them, we can help them iterate we can help them build the product, we can help them understand the product, what's working, what's not working. With Cobo 360 we can do the same. We can tell you our pain points, you can understand our pain points as a large customer go back and sort that out. Soko watch for example are distributing our products so we can get data from them and consumer we were never getting data on before and we can subsequently also give them more efficient ways, we can help them build their own network, we can help them get more and more supplies, credits, and so on and so forth. So we wouldn't go in on a day to day operational role, we wouldn't go as me or Bruce and sit in the company in period of time, like I said, the entrepreneurs that we invest in, often don't need this kind of support, they would need much larger, bigger picture support, like what I'm going to write. In some cases, obviously, we can't do that. In some cases, we will sit on the board and we'll give advice on a board level. In some cases, we have no board seat, but we'll essentially sit with them every quarter to basically rip through the last quarter understand what has been happening, operational pain points, you know, economic financial pain points, growth challenges, so on and so forth, and really delve into the business and then see what they can be doing and what we can be doing, and how to basically help them with these problems.

Henric Hansson 55:00
And you mentioned before, that you have sort of African entrepreneurs with African solutions to African problems. And I just wanted to know, how do you think it would work for? For someone who doesn't have

that knowledge? Who doesn't have this, this local knowledge if you have a completely foreign founded company?

Hamza Butt 55:18
We have foreign founders! I mean, look, it's African problems and African solutions, I mean, now is a mix of both local and foreign founders. We do have a lot of foreign founder, the founder of Soko watch, he's from Chicago. He kept his really good business model and did a great job with it. The guys from cocoa networks are Australian and they came and built this model. The founders of Cobo 360 are local guys. They built out a really really strong business and really helped it grow in scale by being so so it's just about back in the right entrepreneur. It's got nothing to do with where they're from and what you know their social background is, its more to do with their ability to grow a business and execute a business properly.

Henric Hansson 56:05
Yeah. And in terms of that, sort of like understanding the local context. Do you see a difference in how foreign firms or foreign ventures and local ventures do?

Hamza Butt 56:16
We just see a difference in how good entrepreneurs and bad entrepreneurs do. That's it.

Henric Hansson 56:24
And I just wanted to ask you, how do you see that the government is currently influencing the VC industry?

Bruce Lule 56:42
Do you mind us not answering that question? Yeah, we could just eliminate that question. Okay.

Hamza Butt 56:57
There's a lot of reading available on how to elements here, not just in Kenya, but in Africa, there's a lot of reading available on steps and measures that the governments are taking towards supporting entrepreneurship and young entrepreneurs in particular. So you wouldn't find a lack of resources on that particular subject matter.

Bruce Lule 57:15
That's true. But then what I'd say to add on to that is, then think, how effective are these services? And are they actually providing what they're meant to?

Henric Hansson 57:24
Correct? And the reason why I'm asking these sort of questions about the external environment, the government about how it is for locals or foreign founders or foreign employees and local employees, as you as we spoke about before, the VC sector and and the sort of startup sector is rather young, in in comparison to, for example, Silicon Valley, or England or London or whatever. And so that's just why I thought it would be interesting to see what is sort of different in Kenya and and perhaps in eastern Africa, in comparison to, for example, Silicon Valley. Because what you see, when you read a lot in the in the literature, you often see that it looks on a theoretical level, like there's a lot of copy paste like that you've taken the VC industry in, in Silicon Valley and and that it's been basically just pasted onto Kenya. So I just wanted to know if that's sort of what we're trying to find out as well. Is that a good model or if it also needs some sort of local adjustments? That's why I asked a bit more Kenya specific questions.

Hamza Butt 58:36
Thats a valid point. I can say there's a lot of discussions that are going on and the government does engage in that. And again, like I said, if you read up on it, you'll find it. There's a lot of sandbox discussions around regulation and, and how to support this particular ecosystem. .

Henric Hansson 59:18
Okay, but I think that I sort of ticked all my boxes. I'm super grateful that you took your time to do this with us. Mads do you have anything that that we sort of that you think I missed during this graduate

Hamza Butt 59:34
His just been busy writing notes

Mads Robdrup 59:37
Thats correct Hamza! It's nice for Henric and I to divide the roles when we interview. So I think in terms of the boxes, I also agree with Henrik that we kind of ticked all of them, whether or not that that goes for The legal or institutional framework around the Kenyan industry that's okay that you don't want to go into that and fully understand. And if it has anything to do with whether we will publish anything in the report, I'll just say that our thesis is only to be used for university purposes. So, so you should not be afraid of anything going out to public.

Bruce Lule 1:00:25
I think to be honest with you, it's also a complex question. And I don't think we can answer it well, because there is a lot of government efforts to do stuff and to help the ecosystem growth, but we're quite active in the ecosystem. So have we really felt the effectiveness of what we're doing? That's, that's a, that's a question on its own. And, you know, is it that we don't know? Or is it that they're not being effective in letting us know so.

Mads Robdrup 1:01:12
Yeah, I think perhaps I can, I can ask a different question. So we know that there is the East African private equity and venture capital Association, that lobbies the government on behalf of all VC firms and private equity firms. So how does this work for for Chandaria capital? Do you have a voice in terms of this EAVCA? Or do you feel that your needs are sort of being heard anywhere?

Bruce Lule 1:01:45
I think the EAVCA is actually a very useful institution in the ecosystem because they look to do a wide range of activities and it's really to support the venture capital and private equity within these ecosystems. This is in terms of growth and in terms of having the right environment, to proceed and so on. So we can pitch our views on certain items to them, and they can represent us. And I've seen them actually representing the whole ecosystem on very important issues such as taxation. And so in terms of representation and what we believe is right, and how the ecosystem should grow. I think they have proven to be a very valuable part in the in the ecosystem. Actually they are also educating investors in terms of investment practice, how x,y,z ed should be done. So it is actually a very valuable institution in this ecosystem. And I'd say that they're playing a very good part terms of supporting the growth of venture capital and private equity here.

Mads Robdrup 1:03:31
Interesting, I see that also because this industry is rather newest as you both have explained very well. How has EAVCA, how has it lived up to its role or responsibilities and how has it developed in terms of the activities it's performing for the venture capital firms?

Bruce Lule 1:03:53
Okay, we have only been a member of it for a year or so. So what I can say, I can really only speak about the context of Chandaria Capital, I think it'd be good to interview a few other players. But what I've seen in terms of legislation and lobbying, they've been very active in ensuring that legislation is to the benefit of the VC ecosystem. And I know they're also quite proactive in terms of finding out details in terms of legislation that could affect us if it was brought into play or pulling back investments that we have made. We have been very proactive even in this COVID 19 scenario, in terms of producing information as of to what's happening in each of these countries. What are the restrictions. Therefore, what are the possible impacts to you as a company. The have been very proactive in terms of training people to understand various forms of investment procedures. So really from from our view, or from my view, I think that those are the ways that they are being proactive, which given the size of the team is quite admirable.

Mads Robdrup 1:05:23
Wow. Yeah. And I can say that from, from my perspective as a complete external person to this eco ecosystem. We had an interview with Eva, the director of the VCA that these changes in terms of corporate taxes or the law about the mergers, they're really something that perhaps could help the VC funds a lot. So, indeed, it it seems that it's it's been something that has developed a lot.

Bruce Lule 1:06:03
They are needed, they play an important role. I think a lot of the funds that are in the ecosystem are not like us, so they're not home grown. Given that, when you come into an ecosystem and a government decides to set this legislation, you know, that legislation might not necessarily be to the benefit of the ecosystem. So local fund like us, at least we have channels to have conversations on higher matters. Were as to a lot of funds that come into this ecosystem don't have those channels. So the EAVCA really helps such institutions, to get ahead and and set up quickly.

Mads Robdrup 1:07:01
Yeah. All right. Thanks a lot, Bruce. I was wondering if you have any any aspects of of these things that Henrik has covered in previously in the interview that you think we should perhaps look more into in terms of our research?

Bruce Lule 1:07:18
I think actually, what could be quite valuable is actually back in government, on the ecosystem, really seeing what what initiatives are government taking on and what level of impact are they having on the ground. I think that that would actually be quite valuable to look into.

Hamza Butt 1:07:46
I'm gonna put a link here to an interesting opinion piece by a fund based in Morocco, we know them well. These are not necessarily our views entirely. But it's a very interesting read that I think could give you guys a little bit of insight in terms of the space. Because it touches on in Henrics point about deal availability and it touches on our point in terms of early stage investing and it touches about the future outlook and how it needs to grow and stuff.

Henric Hansson 1:08:13
Thank you so much

Mads Robdrup 1:08:44

Yes, sure. We're also very grateful for you taking the time to to participate in the interview Bruce, and of course we will share with you both the report and and a small piece that's more easily readable. In terms of the interviews, we have so far interviewed, the Pangea accelerator. We have interviewed the EAVCA, Enza capita and hopefully we have some more interviews coming up next week.

Bruce Lule 1:09:27
Sounds good. Sounds good.

Hamza Butt 1:09:30
So guys, thank you once again for your time.

Henric Hansson 1:09:36
And I also just wanted to say that if you ever need something in Denmark or Sweden, or should invite you for lunch or dinner, when we actually get to come to Kenya.

Transcribed by https://otter.ai
Edited by Henric Hansson

APPENDIX F. Interview with interviewee from VC 4

Transcript of Interview. Interviewee from VC 4, Pearl Capital

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee: Hiram Githuku (Analyst)
Time: 1:15.43

Henric Hansson 0:00
I would just like to jump straight into it and by asking you if you could describe your fund and what kind of investments you're making a little bit more in depth?

Hiram Githuku 0:12
Currently, at Pearl Capital Partners we are managing a fund based in Uganda, it's called yield Uganda Investment Fund which was raised in 2017. Our anchor investor is the EU, European Union, who have invested through IFAD, and we also brought on board NSSF Uganda that served as part one of fundraising. Second phase we brought on board the FC investments and OSF through the Soros Economic Development Fund. Okay so they joined the fund jointly and brought on board 8 million euros, each contributing 4 million euros, and we closed the fund with 20 million euros as of last year in June.

Hiram Githuku 1:24
We mainly invest in Ugandan agribusiness, where we are basically interested in scalable business opportunities, SMEs operating within the agri agribusiness value chain.

Henric Hansson 1:40
I understand. And I saw on your website that you also made some investments in Kenya earlier. I think the last one was in 2014. Is that right?

Hiram Githuku 1:52
That is through our earlier investment funds. This is our fourth Find, our first fund was Africa - the cultural capital, which we raised in, you know, 2005-2006. It started as a holding company. And when restructuring the process or the investment structure, you know, where you have the LPs and the GPs, in a way of improving the governance structure, that's where Pearl Capital was born. We had the management section and now the fund as a holding company. In 2008 we raised our second fund that is Africans - the investment capital. This fund was focusing on seed seed businesses. And we raised a total of $12 million. We invested in a total of 16 companies within the larger East African countries, focusing on Mozambique, Malawi and one investment in Botswana, one investment in Ethiopia. Then our third fund we raised $25 million in 2010. We invested in 8 opportunities with African - agricultural capital fund is Yeah, so we raised $5 million. We invested in 8 opportunities in Kenya, Uganda and Malawi. So those were basically the main focus with most of the opportunities, you know, coming in Kenya and Uganda.

Henric Hansson 3:48
Sorry. I just wanted to know, so the Kenyan fund, or sort of the Kenyan investments, what was that part of your of your second fund?

Hiram Githuku 4:00
Yes, second and third.

Henric Hansson 4:04
Yeah. Yeah, as Mads explained, and I'm sorry if there are a lot of questions about Kenya, but that's sort of our research focus. I'll probably ask a lot about, about Kenya going forward.

Henric Hansson 4:17
Fantastic, I know Kenyan as well.

Henric Hansson 4:21
Yeah. And also, of course, it's super interesting to hear about the differences between these countries. And s, but can I just ask, what happened with these or maybe, first off, what kind of investments were these in, in in Kenya? What size was it and sort of which industries and so forth?

Hiram Githuku 4:44
Our focus has basically been agribusiness since 2006. All the investments that we've made in Kenya are all agribusiness, in agro processing, primary agriculture and business providing peripheral support to the main, outstream of the agricultural value chain. So that includes basically logistics services, companies providing cold chain facilities. So we mostly considered them because they kind of support the larger, you know, agriculture, mainstream business. Our investment size was basically $500,000 - $2.5 million. The reason why we focused on that is that in the front management, one of the challenges that we face is the management costs, and if you want to have, and maintain, a lean team entirely, then you have to focus on businesses that have huge potential for scalability and businesses that will require a huge investment opportunity. That is to end up with a manageable portfolio of companies instead of ending up with 20-25 businesses which you can't manage internally. So that is one of the considerations we are making when setting up the parameters.

Henric Hansson 6:42
And in terms of managing you said it's crucial for you to have fewer investments that you can focus on rather than having a lot of smaller investments that you can't really focus on. Does that also mean that you support the firms operationally or is it mostly strategic?

Hiram Githuku 7:11
Our support is mostly strategic. Basically once we invest in the company our support is at a strategic board level. What we normally do is to support the business by improving the corporate governance, improving the internal control measures, ensuring that the internal control is robust and that the reporting system is improved. Also we are involved in setting up a team of professionals that will be able to oversee the daily operations of the business. So we rely on the promoters who rely on the management, rely on the professionals that we set up there. So by using the controls and the input system of governance, we get to have an input in the operations of the business, but we don't participate in the day to day running of the business.

Henric Hansson 8:15
Okay, can I just ask, what's sort of your background and what's sort of your main responsibility? Right now at Pearl Capital?

Hiram Githuku 8:27
Right now as an investment analyst. The firm is structured in such a way that you get allround exploration exposure, you know, from deal sourcing to portfolio management. So, I'm part in deal-sourcing, pipeline generation, pipeline development, you know, screening of the pipeline because at times, it can have 20 companies in the pipeline and then after screening you end up with only three, or one opportunity which

is which is bankable. So it's also a tedious process, which is also very important. Then, you know, writing investment memos which we present to our investment committee for approval, and then post-investments involvement in the portfolio management by supporting the companies at a strategic level.

Henric Hansson 9:37
Yeah. And how big is the team overall?

Hiram Githuku 9:46
Overall we have two offices. Our headquarter is in Kampala and we have an office in Nairobi. Most of most of the staff are now in in Kampala, since that's where the active fund is. Overall the team, including the admin and the finance team, we are 15.

Henric Hansson 10:10
I see. And how long was the fund operational in Kenya?

Hiram Githuku 10:21
The first fund, the investment phase was 5 years, up to 2009. Okay. Yes, and then we just exited. we exited our last investment in 2018.

Henric Hansson 10:40
From Kenya or East Africa in general?

Hiram Githuku 10:43
The East African region but the last investment was in Tanzania, but it was a regional fund.

Henric Hansson 10:51
Okay. And, in terms of the VC investments in Kenya, are there any success stories? Did you do any good exits in in Kenya

Hiram Githuku 11:19
Yeah, we have a couple of success stories. From the second fund we have not exited but from the first fund we have exited one company which was called Real IPM. It was a certification company that was operating in this sphere and also providing ancillary support to the farmers to improve their productivity. It it was focused on supporting organic farmers rather than you know, using this type of pesticides. So farmers aiming at the organic market in the EU market. So they were supporting the farmers with the certification process and also supporting the farmers by improving their activity without using external chemicals. So basically using using organic ways of you know, preaching, waste management and pest control. Unfortunately we missed the opportunity because we didn't invest in equity, we only invested in debt. This show how the business has performed over the years and how the main promotors exited the opportunity and you know, how through external buy-outs to a bigger strategic company, they made 10 times the money of the initial investment. Yeah. It is one of our success stories.

Henric Hansson 13:36
And if I can just ask, what do you think was it that made this venture so much more successful than any other ventures? Was it their understanding of market? Was the staff or what was it that made that venture so particularly successful?

Hiram Githuku 13:56

Number one reason for success, I would say the promoters [founders]. They were coachable people, they had the business acumen, and they also understood the market, they understood the business model. They were not experimenting. It was a very early stage business but they understood their market. Also the fact that they were willing to, you know, restructure the company, improving the corporate governance and the internal control of the business. Also, they were well aligned with us, very receptive in, you know, in the process of bringing on board professionals who could support in running the businesses. So, that is one of the reasons why the business was successful. It always happens in a success story, if the promoters are well aligned with the investors and willing to listen to the professionals.

Henric Hansson 15:13
So, the founders were Kenyan as well, or where are they from?

Hiram Githuku 15:29
No, the founders were from the UK but had lived in Kenya for more than 15 years. They had a very good understanding of the local, you know, the local environment.

Henric Hansson 15:45
Have you seen that that's sort of crucial for the ventures that are successful, that they understand the context, the local context?

Hiram Githuku 15:55
Yes, it's very important. For some of these businesses you have to be aware of the environment, you have to relate well with the value chain whether you're sourcing products from the farmers, you have to be able to relate well. Mainly because the farmers have to trust you, they have to believe you. You have to have exposure to the market in order to understand your customers needs to improve your business model. If your customers are demanding high quality, then, you go back to your suppliers and you also demand the high quality supplies. If you have a good understanding of your suppliers and your farmers, then, they're receptive, and you can also implement some of the measures to improve the quality like training and a business support. So, yeah, it's very important.

Henric Hansson 16:51
Yeah, it makes absolute sense. Have you seen cases of the other way around, where people have not had that understanding?

Hiram Githuku 17:03
Yes, it has happened. Okay, of course without disclosing the name. One of the investments made in Kenya where we had a founder who was an American, who had been in Kenya for about three years. He wanted to venture into the flower business, but he didn't have a good understanding of the local local context, the local farmers,the local framework, the policies around land, policies around farming. He had good business acumen, but the lack of understanding the local market made the business drastically underperform within the first few years until he brought on board professionals who had good understanding of the local market. Since we are in impact management we are not only providing commercial capital, but we also focus on impact return. So the kind of impact are you making. So, the business was underperforming on the financial returns but also on the impact end so we had to bring on partners who had good understanding of the flower business, partners who had an understanding on how to mobilize farmers, how to develop a good core network, and how to train the farmers to provide quality product.

Henric Hansson 18:59

Yeah, I see. And can I just ask on a bit more general level in Kenya now? What is your perception of the amount of investable ventures in the Kenyan industry? Is there a good fit? Would you say that there are too few ventures in comparison to to the investors or the venture capital investors?

Hiram Githuku 19:30
It depends which industry you're looking at. Looking at a whole industry, the entire, you know, market as it is, we have opportunities. We have bankable opportunities. But then when you come back to the impact point of view, you know, the impact venture capitalist, we have a lot of parameters that we'd have to take into consideration. This is why we end up narrowing down, and you might end up with zero, or one bankable investment. You have to strike the balance between commercial returns and the impact returns. So, sometimes it might seem like, we don't have bankable investments, it is because of the parameters that we have to meet. So a business is making a million dollars in terms of revenue, but it has zero growth in the network.

Hiram Githuku 20:47
Or, it's highly automated such that it can only provide a minimum of 50 or hundred employees. So sometimes you have, you have to be diverse in terms of, looking at it from the impact point of view. So, yeah, we kind of sometimes narrow down to very few investment opportunities. I could give an example with our current fund, where we're constrained with the single market forecast, single sector forecast, which makes the investment very risky. Yeah, so, if I were to advise on, developing or raising of funds within East Africa, then it would be ideal to have a multiple country focus, it would also be ideal to not to limit yourself into one sector. It would make more sense in terms of the de-risk profile and also diversifying your, you know, your portfolio.

Henric Hansson 22:18
Yeah, I see. And I just wanted to ask you about the impact investment requirements, is that the ESG criteria or is impact mostly in terms of employment?

Hiram Githuku 22:33
Yes, but there is also, like our previous fund, were some sort of the KPIs which you were supposed to meet. These were for example, revenue increase per dollar invested, increase in household investment per dollar investment, increase in growth earnings per dollar investments. So it's quite, it's quite advanced and sometimes it's well defined, but then if you look at the entire spectrum, the KPIs are a bit limiting, you know, in terms of the number of investment you can pick.

Henric Hansson 23:39
I understand that this this affects your deal sourcing, as you said, but are you using any of the accelerator programs in in Kenya to discover viable firms for investments? Or were you doing that when you were looking into Kenya?

Henric Hansson 23:54
Yes, we do. Sometimes we look at an investment where it's scalable, but it is not investor ready. Then we'll refer them to, you know, to transaction advisors or accelerator programs. At least, you know, to be made invest ready for a period of one or two years. We even currently rely on them as we sometimes come across potential pipeline companies which seem as if they have high potential, but they don't meet the minimum criteria for us to invest. So you have that case, you have to refer them to a different firm, which would advise them for a period of one to two years and then they'll be brought back to us when they're ready.

Henric Hansson 24:59
Okay. Understand, so the firm's you invested in, in Kenya, were any of those directly from an accelerator?

Henric Hansson 25:08
Yes, some, like IPM was from an accelerator program that was sponsored by a think defeat.

Henric Hansson 25:23
Yeah. Okay. So in general, you'd say that accelerator programs are good for bringing investable opportunities to you?

Hiram Githuku 25:35
Yes, accelerators are good, to some extent. The reason I'm saying to some extent is that it depends on the parameters. You see, when a business goes through an acceleration program, if the program is not well tailored, to meet what we demand, or what we require as the threshold to invest in a company, then it doesn't work. What we have come to realize is that sometimes it becomes much easier for us, as an investment team, to close deals which have come directly from an accelerator. If you look at the period of time we spend in a particular deal. It takes less time to close a deal that has come directly from an accelerator program. This is basically because they have information supply available, because that's actually one of the challenges that we encounter, especially during due diligence. They have advisers who understand the entire process for information providing and also guiding them through their holistic outlook of the market and also they are very supportive in our due diligence process.

Henric Hansson 27:13
And apart from accelerators, what are your other strategies for deal sourcing?

Hiram Githuku 27:26
Referral comes in handy, Investor conferences, subsector marketing, you know, you map out and identify some of the companies operating in a particular sector and then, you know, you pay a visit. The fact that we've been in the industry for more than 15 years, also gives us an edge when it comes to sourcing deals. I mean, we've created a good name, within the networks. Sometimes we also co-invest because we are not fully allowed to market ourselves as a commercial bank. So you have to use other avenues, you know, approaching banks sometimes, you know, banks have these, they have these deals which are hanging in their pipeline and the reason why they're hanging is because the balance sheet is probably thinly capitalized. So, we come in and provide some equity to some extent and then the business will extend its working capital facility. Sometimes, you know, we use structure facilities which was poorly structured to provide the business you have flexibility to access more sustainable capital. So those are some of the strategies that, you know, we explore within the industry.

Henric Hansson 29:21
Yeah. So it sounds like understanding where you find all these conferences, but also really building a brand name and keeping a lot of connections seem to be important sort of strategies. Is that Is that a fair admit?

Hiram Githuku 29:40
Yes.

Henric Hansson 29:41
I see. And you talked a little bit about before, that information can be a large issue. What would you say is the level of information available about ventures and the markets they operate in?

Hiram Githuku 30:01
On a scale of 1-10, most of the ventures rarely have sufficient information to use so I would give 5. So what happens in this industry is kind of weird and also sometimes it's very funny how these entrepreneurs operate. You know integrity is very key especially when you are fundraising. So, sometimes you will find that you know a founder who is approaching a venture capital with a few sets of accounts, which he prepared for the fundraising, and then they have another set of accounts which they prepared for the tax man, and then a third one which reflects the actual position of the business. So you have to earn their trust to access the real original books of accounts, which speaks to the business performance, because that's the only way you're going to have a viable investment decision. It's one of the challenges that we've been experiencing in the industry, you know, someone shows the books just to impress you, but then, you know, if you dive into the business and you make a simple analysis of the value chain, then you will understand.

Henric Hansson 31:54
yeah, but it sounds like this is sort of a challenging process? Does it impact your performance of due diligence on the firm?

Hiram Githuku 32:08
Yes, it does because sometimes when you identify some of these challenges, they're basically loopholes. So, the first thing is that these sorts of challenges will definitely be fair, they are sort of embedded in the process, it's basically an integrity issue. So, you approach every investment opportunity with that skeptical mindset, anything can happen, but then when this happens, you start facing the red flags that you start identifying in the process. These are integrity issues. So you have to raise it with the management. If the company has proven to be less ethical before I invest, then I have to explore the options on whether I want to move forward with someone that is less trustworthy or take that risk and have a very hostile environment. So sometimes they can take us back and we even reject some business opportunities based on the integrity and ethical values of the founders and sometimes we can have a chat. Others portray a very innocent picture, you know, was in a way of, this is man's money to the finance department. So it's a case by case by. But yes, it's always a big, big setback.

Henric Hansson 34:05
I see. And you mentioned that for example, understanding the value chains will sort of increase the likelihood of you actually, you know, seeing through these issues, are there any other sort of strategies or or ways that you can sort of navigate around this issue of, of lack of information or wrongful information or these kind of things?

Hiram Githuku 34:38
Yeah, basically, we rely a lot on the industry experts. Now part of the challenge we face as venture capitalists in the entire sub-saharan region is the lack of professionally published secondary data. It's rarely available, so we don't have access to that data. So, part of the process or normally what you do is to rely a lot on the industry expertise. Either external firms that you know, individuals working within different oversight bodies, government or industry bodies, or private related research that has been conducted by the private sector.

Henric Hansson 35:43
Is that mainly websites or is it? Do you have to have a personal meeting with someone?

Hiram Githuku 35:49

Yes websites, but we prefer to collaborate to get the information through one on one interviews, or questionnaires. So, it's basically what we do. Most of the information we have is through collaboration with industry experts.

Henric Hansson 36:20
You said that these are one on one interviews. How do you get those connections?

Hiram Githuku 36:28
You know, being in the industry. That is one of the advantages that we have, you know, we've been in the industry for so long, so we've created a wide network of professionals. So sometimes you just request a courtesy call or a courtesy visit. Usually they're kind enough to provide the time that you may need. A coffee or lunch or you can have a professional meeting either in our office or their offices. Also for instance, you know, government bodies or donor funded projects, which are ethically mandated to support a particular industry, and to catalyze investment in a particular industry. Say for instance, you know, you want to do research in seed oil Uganda. So, currently we have IFAD, who have been very active in seed oil in Uganda. So I am expecting that they would have access to some level of research that we probably don't have. So we would rely on the research that they have, since they are mandated to promote the seed oil industry and to catalyze the industry. So sometimes you work hand-in-hand with donor funded projects to get expertise from those who are doing research in the local market, and the government bodies come in handy around regulatory framework.

Henric Hansson 38:20
To switch topic, do you have a current process for finding locally born ventures? And is that process different from the way you find, you know, other type of ventures?

Hiram Githuku 39:19
No, we don't. We actually don't have a preference. As long as the projects are bankable, we take them all. We don't have a preference, we don't have a matrix or balancing local re-insurance versus international ventures. Of course because of the outlook, you know, the market and the industry out there. We have to be cognizant that we really need to support the local ventures but we also look at how these ventures are made to support the local economy, and if it is, how is it supported. So we really don't have a preference as long as it is meeting those minimum parameters in terms of the impact, in terms of supporting the local economy, and supporting the local entrepreneurs, directly or indirectly in terms of knowledge transfer. So, one of the advantages with, you know, these international founders who are coming to start their ventures here is that they are well advised you know, with the institutional environment, and this was also that aspect of knowledge transfer. So, it's also very important because we leverage a lot on their understanding of the international market and if they get to meet with local entrepreneurs who have a good understanding of the local environment then it's always a very impactful partnership.

Henric Hansson 41:14
And do you think that that is what has happened in the last 10-15 years? Can you actually start seeing some of these knowledge transfers?

Hiram Githuku 41:25
Ah, yes. In agriculture there are positive knowledge transfers, but unfortunately in technology it has actually been the other way around. If you look at the venture capitals in Nairobi, most of them are owned by foreigners. If you look at the investors they are mostly foreign, and if you look at the venture, they are also owned by foreigners. Early last year, I realized there was a very huge debate on the impact of these foreign based venture capitals in the local market. So people were worried if, as they are coming, are they

coming in to kill the local entrepreneurs? Or are they coming in to promote the local entrepreneurs? And, what are some of the synergies that we exploit from the, from the process? Now, in agriculture, it's been very positive. You get to have an internationally oriented promoter who comes in to set up business and ends up promoting, you know, the local entrepreneurs but in technology it's been the other way around. It's been very difficult for the local entrepreneurs, it's actually very difficult for the locals to raise capital for a tech related venture in Nairobi.

Henric Hansson 43:17
I see your point. So how do you think the local entrepreneurs are dealing with that? I mean, you said that for them, it's much harder. How are they dealing with finding funding in comparison to foreign countries?

Hiram Githuku 43:42
So I think the reason why foreign ventures are getting much traction in the local markets is because they have what I would call bankable, real solutions. They've come in, identifying real problems on the ground. Then they are pricing real solutions to support the local economy. I think it's also because of the exposure that they have. I don't want to go back to our educational background claiming anything. But I think that the exposure gives them an edge as opposed to the local entrepreneurs. So, I mean, it's been difficult. Actually, I have a couple friends who started M-kopa, you know it was a good venture. They were providing energy solutions to the farmers. Solar energy solutions to the farmers. So a while back, I have a friend of mine who was involved in that project. And it took them quite some time to raise capital. When they came in touch with Safaricom who helped them, linking them up with, you know, external, first of all was donor-oriented project and later commercial venture capital. But it took them five years to hit the ground running even, you know to even conceptualize the entire project. So, they end up finding you know, commercial capital accessing commercial capital, but it took them a while.

Henric Hansson 46:23
Do you see that foreign founded ventures have sort of, an advantage?

Hiram Githuku 46:41
Yes, to some extent they do. Because some of the local ventures, especially within technology, struggle alot with packaging their products or services and demonstrate it to commercial banks. Also, the knowledge of the fundraising process is something that might be lacking with local founders. Here, you may encounter, you know, a very experienced team of tech-savvy individuals who have developed a very good program but they don't have the slightest idea of how to develop or to commercialize the idea nor to develop a proper investment thesis that could be presented to private equity or venture capital. We're not experts in these industries so we basically have to rely on the packaging and their proposal and also collaborate this information with the industry expertise. So that's basically one of the challenges that they experience, when they don't have the knowledge to, to package their product and that's why these accelerator programs are very, very crucial.

Henric Hansson 48:45
So, just what would you say are sort of the biggest differences in the ventures you find in Kenya in comparison to the ventures you find in areas that have a longer history of venture capital, like Silicon Valley?

Hiram Githuku 49:37
I would say number one is preparedness, the level of preparedness. In environments where they have a long history of venture capital, they have wide access to industry data, good structures and policies and the regulatory framework which will influence investors confidence in the market. So taking for instance,

Kenya and Ethiopia. Kenya is a more developed market in terms of venture capitals and foreign oriented investments than Ethiopia, which opened their economy to foreigners as of last year. So when it comes to this you have to look at the political risk which arises from institutional fragility, and probably local government legitimacy, which basically diminishes that shortage of the investment opportunities in the local market. So policies, regulatory framework, understanding of the market understanding, the sourcing framework is basically the key. The fact that they've been in the environment for quite some time, they have a good understanding of the cultural environment.

Henric Hansson 51:37
Related to that topic, how do you see that the government is influencing the industry?

Hiram Githuku 52:16
I mean, some of the things that we've been focusing on, especially when it comes to the public sector, is development of policies. Policies which are attractive to VCs. For instance, we could look at Malawi. We've made a couple of investments in Malawi, two or three investments. We have to look at the exit options as Malawi is one of the countries which doesn't allow repatriation of funds, especially not in dollars so it's very difficult. It's a very bureaucratic process when investing in a company based in Malawi because you have to sign a lot of declaration with the controlling and the regulatory bank. Then there is policies regarding deployment of funds. Sometimes they charge, very high interest and, taxation rate just by deploying the funds. So we've been exploring potential options. For instance, most of the funds deployed in the entire Sub-Saharan region are listed in the tax-haven countries in Malaysia and the rest. So we have been exploring the option of instead of registering funds in tax haven countries which end up increasing the administration cost of the fund, just to set up, we have tried to use local holding companies. Then the government can provide concessional periods on the next or tax holidays on investments. So, these are some of the policies, which we've been engaging with to try to popularize the government with such ideas to ensure that we have locally set up funds. Number two is to influence, or rather, to drive public pension funds to focus on alternative investments. Today, most of them are only focused on the mainstream traditional investment channels. I mean this is investment bonds and investments in the market capital. But then you also have, you know, alternative investment vehicles like the fund management and private equity. In Kenya, it's been successful because we have a couple of pension funds committing their investments to venture capital management and fund management. In Uganda with our current fund, we have NSSF Uganda who joined with 2 million euros in the Yield Uganda Fund. So it's been a gradual process, it's been gradual, but it's slow.

Henric Hansson 56:08
I think that was all the questions. I had, I think ticked all the boxes here. So thank you very much for that. It was really fruitful to talk to you and you had a lot of really good insights for us. Mads, do you have any questions that you think I missed out on?

Mads Robdrup 56:35
Yeah, thank you, Henric. I'd also say that, pretty much what I had in mind has been covered in this interview so far. But perhaps I can, I can ask you into some of the things you mentioned. So, first of all, when you're talking about this integrity that you have to build up between the investor and the investi company. You mentioned this about trust and getting to know the founders in terms of getting access or their willingness to share perhaps the real financial situation, and documents of the company. How do you create this integrity? How do you build up this trust and perhaps you can elaborate a bit on that?

Hiram Githuku 57:41

Most of these promoters have different sets of documentation because they are more or less used to the conventional commercial lending system with a bank, the commercial banks. Now, what they don't understand is we don't only focus on the numbers. Yes, the numbers are an important part of the process, but they are not the core of the decision to invest in the business. The numbers might be good, but we might not love the business model or the business model is too complicated for us. So how you get to earn their trust is by making them understand our investment process. The numbers are important to us, but we're about your business model. And when you dive into their conversation to understand their business model, then they will open up. Then they end up providing information that you didn't even expect, they can even tell you how their bedroom looks like you know. It's just about making them understand that we are not commercial lenders. We are not only focused on giving you the money, but we also focus on improving how your business operates. How we do it is when we are addressing a business we also bring on board a tier facility which is basically focused on the business services. This includes the soft issues like improving the governance system by bringing on board experts who have knowledge in production systems or processing systems, who know how to develop a sustainable growth model. So when you get to explain your benefit to them versus what they would get if they were to approach a traditional commercial lender, then they'll stop seing you as a money lender and start really viewing you as an investor. Yeah, so basically selling your value to them and making them understand your input into the business. It's always always a key point.

Mads Robdrup 1:00:44
Yeah. And you also said before that perhaps that was some of the differences between promoters from Kenya, local promoters, and then those promoters from developed VC Industries?

Hiram Githuku 1:00:59
Yes.

Mads Robdrup 1:01:01
Okay, I had another question which is about this investment criteria that you mentioned. These impact requirements in Pearl Capital are perhaps more important to you than they are to other VC firms. So, do you find it more difficult? Or how do you perceive your chances of finding investable ventures in relation to other VC firms?

Hiram Githuku 1:01:49
Number one, even though the entire industry is currently very saturated with VCs coming from all over, we don't necessarily view them as competitors or feel the commercial banks as competitors. We just view ourselves as investors who are bringing local solutions to the local enterprises. So, basically one of the reasons why we see ourselves as competitive and that we have an edge is because our team is local. We understand the local environment, we understand the local challenges of these entrepreneurs. We also have a pool of data. We have a database where we can always go back and refer to the lessons learned from previous investments and we explore ways of improving our subsequent investments. So I would say it's not always difficult for us but sometimes we actually partner with these international international businesses. For instance, we have a couple of funds which are based in the Netherlands and they don't have local representation. So what we normally do is to co-invest alongside them. Since they don't have local reputation, they rely on our local expertise and representation in the business to manage and monitor the portfolio on behalf of them. So that actually gives us an edge, the fact that we understand the local environment. We know who to go to.

Mads Robdrup 1:04:23

Yeah, I think maybe another question in that regard about this perception about the venture and so on. There's a lot of talk in the literature about this, you know, finding the unicorns and these high potential growth ventures and is also something that impacts your investment criteria. Perhaps you're looking for a unicorn or are you looking for ventures with lower growth rates.

Hiram Githuku 1:05:04
We don't necessarily look at unicorns. Sometimes we even invest in ideas, basically startups. As long as there is evidence of potential to grow, if the idea in itself is scalable, then we invest in them. Also for the purpose of portfolio portfolio management and risk diversification. We want to balance you know, the portfolio balancing. We can't invest in startups all-through, if you have invested in 2-3 startups then you have to invest in mature businesses which you know have high potential returns. Basically what you do is to structure and when you're structuring the investment, the risk-profile over particular investments has to reflect the potential return. So it's basically a case by case and then sometimes these start-ups have a good story. They can tell a better story than investing in mature businesses. So this actually conforms to our investment criteria within the mandate we have been provided it

Mads Robdrup 1:06:50
Okey, so you mentioned some things before about structuring the fund regardin ow would you divide the resources and how what kind of secto focus you would have and so on. And so far we have been interested in this finance gap of ventures coming out of of the accelerator programs and perhaps the role of business angels in that regard. Especially whether the business Angels sufficiently can fill out that finance gap, or whether, in fact, in perhaps your ideal perception could be some other fund or VC fund or another type of financial institution that could come in with with capital at that point. This is just you know, thought experiment because it's more hypothetical, but maybe you can elaborate a bit on that.

Hiram Githuku 1:08:09
Yeah, so when setting up a fund it would be ideal to focus on multiple countries. Now, I wouldn't say, focusing on the entire Sub Saharan Africa because then that will mean spiking up your your administration costs. But, if you have a fund focusing on the great Eastern-African region which is also focusing on multiple industries, the agribusiness industry and focusing on how to integrate the energy with agribusiness, supporting the two industries as long as the impact. Because the challenge has been that you find a very attractive venture but then in terms of the metric evaluation, it's below threshold so you end up passing on it. Now, if you had broader impact evaluation metrics, then some of these ventures would come on board. When you incorporate clean energy in agribusiness that in itself is impact from the ESG point of view, that in itself is an impact whether you provide access to market to small holder farmers or not. Then in terms of the other form of capital, when investing in startups, most of them are thinly capitalized. They will need a lot of business interventions and as much as we bring along our tier facility which is in the form of a grant to support the business operations, it's not sufficient. The human capital is very important. So, we have organizations like PUM from the Netherlands, we have SES from Germany, we have partner solutions from the USA. So, these are some of the organizations which come in handy in terms of bringing in international expertise. This is the human capital, the knowledge that we lack, they come in to preach the knowledge gap within the industry. They are involved a lot in the process of supporting the improvement of our product- and sourcing standards. In the process, we accelerate this access to external certification, ISO certification and concepts certification and extra access to the local certification to access the retail market. So, these are some of the organizations which come in handy. Then the other one is organisations which would bring in concessional capital. Capital which comes in as discounted, or blended finance. So in the past, we've invested alongside DFI-funded projects like the UNCDF. They come onboard and provide a guarantee on our investment as a security on top of being first spring is especially to de-risk businesses, especially startups. So they come in handy.

Mads Robdrup 1:12:42
Okay, that's interesting. Yeah. And that's something that you're actually experiencing both in the Kenyan and the Ugandan market?

Hiram Githuku 1:12:53
yes, both Kenyan and Ugandan market.

Mads Robdrup 1:12:55
Okay. Yeah. So do they go in and invest specifically, this extra risk capital in the fund or is for a particular venture?

Hiram Githuku 1:13:10
Mostly for venture enterprises. They can provide either concessional capital, especially to CAPEX. Say for instance an investment in an off-grid solar management system which is focusing on a remote region like in Kenya. So if you look at a North Creek facility, because of the kind of the clientele or the market access, it normally serves the local and the underserved market who don't have access to clean energy. They don't have disposable revenue because these are Farmers. Farmers who rely on, their farmin and don't have a reliable source of income. So, even the average revenue per user of that electivtiy is also low. So, if you were to compare the high capital investment and the revenue generated from that capital invested, then you wouldn't go for that business. But, because we have partners like UNCDF who comes on board to provide capital or to provide additional security, which actually backs up the company's balance sheet to unlock more capital. Then it makes some of these investments more bankable. Okay, so these are some of the trends that we now see in the industry.

Mads Robdrup 1:15:01
Okay, that's also some interesting developments. Yeah. Yeah, I think that was also all from my side. Again, thank you very much for participating in these questions that we have prepared for you. Are there any things that we have not covered so far that you think would be interesting to mention?

Henric Hansson 1:15:40
I think we're good. We've covered more or less the industry performance and the expectations. Okay.

Transcribed by https://otter.ai
Edited by Henric Hansson

APPENDIX G. Interview with interviewee from VC 5

Transcript of Interview. Interviewee from VC 5, Goodwell Capital

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee: Joel Wanjohi (Associate Partner)
Time: 51:15

Henric Hansson 0:00
I interrupted you there but you just told a lot of interesting things. So I just wanted to, to make sure that we get that down for the tape as well. But sorry, you were saying that your fund is currently making investments all over eastern Africa or?

Joel Wanjohi 0:24
Yes, to give a little bit of a rap about the fund Goodwell Investments. Of course, this is our fourth fund, we are managing the first three funds, or the first two funds were deployed in India, in microfinance institutions, startups or venture capital. That was way back in 2008 to 2010. Then we had a third fund, which was deployed across West Africa in South Africa. And right now we have the fourth fund, which is deployed between South Africa, West Africa and East Africa. For this office in Nairobi, we are in charge of looking at the investment opportunities, and also portfolio management in Kenya, Tanzania, Uganda, Rwanda and potentially Ethiopia. So that's how the fund is divided in terms of geographic reach. In terms of the sectors we are looking at, unlike the first, second and third fund, where we are predominantly looking at financial inclusion type of investment, for this one the theme is an access fund. So what that basically means is offering access to basic goods and services to the bottom of the pyramid. So any sector which can really help us In terms of reaching that goal, we can potentially look at it. But just to show now, the key priority sectors are still financial inclusion, agribusiness, mobility, transport, retail and distribution, and, finally, we can potentially look at the renewable energy sector.

Henric Hansson 2:26
And can I just ask, because I was in contact with your colleague in the Netherlands, Wim. So how does it work with the limited partners who are in the Netherlands or?

Joel Wanjohi 2:47
Just to give a good overview of their entire firm, we have three operations offices. That's the Nairobi office, which focuses in East Africa, the office in Lagos, Nigeria, which is more of a partnership. So the staff there is not Goodwell staff. So we have a partnership in terms of managing the investment in Ghana and Nigeria. Then in Cape Town, we have our own staff to manage the investment in the southern part of Africa. Then now we also have the head office which is based in Amsterdam, which is mainly involved in further build and in fundraising. To answer your question, Wim and who else that sits in Amsterdam are general partners. So they are not LPs. Much of our LPs are also scattered through Europe. Many of them are in the Netherlands, in Italy, in Germany. They are mainly family offices and private equity investors.

Henric Hansson 3:51
Okay. I see. Thanks for giving that overview over Goodwell and and you told me you had a background in finance?

Joel Wanjohi 4:02

Yes, um in terms of my undergraduate I did a Bachelor of Commerce in accounting. My master's, I did a Masters of Science in finance investment. I am also a certified public accountant. I'm still a student of certain financial analyst CFA but I manage to complete so I'm supposed to be sitting level two. So hoping I'll be able to complete that on time. In terms of the work experience, my career started in a finance department in 2004, as an accountant, and I worked for five years in the finance department mainly reporting on the investment and also hoping valuation on the investments in the books. Then I moved to investments. And this was a state-owned development finance institution in Kenya called ICDC, where I spent almost 10 years, maybe four years was in finance department and about six years in investments. Then I moved out of the state Development Financial Institution back in 2015, and joined voxer agribusiness, which was a private equity fund, focusing on investment in agribusiness in East Africa region. And the LPS were mainly based in Norway, Oslo. So when the firm did successfully raised the second fund and that's when I joined GoodWell in 2017.

Henric Hansson 5:57
that's really interesting. You've you've done a lot Could I could I just ask what so what are your sort of main responsibilities at Goodwell?

Joel Wanjohi 6:07
Great. So, as I mentioned, I head the staff of the regional office in Nairobi. Basically, what that means is that I manage people of course and I have two investment associates. We work together mainly in terms of investment, where our major responsibility is sourcing over the investment, appraising the investments, negotiating and structuring these investments, carrying out the due diligence on these investments, and pitching these to the Investment Committee for approval. When we get approval, we are also mandated to do value addition to these companies through portfolio management, and also mandated to do exits on these investments as well. So it cuts across the invest from sourcing all the way to the exit.

Henric Hansson 7:06
Okay, I see and what kind of what kind of ventures is it that you're you're mainly looking for?

Joel Wanjohi 7:13
What do you mean by ventures? sectorial.

Henric Hansson 7:17
So kind of, is it early stage startups? Or is it more later stage or

Joel Wanjohi 7:22
It is early stage companies. Because, what we give is growth capital for the early stage. We are looking for companies which have already proved the tractions and that have already registered some revenue. So they have to be post-revenue, but they don't have to be profitable. Mainly we do invest in companies which have a history of about two years to three years. In terms of monetary terms, that could be somewhere between half a million to 2 million dollars revenue. As I say, they don't have to be profitable, but they need to show good signs of becoming profitable and also to be scalable.

Henric Hansson 8:10
And how big are those ticket sizes usually?

Joel Wanjohi 8:15
in terms as a fund all you look at in terms of the ticket sizes between 1 million USD to 5 million USD. Right now on the portfolio we have the average ticket size about 1.5 million USD to about 2 million USD. How to

do it is that we start low, then we keep following up these investment, I would call this kind of milestone type of investment, you know, getting into investing the entire amount, like within one track, so we keep on following. So, the first investment could be between 1.5- 2 million, and this can grow up to 5 million over the years.

Henric Hansson 9:05
Yes. Okay. So that would be somewhere between round a and round B or where would you positions these investments?

Joel Wanjohi 9:13
So that would be round A and pre-round A?

Henric Hansson 9:16
Round A and pre round A. Okay. And I just wanted to know, maybe you said this before, but how long has it actually been operating in in Kenya? How long have you actually been operating in Kenya? You said that you also invested in India. But how long has it been in Kenya? As good? Well, yeah, exactly.

Joel Wanjohi 9:46
Ah for from 2017. So that's three years almost. Okay.

Henric Hansson 9:51
Okay. And are there any like, success stories that that you want to share, like any ventures that you've You've done very well with

Joel Wanjohi 10:03
Well, it's still a bit early to say, but I think our portfolios are doing well. In East Africa, right now, we have three portfolio companies. One is basically in mobile commerce, what we call E-commerce, for the rural areas, and they're trying to give access to basic products and services to the rural population. The other one is basically a delivery platform connecting the truck owners and motorbike owners with the goods owners, so that they can carry their goods. And the third one is market shrinkage for the small scale farmers in Tanzania, where the company is helping small scale farmers to approach the urban areas through a distribution channel. All our three companies so far are success stories, definitely. Of course, there's a long way to go, because when we do invest, we look at what is our low in terms of value addition. Because we are not only capital, we also try to look at what other areas we can help the companies improve on areas such as corporate governance, streamline the process, and strengthen the management team. And also, trying to expose the company to our network in terms of trying to get them finance assistance, probably through debt from some of the peers we work with. So far so good, for the three companies, in terms of meeting the key performance indicators. But as I say, there is still a long way to go, because our investment cycle lies between five to seven years and all of these investments are still under two years. So you can see we have a long way to go.

Henric Hansson 12:15
Yeah. And in terms of industries that you invest in, are you sort of industry agnostic or?

Joel Wanjohi 12:26
All right. Yeah, well, good question. I think as I said, we are not really industry agnostic, but we can potentially look at any sector or industry, which helps you know, in terms of achieving our mandate of accessing the basic goods and services to the bottom of the pyramid, but I have to mention that we are quite good in financial inclusion, since our first ones are mainly investments in financial inclusion.

Personally, all along my investment has been in agribusiness. So we do consider our expertise mostly in terms of financial inclusion and services and also in agribusiness. Potentially we can also look at other sectors, but for those sectors where we don't have good exposure, we try to co-invest with someone who has experience in that area.

Henric Hansson 13:28
I nderstand and would you say that there are any specific challenges that you see for ventures that are quite typical for Kenya?

Joel Wanjohi 13:40
Definitely challenges occur in that way. I will go through some of these challenges. What we see when we look at the entrepreneurs, or the people behind these ventures, it is mainly Western people. We are not seeing local people driving businesses, so much of the business here in Kenya, or the startups in Kenya, they are being founded and run by people from Europe or America. It's a challenge in one way or the other. Because sometimes when these foreigners come in, they try to come up with solutions, which are Western, but the problems are here, and they don't teach those solutions. Sometimes many of these fail, because they lack that local nuance in terms of trying to make the solution a bit shorter. So that's, that's a big problem in Kenya when you look at most of the startups that are attracting capital from venture capitalists. There are many of these foreign. Yeah. I think sometimes they miss, you know, seeing what can work.

Joel Wanjohi 15:17
And the other aspect is in terms of Kenya, and also the rest of East Africa, is that for the few businesses where you come across, you know, typical entrepreneurs then the big challenge is always in their corporate governance. In terms of these being family businesses, people are not accountable, they have some integrity issues here and there, which is a big problem for local businesses. This sometimes explains why the VCs try to look at businesses that has some people who are exposed to the Western world and because of that aspect of corporate governance.

Henric Hansson 16:06
And these problems that they're facing are, are you stepping in as sort of an operational actor there? Or are you more as a strategic?

Joel Wanjohi 16:18
sort of more strategic point of interference, helping to come up with a proper strategic plan. So we don't have the capacity to be participating from operational perspective, but what I want to make really active investors, so even if we try to look at it from a strategic point of view, get these ventures almost on a weekly basis, and where we'd be more meeting and brainstorming on the best way.

Henric Hansson 16:54
So just to give you a little bit of background for our, our thesis. Basically what we're looking at is some of the challenges that are quite specific for Kenya, considering that the VC and the startup environment is rather young in Kenya, in comparison to, for example, Silicon Valley where it's been around for maybe 30 years. So we're basically trying to look at if if it is possible to sort of, or which specific challenges that the Kenyan VC sector or industry at large are actually facing. So in relation to that, I just wanted to ask, What is your perception of the amount of investable ventures in the Kenyan industry? Is there a good fit? Or would you say that there are too few ventures in relation to the investors?

Joel Wanjohi 17:59

Great question. I think there are too few opportunities in Kenya in relation to a number of investments in the region. And as I say, this is mainly because of the quality of entrepreneurs available in the country. I think also that what I haven't seen is a complete investment cycle. As you're aware in Kenya and the rest of East Africa, private equity and venture capital is relatively young and we haven't seen much of an exits. So in terms of keeping confidence for the investors in the region, that would be some kind of a challenge, because people are not sure about how the sector will shape up over the years. I will say that the opportunities are few compared to the available capital.

Henric Hansson 18:53
And are there any strategies you can take to still find these ventures, how are you at Goodwell dealing with that?

Joel Wanjohi 19:04
So,what we have seen is the point of accelerators and incubators, which try to bring together the entrepreneurs and kind of try to coach and mentor them, and try to identify these opportunities as early as possible, and try to get them where we can invest in them. This has been working well, in Kenya, in particular, as there are a number of accelerators and incubators trying to bring these entrepreneurs together and trying to mentor them. So that is one way to address these problems and to ensure that the sector is sustainable in the future.

Henric Hansson 19:49
Yeah. And are you at Goodwell if you look at your portfolio of your investments, are you using the accelerator programs in Kenya or Nairobi to discover these viable firms for investment?

Joel Wanjohi 20:07
No. Like the three that are mentioned, we did invest probably in series A, meaning they were a bit mature. Well, of course, one of them, Copia, came through an accelerator. But at the point in time that we looked at it, they were not using the incubator program any longer. But they started from an incubator called Growth Africa. But currently in the pipeline, we do have a number of startups, which we are monitoring in the incubator and accelerator programs. They are not yet ready for us to get in. But when they're ready, there could be potential for us to look at them.

Henric Hansson 20:52
Hmm, understand. And so how do you usually find your ventures like what's your strategy? For deal sourcing?

Joel Wanjohi 21:02
Good question, as I mentioned, accelerators and incubators are one way of looking at it, and participating in those as much as possible. Also in the region, we do participate in a number of forums. The forums usually bring together entrepreneurs and investors, and one forum is called Sankalp. Here, you can be able to get to know network or potential investee companies, we have good references from our peers and the co-investors whom we work with in the region. We also have an application to our website. Sometimes you do also have a code course you know, like trying to move to the company, potentially they could be looking for funds. So it's a whole myriad of approaches, and I would say that probably the most successful thing is to pull up these companies from an accelerator program in order to get yourself in terms, and have some relationship over a longer period of time.

Henric Hansson 22:11

Yeah. So would it be a fair sort of, would it be fair to say that accelerators and incubators are good for monitoring and and sort of creating the first the first relationship but then usually when they graduate the accelerator does still need some time. Some growth and some some investments before they're sort of ready for you.

Joel Wanjohi 22:40
Yeah, exactly. We call it traction, as they get some numbers before we jump into them.

Henric Hansson 22:46
Yeah. So how do you see who invests in the startups at the accelerator stage or at this earlier stage before you can go in?

Joel Wanjohi 23:00
It's mainly angel investors from Silicon Valley. So it's not like big house names. You see a lot of angel investors from Silicon Valley and also parts of Europe, supporting the early ideas for like before we come in.

Henric Hansson 23:19
Yeah. Are there any other sources of funding they can receive such as grants or things like this, at this early stage?

Joel Wanjohi 23:29
Yeah, some who have access to grants, but it depends on the sector, and who is trying to promote that sector. Not everyone has access to grants. But some here have access to the grants as well.

Henric Hansson 23:43
And just to experiment a little bit with the thought, would you think it would be possible for venture capital funds to invest at this earlier stage? Or are the economic mechanisms simply not there?

Joel Wanjohi 24:01
You know, we have to risk capital and, you know, it's a matter of trying to be risk averse as a return. You know, for much of these startups, the success rate is really below what you could consider a VC to take some risk on. So I'll still be hesitant in terms of participating in startups and rather wait and see at least until some product has been developed and some traction has already been developed. So someone can be able to see if there's already a ready market for their business. You know, the startups still have a lot to work on. I will still not want to go that route, because I know the risk is a bit tight, so I would still encourage them to source capital like grants or like angel investors. And when they have proven the concept, now probably that's where VCs can come in as the risk is not as high as from a startup point.

Henric Hansson 25:10
And do you think there are enough? Is it sufficient the investments that startups can get at this at this early stage right now?

Joel Wanjohi 25:20
No, I think the answer is no. Because one, it depends on the network of these entrepreneurs. What we are seeing is that the entrepreneurs, who are from the origin of either America or Europe, have good access to angel investors and some of these donors, but the local entrepreneur does not have the access to that. So there's a gap for that.

Henric Hansson 25:48
And just to jump to something else, what would you say is the level of information available about the ventures or the startups and the markets they operate in? Is it sufficient today?

Joel Wanjohi 26:08
Sorry. If I got your question correct, you're asking whether the level of information available is sufficient. To everyone or just to the VC?

Henric Hansson 26:24
So I'm thinking mostly as a background for making an investment for the VC.

Joel Wanjohi 26:33
There is still not a good way or mechanism for modeling this information. We have seen a number of institutions that create a knowledge base of venture capital, and we have seen a couple of other guys trying to consolidate information, but the nature of the information within the sector is still a private one. So it's not like public information and sometimes it's more like market intelligence, so I would say that the level of information is still not at the level you may want it. Can you rely on such information? And by this I mean, whatever piece of information you come across, you really need to use your market intelligence to see whether it's true or not. So we don't really have a good mechanism for this information for the sector.

Henric Hansson 27:30
I understand, and how does that affect your company, doesn't, for example, affect your due diligence?

Joel Wanjohi 27:40
Yeah. It does affect due diligence, and that's why probably before we do the due diligence, we really have to look at a number of sources of information from the experts point of view, market intelligence, we try to gather as much as possible through our network. Yeah, of course, if this information was readily available, it would make the due diligence easier and probably take a shorter period and be able to validate this information if we had like a forum where all this had been gathered.

Joel Wanjohi 30:07
Sorry, Henrik and Matt's my internet was disconnected for some time but I am back.

Henric Hansson 30:12
No worries. No stress.

Henric Hansson 30:18
Yeah, I was just wondering a little bit about the information. You said there is a bit of information gap or lack of information. So I was just wondering, where do you get the information from mainly to do this sort of due diligence on this kind of thing?

Joel Wanjohi 30:42
No, no, as I said, it's through their experience and their connection. Like myself, having worked in the sector for long, I'm looking at a particular VC, which is in a certain area, I probably have a couple of guys who I might reach out to, and try to gather information for the sector, their expertise and all that. Yeah, so it's mainly individual connections.

Henric Hansson 31:13

So, it's a lot about the sort of social social network that you have. Exactly. Yes. And do you think that foreign VCs or foreign ventures struggle with that sort of network?

Joel Wanjohi 31:34
Not exactly, because again, you look at most of the VC or most of the PEs In Kenya, almost all of them are foreign. So it is actually easier for them in terms of networking, than for a local person. Because you see, they know each other for one aspect or the other. So I won't say it's a problem for them in terms of networking the region or getting the information in the region.

Henric Hansson 32:10
But would that then mean that most foreign funds also end up with for example, foreign foreign ventures or?

Joel Wanjohi 32:21
That's a challenge in the region. The main reason is not just because they are networking the foreigners themselves, but because of a selection we have in the region. As I mentioned, you know, the issue of the corporate governance, makes people fear a lot the ventures which are started by the locals, so we see people that are just being interested with the ventures which are started by the foreigners, because it's perceived that the corporate governance is a bit higher than the local startups.

Henric Hansson 33:02
But do you do you see that there are any other sort of barriers in between foreign VCs and, and and local local startups are there like any cultural barriers or anything like that, that you believe exists?

Joel Wanjohi 33:18
You know ,probably in a country like Ethiopia, yes, for you to be able to be successful in terms of getting the best attention. You need to have a local team. And this is mainly because of just over casual aspect of it. But it's also because of issues of language barrier. Because, you know, Kenya, Uganda, Rwanda, Tanzania, you know, English is is a mode of communication. Yeah, but for Ethiopia, it's, Amharic, so it's more to do with language than culture.

Henric Hansson 33:59
Yeah. Okay, I understand. And can I just ask you what is sort of your current process for finding locally born ventures? Sorry, local. Yeah, for finding locally founded ventures.

Joel Wanjohi 34:16
Um, as I mentioned. What we normally do is that we have a number of incubators and accelerator programs which we collaborate with to spin up the companies. One of our mandates as a fund is to provide local solutions to local problems. So what that means is that we're trying to get new innovations which are learned by locals. So we don't really discriminate, but even if it's a foreigner who is running the venture, we try to see how exposed he is to the region, and how he understands the problem. So we do have a checklist in terms of trying to check whether the founder is local or foreigner, does he fully understand the local problems, and whether the solution he is providing really is a local solution. So as I said, the first and the easiest way of doing this is always to work with the incubators and really just trying to identify these locals who are trying to provide local solutions for the local problems they are coming across.

Henric Hansson 35:25
Okay. So sort of employment of staff into ventures with local knowledge is crucial for there.

Joel Wanjohi 35:32
Yeah. Actually, that's, that's crucial for a firm like us. Yeah.

Henric Hansson 35:37
Yeah, I understand that. But do you have any? Have you seen that, in practice, sort of both, both of failure of that of lacking local knowledge, or perhaps a good example of when someone has really shown that they've understood the local sort of landscape?

Joel Wanjohi 35:56
Yes, I don't want to name examples here, but what we have seen in a number of other VCs is a number of startup teams, because probably these were run by foreigners, because much of these VCs don't have consistent presence in Kenya, and they are still remotely from Silicon Valley. So we have seen a number of them attracting a lot of capital, but also failing because probably the problem was that the solution was not a local solution, something is working either in Silicon Valley or somewhere in Europe, which they are trying to plug into Kenya. So we have seen quite a number of booths being unsuccessful. We are quite careful on that, and that's why probably we are a local team. When you approach as we're able to see whether the problem you're trying to sort out is really there. And also whether the solution you're trying to give is really a local solution.

Henric Hansson 36:58
and it you said before that you are not working operationally in the companies you invest in, but more as a strategic partner?

Joel Wanjohi 37:08
Yeah, more strategic question. So it's either we get represented on the board, or we get a board of satellite (observer?). As I say, we go beyond that and we try to engage with the entrepreneurs or the startups, either on bi weekly or weekly in terms of trying to get the problem they are facing, and also in terms of coming up with solution. So we don't sit and wait for the board meeting, bu try to proactively engage with startups. From a strategic point of view.

Henric Hansson 37:42
Yeah. Yeah. And is that also do you think that that requires a lot of local knowledge as well?

Joel Wanjohi 37:52
Yes, it does. It does require local knowledge to be able to do that.

Henric Hansson 38:00
And you touched upon that before that, of course. Kenya is not it's not Silicon Valley or Nairobi is not Silicon Valley. And the VCs have been around for a longer time in in Silicon Valley. But what would you say is the biggest difference in the ventures you find in Kenya, compared to the ones in, for example, Silicon Valley or somewhere where venture capital has been around for a longer time?

Joel Wanjohi 38:27
I think, even the level of people accepting the idea of venture capital in Silicon Valley is very much higher, and most entrepreneurs are working hard to attract VCs. In Kenya people are still like trying to push on to make it happen. That's one of the biggest differences. Also in terms of the opportunity. Because in the Silicon Valley, I think the opportunities there are so much more, compared to Kenya because we have seen very few opportunities. I think a reason for this is probably also to be found in the development aspect of

the country. Kenya being almost a third world country, I think in terms of the spending power and all that is probably not as high as one would see in a Silicon Valley setup.

Henric Hansson 39:37
And in relation to that, how do you see that the government is currently influencing the industry?

Joel Wanjohi 39:49
I think what we're seeing from the Kenyan Government is that they are quite pro business and make an effort to set a good environment for everyone to walk in. I think what Kenya is known for in the region is that the government doesn't really interfere with the private business, they work as hard as possible to attract any entrepreneurs and investors, which is also provided through the tax holidays and all those aspects of business. So I'd say, from the government point of view, I think it's mainly through policy making and also making the business environment conducive for everyone. I think that's helping me know investors in the region.

Henric Hansson 40:44
Understand, and would this would you say that there are any benefits to being a local, locally, local VC firm in this sense there?

Joel Wanjohi 40:59
Currently No, I don't think is the differentiator between a local VC and foreign VC, in terms of tax or whatsoever. So I'll say that god is fair for everyone. And by local VC, I want to assume you mean, VCs that have local LPs?

Henric Hansson 41:25
Yeah.

Joel Wanjohi 41:27
Okay. Yeah. Cuz Yeah. The other thing is that there are very few LPS in the regions. Of now, there are just probably two or three pension funds that do it, because people in the region area don't believe in putting their money in VC. So people are being seen putting money in real estate like it's where they will be able to get more done than VC. So the VC is still quite early in terms of being accepted by the people in the region. We are not seeing a lot of people. We're trying to look at the VC as an alternative investment vehicle.

Henric Hansson 42:16
So would you say that, for example? Yeah. Well, we spoke to the East African private equity and venture capital Association, and they were mentioning a little bit around sort of relations with local government, the importance of gaining agency and sort of lifting the voice towards the government to make sure that that your sort of wishes are granted. Do you see that happening? Does the VC industry in general have a voice?

Joel Wanjohi 43:03
Um, that's a good one. What I know is that the government of Kenya is quite open. If venture capitalists knock on their door and go to them, the government will be able to listen to them. Well, I haven't seen a specific new thing being done for the VC. So it's still quite open. And the only thing probably I would mention is the local LPs scene for the VCs are mainly pension funds. And if the government, at any time could kind of emphasize pension funds like they have to invest 10 percent of the year in either PE or in a VC. I think that's one way of trying to promote the sector. But again, in terms of institutions it becomes very difficult because pension funds are still shy and they still don't believe they can make money from VC.

And this I will attribute to the aspect of the VC scene still being quite young in the region. We have not seen enough exits, generating enough returns. So that's probably also what is making them shy from participating in the VC. In terms of lobbying through agencies, I don't want to believe that, but maybe EAVCA has more exposure to that than myself.

Henric Hansson 44:45
just a last thing here and it's quite open. Are there any other sort of challenges that you think are specific for Kenya that you as a VC are facing right now? And if so, how are you overcoming that?

Joel Wanjohi 45:03
Yeah, yeah. Yeah, definitely. In Kenya, we are quite sensitive with the election cycles. Whenever we have general elections, VCs tend to shy away for that period, because it's always uncertain what will happen and how we are trying to overcome that is through diversified geographies. You know, having some investment in Kenya, Uganda, Rwanda, Tanzania, which have different election cycles. So, that's one uncertainty in terms of the election cycles.

Henric Hansson 45:47
And sorry if I'm a bit ignorant here, but is that because some of the some of the politicians are not supportive of the venture capital area

Joel Wanjohi 46:00
Not exactly what I've seen is that the VC world when it comes to the election time they are not sure what will happen after the election. I'm sure there'll be peace and stability and the business will be as usual. So they want to wait and see kind of. So it's more like apprehension from the VC rather than from the politician.

Joel Wanjohi 46:26
I see. Yeah.

Henric Hansson 46:28
Okay. I think that was all the questions from me. Thank you so much for sticking out with that. Mads, do you have any, anything I missed or anything you want to fill in with?

Mads Robdrup 46:43
Yeah, thank you, Henrik. And thank you also, Joel. And I think most of my boxes were tickets, pretty much all of them yeah. But there was one thing I'd like to probe a bit into, and you say that it would be good for the industry in general if there were more success stories. And I wonder, okay, what really creates good success stories? Is it the exit? And if so, how do you make more exits?

Joel Wanjohi 47:16
Good one, I think this one is more of a like, time being the best healer. When we look at the VC in the region, it is barely eight years old, meaning probably you're starting to see the first type of exits coming in from this year going on. Because for you to be able to exit into land the investment period, which most VCs are between five to 10 years. So I think that time will be the best deal I know as time moves on, to give us an opportunity to have more exit happening in the region and people making money from these VCs.

Mads Robdrup 48:00

Yeah, of course, it makes good sense that of course you need more time before you can exit the company. So, in terms of the IPOs, I read somewhere that there have not been many IPOs in Kenya. Is it the same factors that are hindering more ventures to go public?

Joel Wanjohi 48:35
Well, I think we had a few IPOs sometime back in 2015- 2014. Actually they didn't go as planned. think in terms of information asymmetry between you know, the local and the public. Okay, now, let me be honest, I'll put it this way. I think the quality of the financial market in Kenya is probably not as you would expect it to be compared to like South Africa or compared to other parts of Europe, and people probably feel the information flow is kind of sometimes interfered with. What I mean by things is that even if there is an IPO, people probably don't think the information for you know, the prices and all that is, is information which is public information. People tend to think that the corporations and their people is some kind of private information and they try to make it easy there. And we did see one or two IPO kind of crashing down from the price they started on and it crashed almost like a half price. So what that did. It kind of generated some fear in the public. So even if today we have some IPO, we are not likely to see the public being attracted to the IPO, because they feel a kind of a bit of interference. And that's to do with the quality of the financial market.

Mads Robdrup 50:21
And perhaps I assume that's also related to the, the thing you described before about the level of information available.

Henric Hansson 50:37
Well, thank you so much for taking your time. Joel, do you have any other questions for us? Anything you were wondering about?

Joel Wanjohi 50:46
Not exactly, but to just when will the report be ready so you can share it with us?

Henric Hansson 50:51
So we should have this done in May. We still have a couple of intense months in front of us. But but we will share with you an abstract and readable report as well.

Henric Hansson 50:51
And if you ever need anything in Sweden or in Denmark, just reach out. I'll connect with you over LinkedIn and we owe you lunch when we come to Kenya.

Joel Wanjohi 50:51
Great. So looking forward to see you in Kenya.

Mads Robdrup 50:51
Yeah, thank you.

Transcribed by https://otter.ai
Edited by Mads Robdrup

APPENDIX H. Interview with interviewee from the industry association

Transcript of Interview. Interviewee from the industry association, EAVCA

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee: Eva Warigia
Time: 54:06

Mads Robdrup 0:09
I think it's because everybody's staying at home. So the internet connection is a bit overwhelming. Um, so until he is back in, I'll just say that Henrik is going to carry out the interview. But the part that we're going through is, first of all, a bit about the nature of your operations. And then afterwards, based on the literature, we have some questions that we'd like to ask you about the VC firms.

Eva Warigia 0:52
Okay. So the nature of VCs, what an overview of what we do, is that what you want to ask?

Mads Robdrup 0:58
yeah, that's what we will start with But now I can see Henrik is back. So he would just, he would carry out the interview with you. Okay.

Henric Hansson 1:20
I'm sorry about the poor internet connection sometimes I think everyone is working from home. So it's a bit of work here. In any case, I guess we'll just jump straight into. So I would just like to ask you, first of all, what is the East African venture capital Association, what do you work with and sort of what is your your main goals?

Eva Warigia 1:48
So the East African private equity and venture capital Association, that's the complete name, is umbrella body or business membership organization for Private equity and venture capital funds investing in East Africa. And our primary mandate is twofold. One is to showcase the investment opportunities of East Africa. So presenting East Africa as a as a destination for private capital. And then the second mandate is creating awareness of a lot of private capital and how it works to the business and public stakeholders of the region. So and I can get to the second one later, but do this across five countries in East Africa, and that's Kenya and Uganda, Tanzania, Rwanda, and Ethiopia. Currently, membership is from the name, private equity firms, venture capital firms, and other players will deploy further capital and this can be through Foundations, in fact grants and grants providers. We usually have about 100 members in the management within our industry association. So what we do with the enterpreneurs and public sector, like I said, is to create awareness of private capital and how it works, so that they work with us from an informed perspective and are a bit more confident in when engaging PE and VC investors. And we'll do this through a few things. One is to carry out training to the communities around how private capital works or specific fractions of private capital like how to build a structure for due diligence. Legal due diligence and what financial duties, information due diligence and the intention is that the entrepreneur is better equipped at positioning their businesses to attract the right kind of partner. At the end of the day, what we hope to showcase is that we're partners and not necessarily people who are there to take over the business as is traditionally the perception of private equity or venture capital.

Henric Hansson 4:23
And when you say community here is what, like you said that you're trying to raise awareness to the community. Is that mainly to entrepreneurs, or is it to others I don't know educational institutions or who is the community in that sense?

Eva Warigia 4:40
You work with the different kinds of stakeholders. And so when I use community, these programs are normally tailored to suit different stakeholders. I can talk to them. The easiest is the business community, and it can refer to anything for family business owners before production. We currently manage international businesses. And we like to engage them at some point, they probably have been self financing their business or use it for commercial capital or debt to fund the business and are now starting to think of PE partners or VC partners. So talking to those guys. The others are up and coming entrepreneurs with business ideas or tested prototypes of their concepts and wants to get VC funding or some form of early stage funding, including grants. But just don't know how to make their business bankable. So that's one level of stakeholder

The other people that we work with are the rest stakeholders for business. Then there's the data we call public, public stakeholders, governments, Ministry of Finance, and Treasury officials within the government regulators such as Central banks, capital markets, apologies as people who oversee any financial transactions in the region, and tax authorities. The reason we engage with this public stakeholders is so that we can sensitize them on how their decisions in policy affect private capital deployment. So we've done a lot of work around tax and getting tax breaks for venture capital as it supports and estate businesses. We've also gotten some level of exemptions from the capital markets authorities in terms of filing requirements. And so generally this is to allow for a favorable policy environment making sure that the laws and the legislations of the return do not adversely affect the ease of capital flows into the region. So that's the column called public, and public is everything from a regulator to government. In the state of Corona are actually being asked to provide insights on how private capital can support governments in mitigating some of their health concerns or the health strains. So how much how many people have invested in health care facilities? To what extent can they donate, or put forth some of their health facilities as centers for incubation, or testing of the virus? So, that's how we work with government. And that's the second the stakeholder called public. And then the third stakeholder. I don't really have a name for them. But it's people like incubation and accelerator hubs, people who know where the ecosystem is sitting and they provide some sort of advisory to enterpreneurs. And we try to link up with them so that we can create that connection between the owners of capital and the owners of business or for engagement in collaboration. So sometimes accelerator have you can say equity designing programs on financing your business, and they asked us to share with them our training curriculum. So that's how we support them. And that's pretty much the universe of potential that we navigate through.

Henric Hansson 8:19
Yeah, that's, that's really interesting. I would just like to ask you more regarding venture capital and these like early stage, or more early stage investments. How are you currently working with them for VC firms?

Eva Warigia 8:38
So how we, as a EAVCA, are currently working with and for VC funds, okay, I'll set you for. And like I said, we are sort of the interface between private capital owners and the ecosystem the community, which I have explained earlier. So our responsibility is to plan, make sure the policies in place favour them and to make sure that they have the right conducive environment for doing business. The second way that we

work for them is again, like I said, making the connection between them and their portfolios or potential portfolios for investment. Often times the money people may not know where the business side is sitting and the business does not know where to find the money people, and we trust that we are the link between the two sides so that they can get to know each other and talk to each other and hopefully meet some bills together. So that's how we work for them. And then I think what we do is provide industry material on sectors of interest and investment activity, with the hope that this will drive more capital inflows into the region. So we track all the private equity investments in the region to manage sure that it's it helps someone in making the investment into the region. So how work with them is if they're members of the association, they get access to all our events on our networks and databases of information. And hopefully they can use that for their investment decisions or to further understand the market.

Henric Hansson 10:23
Understand, and and so you said, apart from these things, you're also working with sort of private equity funds at large. Are there any other things you also working for or with, like business angels for this kind of thing?

Eva Warigia 10:40
So I mentioned impact funds, providers, foundations or family offices. Do not have a very prevalent Angel community here. We do not have a lot of individuals that are angels on this part of the continent, pretty much most of Africa. So, Angels may not be as many. But family offices.

Henric Hansson 11:09
Okay, understand, and it was a short one, how long have you been operating in Kenya?

Eva Warigia 11:15
The EAVCA has been in existence since 2013.

Henric Hansson 11:18
Okay.. Are there any like success stories that you want to share any specific events or things like that, that you think EAVCA have done very well in.

Eva Warigia 11:39
Success for us is measured in the ability for private capital to ease into the region with minimum disruption. So you can deploy money with minimum progress, because of regulation, because they cproceed to get active. So in that space, I want to say maybe most of our success then would be measured from a police perspective to push governments to do it right by the investors. So one of the examples I can give is, in 2019. Last year, the competition authority, which is the overall regulator for mergers and acquisitions in the region, exempt the VC transactions from competition pilots, so they don't have to get regulatory approval to invest. And what that means is the VC then, people who are investing less than $100,000. That's the bracket that was exempt. What that means is, they are able to deploy without spending more money for regulatory filings because about maybe 1000 to $10,000 depending on the transaction. So that is an incentive for them and they can go ahead and deploy capital without the increased cost of doing business. Yeah. And that's one of how we measure success, minimum barriers to trade. The other one that we have that's quite notable is we have been able to mobilize some local pension funds and insurance funds to invest in private equity as LPs. We get some aspects of local capital supporting the PE and VC industry. This is as recent as in the law came into effect in 2016. And before that local institutional investors could not investing. But then we changed a little and then we since then had about $300 million deployed into the asset.

Henric Hansson 13:54
Well, that's really impressive.

Eva Warigia 13:59
Success. Based on how is easy to do business here, investor can do more deals with minimal barriers, then that's how we perceive our success.

Henric Hansson 14:12
super interesting. Thank you so much for describing EAVCA. And now I'll just move on to the second part. And as perhaps you noticed a little bit sort of our, our aim is quite broad. We are looking into sort of venture capital and early stage financing. And looking into sort of some of the external challenges that early stage investors are actually running into, so to speak. So I'll just like to ask you, what is your perception of the amount of investable ventures in the Kenyan industry? They're in good fit, or would you say that they're too few ventures in comparison to, to venture capitalists? Or how do you perceive the perceived amount of investable ventures?

Eva Warigia 15:11
I wouldn't say there's too few of them.
The venture scene is meant to support the business opportunities for capital to support.

Henric Hansson 15:19
Yeah, exactly.

Eva Warigia 15:22
So in that sense, I feel like this, right. (on amount of investable ventures)So Africans have this myth. It's not Africans. It's a significant. They call it the hustler mentality. Everyone has at least two jobs: your day job, which you get paid for. And then there's this entrepreneur side hustle that you do as a hobby or to supplement your income, right. So there's always someone who's innovating something to complement their day job and enterprise, which means it's quite a lot of up and coming businesses. available for venture capitalists to support. And then tied to that is the prevalence of mobile technology and especially mobile payments and mobile money. In fact, it's allowed people to be more bold with their tech innovation, so that everyone's creating something that can elaborate on the tech platforms, to design a product or to offer service solutions. And then that also obviously attracts the VCs who are especially very tech lenient, you have tech leading in funding. So I will say we do not have a shortage of businesses to support at all. And equally we do not have a shortage of venture funds to support. I think Kenya is one of the leading African destinations of venture capital.

Henric Hansson 16:58
Yeah, then Then what, what sort of types of VC firms do you mainly see in the industry? Are they more tech focused? Or is it more like industry agnostic, or? I think,

Eva Warigia 17:11
To be fair and honest, most of the VC funds in East Africa have that focus, especially in Kenya, for the reasons I just gave. Everyone is trying to tap into that whole narrative of tech platforms and mobile money and with M pesa, I'm sure you know M pesa. So the prevalence of M pesa. in the region, everyone's trying to tap into that to extend a product that has a mobile wallet mobile payment or a FinTech handle. And so subsequently, I want to say, tech as the leading VC funds in the region and leaving the other venture capital funds very few. You're more likely to see at Tech VC than your are yo see a sector agnostic VC fund.

Henric Hansson 18:00
Okay, and are you seeing that most of these VCs are foreign or local?

Eva Warigia 18:05
And most of them are foreign. Yes. We still don't have a sizable mix of. I mean, when I say foreign, I mean, yes, most of them. It turns out them A) being partners in the organization structure so then B, the leading partners will be foreign, but also in terms of the source of capital. So our insurance fund and our pension funds just about four years ago started investing in PE, which is even more mature than VC. Because of that a lot of the fundraising for venture capital in the region will tend to also come from the west, the more developed markets and the DFIs. And very few are raising money from local sources.

Henric Hansson 18:51
Yeah. Do you think that these sort of foreign firms are facing challenges that the local investors are not facing?

Eva Warigia 19:03
So, I think for East Africa, I don't think they have unique challenges themselves. Just because most of the VC capital across the continent tends to come from the same market, so we're all seeing the same thing, even if it's a historically focused tactic VCs will still have fundraised from the developed markets and they have the same situations or problems that. Foreign investors, they have the same point of view, and its own challenges. One of them is that they are oversaturated; all the entrepreneur perceives the market and how the investor will see it. In fact, because a lot of the capital is foreign. For example, when you're thinking about if I just use the example of a retail shop or a set up that business and enter normally wants to go to the densely populated city or central business district and an investor who may perceive that as a relatively unsafe place, maybe she will positioning their business there, even though it's the place that has the most density, and it's more likely to get a lot of food traffic. So those kinds of the sort of cultural norms that come with being foreign backed, again, that's the majority of the investment available in East Africa, so everyone just has to comply and deal with that.

Henric Hansson 20:50
Well, of course, and I just like to ask you as you mentioned shortly before that you're also working a little bit with accelerator programs. And to ask in general, are you seeing that VC firms or early stage investors? Are you using the accelerator programs in Kenya or Nairobi to discover viable firms for investment?

Eva Warigia 21:14
There are a lot of accelerators and incubators in Nairobi, but I don't think we are the place for these seeds and these sorts of fields. And I feel like that's a challenge that people haven't uncovered yet. That's the accelerated cost to build the bankability of a business. But if you ask the VCs this stuff, the businesses that go through these programs are still not ready for investment.

Henric Hansson 21:41
Okay. And why do you think it is like that?

Eva Warigia 21:47
Honestly, I am not sure. And I don't think they know. And the incubators and accelerators, maybe they're not as properly resourced, to give the kind of guidance and training that is needed. It's the really young businesses, the people who are already established may not need to go through an acceleration.

Henric Hansson 22:21
Yeah. Okay. But do you see that VCs are, are using some other strategy then to find these early stage investments? like where do they find their pipeline? How do they find their ventures?

Eva Warigia 22:42
How do they find their ventures? And I think social networks and not social networks as in Facebook but social networks as networking platforms, events or on for instance workshops. Word of mouth is very strong. They share a lot of information. Most of them do club deals where more than one will invest in a single transaction. So because of that they tend to talk a lot to each other. Yeah, I want to say, number one, mission user, fellow VCs.

Henric Hansson 23:28
Yeah. Do you see any difference in the way? For example, VCs who've been operating in Kenya for a longer time? Are they more prone to do these club deals or who do you think benefit from these kind of social network?

Eva Warigia 23:52
Most of them will do club deals to spread the risk. Very few people fully absorb the risk. Especially if you think of venture capital being a very early stage tried and tested businesses, and they're ending in local currency and you're deploying in US dollars or any other form of hard currency. So, to be able to capture that, and that risk and own it, your entire portfolio can be significantly risky for both local and foreign VCs. So they tend to want to share those and do small minority stakes but in club deals.

Henric Hansson 24:34
and do they do that, do you see often that a local VC, for example, or a local investor go together with a foreign investor to do a club deal?

Eva Warigia 24:44
And yeah, definitely foreigners will not touch a company they do not have a local backing because they assume the locals knew more about the market can do so no one will come from outside of the country outside of the continent and do a deal by themselves because they they do not know how Africa works just as much as a local. They wanted to use this Club's space to also learn about how to do business in the region.

Henric Hansson 25:15
So in general, local for sorry foreign firms are quite reliant on local firms for their like, knowledge about the markets, these kinds of things.

Eva Warigia 25:29
Yes, a hundred percent!

Henric Hansson 25:30
Okay. And would you say it's the same that they usually tend to employ local staff as well when they open up if they open up an office in Kenya

Eva Warigia 25:42
For the most part, I mean, the LPs will be foreign but the boots on the ground will a lot of the times be locals. Again, for the same assumption that you know where to go to get deals as a local you know, how to

understand how the markets work as a local, and how to evaluate the product or service in the market to realize the potential returns of the investment.

Henric Hansson 26:14
And I would just like to know, because you said before that some of the investments are not really large enough. Or sorry, some of these ventures that go through accelerators, they're not really large enough for VCs or VCs don't find them attractive enough. Do you think there's a need for VCs to sort of change their requirements of investments or in order to actually fetch these more sort of early stage investing investment opportunities?

Eva Warigia 26:53
I don't think it would happen if they did. There's a lot more business opportunities, what you call ventures. Whether they are considered that to be less attractive, have higher risk or are untested. That's where a lot of the market is. Where a lot of the entrepreneurs slash opportunities are. So it would enhance if someone revalued their position in a way that they can capture or tap into that network, whether it's by low risk metrics is on being more conscious and supportive of those young, young or early stage businesses. So currently, a lot of the people are investing into the latest stage startup ventures. They tested, she is about five years older, and of VCs, yet the market is more in the one to two year space old one to two year old ventures. So there's a thing to be said about refusing AAA in one strategy where you go into the less than a year old ventures or even supporting backing ideas and prototypes.

Henric Hansson 28:13
That's, that's really interesting. And just to move over to this thing, again, you said about, for example, the information. And you said that most foreign firms say they probably require some sort of local knowledge to get information. Would you say in general that there is or what is the level of information available about ventures and markets they operate in? Is it sufficient to make sort of investments?

Eva Warigia 28:44
And I want to say it's not at the level where Europe is, where just on your laptop you get tons and tons of valuation or industry insights, especially for Tech spaces, whether it's biotech, or education, or even FinTech, we are definitely not there, but through efforts like ours at EAVCA, you'd get some sort of information, be 100% enough to allow you to do a single transaction, but it's a start. And then from there, then you can really supplement to what you have in Europe. But yeah, we put all this into our resources.

Henric Hansson 29:33
Yeah. And it's there. How do you deal with that? For example, is it a problem for doing due diligence?

Eva Warigia 29:44
Certainly. Especially frankly, how do you decide the valuation of a business? That's the first time in the market? Yeah, it's definitely a concern in due diligence and more so in valuation.

Henric Hansson 29:58
And how do you How do you sort of overcome that? How do you think most VCs are doing to maybe first gain the information and if they don't gain information, how are they doing, then proceeding?

Eva Warigia 30:16
I think you went. I don't if you're still there. Your network is that.

Henric Hansson 30:31

Sorry. Do you hear me now? Am I back?

Eva Warigia 30:33
Yes. Now you're back.

Henric Hansson 30:34
Okay. Thank you. I would just like to ask you, how are you sort of overcoming the lack of English

Mads Robdrup 30:56
I think there's a bit of a problem now with the connections, Eva.

Eva Warigia 31:00
Okay. Are you in the same country?

Mads Robdrup 31:04
Yes, we are in the same country. Henric, can you repeat the question one more time, please?

Eva Warigia 31:13
I can hear.

Mads Robdrup 31:15
You cannot even hear me

Henric Hansson 31:18
I am back now. Okay. Sorry about that. So I was just wondering about the information like if there is a lack of information, how do you how do you deal with that is the best thing to work with local? Or how do you sort of overcome the lack of information?

Eva Warigia 31:42
I feel like that's one of the main reasons people do club deals. This is going to get at least one person who has experienced in a similar deal and who can give insights. Now you disappeared I don't know if you can hear… So I was saying this is one of the reasons why people do clap deals because their assumption is if you have more than one investor in a transaction, chances are the second person or the third person or someone within that club will have experience having done a similar transaction and has that kind of information still. And then it's the other reason why people are better, more so reliant on social or peer to peer referrals for transactions, because it's probably a deal someone looked at and decided to pass it along to the next person. And then they use that kind of level of peer to peer lending and sharing to grow the lessons that may have been incurred by the other practice of the other investor.

Henric Hansson 33:03
That's really interesting. I think I'm back. Again. Sorry about this. Okay, good. I'm also recording. So I think that should be to be here as well. But that's super interesting. I'll just like to know, sort of when it comes to finding locally born ventures. So like local investment of startups that were founded by locals from Kenya, what sort of efforts have you seen that actually work to find local born ventures?

Eva Warigia 33:48
I think that's where the rubber meets the road. Okay, now, this is not reflective for the rest of east African matters, certainly not for the continent. But at least for Kenya. A lot of these startups that have benefited from VC funding have foreign backers. So it could be a Kenyan venture in the sense that the target market

is Kenyan, or the bulk of employees are Kenyan. But the founder is a lot of the time not a Kenyan, and there's a whole social discussion about that, whether it's the right thing to do, and whether it should even be encouraged. So, because of especially the noise in the last two years that VCs are facing in terms of being accused of, finding people who look like them, not so much investing time to, to support or to find locally backed companies. There's a lot more effort that's going into getting all the Kenyan based entrepreneurs. It's not easy but people will find out by being more deliberate. So they will say, we have a target to close five deals this year, and half of those should be Kenyan, which means they will spend a little more time than they normally would that deal just to be able to find that person to fix that. It's a start. We're not there yet in terms of the ideal situation, but it's a start.

Henric Hansson 35:27
Yeah so some of the VCs actually have sort of a quota to take in of Kenyan founded startups.

Eva Warigia 35:39
Yeah, yeah. And I'm not sure I mean, I don't know whether it's something that their investors push up on them. Or it's something that they just do because it's an especially right thing.

Henric Hansson 35:58
Okay. Are there any other sorts of strategies that VCs can take to take to make sure that they find these local important ventures.

Eva Warigia 36:11
I feel like something I mentioned earlier, probably lowering the level to which they will use to engage so that they're not targeting companies that are a bit more experienced in, in, in the market or in terms of having been in existence for a long time. I think if they go up or down to target businesses that have been set up probably in the last one year or so one to two years, then they'll find a lot more Kenyan deals. Most of the entrepreneurs close their businesses after an average of two years, because they can't get funding right and need more resources to be able to sustain a business beyond standard two years.

Henric Hansson 37:08
Do you think that the VCs will have to lower their sort of requirements or change the requirements? Especially like, required return rates and these kind of things? Could that be a solution? Or do you think it's more to this sort of bulk from funding

Eva Warigia 37:35
that you've been lowering expectations. And if you think about the venture, it's going to be any local currency. So you have to be a bit flexible in your expectations for returns because this returns are not going to render you're investing in hard currency the returns will not be generated in hard currency. They are earning in local currency, and currency fluctuates all the time for developing countries like Kenya will always be at a lower position than the hard currency. So being cognizant of that to adjust downwards your returns may be one of the steps one can take in ensuring that they get more of the local businesses more that can fit to their basket and package deals.

Henric Hansson 38:35
You mentioned quickly before that some of the VCs are are sort of employing their own staff in certain startups. You see that most VCs are also working operationally in the companies they invest in, like both foreign and local.

Eva Warigia 38:58

I don't know about that. The assumption is as a VC, you do a lot of work in the startup. And I don't think that's unique to Africa. Actually, it's where the nature of a VC and where they invest in their investing in young businesses that need a lot of guidance. So they can know a lot more hands on. Does that answer your question?

Henric Hansson 39:23
Yeah. Yeah, of course. Thank you so much. And I in the beginning of the conversation,you talked a little bit about that you're working with authority and government authorities. You mentioned that you are working with them to provide information about health companies right now. How do you otherwise see the government is currently influencing the VC industry?

Eva Warigia 40:02
(How the government influences the venture capital) For the most part, they don't, they just steal the dairy.

Henric Hansson 40:18
Right? And are there any I mean, pension funds being able to invest in private equity firms are they doing any other sort of similar measures to sort of support growing private equity but also maybe more venture capital in the early stage.

Eva Warigia 40:44
They rarely invest in venture capital because the perceived underlying assets holders in venture capital. So they will be willing to support private equity firms and to buy out some of the assets held by PE firms. And they can establish the bank. But I rarely really see a fund investing in VC, because the assumption is the underlying company is more risky because it's an early stage business. And federal funds have a responsibility to that. What follows because that's people's savings.

Henric Hansson 41:27
And then when it comes to more, maybe like legal frameworks, are there any specific other legal frameworks that you think are very supportive of the private equity and venture capital industry in general? Or are there some that are perhaps a bit more constraining?

Eva Warigia 41:47
So for the most part Kenya is very progressive, in terms of the legal structures supporting the business environment, one of the ones I mentioned earlier, last year, a competition authority of Kenya, which is the regulator mandated to approve all mothers in all M&A activity in the country center created an exemption for filing requirements for venture capital firms. So the background is every merger that happens in this country, whether it's between two companies or whether it's an investment getting into our company, it has to be reported to the competition authority. And they have to review the transaction. They have certain matrices, but I won't get into what they look at and if a company meets all their obligations or all their expectations, then they're given the go ahead to transact in the merger. A merger here also includes a PE and VC transaction. And all of this transaction, these filings with the regulator have a cost and every time you do a transaction, you have to pay that cost. So last year, they created a new rule that exempted VCs from applying, incurring costs. And it's a progressive thing because it allows, it's one expense that the VC has to deal with. And so when you talk about other measures that the government is putting in place, or maybe the regulation is putting in case, it's such where they look at where are the ping points for doing business for a VC, they realize it's in the filing cost and then they exempted those. And then the outcome is the time it takes for the VC deal is shortened because you don't have to wait for a regulator to give you the “Go ahead”. And the second thing is the monetary cost attached to doing metals. This is one regulator less

that you have to deal with. So what you are going to look for then is the competition authority of Kenya and then look at mergers rules 2019.

Henric Hansson 44:30
Definitely. Thank you so much. It was a really nice conversation. And I don't know, Matt, do you have any other questions? Anything you've been been wondering about? And we've been talking?

Mads Robdrup 44:46
Yes, sure. And I'll also say thank you for participating so far. It's been very, very insightful and very getting past terms of getting to know more about the industry and how you work in the East Africa private equity venture capital Association. I think like one thing I found very interesting is how you work with the public authorities in terms of making a more enabling and effective market for the venture capital firms. And so you talked a bit about before. How you say like these both the legal frameworks, but also how it's a very progressive government at the moment. Would you say that there's some kind of benefit or perhaps a need for for VC firms to have any kind of relationship to, to people within these authorities and public authorities?

Eva Warigia 45:49
Yeah, I mean, relationships are what makes the VC ecosystem work. people invest into other people based on the relationships they hold. So If you can get relations with the policymakers or the regulators, it just is one other measure that helps you to do your business more effectively in terms of you know, the right person to call to get things done. So, yeah, definitely.

Mads Robdrup 46:18
Okay. So that would be specifically for VC firms also in terms of knowing people within these authorities?

Eva Warigia 46:26
Yeah. If they can, yes.

Mads Robdrup 46:32
So, yeah, besides this rule of mergers in 2019, are there any other mechanisms that the public authorities have made to to make a more effective market

Eva Warigia 46:52
People are not taking them up yet. So for instance, if a VC is registered in Kenya it is exempt from paying taxes, corporate tax, but they do not have any VC exempted and registered in Kenya, which means none of them has to pick on that incentive.

Mads Robdrup 47:19
Can you elaborate what what does it mean to be registered in Kenya for a VC firm?

Eva Warigia 47:25
So I don't know if you know how funds structures work fund is a pool of assets, different players put into this basket that becomes a fund. Normally those funds will be operating as LLC's limited liability companies. And for them to operate that structure, it means you have to as much as possible protect the underlying shareholders from any legal repercussions. So they tend to look for jurisdictions that favor this kind of fund structures or business structures where the underlying shareholders are as much as possible protected. Now this jurisdictions are like Luxembourg. And you know that jersey goes to Europe, and then for Africa, it's Mauritius. For the Americas, it will probably be the islands, British Virgin Islands, Cayman

Islands. So, and it's because all this jurisdictions have in place all laws that protect underlying shareholders. And what you want as a fund manager is to protect as much as possible your underlying shareholder. So in Kenya, we do not have those kinds of policies. But the regulator is trying to attract people into registering their funds into this market, even though we do not have those policies. And one way to incentivize people to register here is by giving them tax breaks. You can give them tax breaks, but if the underlying shareholder is is not protected, not many people will be willing to take that risk. And that's what I mean by registration, where you set up your fund matters because it's dependent on the laws of that place for the protection of the underlying shareholders.

Mads Robdrup 49:18
Yeah, okay. So even for local Kenyan venture capital firms, there will be an incentive to to set up the fund in another country.

Eva Warigia 49:28
Yes, because at the end of the day, you're protecting their shareholders.

Mads Robdrup 49:32
Okay, I was wondering perhaps you could help us by mentioning some of the local VC firms in Kenya

Eva Warigia 49:44
There is quite a number and most of them have a pan-African mandate so they steal from the large tech based bays Patrick ventures from African based in France. A base Give me one second, you can pull up a whole list. Okay? Now I can't think of anybody

Mads Robdrup 50:16
because for example by by googling on the internet I stumbled upon something called Savannah fund, for example. And

Eva Warigia 50:25
yeah, Savannah Fund too.

Mads Robdrup 50:30
them, but, but some of those that I found would seem to be local VC firms. They also had much fewer ventures in their portfolios. And maybe they were not as transparent as some of the larger foreign VC firms.

Eva Warigia 50:47
That's true, but there's also not many local funds. So Savannah will probably be one of the very few locals actually don't face any other Hmm.

Mads Robdrup 50:59
So For example, there's this a Chandaria Capital. I Yeah, I was gonna categorize them?

Eva Warigia 51:06
They're local too. Yeah. They are also local. It's a local family backed VC $1 million assets under management. Yeah, it's, it's owned by one family. Which other names did you find?

Mads Robdrup 51:29

I think that was the only ones that I remember as as as Kenyan. Yeah. But, so you earlier you were talking about this benefit of, of, of co-investing with some Kenyan VCs, such as a kind of security for the foreign VC firm. To know that. Yeah, sort of For an assurance that it's a good investment and so it would often be either one of these two or?

Eva Warigia 52:08
No, so at that level what it means is a person who does not have an office here even though they are international can partner with an international or pan-African VC that has offices here. So you do not necessarily have to invest is just Savannah or Chandaria or there's another one called Grey Elephant Ventures. It means you can invest in one of the larger ones, as long as they have an office here because you assume the I need to charge my laptop so on second

I forgot to charge so VCs, there is 4DX Capital it's South African but they have invested here, ChanDaria capital, Energy Access Ventures, it's Dutch backes but they have their headquarters in Nairobi.

Can you still hear me?

Mads Robdrup 53:15
Yes. Okay.

Eva Warigia 53:19
So these no energy access ventures or dx capital.

Mads Robdrup 53:25
Okay. So even this for example, the energy axis ventures, even though there are Dutch back and you will still categorize them as a local venture firm, venture capital firm?

Eva Warigia 53:39
Yeah, because they sit here. Oh, my laptop has gone off...

Mads Robdrup 53:55
Yeah, yo, there we lost Eva.

Henric Hansson 54:06
Yeah yeah

Transcribed by https://otter.ai
Edited by Mads Robdrup

APPENDIX I. Interview with interviewee from the accelerator

Transcript of Interview. Interviewee from the accelerator, Pangea Accelerator

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee: Anne Lawi
Time: 58.43 h

Mads Robdrup 0:01
Yeah, and of course, we will make you anonymous. The purpose of this paper is only to be used in university related aspects, and it's not going to be published in any journal or magazine.

Anne Lawi 0:29
All right, that's fine. Um, I don't mind being quoted. That's fine also. Um, yeah, but then that may be yours will be my views and doesn't represent my companies or the company that I work for. It'd be my personal view.

Mads Robdrup 0:46
Okay. Thank you. And then just for now, I'll just say that, Henrik, he's going to take over for conducting the interview. The rest of this hour you will you will be spending with And I will be taking some notes Meanwhile,

Anne Lawi 1:03
That's fine.

Henric Hansson 1:07
Thank you very much for the introduction, Mads. thank you very much for taking your time Anna. So the way we have sort of divided this interview is basically in two parts. So the first part, we'll just basically run through what kind of operation Pangea is, I'll just ask you a little bit about that. And then the second one will refer more to some of the challenges that we have found are present in the literature in terms of the VC industry in Kenya in Nairobi. So without further due, I would just like to ask you if you can describe your operations and what kind of services you're providing to VCs and startups at Pangea?

Anne Lawi 1:55
Okay. Um, so Pangea is a business accelerator. It's a Norwegian business accelerator, supporting, providing technical support to start-ups but also runs an investment platform where we're able to link up and invest, provide risky investment to the business or startup that we support. So in terms of operations, we had to work. We provide technical support, investor readiness, support to the businesses that we take through the accelerator, but also at the same time we do invest in investment programs for the investors that we work with. Reason being is because as you already know, there is a missing middle in terms of them funding our business, tech startups. And what happens is because there's a lot of unknown and a lot of high risk associated with this kind of business. So what we do is to provide information and create knowledge, a dissemination mechanism to the investors for them to understand why they need to invest as early, as the business starts, but also assure them that we will provide the supporting system in terms of making sure that we do the first level of due diligence and we also involve them in being part of that due diligence. What that does is improve the confidence of the investors to come in quite early on but also

provide a de-risking mechanism because they are not investing alone. They invest in these businesses with us.

Henric Hansson 3:57
Okay, and What is the sort of your business model here? Do you take stakes in the companies? Or do you have any other returns for fees?

Anne Lawi 4:09
No, we have a business model we do. So, maybe just to create a bit of clarity, in terms of investment, we use different tools. The most used, the most utilized skills, tools are convertible notes, in the sense that the next two years, the next five years or so, or three years, when the convertible notes mature, it can either convert to equity or debt. So we do that because some of the companies that we are most of the companies that we work with or support are quite early on and we are not able to have very correct valuation at that point. So be obvious either to the investor or to us to all to the startup to start doing valuation. Now, in terms of how we make money or how we sustain ourselves. When we work with partners who are able to take care of the investor readiness program.

What that means is that the cost incurred with getting this business really is taken care of by a partner. In most cases what happens is, our focus area as a business has been beneficial, addressing challenges and providing or challenging or stimulating innovation generation that are addressing major challenges when it comes to urbanization. It can be water and sanitation, it can be affordable housing, it can be mobility, it can be transport and logistics can be anything that also have ripple effects to several areas. Now, when you work in that area, there are so many other interested parties, the government being one of them, and other major, major development agencies, but their core mandate is not generation of innovation so they see value being part of our process. You'll find that they take care of day to day, take care of expenses incurred to build businesses that can be able to grow the right solutions that they come plugging in to address some problematic aspect of their, or their core mandate as urbanization.

Henric Hansson 7:11
Okay, okay. I see. So in terms of industries that you're mainly targeting, you said urbanization, that sort of your main focus in general. Okay. Okay. And you also said quickly before that you provide your startups with some technical support. Yeah. Could you describe a little bit how that works like what kind of support the companies in your program receive

Anne Lawi 7:52
It differs from from program to program, depending on the stage of growth of the businesses that we are supporting, and this is informed by a diagnostic need analysis that we do at the beginning of every program. So it's not what you think it's fit for the business. It's what the business is required. And also, it's not what they think they require, because when they also joining the program, they think they require 123. So when we do that diagnostic it's just digging deep and understanding if this is where you are, and this is what you need to be at this is the need that you're solving. What do you require to grow and achieve this growth milestone in the next six months? And based on that, we agree on the Grand Master No, in most cases is roll out

So No, no, it's okay. I'm just trying to put it into perspective. It's a good market strategy, refining business models to fit new market segments. You might have piloted business model, a product that was for a certain market segment when it's more a bit when it's manageable numbers, but when you expand then you require a different business model or a different approach in terms of how you scale that also digital marketing and marketing in general, and actually the core of it is how do you hire, how do you build the right team to build your business and also, growth strategies in in terms of just being a one town business to being a national-wide regional-wide business, how do you grow to that magnitude?

And what what is expected of you in all angle as a business? Also distribution channels, and distributes strategic partnerships and strategic, b2b networks.

Henric Hansson 10:28
Is this all done internally. So it's all from your staff.

Anne Lawi 10:34
Yeah, yes. If done internally also the missing key is the day, obviously financing.

Henric Hansson 10:45
And is there any particular like success story that you want to share? Is there one company that you've been particularly proud with in the in the last cohort or something like that?

Anne Lawi 10:55
Yeah, we have a couple we have invested in 10 businesses. We have been existing for three years now, we have one of the company that came in for my first cohort called waki. They provide breeding finance to or they provide financing and structure for informal employment organization that have a huge number of employees that work in informal sectors. So, for example, there are companies that provide security services and one of the key challenges for the high human traffic organization is monitoring and tracking of the hours worked versus how much you pay them. And they were able to create a solution upon that, that can be critical. Even in the government can be replicated in any logistic business that have high number of human traffic. And what they have done, they have been very successful. They have been growing month to month. And recently they just got admitted in a Y Combinator in Silicon Valley.

Henric Hansson 12:28
Oh, nice. It sounds like you have a lot going on. That's very interesting. Thank you for that. So the second part now, we have of course, done a lot of readings on venture capital in general and venture capital, specifically in eastern Africa, specifically in Kenya. And based on that, we have a couple of questions. And these are more of course, perhaps your opinion on and how the The sort of venture capital industry is evolving at large. So without further ado, I'll just jump into them.
I would just like to know, what is your perception of the amount of investable ventures in the Kenyan startup industry? Would you say that there are too few ventures or would you say that there are too many ventures compared to investment firms that could invest in these ventures?

Anne Lawi 14:03
There are very few venture funds, very few angel investors, but a considerable number in terms of investments.

Henric Hansson 14:21
And what would you say about the ventures themselves? So the startups, would you say that there are enough startups in relation to the actual capital that exists or is it too few ventures in relation to the capital that exists?

Anne Lawi 14:41

Now, the dynamics when you talk about ventures, you can categorize those into three. Firstly, good investable businesses, which there are very few of. Second, foreign founded business which there are quite a number of. Thirdly, local good investable businesses which there are very few of.

Henric Hansson 15:06
I understand. Would you say that there are any particular strategies that you as an accelerator or that VCs can adopt to still find the investable opportunities?

Anne Lawi 15:30
So our accelerator is focusing on 3 things to find investable opportunities. Firstly, we focus on improving the investor readiness of the businesses which we see have potential for receiving investments. And that's why we do technical support. Secondly, we aim to increase attractiveness of the investors, not only ventures capital funds, but increase the number of angel investors to be connected to the cohorts. Thirdly, we do de-risking by investing together. We also do an investment program where we support investors in trying to provide as much information as possible to help them make informed decisions. By doing so, they can be part of the process, they can be part of the due diligence early on. We do this as investors make informed decision to invest in a venture arena, in a startup based on how they understand the market or based on how they understand the business and what they're doing, and how well you understand their founder and what drives them. That's why we are doin these programs.

Henric Hansson 17:01
Okay, interesting. And this is a bit broader again, but how do you actually see the role of accelerator programs in Kenya? And how are they generally used by the VC firms today?

Anne Lawi 17:21
Pipeline creation and deal flow structuring. So pipeline creation for investments and deal flow.

Henric Hansson 17:34
Do you see that VC firms are actively using this i'm not talking just about Pangaea but perhaps on a broader scope as well?

Anne Lawi 17:44
I think you have to look at it from how far along we have come as an ecosystem. We've seen the way it was five years ago. Hello! It has grown so much. Have we seen it grow and having an impact? Yes! Are we anywhere near the numbers that we are proud of? No, not at all. So, it's a work in progress. It's growing gradually and we can do better.

Henric Hansson 18:26
And are there other types of investors also leveraging the accelerator programs such as business angels or larger PE funds?

Anne Lawi 18:40
I think they are exploring that more and more and we see an effort from both accelerators and venture funds. We have also seen exploration by PE funds, wanting to know what is happening in this industry. How can they collaborate better to create a better pipeline for us in this industry from early on. So we have started having those conversations. I believe in the next years or so, there'll be much coming out of the collaboration or the composition that are happening now.

Henric Hansson 19:30

And what do you think is, is the key factor that makes an accelerator attractive for VC firms?

Anne Lawi 19:40
I think having a well structured offering, understanding your focus area, being a thought-leader in your focus area, and having capacity to attract and grow a high quality pipeline.

Henric Hansson 20:07
And are there any strategies that you can adopt in order to create a pipeline like this?

Anne Lawi 20:21
Just to add on to something I didn't say but also co-investing together with VCs. I'm however a bit hesitant to use VCs because we have a very small or non-existing community of VCs which would work to invest in pre-seed. And you will find that accelerators work with pre-seed and, and even the stage before pre-seed at a stage where you require a bit of funding for you to be able to grow into pre-seed and then seed. And you'll find most of the VCs will do a ticket size of 500,000 USD to 1 million or 250,000 to 500, 000. So there you'll find it is post-seed. That is quite advanced in the process of where the accelerators are in terms of the growth, growth patterns of the business.

Henric Hansson 21:40
So, would you say that VCs are not in general using accelerator programs to find investable ventures?

Anne Lawi 21:50
They are but there is a huge huge gap between the businesses that are being supported by accelerators and what VCs are looking at. This is in terms of their structures doing ticket size of 50,000 and 100,000. Sometimes, this doesn't have ROI in the long term for them as they are looking for ticket size between 250,000 and above where you'll find these businesses don't have capacity at what level to be able to absorb that. So how do we create a funding mechanism that is able to help these businesses leapfrog from a ticket size of 50,000 up to 150,000. That's where we have, we have a huge gap. And that's where the Angel investors come in. And until we are able to figure out how that transition will look like, it will still be a far fetched conversation, but I'm not saying that VCs are not reaching out. I can say I've had like five conversation with different VCs who see value in starting to have conversation, and starting to have interaction and getting to know the businesses that we are supporting. Reason being that our ticket size can be between 50,000 USD to 200,000 USD, and they see opportunity for those businesses being able to raise the next round with their structure. but you see now, very few accelerators are able to do that kind of funding. And then your accelerator dealing with the businesses that are looking at 50,000 USD as a ticket size. So how do we help this business? How do you support these businesses to be able to to qualify or be able to absorb ticket size of 250,000 USD?

Henric Hansson 23:52
That's, that's very interesting. So there's clearly a gap between the accelerators and the VC firms. But when you've had these conversations with the VC firms, how are they finding their their investable ventures right now, if not through platforms like accelerators?

Anne Lawi 24:14
So they have their own mechanism. They have their own applications and they, you know, they do haead-hunting, and with the era of internet, it is easy to find some of this information and be able to know who is doing what. Because some of these businesses are, you know, growing their brand and they're utilizing digital platforms to amplify what they're doing so so they have their own internal system. They're also reaching out to accelerators to see how they can start engaging more and you know, exploring the

businesses that are being supported by accelerators. And start having conversations with them to see whether they can be potential investee in the coming months. But it's not. It's not a very closed, it's not a very short time conversation. It's a long term conversation where they will say, maybe we'll have a look at the business in the next year or so to see where they'll be. So that means that by than, the business can be bad. Or you know, if they don't make so much progress, if they are not able to close funding that will enable them to grow, and sustain their business for the next one year before they have conversation with a VC. But also to add on to that, for you to be at a level where the VC will see and evaluate if you are within their parameter of investments, you must have capital or you must have investment, investment in your business. So how do you grow to that? So, yeah, those are the things we are still grappling with.

Henric Hansson 26:14
And perhaps in relation to that, how would you say that your accelerator model is different from other accelerators operating in Kenya?

Anne Lawi 26:30
Our focus area is very unique to this region. Very few accelerators are focusing on urbanization of an area. Secondly, having an investment program as part of the accelerator, not a standalone but part of the accelerator. Also by providing de-risking mechanisms and creating deal flow structures. This is very attractive to investors as we are able to not only increase the confidence but also be in the process with them. That is attractive to the investors that we work with.

Henric Hansson 27:18
It's super interesting. And can you just tell me how short we are and how these investment programs work? I read shortly on your website that you have. You have these cohorts of $13,000 split over 30 investors.

Anne Lawi 27:40
I am not the right person to talk to about investment. My mandate is the accelerator program and consolidating the investments to the startups. My understanding is that there is a minimum investment amount that you commit when you join the program. So we do recruitment of investors, and we'll have a cohort of investors from e.g Gazprom, and we will also add local investors to that cohort. What we do is that they will pay out five investors to one on one startup or business in Kenya during the accelerator program. At the same time, the investors will be tasked to collect information based on the tools that we have. And then they vary by each we, we buried by it concurrently, separately, so during the investor program, the direct the companies and what they're doing, and then they will have sections where they're able to ask specific questions based on where the business is in line with what we are doing as an accelerator program. What that does is it provides a better understanding of these businesses, their areas of weaknesses and how they can support them as investors. They also provide us insight as an accelerator on areas that we need to support these businesses. So in terms of the amount one, I'm not so sure how much that is committed by the investor. I know there is a minimum of 50,000 USD to form a group of five investors, not very sure but the number so don't put that as a base of how the investment group is constituted. And then we evaluate the business to be invested in and then the investment is put in a special purpose vehicle at the Pangaea. When the tools are done for the investment, the investment is dispersed to the businesses that have been selected at the end of the program and is done on Track based on the roadmap which is agreed upon during the accelerator program.

Henric Hansson 30:07
Okay, and is this a way for you to sort of fill this gap that you were talking about before?

Anne Lawi 30:15
Yeah, because like I said this allows us to do up to 50,000 to 200,000 USD. So that means that then we are able to help these businesses leapfrog from 50,000 to 250.000 means it's easy for them to attract the next level funding.

Henric Hansson 30:36
Is this a common model to do? Are there any other accelerators that are doing similar things? .

Anne Lawi 30:54
Exactly. I don't know of any other that is doing this in Africa. If you come across another, let me but I don't know of any other that is doing this model in Africa.

Henric Hansson 31:06
Well, it's super interesting.

Okay. I just wanted to ask you a little bit more about the information. You touched upon it before. But would you say that there is currently an issue around the level of information available about the ventures and the markets they operate in? .

Anne Lawi 31:27
Yes, yes. And this happens if you're dealing with diaspora investors, because they are not in this market. They may have the business know-how and they may understand the principles of building a business, but they can't contextualize the dynamic of this market. They will not understand why it's easy to build mobile based payment platforms in Kenya compared to Denmark, because of the business climate here and adaptability of, of mobile payments in Kenya which is very high and easy. So for example, right now if you want to build that you will really struggle because you don't understand the local dynamics and how that works. And if you are a new investor you will land on how we even make money. But if you're a local investor, and you're guided by someone who understands the market, then you're able to see the business opportunity, you're able to clearly see that business model and how they can sustain themselves and how they can scale to other markets. So there is that aspect, but they come in handy in terms of other business model principles because they are standard across the globe. Doesn't matter where you come from. So one of the other things that we are very keen on is called a strategic options workshop which we have every three months. During these we'll do strategy workshops with the other investors that have invested in a particular business to just go through where they are and help them think through how they can improve in areas that they have struggled with, or areas that they experience challenges as they grow. That is super important because you want to work with investors who don't only come with money but come with other support, but also if you are struggling they will understand and they will not only push you to provide return on their investment.

Henric Hansson 34:05
In terms of challenges for the businesses, would you say that, for example, due diligence or where do you see that this is most sort of painful for businesses, this information gap?

Anne Lawi 34:37
In terms of making a decision on whether to invest, whether it's a good business to invest in or not. The basis of making that decision is informed by the ability of that business to grow and skill. So if you're not able to decide, and break that information down based on local markets and you instead use what you're used to, maybe a broad way of doing things, you will be misinformed. And that's what we're able to provide as an accelerator.

Henric Hansson 35:25
Okay. So that's basically the way that you are helping investors to overcome these issues of information gap?

Anne Lawi 35:36
Exactly, but also we are very intentional in making sure that whatever works elsewhere, it doesn't necessarily succeed. It's not a cut and paste. Just because other things, other investor tools, and the way of doing things work in Europe or in Silicon Valley doesn't mean it will work in Kenya, or in Africa. We have very different market segments, and different nuances and you have to adapt in and put in consideration those markets and nuances that come with this market.

Henric Hansson 36:18
It's really interesting. So, in relation to that, what is your current process for finding locally born ventures?

Anne Lawi 36:28
Ah there are not so many, that I can tell you for sure. Because there we are very wired. Here, you work so hard to get you know, a little bit of finances that you can put aside, and the last thing you want to do is to gamble in high risk investing in startup. It's very high risk and the last thing you want to do is to put money in a venture which is considered very high risk. But we have to educate it, we have to provide information that if we want to grow our entrepreneurs and if we want to grow the SMEs and continue being the frontrunners when it comes to innovation and technology in this side of the world, then we must take a risk. It starts with me, and everyone, and also in creating system or structures where, for example like Pangea where I can choose to be an investor and put it in a pool and with 500 USD I can become an investor. That ensures and encourages that anyone with a little bit of some funds can become an investor. Also, just a change of mindset I would say because in Kenya and in, in East Africa, when you have a little bit of finances to spare, I want to buy an asset I want to buy land. Because that is a security not only for me but also for my children, in case of anything I can sell it. That's how culturally we are wired to be our fathers are doing the same and we are doing the same. That is the security for me. But we need to change our mindset and show that there will be a time where you can't buy anything, where land will not be available. You will not be able to afford it. So what can you invest in that will give you returns? Another area that is helping to inspire mindset also is investing Government bonds. Where with as little as $3 to $10, you can invest in different government bonds. When that kind of investment opened up then people started seeing investment from a very different perspective. And that is facilitated by mobile payments. So you don't even have to fill papers, you just need to use your phone, do a certain code and then you're able to enroll. So I think a different way of doing things are being adopted also by the government and availability of information online. It's helping people see things in a different way. Now, what do we do as an organization we are creating a very close collaboration with investors' networks, they're not so many. They are very few. Currently we have two of them as part of our investors. But the other things we have seen as successful is, for example, when we were doing a program in affordable housing, we worked with partners who are already doing things, or have been doing things in the sector. And when you demonstrate and show value of them, not only providing alternative services or solution for for the housing sector, but also they can be involved in terms of investment and growing businesses, innovative businesses that are providing innovative business cases, they see value in it. So we also creating that kind of conversation. But it'll take time because you know, it's human behavior that takes time.

Henric Hansson 41:02
But would you say that there any difference in the way you work with locally born ventures in comparison to to other ventures in general?

Anne Lawi 41:38
I'd say in terms of our approach and our support mechanism, is unique to us. Also our opportunity offering to startups that we are working in. It's very focused on particular themes, like I said, before us there was was no program or investment for urbanization, for affordable housing. So that is unique to us as of now and we are able to provide value to those businesses that we are supporting in those areas.

Henric Hansson 42:23
Yeah. And, if we look at the broader picture in general, are there any differences in the way locally grown startups find investors compared to those with foreign founders?

Anne Lawi 42:47
Yes, huge differences in the sense that the white founded businesses are easily able to get investment because of their advantage of where the white founder comes from. In Europe or in the US, it's easy for you to mobilize and get capital from different capital funds, venture funds or angel investors or different funding mechanisms that exist, which don't exist in this side of the world. With that in mind when you have many options to explore compared to here then, when you look at the funding process is that you start with family, friends, and fools and then you'll go to the next which is the pre-seed. We don't have family, friends and fool group of where you can get investment because of the country, or this demographic, economic status. So you will find that it's easy to raise money from the rest of the family and friends because they may have some fans or yes some disposable income that they can be able to share with you, which is very different from here. Also being honest familiarity attracts familiarity and white VCs find it easier to give money white founders. And that's how it is that is the nature of human being. So you will find they find it easier to invest in white founders. But also I guess is how white are able to articulate and speak to what white investors want to hear. If I haven't understood, for example, the culture in Denmark or in Netherlands, I know they're very direct. Sometimes they would say things which to us is very offensive and you don't ask straightforward and you don't say things this way, but if you understand those nuances, then you will find that the investors will be more forward leaning you will feel like this is their own, they can trust these ones. But compared to the other cultural dynamic, it's not always the same. So some of those market nuances, we have to deal with and we have to accept that is what it is. But also to add to it, like we keep on sayin, create investment groups and networks also in Africa to provide de-risking, and also to make them comfortable because you can't keep on expecting the rest of the world to solve our problems.

Henric Hansson 46:30
Yeah, I do have an interruption. If you do need me more questions. I'm sorry if we're running maybe five minutes over time. So I just have a few short questions left. So I would just like to ask you, how do you see that the government is currently sort of influencing the VC industry.

How do you see the government is currently influencing the VC industry in Kenya?

Anne Lawi 49:47
Okay, I don't know whether you're able to get my last point.

Okay. All right. Um

I think the government does what it needs to do and I think there's goodwill. They have a lot of entrepreneurship programs, in terms of ensuring this program are effective or take place, that's another discussion. But we have seen goodwill. I think there is however a lot of misconception and misunderstanding on what kind of support the ecosystem require, and how that can be facilitated for the ecosystem. The reason I'm saying this is that that in one minute you'll hear there is a fine for this, and for SMEs and here there is a font for this data for me, and then the next minute up or there is there is the tax regime of 3% for income and SME generate, like okay, we've got min. The next thing here, these are Find support intrapreneurs and native digital entrepreneurs on digital platform or digital entrepreneurs. Why big things digital? The next minute, you'll hear that they need to pay taxes for second year going on. So it's a mixed feeling. I can't say. I think they can do better. I think we have an obligation as an ecosystem to push them to be able to deliver for us. I think we have not been putting enough in terms of structuring and consolidating and compiling our voice to be hired and to demand what the government can do for us.

Mads Robdrup 51:43
Hi again. And so I just want to follow up on one thing you are you said earlier about, about the gap of investors. And you said that the business angels are somehow filling that gap of the 50,000 US dollars to 200,000 US dollars. But do you find this these BAs are filling that gap sufficiently?

Anne Lawi 52:52
What I said is that there's an effort to address it. I don't think it's addressed at all, but there is a leaning towards addressing it, and there is a leaning towards finding a solution or collaborating with accelerators to find a solution. And recently I have personally have had different conversations with different VC who are willing to start conversing and touching base with the setup of the support to see whether they can form a pipeline for the investment in the future. So, that's a good indication in the right direction.

Mads Robdrup 53:44
And there was another question I also had when we talked about this information gap. And you said that the local investors they have a better understanding about the market and the ventures. Such as when it comes to these mobile Pay digital solutions, then compared to foreign investors, where and then I was curious about the number of local investors that you work with both in terms of local business angels and local VC funds. Yeah, if you can maybe elaborate on it.

Anne Lawi 54:20
So, currently I know we work with two angel investors networks, which have more than 50 angels in one and the other one I'm not sure about the number. There are not so many networks in the country, but I know there are a couple of networks in the continent. One of the forums that is able to provide information in terms of the networks and investors that exists. It's called Afrirab. It's a pan-African umbrella body that brings together all the hubs, accelerators and supportive systems for entrepreneurs in Africa. So not so sure the kind of data they have in terms of pan-African. But for Kenya, I just know of two, there might be others that I may not be aware of, but those are the networks that I know in terms of data. I'm not so sure how many we have in Kenya that are Kenyan-based.

Mads Robdrup 55:45
Okay. Thank you.

Anne Lawi 55:48
Thank you, sir. I guess we come to the end of

Henric Hansson 55:54
your face.

Is there just like as long as the last thing is there Any other sort of challenges or strategies or something that you think we should look into more that we sort of missed here? Or do you think we

Anne Lawi 56:11
know, I'll be curious to know, what did you have any focus? Did you have a specific focus area on the startup startup businesses that are being supported? Or was it cutting across are the businesses?

Yeah. Did you have a specific focus area or are the businesses do better across all the businesses?

Henric Hansson 57:00
And our main focus has been on the external challenges. So not so much internally at at accelerators or at VCs, but sort of what external challenges that VCs and accelerators are facing, or working.

Anne Lawi 57:16
The reason why I'm asking that is because when it comes to certain areas, certain focus areas like FinTech, financial inclusion, there has been a huge growth in terms of, of the support and investments that have been around that. And there are so many factors contributing to that kind of interest, but also when it comes to other areas, they are quiet untracked. I've heard investors say we're looking for different businesses, not anything in tech any longer. I think we just want to see if anything else is interesting outside of tech. So I just wanted to hear your view about something you have paid attention to.

Mads Robdrup 58:21
In some ways we have been aware of, of the big focus on tech startups in Kenya, as they have evolved as a phenomenon in the worldwide literature and in the media. But it's also interesting to see in this point of view, what other ventures that work in other areas and other sectors, how they're actually able to gain finance.

Anne Lawi 58:58
Yeah, okay. There are other areas that are quite promising edu-tech. Edu-tech is also a promising area and so many opportunities because its a mandatory. It's something that needs to be figured out because it's a mandatory and essential service offering. But I'll say it doesn't have an effective mechanism of offering these services or essential services to the ordinary citizen. There is also healthcare and you have so many dynamics there is.

So by now you know, mobility is also an area that is highly potential. Housing also, it may be capital intensive, but it's an area. But what is happening is that if they're not able to get investment. There's a lot of grants, which they can apply for an and utilize to prove. Then you also find that most of the businesses doing this grow to lack of accountability in terms of growth that is expected with any money that is pumped in the business and you become comfortable and you become a machine that apply for grants. Nothing much comes out of what you're doing.

Transcribed by https://otter.ai
Edited by Mads Robdrup and Henric Hansson

APPENDIX J. Interview with interviewee from the startup

Transcription: Interview w Johannes Traerup (Founder and CEO), Social Bites

Interviewer 1: Henric Hansson
Interviewer 2: Mads Robdrup
Interviewee: Johannes Traerup
Time: 49:01

Henric Hansson 0:00
Yeah, of course. I mean, it's also interesting to hear what kind of challenges there are in terms of getting funded as a start-up operating in Kenya.

Johannes Traerup 0:10
We've dealt with a lot of venture funds but not landed any of them just yet.

Henric Hansson 0:27
Yeah I see. But maybe you can just refresh our memories a little bit. What is *Social Bites*?

Johannes Traerup 0:37
Yeah Social Bites is a dairy company. And we sell frozen dairy products for the low-income earners. We do that by incentivizing people to become a vendor's for us whereby they are being provided with the means to sell. So they are being provided with the equipment, the uniform with the products on credit. Then they go out and they find a market to sell these products and then they come back and we reconcile with them. So we are a dairy company selling frozen flavored milk to the low income earners.

Henric Hansson 1:29
Yeah. And how long have you been in Kenya?

Johannes Traerup 1:33
Personally, I've been in Kenya for about six years. But I have been working on Social Bites since I founded the company in 2017. For the last three years, I've been working on Social Bites.

Henric Hansson 1:52
And correct me if I'm wrong, but I remember something that you were working at Danone previously?

Johannes Traerup 1:59
Yeah well I was working at a company called Fan milk, which is at that time was a Danish owned company in operating in West Africa. But that was now bought up by DANONE some five, six years ago.

Henric Hansson 2:16
Okay. So you've sort of worked in Western Africa before within the dairy industry, Okay. And regarding social bites, are these employees all these re-seller?

Johannes Traerup 2:34
No, so the vendors who sell the products to the consumer in the market, they are not employees. They are independent contractors, and they make commission on every product they sell. So, they are not employees of the company. We also have a group of employees obviously but that's different.

Henric Hansson 3:00
Yeah, okay. And you were mainly operational in Eastern Kenya?

Johannes Traerup 3:05
Yes, well, well that is correct, we only sell our products in Mombasa which the second largest city.

Henric Hansson 3:17
And is that where you have your your office as well?

Johannes Traerup 3:20
No. So actually we produce our products in Nairobi just but we don't sell on those sites. We only sell in Mombasa. So there's a bit of transport between the market and our production.

Henric Hansson 3:37
Yeah. And, which stage are you at right now? Have you received funding?

Johannes Traerup 3:47
Yes, we've closed to two rounds of funding from angel investors. The first one was in July, 2018. And then the second one was in a year later in July 2019. And so we've closed the 2 seed round. So, you know, not huge rounds.

Henric Hansson 4:21
And is that confidential?

Johannes Traerup 4:24
You mean the amounts? Yeah.

Henric Hansson 4:32
And those Angel investors, did you find them in Kenya?

Johannes Traerup 4:40
They are Danish investors. So there are three groups, self made investor groups, you know, people coming together thinking this was a good idea. So three of those groups and then there's one UK angel investor

Henric Hansson 4:59
okay and have they done similar investments before?

Johannes Traerup 5:04
Yeah, kind of. One of them, the UK one has done a number of them. And the Danish investors have done investments as well. Not so much in Africa, but a little bit. So yeah, they are familiar with the, you know, how it all works when you invest.

Henric Hansson 5:31
And these investments were made to sort of scale up the business or was it more to test the validity of the services?

Johannes Traerup 5:42

yeah, I mean they all have invested differently, obviously, it's quite a number of them, but the largest investor then UK investor is investing at early stage companies. Companies that will be at our stage. Or maybe a bit a bit further.

Henric Hansson 6:10
Okay, I see. And just in terms of Social Bites, I mean, you had some experience from the dairy industry before, are there any challenges that you've run into that you didn't expect? Or has everything been smooth sailing?

Johannes Traerup 6:32
Um, well, it's definitely not been smooth sailing. There's been a lot of challenges. But when I was in West Africa, we worked with a similar concept, the frozen dairy and street distribution. So there's a lot of learnings that I've been able to get. But every place has its own context and its own mentality of how to go about things. So there's been different challenges.

Henric Hansson 7:07
Yeah. Is there anything, that's sort of been a major challenge?

Johannes Traerup 7:12
No, there hasn't been. I wouldn't say there's been any major challenges. I mean, if you plan well, you're able to predict what kind of challenges the environment that you're in, will give you. Then you have the ability to sort of plan around those challenges that you think might come, right. I think that's something you learn when you've been on these sides. Sometimes you know, you get an idea of where things can go wrong and then consider that in your planning.

Henric Hansson 8:03
And you mentioned just briefly that you've been in contact with a lot of VC firms and these sort of, perhaps a little bit larger investors. What is your perception of the competition for funding between ventures in Kenya? Are there like too many ventures in general competing for the same capital from these VC funds? Or is it rather the other way around?

Johannes Traerup 8:30
Well, I would say that if you're at the right stage, with your company, in terms of having achieved some kind of scale, it doesn't have to be a huge scale, but you've been able to prove some traction, you have a business model that is proven and that seems to work. Then attracting funding from VCs that have a presence in Kenya is not impossible at all. It's quite possible, I would say. But the challenge is if you don't, if you are where we were in 2018, where it just started, and you don't have anything to prove and now you need to raise money. There's not a lot of venture funds in that space that are willing to come with money when the risk is that high. There's a few but not a lot.

Henric Hansson 9:42
So it's kind of dependent on these more early stage pre-seed or seed kind of investors?

Johannes Traerup 9:51
Yeah, I mean I ended up raising from angel investors. I mean, individuals where there's not a lot of bureaucracy. You know if you approach a venture fund, it can take you up to probably between six and nine months from when you initiate your talk to when you actually agree to sign the term sheets. So that's

a long process. With individuals, a lot of it is relationship-based, you know. It is not as bureaucratic, where the due diligence is carried out in the same way. It's a bit more simple, the process.

Henric Hansson 10:45
Yeah, and have you been in contact with these networks in Kenya as well?

Johannes Traerup 11:06
Not really. The people I've been in contact with in Kenya have been the venture funds. Not so much individual investors.

Johannes Traerup 11:21
Yeah, not not so much a little bit but not so much.

Henric Hansson 11:25
Is it? Is it easy to find those business angels?

Johannes Traerup 11:34
It's probably a bit difficult to find Business Angels in Kenya. I also think that you do have to be extremely careful when you find your investors because you don't want to get the wrong people involved in your company from the outset. It is actually a balancing act, when you're raising money. Of course you need to expose yourself and expose your business to them, because they'll have a lot of questions, but you also have to be careful, because you don't know what they might want. And maybe you don't want them to have what you're doing now.

Henric Hansson 12:29
yeah. Is that something you've seen with other ventures in Kenya?

Johannes Traerup 12:38
I haven't seen it per say but I've heard a lot of frustrations which comes down to a malfunctioning board, or investor group where people get stuck on certain issues because there are disagreements. And when you have frustrations like that it takes away a lot of your focus from what you should be doing.

Henric Hansson 13:20
Makes sense. I just wanted to ask you a little bit because a lot of the literature is talking about, you know, deal sourcing and how these investors or VCs are actually finding their ventures, so to speak. One part of the literature is talking about intermediary agencies. So like accelerator programs, and similar programs, have you been through an accelerator program in Nairobi or anywhere else?

Johannes Traerup 13:53
I have not.

Henric Hansson 13:59
I just want to ask you, have you seen any, any accelerators? Do you run into them often? And how do you see that they work in this ecosystem of startups and investors?

Johannes Traerup 14:14
To be honest, I don't have a lot of ideas about that because I haven't been part of them. And I've been too busy on my own track with the things that I feel make more sense to focus on. So I should be careful what I say but I know that there are many different accelerator programs, some are more professionally run than

others. They all target, you know, different types of companies at different stages. But my own sort of perception about that thing is that it's extremely time consuming. I think it can still actually be a help to a lot of people, a lot of entrepreneurs, but I think you also have to be careful so you don't end up in a situation where you're not spending your time in the right way, as an entrepreneur. Things have to happen fast.

Henric Hansson 15:24
Yeah. Because of what we sort of heard when we talk to all these other actors, it seems like that many of the accelerators are very good in terms of technical assistance but that sometimes when they sort of exit the accelerators, they're still not sort of investor ready. So this sort of purpose of catapulting them into investments, have perhaps not always worked. So I just wanted to know, was that sort of a strategy that you took? When you found funding, to target these business angels outside of Kenya, or was it just something that that sort of naturally happened?

Johannes Traerup 16:17
I think it sort of naturally happened. So I spent probably around four months chasing investors in the beginning. I guess I thought I just had to find a little bit of money. Then I managed to line up meetings and you know, when you have a meeting with the firm or lets say a VC, you know, if they like you but they can't invest in you, they'll always try to refer you to someone else. So it's like a journey where you have so many meetings and you're being referred to people all the time. Then, one or two of these people sort of agree and then then then it works out. So I think I didn't have a clear strategy when I started out, I was just trying to, to meet as many investors of any kind in the beginning. Then when I sensed some interest in with a few of them, they started guiding me in terms of, you know, you're saying you need to raise this money, but actually you might need to raise four times as much money. Then one investor will say, "okay, I will agree to invest, but on the basis that we raise four times as much money that you wanted, and that you find at least two others investors who can come with at least the same amount as me" something like that. So it's like that, they'll never say yes from the outset, there's always criterias.

Henric Hansson 16:17
Yeah, I think and at this stage where you're already operating in Kenya?

Johannes Traerup 18:22
we actually weren't but when I raised the money, or when I got commitment from the first investors, we hadn't yet launched, we were just about to launch. So we actually hadn't sold a product at that point. We had done all the other things, we had you know, gotten all the permits, we had developed the products recipe, we had gotten a partnership with a dairy plant, we had done trials, we have all these other things. So that was the stage that we were at.

Henric Hansson 19:03
So all of those sort of things that you had already put in place. You were able to do those because you had been operating within the industry and you knew what was required?

Johannes Traerup 19:16
I think that that's why the investors felt like, okay, there's risk involved, because he hasn't put the products out on the street yet, but at least he's tried this before.

Henric Hansson 19:26

Yeah. And what were some of the main challenges you faced in terms of the requirements from the investors? Was it challenges relating to reporting, or providing information or was it more challenges relating to scalability or what were they most hesitant about, so to speak?

Johannes Traerup 19:53
Well, I would say probably the fact that I was the sole founder. Investors like to see a founding team and not just a sole founder. I think that was one of the worries they had. And well, I guess the team, for a long period of time I was alone. It took me a while before I got a management team in place. So, that was a worry as well for them that they might have thought, is he doing everything? Can he cope with it? What if something happens to him? Is there no one else to take over and stuff like that?

Henric Hansson 20:38
Yeah, there's a lot of eggs in one basket. Yeah. That must be a must have been a lot of pressure as well.

Johannes Traerup 20:47
Yeah, it was, but I've enjoyed it a lot. Because I, I like what I do, so that has driven me you know, to to get things done and you know, make things move.

Henric Hansson 21:00
Yeah, yeah, I mean, it's really impressive product and journey and it seems like a really fun thing to work with. I just wanted to know, you spoke a little bit about the struggle of setting up a management team. How did you end up doing that?

Johannes Traerup 21:21
So I knew that the right way is not to hire a management team from day one. We have to grow the organization organically so it's better if you find the qualified people. Then you train them and you spend time with them, and you make them own the culture, and then you promote them. That has been my sort of thing from the beginning. That means that it took a while before we actually were able to say that we have a management team. Now, we have a sales manager, we have an operations manager, we have a finance manager. In case of the sales manager, for example, we promoted her to the role of sales manager, I'd say probably a year into operation. Up to that point, I had sort of been involved in a lot of, you know, sales management tasks. And the same with finance, I had been the finance manager. So you're always looking for talent, you're always scouting and getting meetings with people that have been referred. That's something that's always there in the background even now. When I felt the time was right was when we actually hired these people.

Henric Hansson 23:08
Was a strategy for you to get people with sort of knowledge about the local settings and the local context?

Johannes Traerup 23:19
So for operations, we now have a guy, he was one of one of the first employees actually and he's been a production manager in other companies so he knows about that, and all the operational things. He has that specific knowledge and skills. Of course for finance, we found a lady who also has experience in finance, but I'd say one thing that has to be common and one of the things I look at is their ability to be organized and to be able to plan. I think that's something you can very quickly sense with people when you meet them, and my experience is that if you have an accounting background, that's something you normally go to. So we've actually ended up recruiting quite a number of young accounting, ladies. Because they're young, they are eager to learn, then they have that structured mind because they are used to doing

accounting. Some of them have proven to have a lot of talent. And so then we're just, you know, training them and spending time with them. And so I really like accountants.

Henric Hansson 24:46
yeah. Have you seen other startups that have not succeeded with finding the right staff?

Johannes Traerup 25:08
So what happens is that many of these startups that managed to raise a lot of money because there's quite a number of them in Kenya. In order to fulfill their scale up plans and their ambitious plans they hire very fast and people below them are also hired in very fast and large numbers. And that means that that there's no structures in place, there is no processes in place that regarding how things should be carried out. That means that you get people who are not empowered. Because they don't know exactly if the way they are doing things is the right way. I think that's the danger, when you hire too fast, especially in this environment here where you cannot undermine the importance of training. I think that's what's happening to a lot of the big companies, that they don't have a strong culture where people in the company feel a lot of ownership and a lot of empowerment. That rollout plan has just been too ambitious and they've spent too much money to try and make things happen too fast. So the foundation is simply not strong enough. But it's always difficult because all of a sudden you have investors who want to see things develop very fast. Now, on the other hand, you are in need of a manager and your organization needs to be able to keep up. So you find yourself in that sort of a bit of space.

Henric Hansson 27:05
I guess it's a bit of a trade off between this insane scale up and also organic growth.

Johannes Traerup 27:11
Correct. Correct.

Henric Hansson 27:15
This is perhaps a little bit of a sensitive topic, but there's a lot of literature on, you know, foreign foreign entrepreneurs entering Kenya or and local entrepreneurs, locally born ventures perhaps. Do you see a difference in the way they handle this process? Like do you see that that foreign firms struggle more with the scale up process or they have any particular challenges?

Johannes Traerup 27:47
I think foreign firms probably manage to raise more money than the firm's that are founded by local people. That's sad, but I am quite sure that's a fact.

Henric Hansson 28:10
And you think that's because they get the funding from their home countries?

Johannes Traerup 28:16
I think that part of the reason is that they get funding from their home countries. But I also think that it may also come down to skill set. I mean, if you have a European education, you know, you've worked in Europe, you have the upper hand compared to someone who took the Kenyan education. And of course, now, when you meet a venture firm, they're looking at you as a founder, and evaluate the skills you have and, and what you can do out of this.

Henric Hansson 28:49

And, but in terms of the like business operations and, and their ability to actually distribute. Do you think that foreign founders are facing other challenges? Have you seen that in reality?

Johannes Traerup 29:05
Well, I think, of course, I think there's always that thing of understanding the market and the consumer. Especially if you are doing FMCG you have to understand the context that you operate in. I get that that is an obvious challenge that foreign founders would have, understanding the local context. Understanding the local context. Definitely.

Henric Hansson 29:35
And, and so you said locally born ventures have a difference between the way they find funding. Have you seen that pan out, have you seen locally born ventures and the way that they find funding?

Johannes Traerup 29:57
I think there are many levels in local companies. So I'm sure many local companies can do the same as some foreign founded companies right and, and there's also some European funded companies that fail big time. I think there's Kenyan founded companies that have a real hard time raising the initial money to get started.

Johannes Traerup 30:46
So I think if you look at the companies in Kenya that have raised a few million dollars in total. Startups set up over the last say three years, you will not find a whole lot of companies. I mean, you know, they probably could fit into a relatively small group. That is founders who've now raised money from a venture fund. Then there's a whole lot of other companies that have a business idea and they don't need a whole lot of money to do something very small scale and that's what they do, but I don't know if that's part of your scope of what you're looking into.

Henric Hansson 32:01
Yeah, it's a really interesting point and it seems like everyone we've talked to have more or less the same idea about that. I didn't know that it was that widespread, but it's interesting that people ha've seen that sort of development happen. I just wanted to know, within social bites, are investors working operationally in the company or are they in the board or how are they active?

Johannes Traerup 32:37
So we have a board which is made up of myself and two of the investors. And then there's a number of investors that are not on the board. So they still get the monthly report, so they're still getting updated about the progress and they still receive the financials for every month but they don't sit on the board. So we have a very small board of three people.

Mads Robdrup 33:35
I think he's, he's trying to reconnect. But talking about the point you said before about these small ventures that perhaps do not have the growth strategy to attract VC funding, what other opportunities are there in order to receive capital?

Johannes Traerup 33:55
Well, maybe there's the accelerator programs. Maybe they offer some kind of assistance to help to get ready for investors. I can imagine that's probably where they fit in, the accelerators to a large extent.

Henric Hansson 34:17

I think I'm back. Yeah so would you say that your investors are sort of like strategic sparring partners do you right now how are they sort of supporting Social Bites?

Johannes Traerup 34:50
It's more on a strategic level. You know, when we have board meetings there's always a few sort of high level topics that need to be addressed. They come with their views, they are very experienced. They have a lot of private sector experience so they actually add a lot of value to our strategy and our company.

Henric Hansson 35:25
Do you think they can do so because they've had this experience of investing in ventures in Africa before or in similar contexts before?

Johannes Traerup 35:36
Yeah. And I will say a lot of it is not Africa specific. The same would be relevant if the company was run in Denmark.

Henric Hansson 35:50
And then just to jump to a completely different topic. How do you see that the government is currently implementing sort of the VC and early stage financing for Star-ups in Kenya right now?

Johannes Traerup 36:07
I may not be the right person to ask about that. I mean, if you asked me, I'd say I haven't seen it, but something might be happening that I just don't know of.

Henric Hansson 36:17
Yeah. And in general, like, Are there any? I don't know, how is the regulatory framework sort of effect affecting the way you do the business at Social Bites?

Johannes Traerup 36:35
Well, to be honest, we don't get so much support. The system that's in place is more to make sure that we live up to certain standards so that is monitoring and doing inspections. They come to do inspections on premises, and so on. We don't sort of get support. I don't know what support that would be excellent. But we are on our own in that sense.

Henric Hansson 37:10
Yeah. I see. Yeah. I think that we ticked all my boxes here. Mad's I'm sure you have a couple of other questions.

Mads Robdrup 37:25
In relation to this last point, I read somewhere that the National Bank of Kenya is lowering the interest rate which maybe affects the private banks also, which should make it easier for firms to get capital through debt in the banks. Is it something that you feel has an impact on social Bites? Well,

Johannes Traerup 37:56
No, not really. I mean, loans will still be extremely expensive compared to what you would be able to get in Denmark. I mean, it would never be attractive for us to get a bank loan in Kenya. A lot of these venture firms are also offering loans. Not offering but, they also provide that as a financial instrument instead of equity to the companies that they decide to move on with, and I think those terms are probably more

attractive than going to the bank. If we will go to the bank to get a loan, I wouldn't know exactly, but it w, it would not be less than an interest rate of say, 9%.

Mads Robdrup 39:03
Perhaps much higher actually.

Johannes Traerup 39:06
Okay, well, then maybe, you know, yeah.

Mads Robdrup 39:08
Not Not exactly. No, because I have not been in talk with any banks either. But my perception is 15% or above.

Johannes Traerup 39:20
Oh, yeah probably. I don't know, to be honest, but it's way too expensive.

Mads Robdrup 39:26
So, so the kind of capital that you're looking for in Kenya would always be equity from outside investors. Is that correct?

Johannes Traerup 39:36
Well, I think loan capital is very risky when you are a startup in this environment. Maybe everyone would not agree with me, but that's my view. So I would rather take equity and then try and negotiate again. valuation, as opposed to going out at this point and trying to obtain loans. Maybe that that will be different three years down the line when we are making profits and, and things are looking very good. Or two years down the line or whatever but at this point, I don't think it's very advisable for very early stage companies to take loans. I think it's quite reasonable.

Mads Robdrup 40:30
Yeah. I think you had some very interesting points about the networking with the angel investors as well as venture capital firms. Also concerning the type of venture or startup that you were at that point and whether it makes sense to go into an accelerator or actually making the firm investable and growing as you said, you had more focus on operating Social Bites than participating in accelerators. I wonder if you still perceive that as a good strategy? And in that case, what would really make it possible for you to meet these business angels or investors? Would there be some networks? Anything that you have heard of? Or that you could imagine being a good idea if they existed in terms of you accessing these investors?

Johannes Traerup 41:35
So you mean what I would advise other companies to do? Or tips on how to find these investors? What exactly did you mean?

Mads Robdrup 41:48
I'm rather asking into what you perceive as, as a good strategy. Where would you go from now on in terms of finding investors now that you have spent all these months previously on finding capital. So I assume that it's sort of too late for Social Bites to go into an accelerator, would there be some networks that you could look into?

Johannes Traerup 42:16

Well, I think people go into accelerators for different reasons, I suppose. And I think for a lot of people it does make sense to do. Especially if the accelerator can provide you with the skills and upgrade your skills and make you invest ready. So I'm not saying that it's a waste of time for everyone. I don't think it is. And I think it depends on where you are as a company and where you want to go. I also think it's difficult for companies to go straight to VCs after founding the company, right. I mean, most VCs, they don't want to invest into companies that have just started up, they want to see some traction. So what about what my point is that I think getting that investor base right is very important. So not just accepting whoever wants to invest into the business, but actually being very critical about who you let in, and that that's difficult because you need the money but at the same time, you don't want any kind of money. So spending time on that, actually taking our time to make it into a journey, that whole fundraise, where you do it thoroughly you really try and get to meet as many people as possible. I think that makes sense. Because you learn a lot in the process, and it's a way of rehearsing your own pitch. Because they ask a lot of questions, it's actually quite a fun journey but it's time consuming.

Henric Hansson 42:16
But yeah, thank you so much for taking your time. How is it going for Social Bites? Now you're back in Denmark are you? Are you going back?

Johannes Traerup 45:13
I'm back in Denmark and it's not going so well like for anyone else at the moment. Well, we'll just have to wait to see how things develop so we've had to scale down quite a bit. And we'll see how it goes but Kenya is pretty much like Denmark. Of course you have the slums and the highly populated areas in Nairobi. The guys who live there will continue with the daily life, more or less, but in other parts of Nairobi streets are empty. People are staying indoors, people are afraid. So it's changed a lot to be honest.

Mads Robdrup 46:01
So how about your vendors in Mombasa? Are they able to go around?

Johannes Traerup 46:05
Not really. I mean there's been a lot of restrictions coming out the last few days in government so we've had to scale down and get a few of our depots activated and send a lot of our staff home and, you know, close down production temporarily and all those things. So it's actually a bit of a mess to be honest. But everyone is in the same boat here. Except in Kenya, we don't get government support.

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