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THEORY AND PRACTICE OF VENTURE CAPITAL FINANCING

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PART I & II

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Dedication

I dedicate this book to my mother**, Cecilia Amuah** and my maternal grandmother, **Maame Adubraah** who taught me the basics of management.

Acknowledgement

Thanks be to God for His grace and mercies.

Also, I would like to express my deepest appreciation to Mr. Patrick Ntserful Arko, my former student who did the initial editing.

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Chapter 1

The Concept of Small and Medium Enterprise

❖ Introduction

Small and Medium Enterprises (SME's), which several researchers have credited as engine to the growth of the economy for nations, suffer funding gap that inhibits growth of such businesses (Matlay and Westhead, 2005; Green, 2003). The funding gap denies SME's the potential to grow into larger organizations for higher productivity, increased employment and economic benefit to nations as envisioned. Research has established that this funding gap exists because whilst venture capital financing has been thought to be the suitable financial intermediary for funding SME's, they rather turn to commercial banks as their primary source for funding, where they fail to secure financial support or business credit (Dockery and Herbert, 1996). It has also been recognized by research that, SME's have not embraced venture capital financing because of the fact that it is a high risk financial instrument; even though it is best suited for these organizations to obtain credit support for their business (Wonglimpiyarat, 2005).

Venture capital financing refers to the financing of a start-up, development, expansion and purchase of a firm in the act of which the Venture Capital Investment (VCI) acquires by agreement a proportion of the share capital in the business in return for providing funds (Reid, 1998). Venture Capital has developed as important intermediary in financial market, providing capital to firms that might otherwise have difficulty in attracting financing. These firms are typically small and young or start-up; here in this study, all such status of firm's referred to as SMEs, are plagued by high level of uncertainty and large differences between what entrepreneurs and investors know (Gompers and Lerner, 2001).

In Ghana, The Government established the Venture Capital Trust Fund (VCTF) by an Act of Parliament (VCTF Act 680) in 2004, as a provision to support SME's out of their financial problems. The Fund was intended to provide low cost financing to small and medium enterprises so as to enable them expand, create wealth and jobs. This it does, by providing credit and equity financing to eligible Venture Capital Financing Companies to support SMEs, and the provision of monies to support the activities and programmes for the promotion of venture capital financing as the Board may determine in consultation with the Minister (VCTF Act 680). However, the market for venture capital investments is far from perfect market (Brealey and Myers 1996, Wright and Robbie 1998, Black and Gilson 1998).

The facts established in the foregoing paragraphs point that even though venture capital financing is a great financial intermediary for SME's, it is plagued with uncertainties, in other words risks that are making venture capital financing disincentive to both SME's as investees as well as venture capitalists.

❖ Definition and Concept of SMEs

The term SME is widely used to describe small businesses in the private sector. There is no universally accepted definition for small or medium scale enterprises, due to its classification as varies and stargened into small, medium or large scale. It makes it subjective (Ogboru, 2007). In some cases, definitions are based on the number of employees or based on business turnover and assets. Akorsu and Agyapong (2012) observed that, different definitions are used across countries, regional and economic groupings and international organizations using various criteria. As a result, different researchers, have various definitions of SME. Though, most criteria use number of employees, turnover or assets based definitions. Yeboah-Boateng (2013) used the number of employees for developing economies, argued that the uncertainties associated with fluctuating exchange currencies make it untenable with any monetary based definitions. SEDCO (2010) has defined a small and medium enterprise as a firm that has not more than hundred employees and maximum annual sales turnover of US$830 000.

Again, the environment in which the SME is found determines the acceptable definition for SMEs, because the environment keeps on changing day – in-day out. A small business today in one particular environment may be large business tomorrow in another business. Also, looking at the sales volume, number of employees and the capital of businesses which have different levels and sizes would not give room for researchers to be able to out with a unified and accepted definition for small, medium and large-scale enterprises. Even though there has been various definition of small scale business in Ghana, the most commonly used is one involving the number of employees of the enterprise by (Kayanular & Quartey, 2000).In Egypt, the SMEs are considered as businesses employing between 5 and lees than 50 people. Vietnam, also defined small and medium scale enterprises to be firms employing 10 and 300 employees. Akorsu and Agyapong (2012)

On the other hand, the Inter-American Development Bank, regarded SME as a business employing up to 100 employees and earning not more than US$3million in revenue (Dalberg Global Development Advisors, 2011). European Union defines SMEs as a venture that employ fewer than 250 persons and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.' Small and medium enterprises are thus defined as firms with 10 to 250 employees, as and more than 10-million-euro turnover or annual balance sheet total. From the above definitions one can easily conclude that the meaning of the small and medium sized enterprises can be defined or explained based on the number of employees, total value of assets and turnover in the company and also environment in which a particular business find itself. Due to variations in the aforementioned definition, the concept of SME's varies from country to country and even within the same country, it may vary from sector to sector depending on the purpose for which the definition is sort. However, there are some common indexes of the definition such as number of employees, value of assets and turnover as stated earlier. These are very important information that influence in the definitions of small and medium scale enterprises globally.

In Ghana, definition of small and medium scale enterprises (SMEs) may be based on Dalit so and Quartey (2000) definition, which based their definition of SMEs on the number of employees of a particular business. Adding to this, Ghana Statistical Service (GSS) also defines small enterprises as firms that employ less than 10 workers where as those that employ more than 10 persons are into medium and large-scale enterprises. On the other hand, National Board for Small Scale Industries (NBSSI) in Ghana considered both the fixed asset and number of employees as basis for defining SMEs. According to NBSSI, small-scale enterprise as a firm is define with not more than 9 workers, and has plant and machinery (excluding land, buildings and vehicles) not exceeding 10 million Ghanaian cedis and micro with employee less than five (NBSSI, 1990).

Osei *et al.,* (1993) classified SMEs into four major groups; (i) micro enterprises are businesses that employ less than 6 people; (ii) very small enterprises which comprises of those employing 6-9 peoples; small enterprises are those firms that employ between 10 and 29 employees while medium scale businesses refer to those that employ between 29 to 50 employees. Learning on the above definitions on SMEs, one carefully argues that the statistical definition of SMEs differs by country and especially the number of employees or the value of fixed assets. Clearly the number of employees and assets may differ from one country to the other. Also, Venture Capital Trust Fund (VCTF) Act 2004 (Act 680 section 28) defined SME's as "an industry project, undertaking or economic activity which employs not more than 100 persons and whose total asset base, excluding land and building does not exceed the cedi equivalent of US$1 million in value.

❖ Characteristics of SMEs in Developing Countries

Despite their important role in creating employment and alleviating poverty as well as contributing to economic growth, SMEs worldwide are found to be financially constrained due to limited access to external finance. Studies have shown that over 95 percent of businesses across the globe are SMEs and they contribute about 60 percent of employment in the informal sector (Ayyagari et al, 2011). However, limited access to finance for SMEs has been noted to be the single most pressing challenge that characterizes SMEs worldwide (Hansen et al., 2012). Quartey et al (2017) noted from their study on the constraints to SME financing in the West African sub-region, bemoan the challenge of access to finance by SMEs and contended that, the very survival and growth of SMEs largely depends on their adequate funding.

World Bank (2015) report on access to finance for SMEs in Africa stated that beyond difficulty in accessing finance, SMEs are characterized with a myriad of challenges such as: lack of managerial skills and expertise on the part of owner-managers, poor corporate governance structure, and unavailability of research Centre's for SMEs development. Other factors outlined included limited access to market, lack of access to affordable legal and accounting and business advisory services, lack of formal or informal business networks and limited government support in terms of favorable economic policies and programmes aimed at SME growth and development.

Similarly, Seidu et al (2015) assert that SMEs are exposed to common challenges ranging from difficulty in accessing external finance, poor corporate governance structure, limited access to market, owner-mangers with low managerial skills, poor business networks, poor records management and accounting practices and high tax non-compliance among others.

Moreover, Antwi et al (2015) found that SMEs in Ghana are characterized by challenges such as poor bookkeeping and financial reporting practices, lack of managerial skills on the part of owner-managers, and lack of collateral security to access bank credit. Other factor reported by Antwi et al (2015) include high interest rates on bank loans and other credit facilities, exchange rate fluctuations, lack of credit information bureaus, high utility tariffs and unreliable power supply among other factors. Nkuah et al. (2013) found that high utility tariffs, lack of access to international by SMEs, importation of cheap goods to compete with produce of SMEs, limited access to finance, high tax rates, high cost of credit, among others were some of the factors militating against the growth of SMEs in developing countries.

Apart from the major challenge of access to finance that has become a common characteristic of SMEs across the globe, SMEs are found to be heterogeneous in nature in that they vary in many ways from nature of business, ownership structure, management structure, managerial skills and experience, type of industry, number of employees, size of firm among other factors. In terms of the nature of their business activities, SMEs are found to be mostly engaged in retailing, trading, or manufacturing activities (Fisher &Reuber, 2000). Moreover, Quartey et al. 2017 assert that SMEs in West Africa comprise mainly sole proprietorship business and family owned enterprises engaged in a various forms of business activities and are mostly located in urban centres.

It must be emphasized that while majority of SMEs may find themselves in the retail business especially in developing countries, the proportion of SMEs engaged in this sector varies largely across countries, and between rural and urban areas within a country (Abor & Quartey, 2010). In terms of manufacturing, Fisher and Reuber (2000) indicate that SMEs' involvement in manufacturing activities depends largely on the availability of raw materials locally, taste and preferences of domestic consumers, and access to the export market.

In Ghana, Abor and Quartey (2010) classify SMEs into rural and urban enterprises with the latter further divided into "organized" and "unorganized" enterprises. Rural SMEs are mostly unorganized and tend to be owner-managed and rely on family members or apprentices in the case of artisans as employees. Kayanula and Quartey (2000) indicate that rural SMEs are usually engaged in activities such as hairdressing, soap making, fashion design and tailoring, textile and leather works, auto-mechanic repairs, food processing, bakery and pastries, agro-processing, furniture design and wood works, block laying and concreting among others.

With regards to urban organized SMEs, Abor and Quartey (2010) contend that they are somewhat formalized with registered office, adopt proper accounting practices, and provide better conditions of service for their employees. However, the unorganized enterprises are mostly owner-managed and rely on family members as employees without any proper management structure. This group normally involves artisans and traders, who work in open spaces or shops within the market area or work from their homes and employ very few or no salaried workers (Kayanula and Quartey, 2000).

❖ Constraints for Small and Medium Enterprises

The private sector businesses in every country are seen to accelerate the engine of growth of the economy. Although the major role of SMEs is to accelerate growth and job creation mostly in developing countries, a number of setbacks affect their ability to develop their full potential come to fruition. The developmental dream of SME is constraints by a number of factors which include access to finance, lack of managerial skills, equipment and technology, regulatory issues, and access to international markets (Anheier and Seibel, 1987; Steel and Webster, 1991; Aryeetey *et al*., 1994; Gockel and Akoena, 2002). According to Jagongo (2012) lack of reasonable collateral, lack of credit history, poor documentation; cash flow analysis and financial statement were the obstacles that impede growth of SMEs in Kenya. Again, it was found that most of the SMEs in Kenya were not aware of the existence of Venture Capitalist, therefore educational programmes should be organised to the SMEs for the awareness of Venture Capital Fund.

♦ Financial Constraints

Access to finance has been a major drawback which affects SMEs in their operations. Owners of small firms find it difficult to meet criteria of financial institutions as they demand collateral security before granting them access to finance or credits. Formal banking institutions always demand collateral such as immoveable properties like land and houses and also plant and machinery to act as a security on loans. Access to credit is therefore a constraint pertaining to working capital and raw materials are some of the biggest obstacle to the SMEs in Ghana. A study by Aryeetey *et al.,* (1994) conducted on SMEs access to finance showed that 38% of the SMEs face finance as a major constraint. In Ghana, SMEs have limited access to capital markets both locally and internationally, with the reason that they are exposed to higher risk, weak management techniques, informational asymmetry, and higher costs of financial intermediation. According to Green *et al.,* (2002), financeis said to be the “glue” that holds together all the diverse aspects involved in small business start-up and development.

Due to this, SMEs are not able to obtain long-term debt financing from formal financial institutions such as banks. Abor and Biekpe (2006) observed that in Sub-Sahara Africa, majority of small businesses fail during the start-up year due to lack of support from government and traditional banks.

Cook and Nixson (2000) found that, lack of recognition of the role of SMEs in the development process in many developing countries, SMEs development is always constrained by the limited availability of financial resources to conform to a variety of operational and investment needs and requirements.

While many researchers have commented about the constraints SMEs are facing in accessing finances to embark upon their day to day activities of the businesses (Bigsten et al, 2000; Coleman, 2000; Buatsi, 2002; Kauffmann, 2005; Abor and Biekpe, 2006; and Biekpe, 2006). The author also think that SMEs in Ghana should pool their resources together to form provident fund or scheme, allow fund managers to manage it in order for SMEs to access loans from their own fund at a lower rate than other lenders or financial institutions and non-financialinstitutions which charge higherinterest rate in the country in order to improve the SMEs' activities.

in a similar study by Aunga and Birone (2017) on the constraints facing medium and small-scale Entrepreneurs in Accessing Loan from Banks at Ngogongare, in Tanzania using a survey design with the aid of a questionnaires, stratified and systematic sampling, recharge on a sample size of 65, it observed that SMEs face some challenges in their day-to –day operations of the business. Among them are: lack of collateral security, high interest rate, high transaction costs, availability of information in finance i.e (no transparency or openness of business to outsiders), location of the business, financial statement, short period of repayment of loans and bureaucracy are the most obstacles impending SMEs in their business, when descriptive analysis was applied to the data collected.

♦ Management Constraints

The lack of managerial know-how, remain a significant constraint to SME development. Owners of SMEs lack the needed managerial skills and attitudes in spite of the numerous training and advisory services in Ghana. They mostly develop their capacities by means of trial and error. Also, most of these SMEs are managed by their owners and these owners often lack the needed skills and expertise to manage these firms at keep the firms at turbulent times. Besides the owners and managers of SMEs are individuals with low or no educational background; hence, they are ill-equipped to carry out managerial duties for their enterprises (King and McGrath, 2002).

Undoubtedly, the scarcity of management talent, exiting in most countries in the region, has a significant impact on SMEs operation and growth. in spite of numerous institutions providing training and advisory services like National Board for Small Scale industries (NBSSi) to SMEs, there is still a skills gap or deficiency in the sector as a whole (Kayanula & Quartey, 2000), due to the high cost of their training and advisory services, while others do not see how vital to upgrade their skills. Finally, Aunga and Birone (2017) added that managerial skills, level of education are some of the major setbacks that impede SMEs in their operations of the business.

- ### **Equipment and Technological Constraints**

Equipment and Technology are some of the tools which affect the smooth running of the operation of the SMEs mostly in Ghana. On the part of technology, SMEs see to be constraints in gaining access to appropriate technologies or information on available techniques to be used. This normally diminishes innovation and SME competitiveness in Ghana. SMEs in most cases utilize foreign technologies with a scarce number of them sharing in the ownership or lease.

Furthermore, apart from lack of access to credit and managerial obstacle old or inadequate use of equipment's have negative impact on the operations of SMEs in Ghana where entrepreneurs are unable to use modern equipment's in their firms' due lack of funds on the organization and registration requirements which can impose excessive and unnecessary burdens on SMEs.

- ### **Regulatory Constraints**

Regulatory issues also add up to the serious challenges facing SME development and although some intensive structural reforms have led to some improvements and prospects for enterprise development at the firm-level. Their start-up costs are too much for such firms, including licensing 6) cited in Abor and Quartey (2010), stated that one needs to takes 127 days to deal with licensing issues and there are 16 procedures one goes through in licensing a business in Ghana. Also in South Africa it takes longer period of 176 days and involves 18 procedures in dealing with licensing issues. Moreover, the non-existence of antitrust legislation favours firms of larger in nature, while the lack of protection for property rights limits SMEs' access to foreign technologies (Kayanula & Quartey, 2000).

According to a study by Jagongo (2012) on his paper titled Venture Capital (VC): The all-important MSMEs financing strategy under neglect in Kenya. It was established that probability random sampling method was used to select the sample size of 60 SMEs through both stratified and simple random methods. The simple random sampling was used to carry out by giving numbers to each subject of stratum size in other to determine the businesses which come under medium and small unit. The study revealed that the constraints that impede SMEs acquisition of financial services mostly include lack of tangible security mostly coupled with appropriate legal regulatory framework.

- **Lack of Access to international Markets**

Access to international markets has become a major drawback for SMEs especially in the developing country like Ghana. SMEs limited international marketing experience, poor quality control and product standardization, and little access to international partners, continues to impede SMEs' expansion into international markets (Aryeetey *et al.,* 1994). Also, the necessary information about foreign markets is not adequate.

- **Lack of Corporate Governance**

The existence of corporate governance can bring the process of separation between management and owners and can help in accounting controls and internal audits could bring promotion and growth for SME firms. Corporate governance incorporation could greatly limit this constraint. The inclusion of external board into SMEs can be advantage because the board member(s) can introduce ways of attracting finance. Also, the non-executive directors could bring creativity and innovation to SMEs through opinions and suggestion during decision making.

❖ Chapter Summary

Review of available literature has proved that Venture Capital play key intermediary in financial market, providing capital to business that might otherwise have difficulty in attracting financing. The term SME is widely used to describe small businesses in the private sector. There is uncommon definition for small or medium scale enterprises, due to its classification as varies and staggered into small, medium or large scale. The jurisdiction in which the SME is found determines the acceptable definition for SMEs, because the environment keeps on changing day – in-day out.

Globally, SMEs were found to be financially constrained due to limited access to external finance. This limited access to finance for SMEs has been noted to be the single most pressing challenge that characterizes SMEs all over the world. It has also been relegalized that access to finance for SMEs in Africa is beyond the difficulty in accessing finance, however, SMEs are featured with a myriad of challenges such as lack of managerial skills and expertise on the part of owner-managers, poor corporate governance structure, and unavailability of research Centre's for SMEs development. Additional factors included limited access to market, lack of access to affordable legal and accounting and business advisory services, lack of formal or informal business networks and limited government support in terms of favourable economic policies and programmes aimed at SME growth and development.

Chapter 2

Financing Small and Medium Enterprises

❖ Introduction

SMEs financing has been a major issues in business environment. Whenever, SMEs contemplating in investing in capital equipment or expansion, it would require additional finance when its current financial resources is inadequate. However, lack of access to finance remains a major constraint to many SMEs worldwide especially developing countries. Many studies have also concluded that high interest rates and the cumbersome processes have often been mentioned as the main impediments to SMEs' access to bank loans in Ghana. Some prominent researchers have noted that, about 90% of small firms are refused loans when applied from the formal financial intermediaries, due to inability to fulfill stringent collateral conditions. This unit provides a basic overview of SMEs financing and sources of finance for SMEs.

❖ Overview of SMEs Financing

Despite the fact that SMEs contribute immensely to the economic development of the nation, most of them are confronted with financing challenges essentially due to their characteristics of being small, inexperienced, managed by individuals and sometimes not having the requite educational background and inadequate collateral (Mensah, 2004). It has been reported that most SMEs operating is Sub-Saharan Africa are usually denied access to credit facilities by financial institutions (e.g. Osei et al. 1993). According to Basu et al (2004), for instance, less than 6% of SMEs are successful in securing loans from financial institutions to expand their operations. This situation makes it challenging for SMEs to move to the next stage of their operations and most of them get stuck at the very rudimentary stage for several years if not forever (Bani, 2003).

Several authors (e.g. Tagoe et al. 2005; Arthur, 2003; Mensah, 2004) have all concluded that Ghanaian SMEs face financial challenges essentially because of their unique and peculiar characteristics which make financial institutions uncomfortable in lending to these SMEs.

According to Mensah (2004), there are basically two sources of financing available to SMEs. These are either through debt financing or equity financing. Debt financing usually comes in the form of borrowing from financial institutions, friends, money lenders etc. However, equity normally originates from different sources including the personal savings of SME owners, gifts from friends, family and associates and from venture capitalists.

One of the Flagship Programme of the Government of Ghana is the District Industrialization Programme dubbed 'One District One Factory' (1D1F).This Programme as captured in the 2017 Budget and Economic Policy of the Government, local and foreign investors, be it individual, public institutions or private companies are exploring various financing options to take advantage to either set up a factory/company, expand existing one or to resuscitate a distress factory/company.

Debt financing such as overdrafts and loans appears to be the first option of external finance for SMEs in Ghana. SMEs sources of financing are depicted below.

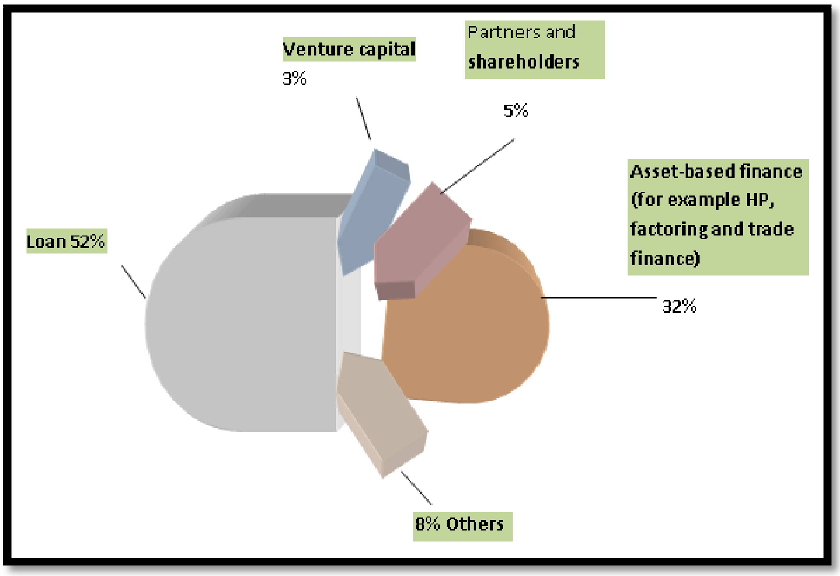

Figure 1: Sources of SME Financing in Ghana

Venture capital, though important source for financing SMEs represents a very small part of finance in Ghana and mostly the least considered by most entrepreneurs.

❖ Sources of Finance for SMEs

There is no doubt that access to finance for SMEs is a major challenge to the growth and sustainability of SMEs in both developed and developing countries. Over the last few decades, the issue has received considerable attention from researchers and policy makers across the world. However, in developing countries such as Ghana, the challenge is compounded by deep-rooted issues pertaining to financial exclusion, weak macroeconomic fundamentals, as well as the business environment in which SMEs find themselves (Quartey et al., 2017). The limited access to finance by SMEs is noted to be the major factor among others that stifles the growth of SMEs in developing countries (OECD, 2018). Hence, an exploration of alternative innovative financing options for SMEs to help bridge the financial gap is more important than ever. Generally, SMEs are faced with two major sources of finance – traditional sources which may be subdivided into internal sources and external sources, and emerging alternative financing options.

♦ Traditional Financing Options for SMEs

In terms of traditional financing options, SMEs may choose between internal or external sources of finance. With regards to internal sources of finance, SMEs may rely on personal savings of owners, support from friends and relatives, and retained earnings. On internal sources of finance, Osei et al.'s (1993) revealed that about 95 percent of the SMEs in Ghana rely on personal funds and financial support from family and friends.

The external sources of finance can be subdivided into informal sources and formal sources depending on the nature of the financial institutions from which the finance is sourced. Informal sources of external finance include trade credit, loans from informal financial institutions such as credit unions and susu operators, microfinance institutions and savings and loans companies, and finance houses (Kuntchev et al., 2012; Gbandi & Amissah, 2014). The formal sources of external finance include equity finance, loan and bank overdrafts from banks and other formal financial institutions, government grants and support schemes.

Studies have shown that despite the challenges with accessing bank credit and other external source of finance, SMEs appear to continue to depend on a mix of internal sources and external sources (mostly bank credit) to finance their business operations. The OECD (2016) reported that bank credit remains the common external source of finance for SMEs. Concurring with the assertion of OECD, Quartey et al. (2017) revealed that with the exception of developed economies, high income countries, and bank credit contributes over 90 percent of the finance needs of the private sector in developing countries over the period 2000–2014. However, they were quick to add that the chunk of the bank credit to the private sector goes to large firms with the required collateral and good credit history thereby leaving SMEs with limited access to bank credit.

In terms of external support from government towards SME financing, Quaye and Sarbah (2014) found that in Ghana, government provide financial assistance to innovative and high-growth potential SMEs in the form of soft loans, grants and subsidies. They revealed that over time, government agencies such as National Board for Small-Scale Industries (NBSSI), Business Assistance Fund, Ghana Investment Fund (GIF), GRATIS Foundation, Rural Enterprise Project (REP) and Microfinance and Small Loans Centre (MASLOC) have provided some sort of financial and skills development support for SMEs in Ghana.

Given a breakdown of external finance for SMEs in sub-Saharan Africa, Kuntchev et al. (2012) found that 6.3% of SME finance is in the form of equity, 27.8% from informal sources, 17.4% from semi-formal sources, and 48.5% comprising debt from formal financial sector. However, Gbandiand Amissah (2014) found that in the West African sub-region, informal sources of finance contribute about 70% of finance for SMEs while formal financial sector contributes less than 30% of the finance required by SMEs. In addition, Quartey et al. (2017) posit that informal sources of finance and government support schemes and/or grants from international bodies and donor agencies remain the main alternatives of SME financing in West Africa.

♦ Alternative Financing Options

In its 2018 ministerial conference on strengthening SMEs and entrepreneurship for productivity and inclusive growth, the OECD (2018) indicated that despite the challenges encountered by SMEs in accessing bank credit, there are opportunities for SMEs to tap into a wide range of alternative financing instruments as an innovative means of meeting their finance needs. The importance of alternative financing instruments in closing the financing gap of SMEs cannot be overemphasized in that such instruments tend to alter the risk sharing mechanism of traditional sources of finance (OECD, 2015).

It must be noted that while the emerging alternative financing instruments available to SMEs may constitute manifold and competing financial options, not all SMEs can access these instruments. This is because the utilization of majority of these financing options depends on some SME specific characteristics risk profile, size of business operations, ownership structure, and top manager financial and managerial expertise among other factors (OECD, 2018).

In Ghana, Abor and Biekpe (2006) contend that majority of SMEs fail to explore alternative financing options because they lack knowledge of such financial instruments and therefore are unable to take advantage of the available alternative financing instruments. Moreover, they found that there is the perception by majority of SMEs that most of the alternative financing sources are difficult to access and therefore do not even makes the attempt to explore them. OECD (2015) report on the new approaches to SME and entrepreneurship financing, categorized the alternative financial instruments for SMEs into four major groups based on their risk/return relationship as follows:

- **Asset-based Finance**

This form of alternative finance is widely used by SMEs in developed countries to meet their short-term cash flow needs and in recent times has gained considerable attention in some emerging economies as an effective financial instrument for meeting the working capital needs of SMEs (OECD, 2018). Asset-based finance may be defined as a financial arrangement whereby a business uses its non-current assets other than cash as collateral to obtain short-term credit without much emphasis on its credit history. Examples of asset-based financing instruments include asset-based lending, factoring, hire purchase, invoice discounting, and leasing.

It must be emphasized that an SME's qualification for asset-based finance depends on the liquidation value of its underlying asset, rather than on its credit history. Abor and Quartey (2010) contend that while banks demand for short-term assets such as account receivables and warehouse receipts to facilitate working capital financing, asset-based lenders consider the underlying assets of the firm as enough collateral for granting short-term finance. However, Nkuah et al. (2013) argue that using inventory or account receivables as collateral for short term finance by itself does not distinguish asset-based lending from any of the other lending technologies. They posit that collateralization with accounts receivable, inventory and/or equipment is not new and over time has often been associated with financial statement lending, relationship lending, and credit scoring where collateral is used as a secondary source of repayment. The major examples of asset-based financing instruments have been discussed as follows to give an overview of the instruments and how SMEs can explore them in meeting their financing needs:

Asset-Based Lending

Asset-based lending is an alternative financial arrangement where a finance company grants a short-term loan to a business using the value of assets pledged as collateral occurs when a loan is granted to a firm solely on the value of assets pledged as collateral (Abor &Quartey, 2010). It must be emphasized that the terms and conditions of an asset-based lending depend on the type and value of assets offered as collateral for the loan with lenders preferring highly liquid securities that can readily be converted to cash in situations where the borrower defaults on its payments (OECD, 2015). This implies that the higher the liquidity of the asset, the higher the loan-to-value ratio. However, it is worthy to note that the amount granted under asset-based lending is not equal to the full book value of the assets pledged.

Factoring

Factoring has become a more widely used and accepted alternative to liquidity-strapped SMEs in many countries, with volumes expanding significantly over the last decade, especially in emerging economies (OECD, 2018). Factoring is a financial arrangement whereby a business entity sells its account receivables (invoices) to a third-party called a "factor" at a discount to meet its present cash needs (OECD, 2015). In a typical factoring arrangement, the business makes a sale, delivers the product or service and generates an invoice. The factor then buys the account receivables of the firm to gain the right to collect the amount on invoice by agreeing to pay the firm the invoice's face value less a discount normally in the region of 2 to 6 percent. With this type of arrangement, the factor takes full control of managing the sales ledger and credit control with the right to pursue the customers for settlement of their invoices.

The underlying reason why firms adopt factoring as a short term financing option is to reduce their debtors' collection period by turning their account receivables into cash to build up their cash flow. Milenkovic-Kerkovic and Dencic-Mihajlov (2012) assert that a firm qualifies for factoring arrangement not based on its creditworthiness but rather on the ability of its customers to pay their debts with the stipulated debtors' collection period. This implies that a firm with creditworthy customers may be able to factor even if it lacks the collateral and credit history to qualify for a loan.

Invoice Discounting

Just like factoring, invoice discounting is a form of short term borrowing where a business pledges its account receivables (typically 80% of invoices less than 90 days old) to a third party as collateral for cash to enhance its present cash flow (Milenkovic-Kerkovic &Dencic-Mihajlov, 2012). After collecting its debts, the firm then pays back the finance company the amount borrowed plus interest charge which is normally a percentage of the account receivables. Invoice discounting is almost the same as factoring except that in this arrangement, the business retains control of its own sales ledger and pursues its customers for payment without the third party been known to the customers. Thus, the key difference between invoice discounting and factoring lies in who takes control of the sales ledger and responsibility for collecting payment from customers.

Leasing

Leasing is a form of financial agreement whereby one party conveys to another party the right to use an asset for an agreed period of time in return for specified rental payment while retaining the legal ownership of the asset (Addo, 2011). In a typical lease arrangement, the lessor transfers the right to use a property to a lessee in exchange for rental payment for a specified period after which the lessee can do three things: buying the property outright, return the property to the original owner, or extend the leasing period. There are two types of lease agreements - operational lease and finance lease.

In an operational lease, the lessor supplies the property or equipment to the lessee; the lessor is responsible for servicing and maintenance of the leased equipment; and the period for the lease is fairly short, normally less than the economic life of the asset, so that at the end of the lease period, the lessor can either lease the asset to the same person or someone else, and obtain a good rent for it; or sell the equipment. In an operating lease, the lessor (often a finance house) purchases the asset from the manufacturer and then leases it to the user (lessee) for the agreed period. On the other hand, finance lease is an agreement between a finance house (lessor) and a lessee where a finance house agrees to act as a lessor in a leasing agreement and purchases the asset from the dealer and intend lease it to the lessee. Here, the firm (lessee) takes possession of the asset from the seller and makes regular payments to the finance house under the terms of the lease.

Hire Purchase

Another alternative form of asset-based finance is hire purchase. Under a hire purchase form of financing, business agrees to make payments in installment for a non-current asset over a period of time within which the legal ownership of the assets still resides with the seller until the final installment is paid for the asset to be legally transferred to the buyer (Addo, 2011). Thus, under a hire purchase agreement, the business or buyer possesses the asset after the initial installment payments while the legal ownership of the asset still remains with the supplier/finance house until the last installment payment is made.

- **Alternative Debt Instruments**

Alternative debt instruments comprise an external financing option which grants businesses access to credit form the capital market through the issuance of various forms of bonds. Examples of alternative debt financing instruments include corporate bonds, covered bonds, securitized debt, and private placement. The difference between alternative debt and bank credit or other traditional forms of debt is that, alternative debt instruments are issued in the capital market while bank credit is issued by banks and other financial institutions. In a report of OECD (2018) on alternative financing options for SMEs, it was revealed that despite the various forms of alternative debt instruments available to SMEs, it appears that SMEs do not utilize these financing options and tend to rely on traditional sources of finance.

- **Equity Instruments**

Over time equity finance has become a major source of finance for medium-sized and large firms who are listed on the stock market and have the license to obtain finance from the capital markets in the form of equity. Oteh (2010) defines equity financing as a strategy for obtaining capital that involves selling a partial interest in the firm to investors. The equity, or ownership position, that investors receive in exchange for their funds usually takes the form of stock/shares in the firm. In contrast to debt financing, which includes loans and other forms of credit, equity financing does not involve a direct obligation to repay the funds. Instead, equity investors become part-owners and partners in the business, and thus are able to exercise some degree of control over how it is run. Equity finance holds particular promise for new and innovative SMEs who are deemed to have high risk-return profile (OECD, 2018). This is because it provides SMEs with a broader scope in terms of financing as they gain access to multiple funding sources. (Oteh, 2010).

In the face of financial exclusion with SMEs finding it difficult to access bank credit, Bondinuba (2012) contends that equity finance comes as a better alternative to bank credit. However, he asserts that raising finance through equity require much harder effort as investors need to be convince of the market potential and of the business and good returns expectations. While studies have shown a significant positive relationship between equity finance and SME growth as reported by Didier et al. (2015), they found that access to equity finance for SMEs in developing countries remains a major challenge. Some examples of equity finance instruments are as follows:

Venture Capital

Vaitkevicius (2014) defines venture capital as a financial intermediary, which operates as a special form of private equity where private equity firms raise capital from investors such as pension funds, insurance companies, financial institutions and other institutional investors and makes investments in private new and innovative private ventures. Thus, venture capital funds are raised from institutional investors and wealthy individual investors and are usually managed via partnerships (Arvanitis, 2015). The main difference from other private equity products is that venture capital is primary focused to provide several stage financing for young, unlisted dynamic venture companies, while private equity deals with a broader range of companies, frequently even mature companies with prospects for restructuring. OECD (2015) report on the new approaches to SME and entrepreneurship financing, they noticed that venture capital investments differ widely across countries, and only account for a very small share of SME financing.

Private Equity

A discussion paper on enhancing SME access to diversified financing instruments, the OECD (2018) indicated that over the past few decades, private equity financing has emerged as a widely accepted form of financing for SMEs in developed countries. This development has somewhat led to a decongestion in the mainstream capital market and serves as an avenue for SMEs who cannot access finance from the capital market. Choudhury (2015) asserts that avenue for private equity such as the creation of specialized equity markets platforms for SMEs is a laudable initiative towards solving the problem of capital market exclusion of SMEs.

Business Angel Investments

The ability of SMEs and entrepreneurs to raise large amount of funds internally for their operations is very important in enhancing the strength and growth of the business though in most cases the internal financial resources of owners of SMEs tend to be woefully inadequate. Therefore, in search for alternative sources of finance, Vaitkevicius (2014) suggests that SMEs should reach out to business angel investors when they are in need of additional funding to expand or sustain their operations. According to OECD (2015), business angel investment plays a very crucial role in term of bridging the financing gap of SMEs by serving as an alternative financing option though its impact on SMEs has not been estimated accurately due to lack of data on its application by SMEs.

Business angel investors are individual or informal investors who are interested in investing locally and in projects they understand and believe in their growth potentials (Zavatia, 2008). Bottazzi et al. (2002) explains that business angels provide not only finance but also the managerial experience, since many of the investors have made their fortunes in the same industries that they subsequently invest in. Due to special knowledge and experience they may have a higher ability to screen for higher quality projects, increase the survival probability of the company or both at the same time.

Crowd Funding

In the Africa Development Bank' s (AfDB) economic brief on financing innovative SMEs in Africa by Arvanitis (2015), the author indicated that crowd funding is emerging as a financing model for innovative firms worldwide but Africa lags behind. It is a type of financing option which provides the platform where a number of individual investors and entrepreneur come together through social media, internet and informal social networks to pull financial resources together towards a common goal (Arvanitis, 2015). While the concept of crowd funding is still in its embryonic stage in the sub-Saharan African (Oteh, 2010), it is believed that this form of financing for SMEs has a greater potential of bridging the financing gap of SMEs in the near future, when this instrument becomes more regulated in developing countries (OECD, 2018).

Peer-to-Peer Lending

Peer-to-peer lending provide alternative sources of financing and have experienced rapid growth in many parts of the world, as they enable investment projects that are too small or too risky for traditional banks to address (World Economic Forum, 2015). While this form of financing represents a small share of the alternative financing option utilized by SMEs, it appears to be rapidly expanding from the starting non-profit and small scale entertainment niche, to for-profit activities and businesses (OECD, 2017).

- **Hybrid Instruments**

Another group of alternative financing instruments for SMEs is a hybrid financial instrument which combines debt and equity in a single financing vehicle. In recent times, hybrid instruments are gaining considerable attention in developed countries and other emerging economies as revealed by OECD (2015). Examples of hybrid financial instruments include subordinated loans, silent participations, participating loans, convertible bond and mezzanine finance.

❖ Chapter Summary

Even though, SMEs contribute immensely to the economic development of the nation, most of them are confronted with financing challenges essentially due to their characteristics of being small, inexperienced, managed by individuals and sometimes not having the requite educational background and inadequate collateral. There are two sources of financing available to SMEs. These are debt financing and equity financing. Debt financing are normally borrowing from financial institutions, friends, moneylenders etc., whiles equity financing originates from different sources including the personal savings of

SME owners, gifts from friends, family and associates and from venture capitalists. Moreover, traditional financing options are also another avenue SMEs. SMEs may choose between internal or external sources of finance. Concerning internal sources of finance, SMEs may rely on personal savings of owners, support from friends and relatives, and retained earnings. With regard to internal sources of finance, SMEs rely on personal funds and financial support from family and friends.

Despite the constraint faced by SMEs in accessing bank credit, there are opportunities for SMEs to tap into a wide range of new approaches to alternative financing instruments as an innovative means of meeting their finance needs. These new approaches include asset-based finance, alternative debt instruments, equity instruments and hybrid instrument.

Chapter 3

Venture Capital Financing

❖ Introduction

Funding and financing are essential business imperatives for starting a new business. In addition, when an existing venture is expanding, it would require additional finance when its current financial resources are inadequate. Conversely, limited access to finance remains a major challenge to many start-up and existing businesses who are considering expansion. Evidence from literature have showed that high interest rates and the burdensome processes have often been mentioned as major difficulties to new and existing SMEs in accessing loans, mostly in developing countries. However, Venture Capital financing has been a key alternative source for SMEs finance globally. This chapter focuses on nature of venture capital, actors in venture capital financing and venture capital models.

❖ The Nature of Venture Capital

Venture capital refers to the financing of a start-up, development, expansion and purchase of a firm in the act of which the Venture Capital Investment (VCI) acquires by agreement a proportion of the share capital in the business in return for providing funds (Reid, 1998). Bygrave and Timmons (1992), as well as Gompers and Lerner (2001) define Venture Capital as a source of funds that typically finance new and rapidly growing companies through equity participation. In other words, VC is pre-IPO equity capital provided by professional investors. The concept of modern venture capital is defined by Megginson (2002) as a professionally managed pool of money raised for the purpose of making equity investments in growing private companies with a well-defined exit strategy.

Venture capital is financing that investors provide to relatively new and/or small businesses that are believed to have long-term growth potential but with little or no substantial collateral making it impossible to access funds from commercial banks. They are targeted at enterprises that are inherently new and small, often with little or no substantial collateral, their package is riskier than the loan package provided by commercial banks. The attraction for the venture capital investor investing in higher-risk

businesses is the prospect of higher returns. Venture capitalists look for businesses where the owners are seeking significant revenue; profit growth coupled with social impact and need some outside help in order to achieve these. The venture capitalist will often make a substantial investment in SMEs usually in the form of ordinary shares. However, some of the funding may be in the form of preference shares including redeemable preference share or loan capital. To keep an eye on the sum invested, the venture capital company will usually require a representative on the board of directors or management or both as a condition for the investment. The venture capital company may not be looking for a very quick return, and may well be prepared to invest in a business for five to seven years and sometimes more. The few venture capital investors in Ghana normally invest between 5 to 7 years with various options for exit. The return may take the form of a capital gain on the realization of the investment (typically selling the shares), dividend or both.
A model structure of a venture capital fund is depicted in Figure 2.

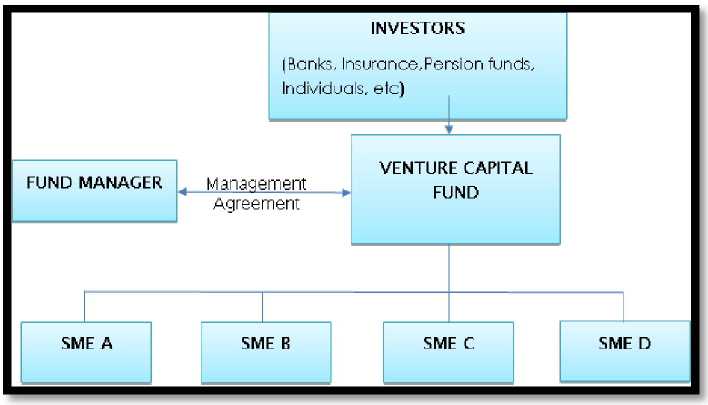

Figure 2: Model Structure of Venture Capital Fund

❖ The Actors in Venture Capital Financing

The venture capital financing model involves actors who perform certain roles and relationships, in a systematic process to make possible venture capital investment. Research has shown that the main actors in any venture capital financing model include: the investor, the limited partner, the general partner who is also known as the venture capital firm or venture capitalist, the entrepreneur or the investee organization, and the Public market. Occasionally, a sixth actor becomes necessary as investment advisor, when the venture capitalist needs consultation (Fried, 1992, Hisrich, 1992, Metrick, 2011, Yasuda, 2011). See Figure 2.1 for details.

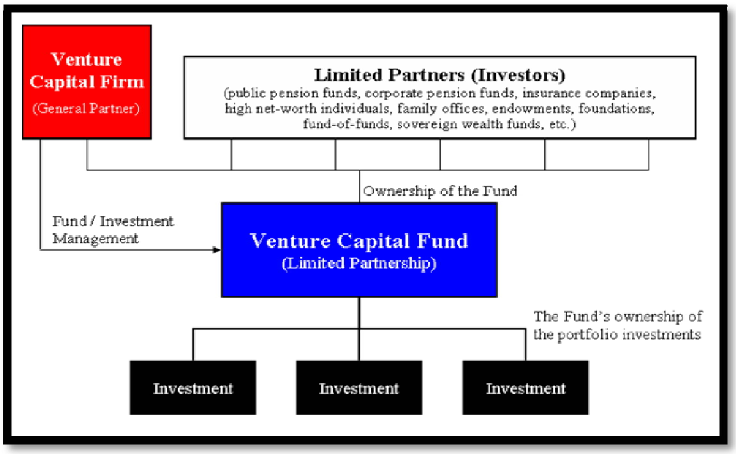

Figure 3: A Typical Venture Capital Financing Actors
Source: (Yasuda, 2011)

♦ The Investor

The Venture capital cycle starts with raising a venture funds. The investor performs the role of organizing or securing venture capital funds through pension funds, foreign investors, insurance companies, endowment and foundations, and other corporate sources etc. After the funds have been secured, the investor has the prerogative to invest directly or indirectly. With direct investment, the investor chooses to have its portfolio managed internally by members of its staff. In other words the investor selects, negotiates and monitors stock investments in individual companies. Investors using this approach have in effect created a captive venture capital fund. This approach is used by a few, generally large, investors. Indirect investment is the most common method, where investors invest through limited partnerships. The investor purchases a limited partnership interest in a partnership created for the purpose of making venture capital investments. These partnerships are often referred to as venture capital funds (Gompers and Lerner, 2001).

♦ The Limited Partner

The limited partner is the overseer to ensure venture capital investment is successfully carried out. They place funds with the general partner or venture capital firm for a return for profit. The operations of the partnership are managed by one or more general partners. These general partners are responsible for making investments in individual companies (referred to as portfolio companies). They then monitor these investments and provide management assistance to portfolio companies. They expect that the venture capitalist would invest the funds and at end of the investments return the money with interest to the limited partner. Limited partners are not involved in the active management of the partnership (Gompers and Lerner, 2001). The limited partner could be likened to the Venture Capital Trust Fund (VCTF) in Ghana.

- ### The Venture Capital Firm / Venture Capitalist or General Partner

The Venture Capital Firm or the General Partner serves as the intermediary body between the limited partner and the entrepreneur or the investee organisation. Venture Capital firm takes money from its investors and makes equity investments in portfolio companies (investee organization). Typically, a Venture Capital fund is organized as a limited partnership, with the venture capitalist acting as the general partner (GP) of the fund and the investors acting as the limited partners (LP) (Metrick and Yasuda, 2011).

- ### The Entrepreneur / Investee Organization(SME)

The entrepreneur is commonly seen as a business leader and innovator of new ideas and business processes. They start companies and create jobs at a breath-taking pace. In this context, an entrepreneur starts a small business and may need capital at start-up or at some point in time when the business is in operation. The Entrepreneur becomes the investee organization under venture capital investment. This is at the time when an entrepreneur had sought venture capital as financial intermediary to inject capital into the business (Kuratko and Hodgetts, 1998).

- ### The Public Market

The Public market is the financial institution through which venture capital investment is exited through a sale or initial public offering (IPO). This is where the number of shares and the value of the investee organization necessary to achieve a successful exit is estimated. At the public market, venture capital firm exits with proceeds of this exit returning to the Venture capitalist and its investors. Exits can occur through an IPO, with a subsequent sale of the VC stake in the open market, through a sale of the company to another investor, or through the sale of the company to a larger company (Metrick and Yasuda, 2011).

- ### Investment Advisor

Investment advisors are independent investment advisors who provide advice on investments but are independent from the investor. Independent investment advisors are sometimes referred to as money managers. Investors who use an advisor feel that venture capital investing requires experience and industry specific expertise which their own staff does not possess. These investors do not feel that they can attract and retain staff members who are appropriately qualified. They also point out that venture capital is more labour intensive than other asset classes (Fired and Hisrich, 1992).

❖ Venture Capital Models

The Venture capital financing model has been well described by numerous academic studies (Tyebjee and Bruno, 1985; Fried and Hisrich, 1994). Of the studies conducted, it is believed that the most significant contributions came from Tyebjee and Bruno, Fried and Hisrich. This is because firstly, the Tyebjee and Bruno model of the venture capital process is complete – it includes the description of the venture capital investment process from deal generation to exit. Other proposed models of the venture capital process, while providing a more detailed description of specific activities at each stage, conclude their analysis at the deal closing stage, effectively omitting any post-investment activities from consideration Klonowski (2007). Tyebjee and Bruno (1985) proposed a five-stage model of venture capital investing (i.e. deal origination, screening, evaluation, deal structuring, post investment activities). This model is described to be generally descriptive and simplistic; however it consolidates the heterogeneity of the investment process across different venture capital firms. It describes the entire investing process and broadly highlights key venture capital activities at each stage applicable in the Western Countries Klonowski (2007).

♦ The Five-Stage Venture Capital Investment Process by Tyebjee and Bruno

This section presents Tyebjee and Bruno's Model five-stage venture capital model.

A. Deal Origination

This is the start of venture capital financing where venture capital firm seeks information that leads to securing a deal with investee organization. Venture capital firms rely on their relationships with investment bankers, brokers, consultants and lawyers to obtain leads on deals, and also count on referrals from firms they have successfully financed in the past. Venture capital firms also compete directly with other agents (i.e. investment advisory firms or brokerage houses) to locate suitable candidate investee firms. Some of the most popular deal generating techniques include self-generation (where firms seeking capital will generally identify venture capital players through professional advisers or themselves directly) and direct marketing (where the venture capital firm's efforts are focused on identifying deals in the desired size range, industry, stage of development, etc.) (Tyebjee and Bruno, 1985).

B. Screening

Venture capitalists commonly receive many business proposals (Manigart et al., 1997), of which only less than 5 percent convert into actual investments (Silver, 1985). In order to filter out the majority of proposals, venture capitalists use a process known as screening. Venture capitalists eliminate the proposals that are unable to meet the venture capital firms' investment criteria, have been previously unsuccessful in certain sectors, and seem generally unpromising (Fried and Hisrich, 1994). Significant amounts of proposals are rejected during this stage of the process (Zopounidis, 1994; Dixon, 1989).

C. Evaluation

The proposals that have successfully passed the initial screening phase are more heavily scrutinized. Information included in the provided documents is confirmed and financial forecasts are investigated (Plummer, 1987). The company's key employees, customers, suppliers, and creditors are also consulted. The key evaluation criteria include product, management, market, returns, etc. (Tyebjee and Bruno, 1985; Fried and Hisrich, 1994). Though the general objective of this due diligence process is to gain a thorough understanding of all business aspects, the focus of investigation may vary from deal to deal (Silver, 1985; Dixon, 1989). The venture capitalists professional experience is crucial to the general effectiveness of the evaluation process (Carter and Van Auken, 1994; Silver, 1985).

D. Deal Structuring

If due diligence does not identify any major areas of concern, venture capitalists proceed to negotiate the deal (Fried and Hisrich, 1994). The academic literature relating to venture capital contracting is significant. Sahlman (1990), Gompers (1997), Black and Gilson (1998) and Kirilenko (2001) focus on the degree of control exercised by venture capitalists and confirm that venture capitalists enjoy a disproportionately large degree of control. Kaplan and Stromberg (2003) provide a comprehensive description of the basic rights found in venture capital contracts. Chan et al. (1990) describe the salient features of venture capital contracting, including the inability of entrepreneurs to walk away from the business.

E. Post-Investment Activities

Venture capitalists' active involvement in their investee firms is related to information asymmetry and an extended period of illiquidity. Any information asymmetry venture capitalists face can cause significant agency risks. An extended period of illiquidity, in turn, can result in a questionable exit scenario and poor returns. In order to reflect current market conditions and changes in business opportunity, business plans, operational goals, and shareholder agreements need to be regularly evaluated and revised, from time to time, after the initial deal is closed (Sadtler, 1993; Bellas, 1993). While venture capitalists' participation in an investee firm varies from deal to deal, new ventures require more assistance than developed businesses (Sapienza, 1992; Barry, 1994; Sweeting, 1991).

Achieving an exit, or divestment, is the most important of the post-investment activities. Divestment is driven by a venture capitalists need to generate a profit for their capital providers and partners. This process can be achieved through two common routes: a public offering (IPO), or a trade sale to strategic investors. Regardless, each exit route has a different consequence for both venture capitalists and entrepreneurs (Rind, 1997; Andrews, 1995; Lim, 1990). Investee firms generally favour a public offering because it preserves the independence of both the firm and the entrepreneurs, in addition to providing the firm with continued access to capital. For venture capitalists, a public offering rarely concludes their relationship with the investee firm, as the underwriters can prevent venture capitalists from disposing of all shares at the time of an IPO. Private sales, in comparison, will almost certainly end a venture capitalists involvement with the investee firm (Rind, 1997).

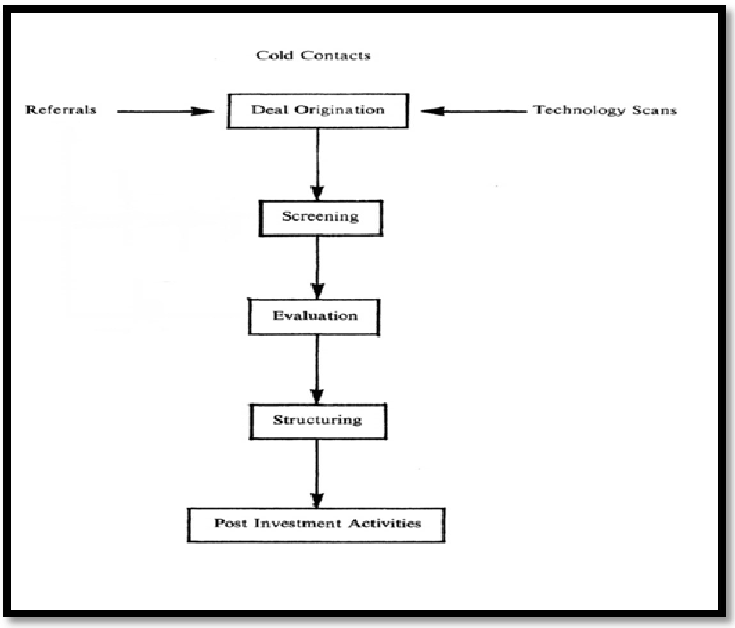

Figure 4: Decision Process Model of Venture Capitalist Investment Activity
Source: Tyebjee and Bruno (1985)

❖ What Distinguishes Venture Capital from other Investments?

Venture Capital investor combines the qualities of a banker, stock market investor (equity/quasi equity investor) and entrepreneur in one. This is evidenced in the following:

A. High Degree of Risk

Venture capital represents financial investment in a highly risky project/company with the objective of earning a high rate of return.

B. Equity Participation

Venture capital companies' provides equity or quasi equity finance with the objective of the investor to make capital gain by selling the shares once the company becomes profitable whiles expecting to also receive dividend/returns on his investment when the SME makes profit and dividend is declared and paid out.

C. Long-term Investment

Venture capital financing is a long term investment. It generally takes a long period to cash out the investment made by the venture capitalists n the SME/Project. Profit from the company in 2-3 years is mostly reinvested and exit periods are mostly from 7 years upwards.

D. Participation in Management

In addition to providing capital, venture capital funds take an active interest in the management of the business. The investor appoints director(s) and or management to represent their interest. This approach is different from that of a traditional lender or banker. It is also different from that of an ordinary GSE/GAX investor who merely trades in the shares of a company without participating in their management.

E. Invest for Social Returns

Venture capital investors in addition to the financial returns also expect/invest for social and environmental impact**.** Venture capital investment in SMEs should generate employment; contribute to tax revenue, potential for scale-up the business, introduction of innovation to the business, knowledge and technology transfer and good corporate governance practices due to the investment in the business.

F. Investment is not Liquid

A venture capital is not subject to repayment on demand as with an overdraft or following a loan repayment schedule. The investment is realized only when the company is sold or achieves a stock market listing. It is lost when the company goes into liquidation or does not make profit. The investment is recouped when there is successful exit which may include private placement, listing on the GSE/GAX, the entrepreneur buying out the venture capital investor or converting the equity to debt to be paid over a period.

Many small businesses are designed to provide the owners with a particular lifestyle and with job satisfaction. These kinds of businesses are not of interest to venture capitalists, as they are unlikely to provide the desired financial returns. Instead, venture capitalists look for businesses where the owners are seeking significant sales revenue and profit growth and need some outside help in order to achieve this. The risks associated with the business can vary in practice. They are often due to the nature of the products or the fact that it is a new business that either lacks a trading record or has new management or both of these. Venture capitalists provide long-term capital in the form of share and loan finance for different situations.

The Venture Capital Trust Fund in Ghana assisted in establishing five venture capital trust companies. However, the initial capital was not adequate and most of them ended up giving working capital loans and facilities to the SMEs. Two of them, however, through funds from foreign PEs have expanded their operations. Jacana Capital Partners and Ebankese Venture Capital managed by Oasis Capital Ltd have had successful operations. The Venture Capital Finance Companies (VCFCs) are - Activity Venture Capital Finance Company, Bedrock Venture Finance Com2X\Swpany, Fidelity Equity Fund II, Gold Venture Capital Limited (GOLD), Ebankese Fund Limited (EFL). Thus, there is huge market for venture capital financing companies but the risk level is high some of the Venture capital funds in Ghana are:

Company	Brief Description	Portfolio Size	Areas of financing
Bedrock Venture Capital	Bedrock Venture Capital Finance Company was born out of a partnership between SIC Insurance Company Limited, National Investment Bank and the Venture Capital Trust Fund.	US$ 10 million	The Company was set up to provide financial resources for the development and promotion of venture capital financing for small and medium enterprises in priority sectors of the economy like Agriculture, Information Technology, Education, Tourism and Health care.
Activity Venture Finance Company	The Fund is managed by Blackstar Fund Managers	US$ 5 million	AVFC has the sole authorized business of assisting in the development of SMEs by making available for their use, equity and quasi-equity financing and providing them business and management expertise. AVFC's portfolio contains a variety of SME's in various sectors of the economy spanning education, Information Technology, Agriculture and Agro processing, financial institutions etc. AVFC also offers services such as the provision of credit and/or equity financing to eligible SME's; monitoring of activities of SME's financed by AVFC with the aim of improving their profitability; and coordination and provision of post investment assistance to investee companies especially relating to capacity building
Fidelity Capital Partners Limited	FCPL recently entered into a strategic partnership agreement with Jacana Venture Partnership LLC, a group that supports emerging SME private equity firms in Africa.	US$32.0million	As a fund manager of generalist SME funds, FCPL's portfolio companies span across several industries.

Gold Venture Capital Limited	Gold Venture Capital Limited (GVCL) is a limited liability company owned by the Gold Coast Securities Limitd and the Venture Capital Trust Fund. Boulders Advisors Limited, a licensed investment advisory firm, manages GVCL.	$2.3 million	Gold Venture Capital Limited invests in the following sectors of the economy: Education, Agric and Allied Sector, Tourism, Construction, Services, Pharmaceutical, Manufacturing, ICT, Mining, and Finance.
Sagevest	Sagevest is an Investment Holding Company, established to invest shareholders' and funding partners' capital in select companies. Its preferred style of partnership is to take controlling equity stakes in companies. The company has offices in Mauritius and Ghana.	US$ 5 million	SME investment in full equity and Quasi equity
Aureos	Aureos is a specialist private equity firm helping to build sustainable small and medium-sized businesses in emerging markets.	US$381 million	Aureos targets opportunities in well-established businesses with strong market positioning. Main investment sectors are financial services, general services, construction & engineering, manufacturing, FMCG and TMT (telecoms/media/IT).
Ebankese	Ebankese Venture Fund Limited was established in December 2009 and became operational in March 2010. The Fund is owned by Venture Capital Trust Fund (VCTF), HFC Bank Ghana Limited, Ghana Union Assurance Company Limited, WDB Investments Limited, and Oasis Capital Ghana Limited.	US$10 million	Ebankese Fund invests in projects in the minimum amount of US$100,000 and maximum investment is 10% of the fund size with US$2,000,000 as hard cap. Ebankese focus primarily on assisting small and medium scale enterprises engaged in the real estate development sector. The Fund seeks to exit after 4–7 years of investments with preferred exit strategies being through sale to shareholders, local & strategic partners or mid-market players.

Table 1

❖ Types of Venture Capital Financing

A. Early Stage Financing

a. ***Seed, Research and Development Finance:*** Venture capitalists are more often interested in providing seed finance i. e. making provision for very small amounts for finance needed to turn into a business. This financing option is ideal for students and young entrepreneurs who have developed software and applications, graduates who come out with innovation in different fields who require years to test and refine their products, technology or innovation. Research and development activities are required to be undertaken before a product is to be launched. The financial risk increases progressively as the research phase moves into the development phase where a sample of the product is tested before it is finally commercialized. Venture capital investors are always ready to undertake risks and make investments in R & D projects which promise higher return in future. The funding at this stage may include providing office space to test or refine the idea, allowance to support entrepreneur at the idea/seed stage. The venture capital company at this stage may offer business development services and coaching in addition to the finance.

b. ***Start -Ups SMEs:*** The most risky aspect of venture capital is the launch of a new business after the research and development activities are over. At this stage, both the entrepreneur and his/her products or services are not tried. Start-ups may include new industries/businesses set up by the experienced persons in the area in which they have knowledge. Most investors for the 'One District One Factory Programme' may fall under this category. Venture Capital provides good financing option for start -ups. This stage of venture capital finance provide the much needed space for the entrepreneur to breath and focus on the business instead of paying for loan at such an initial stage of the business .It allows for surplus cashflow generated from the business to be reinvested in the business.

c. ***Second Round Financing***: It refers to the stage when product has already been launched in the market but has not earned enough profits to attract new investors. Additional funds are needed at this stage to meet the growing needs of the business. Venture capital financing provides larger funds at this stage than at other early -stage financing in the form of debt or equity to increase their shares in the business. When the Round 2 finance is debt, the debt will typically be in the name of the business so that the business owners (shareholders) will work to pay for the debt and when dividend is declared, shareholders will benefit in relation to their shares. The time scale for such an investment is usually three to seven years.

B. Later Stage Financing

SMEs which require additional finance but cannot raise capital through the public (stock exchange or GAX) can approach venture capital financing company for expansion capital, buyouts, and turnarounds or for development capital.

a. ***Development Capital***: It refers to the financing of an SME that has overcome the highly risky stage and has recorded profits but cannot go public, (to be listed on Ghana Stock Exchange or GAX) thus needs financial support. For example, funds are needed for the purchase of new equipment/plant, expansion of marketing and distribution facilities, launching of product into new location/markets and so on. The time scale of investment is usually one to three years and falls in medium risk category.

b. **Expansion Capital**: Venture capitalists perceive low risk in ventures requiring finance for expansion purposes; either by growth - implying bigger factory, large warehouse, new factories, new products or new markets or through purchase of existing businesses. The time frame of investment is usually from one to three years. It represents the last round of financing before a planned exit.

c. **Buy Outs**: It refers to the transfer of management control by creating a separate business by separating it from their existing owners. It may be of two types.

   i. *Management Buyouts (MBOs):* In Management Buyouts (MBOs), venture capital institutions provide funds to enable the current operating management/ investors to acquire an existing product business or product/service line.

   ii. *Management Buy-ins (MBIs):* Management Buy-ins is capital provided to enable an outside group of manager(s) to buy an existing company. It involves three parties: a management team, a target company and an investor. For example, a company that has experienced and known how in media/TV (Management Team) can approach a venture capital company (investor) to acquire finance to acquire a media company (Target Company) which when acquired will be managed by the management company. This is common in the hospitality and media industry. MBIs are more risky than MBOs and hence are less popular because it is difficult for new management to assess the actual potential of the target company. Usually, MBIs are able to target the weaker or under-performing companies.

   iii. *Replacement Capital:* Another aspect of financing is to provide funds for the purchase of existing shares from owners. This may be due to a variety of reasons including personal need of finance, conflict in the family, or need for association of a well-known name. The time scale of investment is one to three years and involves low risk.

   iv. *Turnarounds:* Such form of venture capital financing involves medium to high risk and a time scale of three to five years. It involves buying the control of a sick company which requires much specialized skills. It may require rescheduling of all the company's borrowings, change in management or even a change in ownership. A very active "hands on" approach is required in the initial crisis period where the venture capital investor may appoint its own chairman or nominate its directors on the board as well as appoint management.

❖ Venture Capital Investment Criteria

Venture Capital investors normally invest in SMEs/companies that provide good prospects for capital growth over a 5 to 15 year time horizon. They undertake investments based on a well thought-out investment criteria. Investment decisions may be based purely on viability, growth potential and sustainability of returns of the target portfolio or investee company.

To invest in an SME or in a Company, may be based on the following:

a) Viability of the Company/Project: This may be determined based on product/service assessment, market assessment, distribution/channels assessment, and management capacity/operational sustainability.
b) Business Plan/Investment Memo: Detailed due diligence and a comprehensive business plan for the Company/Project to be invested in.
c) Off taker Agreement/SLAs: Acceptable contractual arrangements with key suppliers or buyers of the products or service to be produced and service(s) to be offered.
d) Track Record: Demonstrable track record and technical expertise in the particular sector, as well as the professional reputation of the entrepreneur/project promoters.
e) Availability of satisfactory exit mechanisms. The exit strategy for investments will typically be negotiated with the entrepreneur/project promoter before the investment closing.
f) Adherence to best Business practices: Companies' consistent adherence to international standards of corporate governance and local environmental standards. This also includes Environmental, Social and Governance (ESG) issues affecting the sector or business in question.

SMEs have been found contributing immensely to the Socio-economic development of every nation in both developed and developing countries all over the world. Venture Capital companies have found it necessary to finance or assist the SMEs which are known to be potential to grow; if they are assisted financially and technically in other improve the nation. In Ghana, the government deems it necessary to establish venture capital fund in 2004 in other for small and medium enterprises in the country to have access to enough funds in the operations of their businesses so as to reduced poverty by creating employment and improve the standard of living and also make the country an industrialized one.

❖ Venture Capital Financing and Private Equity in Ghana

The Venture Capital Trust Fund (VTCF) was set up in 2004 with the main objective of establishing a fund capable of supporting and assisting SMEs in terms of access to investment capital. The VCTF is managed under the auspices of a nine-member Board of trustees as appointed by the President in consultation with the Council of State. The initial capital fund to kick-start the operations of the VCTF was USD 22.5 million (VCTF Report, 2007). The VCTF was set up against the backdrop of the financial constraints confronting SMEs (Boadu et al. 2014). Certain critical areas of the economy have been ear-marked for SME operators to receive financial assistance. The areas of interest and where attention is focused on include the information and communication technology, education, agro-processing, pharmaceutical, financial services and poultry (Boadu et al. 2014). Essentially the arrangement of the VCTF is such that VCTF gives credit and equity financial assistance to qualified venture capital financing firms who subsequently assist eligible SMEs for equity and financial assistance. Again, the venture capital financing firms provide other assistance and support such as the provision of funds to facilitate the development, dissemination and the promotion of venture capital financing in Ghana.

To ensure that the above stated objectives and goals are realized, the VCTF has collaborated with private entities to set up several venture capital financing companies (VCFCs). The key players of the venture capital market include venture capital trust fund, venture capitalists, business angles and off course, SMEs. In Ghana, the main VCFCs include Activity Venture Finance Company, Bedrock Venture Capital Finance Company, Gold Venture Capital Limited and Fidelity Equity Fund II, Oasis Venture Capital etc. This collaboration is to ensure that eligible SMEs are assisted to grow and sustain their operations through the provision of equity, quasi-equity and credit financing. Moreover, the VCFCs also render other invaluable services such as providing technical assistance which ultimately leads to efficient management and productivity of the SMEs. The venture capital financing companies (VCFCs) have over the years invested in different sectors of the Ghanaian economy all with the intention of boosting the management, development, growth and sustainability of Ghanaian SMEs through the provision of low cost financing to SMEs. The belief is that assisting SMEs to get access to low cost financing will stimulate growth in the Ghanaian economy and this will lead to a multiplier effect in terms of job creation, increased revenue for the state (through tax inflows) and eventually, to replenish the pool of funds available to be down-streamed to businesses for reinvestment.

❖ Venture Capital Financing Models

The venture capital financing model involves actors who perform certain roles and relationships, in a systematic process to make possible venture capital investment.

Research has shown that these are mainly five (5) factors, namely; the investor, the limited partner, the general partner who is also known as the venture capital firm or venture capitalist, the entrepreneur or the investee organization, and the Public market. Occasionally, a sixth actor becomes necessary as investment advisor, when the venture capitalist needs consultation (Fried, 1992, Hisrich, 1992, Metrick, 2011, Yasuda, 2011).

The Venture capital cycle starts with raising a venture funds. The investor performs the role of organizing or securing venture capital funds through pension funds, foreign investors, insurance companies, endowment and foundations, and other corporate sources etc. After the funds have been secured, the investor has the prerogative to invest directly or indirectly. Again, the limited partner is the overseer to ensure venture capital investment is successfully carried out. They place funds with the general partner or venture capital firm for a return for profit. The operations of the partnership are managed by one or more general partners. These general partners are responsible for making investments in individual companies (referred to as portfolio companies) Limited partners are not involved in the active management of the partnership (Gompers and Lerner, 2001).

The Venture Capital Firm or the General Partner serves as the intermediary body between the limited partner and the entrepreneur or the investee organization. Venture Capital firm takes money from its investors and makes equity investments in portfolio companies (investee organization) (Metrick and Yasuda, 2011). The entrepreneur is commonly seen as a business leader and innovator of new ideas and business processes. They start companies and create jobs at a breath-taking pace. The Public market is the financial institution through which venture capital investment is exited through a sale or initial public offering (IPO). This is where the number of shares and the value of the investee organization necessary to achieve a successful exit are estimated (Metrick and Yasuda, 2011).

❖ The Eight-Stage Venture Capital Investment Process by Klonowski

Klonowski (2007) proposed a nine-stage generic model for Central and Eastern Europe (CEE), that is better suited for the basis of analysis rather than one drawn from a detailed analysis of one particular country at one particular time. The model also captures in detail venture capitalist decision making process. This model was designed based on Tyebjee and Bruno (1985) five-stage model of venture capital investing. It involves Deal generation, Initial screening, Internal feedback and due diligence Phase I (Investment Committee initial feedback, Supervisory Board initial feedback) Pre-approval completions, Internal approvals and due diligence Phase II, Deal completion, Monitoring, Exit.

Klonowski (2010) proposes a more comprehensive view of the venture capital investment process. The mechanics of processing venture capital deals are more complex than initially suggested. The following eight-stage model aims to capture the essence of the venture capital investment process as stated above. The proposed model has a number of unique features. First, it defines the various approvals that venture capitalists must go through with their venture capital firms' approval bodies (namely, the investment committee and supervisory board) in order to complete the deal and exist. Venture capitalists must effectively consult with this decision- making unit during every step in the investment process. Second, the level of internal documentation needed throughout the life of any investment is high to ensure a careful approval process. Venture capitalists need to produce at least ten different pieces of documentation for review by internal team members or the investment committee and supervisory undoubtedly board. Venture capital firms are subjected to by their venture providers (namely, Limited Partners) and reflect the high perceived level of risk that Limited partner see in the market place. The third model provides a clearer definition of the differences between the specific stages that occur during the evaluation of investees firms, the initial screening stage. Due diligence phase l focuses on the due diligence program organized by venture capitalists based on more intense interactions with founders and entrepreneur. The third level of evaluation is generally driven by external consultant (i.e. accountant, lawyers, environmental and technical specialists etc.) with Limited involvement from venture capitalists. This represents the most expensive stage of the evaluation process.

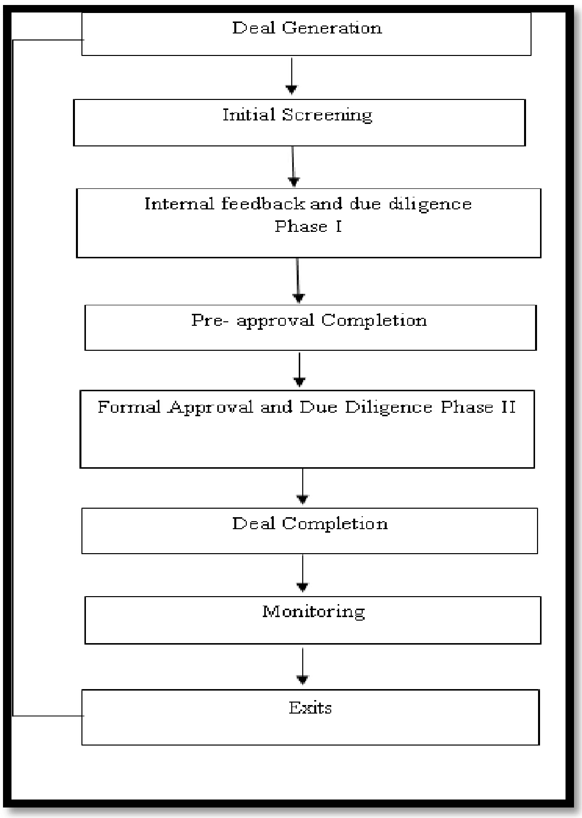

Figure 5: The Eight-Stage Venture Capital Investment Process

Source: Klonowski (2007)

❖ Factors that Influence Venture Capital Financing Decisions

There are a number of factors that influence venture capital financing decisions of SMEs as to whether to finance them or not. The variables include: management support/style, technical support, the size of SMEs and the type of project undertaken by them, business strategies, viable ideas and others. Venture capitalists consider most of these factors if not all before firm decisions are taken to invest in a particular business.

♦ Technical Support

Provision of Capital alone cannot be enough to develop growth oriented SMEs in their business. These companies need technical know-how and management training, advice from experienced business people, technical knowledge of equipment and processes, knowledge on market survey to build their businesses.

Venture Capitalists will consider this as a factor before investing its equity capital in the firm, since there can be negative impact on their capital investment. Therefore, the venture capitalists will look for the ability of firm to encourage and sustain technological innovation in the business which is one of the major considerations in their investment decision. Similarly, the existing technology used by the SMEs and any technical collaboration agreements entered into by the promoters also to a large extent affect the investment decision. According to Mani and Bartzokas (2004) a distinguishing feature of venture capital finance is the additional support and knowledge transfer provided by the investing firms to the firm they invest in. Again, U.S. practice also said "Venture capital firms are Professional, institutional managers of risk capital that enables and supports the most innovative and promising companies"(NVCA Yearbook, 2010).

♦ Size of the Firm (SMEs) and Type of Project

The size of the firm and the type of project undertaken by the SMEs will one way or the other influence the investment decisions of the venture capital companies. If the firm is too small to be financed or the type of the business the SMEs are undertaken is not prudent or secured for them, will not invest in this business venture and eventually will have an effect towards access to venture capital fund for SMEs Growth.

♦ Business Strategies

Business Strategies is also a factor that influences venture capital investment decision. B*usiness strategy* can be explained as a long-term plan of action undertaken to achieve a specific goal or set of goals or motives. Venture capitalists will also consider the strategies the SMEs plan to undertake if it will be feasible and how best it will help to administer them by looking at their business plan. Business plan entails in details the vision the firm is intended to achieve and the procedure it would use to achieve the set goal(s) in the long run. According to Boadu (2008), a business plan is a critical component of the success of a business and therefore, a sound business plan is the first element of the request for funding and the process of investment usually begins with the assessment of its content. The business plan should simply describe the nature of the business and some key members of the management, their qualifications and how well; the business has performed in the past and business projections and forecasts should be seen in the plan. Venture capitalists upon having assessed this document and study them critically will then make a decision as to finance the SME or not. Therefore, a good or sound business strategy which contains a good business plan is likely to win venture capital investment fund.

- **Viability of Ideas**

Venture capitalists will embark on project assessment and evaluation to screen the companies which have apply for funding to see if the projects it intends to finance with the SMEs are viable before taking investment decision. Because a viability of idea will establish the market for the product or service to undertake. It is upon this reason that customers would want to know the kind of product he/she will purchase, who the ultimate users are, who the competition is with and the projected growth of the industry? This reason will immensely affect choice of SMEs the venture capital firm will select for funding even though their work is a high-risk venture.

❖ Chapter Summary

Venture capital is financing SMEs by which investors provide to new or small businesses that are believed to have long-term growth potential but with little or no substantial collateral making it impossible to access funds from commercial banks. The assumption is based on business that are inherently new and small, often with little or no substantial collateral, their package is riskier than the loan package provided by commercial banks. The possibility for Venture capital investor to invest in higher-risk businesses is the prospect of higher returns. Various studies has conceded that the main actors in venture capital financing model include the investor, the limited partner, the general partner who is also known as the venture capital firm or venture capitalist, the entrepreneur or the investee organization, and the Public market. Additionally, other researchers have proposed five-stage model of venture capital investing which are key for SMEs owners. These include deal origination, screening, evaluation, deal structuring and post investment activities.

Chapter 4

Risk Management in Venture Capital

❖ Introduction

Risk management is undoubtedly among the most crucial issues in the field of SMEs and Venture Capital financing. LiPuma and Park (2014) stated that venture capital investments are well-known as high-risk investments since venture capital institutions invest in business with a high growth but also high risk potential. It has been revealed that SMEs face the challenge of liability of newness resulting in particular difficulties such as shorter expected life, and a greater risk of failure (Coleman, 2004).In the investment decision-making process, venture capital institutions often encountered with uncertainty about the future performance of the venture and the adverse selection problem. In this regard, this chapter focuses on concept of risk in venture capital financing, typologies of risks in venture capital financing and risk register.

❖ The Concept of Risk in Venture Capital Financing

A very important concept in finance is the idea that an investment that carries a higher risk has the potential of a higher return. For example, a zero-risk investment, such as treasury security has a low rate of return, while a stock in a start-up company has the potential to make an investor very wealthy, as well as the potential to lose one's entire investment. Certain types of risk are easier to quantify than others. According to Valsamakis (1999), risk is defined as a deviation from the expected value. It implies the presence of uncertainty, where there may be uncertainty as to the occurrence of an event producing a loss, and uncertainty on the outcome of the event, where the degree of risk is interpreted with reference to the degree of variability and not with reference to the frequency with which the event will occur or to the probability that it will display a particular outcome.

Institutions often distinguish between expected and unexpected losses. Expected losses are those that the institution knows with reasonable certainty will occur such as default rate of corporate loan portfolio. Unexpected losses are those associated with unforeseen events. Institutions often rely on their capital as a buffer to absorb such losses. Risk is usually defined by the adverse impact on profitability of several distinct sources of uncertainty. The types and degree of risks a SMEs often exposed to depend on its size, complexity in operations and volume of transactions (Oldfield et al, 1995). Thus, it can be seen that in broad terms, the risks faced by an SME can include the following:

a. failure to accomplish established objectives and goals for operations or programmes,
b. failure to meet statutory and regulatory requirements,
c. wrong decisions taken because of incorrect, untimely, incomplete or unreliable information, poor record-keeping, inappropriate accounting, inaccurate financial reporting and financial loss and exposure,
d. fraud, corruption, misappropriation of assets, waste and loss, failure to safeguard assets adequately,
e. customer dissatisfaction, negative publicity and damage to the organization's reputation,
f. Failure to safeguard staff and customers adequately, and acquiring resources uneconomically or using them inefficiently or ineffectively.

Every business is an integration of people, processes, premises, providers, profiles, performance etc. These entities have risks inherent in themselves. Therefore risk is experienced in every business due to the uncertainty of the outcome of decision or the activity of the business (Mckim, 1992). Conceptually, each firm has certain amount of risk inherent in its operations (Brigham and Ehrhardt, 2005). In view of what has been established above, it could be concluded that there are risks in venture capital financing. This assertion has been confirmed by research that Venture capital financing is a high risk high return investment. This is thought to be so because venture capital is a source of funds that typically finance new and rapidly growing companies through equity participation (By grave and Timmons 1992; Gompers and Lerner 2001).

❖ Typologies of Risks in Venture Capital Financing

♦ High Level of Uncertainty of SMEs

Referring to the definition given by Gompers and Lerner (2001), beneficiaries to venture capital financing who are investee organizations are usually, new venture or start-ups, organizations in developmental stages, and expansion of purchase of a firm, which are all categorised as SME’s in this study. The status of such organizations at these stages makes it highly uncertain for success if funded through venture capital financing. Hence Venture Capitalists shy away from investing in SME businesses of this nature because they have the fear that they will lock up their funds in an unprofitable business venture (Boocock and Presley, 1993).

- ### Information Asymmetry

Information asymmetry is a risk in venture capital financing where there is a large difference between what entrepreneurs (SME's) and investors (Venture Capitalist) know. This occurs when information known to the entrepreneur is not known to the venture capitalist. Venture capitalist or investor does not only provide funding for start-ups and small businesses but also take part in the management of the firm. Therefore information or the idea that is necessary to operate the firm successfully must be known to the venture capitalist. Lack of such information to the venture capitalist poses a risk to the venture capital financing. This risk could be attributed to the entrepreneur refusing to reveal critical business information to the investor or, as suggested by Dockery and Herbert, (1996) that start-up and small business fail to keep financial records.

- ### Lack of Trading Record

Researches have proven that SME's fail to keep proper business records from inception of operations. Business operations are carried out from memory without reference to any documented information. Much the same way, no proper records are kept in terms of the happenings and transactions taken place in the business process. This therefore creates the lack of trading records for SME's making it difficult for venture capitalist to lay hands on trading records that they could evaluate or analyse in considering venture capital funding (Verheul and Thurik, 2001).

- ### Lack of Substantial Tangible Assets

SME's that lack substantial tangible assets and have large degree of uncertainty about their future are unlikely to be funded by venture capital financing. These organisations face many years of negative earnings and are unable to make interest payments or meet principal repayments. These are the business that Fazzari, Hubbard and Petersen (1998) show they are severely capital constraint. This makes it difficult for such companies to be funded by venture capital, thereby hampering its growth (Gompers and Lerner, 2001).

- ### **The Fear One Party Entertains To the Other Party**

Venture Capitalist and Entrepreneurs (SME's) both do entertain fear for each party during venture capital financing engagements. This risk might exist because each of the party might wish to maximize profit singularly for the benefit of their respective individual organizations and not for the benefit of the engagement. Venture Capitalist fear that entrepreneurs (SME's) might exaggerate about their ventures and post investment, and may utilize the capital in non-value adding activities, e.g. drawing a huge take home salary, buying high end cars, etc. In the same negative, entrepreneurs (SME's) fear that venture capitalist having got to know their business model shall take over the business (Swati Panda Shridhar Dash, 2013).

- ### **Adverse Selection**

Adverse selection is a type of risk that occurs in venture capital financing where undesired results occur when the investor and entrepreneur has asymmetry of information. This was modelled by Koskinen et al. (2013), using the bargaining power between of the investor and the entrepreneur. Entrepreneurs are likely to be better informed than venture capitalists about some aspects of their projects while venture capitalists are likely to be better informed about some other aspects. In this model, the entrepreneur has an informational advantage regarding the technology employed in the venture and her project's likelihood of successful scalability from a chronological perspective.

The venture capitalist, in contrast, is better informed about factors that are of great importance in later stages of projects: the management, marketing, and financial know-how needed to successfully commercialize a venture. Thus, the locus of information asymmetry switches over the life of a project. The allocation of bargaining power between the venture capitalist and the entrepreneur varies independently of their private information and is determined by the relative scarcity of venture financing. When a venture capitalist has an absolute bargaining advantage over an entrepreneur, the optimal contract minimizes the sensitivity of the entrepreneur's claim to project profitability. Granting the venture capitalist equity or convertible claims that can be exchanged for a greater ownership share of the project is one way to generate this sort of cash flow pattern.

- ### **Risk of SMEs Being a New Venture**

Venture capitalists worry that if the business is a new venture, whether the management team is skilled and sufficiently adept in management, production, marketing, and finance, how the actual investment will be realised, the capability of the management team in achieving growth in sales within its market, how well the company understands its customer base, and the company's market and growth potentials and strategy, etc. This is because VCFs are targeted at enterprises that are inherently new and small, often with little or no substantial collateral, their package is riskier than the loan package provided by commercial banks (Fiet and Fraser, 1994). Hence, start-off businesses are considered a risk by venture capitalist, even though some might appear to be promising in its growth, profitability of such ventures is uncertain. Fiet and Frazer (1994) buttresses the point that venture capital financing is targeted at financing enterprises that are inherently new and small, often with little or no substantial collateral, therefore their package is riskier than the loan package provided by commercial banks.

- **Inexperience Investor (Venture Capitalist)**

Inexperienced investor to venture capital financing could also pose a risk to the success of the engagement. Evaluation of an entrepreneur by an investor who is inexperience for venture capital funding could impact the process negatively. A relatively inexperienced investor would decline venture capital financing because the investor might have been drawn into a previously failing investments. This position of an investor would have impact on the entrepreneur and the business venture yet to be started or needed support for growth. The business might not be started or be liquidated if it's already started (Mantel, 2009).

From what have been established in literature so far, the phenomenon of venture capital financing would be successful when the enumerated above could be overcome. This means that the venture capitalist and the beneficiary, entrepreneur or SME have some risks to deal with before a successful venture capital engagement. It presupposes that before a successful venture capital takes place, VC's and SME's must look forward to encounter these risks which have become determinants for fruitful access to venture capital finance.

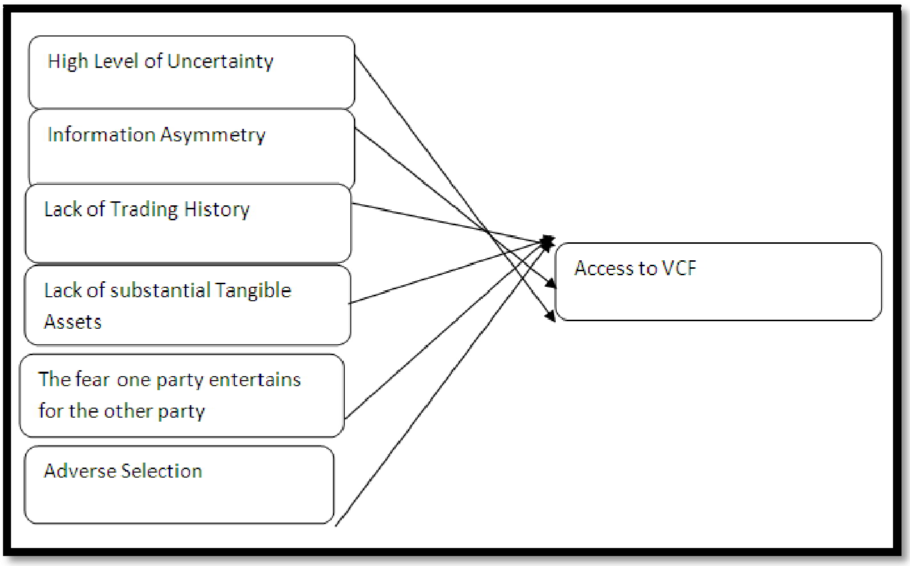

Figure 6: Conceptual Framework to Accessing Venture Capital Funds

❖ Risk Register

Table of risks identified with venture capital financing, analysed and classified with the help of the criteria set out in the tables under the theme "Risk Score".

S/N	**RISK DESCRIPTION**	**RISK FACTORS/SOURCE**	**RISK EFFECT**	**RISK L./HOOD**	**RISK IMPACT**	**CURRENT CONTROL**	**RISK LEVEL**	**RISK RESPONSE**	**RISK TREATEMENT/ CONTROL**
CATEGORY A: RISK RELATING TO INVESTEE FIRM (SME)									
1	High Level of Uncertainty	1. Absence of a quality business plan 2. Poor organizational structure	1. Unclear business direction 2. Unable to determine business survival	4	4	1	HIGH	TREAT	1. Engage an experienced Chartered Accountant or a qualified Business Consultant to help develop; a) a quality Business Plan and b) Advice on effective organizational structure (It is important to note that this activities must take place at the

									inception of SME business)
2	Lack of Trading Record	1. Failure to record all business transaction and business communications	1. Uncertain business activities 2. Unable to prepare yearly financial statements 3. No appropriate /historical information for effective decision making.	4	4	1	HIGH	TREAT	1. Record all business transactions and any business communication at the inception of the business and keep this in an ongoing basis.
3	Lack of substantial tangible assets	1. Unable to acquire tangible assets at the beginning of the business	1. It presents a situation of instability	4	4	1	HIGH	TREAT	1. Provide good prospect of business by presenting quality business plan 2. Consider indemnity by an insurance company when it is necessary while seeking venture capital financing
4	Fear of Losing my business	1. Not having proper understanding of the operations of VCF 2. Not knowing clear intentions of Venture capitalist	1. SME not trusting venture capitalist	4	4	1	HIGH	TRE AT	1. Effective education on venture capital financing 2. Transparent contract 3. Adequate information flow and sharing
5	Lack of audited financial statement	1. Unavailable transaction records	1. No data / information to prepare financial statement	4	4	1	HIGH	TRE AT	1. Ensure all business transactions are recorded 2. Engage an accountant to prepare yearly audited financial statements
6	Lack of Quality business plan	1. Failure to write down business	1. No business direction	4	4	1	HIGH	TRE AT	1. Engage an experienced

		idea and how profit is to me made in a long term	2. Unable to ascertain profitability of business						Chartered Accountant or a qualified Business Consultant to help develop a quality Business Plan
8	SME / Investee firms attitude about control of business	1. The desire for absolute ownership and total control of business	1. Unwilling to share hence unwilling to engage in venture capital financing	4	4	1	HIGH	TREAT	1. Acquire training on business structure and management 2. Acquire training on venture capital financing
CATEGORY B: RISK RELATING TO VENTURE CAPITAL FIRM (VENTURE CAPITALIST)									
1	Inadequate qualified personnel	1. Few qualified personnel	1. The process of venture capital financing is delayed 2. The process of venture capital financing is complicated	4	4	2	HIGH	TREAT	1. More people must be trained into venture capital financing
2	The process of venture capital financing too slow	1. Inadequate qualified personnel 2. Complicated VC process	1. Low patronage of VC	4	4	2	MEDIUM	TREAT	1. More people must be trained into venture capital financing

Table 2: Table: Risk Register of Venture Capital Financing

S/N	RISK DESCRIPTION	RISK FACTORS/SOURCE	RISK EFFECT	RISK L./HOOD	RISK IMPACT	CURRENT CONTROL	RISK LEVEL	RISK RESPONSE	RISK TREATEMENT/ CONTROL
3	The process of venture capital financing is too complicated	1. Incompetent staff 2. Inadequate qualified personnel 3. Long VC process	1. Low patronage of venture capital financing	4	4	2	MEDIUM	TREAT	1. Review the process of VC and shorten if possible 2. Provide training to VC staff
Category C: General									
1	Information Asymmetry	1. Critical business information kept with entrepreneur / investee (SME) – not sharing business idea with Venture capitalist	1. Business is managed without critical business information 2. Results of business might not be as expected	4	4	1	HIGH	TREAT	1. Provide training on venture capital financing to (SME) 2. Contract must include information flow between venture capitalist and investee 3. Business operations must be transparent to venture capitalist and investee
2	The fear of one party to the other	1. Lack of information flow 2. Non-transparent contract 3. Lack of training on venture capital financing	1. Both Venture capitalist and Investee might not want to engage in venture capital	4	4	1	HIGH	TREAT	1. Provide training on venture capital financing to both (SME) and venture capitalist 2. Contract

			financing						must include information flow between venture capitalist and investee 1. Business operations must be transparent to venture capitalist and investee
3	Adverse Selection	1. Power due to Venture capitalist or Investee during the stages of venture capital financing	1. Inappropriate decision or judgment made by either venture capitalist or investee	4	4	1	HIGH	TREAT	1. Business operations must be transparent to venture capitalist and investee 3. Contract must include information flow between venture capitalist and investee
4	Exit Challenges	2. Non-transparent contract 3. No knowledge on exit methods 4. IPO challenges in Ghana	1. SME disagreement to exit method 2. Venture Capitalist unwilling to engage in venture capital financing due to exit	4	4	1	HIGH	TREAT	1. Transparent contract 2. Provide education on exit methods to both investee and venture capitalist 3. Improve on

			challenges						IPO in Ghana 4. Seek different exit methods
		2.	2.						

Table 3

S/N	Risk Description	RISK FACTORS/SOURCE	RISK EFFECT	RISK L./HOOD	RISK IMPACT	CURRENT CONTROL	RISK LEVEL	RISK RESPONSE	RISK TREATEMENT/ CONTROL
4	Inadequate flow of Information	1. No trust in the venture capital financing engagement	1. Poor judgment and ineffective decision making by both investee and venture capitalist	4	4	1	HIGH	TREAT	1. Transparent contract 2. Provide education on exit methods to both investee and venture capitalist 3. Business operations must be transparent to venture capitalist and investee
5	Weak regulatory Environment / Legal Documentation	1. Incompetent regulatory personnel 2. Lack of education to the general public on venture capital financing	1. Unwillingness to engage in venture capital financing by both venture capitalist and investee.	4	4	2	HIGH	TREAT	1. Adequate training must be provided to regulatory personnel 2. Regulatory body must provide education and awareness t the general public especially those engaged in venture capital financing
6	Poor / Weak micro economic environment	1. High inflation 2. High interest rate 3. Currency fluctuation	1. Discourage patronage of venture capital financing	3	3	3	MEDIUM	TREAT	1. Government must manage economic environment to the benefit of all and venture capital financing

Table 4

❖ Chapter Summary

In conclusion, a major concept in finance is the idea that an investment that carries a higher risk has the potential of a higher return. For a zero-risk investment, such as treasury security has a low rate of return, while a stock in a start-up business has the potential to make an investor very wealthy, as well as the potential risk of losing one's entire investment. The nature of risks SMEs mostly exposed to depend on its size, complexity in operations and volume of transactions. The risks faced by SMEs all over the world include high level of uncertainty, information asymmetry, lack of substantial tangible assets, adverse selection, risk of stage being a new venture and inexperience. Other addition include failure to accomplish established objectives and goals for operations or programmes, failure to meet statutory and regulatory requirements, wrong decisions taken because of incorrect, untimely, incomplete or unreliable information, poor record-keeping, inappropriate accounting, inaccurate financial reporting and financial loss and exposure, and fraud, corruption, misappropriation of assets, waste and loss, failure to safeguard assets adequately.

Chapter 5

Case Study

The case presents how to prepare Venture capital Fund Investment Memoranda and also an example of a Fund in West Africa. It is aimed to provide readers Investment Memo for Venture capital Fund is prepared.

❖ SME Growth & Venture Capital Fund

SME Growth & Venture Capital Fund gives investor's access to a professionally managed Investment Fund which will actively invest in selected Small and Medium Size Enterprises (SMEs) in with principal operations in Ghana, Cote D'Ivoire and Liberia.

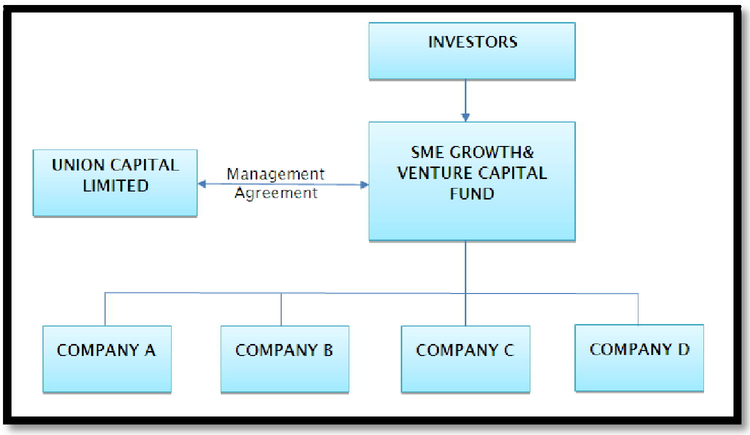

Figure 7

SME Growth & Venture Capital Fund will be managed by Union Capital an investment bank licensed by the Securities and Exchange Commission of Ghana.

❖ Why Invest in SME Growth & Venture Capital Fund?

a) Unique investment opportunity in SMEs.

b) The Fund's objectives are to achieve a gross financial return of 25% IRR in US$ terms at the portfolio level and measurable socio-economic impact like employment generation and wealth creation
c) Immediate cash flow from interest payments.
d) Limited downside risk by financing through equity and debt instruments and a diversified portfolio of SMEs.
e) Significant upside potential through equity options and active engagement in the target companies
f) Diversified portfolio of companies within the West African Sub-region.

❖ Why West Africa?

A survey of Limited Partners by Emerging Market Private Equity Association (EMPEA) ranked sub-Saharan Africa (SSA) as the fourth most attractive emerging market behind India, Southeast Asia, and South America (excluding Brazil). The African Private Equity and Venture Capital Association (AVCA) reported that PE funds invested US$21.6bn in 833 deals over 2010-15 – targeting mostly fast moving consumer goods (FMCG), banking/finance, industrial and telecoms sectors. The total value of African-PE fundraising between 2010 and first-half 2017 was US$20.5bn.

The arrival of global funds shows investor's appetite for Sub-Saharan African companies (including start-ups), seeking both scale and diversification of country-risk. Private equity funds under management have exceeded US$30bn according to US' Boston Consulting Group (BCG). Among some prominent groups are:
London-based Helios Investment Partners (founded in 2004), which operates a diversified portfolio in 25 countries worth US$3bn. It also manages the US$110mn Modern Africa Fund on behalf of foreign entities, including US Government's Overseas Private Investment Corporation and few leading US firms. This year, Helios supported by GE Ventures has led the largest venture capital raising (US55mn) to provide off-grid power in West Africa.

Black Rhino (owned by US Blackstone Group) focuses on the development and acquisitions of infrastructure projects across Africa. It has invested over US$2bn mostly in Nigeria, Ethiopia, Mozambique and Togo. Dangote Industries and Black Rhino have agreed to jointly invest US$5bn over the medium-term across SSA with a particular emphasis on power, transmission and pipeline projects.

Emerging Capital Partners (ECP) is a Pan-African PE-firm with a portfolio of 60-plus investments (worth US$2.7bn) across 40 countries and has realised nearly 40 full exits. It specialises in seed, start-up, venture, growth capital, development, bridge financings, buyout and recapitalisation in mid-cap markets. The firm also makes mezzanine investments (subordinated debt). Actis Capital (UK), founded in 2004, has invested over US$5.5bn in 70 African companies, of which 50 have been exited. Its third Africa Real

Estate Fund-3 (2015) still remains sub-Saharan Africa's biggest fundraising that targets prime retail, office and industrial developments in eight countries (excluding South Africa). The Dubai-based Abraaj Group with reported investment of US$3.2bn in over 80 mid-cap companies over the last two decades.

♦ Ghana

Ghana is one of the key lower middle income economies in Africa. A diversified commodities endowment with traditional gold and cocoa, enhanced by rapidly developing hydrocarbon production provides a powerful foundation for future growth. The Ghanaian economy is currently in its fourteenth consecutive year of growth and, with IMF assistance, is in the process of consolidating its transition to a lower middle-income country.

In 2015, the country faced significant economic challenges with persistent power outages, a highly volatile currency amidst falling global commodity prices, high levels of inflation together with increases in fuel and utility tariffs. Ghana's rating stands below investment grade due to rising public debt stock and a slumping cedi (which will magnify the burden of the country's foreign-currency debt). To curb inflation, the Central Bank continuously increased primary rates from 21% to 26% with less impact on both inflation (averaging 17%) and general lending rates which stood at about 30% against 25% for 91-day Treasury Bills over the period.

Despite current challenges, Ghana’s robust fundamentals will support continued inclusive development and high growth. Effective institutions and public sector reforms which rival many peers – a continuation of its leadership role for political independence with a robust institutional framework which provides a stable foundation for future growth.

♦ Cote D’Ivoire

Subsequent to the political instability of the past years, the economy of Côte d'Ivoire has stabilized and is currently growing. The country is heavily dependent on agriculture and related activities, which employs roughly 68% of the population. Cote d'Ivoire is the world's largest producer and exporter of cocoa beans and is also a significant producer and exporter of coffee and palm oil. In addition, the commercial sector is a leading and growing sector which makes it attractive for investment. Sub-sectors include building and construction equipment and materials, oil and gas field equipment, drugs and pharmaceutical products etc.

Foreign direct investment (FDI) plays a key role in the Ivorian economy, accounting for between 40% and 45% of total capital in Ivorian firms. France is overwhelmingly the most important foreign investor. In recent years, French investment has accounted for about one-quarter of the total capital in Ivorian enterprises, and between 55% and 60% of the total stock of foreign investment capital.

♦ Liberia

The earlier civil war in Liberia retarded the country's economic development. Upon the end of the war in 2003, GDP growth began to accelerate, reaching 9.4% in 2007. The global financial crisis slowed GDP growth to 4.6% in 2009, though a strengthening agricultural sector led by rubber and timber exports increased growth to 5.1% in 2010 and an expected 7.3% in 2011, making the economy one of the 20 fastest growing in the world.

Real gross domestic product (GDP) growth in 2017 is estimated to have recovered to 2.5% and is projected to rise to 3.0% in 2018. The incipient recovery is driven largely by increased production of gold and iron ore, following the uptick in the prices of gold and iron ore on the international market. Non-mining sector GDP growth remains very low. Agricultural sector growth remains subdued due to weak recovery in global prices of rubber and palm oil.

❖ Investment Strategy

SME Growth & Venture Capital Fund will invest in targeted SMEs in expansion stage with strong growth potential and clear pre-identified expansion prospects. Under this Fund, only SMEs with a strong proven track record and potential will be considered and a realistic opportunity for the Fund's exit.

The Fund will focus its investments in the following 5 Key Sectors:

a. Health Care and Health Services
b. IT/Telecommunication & Media
c. Infrastructure & Energy
d. Agribusiness

Utilizing its in-house transaction advisory expertise, the Manager will seek to negotiate and structure the Fund's investments to provide a strong foundation for success, and then work actively with the investee company to deliver its business plan and drive the company towards the Fund's exit event.

Allowable investment categories will be:

a. Growth capital;
b. Management buy-outs for SLCs;

c. Cash-out deals;
d. Working capital in the form of debt and
e. Turnaround investments

♦ The Market opportunity

While bank financing will continue to be crucial for the SME sector, there is a broad concern that credit constraints will simply become "the new normal" for SMEs and entrepreneurs. It is therefore necessary to broaden the range of financing instruments available to SMEs and entrepreneurs, in order to enable them to continue to play their role in investment, growth, innovation and employment and this creates a broad base opportunity for the fund.

According to the OECD (2015) the market for hybrid instruments, which combine debt and equity features into a single financing vehicle, has developed unevenly among countries, but has recently attracted interest of policy makers across the board. These techniques represent an appealing form of finance for firms that are approaching a turning point in their life cycle, when the risks and opportunities of the business are increasing, a capital injection is needed, but they have limited or no access to debt financing or equity. Further, young high-growth companies, established firms with emerging growth opportunities, companies undergoing transitions or restructuring, as well as companies seeking to strengthen their capital structure which is the current state of most SMEs in Ghana cannot use the traditional debt/bank loan finance. This creates an opportunity for a Fund that understands these business cycles and stages and tailors the financing structure to SMEs in these stages.

Equity finance is key for companies that seek long-term corporate investment, to sustain innovation, value creation and growth. Equity financing is especially relevant for companies that have a high risk-return profile, such as new, innovative and high growth SMEs. Given that most SMEs in our sector of focus can be categorized in this group, it is an opportunity for the Fund to invest to provide the needed equity finance while at the same time benefit from the superior returns that these SMEs can provide given a well-managed company.

Managers of the Fund have in-depth experience in SMEs operations and gaining more expertise with in-depth knowledge of markets and currently managing investments in Five SMEs with a Portfolio size in excess of Six Million Dollars ($6,000,000). The different missions, structures and investment strategies of the Fund (debt, equity, quasi-equity) also give the Fund several investment options depending on profile and targets of SMEs. Whilst the success of the Fund will depend very much on the execution of the Fund's investment plan, the Manager believes the macro-environment for sourcing and securing good deals in SMEs is positive.

♦ Fund Impact

Impact of SME Growth & Venture Capital Fund

As an impact investment Fund Manager, UCL will only invest in SMEs whose products or services and impacts are intrinsically linked. By this, any revenue generated by the investee should result in a corresponding positive social and/or environmental impact.

The Fund exhibits the following impact characteristics:

a. Addressing critical social problems in the area of Healthcare, Agribusiness, Technology and Infrastructure and Energy;
b. seeking to generate financial, social and environmental returns; and
c. Seeking to generate risk-adjusted returns for Investors through the delivery of specific and measurable targets.

♦ The Social Impact of SGF

a. Over 5,000 direct and indirect jobs will be created across the country;
b. Many people will have access to affordable health care delivery, food and housing;
c. It is envisaged that over 100,000 people will have access to sustainable energy sources;
d. Significant reduction in the risk of health issues associated with pollution and lack of access to healthcare
e. Significant reduction in environmental pollution in areas where investees work

♦ The Environmental Impact

Problem: Ghana is still confronted with serious climate and environmental challenges, despite the various interventions by the Environmental Protection Agency (EPA) and other private institutions. Exploitation of resources through subsistence agriculture and cutting fuel wood, by-products of business activities poses threat to the environment. Addressing these environmental and climate change require the need to alternative energy sources and best practices. SGF will invest in only SMEs that are committed to environmental protection to achieve the following impact:

a. Significant reduction in C02 emission;
b. 500,000 people to use low-carbon and low-cost energy solutions;
c. Increase generation of renewable energy annually; and
d. Increased use of post-consumer and industrial recycled material

e. The Fund will encourage good farming practices that will lead to more environmentally friendly production and increase climate resilience of Agribusiness companies of the Fund.

♦ Economic Impact

a. Significant reduction in poverty particularly in underserved areas in Ghana, Cote D'Ivoire and Liberia;
b. Significant increase in employment opportunities in the IT, infrastructure, Health and Agribusiness value chain;
c. The transfer of knowledge and skills by the Fund will enable the SMEs to build and expand their business in a sustainable manner.
d. SMEs will be able to boost turnover and assets, improve working conditions, and build long-term relationships with suppliers.

♦ Structure and Management

a. The Fund is structured as a closed-ended limited liability company, and registered as SME Growth & Venture Capital Fund Limited
b. Eligible investors will receive limited partnership interests in the company as per the Memorandum of Association of the company.
c. The Fund will be managed by UCL which holds Ghana Securities and Exchange Commission License. UCL will be responsible for the day to day control of the Fund and will have all necessary powers with respect to the investment management of the Fund.
d. Investment decisions will be made by an Investment Committee comprised of:
   i. Three Investment Reps of the Manager;
   ii. Two Investment Reps from limited Partners; and
   iii. Further detail about the Fund's structure and management is set out at Section 3.0

♦ Key Features of the Fund

The key features of the Fund are set out in the table below.

Fund Manager:	Union Capital Limited
Target fund size:	$40 million
First close:	$10 million

Minimum subscription:	$0.5 million, subject to the discretion of the Manager. No brokerage or stamp duty is payable on the issue of interests in the Fund.
Term of the Fund:	7 years, subject to extension by consent of Investors
Investment Period:	5 years
Target investments:	SMEs with strong earnings growth potential and management with passion to excel
Target portfolio size:	6 – 8 investments
Management Fee:	1.75% p.a.
Performance Fee:	40% of profit after the return of capital and payment of a hurdle rate to Investor

❖ Risks in West Africa SME Venture Capital and Growth Fund

The Fund is being established to offer Investors an opportunity for above average equity returns. The Manager intends to use experience and good practice procedures to minimise the risk associated with private equity investments, however, potential Investors should assess their appetite for such risks independently. Before making a decision to invest, investors should consider the appropriateness of an investment in the Fund, having regard to their relevant personal circumstances, as the Manager has not taken into account the investment objectives, financial situation or particular needs of any particular investor.

These risks include, but are not limited to the following:

a. The success of the Fund may be affected by many factors including changes in general economic and market conditions involving interest rates, availability of credit, inflation rates, currency movements and economic uncertainty;
b. The success of the Fund will depend on the availability of investment opportunities and the ability of the Manager to identify, purchase, improve and exit those investments. No assurance is provided that the Fund will fully invest its Committed Capital;
c. It is expected that individual investments by the Fund will not generally be sold until a number of years after the investment has been made, by which time the environment for liquidating the investment may have changed materially, with the corresponding risk of a lower return than expected;
d. Investors should be aware that the Fund is close ended with no rights of redemption.
e. Capital returns will be made as individual investments are excited by the Fund, but the timing of these returns is uncertain;

f. Many unlisted private equity entities have small management teams and are highly dependent on the skill and commitment of a small number of individuals. Whilst these key individuals will generally be incentivized to remain and perform throughout the time they are with the company, their leaving the Company may adversely affect the performance of the Fund's investment;
g. The Fund may be competing for investments with other parties. It is possible that competition for appropriate investment opportunities may increase, which may reduce the number of opportunities available and/or adversely affect the terms upon which such investments can be made;
h. The Fund may participate in a limited number of investments; as such the Fund's returns may be adversely affected by the poor performance of a relatively small number of individual investments.
i. Changes in legislation and Government policy, including, but not limited to taxation changes, accounting and the environment, may impact upon the operations, earnings and performance of the Fund, and or on the returns achieved for the Investors;
j. No assurance can be given that any target returns of the Fund will be achieved;
k. Investors should have the financial ability, appetite, and willingness to accept the risks and lack of liquidity associated with an investment in the Fund;
l. Investors will not receive any financial information issued by prospective investment companies which will be available to the Manager prior to the Fund making an investment, and will have no veto rights on investments made by the Fund; and
m. Investments made by the Fund may be made through intervening holding companies or other vehicles for regulatory or similar reasons. No assurance is given that any particular structure will be suitable for all Investors, and, in certain circumstances, such structures may lead to additional costs or reporting obligations for particular investors.

❖ Summary of Risk Analysis

Below is a detailed description of major inherent risks associated with investing in the SME Growth & Venture Capital Fund. It outlines our categorization the risk identified, their impact and how those risk would be mitigated by the Fund Manager. Prospective investors should carefully consider the risk factors set out below before making the decision whether or not to invest in the Fund. These are however not intended to be exhaustive.

Risk Type	Market for investment and liquidity Risk
Risk Definition	Liquidity risk is a financial risk that for a certain period of time a given financial asset, or security cannot be traded quickly enough in the market without impacting the market price.
Impact on Fund	The relatively low historical market liquidity in the region may inhibit the Fund's ability to value the Fund's investments or to sell them at desirable prices.
Strategies	The Fund Manager will use a combination of self-liquidating instruments. Investments will be made only when there are clear exit opportunities.

Table 5: Market for investment and Liquidity Risk – MEDIUM

Risk Type	Foreign Exchange Risk
Risk Definition	The risk of investment's value changing due to the changes in exchange rates.
Impact on portfolio	Distributions to investors of the Fund may be adversely affected by exchange rate volatilities.
Policy Objective	It is the policy of the company to ensure that foreign exchange volatilities do not affect the performance of the fund adversely.
Tools and Techniques	Foreign exchange analysis table; asset-liability maturity schedule and gap analysis.
Strategies:	The Fund Manager may hedge or swap foreign exchange with approval from the Board.
Supporting document and manuals	Risk management policy

Table 6: Foreign Exchange Risk – High

Risk Type	**Investment Portfolio Risk**
Risk Definition	This relates to investment decisions that have adverse implications on liquidity or cash management decisions.
Policy Objective	Investment portfolio risk management is to ensure that the Company does not suffer any loss in relation to liquidity or cash management as a result of mismatch in the terms of its investments. The Company will ensure that an appropriate mix is maintained to meet maturing obligations.
Tools and Techniques	Investment maturity term analysis; investment summary analysis schedules.
Strategies	▪ Adopt limits on investment proportions in line with cash flow projections / liquidity plan; ▪ Review contracts and other schedules in respect of investments. ▪ Maintain and undertake periodic update of due diligence on Investee Companies to facilitate continuous assessment of the safety and soundness of the Company's investment. ▪ Limit investment concentration with individual institutions.

Table 7: Investment Portfolio Risk– Low

Risk Type	**Country Risk**
Risk Definition	Political risk occurrences could destabilize the overall business climate in Ghana, which will affect Fund's ability to operate profitably and return money to investors. Ghana has however maintained more than a decade of democratic governance with peaceful transitions in power to opposing parties.
Policy Objective	The policy objective is to insulate the fund from risks specific to the country that in most case is from the political establishment i.e political risk.
Tools and Techniques	Investee promoters screening for PEPs, timing of investment and exit to political process like elections.

Strategies	▪ Adopt thorough screening process to ensure politically exposed persons businesses are not funded by the fund; ▪ Investing in areas that are not affected by political events like change in government. ▪ Timing entry and exit to election periods so as not to be affected by any change in government. ▪ Limit investment concentration within country.

Table 8: Country Risk – Ghana – Medium

Risk Type	**Country Risk**
Risk Definition	Political risk occurrences could destabilize the overall business climate in Cote D'Ivore, which will affect Fund's ability to operate profitably and return money to investors. The recently ended political conflict in the country is an indication of the countries susceptibility to conflict.
Policy Objective	The policy objective is to insulate the fund from risks specific to the country that in most case is from the political establishment i.e political risk.
Tools and Techniques	Investee promoters screening for PEPs, timing of investment and exit to political process like elections.
Strategies	▪ Adopt thorough screening process to ensure politically exposed persons businesses are not funded by the fund; ▪ Investing in areas that are not affected by political events like change in government. ▪ Timing entry and exit to election periods so as not to be affected by any change in government. ▪ Limit investment concentration within country to max of 30% of Fund size

Table 9: Country Risk – Cote D'ivoire – Medium

Risk Type	**Country Risk**
Risk Definition	Political risk occurrences could destabilize the overall business climate in Liberia, which will affect Fund's ability to operate profitably and return money to investors. Other Risks include outbreak of epidemics like the recent Ebola crisis in the country.
Policy Objective	The policy objective is to insulate the fund from risks specific to the country that in most case is from the political establishment i.e political risk.
Tools and Techniques	Investee promoters screening for PEPs, timing of investment

	and exit to political process like elections.
Strategies	▪ Adopt thorough screening process to ensure politically exposed persons businesses are not funded by the fund; ▪ Investing in areas that are not affected by political events like change in government. ▪ Timing entry and exit to election periods so as not to be affected by any change in government. ▪ Limit investment concentration within country to max of 30% of Fund size

Table 10: Country Risk – Liberia – HIGH

Risk Type	External Business Environment Risk
Risk Definition	Business environment risk refers to the inherent risks of the Fund’s business activity deriving from the external business environment. This includes competition and counter party or institutions in our value chain
Impact on Fund	Unfavorable external environment may affect the Fund ability to generate projected results.
Policy Objective	The Fund recognizes that the business environment is dynamic and the Fund Managers will develop strategies to ensure that its operations remain profitable and sustainable notwithstanding changes in the business environment.
Tools and Techniques	Competitor Assessment, Counter-Party Review, Porters 5 Forces Analysis, SWOT Analysis, PEST.
Strategies	The Fund Manager will diversify its portfolio across high growth potenital companies to mititage risk. Furthermore, the Manager intends to use conservative instruments to minimize liquidity risks while at the same time maintaining the option to participate in upside should the economic environment Change Company Board shall periodically (at least quarterly monitor budgeted and actual income statement, cash flow, portfolio report and capital budget.
Planning and Monitoring Indicators	Business Plan, Annual Budgets and Sensitivity Analysis Indicators; Management Reports.
Responsible for Monitoring	Board and Management.
Reports	Budget Review Reports; Market Research Reports; Product Development Reports.
Supporting Policy and Procedures Manual and Other Documents	Accounting Policies and Procedures Manual; Strategic Plan; Business Plan; Annual Budget.

Table 11: External Business Environment Risk - LOW

Risk Type	Lack of liquidity of investors' shares
Risk Definition	Liquidity refers to the extent to which a market, allows securities to be bought and sold at stable prices.
Impact on Fund	The relatively low market liquidity in Ghana may affect the affects the sales of investments at desirable prices.
Strategies:	The Fund will invest in entities which good exit options. It will also make use of self-liquidating instruments.

Table 12: Lack of Liquidity of Investors' Shares - MEDIUM

An Assessment of Risks in Venture Capital Financing

PART II

Chapter 6

Research Methodology

❖ Introduction

To achieve desired results for this study, there was the need to obtain information or data items within which to determine what could constitute potential risks in venture capital financing. This information or data items were collated from organizations that are practicing venture capital financing, including venture capitalist and the beneficiary investee organizations (SMEs). These organizations served as the respondents for the study. A carefully laid out plan was designed to aid in the systematic collection of required data items successfully. This chapter therefore describes the methodology and methods that were adopted to carry out the research.

❖ Research Strategy

Being a qualitative study, the concept of research philosophy adopted was the interpretivist approach. Interpretivism is an epistemology that advocates that it is necessary for the researcher to understand differences between humans in our role as social actors. This stance was appropriate as the study concerns social phenomenon of the roles, responsibilities, relationships etc. that were practiced by the actors engaged in venture capital financing (Denzin & Lincoln, 1994). This was to develop knowledge relating to the potential risks that were thought to be inherent in the roles and relationship among the players of venture capital financing (Hughes, 1994). With this philosophy the differences between the actors and their roles were understood and based on that, items thought to be risks affecting venture capital financing were identified and interpreted. This required that information be collated by eliciting respondents who are the actors of venture capital financing. The information collected were then analysed and interpreted in relation with the study, research questions and the objectives in order to identify the potential risks that are involved with the process of venture capital financing.

♦ Approach

Based on the research philosophy, the approach adopted to carry out the study included research design, population used, the sample and sampling procedures / techniques, Data collection tools / procedures and Data Analysis / presentation procedures for the study.

♦ Research Design

Research can be said to be very essential and key to the development of all sectors of societies; especially in business and academic (Neuman, 2007). However, and in spite of all its importance, there is no agreement on its definition. According to Yin (2003), the disagreement stems from the fact that every research has a different meaning to the researcher involved, as well as meaning differently to different people, institutions, agencies etc. According to (Amaratunga et al, 2002), however, from the various definitions available they all essentially agree that research is regarded as a process of enquiry and investigation, that is systematic and methodological; and finally that research leads to an expansion of knowledge. Research should always be conducted within the ambit of inquiry which depends on experience, hard facts, principles, laws, hypothesis, concepts, constructs etc (Amaratunga et al, 2002).

The research design adopted for the study was a survey. The design served as the architectural blueprint of the research project, and was linked to data collection and analysis activities to the research questions, and ensuring that the complete research agenda is addressed. It followed a systematic set of rules; a formal and logical operations. The survey design was developed to make the study credible, useful, and feasible, so that a high-quality applied research is achieved. The objective for this design was to elicit information from respondents with which the risks associated in venture capital financing could be determined. The essence of deploying the survey method in this research is to make sure that any later research or analysis of the attributes of the population sampled will be precise and also the findings and results being able to be generalized everywhere in the world. Another reason is because it is easier to administer and analyzed since the data collected involved asking SMEs structured and predefined questions. This research design was suitable because the study involved collecting information to gain insight into people or problems under study. It was fitting for data-gathering and analysis approach in which respondents were made to answer questions and / or responded to statements that were developed in advance. During the research, five activities were performed almost simultaneously; namely; selecting a design, choosing data collection approaches, inventorying resources, assessing the feasibility of executing the proposed approach, and determining trade-offs.

❖ Research Data Sources

The study used both primary and secondary sources of data to enable useful information for this study to be obtained.

♦ Secondary Source Of Data

For secondary data the researcher aims at finding out other studies related to the topic area such as journals, books, newspapers and any other document which allowed the study to gather relevant data for this study. Neuman (2007) argued that using secondary sources of data has an advantage for example it is less expensive compared to primary sources of data. Additionally, the authors emphasized that it helps the researcher to make a comparative analysis between the new data and the previous data whereby differences can be examined.

♦ Primary Sources of Data

The essence of any data collection method is the ability to unambiguously answer the research questions (Yin, 2003). With respect to the primary data sources, this study collected data from the Association of Ghana Industries (comprising SMEs who are the beneficiaries of the venture capital fund), Managers of venture capital firms as well as VCTF who is the supervisory body. This was facilitated through the administration of questionnaire designed purposely for this research.

❖ Target Population and Sample Size

It is required with any survey, that the target population be clearly defined (Yin, 2003). Target population can be defined as a complete set of individuals, cases/objects with some common observable characteristics of a particular nature distinct from other population. According to Neuman (2007), a population is a well-defined as a set of people, services, elements and events, group of things or households that are being investigated. Representativeness and reliability of results as well as time and resource restraints were considered in determining the target population. Therefore the target population of this study was the owners and employees of SMEs, Managers of the VCTF and VCFCs all based in the greater Accra Metropolis. The actors of venture capital financing were selected organizations that had commenced venture capital financing in which both the venture capital firm and the investee organizations are enjoying the support of each other.

♦ Sample Size

According to AGI (2014), its membership list made up of large, medium, small and micro enterprises is around 1140. Out of the 1140, almost half can be found in the Greater Accra Region alone and more than 80% of the half fall within the SMEs category. The researcher considered fifty (50) SMEs, as an appropriate sample size for the study to get the necessary or required information needed. The sample size is significant to create the representativeness of the sample for result generalizability (Sekeran, 2003). Kripanont (2007) proposed the following rules of thumb for determining the sample size: (i) sample sizes greater than 30 and less than 500 are suitable for most research; (ii) when samples are to be separated into sub-samples, a bare minimum sample size of 30 for each category is necessary; and (iii) in multivariate research, the sample size should be preferably 10 times or more as large as the number of variables in the research. Following this rule of thumb, the sample size of 50 SMEs in this research was considered sufficient. Again, this study contacted two Managers from the VCTF and two (2) each from venture capital organizations in Ghana; Bedrock Venture Capital Finance and Gold Venture Capital. The decision to contact two managers each from the venture capitalists was arrived at after discussing the objectives of the study with these institutions.

The two VCFCs were chosen based on their willingness to participate in the study as well as access to key decision makers in the organizations.

♦ Sampling Techniques

According to Babbie and Mouton (2006), a sample is the percentage or fraction of the population that answers the survey. It can be said that the reasons for undertaking surveys is to enable the researcher generalize from the sample to the population that the hypothesis regarding attitudes, behaviour among others can be made (Babbie and Mouton, 2006). Thus how respondents are selected for a particular study is very critical for the success or otherwise of the study. To operationalize the objectives of this study, two sampling techniques were employed. With respect to the managers from the Venture capital firms, the purposive sampling technique was adopted. The purposive sampling is a type of non-probability sampling in which the researcher selects the unit to be observed on the basis of the researcher’s judgments about which ones will be the most useful or representative (Yin, 2003). Thus the Managers of the venture capital funds contacted were solely based on their expert knowledge of their institutions’ venture capital financing risks, strategies, policies and issues. With respect to the SMEs, the author used the convenient sampling technique taking cognizance of its drawbacks and random sampling partly. This was used because it enabled the author to have reasonable control over the sample, use his judgment to select cases or units which best allowed him to answer the research questions and achieve the objectives of the study.

- ## Data Collection Tools / Procedures

The data collection tool used for the study was a questionnaire. The questionnaire was designed systematically with sequence of questions with the objective to obtain information on risk items in venture capital financing. As much as possible the questionnaire was designed with the respondents in mind and therefore was made clear, self-enumeration paper-based. Separate questionnaire were designed for each respective survey population. With respect to the SMEs, a self-administered was employed since it was easier for the respondents to fill and also cheaper as well. The questionnaire was set of questions that relate to potential risk items that may be inherent in the process of venture capital investment. Sampling error was anticipated because of the sample size of the survey population used for the study.

- ## Pre-Testing

Before fully administering the questionnaires to the target population, the researcher pre-tested the questionnaires on five SMEs as well as on one manager from VCTF. This was done to ensure that all relevant issues were identified and addressed.

- ## Data Analysis / Presentation

Data collected was analysed and interpreted by summarising the data and interpreting their meaning in a way that provided clear answers to questions that initiated the survey. Data analysis was designed to relate to the survey results to the questions and issues identified by the statement of objectives. The data was analyzed in both descriptive and quantitative forms such using frequency tables, percentages etc. The datasets so collected was then coded and translated to an SPSS (Statistical Package for Social Science) and Microsoft Excel. SPSS especially is a versatile computer package that has the ability to perform a wide variety of statistical procedures (Yin, 2003).

Chapter 7

Data Analysis and Interpretation

❖ Demographic Information of the Respondents (SME'S and VCTFS)

This section presents the findings in relation to the demographic characteristics of the respondents.

♦ Gender

It was found as shown in Figure 8 that most of the respondents were females. In fact out of a total of fifty respondents, thirty four (68%) of them were females while the remaining sixteen (32%) of the respondents were males. This finding implies that more women SME owner managers participated in the study. It does not necessarily mean that there are more female SME owner managers than males.

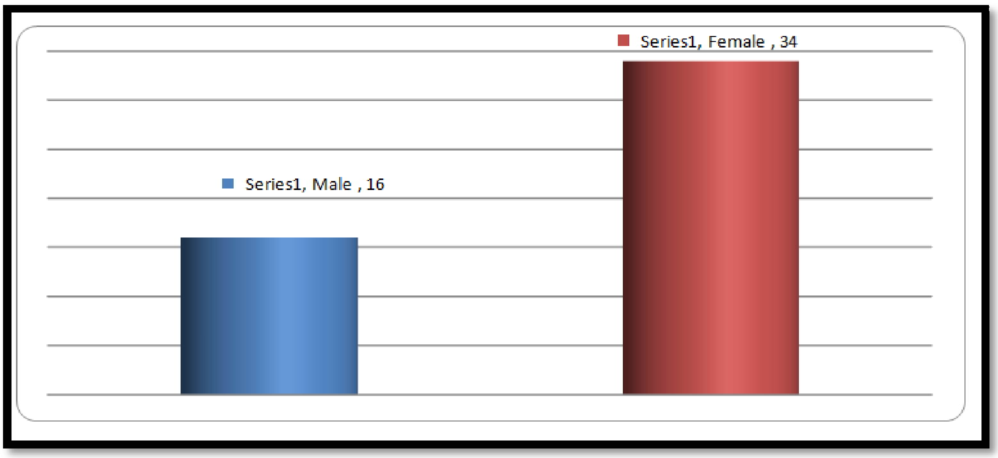

Figure 8: Showing gender of Respondents
Source: Field Research Data 2015

♦ Age of Respondents

It was also found that most of the respondents had their ages falling between 25 and 34 and 35-44 years. As can be seen in Table 13, seventeen (34.6%) of the respondents fell between the 25 -34 age bracket while ten (19.2%) of the respondents fell between the 35-44 age bracket. It was also found that an equal number of respondents, eight (15.4%) had their ages falling between 45 and 54 years; 55 and 64 years; and above 65 years respectively. This finding shows that most of the respondents were relatively young and this makes sense since the most productive age falls between 25 and 44. This finding is therefore not surprising.

Age	Frequency	Percentage
16-24	0	0.0%
25-34	17	34.6%
35-44	10	19.2%
45-54	8	15.4%
55-64	8	15.4%
65 above	8	15.4%
Total	50.00	100%

Table 13: Response on age of Respondent's

Source: Field Research Data

♦ Educational Background

It was interesting to find as shown in Table 14 that most of the respondents had a B.Sc/HND or a professional qualification. In fact, twenty three (45.8%) of the respondents had B.Sc/HND certificates while another twenty three (45.8%) of the respondents had professional qualifications. None of the respondents were uneducated. Two (4.2%) had SSCE qualification and below. Another two (4.2%) respondents had an MSc/MBA qualification (Table 14). This finding implies that the respondents are well educated and therefore were in a better position to respond and give accurate information in relation to the questions posed. This again implies that the researcher collected accurate responses which all things being equal made the findings of the study a valid one. Furthermore, this finding implies that more and more graduates are setting up businesses in the Ghanaian informal and private sector and as pointed out by Luigi and Tullio (2005), there is a high correlation between educational background and the performance of SMEs. According to the authors, all things being equal, the higher the educational background of SME owner/Managers, the higher the chances of succeeding as entrepreneurs. This is because being highly educated makes it possible for SMEs owners to understand their operations and more importantly, their ability to understand financial management issues such as working capital management and this case how to finance their operations (Sletten and Hulas, 1998).

Academic and Professional Qualification	Frequency	Percentage
SSCE and below	2	4.2%
B.Sc/HND	23	45.8%
M Sc/MBA	2	4.2%
Professional	23	45.8%
Uneducated	0	0.0%
Total	50.00	100%

Table 14: Showing Qualification of Respondents
Source: Field Research Data 2015

♦ Business Form

It was also found that thirty (60%) of the respondents stated that their businesses have been registered as sole proprietorships, eighteen (36%) of the respondents stated that their businesses have been registered as partnerships while only two (4%) respondents indicated that that their business have been registered as was other than above mentioned (Table 15). This finding implies that most of the SMEs contacted are properly registered and more importantly, suggest that most of the firms are truly SMEs.

Form of Business	Frequency	Percentage
Not Registered	0	0.0%
Sole Proprietorship	30	60.0%
Partnership	18	36.0%
Other	2	4.0%
Total	**50.00**	**100%**

Table 15: Showing Forms of Business of Respondents
Source: Field Research Data 2015

♦ Nature of Business

It was further found as shown in Table 16 that twenty seven (54%) of the respondents mentioned that they were in the business of providing services; eight (16%) of the respondents stated that their business activity was related to power; four (8%) of the respondents were into mining while four (8%) respondents were into the business of construction. However, seven (14%) of the respondents were into the business of manufacturing (Table 16). This finding implies that the researcher contacted SMEs from different segments of the Ghanaian economy and therefore makes the findings of this study more representative.

Nature of Business	Frequency	Percentage
Manufacturing	7	14.0%
Construction	4	8.0%
Mining	4	8.0%
Power	8	16.0%
Services	27	54.0%
Total	50.00	100%

Table 16: Nature of Respondent Business
Source: Field Research Data 2015

♦ Annual Turnover

It was moreover found that as many as forty four (87.5%) of the respondents had their annual turnover of business being GHc 50,000 or higher. None of the respondents had their business turnover below GHc 10,000. Moreover, none of the respondents had their business turnover falling between GHc 20,000 and GHc 50,000. Again, six (12.5%) respondents indicated that their business turnover falls between GHc 10,000 and Ghc 20,000 (Table 4.5).

Annual Turnover of Business	Frequency	Percentage
Below 10,000	0	0.0%
10,000 to 20,000	6	12.5%
20,001 to 30,000	0	0.0%
30,001 to 40,000	0	0.0%
41,001 to 50,000	0	0.0%
50,000 or higher	44	87.5%
Total	**50.00**	**100%**

Table 4.5: Showing the Annual Turnover of business
Source: Field Research Data 2015

♦ Number of Employees

As can also be seen in Table 17, sixteen (32%) respondents have between 6 and 10 employees; ten (20%) of the respondents have between 11 and 15 employees; two (4%) have between 15 and 20 employees while twelve (24%) of the respondents have employed more than twenty people. This finding implies that most of the SMEs have more than ten employees and therefore not supporting what Osei et al. (1993) reported to the effect that most Ghanaian SMEs employ less than six employees. This finding also implies that the operational capacities of the SMEs contacted are relatively bigger than typical micro scale enterprises.

Number of Employees	Frequency	Percentage
Below 5	10	20.0%
6 to 10	16	32.0%
11 to 15	10	20.0%
15 to 20	2	4.0%
20 or higher	12	24.0%
Total	**50.00**	**100%**

Table 17: Response on Number of Employees
Source: Field Research Data 2015

♦ Record Keeping

It was encouraging to find that only a few of the respondents kept their records improperly. As can be seen in Table 14, as many as forty eight (96%) of the respondents mentioned that they keep their records properly while only two (4%) of the respondents mentioned that they do not keep their records properly. This finding is not surprising considering that most of the respondents are well educated and they will therefore be more likely to keep proper records of their operations so as to ensure that their businesses run smoothly.

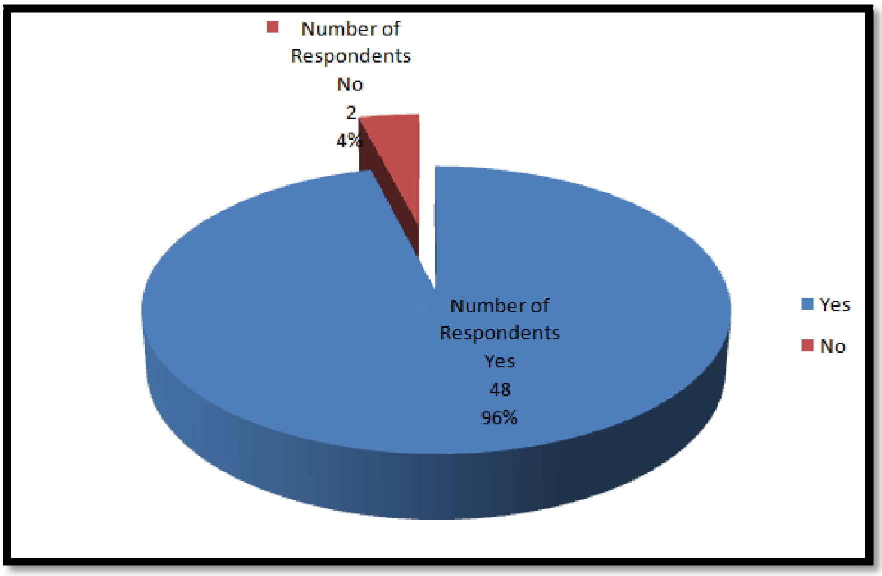

Figure 9: Displaying Response on Record Keeping
Source: Field Research Data 2015

♦ Financial Statement

It was similarly found that most of the respondents prepare yearly financial statements. As can be seen in Figure 10, thirty one (62.5%) of the respondents stated that they prepare yearly financial statements while nineteen (37.5%) of the respondents stated that they did not prepare yearly financial statements. This finding implies that most of the respondents appreciate the importance of preparing financial statements since it is crucial to their survival and success. In fact this find contradicts what authors such as Chandra (2008) and Padachi and Howorth (2013) found to the effect that most SMEs fail to keep financial records essentially because of the lack of financial management skills and also in partly due to their inability or refusal to employ qualified accountants.

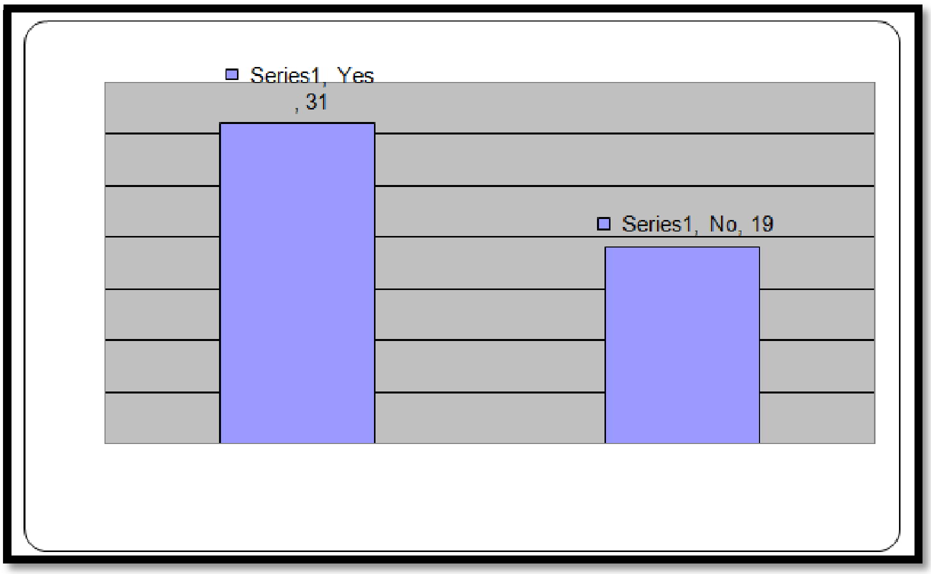

Figure 10: Displaying Response on Preparing Yearly Financial Statements
Source: Field Research Data 2015

♦ Business Plan

It was unfortunately found that most of the respondents did not have a business plan. As shown in Figure 11, twenty eight (55.6%) of the respondents stated that they did not have business plans guiding their operations while twenty two (44.4%) of the respondents said they have business plans. This finding is rather unfortunate because business plans are highly indispensable documents that direct firms as to what to do at any point in time towards the attainment of stated objectives. This finding is quite disturbing because failing to develop a business plan that stipulates exactly how objectives will be realized implies some of the SMEs contacted are operating without any meaningful directions and goals.

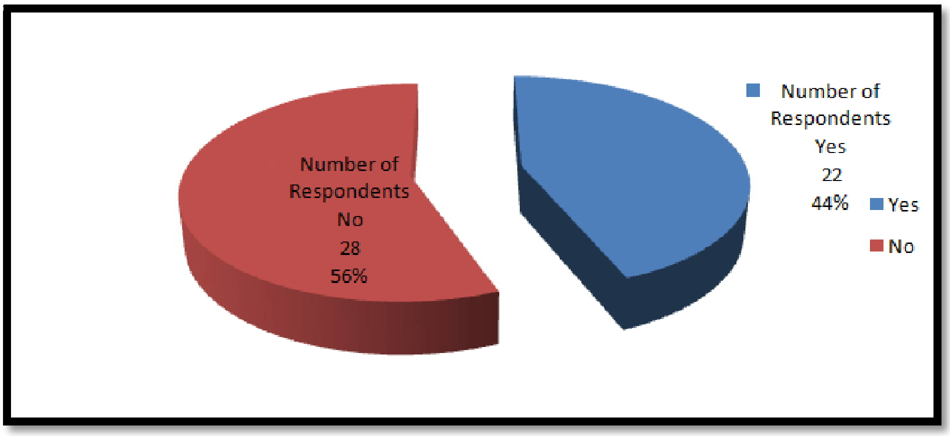

Figure 11: Displaying Respondents with business plans
Source: Field Research Data 2015

❖ Awareness & Usage of Venture Capital Financing

This section analyzes and presents the findings in relation to data collected from the SMEs.

♦ Means of Obtaining Finance

It was found that most of the respondents obtained financing via personal savings. As shown in Table 18, twenty five (50%) of the respondents obtained financing through personal savings; seventeen (34%) of the respondents obtained financing from friends and family; two (4%) of the respondents got financing from NGO's while six (12%) got financing from bank loans. This finding implies that most of the respondents started and indeed finance their operations from their own resources (savings) without seeking for financing from other financial institutions and or agencies. This finding supports what Padachi and Howorth (2013) found to the effect that most SMEs start their businesses from their personal savings due to the fact that most financial institutions and agencies tend to shy away from start-ups due to their high failure rates.

Means of Obtaining Financial Support	Frequency	Percentage
Personal savings	25	50.0%
Assistance from friends and family	17	34.0%
NGO's	2	4.0%
Bank loans	6	12.0%
Others	0	0.0%
Total	**50.00**	**100%**

Table 18: Showing means of obtaining financial support

Source: Field Research Data 2015

❖ Negotiations For Venture Capital Financing

It was interesting to find as shown in Table 19 that half of the respondents have ever negotiated for financing through the venture capital before. It was specifically found that forty-five (90.0%) of the respondents stated that they have negotiated for financing through venture capital while the remaining five (5.0%) of the respondents claimed they have never negotiated for financing through venture capital before. This finding is quite interesting and points to the fact that venture capital financing is at least on the shopping list of SMEs when seeking for finance. Even though this response is encouraging, it still shows that there is more room for improvement and that venture capital trust firms must do more in terms of advertising their operations and making their operations known to the Ghanaian SMEs.

Ever negotiated for Venture Capital Financing	Frequency	Percentage
Yes	45	90.0%
No	5	10.0%
Total	**50.00**	**100%**

Table 19: Response on Ever Negotiated for Venture Capital Financing
Source: Field Research Data 2015

♦ Reasons for Negotiating For Venture Capital Financing

The reasons why the respondents negotiated for venture capital financing were found to include reasonable terms and conditions, cheaper compared to other financing forms, technical assistance and absence of collateral.

i. **To Expand My Operation:** It was found as shown in Table 20 that thirty-one (62.5%) and nineteen (37.5%) of the respondents agreed and strongly agreed respectively that they negotiated for venture capital financing in order to expand their business operations. This finding implies that it gets to a certain point in time when SMEs have to turn to external sources of finance in order to expand their operations (Delmar et al. 2003). This finding implies that these respondents were very much aware of the various financing options available to them but opted for venture capital financing due to its ease of execution and management.

ii. **Reasonable Terms Compared To Banks/Cheaper Prices:** As shown in Table 20 for instance, seventeen (33.3%) and thirty-three (66.7%) of the respondents agreed and strongly agreed respectively that the terms of venture capital financing was reasonable so they negotiated for it. It was in the same vein found that fourteen (28.6%) and thirty-six (71.4%) of the respondents agreed and strongly agreed respectively that the price of venture is cheaper compared to other forms of financing. This finding implies that the respondents were of the view that venture capital financing is relatively cheaper to execute than say, seeking for assistance from banks where the terms and conditions can be frustrating and intimidating. As pointed out by Gompers and Lerner (2001), venture capital financing is relatively easier to operate and when properly explained to prospects, there is a higher chance of succeeding and it is also less stressful.

iii. **Ability to Get Other Technical Assistance:** It was also found that another reason for negotiating for venture capital financing by the SMEs had to do with the ability to get other technical assistance. It was found as shown in Table 20 that nine (18.2%) and forty-one (81.8%) of the respondents agreed and strongly agreed respectively that the ability to get other technical assistance in addition to the financial assistance was another reason for negotiating for financial assistance. This finding is very significant because even though financial assistance is very crucial to the survival of SMEs, getting access to technical assistance in the form of training, business opportunity identification and execution, designing sales and marketing plans as well as ICT support are equally important to the survival of SMEs. As pointed out by authors such as Garcia (2005) and Pansiri and Temtime (2008), most of SMEs fail to manage their business operations successfully because they lack the managerial acumen. This means that most SMEs are constantly in need of technical assistance which in order to manage their operations efficiently. Venture capitalists not only provide financial assistance but also augment it with technical assistance and this obviously increases the success and survival of SMEs all things being equal.

iv. **Absence of Collateral Requirement from Banks:** It was also found as shown in Table 20 that six (12.5%) and forty-four (87.5%) of the respondents agreed and strongly agreed respectively that the absence of collateral requirement when negotiation for venture capital funding made venture capital financing interesting to them. This finding is interesting and also educative in the sense that most financial institutions ask for collaterals often in the form of landed properties) before advancing loans to SMEs. As explained by Richard (2011), there is the challenge of information asymmetry especially when it comes to the financing of SMEs and to safeguard their funds, most financial institutions ask for collateral so that they have something to fall on when the SMEs default in paying back loans. This practice unfortunately adversely affects the ability of some SMEs to access funding from these financial institutions. Thus, these SMEs see venture capital financing as the right instrument to be used in expanding their operations (Gompers and Lerner, 2001).

Variable	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Total
To expand my operation	0(0.0%)	0(0.0%)	0(0.0%)	31(62.5%)	19(37.5%)	5 (100%)
Because their terms were more reasonable compared to banks	0(0.0%)	0(0.0%)	0(0.0%)	17(33.3%)	33(66.7%)	50(100%)
Because I believe it is the only way out for my business	0(0.0%)	0(0.0%)	0(0.0%)	31(62.5%)	19(37.5%)	50(100%)
The price of venture is cheaper compared to other financing forms	0(0.0%)	0(0.0%)	0(0.0%)	14(28.6%)	36(71.4%)	50(100%)
Ability to get other technical assistance to the financial assistance	0(0.0%)	0(0.0%)	0(0.0%)	9(18.2%)	41(81.8%)	50(100%)
Absence of collateral requirement	0(0.0%)	0(0.0%)	0(0.0%)	6(12.5%)	44(87.5%)	50(100%)

Table 20: Showing reasons for Negotiation for Venture Capital Financing
Source: Field Research Data 2015

♦ *Reasons for Not Negotiating For Venture Capital Financing*

Few reasons were found from the five respondents who have never negotiated for venture capital financing. The main reasons were found to be not being aware of the existence of venture capital fund; nobody has ever explained how venture capital works to them, and that they thought the procedures of venture capital was too complex. Some of the respondents said they did not want anybody to own part of their business while another said he could easily get access to a loan from a bank. These findings are quite serious and essentially point to the failure on the part of Ghanaian venture capitalist to educate SMEs on the importance and relevance of venture capital financing. These findings clearly shows that some Ghanaian firms are ignorant about the operations and dynamics of venture capital and hence the refusal of some SMEs to negotiate for funding from them.

As pointed out by Guiso et al. (2004), creating awareness about financial products and instruments tends to clear all doubts that customers have about such instruments, and that once information about the importance of these instruments are effectively communicated, their adoption tends to be high. There is therefore the need for Ghanaian venture capitalist to educate SMEs to double their efforts with respect to training and educating SMEs on the concept of venture capital financing since it is one viable means of assisting SMEs to expand their operations (Wonglimpiyarat, 2005).

♦ Reasons for Successful Negotiation of Venture Capital Financing

It was found that out of the 45 respondents who have ever negotiated for venture capital financing, forty (88.89%) were successful. See Figure 4.10 for details.

Ever negotiated for Venture Capital Financing	Frequency	Percentage
Yes	40	88.90%
No	5	11.10%
Total	45.00	100%

Table 21: Successful negotiations for Venture Capital Financing
Source: Field Research Data 2015

Several reasons were attributed to the successful negotiation of the venture capital financing. Most (87.5%) of the respondents agreed that their successfully signing up of Venture Capital Financing contract was because of the clear and straight forward ownership structure of their businesses (Table 22). It was also found that twenty (50%) respondents each agreed and strongly agreed respectively that their number of years in business contributed to their success in negotiating for venture capital financing (Table 22). Again, twenty-three (57.5%) and seventeen (42.5%) agreed and strongly agreed respectively that the good performance of their business in the past as a factor while another 87.5% of the respondents agreed that their good track record of loan payments as the reason for their success. Other factors the respondents largely agreed on were satisfactory reputation and trustworthiness (75%); good business plan (75%) and high business prospects (Table 22).

These findings imply that access to venture capital financing requires having proper business structures, high future prospects, and clear and straight forward ownership structure of business, strong entrepreneurship characteristics, good business plan, satisfactory reputation and trustworthiness, good track record of loan repayments and good performance of the business. These findings actually confirms what Wonglimpiyarat (2005) and Fiet and Fraser (1994) pointed out to the effect that financing start-ups and small scale enterprises is a risky undertaking and to ensure that funds are not lost, certain criteria, conditions and rules must be set and strictly followed in qualifying venture capital applicants.

Variable	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree	Total
Number of years in business	0(0.0%)	0(0.0%)	0(0.0%)	20 (50%)	20 (50%)	40 (100%)
Because the prospects of my business is high	0(0.0%)	0(0.0%)	0(0.0%)	20 (50%)	20 (50%)	40 (100%)
Because of the clear and straight forward ownership structure of my business	0(0.0%)	0(0.0%)	0(0.0%)	35 (87.5%)	5 (12.5%)	40 (100%)
Strong entrepreneurship characteristics	0(0.0%)	0(0.0%)	0(0.0%)	30 (75%)	10 (25%)	40 (100%)
Good business plan	0(0.0%)	0(0.0%)	0(0.0%)	30 (75%)	10 (25%)	40 (100%)
Satisfactory reputation and trustworthiness	0(0.0%)	0(0.0%)	0(0.0%)	30 (75%)	10 (25%)	40 (100%)
Good track record of loan repayments	0(0.0%)	0(0.0%)	0(0.0%)	35 (87.5%)	5 (12.5%)	40 (100%)
Because of the good performance of my business in the past	0(0.0%)	0(0.0%)	0(0.0%)	23 (57.5%)	17 (42.5%)	40 (100%)
Because of my high educational background	0(0.0%)	0(0.0%)	0(0.0%)	23 (57.5%)	17 (42.5%)	40 (100%)

Table 22: Showing Reasons for Successfully Signing Up for Venture Capital Financing
Source: Field Research Data 2015

❖ Benefits of Signing Up

It was found that all the forty respondents who successfully negotiated for venture capital financing agreed that they have benefited from this arrangement. As shown in Table 23, most (87.5) of the respondents agreed that venture capital financing has enabled their business to expand. It was also found that 85% of the respondents either agreed or strongly agreed that their business has become profitable as a result of securing funds from venture capitalists while another 75% of the respondents either agreed or strongly agreed that they have been able to take advantage of business opportunities quickly as a result of having access to venture capital funding (Table 23). It was further found as shown in Table 23 that 67.5% of the respondents claimed their businesses have reached greater heights because of the technical business advisory services they obtained from venture capitalists while all of them either agreed or strongly agreed that overall, venture capital financing have been beneficial to their businesses (Table 23).

These findings imply that when effectively executed, venture capital can be a viable source of expanding the operations of SMEs and more importantly, these findings have shown that venture capital financing is needed by SMEs. This therefore puts the onus on venture capitalist to put in more efforts in terms of making their activities known and convincing more SMEs to join them. Considering that the traditional financial institutions still insist on taking collateral and other requirements, venture capital financing can be a popular means by which SMEs can secure vital funds needed to expand their operations.

Variable	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**	**Total**
Venture capital financing has enabled my business to expand	0(0.0%)	0(0.0%)	0(0.0%)	35 (87.5%)	5 (12.5%)	40 (100%)
Venture capital financing has enabled my business to be profitable	3(7.5%)	3(7.5%)	0(0.0%)	20 (50%)	14(35%)	40 (100%)
Venture capital financing has enabled me take advantage of business opportunities quickly	0(0.0%)	5(12.5%)	5(12.5%)	20 (50%)	10(25%)	40 (100%)
Venture capital financing has enabled me employ more workers	5(12.5%)	3(7.5%)	3(7.5%)	19(47.5%)	10(25%)	40 (100%)
The technical and business advisory services has enabled my business to reach higher heights	3(7.5%)	5(12.5%)	5(12.5%)	13(32.5%)	14(35%)	40 (100%)
Overall, venture capital financing has been beneficial to my business	0(0.0%)	0(0.0%)	0(0.0%)	35 (87.5%)	5 (12.5%)	40 (100%)

Table 23: Showing Agreement and Disagreement on Venture Capital Financing
Source: Field Research Data 2015

♦ Failure to sign up for Venture Capital Financing

Most of the five respondents who were not successful gave the following reasons for their failure to negotiate for venture capital financing. The among others mentioned

1. short period in business,
2. not having high business prospects,
3. confusing ownership,
4. weak entrepreneurial characteristics and
5. Low educational background.

❖ Information on Processes and Procedures of Venture Capital Financing

It was interesting to find as shown in Table 24 that most of the respondents noted that if processes and procedures for negotiating for Venture Capital is illuminated, they will opt for it. Thirty three (66.7%) of the respondents stated that if processes and procedures for negotiating for venture capital financing is well explained to them and will consider negotiating for Venture Capital Financing in future while seventeen (33.3%) of the respondents did not agree on the fact (Table 24). These findings imply that venture capitalists need to simplify their processes and procedures so as to be able to attract more SMEs.

Process And Procedures Well Explained	Frequency	Percentage
Yes	33	66.7%
No	17	33.3%
Total	50.00	100%

Table 24: Response on Process and Procedures
Source: Field Research Data 2015

❖ The Risks Involved In Venture Capital Financing In Ghana

This section presented the findings in relation to the risks associated with venture capital financing. It was found that there are several risks associated with financing operations of SME customers. According to the two venture capital firms contacted, the main risks of financing SMEs are;

♦ Weak Regulatory Environment/Legal Documentation

Another challenge found that threatens the operations of the venture capitalists have to do with the seemingly weak regulatory environment that venture capitalists operate in. This because the industry is relatively new and still undergoing changes and this makes it difficult for operators to effectively operate. As explained by one of the respondents, "*The activities of operators are currently being overseen by the Security and Exchange Commission* *of Ghana which is also responsible for other financial institutions and because they do not have a recognized independent body through which they will direct all their grievances, issues, concerns and challenges, they believe they lack guidance, direction effective policy formulation and control*". Other bodies such as the insurance industry have the NIC while the banks have the Bank of Ghana (BoG). There is therefore the need for an independent body to effectively oversee the operations of the industry if their objectives of offering alternative sources of capital needed for financing business activities of entrepreneurs are to be realized.

♦ Inadequate Qualified Personnel

It was found that another challenge or risk confronting the venture capital firms is the lack of qualified staff who have the experience and training to handle all issues pertaining to their operations. Venture capital is still in its developmental stages and has therefore not had the time to grow a rich pool of personnel that the industry can draw from such as existing in other industries such as banking and finance. According to one of the respondents, "*what their firm has been doing is taking people from the banking industry with requisite experience in credit risk management and after which they are trained in the actual operations of venture capital. This unfortunately takes time and most also leave for better offers and therefore having to restart the whole process gain"*. This is a challenge that must be addressed urgently since venture capitalist play important roles in facilitating the expansion of small scale enterprises. With the right pool of qualified personnel, the effects of venture capitalists can be far reaching. More importantly, deals can be structured really faster and by so doing, making their operations more attractive to their target market.

♦ Wrong Public Perception

Another major challenge that was found affect the operations of the VCs is the wrong notion by some Ghanaians that the funds given to venture capital firms are for the government and for that matter, it is free money to be shared by all without paying. This mentality and wrong thought sometimes leads entrepreneurs going to political heads to coerce venture capital operators to disburse funds to cronies and party faithful even when they do not have legitimate and qualified business plans and proposals. To dispel this wrong notion and change peoples' perceptions, the VC firms tend to spend much of their precious time explaining to Ghanaians what venture capital funding is all about. This finding further reiterates the fact that the venture capital industry has not done enough in terms of educating the public on their objectives and *modus operandi.* As explained by one of the fund managers, most of the entrepreneurs that come to them are always looking for loans and most of their enquiries and questions and concerns are geared towards issues such as the rate of interest charged, the terms of the loans, whether collaterals are needed.

Obviously, these questions immediately lead to the conclusion that more education is needed since venture capital is definitely not about debt financing but equity financing.

As explained by one of the Managers of the venture capital fund operators contacted "*most of the entrepreneurs are not ready for sharing their businesses with investors and are mostly interested in interest free loans or some form of government subventions that are more flexible in terms of payments".*

♦ SME'S / Investees Not Having Proper Structures

It was found from the respondents that another major challenge of venture capitalist in the country has to do with the lack of proper structures in investees' firms and this makes it difficult stepping in to assisting to have efficient management and operational structures. These entrepreneurs due to the rigid structure of requirements from venture capitalists find it difficult negotiation for funding successfully. As lamented by one of the respondents "*typical owner managers do not have proper accounting systems, take money regularly from their businesses without accounting to anybody, do not employ qualified accountants but rather employ family members with low qualifications and who frequently mismanage funds. Because of these unprofessional practices, investee firms always try to resist VCs whose duty it is to identify and block these loopholes and these degenerates into serious arguments and altercations sometimes*". This finding implies that internal operations and management structures of SMEs sometimes make it difficult for SMEs to get assistance from financiers such as VCs. This finding actually echoes what Paramasivan and Subramanian (2009) found to the effect that most SMEs lack financial management discipline and that most are careless and reckless when it comes to the application of prudent financial management practices.

♦ Exit Challenges

Another nagging challenge making the operations of VCs very challenging and also risky has to do with how to exit from the deal successfully without disrupting operations of the investee's venture. As pointed out by Megginson (2002), a typical practice of venture capitalists is to structure their deals in such a manner that facilitates exiting from the deal profitably. This means that VCs must pay closer attention on explaining to investees how the exit will be done and when it will be done to forestall future misunderstanding. However, the respondents pointed out that there are few exiting options or venues available in Ghana currently and this tends to create problems for all parties to the deal. As mentioned by or the respondents "*Ghana's IPO space is still not vibrant and dynamic enough and that the pre-IPO processes and procedures as stipulated by the Ghana Stock Exchange prevents many VCs from using IPOs an exit option. This unfortunately does not make their* *operations profitable and rewarding enough*". This means that the lack of exit options available to VCs is a major risk of VCs in Ghana. Another respondent added that even there are options available (where the VCs have the sole right of selling their investments to the investees), most of the investees do not usually have the financially resources to buy back VCs' share. It was in the same vein found that investees seen exits as bad omens and therefore employ all manner of strategies to thwart the efforts of VCs from exiting and this tends to prevent them from moving on to sign new investees.

♦ Poor/Weak Micro-Economic Environment

It was found from the respondents from the two VCTFs that the current economic conditions in the country does not auger well for venture capital financing. This is because major micro economic indices such as fluctuations of the Ghanaian currency and high interest rates make the operations of venture capitalists very challenging. This is especially due to the fact that the unstable exchange rates makes their operations unprofitable and unsustainable because most of their business operations are based on the cedi which is a local currency while the investment funding or source o funds are obtained essentially in foreign currencies from investors outside the country. This makes repayment difficult since the cedi is too weak against the major foreign currencies and the venture capital firms have to commit more funds in cedi value in order to repay investors in strong currencies such as the dollar and the euro. It was further found with respect to the interest rate given to customers that this tends to rather higher than what competitors offer and this tends to make their offerings unattractive to their customers.

♦ Poor Keeping of Records

Record keeping was also found to be a major challenge for VCs in their dealings with investee firms. It was found that most of the investee firms do not keeper proper records of their operations and this makes the evaluation of the businesses very difficult and therefore forcing the VCs to resort to other methods of arriving at fair values of their operations. It was in the same vein found that divulging information for evaluation purposes was very difficult for some investee firms. As was vividly captured by one of the respondents "*From afar, you be inclined into believing that a particular firm is doing well and in fact, well-structured. However, when you sit with them to discuss their books and analyze their operations, it is then you realize that they do not manage their activities very and things are rather done haphazardly and this makes accurate evaluations a very difficult one*". This finding is not surprising but rather confirms what Megginson (2002) found to the effect that most SMEs do not have the proper structure of keeping records, forecasting their operations. This finding further point to the fact that most SMEs do not strategically plan their operations but mostly react to what pertains in the business environment and by so doing, failing to take advantage of business opportunities.

♦ Investee Firms' Owners Attitude about Control of Business

Most entrepreneurs according to the respondents are fixated on owning everything and are unwilling to share a certain percentage of their businesses to anybody and the VCs included. This tends to make negotiations very difficult since giving a certain portion of their business to VCs is regarded as "inviting outsiders to take control" and this according to the respondents makes the SMEs lose face in society. According to one respondent, "*Most of the investee firms are so pre-occupied with the fact of sharing power and control of their businesses that they fail to see the bigger picture of being part of something bigger compared owning 100% of a tiny business*".

♦ SMES Challenges of Dealing with Venture Capital Firms

This study also found that the SMEs have their own challenges in dealing the VCs. As illustrated in Table 25, the main challenges of VC financing access are as follows:

1. The process of venture capital financing is too slow
2. The process of venture capital financing is too Complicated
3. Fear of losing my business to venture capitalists
4. Risks of not being able to meet contract terms
5. The lack of audited financial statement impedes access to venture capital financing
6. Inadequate flow of information freely between your enterprise and the venture capital organization
7. Lack of quality business plan

Variable	**Strongly Disagree**	**Disagree**	**Neutral**	**Agree**	**Strongly Agree**	**Total**
The process of venture capital financing is too slow	14(28.6%)	2(4.8%)	7(14.3%)	10(19.0%)	17(33.3%)	50(100%)
The process of venture capital financing is too Complicated	6(12.9%)	6(12.9%)	3(6.5%)	19(38.7%)	15(29.0%)	50(100%)
Fear of losing my business to venture capitalists	2(4.2%)	10(20.8%)	2(4.2%)	25(50%)	10(20.8%)	50(100%)
Risks of not being able to meet	0(0.0%)	7(13.0%)	7(13.0%)	22(43.5%)	15(30.4%)	50(100%)

contract terms						
The lack of audited financial statement impedes access to venture capital financing	0(0.0%)	4(8.7%)	9(17.4%)	26(52.2%)	11(21.7%)	50(100%)
Inadequate flow of information freely between your enterprise and the venture capital organization	0(0.0%)	2(4.3%)	4(8.7%)	24(47.8%)	20(39.1%)	50(100%)
The exit method of sales or IPO can sometimes be unfair	0(0.0%)	0(0.0%)	8(15.0)	28(55.0%)	15(30%)	50(100%)

Table 25: Showing Challenges of Venture Capital Financing Access
Source: Field Research Data 2015

❖ The Effects of the Identified Challenges/Risks

This section presented the findings in relation to the second objective of identifying the effects of the challenges on the operations of VCs in Ghana. It was found that the challenges as identified in section 4.3 have major impact on the ability of the VCs to effectively negotiate funding for investee firms. The two main impacts of the challenges were found to be the following:

❖ Lack of Motivation on The Part of Investors to Invest At Start-Up

It was found that even though some SMEs are eager to negotiate for venture capital funding, the VCs have been very careful in terms of how many they are sign each year. This is primarily because of several factors such as the lack qualified personnel, poor micro-economic environment, SME related challenges and the lack of suitable exit options. All these challenges have therefore culminated in the unwillingness of VCs to take-on more investee firms than they would have wanted to.

As pointed out by the respondents, venture capital funding is quite a risky business since venture capitalist invest in start-ups and due to information asymmetry, they can easily incur huge losses if due diligence and effective underwriting skills are not employed. As pointed out by Green (2003), most start-ups hardly survive their first year of operations. This therefore puts pressure on financial or lending institutions such as VCs to find creative means of overcoming the problem of information asymmetry before taking on board new investee firms. Unfortunately, going behind the scenes to find out all about the operations, profitability and truthfulness about information and data supplied by investee firms can be strenuous, time-consuming and expensive.

This finding is significant because as observed by Green (2003), the problem of asymmetric information is more severe for small businesses than for larger ones because of lower information standards and the greater variability of risk; small, privately owned firms face no legal reporting requirements and are more vulnerable than large firms. Thus the absence of audited financial statements increases the likelihood of non-disclosure of vital information such as the viability and profitability of the operations of the SMEs. This as pointed out buy the respondents therefore forces VCs on the number of SMEs that benefit from venture capital funding.

❖ Limits SME'S Access to Venture Capital Funding

It was also found that the several challenges affects ability of VCs to extend their operations to other parts of the country essentially due to the lack of limited qualified personnel and the lack of resources to educate potential customers on the main functions of Venture capital funding and how its operations are. As pointed out, most SMEs that go to the VCs for mainly are interested in debt finance but not equity financing (which VCs provide).

Again, the fact that some SMEs refuse to negotiate for venture capital funding as a result of wrong perceptions such as fear of losing the control of their businesses to venture capitalists as well as the risks of not being able to meet contract terms clearly demonstrates the lack of education on the part of SMEs. This also impacts negatively on the desire of SMEs to negotiate for venture capital funding. As shown in Table 24, as many as thirty-five (70%) of the respondents agreed that the challenges threatens the successful exit of Venture Capital Financing. While on fifteen (30%) disagreed.

Challenges & Threats impact	Frequency	Percentage
Yes	35	70.0%
No	15	30.0%
Total	50.00	100%

Table 26: Challenges and Exit of Venture Capital Financing
Source: Field Research Data 2015

It was therefore not surprising that most of the respondents were not engaged in Venture Capital Financing. As shown in Figure 12, only eighteen (36.0%) of the respondents stated that they were still engaged in Venture Capital Financing while as many as thirty two (64.0%) of the respondents stated, on the contrary, that they are not still engaged in Venture Capital Financing.

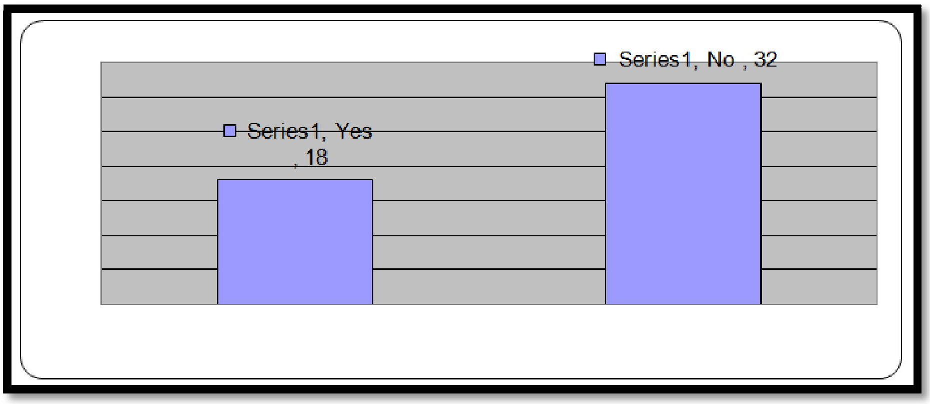

Figure 12: Respondents Engaged in Venture Capital Financing
Source: Field Research Data 2015

It was however found from the SMEs that there is still hope for venture capital funding in the country once all misconceptions and doubts are removed. As shown in Table 27, thirty one (25%) of the respondents stated they will recommend to their family, friends or associates the idea to negotiate for Venture Capital Financing while nineteen(38.5%) of the respondents mentioned that they will not recommend negotiating Venture Capital Financing to their families, friends or associates.

Negotiate for venture capital	Frequency	Percentage
Yes	31	62%
No	19	38%
Total	**50.00**	**100%**

Table 27: Response On If Respondent Will Recommend Venture Capital Financing
Source: Field Research Data 2015

❖ Addressing Challenges of Venture Capital Financing

Most of the respondents stated that more education, free follow of information, simplifying the process of venture capital financing and several exit methods are ways to resolve challenges of Venture Capital Financing. As shown in Table 28, fifteen (30.8%) of the respondents stated that more education was a way of resolving the challenges of Venture Capital Financing.

Way to Resolve Challenges	Frequency	Percentage
More education	15	30.8%
Free flow of information	12	23.1%

Simplifying the process of venture capital financing	0	0.0%
Several exit methods	6	11.5%
All of the above	17	34.6%
Total	50.00	100%

Table 28: Addressing Challenges of Venture Capital Financing
Source: Field Research Data 2015

❖ Managing Venture Capital Risks

This section employs risk management methodology to assess risks identified.

♦ Risk Management

Risk management process involves identification of all significant risks, evaluate the potential frequency and severity of losses, develop and select method for managing risks, Implement the risk management method chosen, monitor the performance and suitability of risk management methods and strategies on regular basis (WDR, 2014). Risk management is an effective way of addressing venture capital risks. The Word Development Report (WDR) 2014 emphasized the importance of risk management in all endeavours. It reported that, "Risk management if ignored, can turn into crises that reverse hard-won gains and endanger the social and economic reforms that produced them. Further it said "The consequences of mismanaged risks may destroy lives, assets, trust, and social stability (The World Development Report (WDR) 2014).

Having identified substantial information regarding the potential risks relating to venture capital financing, risk management methodology was applied to assess the risks. This led to the development of a risk register. The risk register presents at a glance the risk exposures which has the potential to impact negatively if realized. The risk register serves as a tool to aid in performing the critical role or Risk Management effectively. The deficiency of literature concerning risk register has created a huge gap, however gained insight when engaged the Internal Audit Agency as experiential knowledge.

♦ Risk Score

Identified risks were assessed on the basis of three (3) different criteria; Impact of the risk, Likelihood of occurrence and Current Control Effectiveness.
The assessment of the risk impact was scored using the following criteria:

6Scor	**Assessment**	**Meaning**

e		
1	No significant impact	In case the risk occurs, work in process and planned activities are not disturbed
2	Minor impact	In case the risk occurs, activities are disturbed, but this does not bring along the need for additional resources
3	Significant but containable	In case the risk occurs, the activities are significantly disturbed, but this does not disturb achieving objectives
4	High impact	In case the risk occurs, the activities are significantly disturbed and considerable additional resources are needed for achieving objectives
5	Extremely detrimental	In case the risk occurs, it is not possible to achieve determined objectives

Table 29: Risk Impact Assessment
Source: Internal Audit Agency

Risk likelihood was scored using the following criteria:

Score	**Assessment**	Meaning
1	Rarely happen	The occurrence of risk is practically impossible
2	Possible	The occurrence of risk is theoretically possible, but there exist few practical cases
3	Likely	The likelihood of risk occurrence is supported by little evidence
4	Very likely	The likelihood of risk occurrence is supported by clear evidence
5	Unavoidable	The risk has already appeared or the occurrence of risk is unavoidable in the future

Table 30: Likelihood of Occurrence
Source: Internal Audit Agency

Internal control effectiveness was scored according to the following criteria:

Score	Assessment	Meaning
3	Highly effective	Addition/improvement of internal control measures is not necessary at the moment
2	Need to be improved	Internal control measures exist at the moment, but they need to be reviewed and update
1	Inadequate	Internal control measures are missing or immediate improvement of existing internal control measures is necessary

Table 31: Assessment of Current Internal Control Effectiveness
Source: Internal Audit Agency

Using the overall score for each risk, risk level was scored according to the following table:

Attention must be paid to risks that are ranked high (overall cost of at least 17 points).

Risk level	Score	Materiality
Low risk	1-8 points	Issues that need to be reviewed from time to time
Medium risk	9 – 16 points	Issues that need constant monitoring
High risk	17 - 25 points	Issues that need immediate attention

Table 32: Determination of Risk Score and Risk Level
Source: Internal Audit Agency

Based on the evaluation of portfolio of risks, risk response presents set of action to take, to align risk with participants risk tolerance or appetite. This is the strategy that is to be adopted by players of venture capital funding to deal with risks be it downside or upside.

Score	Assessment	Meaning
1	EXPLOIT	Once positive risk is identified, make sure the risk occurs for the participant to benefit from it.
2	SHARE	After opportunity is identified, collaborate with stakeholders to make most out of it.
3	ENHANCE	Increase the likelihood of risk occurring
4	AVOID / TERMINATE	Completely eradicate the risk from the system; even though avoiding risk in the real life scenario is rare.
5	TREAT	Accept Risk and Control / Mitigate
6	TRANSFER	Transfer ownership of Risk to a third party, by paying certain cost. E.g. Insurance
7	TOLERATE	Accept risk and monitor as residual risk, since no risk could be eradicated 100%.

Table 33: Risk Response Strategy

Source: Internal Audit Agency

This is a table of risks identified with venture capital financing, analysed and classified with the help of the criteria set out in the tables under the theme "Risk Score".

S/N	RISK DESCRIPTION	RISK FACTORS/SOURCE	RISK EFFECT	RISK L./HOOD	RISK IMPACT	CURRENT CONTROL	RISK LEVEL	RISK RESPONSE	RISK TREATEMENT/ CONTROL
CATEGORY A: RISK RELATING TO INVESTEE FIRM (SME)									
1	High Level of Uncertainty	3. Absence of a quality business plan 4. Poor organizational structure	3. Unclear business direction 4. Unable to determine business survival	4	4	1	HIGH	TREAT	2. Engage an experienced Chartered Accountant or a qualified Business Consultant to help develop; c) a quality Business Plan and d) Advice on effective organizational structure (It is important to note that this activities must take place at the inception of SME business)
2	Lack of Trading Record	2. Failure to record all business transaction and business communications	4. Uncertain business activities 5. Unable to prepare yearly financial statements 6. No appropriate /historical information for effective decision making.	4	4	1	HIGH	TREAT	2. Record all business transactions and any business communication at the inception of the business and keep this in an ongoing basis.
3	Lack of substantial tangible assets	3. Unable to acquire tangible assets at the beginning of the business	3. It presents a situation of instability	4	4	1	HIGH	TREAT	3. Provide good prospect of business by presenting quality business plan 4. Consider indemnity by an insurance company when it is necessary while seeking venture capital financing

S/N	RISK DESCRIPTION	RISK FACTORS/SOURCE	RISK EFFECT	RISK L./HOOD	RISK IMPACT	CURRENT CONTROL	RISK LEVEL	RISK RESPONSE	RISK TREATEMENT/ CONTROL
4	Fear of Losing my business	3. Not having proper understanding of the operations of VCF 4. Not knowing clear intentions of Venture capitalist	2. SME not trusting venture capitalist	4	4	1	HIGH	TREAT	4. Effective education on venture capital financing 5. Transparent contract 6. Adequate information flow and sharing
5	Lack of audited financial statement	2. Unavailable transaction records	2. No data / information to prepare financial statement	4	4	1	HIGH	TREAT	3. Ensure all business transactions are recorded 4. Engage an accountant to prepare yearly audited financial statements
6	Lack of Quality business plan	2. Failure to write down business idea and how profit is to me made in a long term	3. No business direction 4. Unable to ascertain profitability of business	4	4	1	HIGH	TREAT	2. Engage an experienced Chartered Accountant or a qualified Business Consultant to help develop a quality Business Plan
8	SME / Investee firms attitude about control of business	5. The desire for absolute ownership and total control of business	2. Unwilling to share hence unwilling to engage in venture capital financing	4	4	1	HIGH	TREAT	3. Acquire training on business structure and management 4. Acquire training on venture capital financing
CATEGORY B: RISK RELATING TO VENTURE CAPITAL FIRM (VENTURE CAPITALIST)									
1	Inadequate qualified personnel	2. Few qualified personnel	3. The process of venture capital financing is delayed 4. The process of venture capital financing is complicated	4	4	2	HIGH	TREAT	2. More people must be trained into venture capital financing
2	The process of venture capital financing too slow	3. Inadequate qualified personnel 4. Complicated VC process	2. Low patronage of VC	4	4	2	MEDIUM	TREAT	2. More people must be trained into venture capital financing

S/N	RISK DESCRIPTION	RISK FACTORS/SOURCE	RISK EFFECT	RISK L./HOOD	RISK IMPACT	CURRENT CONTROL	RISK LEVEL	RISK RESPONSE	RISK TREATEMENT/ CONTROL

3	The process of venture capital financing is too complicated	4. Incompetent staff 5. Inadequate qualified personnel 6. Long VC process	2. Low patronage of venture capital financing	4	4	2	MEDIUM	TREAT	3. Review the process of VC and shorten if possible 4. Provide training to VC staff
CATEGORY C: GENERAL									
1	Information Asymmetry	2. Critical business information kept with entrepreneur / investee (SME) – not sharing business idea with Venture capitalist	3. Business is managed without critical business information 4. Results of business might not be as expected	4	4	1	HIGH	TREAT	4. Provide training on venture capital financing to (SME) 5. Contract must include information flow between venture capitalist and investee 6. Business operations must be transparent to venture capitalist and investee
2	The fear of one party to the other	4. Lack of information flow 5. Non-transparent contract 6. Lack of training on venture capital financing	2. Both Venture capitalist and Investee might not want to engage in venture capital financing	4	4	1	HIGH	TREAT	4. Provide training on venture capital financing to both (SME) and venture capitalist 5. Contract must include information flow between venture capitalist and investee 2. Business operations must be transparent to venture capitalist and investee
3	Adverse Selection	2. Power due to Venture capitalist or Investee during the stages of venture capital financing	2. Inappropriate decision or judgement made by either venture capitalist or investee	4	4	1	HIGH	TREAT	2. Business operations must be transparent to venture capitalist and investee 6. Contract must include information flow between venture capitalist and investee

4	Exit Challenges	6. Non-transparent contract 7. No knowledge on exit methods 8. IPO challenges in Ghana	3. SME disagreement to exit method 4. Venture Capitalist unwilling to engage in venture capital financing due to exit challenges	4	4	1	HIGH	TREAT	5. Transparent contract 6. Provide education on exit methods to both investee and venture capitalist 7. Improve on IPO in Ghana 8. Seek different exit methods
		4.	4.						

S/ N	RISK DESCRIPTION	RISK FACTORS/SOURCE	RISK EFFECT	RISK L./HOOD	RISK IMPACT	CURRENT CONTROL	RISK LEVEL	RISK RESPONSE	RISK TREATEMENT/ CONTROL
4	Inadequate flow of Information	2. No trust in the venture capital financing engagement	2. Poor judgement and ineffective decision making by both investee and venture capitalist	4	4	1	HIGH	TREAT	4. Transparent contract 5. Provide education on exit methods to both investee and venture capitalist 6. Business operations must be transparent to venture capitalist and investee
5	Weak regulatory Environment / Legal Documentation	3. Incompetent regulatory personnel 4. Lack of education to the general public on venture capital financing	2. Unwillingness to engage in venture capital financing by both venture capitalist and investee.	4	4	2	HIGH	TREAT	3. Adequate training must be provided to regulatory personnel 4. Regulatory body must provide education and awareness t the general public especially those engaged in venture capital financing
6	Poor / Weak micro economic environment	4. High inflation 5. High interest rate 6. Currency fluctuation	2. Discourage patronage of venture capital financing	3	3	3	MEDIUM	TREAT	2. Government must manage economic environment to the benefit of all and venture capital financing

Table 34: Risk Register of Venture Capital Financing

Source: PMBOK

Chapter 8
Summary, Conclusions and Recommendations

❖ Summary of the Study

This study's objective was identifying the risks and challenges that confront Ghanaian VCs. To operationalize this main objective, the study contacted two VC firms and fifty SMEs.

It was found that 50% of the respondents have ever negotiated for financing through the venture capital before and the reasons for negotiating for venture capital financing include reasonable terms and conditions, cheaper compared to other financing forms, technical assistance and absence of collateral. Only five of the respondents have never negotiated for venture capital financing. The main reasons were found to be not being aware of the existence of venture capital fund; nobody has ever explained how venture capital works to them, and that they thought the procedures of venture capital was too complex. It was found that out of the 45 respondents who have ever negotiated for venture capital financing, forty (88.89%) were successful while only five were unsuccessful. It was further found that all the forty respondents who successfully negotiated for venture capital financing agreed that they have benefited from this arrangement.

The main risks and challenges confronting Ghanaian VCs were found to include weak regulatory environment that venture capitalists operate in; the lack of qualified staff who have the experience and training to handle all issues pertaining to their operations and the wrong notion by some Ghanaians that the funds given to venture capital firms are for the government and for that matter, it is free money to be shared by all without paying. Other challenges were found to include the lack of proper structures in investees' firms and this makes it difficult stepping in to assisting to have efficient management and operational structures; and few exiting options or venues available in Ghana currently and this tends to create problems for all parties to the deal. It was further found that the current economic conditions in the country does not auger well for venture capital financing and that most of the investee firms do not keeper proper records of their operations and this makes the evaluation of the businesses very difficult and therefore forcing the VCs to resort to other methods of arriving at fair values of their operations.

It was found that the challenges as identified have major impact on the ability of the VCs to effectively negotiate funding for investee firms. The two main impacts of the challenges were found to be the lack of motivation on the part of investors to invest at start-up and that the challenges affects the ability of VCs to extend their operations to other parts of the country essentially due to the lack of limited qualified personnel and the lack of resources to educate potential customers on the main functions of Venture capital funding.

❖ Conclusion of the Study

Venture capital funding even though relatively new in the country is making major strides towards assisting entrepreneurs to have alternative means of expanding their operations which in the long run benefits the whole country in terms of the employment avenues they create for Ghanaians. This means that venture capital funding is highly crucial since debt financing comes with its challenges such as the provision of collateral which most entrepreneurs cannot provide. However, the findings of this study have amply demonstrated that the Venture Capital Financing is far from achieving is target and objective because of several challenges and risks.

Based on the findings of this study therefore, the conclusion arrived at is that venture capital funding can be a viable alternative if and only of solutions are found that effectively mitigates and addresses the challenges of VCs. This study further concludes that venture capital funding firms must work hard at changing the perceptions that most entrepreneurs have that VCS take over firms and control their operations without any inputs from SMEs. The point is venture capital funding when effectively executed can help Ghanaian entrepreneurs overcome the challenges of debt financing and rather start seeing equity financing as a viable alternative.

❖ Recommendations of the Study

Based on the findings especially on the risks and challenges of venture capital funding, the following solutions and recommendations have been proffered:

♦ Continued Education

This study found that most entrepreneurs and SMEs have wrong perceptions about the activities of VCs (such as being free money from government and also take over the control of businesses). This study therefore recommends that the VCs in concert with the government must embark on educational campaigns that will effectively educate Ghanaians on the actual role of VCs and also dispel the notion held by some that VCs only are in business to take over the management of firms. Proper education will change entrepreneurs' attitude and this will make them consider venture capital funding as a viable alternative to debt financing.

- **Raising Funds Locally**

This study found that currency fluctuations affect the operations of VCTFs due to the fact that they receive most of their funding from overseas partners. It is therefore recommended that VCTFs must start raising for funds and looking for investors locally. Executing this strategy effectively will curtail the need for looking for foreign currencies to repay foreign investors. Moreover, raising funds locally will enable VCTFs to enrol more entrepreneurs and by so doing, giving impetus to the ever increasing realization that the private sector mostly made up of SMEs is the engine of growth for the Ghanaian economy.

- **Entrepreneurs/SMES Must Put Their Acts Together**

Venture capitalists are in business to make profit and exit quietly. It therefore behoves on entrepreneurs to start putting their acts together in order to attract venture capital funding. Putting their acts together means keeping accurate records and data, having good business plans, employing qualified accountants and also being professional and avoiding all negative practices that tend to make it easy for venture capitalists to accurately evaluate the value and performance of firms. Investors are interested with firms that have goof prospects and professionally managed.

- ***VCTFS Must Liaise with Other Financial Institutions***

Information asymmetry is a serious challenge in the Ghanaian financial sector. This challenge makes it difficult to ascertain the veracity or otherwise of claims made by entrepreneurs. However, through liaising and talking with other financial institutions, VCTFs will be able to identify problematic entrepreneurs and by so doing, avoid dealing with them.

- ***Government Must Create an Enabling Environment***

Another challenge or risk confronting VCTFs is the unstable micro-economic environment such high interest rates, high inflation and currency fluctuations. This tends to affect the smooth operations of VCTFs. It is therefore recommend that government must concentrate on the creation of a stable business environment that augurs well for VCTFs. This stable environment will encourage local investors to participate in venture capital fiannci8ng and by so doing, making VCTFs have enough resources to employ and train qualified personnel who can then enrol more entrepreneurs.

- **VCTFS Must Build Closer Ties with Academic Institutions**

Venture capital funding is all about identifying ideas and business with good prospects and then financing these businesses for future profit. To effectively achieve their objectives, this study also recommends that the VCTFs must liaise with academic institutions such as the Kwame Nkrumah University of Science and Technology so that feasible and viable ideas and projects can be supported. This is because academic institutions are fertile grounds for identifying good opportunities and scientific break-through.

- **Quality but Not Quantity**

It was additionally recommended that VCTFs must focus on identifying few firms but with good prospects instead of trying to find several SMEs with small prospects. In effect, VCTFs must focus on investing heavily in few SMEs that have massive potential than investing small amounts in many VCTFs that do not have very good prospects.

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Small and Medium Enterprises (SMEs) have been recognised all over the world as a viable alternative means to grow the economy of a nation. However, SMEs are plagued with funding gap which inhibits the expected growth. SMEs had sought financial support primarily from commercial banks which most times comes in the form of debt, demand collateral and comes with high interest rates and other conditions that are not met by the SMEs. Venture Capital Financing is one of the best sources of funding which has dual benefits of funding and provision of managerial expert as against securing funding from a commercial bank.
The book provides detailed information on the concept of SME with focus on developing countries as well as traditional sources of financing SMEs.
In addition, it presents succinctly varied innovative sources of financing and zeros in on venture capital as an alternative source of financing. The book also assesses risks involved in venture capital financing and how to manage such risks. The book concludes with brief investment memorandum which is mostly used to set up venture capital or equity fund to attract potential investors.
Theory and Practice of Venture Capital Financing has filled a void in finance and investment especially on venture capital financing.

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