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LINKING ENTREPRENEURIAL INNOVATIONS FROM KENYAN UNIVERSITES TO KENYAN MARKET THROUGH PRIVATE VENTURE CAPITAL FINANCING

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Abstract

Innovation is the process of Entrepreneurship. Companies cannot grow through cost reduction and re-engineering alone. Innovation is the key element in providing aggressive top-line growth and for increasing bottom line results. Universities play an important role as a source of fundamental knowledge and occasionally industrially relevant technology in modern based economies. Financial inaccessibility has been sighted as a major challenge on the growth of small enterprises. Despite the importance of innovations, many innovations go down the drain as the young innovators are unable to take their innovations to the market due to lack of finances. This study seeks to shade light on the existence of private venture capitalist (VC) who is willing to risk with the young entrepreneurs to facilitate market for their innovations. As Universities seek to encourage students to being more of job creators as opposed to job seekers, it's important to shade light on the existence of venture capitalist who come in not as passive investors but active investors willing to risk with the young entrepreneurs. The traditional financial institutions are unwilling to fund young innovations and consider them as risk averse and notwithstanding the fact that many do not have collateral which is a prerequisite for traditional financial institution lending. The study seeks on importance of embracing private venture capitalist as an alternative of funding young innovation in pursuit of mitigating this deep rooted challenge.

Keywords: Innovation, Entrepreneurs, Startups, Venture capitalist, Financing

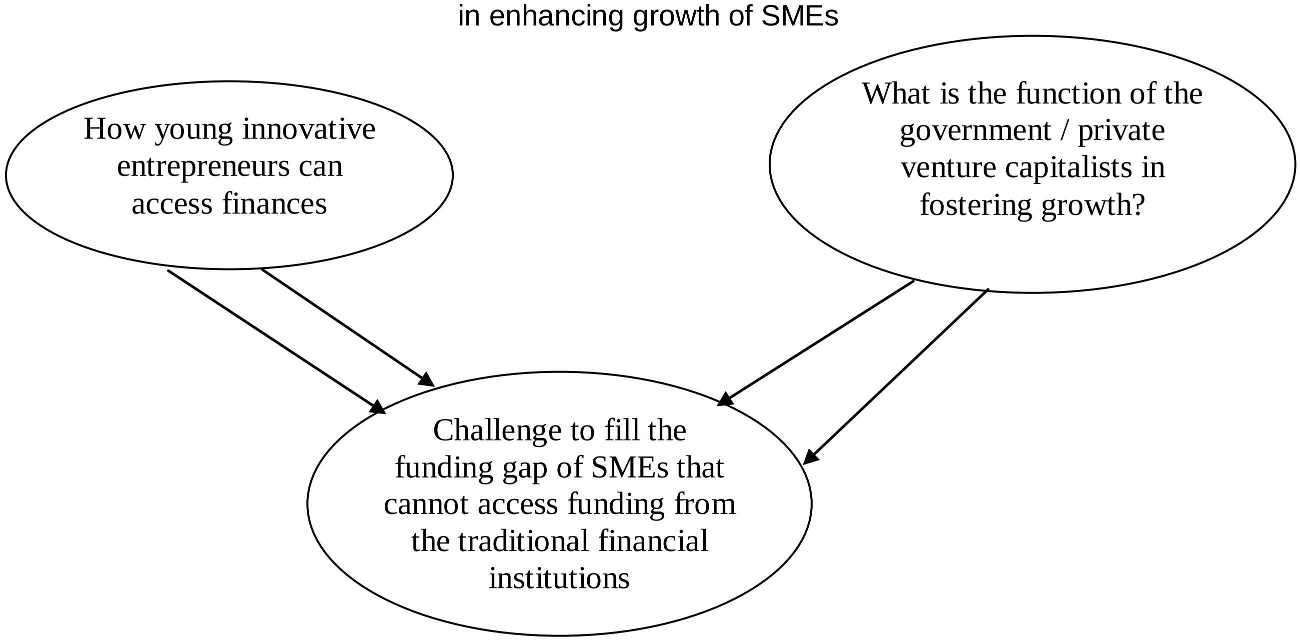
INTRODUCTION

There's no universal definition of Entrepreneurship and the scholar's view of the topic has considerably changed since Schumpeter (1934) defined it for the first time. Drucker (1985) viewed entrepreneurship as an innovative act, which includes endowing existing resource for new wealth producing capacity. Gartner (1985), attempted to find different personality and background that are fundamentally different from those of non-entrepreneurs, that each entrepreneur has his or her unique motivation, goals, and talents for venture creation according to his or her unique background. Gartner (1989) suggested job satisfaction, previous work experiences, entrepreneurial parents, age and education as factors which differentiate entrepreneurs from non-entrepreneurs.

Cho (1998) maintained that if entrepreneurial talents were innate and could not be build up post-natally, entrepreneurship education would lose its significance and that entrepreneurial talent should not be perceived as innate. Cho's study reveals that entrepreneurship education promotes the intention of venture creation because entrepreneurship related knowledge and skills stimulates an individual's motivation to create a new venture. Timmons(1999), stated that team based venture creation is more common than individual venture creation.

Since it is difficult for entrepreneurs to have all required managerial knowledge, individuals with complimentary backgrounds normally make effective teams for creating new venture companies.

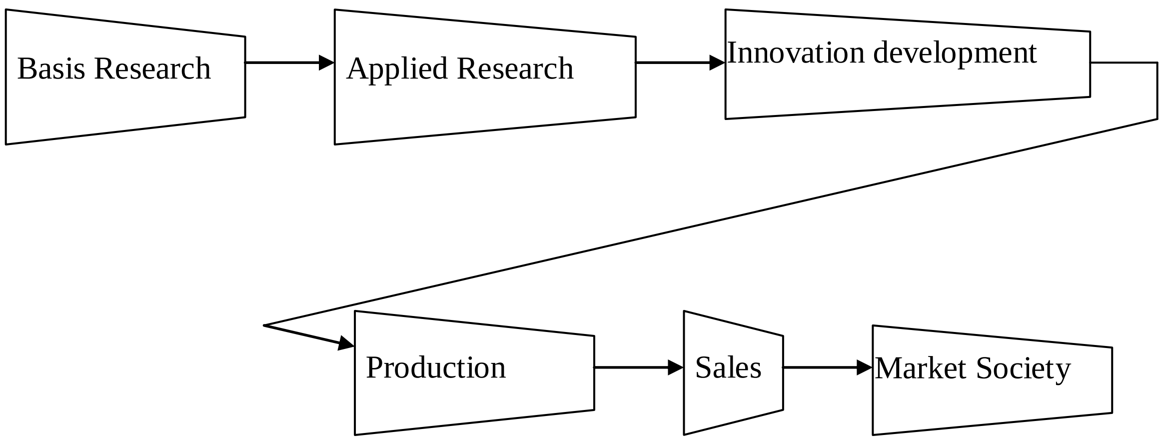
Figure 1: The government and private venture capital participation in enhancing growth of SMEs



Source: Author's Compilation

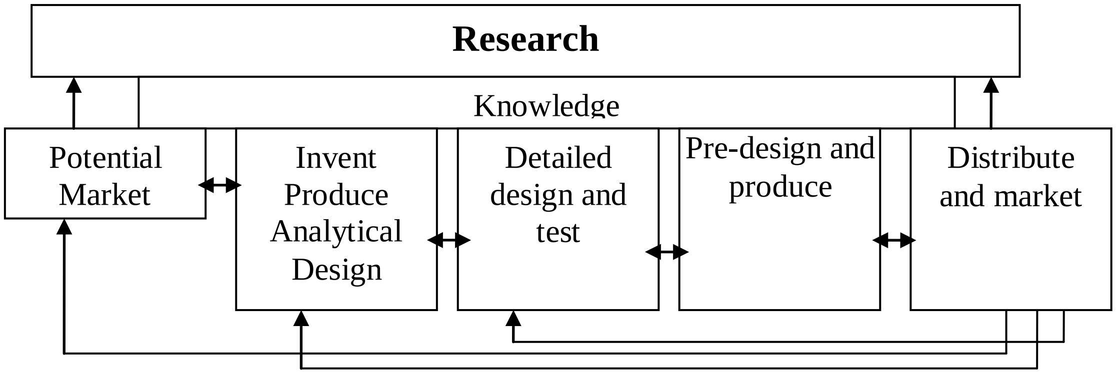
THE CONCEPT OF INNOVATION

There are numerous definitions of innovation (Fagerberg et al., 2005) emphasis that innovations are not only new products and technological production processes, but include new organizational forms and creation of new markets. Many innovation literatures define an innovation as something that is new to the firm adopting it, rather than new to the whole market or the whole world (Van de Ven et al., 1989). Basic research hence plays a major role in many types of innovations.



This model however has been criticized by many researchers (Kline and Rosenberg,1986). He argues that the linear innovation model portrays research as the driver of innovation while in most cases the key driver of innovation is a need found among certain users in the market or within a company. The argument is that it underestimates the many reverse processes and feedback loops inherent in technological change. Other critiques say that the linear model underestimates the importance of incremental changes, particularly those related to the production processes.

These resulted to the development of a more up to date and most commonly used model of technological innovation referred to as the chain-linked model. Kline and Rosenberge (1986) argue that the key process of innovation is to create a design based on needs and demands. Although the process can be sequential, it has several feedback loops. When a problem arises, participants turn to existing scientific and technical knowledge to look for solution.



Implicit in this view of innovation is that the knowledge and skills of the involved firms and individual matter when it comes to being able to utilise relevant scientific and technical knowledge, an aspect often referred to as absorptive capacity. (Cohen and Levinthal, 1990), hence exploiting basic research also requires certain types of knowledge and experience that may be a more important bottleneck to the use of science in innovation than the quality of the research.

Innovation is the key driver of any economic growth. Research and innovation are key components in developing Knowledge based economies. In many African Countries, research has not been accorded the priority it deserves.

VENTURE CAPITAL DEFINED

Venture capital is business financing provided by individual investors or organizations in exchange for a high return on investment in privately owned business ventures. Venture capitalists are not passive investors. They play an active role in the strategic planning phase of business and seek continuing involvement. They also expect to be fully informed about operations problems and whether or not joint goals are being met. VC can be a solution to young innovations that have high potential rapid growth and considerable profits. It addresses the funding needed by local entrepreneurs that generally do not meet the necessary requirements to obtain capital from more traditional sources of finance, which in Kenya has been mainly commercial Banks.

Besides venture capitalists being financiers, are usually involved in management, marketing and strategic planning for the businesses selected for financing. Venture capital growth or development provides the financial market with an avenue for long term capital. Venture capital financing requires a detailed exit mechanisms worked out with the business that has been financed. This is because venture capitalist leaves the business after the stipulated investment period. Venture capitalists can be segmented into two: private venture capitalists and public venture capitalists. Private venture capitalist refers to professionals' investors who managers funds and looks for suitable investments. Private venture capitalists are out to invest in business ventures whose rate of return has a range of 25% to &75%.

A venture capitalist may have no business experience applicable to the industry that the business is involved and is focused on the potential rate of return that the company can provide. On the other hand, public venture capital is a part of the venture capital industry which is relatively distinguished from private equity. Public venture capital is a segment of venture capital where a Government or a Government Agency or Public sector entity is the source of capital. Thus, the Government as public venture capitalists is involved in investment of high technology cluster Industries in order to implement their macro-economic strategies. It is this public venture capital definition that the researcher will use throughout the research.

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

Venture capitalists (VCs) are different from other financial intermediaries in that they provide governance and value addition to the companies they invest in. (Gompers and Lerner, 1998; Cumming et al; 2004). The interaction of many plus value added is supposed to create value in the investee companies. As a result, it is assumed that there is a positive impact on venture capital funding and as Gompers and Lerner (2001) argue, this is one of the pending issues in Research.

CHALLENGES OF VENTURE CAPITAL INDUSTRY IN DEVELOPING COUNTRIES

Venture capital is a risky business because it is difficult to judge the worth of early stage companies as well as correctly predict their future growth. Venture capital firms therefore set rigorous policies for venture proposal size, maturity of the seeking company requirements and evaluation procedures to reduce risks since their investments are unprotected to the event of failure (LaRueJone Hosmer, 2004).

According to Fox (1996), USAID venture capital projects in the developing Countries have almost uniformly failed. It examined 13 of USAID's venture capital investments and found that ten had failed to meet the desired outcome and that three were not even implemented. There were two problems established from the report, first is that the USAID often promoted venture capital projects in unpromising nations where the business climate was uncertain or the prospects for expanding firms were poor. Secondly, that the agency treated an activity requiring great flexibility and initiative as straight forward and simple. The projects were also considered to be overly designed. Some venture funds performed relatively well, but others incurred significant losses. The report suggested a fundamental reason for failure, that the allure of equity investment in emerging companies in developing countries is a mirage that conceptually it appears likely to pay high returns but in practise it does poorly. The conclusion was derived from the notion that a huge difference exists between financial market conditions in developed Countries where venture capital companies have thrived than in developing countries.

The USAID had made two major assumptions in their venture capital projects:

a) That the US experience can be transferred directly to developing Countries by professionals using techniques learnt in the USA
b) Venture capital development is a vehicle for capital market development

Economic and market conditions in developing Countries are significantly different from those in developed Countries. Information about the companies' finances, market conditions and relevant government policies is likely to be much scarcer in developing Countries. Legal systems are frequently less transparent and the government policy may change more quickly and dramatically than in developed countries making the prospects for any company less predictable. Developing countries are far smaller economies. A typical developing Country has a gross national product (GNP) the size of one city in America. Prospects for profits from such transactions are therefore likely to be much smaller. Consequently risks are likely to be much larger and profit prospects much smaller than in the United States.

In United States, venture capital was not a vehicle for stock market development; vibrant equities markets long preceded the development of venture capital industry. Emerging Companies are unlikely to be an important of any Country's stock markets. The backbone of such markets has to be equity and debt of very large and stable companies with large track records and a need for additional capital. Every County has such blue-chip enterprises, ranging from banks breweries and cement plants to public utility debt would seem an important factor even if such enterprises are Government owned. A well-established market for equity and debt in large enterprises would seem to indicate the possibility of developing trading in smaller companies. Where no such market exists, it seems unlikely that promotion of equities in small Companies would produce one (Fox, 1996).

Contrary to the USAID report that painted a bleak picture of venture capital as an instrument applied to poor economies, the implementation of the venture funds did not conform to traditional fund disbursement guidelines. According to Osama (2006) the USAID funded projects revealed serious design flaws that were more likely responsible for premature failure. He sighted the following flaws:

1. USAID provided the money for a venture fund and then began looking for an appropriate person to manage it. This process was carried out in the reverse order to the traditional venture capital setting has inherent problems that could easily cripple the operations of the funds.
2. Less-experienced fund managers were recruited in a rush to get the project off the ground. Their ability to perform was not matched to the size of the fund. In the traditional venture setting, the fund is raised by the fund managers to the size proportional to their ability
3. USAID should utter disregard to the local socio-economic environment as it attempted to literally replicate a US institution in the host Country with unfeasible and unsustainable Organizational structures.

Failure by USAID to successfully establish its venture capital investment has been attributed to its inability to understand the instrument than the failure of the instrument itself to deliverer in developing Country and emerging market environments (Osama, 2006).

WHAT VENTURE CAPITALISTS LOOK FOR BEFORE LENDING?

The different ways in which financial Institutions such as Banks and venture firms would evaluate local business seeking financing is that banks look at the immediate future, and dwell their assessment of a company on its past. Venture capitalists on the other hand focus more at the future potential of a business organization.

According to LaRue Tone Hosmer (2004), venture capitalists are interested in many of the factors that influence bankers in their analysis of loan applications from local businesses. All types of financial institutions are interested in the results and ratios of past operations the amount and the intended use of the needed funds, and the earnings and financial conditions of future projections. On the other hand, venture capitalists look much more closely at the features of the product and the size of the market than do commercial banks in their evaluation.

Financial Banks such as Banks and creditors have interest on product/ market position only to the extent that this service or product can provide steady sales and generate sufficient cash flow to repay the loan. They look at projections to be certain that the owner managers have done their homework.

Venture capitalists on the other hand are shareholders or part owners of a business they have invested in. They hold stock in the company, adding their invested capital to its equity base. They are therefore careful to examine the planned products or services and their existing potential markets with extreme care. They invest only in firms they believe can rapidly increase sales and generate substantial profits for the simple reason that they invest for long term capital gain, not for interest income. A common estimate is that they look for three to five times their investment in five or seven years. It is important to note that venture capitalists do not always realize capital gain on their investment. There are a number of conditions required for venture capital participation (Spies and Agnew, 2003) such as;

1. Existence of product or service that has a potential for growth.
2. The willingness of business owners to give up part of their shareholding to venture capitalists
3. The availability of correct information to assess the profitability and potential growth of a business in question.
4. A large established market for the product or service
5. The availability of high return business to justify venture capital
6. The business owner should clearly understand the business they are in.
7. The availability of a successful exit strategy of the investment put in by the venture capital

VENTURE CAPITAL IN AFRICA

Venture capital is a relatively new concept in Africa, with most projects starting in the early 80s. According to USAID reports, most previous attempt of donor agencies to launch venture capital projects in Africa had mixed though predominately relatively poor results. A good example is Kenya private Enterprises Development Project of 1980. USAID found that there was little interest in the provision of venture capital and most of the owners of small and medium sized organizations that were targeted by the project had no desire to reduce their debts in exchange for potential ownership in their companies. Many of these organizations either were unwilling or did not have financial documentation needed by venture capitalists to assess realistically the potential for investment. According to the report, (Fox, USAID 1996), 17 of 18 firms asked if they would submit proposals for possible venture capital investments showed no interest.

Another International organization that aimed at developing venture capital in Africa was the Commonwealth Development Corporation (CDC) of the United Kingdom. The first venture capital project by the CDC was in Zimbabwe (VCCZ) IN 1991. It injected a total capital of USD 18 million. Other International financial organizations like the International Finance Corporations provided 20% of the share capital. The initial years were difficult with only 2% of over 500 applications resulting in successful deals. By 1996, VCCZ had affected over 20 investments, two of which failed eventually. From VCCZS findings, starts up companies were considered to be riskier than existing ones.

VENTURE CAPITAL FINANCING IN KENYA

Kenya is slowly but surely warming up to the venture capital concept. However like many other developing Countries, not a lot has been written about venture capital in Kenya nevertheless, its importance and existence cannot be ignored. Although many would still be sceptical about partnership and venture capitalist involvement in their businesses, there is need to emphases on other benefits that a venture capitalist brings along in the business besides finances. The Business environment in Kenya can be described as vibrant. Kenya is the largest economy in the East African region with business opportunities ranging from Agriculture to Telecommunication which has demonstrated exponential growth over the years. The Government has made considerable effort to create a favourable environment for both domestic and foreign investors to do business in Kenya across any sector of the economy. Kenya boasts of an equally vibrant human resource capital, comprising of well-educated young professionals with immense talents to scale businesses to success.

Kenya envisions being industrialized by the year 2030 besides becoming a middle income Country providing high quality life for all its citizens (vision 2030). The economic pillar aims at providing prosperity to all Kenyan through an economic development programme aimed at achieving an average Gross Domestic Product (GDP) growth rate of 10% per annum. The viability of this vision can only be ascertained with a focus on growth of upcoming innovations in Kenya. Finances, which are life-blood of any business does not only need to be made available but accessible as well.

PUBLIC VENTURE CAPITALIST

Besides the private venture capital, public venture capital is also part of the venture capital Industry which is relatively distinguished from private equity. Public venture is a segment of venture where a Government or Government agency or Public sector entity is the source of capital. As public venture capitalists, the Government is involved in investments of high technology cluster industries in order to implement their macro-economic strategies. The Government endeavours to grow venture capital through direct measures such as incentivising the creation of public venture capital and through indirect measures such as improving the regulatory framework and providing tax incentives for venture capital investment.

Many Countries have set up public venture capital programmes. Public venture has become an important part of the venture capital industry (OECD, 1997).

Table 1 Public Venture Capital Projects Established in Various Countries

COUNTRY	YEAR	ENTERPRISE
USA	1958	Small business investment company
Japan	1963	Small & medium business investment & consultation companies (SBICS)
Singapore	1983	South East Asia venture investment
Korea	1974	Korea Hi-Tech company
China	1985	China New Technology venture investment corporate

Source: Yong, et al., 2006: Small Business Administrators (2009)

VENTURE CAPITAL, SUCCESSFUL CASES

Different evidence from different economic environments across the world show how carefully designed venture capital programmes that adapt the important features of instrument to their unique socio-economic settings stand a fair chance of success. The international Finance Corporation (IFC) invested US$ 196 million in 49 venture capital funds in developing countries and emerging markets between 1977 and 1995. Over the years, funding increased considerably and from 1990 -1995, it was 12 times higher than during the previous 13 years.

Another example of successful public venture capital initiative is Israel's Yozma programme (which means initiative in Hebrew) launched in 1997, the Israel Government provided venture capital funds to match private investment. YOZMA was hugely successfully within a short time and after four years successfully privatized, the Israel venture capital Industry grew from US$ 30 Million in 1986 to US$ to US$ 60 million in 2000.

The Indian venture capital Industry showed a much slower but sustained growth pattern. Indian benefited from four venture capital programmes founded by the World Bank in the 1980s. While these programmes were only moderately successful, they created the expertise for an entire carder of individuals who had learnt the art of venture investment through trial and error. These people created a second series of successful venture capital funds. Today, India boosts a vibrant venture capital sector that ably supports the growth of its IT and Biotechnology industries.

While attempts to literally transplant US –style venture capital may still be doomed to failure, evidence from across the developing world paints a more optimistic picture and calls for a re-examination of traditional venture capital guidelines. (www.scidev.net).

Examples of Private Venture Capital Firms in Kenya

i. Fusion capital
ii. Fanisi capital
iii. Savannah fund
iv. Maris capital fund
v. DVGrencap (By Heshan de Silva- Kenyan)
vi. Jacana fund
vii. Acacia fund
viii. Gold venture capital
ix. Aureous capital
x. Norfund venture capital

Examples of Public Venture Capital in Kenya

I.C.D. C (Industrial corporation development

K.I.E (Kenya Industrial Estate)

Women Enterprise fund

Youth Enterprise Fund

THE INTEGRATION OF ENTREPRENEURSHIP EDUCATION IN KENYAN UNIVERSITIES

Entrepreneurship Education and training was identified by the World Bank as a catalyst that could stimulate innovation and generate jobs among University graduates especially in sub-Saharan Africa where graduates unemployment rates are high. Jomo Kenyatta University of Agriculture for example has integrated entrepreneurship concepts in most of their academic programme. Mount Kenya University and Kenya Methodist University which are private Universities have integrated entrepreneurship in all there faculties to teach Entrepreneurship and Management. Besides infusing entrepreneurship and innovation concepts across its academic programmes, Strathmore University offers full academic programmes in Entrepreneurship in their school of Commerce and Management. Jomo Kenyatta University, Kenyatta University, and Strathmore University have linked their academic entrepreneurship agendas to incubator programmes that offer a range of service from networking, mentorship connection to accessing potential funding from the private sector. Dedan Kimathi University of

Technology, Chuka University among others have entrepreneurship courses at different levels. This is a clear indication of how Universities have positively embraced entrepreneurship as a potential solution the high unemployment rate and as a way of facilitating the attainment of vision 2030.

LINKING KENYAN UNIVERSITY INNOVATIONS TO KENYAN MARKETS

The fact that Entrepreneurship courses have been widely embraced by Kenyan Universities cannot be overemphasised. However there is a big gap between the innovations taking place in the Universities and the reality in Kenyan market. This is mainly because the students cannot access fund from the traditional financing Institutions as they lack what the Banks consider for lending popularly referred to as the four Cs of lending, that is:i) capacity ii)collateral iii) capital and iv) character.

The truth on the ground is that many colleges and Universities are investing heavily in the development of their students entrepreneurial skills. By the end of the day, many of them can dream of starting the next Face book or twitter which was actually started by students but without financial support, this can only remain a dream. Since many Financial Institutions would be unwilling to fund such innovations as their future is uncertain, there's need to embrace venture capital concept where professionals would be willing to risk with the young innovators.

A perfect example of innovation and funding partnership is when Jomo Kenyatta introduced to the Kenyan market a brand of instant noodles, a fate made possible courtesy of a partnership with Japanese Noodles manufacturer, Nissin Food Holdings. The joint venture, JKUAT Nissin Food Limited was the first of Japanese firm's investment in Africa and also promised to manufacture two flavoured brands of chicken and Nyama Choma flavours. The partnership between Jomo Kenyatta and Japanese Company to manufacture the noodles not only facilitated knowledge on value addition and proper usage of the available raw materials but also created employment for the graduates to work in the joint Company and even other opportunities in the firm. The noodles have steadily gained popularity in the Country fuelled by urbanites whose lifestyle relies more on convenient foods that are tasty and quick to prepare.

In response to a call for competitive grant research proposals by the Kenya Agricultural productivity and Agribusiness project (KAPAP) in 2010, Mount Kenya University, University of Nairobi, Chuka University, Bongo University College, Egerton University, Kenya Industrial Research and Development Institute (KIRDI) and National Museums of Kenya (NMK) prepared a joint research project proposal which was approved for financial support. The title of the research was 'Enhancing production, value addition and marketing of indigenous vegetables among small scale holder farmers in Kenya. Until the concept of venture financing is fully embraced, great innovative ideas will continue to gather dust on Kenyan university libraries which would otherwise be utilized in the Kenyan market.

CONCLUSION

Entrepreneurship education is very important to economic development of any nation in the world. Kenya has underscored this in the national development goals and plans. Like many African countries, Kenya faces the challenge of providing employment especially for the many youth who graduate every year. With the job market shrinking globally, a new strategy of exploring available self-employment opportunities is of paramount importance. Every university has a responsibility towards the attainment of the National strategy on Economic growth as outlined in vision 2030.Entrepreneurial skills empower graduates to identify competitive and viable business ideas and opportunities. With proper funding, a reasonable number of creative and innovative students will be able to start and manage profitable business enterprises. Creative and innovative students should therefore be exposed to both private and public venture capitalist that would be willing to partner with them in order to accelerate their innovations in Kenyan market.

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