UNIVERSITY OF AGDER

Private Equity and Venture Capital in Rwanda

A study of the Essential Factors a Company in Rwanda Must Have in Order to Receive Private Equity and Venture Capital Financing

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This master's thesis is carried out as a part of the education at the University of Agder and is therefore approved as a part of this education. However, this does not imply that the University answers for the methods that are used or the conclusions that are drawn.

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Abstract

The aim of this study is to identify factors investors deem to be important when investing in private equity and venture capital in Rwanda. In order to answer that question, a secondary objective is developed. That is to *refine the stages of private equity and venture capital investment decision process and identify criteria used in each of these processes*.
The underlying theoretical framework of this research is based on two models: Tyebjee & Bruno´s (1984) five stage model of VC investment activity and Fried & Hisrich´s (1994) six-stage model of VC investment decision-making.

In this study, four private equity and venture capital firms that invest in Rwanda are studied. Fund Management Company (FMC) has a focus on growth capital investment. BDF is a Rwandan fund that has a focus on SMEs with profit, high growth and export potential. Kaizen Venture Partners target distressed companies and focus on turnaround investment. Norfund is a Norwegian Development Finance Institutions (DFIs) focused on profitable and sustainable companies. Based on the results, a 6-stage model of the private equity and venture capital investment process model is developed. The stages are deal sourcing, preliminary due-diligence, term sheet agreement, formal due diligence, final negotiations and investment and active ownership and exit. The study found several essential criteria a company in Rwanda must have in order to receive private equity and venture capital financing. First it needs to have growth potential. Second, a good management team is essential. Third, the investment prospect needs to have a competitive advantage. In addition to those essential criteria, private equity and venture capital firms look for companies in industry with growth potential and high-entry barriers.

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1- Introduction

Private equity, as the term suggests, involves investments of equity capital in private businesses. The African Private Equity and Venture Capital Association (AVCA) defines private equity as an investment asset class that predominantly provides investors with exposure to strategic investment in the private sector, or in companies not listed on a securities exchange. Private companies, or unlisted companies can often have significant growth potential but need capital in order to achieve their growth prospects. As these companies are not listed on a securities exchange, they don't have access to public equity capital markets and need to obtain capital from other sources (AVCA, 2013/2014). Private equity provides long-term, committed share capital, to help unquoted companies grow and succeed. To clarify, the term private equity does not require that the investing company itself is private (Cumming, 2010, p. 54).

The supply of capital for private equity comes from a variety of sources. Cumming (2010) describes three types of investors. The first category consists of institutional investors, i.e. professionally operated organizations with the mandate to invest capital on behalf of beneficiaries. The second category comprises banks, nonbank financial institutions (e.g., security firms) and corporations. The third type of investor is government entities at both the national and local/ regional levels. As the different types of investors and their motivations to supply funding vary, the sources of capital for private equity take a variety of forms.

Institutional investors, like pension funds, endowment, and life insurance companies are motivated to invest into private equity in order to improve the absolute returns of their asset portfolios. These investors prefer investing indirectly into private companies through independent private equity funds (limited partnership). Institutional investors tend to commit capital over a 10- to 12-year period, and build private equity programs over multiple years. The second type of investors is motivated by broader strategic goals. In addition to financial returns, banks, other financial institutions and corporations are motivated by strategic goals like gaining insights on new technologies, limiting competitive threats, cross-selling products, and access to potential customers. Non-financial motivations for private equity can consequently lead these investors to behave in a different manner than institutional investors,

and expect different outcomes from private equity. Banks, corporations and other financial institutions invest directly into companies through a business unit, or indirectly through third-party private equity funds. Usually, these investors have formal administrative control as well as informal control through corporate culture. The third type of investors is government entities and is motivated by public-policy goals. Those goals include development of the local venture capital industry, accelerating economic growth and employment, and commercialization of technology (Cumming, 2010). An example of a government entity that invests in private equity is Development Finance Institutions (DFIs). DFIs aim to reduce poverty by contributing to the development of local businesses, jobs and economic growth.

The different types of investors and motivations for investment demonstrate the breadth of private equity capital available to private companies. Private equity has been in existence for hundreds of years in developed markets. In emerging markets, it is becoming more and more known as a source of value-add financing for growing companies (AVCA, 2013/2014). As the industry developed, private equity funds evolved into two species: venture capital and buyout funds (see table 1).

Table 1: Private Equity

Private Equity			
Venture Capital			Buyouts
Venture Capital *BDF*	Growth Capital *FMC / Norfund*	Distressed Investment *Kaizen Venture Partners*	Leveraged Buyouts

Venture capital funds provide financing to high growth potential firms that can´t access the public equity market or secure traditional debt financing. Venture capital investments are typically made in less mature companies, for the launch, early development, or expansion of a business. Among the most common investment strategies in venture capital are venture capital investments, growth capital investment and distressed investments. Venture capital investment refers to start-up financing. Growth capital refers to investments that assist company in its expansion plans. Lastly, distressed investments help an unprofitable company improve its operation to attain profitability. This research studies four private equity and

venture capital firms with different strategies. See table 1 for each of those firm´s respective investment strategy.

The second type of private equity is buyouts. Buyouts are created with the goal of acquiring public corporations or divisions thereof, and taking them private. Buyout funds occupy therefore a different place in the corporate life cycle (Cumming, 2010, p. 31). This research has a focus on private equity and venture capital. That is, buyouts are not considered. The terms "Venture Capital (VC)", "private equity" and "Venture Capital and Private Equity" are used interchangeably.

1.1- The aim of this study

The primary objective of this study is to identify factors investors deem to be important when investing in private equity and venture capital in Rwanda. To the author's knowledge, few studies have focused on private equity and venture capital in Rwanda. This paper aims to fill that void, and the research question is as follow: **What are the essential factors a company in Rwanda must have in order to receive private equity/venture capital financing?**

In order to achieve the primary objective, the investment process and the criteria used in each of theses processes need to be identified. Consequently, a secondary objective in this research will be *to refine the stages of private equity and venture capital investment decision process and identify criteria used in each of these processes*. The underlying theoretical framework is based on two models: Tyebjee & Bruno´s (1984) five stage model of VC investment activity and Fried & Hisrich´s (1994) six-stage model of VC investment decision-making. Those two models made significant research contributions and will be reviewed in the next chapter. First, a brief introduction to Rwanda is given.

1.2- Introduction to Rwanda

Rwanda is a small landlocked country in east-central Africa with a population of approximately 12.5 million[1](Countrymeters, 2015). Also known as "the land of a thousand hills", the country is bordered by Uganda to the north, Tanzania to the east, Burundi to the south, and the Democratic Republic of Congo to the west. Rwanda enjoys strong economic growth, high rankings in the World Bank´s Ease of Doing Business Index, and a reputation for low corruption. However, Rwanda still faces some challenges. (U.S. Department of State, 2014)

1.2.1- Political and Social System

The 2014 U.S. Department of State´s Investment Climate Statement reports that Rwanda is a stable country with low violence crime rates. The country enjoyed a year-on-year average real GDP growth rate of 7.6% between 2007 and 2013, one of the highest among the major African economies and neighbouring countries (see appendix) (National Bank of Rwanda, 2014). The Government of Rwanda (GoR) adopted Vision 2020 in 2000. Vision 2020 is an initiative with a primary objective of transforming Rwanda into a middle-income country by the year 2020 and transforming Rwanda into a knowledge-based economy. Vision 2020 is based on the six following objectives (Republic of Rwanda, 2012):

Table 2: Pillars of Rwanda´s Vision 2020 and Its Cross- Cutting Areas

<table>
<tr><th>Pillars of Vision 2020</th><th>Cross-cutting areas of Vision 2020</th></tr>
<tr><td>1. Good governance and a capable state</td><td rowspan="6">1. Gender equality
2. Protection of environment and sustainable natural resource management
3. Science and technology, including ICT</td></tr>
<tr><td>2. Human resource development and a knowledge-based economy</td></tr>
<tr><td>3. A private sector-led economy</td></tr>
<tr><td>4. Infrastructure development</td></tr>
<tr><td>5. Productive and market-oriented agriculture</td></tr>
<tr><td>6. Regional and international economic integration</td></tr>
</table>

[1] As of May 2015

Since the initiation of Vision 2020, Rwanda has made much progress towards attaining these objectives. Transparency International (2011) reports that remarkable progress has been made in terms of anti-corruption. The government maintains a high- profile anti-corruption effort, and combating corruption is often reported as a key national goal. According to Transparency International (2011), Rwanda is performing better than many other African countries on most governance indicators in terms of control of corruption. In 2008, the Government of Rwanda implemented business reform legislation, which included new bankruptcy regulations and arbitration laws. In 2009, the GoR approved a new intellectual property law. A company law, also adopted in 2009, strengthened investor protections by requiring greater corporate disclosure, increasing the liability of directors, and improving shareholders' access to information. In 2011, the GoR reformed tax payment processes and enacted additional laws on insolvency and arbitration (U.S. Department of State, 2014).

In 2006, the Government of Rwanda (GoR) consolidated multiple investment-related government agencies to establish the Rwanda Development Board (RDB). RDB serves today as the country's chief investment promotion agency and offers one of the fastest business registration processes in Africa. New investors can register online at RDB's website and receive approval to operate in less than 24 hours. The World Economic Forum´s Global Competitiveness Report 2013-204 ranked Rwanda the second easiest place to do business in Africa (see appendix) (National Bank of Rwanda, 2014). According to the 2014 U.S. Department of State´s Investment Climate Statement however, potential and current investors cite a number of hurdles and constraints. Those include high transport costs, a small domestic market, limited access to affordable financing, inadequate infrastructure, ambiguous tax rules, and a lack of skills in the workforce. Moreover, the Rwanda's judicial system suffers from a lack of resources and capacity, including functioning courts.

1.2.2- Product and Labor Market

Rwanda has a market of approximately 12.5 million people with a rapidly growing middle class. Although general labor is available, the 2014 U.S. Department of State´s Investment Climate Statement reports that the country suffers from a shortage of skilled labor, including accountants, lawyers, and technicians. The 2014 Investment Climate Report states however that higher institutes of technology, private universities, and vocational institutes are improving and producing more and better trained graduates each year. Rwanda presents

numerous opportunities in several sectors including renewable energy, infrastructure, agriculture, tourism, mining, and information and communications (Investment Climate Report 2014). In the past years, inflation development have been dominated by prices for food and non-alcoholic beverages as well as transport costs, which altogether account for 46% of the CPI basket (see appendix) (National Bank of Rwanda, 2014).

1.2.3- Capital Markets

The 2014 U.S. Department of State´s Investment Climate Statement reports that there is no difficulty obtaining foreign exchange, or transferring funds associated with an investment into a usable currency and at a legal market-clearing rate. In 1995, the government abandoned the dollar peg and established a floating exchange rate regime, under which all lending and deposit interest rates were liberalized (see appendix).

According to the 2014 U.S. Department of State´s Investment Climate Statement, access to affordable credit is a serious challenge in Rwanda. Interest rates are high, banks offer short-term loans only, and Rwandan commercial banks are unable to issue significant loan values (see appendix). Most Rwandan banks are conservative, risk-averse, and trade in a limited range of commercial products. Rwanda's financial system remains dominated by banking sector, which represents 67.6% of the system's total assets. Microfinance accounts for 5.6% and the non-banking financial institutions account for 26.7% (insurance 9.4% and pension 17.3%). There are very few Private Equity and Venture Capital firms in Rwanda (National Bank of Rwanda, 2014).

2- Literature Review

2.1- Introduction to the Venture Capital Decision-Making Process

Venture capitalists (VC) are considered experts in identifying ventures with high potential. Thus, understanding and describing the venture capitalist´ decision-making process has been the goal of large number academic studies. The earliest VC decision process study found is a study of VCs by Wells (1974). Through interviews with partners at seven venture capital firms, Wells (1974) identified six distinct stages in the venture funding decision process (see Table 3). The first stage was *the search for investment opportunities.* The second and third stages were respectively *the screening of proposals* and *the evaluation of proposals.* Wells found that different criteria were applied, moving from broad questions at the screening stage to more specific ones during evaluation. The new businesses were either funded or rejected once these evaluations were completed. If the new businesses received funding, the VC spent a significant amount of time with them in what Wells described as the fourth and fifth stage. Those are respectively *venture board meetings* and *venture operations.* The sixth and final phase in Wells model was *cashing out of the venture* (Hall & Hofer, 1993).

Wells model of the process was later modified and elaborated on by Tyebjee & Bruno (1984). In their 1984 study, Tyebjee & Bruno developed a more generic model of the VCs investment activity, thus making a significant research contribution. While the authors described their model as highly descriptive and admittedly simplistic, it captured the heterogeneity of practices across the many venture capital firms. Tyebjee & Bruno (1984) described the activities of VC as an orderly process involving five sequential steps (see Table 3). Those are 1) deal origination, 2) screening, 3) evaluation, 4) deal structuring, 5) post investment activities, and will be reviewed in more details in the next section. Compared to Wells model, Tyebjee & Bruno (1984) added a new stage called *deal structuring,* condensed the fourth and fifth stages into a single stage and dropped the cashing out stage (see Table 3)(Tyebjee & Bruno, 1984).

Fried & Hisrich (1994) extended the previous research by Tyebjee & Bruno by investigating VCs decision making in more detail. While Tyebjee & Bruno (1984) models defined the stages in the process, Fried & Hisrich (1994) examined the specific activities made by the VCs, and found that different activities occurred in each stage. Fried & Hisrich (1994) made a major research contribution as they developed a six-stage process model: origination, venture capital firm-specific screen, generic screen, first-phase evaluation, second-phase evaluation, and closing. Table 3 shows the three different models.

Table 3: Stages of Venture Capitalists´ Management Process

Stages	Wells (1974)	Tyebjee & Bruno (1984)	Fried & Hisrich (1994)
1	Search	Deal Origination	Origination
2	Screening	Screening	VC Firm-Specific Screen
3	X	X	Generic Screen
4	Evaluation	Evaluation	First-Phase Evaluation
5	X	X	Second-Phase Evaluation
6	X	Deal Structuring	Closing
7	a) Venture board meetings	Post-Investment Activities	X
	b) Venture operations	X	X
8	Cashing Out	X	X

The venture capital process has been described in numerous academic studies. As shown in Table 2, researchers agreed in two aspects. First, the VC decision process consists of multiple stages. Second, the venture evaluation itself involves at least two distinct stages: a) screening, and b) evaluation. Next, we will take a closer look at the most significant contributions. We will first review the five-stage model of venture capital investment activity by Tyebjee &

Bruno (1984) introduced above. We will then continue with Fried & Hisrich (1994) six-stage model, and particularly elaborate on the different aspects compared to the Tyebjee & Bruno (1984) framework.

2.2- A Five-stage Model of Venture Capital Investment Activity

In Tyebjee & Bruno´s 1984 study, forty-one venture capital firms agreed to participate and provided data on deals that had received serious consideration in their firms. Those firms were located in the states of Texas, California and Massachusetts, states that accounted for a major portion of the venture capital industry in the United States. The 41 cooperating VC firms were mailed a structured questionnaire, and with an average of 2.2 deals per participating firm, ninety completed evaluations were returned. The questionnaire measured the mechanism of initial contact between the VC and entrepreneur, the venture´s industry, the stage of financing, and product development. Major industries represented in the sample of the 90 deals were computers, semiconductors and telecommunications (56.6%), the energy sector (13.5%), and consumer goods (10.1%). The remaining were miscellaneous industries including transportation, construction and biomedical (16.8%). Tyebjee & Bruno´s questionnaire also asked participating VC to rate the 90 deals on 23 characteristics, and on overall expected return and risk. Lastly, VC firms were asked to indicate their decision vis-à-vis investing in that deal.

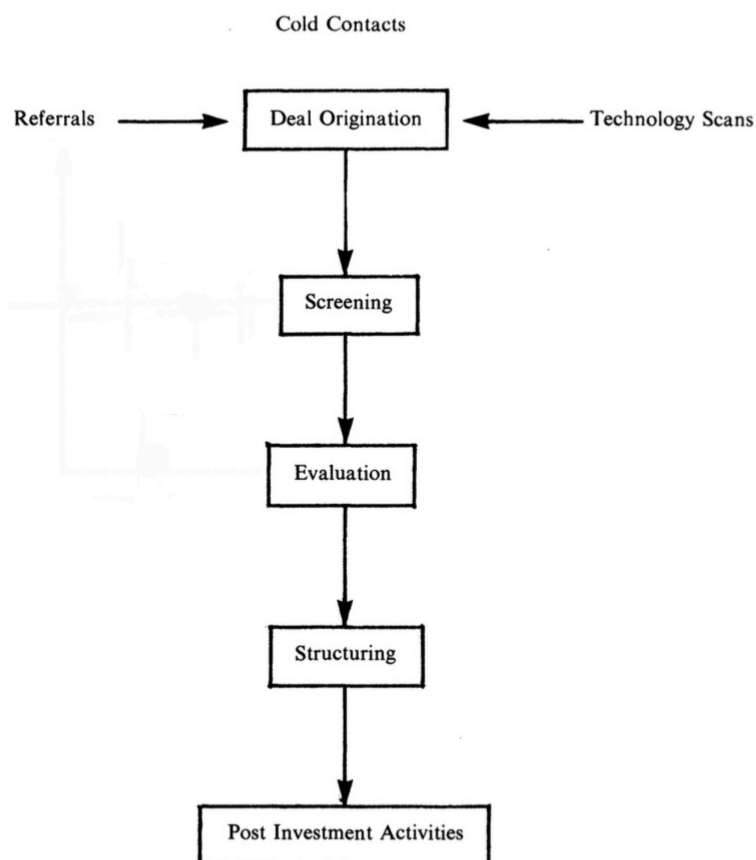
Tyebjee & Bruno (1984) model the investment activity of a venture capitalist as a sequential process involving five steps (see Figure 1). Those steps are as follow:

1. *Deal origination*: this is the process by which deals enter into consideration as potential investments.
2. *Screening*: deal screening refers to the process by which VC seek to concentrate on few investment prospects for further in-depth evaluation. To reduce the number of potential investments to a manageable size, a set of key policy variables are used as guidelines.
3. *Evaluation*: in the evaluation process, VCs seek to assess the venture on a multidimensional set of characteristics. Based on those criteria, perceived risk and

expected return are weighted. Lastly at this stage, a final decision regarding whether or not to invest in a particular deal is taken.

4. *Deal Structuring:* this step describes the negotiation process between the venture capitalist and the potential investee if the outcome of the evaluation process is favorable.
5. *Post Investment activities:* once the deal has been consummated, the VC´s role expands from investor to collaborator. The VC typically has close contact with the firm, and the intensity of involvement in the venture´s operations differs from one VC to another. Lastly, VCs usually want to cash-out their gains five to 10 years after initial investment. As seen in table 3, Wells (1974) differentiates the cashing-out process as the final stage in his model.

Figure 1: Decision Process Model of Venture Capitalist Investment Activity



Next, Tyebjee & Bruno (1984)´s model and result will be described further. We will go through each step in more details.

2.2.1- Deal origination

The access to information about potential investment deals is crucial to a venture capital firm. The environment within which to find those deals however, is poorly define for the VC. As typical investment prospect often are too small a company to easily be identified, various intermediaries play an important role. Tyebjee & Bruno (1984) found in their study that potential deals originated from three sources (see Figure 1). The first of those sources are unsolicited cold calls from entrepreneurs (i.e. “cold contacts” in Figure 1). Of the 90 deals in the study, Tyebjee & Bruno reported that cold calls accounted for 25.6% of the sample. A standard response from the VC is to request the inquirer to submit a business plan. The second source of deal origination is through a referral process. In the study by Tyebjee & Bruno (1984), 65% of the deals were referred to the VC. As the degree of syndication is relatively high within the venture capital industry, a substantial part of the investment prospects are referred to the VCs by other venture capitalist. In this practice, the referring VC acts as a lead investor and seeks participation of other venture capital funds. As the lead investor carries the majority of the administrative burden, co-investors have the possibility to diversify their portfolios over a large numbers of deals without adding to the administrative burden. Tyebjee & Bruno also found that potential investments are referred to the VC by prior investees, personal acquaintances, banks and investment brokers. The third source of deal origination is the active search for deals by the VC. To pursue companies at the start-up stage or those at the critical point of needing expansion financing, the VC monitors the environment for such potential candidates. That is done through an informal network and attendance at conventions, trade shows and special conferences. A way of actively searching for deals is also to first decide which technology market the VC would like to add to the portfolio, to then use executive search agencies to locate the management team for the venture. In Figure 1, this is referred to as technology scans (Tyebjee & Bruno, 1984).

2.2.2- Screening

Venture capitalists commonly receive a large number of business proposals. In Wells (1974) study of seven venture capital funds, he reports that the annual number of proposals received ranged between 120 and 1000, with an average of around 450 per year. This is later confirmed by several studies (e.g. Khan (1987), Klonowski (2007)). Given that most venture capital

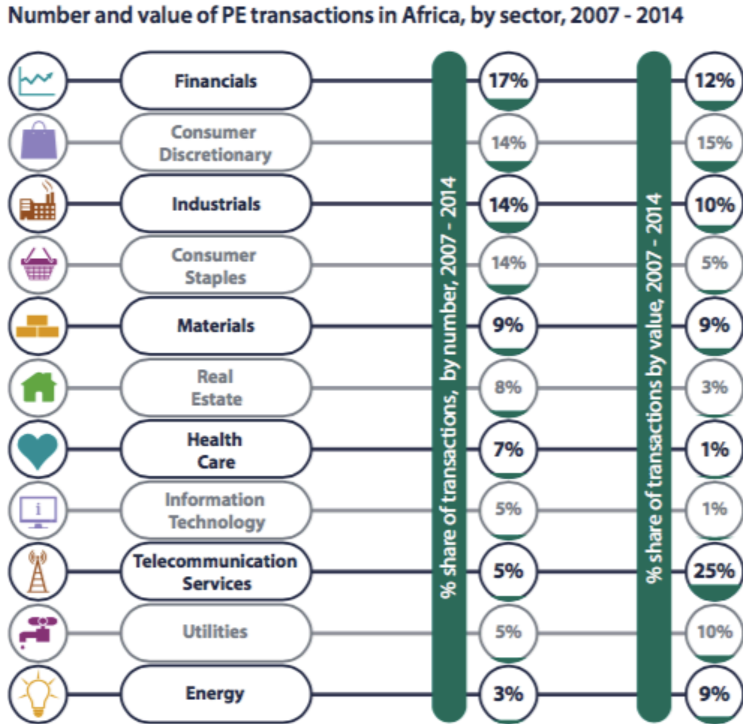
firms are operated with lean staff, the excessive number of proposals represents a significant bottleneck in their operations (Macmillan, Siegel& Subbanarasimha, (1985)). As for any organization, resource deployments are key elements in the VC´s strategy. An important component is the way VC firms allocate their limited yet critically skilled staff across the venture process (Robinson Jr, 1987, p. 57). Consequently, a typical venture fund receives far more proposals than they can possibly fund with the size of the staff and portfolio. Klonowski (2007, p. 364) reports that only less than 5 percent of business proposals convert into actual investments. In order to filter out the majority of the proposals, a process known as screening is used. Tyebjee & Bruno (1984) describe the initial screening based upon four criteria:

1. The size of the investment and the investment policy of the venture fund. After investing in a business, the control and consultation demands placed on the VC are essentially the same regardless of the size of the investment. Subsequently, the VC cannot afford to spread its portfolio over too many small deals as it has fixed staff costs that have to be covered. This place a lower limit to the investment policy. The upper boundary of the investment policy is determined by the capitalization of the portfolio and diversification consideration. This upper limit however is relatively flexible due to syndication. A VC may consider larger deals with the intent of soliciting the participation of other VC funds. In Tyebjee & Bruno´s (1984) study, it´s found that 56% of the deals analyzed involved the participation of more than one VC fund. Tyebjee & Bruno (1984) also report that the investment policy, in terms of the maximum and minimum amount considered, is quite heterogeneous across VC firms. In the 90 deals examined in the study, the amounts ranged from $30,000 to $7,500,000, with median amount being $1,000,000.
The private equity market in East Africa is predominantly focused on investing in small and medium-sized enterprises, with a median PE transaction size of US$5mn compared with US$14mn for all African PE transactions. Between 2007 and 2014, there were 158 reported PE transactions in East Africa totaling US$1.5bn (AVCA, 2014).

2. *The technology and market sector of the venture.* VC will generally not invest in areas outside their technological or managerial expertise. When choosing a deal, the VC is not only investing in a company, but implicitly in the future of a particular technology or market. The VC must therefore be familiar with the technology or market of the proposed venture. Due to the inability of the VC´s fund manager to be well versed across many technologies and

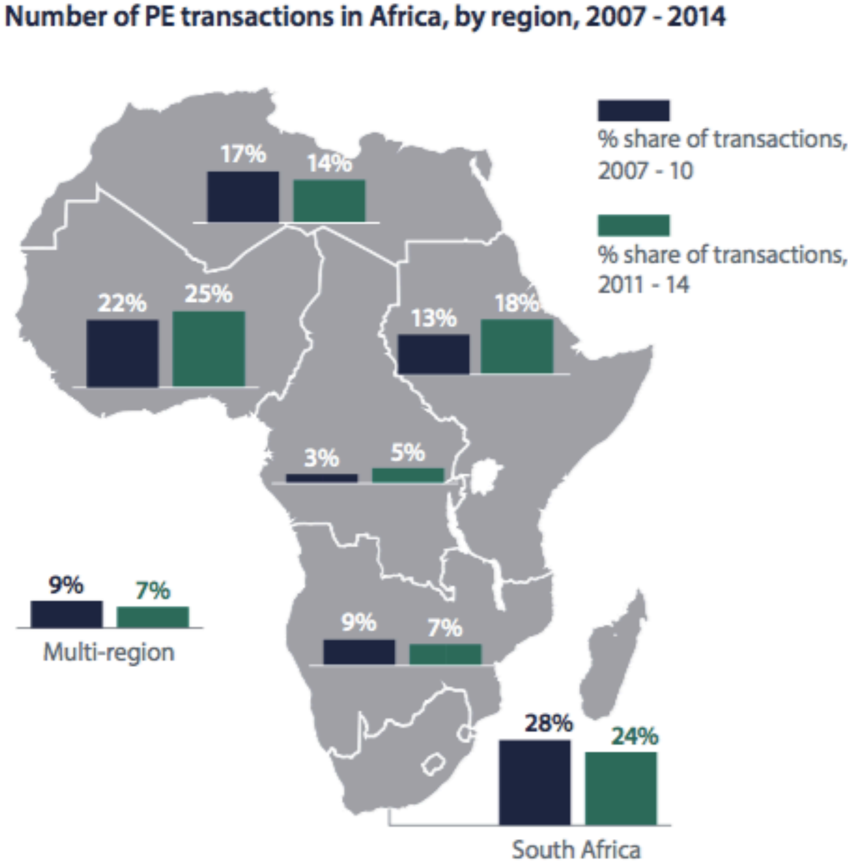
markets, venture capital firms are usually specialized in few sectors. Tyebjee & Bruno´s (1984) study reports that VC tend to favor nascent technology industries over mature technologies, the industrial market over the consumer market and products over services. In the sample of 90 deals, 64% involved either a new technology or a new application, and 18% were described as improvements on current products. Following are statistics concerning private equity transactions in Africa by sector (AVCA, 2014).

Figure 2: Number and value of PE transactions in Africa, by sector, 2007-2014



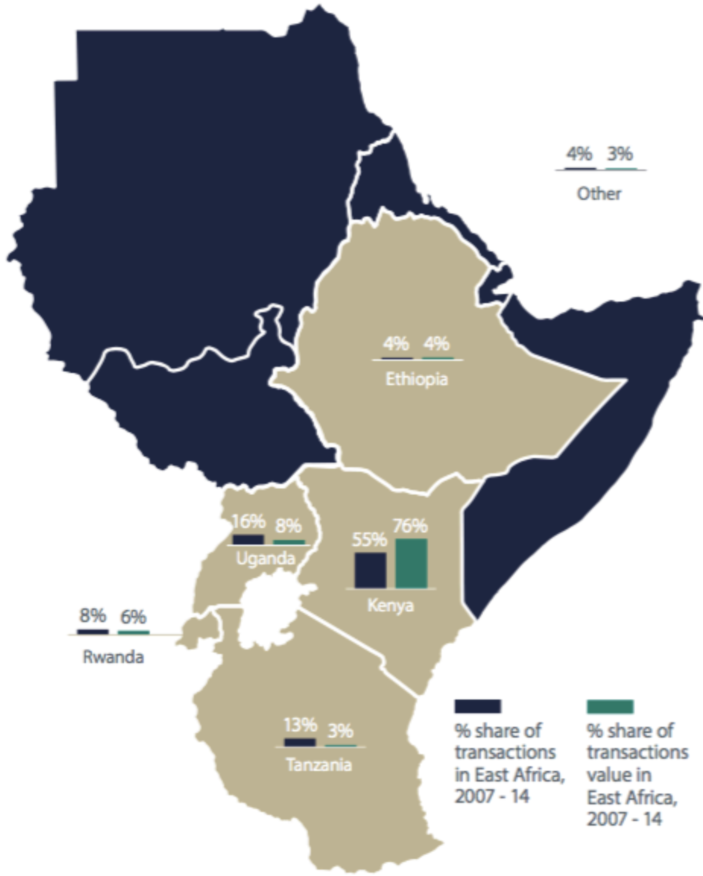
3. *Geographic location of the venture.* In the screening process, geographic location can be important. When a VC invests in a firm, regular meetings with the management of the new venture are expected. In the worst-case scenario, the VC has to oversee the operations of the investment very closely. Although most VC companies do not have a specifically defined geographic area as a screening criterion, their portfolio often exhibit this specialization. Tyebjee & Bruno´s (1984) describe a tendency of entrepreneurs to search for capital close to their venture´s home where their banking, legal, and accountancy contacts are strongest. In syndication however, the geographic location of the venture can become less important. If the investment involves the participation of another VC fund that is close to the venture´s location, it can be overseen with greater ease. Following are the statistics on the umber of private equity transactions in Africa by region (AVCA, 2014).

Figure 3: Number of PE Transactions in Africa, by Region, 2007-2014



East Africa's share of PE transactions in Africa is rising, albeit from low levels. The region accounted for 18% of the total number of PE transactions in Africa from 2011 - 2014, up from 13% in 2007 - 2010. Its share of the total value of African PE transactions was 4% in 2007 - 2010 and 6% in 2011 – 2014. Following are the statistics for East Africa in particular. Kenya has attracted the majority of PE transactions in East Africa, both by number and value. Uganda, Tanzania, Rwanda and Ethiopia, however, are all seeing increased interest from PE investors (AVCA, 2014).

Figure 4: Percentage share of the volume and value of Pe Transactions in East Africa, by country, 2007-2014



4. *Stage of financing.* Venture capital investment into a company can occur at several points in the life cycle of the venture. When the stage of financing is concerned, it is important to note that different meanings are applied to the different stages in the literature. Tyebjee & Bruno (1984) describe seed capital as the funds invested before the venture exists as a formal entity. Start-up capital refers to financing for establishing operations while subsequent rounds of financing are used for expanding operations. Tyebjee & Bruno (1984) report that VC rarely invests in seed capital and entrepreneurs usually turn to informal sources for this capital. To encourage consistency in meanings when comparing to other studies, the start-up capital stage in Tyebjee & Bruno´s framework will be referred to as Stage 1 or early stage (see Table 4). In the sample of 90 deals, Tyebjee & Bruno found that 45.6% were start-ups (stage 1 in table 3), 22.2% were first round expansion deals (stage 2), and 21.1% were second round expansion deals (stage 3). Findings from a later study by Robinson Jr. (1987)

are also reported in table 3 as a mean of comparison. Robinson Jr. (1987) evaluated 53 firms in the United States, and defined the different stages in his study as follow. Stage 1 was the startup stage or first round financing, stage 2 was defined as early growth and second round financing, and stage 3 was defined as a major expansion and third round financing. Stage 4 and 5 were defined as leverage buyouts, secondaries and acquisition of established business in mature or declining market positions. In his study, Robinson Jr. (1987) reports that 90% of the fifty-three firms evaluated indicated the presence of Stage 1 and Stage 2 companies in their portfolio. The average portion of their portfolios was 35.1% in stage 1 companies, and 32% in stage 2 companies. When it comes to the third stage, 80% of the sample indicated its presence in their portfolio, with an average portion of 30%. For companies in the declining stages (stage 4 and 5), only 3 out of the 53 portfolios had investments in such companies. Robinson Jr. (1987) also reports a research from the Venture Capital Journal in his study (see Table 4).

Table 4: Percentage of financing in different stages

Financing Stages	Tyebjee & Bruno (1984)	Robinson Jr. (1987)	Venture Capital Journal (1983)
Early Stage (S1)	45.6%	35.1%	43 %
Expansion Stage (S2)	22.2%	32 %	29 %
Later Expansion Stage (S3)	21.1%	30 %	19 %
Other (S4 and S5)	-	-	9 %

As seen in Table 4, findings from different studies collaborate. Stage 1 and stage 2 businesses are the most popular investments for VC. Stage 3 investments follow closely while stage 4 and 5 investments are unpopular (Robinson Jr, 1987, p. 65). It is however important to note that the risk preferences of VC differ. Therefore, some funds will commit capital to later stage rounds only. On the other hand, some VC will only commit to later stage rounds if they have already invested in the venture in prior rounds.

Venture capitalists differ in the screening criteria used to guide their investments. In order to pass through the screening process, potential investments would have to match the investor´s industry and geographic preferences, risk preferences for different financing stages, and

investment policy in terms of the amount they will invest in a single deal (Tyebjee & Bruno, 1984).

2.2.3- Evaluation

The third step in Tyebjee & Bruno´s (1984) framework is the evaluation process. Cooperating venture capitalists in the study were asked to rate the deals that had passed their initial screen and were under serious consideration. The evaluation process consisted of three steps. First, the deals were rated on 23 criteria. Second, the deals were rated on overall expected return and risk, respectively. Lastly, the VCs were asked to indicate their decision regarding whether or not to invest. Following is a description of each step in Tyebjee & Bruno´s (1984) evaluation process model.

Step 1 of the evaluation process: Evaluation on criteria

As mentioned above, participating VC in Tyebjee & Bruno´s (1984) study were asked to rate deals that had passed the initial screen. Investment prospects were rated on 23 characteristics (see Table 4). In order to explore whether a more general pattern was underlying the VCs answers, the data were factor-analyzed. As seen in Table 4, eighteen criteria were reduced to five major groupings. The remaining five in "*Other Criteria*" had high frequency of deals that were not evaluated on that particular criterion. Tyebjee & Bruno concluded that VCs evaluate potential deals in terms of five underlying dimensions. Those are market attractiveness, product differentiation, managerial capabilities, environmental threat resistance, and cash out potential. Next, each factor will be described in more details.

Table 5: Factor Structure of Evaluation Criteria

Factor 1 Market Attractiveness	Factor 2 Product Differentiation	Factor 3 Managerial Capabilities
Access to Market Market Need for Product Size of Market Growth Potential of Market	Technical Skills Profit Margins Uniqueness of Product Patentability of product	Management Skills Marketing Skills Financial Skills References of the Entrepreneur
Factor 4 Environmental Threat Resistance	**Factor 5 Cash Out Potential**	**Other Criteria**
Protection from Competitive Entry Resistance to Economic Cycles Protection from Obsolescence Protection against Down-side Risk	Opportunities for Exit Merger/Acquisition Potential	Raw Material Availability Production Capabilities Freedom from Regulation Hedge against Current Investments Tax Benefits

1. *Market attractiveness*: the first characteristic in Tyebjee & Bruno´s framework is labeled market attractiveness and depends upon the accessibility, the size, and the growth potential of the market. Another important factor in the attractiveness of the market is also the existence of a market need for the product. In the follow-up study by Macmillan et al. (1985, p. 123), it is found that the critical market requirement is a high growth rate. In general, other market criteria were not regarded as important.

2. *Product differentiation*: the second characteristic reflects product differentiation, and is determined by the entrepreneur´s ability to apply his technical skills in creating a unique product that can deliver high profit margin, and that can deter completion through patents.

3. *Managerial capabilities*: In Tyebjee & Bruno´s evaluation process model, this characteristic is associated with the entrepreneurs´ capability of managing several business areas such as management, finance and marketing. References given to the entrepreneur are also in importance. In a study by Macmillan et al. (1985), participating VCs were asked to

identify criteria used in evaluating venture proposals. Like Tyebjee & Bruno´s study (1984), responses were factor-analyzed and the criteria were classed into six major groups. The first two groups were characteristics of the product and the market, and had lot of similarities with the characteristics described above (1 and 2). The next group was labeled *financial consideration*, and had similarities with Tyebjee & Bruno´s (1984) *cash-out potential.* The last three groups consisted of criteria evaluating managerial capabilities, but had criteria that differed from Tyebjee & Bruno´s model. When it comes to management, Macmillan et al. (1985) concluded that venture capitalists evaluated potential deals in terms of the entrepreneur´s personality, the entrepreneur´s experience and an assessment of the venture team composition (See table 6).

Table 6: McMillianet al. (1985) Management Criteria

The Entrepreneur´s Personality	The Entrepreneur´s Experience
Capability of Sustained Intense Effort	Familiarity with the targeted market
Ability to evaluate and react well to risk	Demonstrated leadership ability
Articulate in Discussing Venture	Relevant Track Record
Attention to Details	Source of the Referral
Compatible Personality	Familiarity with the Entrepreneur´s Reputation

Macmillan et al. concluded that the most important personality characteristics were evidence of staying power and an ability to handle risk. Key experience requirement were concluded to be a thorough familiarity with the target market, closely followed by demonstrated leadership capabilities and relevant track record (Macmillan et al., 1985, p. 121-123).

4. *Environmental Threat Resistance*: The fourth factor in Tyebjee & Bruno´s (1984) model is labeled Environmental Threat Resistance, and represents the extent to which the firm is resistant to uncontrollable pressures from the environment. These pressures may result from sensitivity to economic cycles, or from low barriers to entry. These pressures may also result from obsolescence due to changing technology.

5. *Cash-out Potential*: The final characteristic that deals are evaluated on according to Tyebjee & Bruno (1984) is the investment´s liquidation potential. Future opportunities to realize capital gains by merger, acquisition or public offering at the appropriate time are assessed in this last factor.

Macmillan et al. (1985, p. 123) reports that personality and experience concern generally dominates the financial criteria, which in turn are regarded as more important than product and market. Focusing on performance however, a different conclusion emerges. In a follow-up research by Macmillan, Zemann & Subbanarasimha (1987), criteria distinguishing successful from unsuccessful ventures in the venture screening process were studied. After analyzing a sample of 150 ventures, Macmillan et al. (1987 p. 124) identified two major criteria that were predictors of venture success. Those were 1) the extent to which the venture is initially insulated from competition and 2) the degree to which market acceptance of the product is demonstrated.

Step 2 of the evaluation process: Risk- Return Assessment

The next step in Tyebjee & Bruno´s (1984) evaluation process model is a risk-return assessment (see Figure 2). Participating VC were asked to rate deals on overall expected return and risk, respectively. As most investment prospects have very little, if any, operating history, the VC has to rely on a subjective assessment procedure. In 42% of the deals evaluated in Tyebjee & Bruno´s (1984) research, the VC was unable to assign a numerical estimate of the expected rate of return. Consequently, the expected return was measured on a four-point scale (i.e. low, moderate, high, very high). Using a linear regression model, Tyebjee & Bruno found that expected return was determined by *Market Attractiveness* (factor 1) and *Product Differentiation* (factor 2). Result showed that attractive market condition had the strongest effect on the deal´s expected rate of return, while a highly differentiated product had the next highest effect. Other characteristics of the deal did not influence the expected return at a significant level. Robinson Jr. (1987) reports in his study that an annualized, after-tax return on investments between 25% and 40% was the most common objective across VC firms.

Beyond providing funds to the venture, the VCs real challenge lies in managing the risk of the venture (Macmillan et al. (1985, p.125), Macmillan et al. (1987, p. 133)). In Tyebjee & Bruno´s (1984) research, perceived risk was measured by asking VC to assign a subjective

probability to the venture being a commercial failure. Results from a regression analysis showed that perceived risk was determined by *Managerial Capabilities* (factor 3) and *Environmental Threat Resistance* (factor 4). As illustrated by the signs in Figure 2, managerial capabilities had the highest effect on reducing the riskiness of the deal, and resistance to environmental threat had the next highest effect. Other characteristics of the deal did not significantly influence the perceived risk of the deal. The last factor in Tyebjee & Bruno´s (1984) model was the *cash-out potential*. Interestingly, it did not seem to influence either perceived risk or expected return. For that reason, the factor *cash-out potential* was not a part of the illustration below.

Figure 5: Venture Capital Investment Decision Process

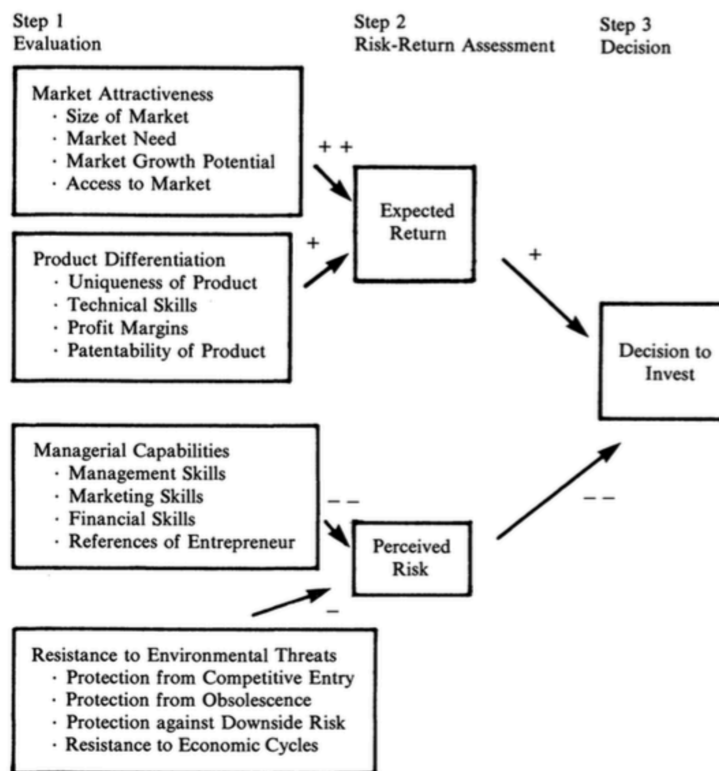


FIGURE 2. Venture Capital Investment Decision Process.*

*The + +, +, −, − − symbols indicate the direction and magnitude of the parameters describing the relationships of variables.

Step 3 of the evaluation process: Decision to invest

As anticipated, venture capitalists are risk-averse and profit-oriented. The decision to invest is based on the expected return relative to the risk level of the venture. In the follow-up study of Tyebjee & Bruno´s (1984) research, Macmillan et al. (1985) sought to determine whether there were any broad types of VC, with common approaches to the overall evaluation of venture proposals. A cluster analysis was carried out, and Macmillan et al. (1985, p.127-128) identified three clusters of venture capitalist.

The first cluster was named “Purposeful Risk Managers”, and represented about 40% of the venture capitalists in the sample of 102 participating VC. This group of VC tends to expect several attributes that assure that the risks are reduced to manageable levels. Risk management characteristics sought by VC are entrepreneurs with demonstrated leadership skills, protectable products with a developed prototyped, a clear market acceptance in an

existing market, and a low threat of early competition. Although few ventures possess all of these attributes, venture capitalist in this group seek to invest in ventures that are high in as many of these as possible.

Macmillan et al. (1985) called the second cluster “Determined Eclectics”, and comprised 33% of the sample. Contrary to the “Purposeful Risk Managers”, this group intentionally imposes minimum restrictions on deals they are willing to consider. Thus, they keep as many options open as possible, and take pride in being open to all types of venture proposals.

The last cluster identified was named “Parachutists”, and represented 25% of the venture capitalist in the sample. This group seeks easy bail out, and can support most ventures as long they feel that a high liquidity “parachute” can be used if things don´t go as planned. Important attributes to the “Parachutists” are entrepreneurs with staying power, and a highly liquid investment. When it comes to venture capitalist, it is important that the venture is in an industry they are familiar with, and be secure in the knowledge that they will be able to recognize problems and bail out if needed.

The decision to invest represents the final step in Tyebjee & Bruno´s (1984) evaluation process model. If the VC decides to invest in the venture, the negotiation process begins. Next follows a short description of Tyebjee & Bruno´s two final stages in the Venture Capitalist Investment Activity model, namely *deal structuring* and *post-investment activities*.

2.2.4- Deal Structuring

Deal structuring is the fourth step in Tyebjee & Bruno´s decision process model of Venture Capitalist Investment Activity. This step represents the phase where the VC has decided that the deal is acceptable. In order for the deal to be consummated, the venture capitalist and the entrepreneur have to structure a mutually acceptable venture capital investment agreement. Some of the agreed upon terms of the deal between the VC and the entrepreneur are the price of the deal, covenants, and earn-out arrangement. According to Tyebjee & Bruno (1984), the price of the deal or the equity share the entrepreneur is willing to relinquish in exchange for the venture capital is decided at this stage. Covenants that limit capital expenditures, management salaries, and the basis under which the VC can take control of the board are

established. Examples of other covenants in the agreement are the venture capitalist´s power to force a change in management, or liquidate the investment by forcing a merger, acquisition, public offering or a buy-back. On the other hand, covenants that limit the venture management´ s power to dilute the equity of the original investors by raising additional capital elsewhere may be established. In the deal structuring stage, the VC is also able to assess the entrepreneur´s expectations for the venture through an earn-out agreement. This is where the VC and the entrepreneur agree on performance objectives that determine the entrepreneur´s equity share (Tyebjee & Bruno, 1984, p. 1053-1054).

Private equity investment in Africa is chiefly growth capital, which is in contrast to the more well-known strategies of the global leveraged buyout firms operating in mature markets. In Africa, the dynamic growth combination of emerging industries and the demographic trajectory, means the strategies used by private equity firms to create value are often fundamentally expansionary. In line with the concept of growth capital, private equity firms in Africa tend to take minority stakes (less than 50%) in companies, and typically alongside management who remain majority shareholders. In 2013, AVCA and EY launched an inaugural industry research study on African Private Equity Exits (the Study), which surveyed the characteristics of 118 exit transactions over 2007 – 2012. Of the 118 deals surveyed, 80% of the managers had invested via minority positions. Minority stakes in Africa are also common due to the developing nature of markets and the consequential shallow pool of executive talent, making incumbent management and effective successive planning very important. To protect their interests, private equity firms will implement contractual minority protections to ensure they have sufficient influence on the portfolio company's strategy, major decisions and board composition (AVCA 2013/2014).

2.2.5- Post-Investment Activities

The last step in Tyebjee & Bruno´s decision process model is post-investment activities. As mentioned in the introduction, the VC´s role expands from investor to collaborator once the deal has been consummated. This new role can be via a formal representation on the board of directors or via informal influence in market, supplier or creditor networks. Although the intensity of involvement in the venture´s operations differs, Tyebjee & Bruno report that it´s

undesirable for a VC firm to exert control over the day-to-day operations of the venture. If a managerial or financial crisis occurs, the VC may intervene or even force a change in management.

Lastly, VCs usually want to cash-out their gains five to 10 years after initial investment. To this end, venture capitalist play an active role in directing the venture towards merger, acquisition or a public offering (Tyebjee & Bruno, 1984, p. 1054). EY & AVCA (2014) report that in Africa, companies that exited in 2014 were held for an average of 4.9 years. That is versus Africa´s longer-term average of 5.1 years, and down 18% from the 6.0 years seen 2013 (see appendix for further statistics on PE Exit in Africa).

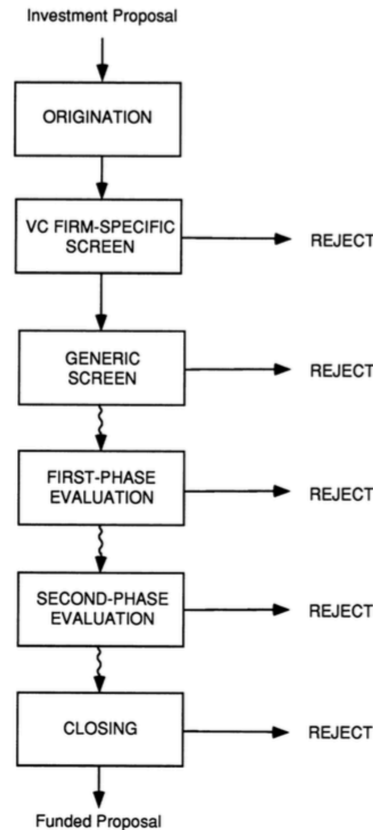
To summarize, Tyebjee & Bruno´s (1984) model of the venture capitalist´s investment activity involves five steps. The first step is *deal origination,* and it´s found that potential deals originate from three sources; cold contacts, referrals and active searches. The second step is *a screening process* that is based on the following four criteria: the size of the investment and the investment policy of the venture fund, the technology and market sector of the venture, the geographic location of the venture, and the stage of financing. The third step is an *evaluation process* where the venture capitalist seeks to assess the venture on a multidimensional set of characteristics. Risk and return are assed before a final decision regarding whether or not to invest in a particular deal is taken. *Deal Structuring* is the fourth step in Tyebjee & Bruno´s (1984) model and represents the negotiation process between the venture capitalist and the potential investee. Lastly, Tyebjee & Bruno shortly describe the final step called *Post Investment activities.*

Tyebjee & Bruno´s (1984) model gives a good overview of the venture capitalist investment activity. However, to give a more complete representation of the VCs investment activity, a follow-up study by Fried & Hisrich (1994) will be reviewed. Compared to previous studies, Fried & Hisrich (1994) had more focus on the specific activities that VCs undertake, and made a major research contribution. To obtain data with more informational content than used in prior studies, 18 VCs from three different regions in the United States were personally interviewed, and followed up with a structured questionnaire. This resulted in 18 case studies describing the investment process in a variety of different industries and stages of financing. Next follows a description of the decision-making process model developed by Fried & Hisrich (1994).

2.3- A Six-Stage Model of Venture Capital Investment Decision-Making

Fried & Hisrich (1994) propose a six-stage model of VC investment decision-making. The stages are as follow: origination, venture capital firm-specific screen, generic screen, first-phase evaluation, second-phase evaluation, and closing (see Figure 3). While this new model developed by Fried & Hisrich (1994) has many similarities with Tyebjee & Bruno´s (1984) model, there are also major differences. Fried & Hisrich (1994) discovered that most proposals passing through the screening process still got quickly rejected. The screening phase described by Fried & Hisrich (1994) was therefore called *VC firm-specific screen*, and a new stage called *generic screen* was added. In addition, Fried & Hisrich (1994) divided the evaluation phase into two parts. The finale stage in this model is called *closing* and describes the deal-structuring phase before the proposal is funded. Unlike Tyebjee & Bruno (1984), Fried & Hisrich (1994) do not include post-investment activities in their model.

Figure 6: Venture Capital Investment Process[2]



As the first stages in Tyebjee & Bruno´s (1984) and Fried & Hisrich´s (1994) models and results are similar, only a brief description will be given. The emphasis will be on the later stages of the model where Fried & Hisrich´s (1994) report the different activities of the VCs.

2.3.1- Origination

Fried & Hisrich (1994) confirm the findings that deal originates from the tree sources: cold contacts, referrals, and active search. While VCs receive many deals cold or without any introduction, Fried & Hisrich reports that they rarely invest in them. As most funded proposals come by referral, a major focus for VCs is to develop a network of referrers. Active search is the third source of deal origination, and the study reports that a growing minority of VCs aggressively seeks out deals (Fried & Hisrich, 1994, p. 31-32).

[2] The wavy lines in Figure 3 indicate that a proposal´s progress through the last three stages is not preordained.

2.3.2- Venture Capital Firm-Specific Screen

The second stage in Fried & Hisrich´s (1994) model of VC Investment Process is the venture capital firm-specific screen. The study reports that venture capitalists have firm-specific criteria on investment size, industries in which they invest, geographic location and stage of financing. As this is similar to the screening process described in the previous model, no further description will be given in order to avoid recurrence.

2.3.3- Generic Screen

The firm-specific screen involves a cursory glance at the business plan at most. When Fried & Hisrich discovered that most proposals passing through the screening process still got quickly rejected, they added a new stage. This third step was called the generic screen, and described a process by which VCs analyzed potential investments in terms of generic criteria. Fried & Hisrich (1994) reported fifteen criteria as a common base for VC investments. Those are grouped in three categories, namely concept, management, and returns (see Table 7).

Table 7: Generic Criteria

Concept	Management	Return
Potential for Earning Growth	Personal Integrity	Exit-Opportunity
A Working Business Idea	Good Track Record	Potential for a High Rate of Return
Competitive Advantage	Realistic	Potential for a High Absolute Return
Reasonable Capital Requirements	Ability to Identify Risk	
	Hardworking	
	Flexible	
	Thorough Understanding of Business	
	General Management Experience	

Concept has four components. The potential for earning growth may come from a rapidly growing market, an increased market share, or through significant cost cutting. The investment prospect also needs a business idea (i.e. new product, service or retail concept) that´s already working or that can be brought to the market within 2-3 years. Third, a substantial "competitive advantage" must exist. Alternatively, the venture can be in a relatively non-competitive industry. Lastly, the concept must include reasonable overall

capital requirements. Through syndication however, capital can be pooled in order to share risk and to increase the total amount invested in one company.

Fried & Hisrich (1994) reported several attributes venture capitalists wanted to see in managers. Those are listed in Table 6. The last group of criteria is named *return* and includes exit opportunity, potential for a high rate of return, and potential for a high absolute return. The study reports that while an easy liquidity is not expected, venture capitalists require the likelihood of some type of exit in a 3-10 year period. The potential for a high rate of return is also important, and Fried & Hisrich report the hurdle internal rates of return ranging between 30% and 70%. Lastly, the investment prospect must offer the potential for a high absolute return. Tyebjee & Bruno (1984) point out that VCs cannot afford to spread their portfolio over too many small deals due to limited staff, Fried & Hisrich add another argument. That is, even with a high rate of return, VCs are unwilling to spend time on small investments that offer low absolute return (Fried & Hisrich, 1994, p. 31).

A generic screen based on the venture´s *concept*, *management* and *return* enables the VCs to screen through the many proposals that passed the firm-specific screen with minimal investment of time. Most proposals are rejected at this stage.

2.3.4- First-Phase Evaluation

If the proposals pass through the generic screen, an evaluation process involving a general monitoring by the VC begins. While the screening process is based upon a reading of the business plan coupled with existing knowledge, the first-phase evaluation describes a process by which VCs begin to gather additional information about the proposals. In the study, Fried & Hisrich (1994, p. 33) asked venture capitalist the following question: “Prior to funding an investment as lead investor, how often do you engage in the following activities?” The answers are reported in Table 7, where activities undertaken by VCs in the evaluation process are listed.

Table 8: Evaluation Activities Carried Out by Venture Capitalists

ACTIVITY	HOW OFTEN (%)
Interview all members of management team	100
Tour facilities	100
Contact entrepreneur's former business associates	96
Contact existing outside investors	96
Contact current customers	93
Contact potential customers	90
Investigate market value of comparable companies	86
Have informal discussions with experts about the product	84
Conduct in-depth review of pro forma financials prepared by company	84
Contact competitors	71
Contact banker	62
Solicit the opinion of managers of some of your other portfolio companies	56
Contact suppliers	53
Solicit the opinion of other venture capital firms	52
Contact accountant	47
Contact attorney	44
Conduct in-depth library research	40
Secure formal technical study of product	36
Secure formal market research study	31

In the evaluation phase, information gathered from the company and outside sources is compared to the information in the entrepreneur´s business plan. Common for all VCs is interviews with all members of the top-management team. The goals of these meetings are twofold. First, they increase the VC´s understanding of the business. Second, it allows an assessment of the manager´s understanding of the industry, the proposal, problems that may occur, in addition to an opportunity to assess how managers think and behave.

As showed in Table 8, venture capitalists partake in different other activities in the evaluation process, some more common than others. The stage of financing can be an example of the cause of variation. For instance, late-stage investors are more likely to contact accountants and banks than early-stage investors due to the availability of financial history.

2.3.5- Second-Phase Evaluation

The start of the second-phase evaluation can be difficult to identify. Fried & Hisrich (1994) define it to be the point when the VC develops an "emotional" commitment to a proposal. While the goal in the first-phase evaluation is to determine whether there is a serious interest

in the proposal, the second-phase´s objective is to determine possible obstacles and solutions. Evaluation activities continue, the amount of time spent on proposals however, increases dramatically. In Tyebjee & Bruno´s (1984) model, price is negotiated in the deal-structuring phase, after the evaluation process is completed. Fried & Hisrich (1994) argue however that VCs wish to have a rough understanding of the deal-structure, including price, before entering the second-phase evaluation. This is to avoid spending a significant amount of time on proposals that will ultimately be rejected due to a price that is too high (Fried & Hisrich, 1994, p. 34).

2.3.6- Closing

The last stage in Fried & Hisrich´s (1994) model is the closing stage. This final step describes the process by which details of the structure are finalized, and legal documents negotiated. After the documents are signed, a check is given to the venture (Fried & Hisrich, 1994, p. 34). Like in the previous stage, the shift from the second-phase evaluation into the closing stage might be difficult to identify. It is important to note that proposals can be rejected at any stage in the process, including the closing stage. Fried & Hisrich (1994) report that a surprising number of deals still get rejected at this stage.

The VC investment decision-making process described by Tyebjee & Bruno (1984) and followed-up by Fried & Hisrich (1994) made major research contributions. A combination of those two models allows an extensive description of the venture capitalist´s investment activity.

3- Methodology

This study is a research project that aims to generate dependable data that answers the research problem at hand, i.e. *"What are the essential factors a company in Rwanda must have, in order to receive private equity/venture capital financing?"* Good research follows the standards of the scientific method, which is systematic, empirically based procedures for generating replicable research. Schindler & Cooper (2008) list several defining characteristics of the scientific method. The purpose of the research should be clearly defined, the research process detailed and the research design thoroughly planned. High ethical standards as well as frankly revealed limitations are also important (Schindler & Cooper, 2008, p. 13-15). This section presents the methodology applied in this study and describes the research process, the research design, the data sources and the data collection method. Lastly, the ethical aspects of the research and the limitations are presented.

3.1- Type of Research

In research methods, a distinction is made between research that departs from existing theory (deductive) and research that departs from observations or data (inductive). Deductive reasoning is defined as the logical process of deriving a conclusion about a specific instance based on a known general premise or something known to be true (Ghauri & Grønhaug, 2010, p. 16, Zikmund, Babin, Carr & Griffin, 2013, p. 43-44). In this type of research, the researcher builds or deduces hypotheses from the existing knowledge or literature in a particular domain. The hypothesis is then subject to empirical scrutiny or testing and thus can be accepted or rejected. In a deductive research, theory and the hypotheses built on it come first and influence the rest of the research process. The other type of research called induction moves in the opposite direction of deduction. Inductive reasoning is defined as the systematic process of establishing a general proposition on the basis of observation or particular facts (Ghauri & Grønhaug, 2010, p. 16, Zikmund et al., 2013, p. 44). In induction, general conclusions are drawn from empirical observations as the research process goes from observations and findings to theory building. In this type of research, findings are incorporated back into the stock of theory or existing knowledge and literature. Thus, theory

is the outcome of research. (Bryman, 2012, p.24-25, Ghauri & Grønhaug, 2010, p. 15-16, Zikmund et al., 2013, p. 43-44). While facts acquired through observations leads to theories and hypotheses, deduction is used to accept or reject these theories and hypotheses. This research is therefore inductive by nature as the goal is not to test a hypothesis but to study the investment process of private equity and venture capital firms that invest in Rwanda and the essential factors of investee companies.

3.2- Research Process and Research Design

Research is often thought of as a process. The starting point is usually a research topic, which in this case is "Private Equity and Venture Capital in Rwanda". The topic is further specified by a research problem (i.e. "What are the essential factors a company in Rwanda must have, in order to receive private equity/venture capital financing?"). Once the research problem is established, a review of relevant theory and literature follows. The author primarily used the University of Agder´s library and large electronic database to search for theory or models that made major research contributions in the Private Equity/Venture Capital domain. Those were found to be the studies by Wells (1974), Tyebjee & Bruno (1984), and Fried & Hisrich (1994), which were repeatedly cited in the literature. The latter two studies were found in the University´s electronic database, and consequently used as the main models in this research. The author also searched for information about Rwanda and investing in Rwanda. To obtain information that is as reliable and of high quality, the majority of the data was collected from international organizations and governments. Examples of the sources used are The Embassy of The United States´ Rwanda Investment Climate Report 2014, reports from the World Bank, and reports from the Rwandan Ministry of Trade and Industry.

The next step followed after the literature review is the choice of research design. The research design is the overall plan that specifies the methods and procedures for data collection and analysis. Thus, the research design relates the conceptual research problem to relevant and practicable empirical research. As the research design provides a framework or plan of action for the research, it is conceived as the overall strategy to get the information wanted. A good research design is effective and has an approach that allows for solving the research problem within the given constraints (Ghauri & Grønhaug, 2010, p. 54, Zikmund et al., 2013, p. 64). First, the research design reveals the type of research. Ghauri & Grønhaug

(2010) distinguish between the three main classes of research and research design: exploratory, descriptive and causal.

Exploratory research designs are adequate when the research problem is badly understood. Exploratory research is not intended to provide conclusive evidence, but rather a first step. They are conducted with the expectation that additional research will be needed to provide more conclusive evidence. The second main type of research is descriptive research, and the major purpose is to describe the characteristics of the given study object. Unlike exploratory research, descriptive research is conducted when the situation being studied is well understood. Accuracy is critically important in descriptive research, and key characteristics are structure, precise rules and procedures. The third type of research is causal research and seeks to identify cause-and-effect relationships. The different types of research are often building blocks. Exploratory research builds the foundation for descriptive research, which in turn usually establishes the basis for causal research (Ghauri & Grønhaug, 2010, p. 55-58, Zikmund et al., 2013, p. 51-55). To the author´s knowledge, there have not been many studies on private equity and venture capital in Rwanda. This study is consequently an exploratory research, and is intended as a first step towards additional research.

In addition to revealing the type of research (e.g. exploratory, descriptive or causal), the research design also describes the research method. While the research design is the overall strategy to get the information wanted, the research method refers to the techniques used to collect data. Researchers distinguish between two types of methods: quantitative and qualitative. Quantitative research can be construed as a research strategy that emphasizes quantification in the collection and analysis of data. It entails a deductive approach in which the accent is placed on the testing of theories. On the other hand, qualitative research is construed as a research strategy that emphasis words rather than quantification in the collection and analysis of data. Qualitative research predominantly emphasizes an inductive approach in which the emphasis is placed on the generation of theory (Bryman, 2012, p.35-36). Ghauri & Grønhaug (2010) state that normally, the basic distinction between quantitative and qualitative research is that quantitative researchers employ measurement and qualitative researchers do not. In qualitative research, findings are not arrived at by statistical methods or other procedures of quantification. However, it is important to note that ambiguity partly prevails with regards to what distinguishes “qualitative” and “quantitative”. (Ghauri & Grønhaug, 2010, p. 104).

Which methods and techniques are most suitable for which research depends on the research and its purpose. Quantitative methods are used when the research purpose is to describe, explain, predict and test theory. The researcher´s involvement is limited to prevent bias, and consistency is critical when collecting data. Probability is used in the sample design and the sample size is normally large. Qualitative methods on the other hand are used when the research purpose is in-depth understanding and theory building. The researcher´s involvement is high as the researcher is participant or catalyst. Other common characteristics of qualitative methods are small sample sizes and a nonprobability and purposive sample design. Qualitative research is particularly relevant when prior insights on the study object are modest, implying that qualitative research tends to be exploratory and flexible (Schindler & Cooper, 2008, p. 16, Ghauri & Grønhaug, 2010, p. 196). In this research, a qualitative method was most suitable and consequently chosen in the research design. The choice of research method has a great influence on the subsequent research activities. A plan or a framework for those activities are included in the research design, and following is a description of the remaining steps in the research process (i.e. data sources, data collection and data analysis)

3.3- Data sources

Once the overall strategy has been selected, the researcher is faced with the choice of data. That decision depends on the type of problem, the information needed and most importantly the data possibilities. A variety of data sources will often be available. A first distinction can be made between primary and secondary data sources. Primary data sources are original data collected by the researcher for the research problem at hand. Secondary data sources are information collected by others for purposes that can be different. The various data sources have both advantages and disadvantages. Secondary data are useful not only to find information that solves the research problem, but also to better understand the research problem. This study began with secondary data in the literature review and in the search for information about Rwanda. While some research questions can be answered with secondary sources only where no further data collection is needed, it is not the case in this study. To the author´s knowledge, there has not been data collected on the essential factors a company in Rwanda must have, in order to receive private equity/venture capital financing. When secondary data are not available or cannot answer the research question at hand, the researchers must collect the data that are relevant themselves. Consequently, the data sources

used in this study are primary data sources. The main advantage is that the data is collected for the particular project at hand, thus primary data are more consistent with the research question and research objectives. The main disadvantage is that collecting primary data can take a long time and cost a lot to collect. Moreover, it can be difficult to get access, particularly when dealing with sensitive issues or research questions. Another major weakness in the quality and scope of information gathered through primary sources is that the researcher is fully dependent on the willingness and ability of respondents (Ghauri & Grønhaug, 2010, p. 90-100). Issues concerning time and budget constraints as well as the willingness of possible respondents have been encountered during this research and will be discussed in the next section.

3.4- Data Collection

The next step after deciding to collect data through primary sources is to select those elements from which the information will be collected.

3.4.1- Sampling

Sampling procedures can be divided into two broad categories, probability and non-probability samples. Generally, quantitative research involves probability sampling while qualitative research involves non-probability samples. As this research is qualitative, non-probability sampling is used hence little attempt is made to generate a representative sample (Schindler & Cooper, 2008).

The unit of analysis in this study is private equity and venture capital firms that invest in Rwanda. When searching for participants for this study, the author started with contacting Rwandan private equity and venture capital firms. Four funds were called and emailed and one ended up participating in the research. That company is BDF Ltd (See Figure 4). Next, the author searched for private equity and venture capital funds that have subsidiaries in Rwanda and/or have or have had investments in Rwanda. Additional 7 private equity and venture capital firms were found and three of those participated. Those are Norfund, Kaizen Venture Partners and a third fund that preferred to stay confidential (See figure 4). Lastly, the author searched for private equity and venture capital funds with a focus on private equity investing in Africa. 17 PE & VC funds were emailed/called and asked if they had investments or potential investments in Rwanda. 10 did not answer, 6 replied that they did not invest in

Rwanda, and one fund referred to their investment manager in Rwanda. The investment manager did not respond to the email subsequently sent, hence none of the 17 PE & VC funds ended up participating in the research. To summarize, 28 private equity and venture capital fund were contacted and 4 ended up as participants. The majority of those private equity and venture capital firms had a focus on growth capital.

3.4.2- Interview

The interview is the primary data collection technique for gathering data in qualitative methodologies. In this research, interviews were done by phone due to several reasons. First there were budgetary constraints. As the participants were all located in different countries, personal interviews were not feasible in any of the cases. Next there were time constraints. Although one advantage of telephone interviewing is the speed of data collection, investment managers in the private equity and venture capital industry are relatively busy. Consequently, it was difficult at time to get response and make appointment for the phone-interviews. Following is a more detailed description of the participants:

Table 9: Research Participants

	Norfund	Kaizen Venture Partners	BDF	Fund Management Company (FMC)
Interview Object	Head of Regional Office East Africa Mr. Kjartan Stigen	Vice President Mr. Sean Nowak	Investment Manager	Investment Manager
Investment Strategy	DFI- Growth Capital Investment	Turnaround Investment in Distressed Companies	SME-focused Growth Capital Investment	Growth Capital Investment

There are three major types of interviews: structured interviews, semi-structured interviews and unstructured interviews (Schindler & Cooper, 2008, Ghauri & Grønhaug, 2010, Bryman, 2012, Zikmund et al., 2013). The most suitable structure in this study was a semi-structured interview with an interview guide (see appendix 1). Open-ended questions were used and the

interviewee had a great deal of leeway in how to reply. The questions did not follow the exact outline but all the questions were generally asked, as well as follow-up questions. Since the different firms had different names for the steps in their investment-process, the wording in the questions got altered depending on the interviewee's terminology. The interviews were all conducted in English and lasted for approximately 45 minutes to 1 hour.

3.4.3- Research and Ethics

Ethics are moral principles that influences the way researchers conduct their research activities. Ethic is particularly important in private equity and venture capital research as most of the information in the field is private and confidential. Due to that, several measures were taken during this study. First, a description of the research´s purpose and the type of information needed was given to all private equity and venture capital firms contacted. In most cases, the interview guide was sent as well. Before the interview, all the participants were asked permission to use an audio-recorder. Due to confidentially reasons, one private equity fund preferred to stay anonymous so that firm is therefore referred to as "Fund Management Company 1". Lastly, each interviewee got sent their respective interview results after they got transcribed. This was to get approval or make modifications if some of the information was incorrect or confidential. All the results in this research are approved by the respective respondent.

3.4- Data Analysis and Limitations

Data are carriers of information and must be interpreted to become information. The purpose of analysis is to obtain meaning from collected data. Ghauri & Grønhaug (2010) state that in qualitative studies, the research is often overwhelmed by the mass of data. Therefore, a key characteristic of analysis is the dividing up some complex whole into its constituent parts. In addition, theory is needed to make sense of the data (Ghauri & Grønhaug, 2010).

One of the most prominent criterion when evaluating a research is validity. Ghauri & Grønhaug (2010) list four types of validity that are often emphasized in qualitative research. Those are descriptive, interpretative, theoretical and generalizable validity. First, descriptive validity refers to the degree to which the actual description holds true. Although all four private equity and venture capital funds in the study had somewhat different investment

mandate and strategies, they all had similar investment process and investment criteria. That has a positive effect on the descriptive validity of the research. Next, interpretative validity refers to how good the interpretation is. In this research, this is dealt with by sending the interview-results to the corresponding investment manager for approval. One of the interviewee made some minor changes. Third, theoretical validity refers to the adequacy of the suggested theory on explanation. Lastly, generalizable validity refers to the extent of which the findings from a study can be generalized to other settings. As the sample in this research is relatively small for the findings to be generalized, additional research needs to be conducted. As mentioned above, this study is intended as a first step towards further. Consequently, the study´s limitations are theoretical and generalizable validity.

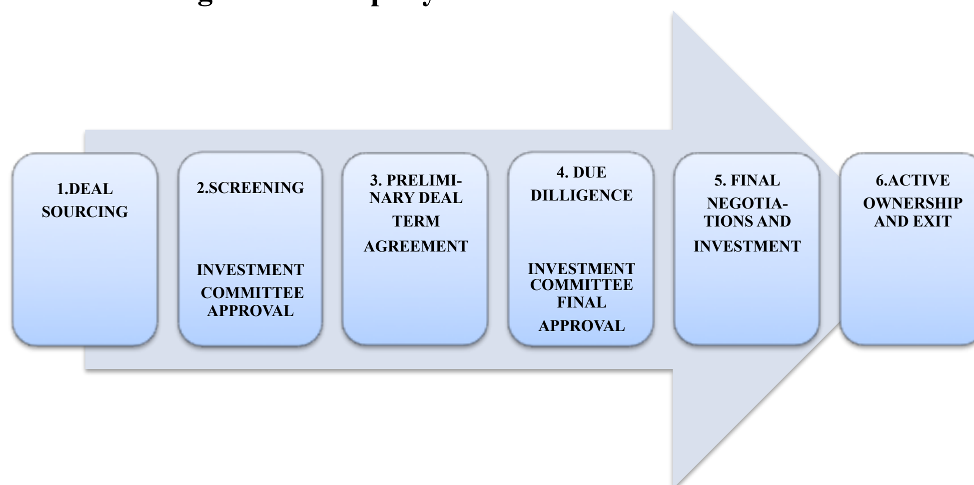
4- Results

This research studies the investment process in four private equity and venture capital firms that in invest in Rwanda. Fund Management Company (FMC) has a focus on growth capital investment. The second firm in the sample is BDF and is the only Rwandan fund. BDF has a focus on SMEs with profit, high growth and export potential. The third private equity and venture capital fund is Kaizen Venture Partners (KVP). KPV target distressed companies and focus on turnaround investment. The fourth PE & VC firm is Norfund and is a Norwegian Development Finance Institutions (DFIs). Following are the results of the interviews conducted for this research.

4.1- Fund Management Company (FMC)

The firm is a fund management company with a focus on private equity investment in Africa. The fund adopts a growth and expansion investment strategy, and is backed by local private capital alongside international private investors and development finance institutions. Through minority investments in growth companies, FMC seeks to achieve superior returns for its investors, as well as value addition beyond financial contributions. To study the fund´ s investment process, the author conducted a telephone-interview with one of the fund´s investment manager. The interviewee described the following investment process:

Figure 7: Fund Management Company 1´s Investment Process



4.1.1- Deal-Sourcing

According to the investment manager interviewed for this study, private equity funds usually have a couple of options available in terms of deal sourcing. The first option tends to be the personal network of the investment professionals. The fund is managed by a fairly diverse team of African private equity professionals that over the years, developed relationships with individuals and entrepreneurs in the region. Secondly, the fund leverages its online presence. Through the company´s website, potential investee can learn more about the fund management company. In addition, opportunities can be sent in for review through a submission form available on the fund´s website. Thus, personnel networks as well as leveraging the fund´s online presence are important sources for potential transactions.

4.1.2- Screening

The next step in the fund´s investment process is the screening stage, and is conducted by an internal screening committee. According to the investment manager interviewed for this study, the screening process is in line with the fund´s mandate and follows several criteria. First, target companies are strong growth companies operating in West and Central Africa. As the fund´s mandate precludes start-up investments and investments in distressed companies, target companies are mature and generate revenue and operating profits. They are however unable to generate sufficient cash to finance a transformational event in their life cycle, and are looking for capital to expand through product diversification or geographic expansion. Capital can also be needed to restructure operations, or to finance a significant acquisition without a change of control of the business. Target companies need to have a proven track record in terms of satisfactory and measurable performance, typically with a minimum of 3 years´ operating history.

Moreover, potential investee companies need to have a very capable management team. As the fund has a very small staff, it is dependent on a good management team to drive the strategy for growth going forward. The interviewee pointed out the importance of the management team to have the necessary skills as well as a vision for growing the company. The management team needs to have a solid business plan, and the ability to demonstrate a need for capital to assist in the company´s growth.

The fund considers investments in all sectors, with a particular focus on financial institutions, industrial firms, and companies investing in infrastructure and other related sectors. Target

companies operate in industries that have favorable growth trends, and in sectors with high-entry barriers. Desirable market advantages are long-term contracts, recognized market leadership, strategic location, first-mover advantage, strong local presence, more advanced technology or a unique expertise.

The investment size is also significant when considering an investment. The fund management company is able to invest at a minimum of 4 million dollars. According to the investment manager interviewed for this study, Rwanda has a small market thus very few companies can absorb capital of that magnitude. Some of the opportunities in Rwanda tend therefore to be too small for consideration. Other common shortcomings mentioned were companies at a precarious financial position. Some companies were either badly managed, not profitable, or significantly losing market shares without a proper strategy to turn it around. Based on the results described above, the following table of criteria is developed:

Table 10: Fund Management Company 1´s Criteria in the screening process

Company	Management	Industry/Market
Proven Track Record Growth Opportunity Unique Expertise Long-Term Contracts More Advanced Technology First-mover Advantage Strategic Location Recognized Market Leadership Strong Local Presence	Management Skills Vision for growth Solid Business Plan Demonstrate a need for capital	Favorable Growth Trends High-Entry Barriers.

Investment Committee Approval: If potential investments meet the investment criteria, a presentation is made to the fund´s investment committee. It is here important that all the risks associated with the investment are identified, as well as a way to mitigate against those risks. In order to move forward with the transaction, an investment committee approval is needed.

4.1.3- Preliminary Deal Term Agreement

Once the investment committee approves a transaction, the fund will work with the investee company to get a better understanding of the business. At this stage, the fund management company focuses on getting the preliminary deal terms like price and exit-options agreed

upon. The investment manager described a few cases where the potential investee company was doing exceptionally well and had all the requirements to receive funding. The parties involved could not come to an agreement however, due to for example a high price. To value the potential investee company, a combination of methodologies is applied. The different methodologies reported by the investment manager include discounted cash flow analysis, and relative transaction multiples such as comparable company analysis, or precedent transaction analysis. Depending on the industry, unique methodologies can also be used like embedded value for insurance companies. If a business is fairly asset intensive, the book value on the value sheet might be a meaningful valuation method. If the investment deal terms and conditions are agreed upon, the fund will move forward to the due diligence stage of the transaction.

4.1.4- Due Diligence

The due diligence process is a fairly comprehensive review of the business. Depending on the industry, the fund engages various service providers to assist in getting a better understanding of the company. At this stage, the fund reviews the financials as well as the management team of the company. The fund typically assesses the systems the company has in place, especially information systems and IT. The fund may also conduct an environmental, social, and government review of the companies operations depending on current investments. The fund might also conduct a market study to better understand the drivers of the industry.

Investment Committee Final Approval: Once an extensive financial, technical, operational, legal and environmental due diligence is performed, the investment committee is approached once again. A final approval to invest is requested in order to move forward with the transaction.

4.1.5- Final Negotiations and Investment

The purpose of the due diligence process is to better understand the key risks associated with the transaction, and possibly revise the structure to mitigate against those risks. Although key terms and conditions are agreed upon earlier in the process, important negotiation might still take place at this stage. Depending on what is discovered, certain terms might need to be renegotiated before drafting the legal documentation for investment. Once the final

negotiations are concluded, the legal documents are signed and the investment finalized. The fund generally invests with minority stakes through straight and quasi- equity structure. The investment manager reported equity investment as most common, but quasi-equity investments like convertible bond may also be consider.

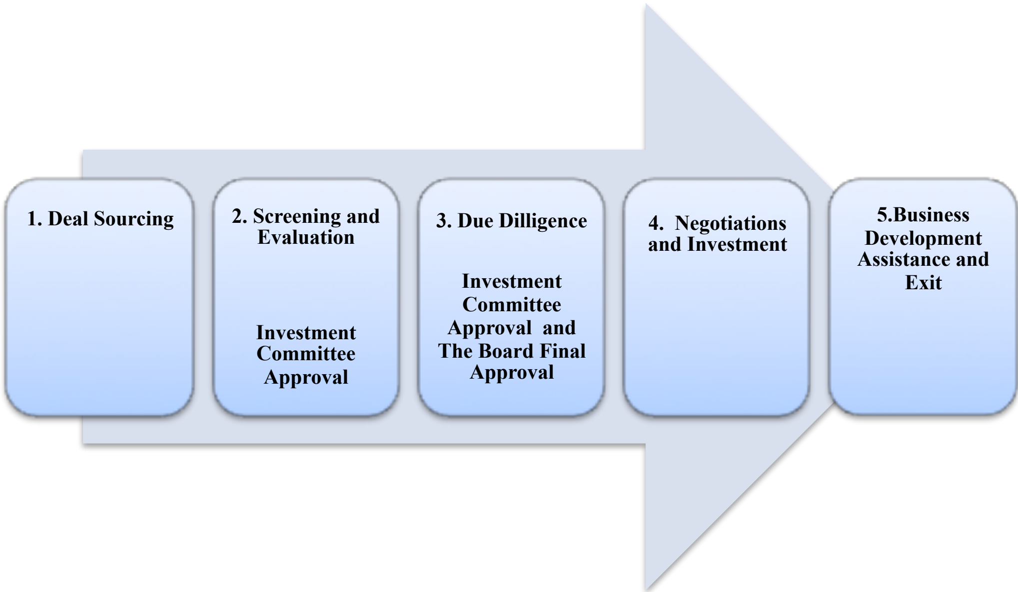
4.1.6- Active Ownership and Exit

After investing in a company, the fund typically expects to be a part of the company´s governance. The investment is generally structured to ensure strong shareholder rights, including board representation. Through board membership, the fund is allowed to observe the company and add value in ways ranging from analysis of strategic issues to recruiting senior management if necessary. The fund targets an investment timeframe of 5 years before exiting the investee company.

4.2- BDF

BDF is a Rwandan fund that provides quasi-equity to SMEs with profit, high growth and export potential. The quasi-equity product is a flexible equity and debt financing solution that is designed to address the individual need of SMEs. It offers 10-90% of the total funding needs of the investee companies in the range 25 thousands to 1.5 million dollars. The investment period is up to 7 years. The fund aims to making socially and environmentally responsible investments in addition to realizing an appreciable financial return. The fund particularly seeks to facilitate Rwandan SMEs´ access to finance, especially those without sufficient collateral to obtain credit from traditional financial institutions at reasonable rates. The investment process is as follow:

Figure 8: BDF´s Investment Process



4.2.1- Deal-Sourcing

The quasi-equity product is promoted through various channels. Through referrals and/or response to marketing, investment prospects can submit an application to local Business Development Services Providers and/or directly to banks or finance houses. Investee companies are then selected from the application pool. The fund works towards obtaining a large number of applicants in order to have a better chance of selecting high quality businesses to invest in.

4.2.2- Screening and Evaluation

BDF seeks to have a balanced portfolio of SMEs with profit, high growth and export potential. The investments prospects need to be legally registered Rwandan Private Companies limited by shares with at least 71% Rwandan ownership. Target companies are innovative and viable enterprises from start-up, early growth, accelerated and sustained growth to expansion stages of their business life cycle. The investments are especially focused on SMEs with high growth and export potential in the start-up and early growth stage of their development. The fund additionally focuses on agro-processing and agro-value add services, as well as companies owned by women and young entrepreneurs. Once the fund receives an application, it will assess it based on broad criteria. The client is then invited over for a screening meeting if the potential deal passes through the initial screening process.

At the screening meeting, the client is interviewed and asked to fill an application pack. Upon receiving a completely filled application form along with all required documents, the evaluation process continues. A central analysis is the business failure risk of a potential investment. The main purpose of this analysis is to identify all possible business failure risks and develop mitigation strategies. The risks and focus of analysis vary depending on the stage of the companies. Following is a description of the different risks associated with each stage and the fund´s focus depending on the stage.

First there are the start-ups and early growth-stage businesses. The Fund describes them as companies that are legally established with identifiable customers. Products or services may or may not be in production, and the firms will typically not be profitable or making earnings yet. They will however be able to demonstrate the viability of their products/services and market in the short term (less than 1.5 years). Some of the challenges faced by this group are underestimation of funding needs, overestimation of time to market and cash flow management. In the evaluation process, it is important for the fund to establish the validity of reliable and profitable customer base and market. It is also essential to assess management competency and ability to manage business. The fund also investigates sales assumption, time to market and cash flow projections.

The second group of companies is in the growth/accelerated growth stage of their business cycle. Those firms have been in business for a few years. They typically have increasing revenues and customers, with many new opportunities and challenges. Companies in this group have improving profits and face increasing competition. Some of the challenges are capacity-constraints due to sales growth, and training and delegation challenges. The focus in the evaluation process for those firms is on effective and structured management to cope with increased sales and customers, as well as better accounting, human resource, risk and management system.

The last group of enterprises is in the expansion phase. Those are mature companies that are well established in the market, operating profitably or at cash-flow break-even. They are typically growing at an above-industry growth rate. The investment need is due to an opportunity for further expansion in order to gain increased market share, and find new revenue and profit channels. Growth into new markets and distribution channels can also be through export. A major challenge is the planning and research of new markets, and a

possible need for a new business plan. In the evaluation process the fund assesses the firm´s ability to leverage on existing experience and capabilities, as well as the ability to service existing and new customers. Other aspects that are evaluated are the ability to add new products or services to existing market, or expand existing businesses into new markets (export included). The fund also evaluates synergies in existing and new product offerings, and distribution channels.

Combined with the business failure risk assessment, is an evaluation of the transaction risk. This is done by evaluating the investment prospect on 5 dimensions: business profile, market profile, entrepreneur and management team profile, operations profile and financial profile (See Table 11 below). The fund assigns the highest weight to the market profile, followed by the financial profile, the management team profile, the business profile and the operations profile respectively. The table below shows the factors associated with each of the 5 dimensions:

Table 11: Transaction Risk Evaluation Factors[3]

Management Team Profile	Market Profile	Business Profile
Years of Relevant Experience Educational Background Personal Security Committed Personal Financial Commitment Personal and Business Credit History Ability to Manage Cash Management Shareholders Involvement Quality of Banking Relationships Length of Banking Relationships Reputation with Stakeholders Professionalism Age of principal Succession Planning	Product Differentiation Product Range Product Seasonality Economies of Scales Capital Requirements Sources of Supply Bargaining Power of Suppliers Threats of New Entrants Pressure from Substitutes Currently Category Rivalry Category Capacity Industry Stage Regulatory Impact Government Dependence	Business Growth Age of Business Net Operating Profit Gross Margin Inventory Liquidity Sales Terms Purchase Terms Value Proposition Location
Financial Profile	**Operations Profile**	
Financial Buffer Collateral Cover Quality of collateral Realism of cost structure Repayment terms Gearing Continuity	Business Metrics Accounting Systems Level of Process Complexity Level of Planning and Control Quality of Operating Assets Cash Diversion ESG risk mitigation Regulatory Compliance	

Depending on all the information gathered so far about the potential investment, the Fund makes a decision whether the deal is still of interest. If the investment prospect does not get rejected, it is presented to the Fund´s Investment Committee for approval.

4.2.3- Due Diligence

The Fund has three main assignments in the due diligence process that occurs after the Investment Committee´s approval. First, conduct a due diligence by verifying all assumptions and claims presented in the business plan. The outcome of this exercise will be an enhanced

[3] *The weight of each factor is not pre-determined.*

Business Plan and Due Diligence Report. The second assignment in the due diligence process is to make an Investment Committee Report that will focus and give details on entrepreneur viability, market viability, financial structure and viability, risk analysis and mitigation strategies, and post-finance Business Development Assistance plan. Lastly, the Fund needs to prepare a proposed Loan Term Sheet. Upon completion, those three reports are first sent to the Investment Committee for approval, and then to the Board for final approval.

4.2.4- Negotiations and Investment

If the potential investment receives final approval, an offer letter is sent congratulating the client for a successful application. The client is at liberty to negotiate the terms of the offer letter and is made aware that any material difference in the offered terms will have to go back for approval. Upon signing the offer letter, the legal implementation is completed and transaction finalized.

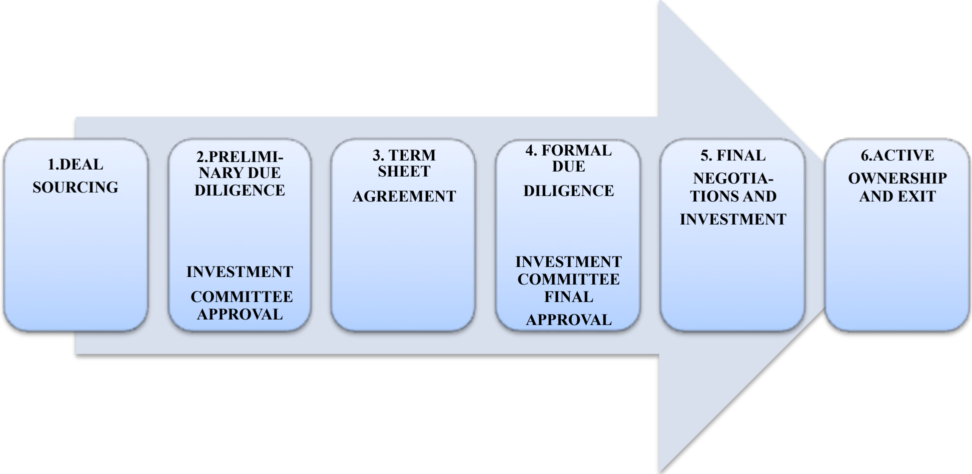
4.2.5- Business Development Assistance and Exit

The Fund aims at increasing the ability of SMEs to succeed by providing investee companies with more than finance. The quasi-equity product is therefore combined with Business Development Assistance in form of trainings, technical assistance, mentoring, coaching, business diagnostics and advisory services. Business Development Assistance provides a way to assist entrepreneurs grow profitably, compete, and generally increase the probability of success for entrepreneurs in Rwanda. FThe Fund´s investment period is up to 7 years.

4.3- Kaizen Venture Partners

Kaizen Venture Partners (KVP) is a private equity firm focused on distressed companies in Sub-Saharan Africa. The firm makes controlling-stake investments with a focus on five target countries: Rwanda, Kenya, Nigeria, Ivory Coast and Ghana. In early 2011, KVP consolidated three distressed coffee processing companies in Rwanda under the holding company KZ Noir. KZ Noir is now a leading Rwandan specialty coffee producer and exporter, operating eight coffee washing stations. For this study, the author conducted a telephone-interview with Mr. Sean Nowak, Vice President at Kaizen Venture Partners. The interviewee describes the following investment process:

Figure 9: Kaizen Venture Partners´ Investment Process



4.3.1- Deal-Sourcing

The interviewee describes two overlapping sources of new deals in Rwanda. The first source of deal origination is the professional network in the country. That is other professionals and investors, lawyers, accountants, local businessmen/women, or individuals in the government. The second major source of potential deals is local banks as KVP has a close relationship with them. Local banks will make referrals if they are aware of clients that are having difficulties servicing loans, and looking for outside finance. The number of deals per year under consideration varied in Rwanda, and it was difficult for the informant to generalize.

4.3.2- Preliminary Due Diligence

Kaizen Venture Partners begins the investment process by gauging initial interest in the potential deal. To pass through the initial screening, key investment criteria have to be met by the distressed company. First is the geographic coverage. KVP has a strong preference to do deals within the 5 target countries (i.e. Rwanda, Kenya, Nigeria, Ivory Coast and Ghana). The second criterion is the investment size and whether the potential deal fits within the firm´s transaction range. KVP´s investments range from approximately 3 million dollars to 10 million dollars. Investments are typically made in mature business that are struggling around profitability or cash flow. Consequently, an important criterion is a good track record and a demonstration of prior success. Kaizen is fairly open in terms of sectors, and only few industries are outside the investment mandate. KVP does not invest in really extractive industries such as oil and gas, metals and mining. Other types of investments like energy and infrastructure have a longer time horizon and might not fit as well.

Kaizen typically have a meeting with the shareholders and/or management of the company to get a high level overview. As the due diligence progresses, potential deals are analyzed on 3 levels. The first level of assessment is on a country/ industry point of view. When analyzing the coffee sector in Rwanda, Kaizen found that it was heavily distressed and most washing stations were operating well under capacity. There was however a high quality product in Rwandan coffee, and KVP saw a lot of potential in the product. When considering a deal, fundamental industry dynamics need to be assessed. Are there for example strong competitors that have better terms with suppliers? The next level of analysis is on a company level. In addition to a good track record, there needs to be a strong team to invest in. The interviewee points out that the due diligence process broadly seeks to answer 2 key questions. Those are a) What are the real causes of distress, and b) Are those things we can fix if we invest? The third level of analysis is an assessment of the specific deal.

Investment Committee Approval: As a part of the preliminary due diligence, an internal investment committee memo is put together. That is a 3-page document about the main findings of the potential investment, and is presented to the investment committee for approval.

4.3.3- Term Sheet Agreement

The next step after the investment committee's approval is to develop and sign a term sheet agreement. The term sheet includes the key deal terms like price and deal structure. At the point where the parties agree on the term sheet, they are in agreement on key terms of the deal. The term sheet agreement is however not a binding offer to sell or buy the company. From Kaizen´s point of view, it is subject to the due diligence checking out. That is, the financials are as the company says, relationship with buyers and suppliers etc. Typically, there is an exclusivity period attached to the term sheet agreement. It allows Kaizen to focus on doing due diligence without having to worry about the company taking on another investor instead. There might be a breakout fee if the seller changes its mind and no longer agrees on the terms.

4.3.4- Formal Due Diligence

Following the term sheet agreement stage is formal due diligence. Kaizen will here go into deeper details on the issues covered in the preliminary due diligence. The process includes looking at track records, historical financials, prior operations, company assets etc. KVP assesses a number of factors to determine the company´s competitive advantage and opportunity for growth. Activities include numerous meetings with management and owners, touring facilities and locations, and speaking with any partners of the company (e.g. buyers, suppliers, customers). Compared to more developed markets, information in Sub-Saharan Africa or Rwanda is more fragmented so it often comes by word of mouth. Consequently, Kaizen will speak with people that may be familiar with the business or the owners.

Investment Committee Approval: After the formal due diligence, a more formal and slightly longer memo will be submitted to the investment committee for approval.

4.3.5- Final Negotiations and Investment

The term sheet agreement signed earlier in the process is a fairly short document with the broad key terms (usually 2-3 pages). At the final negotiations and investment stage, the final binding transaction documents are signed and the transaction completed.

4.3.6- Active Ownership and Exit

Normally, Kaizen requires a majority stake in distressed companies. Given the nature of the investment strategy, Kaizen is typically very involved post-investment. That is one of the key differentiators compared to other private equity funds. They will normally succumb a professional from Kaizen to work at the company for most of their time for a certain period. Kaizen will also look for other ways to support the business. That can be through other in-house professional support from Kaizen. Examples are accounting and finance training at portfolio companies and legal support. KVP will also look to see what more permanent management need the investee company will have. Often times, it will be a family run business where the owner/operator is looking to take a step back from the business so Kaizen will have a new managing director running the business.

While a typical private equity fund might look at an investment horizon of 3 to 5 years, Kaizen will take a longer-term view. In order to give time for turn-around and growth, KVP normally expect a time frame of 5 to 7 years before exit.

4.4-Norfund

Norfund- the Norwegian Investment Fund for Developing Countries- aims at reducing poverty by contributing to the development of local businesses, jobs and economic growth. Norfund and similar investment funds are know as Development Finance Institutions (DFIs). Norfund investment strategy is to invest in profitable and sustainable companies with a maximum of 35% ownership share. The fund has two investments in Rwanda, namely TPS Rwanda and Scatec Solar Rwanda. TPS Rwanda is tourism and hotel company while Scatec Solar Rwanda will be the first large-scale solar PV park in East Africa when completed. The author conducted a telephone-interview with Norfund´s Head of Regional Office East Africa Mr. Stigen. The following investment process was described:

Figure 10: Norfund´s Investment Process

4.4.1-Deal-Sourcing

The interviewee reports several sources of deal origination. First there are Norfund´s partners. Another source may be other Development Finance Institutions (DFIs), or investors looking for co-investors. Potential deals can also come from international meetings and financial brokers in equity firms. The interviewee also had a couple of proposals personally brought to

him at the hotel or office during his stays in Rwanda. Furthermore, investment prospects can originate from seminars arranged by governments. The Rwanda Development Board organized a workshop in Kigali Rwanda for Norfund, and invited companies. Norfund had a presentation and discussed individual project proposals. The country does not have a big market so deal sources can vary from personal network to workshops and seminars. The interviewee reports that Norfund is considering a few opportunities in Rwanda. The reasons why there are not that many Norfund investments in Rwanda are a combination of business plan issues and country specific factors.

4.4.2- Business Plan Review and Negotiations

The first step when considering a potential deal is a review based on Norfund´s investment strategy. Norfund´s mandate dictate a focus on a limited number of sectors, namely renewable energy, financial institutions, agribusiness, tourism, and SME-Funds (small-and medium-sized enterprises). The sectors chosen yield particularly high development effects and have high employment potential. The interviewee points out that for direct investments the investment focus is mainly on agriculture, and to some degree tourism.

The interviewee stresses several essential criteria. Most important is that the project is profitable. He reports that although Norfund can look at start-ups, they are more comfortable with expansions in most cases. When asked about the essential factors that prompted Norfund to invest in the two companies in Rwanda, he pointed out the importance of strong and experienced partners. Norfund was well acquainted with the partners in both investments, as they already had co-invested in previous projects. They viewed the partners as very capable with important experience and technical skills. Another important criterion is a well thought-through business idea and business plan. It needs to be realistic and viable. Factors like product quality, budgets, technical capabilities, timeline, and a sound funding structure including equity have to be evaluated. A market analysis including an assessment of the competition is also important. Prior to investing in Scatec Solar Rwanda, Norfund evaluated the country´s market and found that there was a shortage of electricity. For TPS Rwanda, it was considered that the hotel could become the best hotel in town at that point, so selling it would not be too difficult. Essential criteria to invest vary depending on the industry. When considering local investment funds, performances of the fund management are important. In sectors like energy, political stability becomes critical, as these investments are long term. That is due to the large amount of money invested upfront and the long investment period of

approximately 20 years. To that end, a power purchase agreement is very important when investing in the energy sector. With that agreement comes a fixed price on energy for a number of years and financial calculations can be made and return calculated. The interviewee also reports site-visit as a part of the business plan review.

Based on all the evaluations, Norfund assesses whether the project is of interest to the fund. If the potential investment is deemed interesting, it gets presented to Norfund´s investment committee for approval. A document of approximately 10 pages is prepared and contains the key findings of the business plan review (e.g. deal, company, sector, partners, country). Once the investment prospect receives approval from the investment committee, negotiations on the term of the investment can follow and a term sheet is signed.

The term sheet agreement includes the head terms. For valuation, the interviewee reports using a number of methods including book value, standard valuation methods like discounted cash flow analysis, multiple based pricing, or ratchets. A ratchet is sometimes used as a contractual agreement between the investor and the investee company that states that in the event of a reduction in targeted growth, the PE fund can increase its stake in the company without infusing new capital. It is a way to committ the partners to their targets. Term sheet agreements includes head terms like exit options. The three potential exit routes are sale to other existing owner, sale to new owners and Initial Private Offerings. A list of legal aspects is included as well in the term sheet agreement. An example is the sharing of cost for the due diligence.

4.4.3. Due Diligence

The interviewee calls the next stage a confirmatory due diligence. At this stage, Norfund seeks to confirm the findings in the business plan review and obtain a deeper understanding of the investment prospect. Norfund performs a thorough evaluation of the legal, operational, technical, organizational, financial and environmental aspects. A team of lawyers are brought in to control assets, debt, licenses needed to operate, whether the company is properly registered etc. Operational consultants are hired to do a total evaluation of the business plan and technology. Norfund has an ESG-consultant as well to review the investment prospect from an environment, social and governance point of view. The due diligence process varies depending on the industry. In the agriculture sector, an agronomist is brought in to check the agronomic practice. They will assess whether the business is run according to norm,

regulations, and standards. The agronomist will generally evaluate the proposal and whether the expansion plan is realistic. On the environmental side, they will look at the pesticides used. The agronomist evaluates the market conditions as well. If the investee company aims to be an exporter, prospective importers are asked whether they think the project is ready. After the due diligence, a final approval is needed from the investment committee in order to proceed with the final negotiations and investment.

4.4.4-Final Negotiations and Investment

The head terms of the investment are included in the term sheet agreement signed earlier in the investment process. The potential deal might still get rejected if Norfund´s findings from the business plan review don´t get confirmed in the due diligence process. In most cases however, the initial assessment is correct and the agreement is finalized without too much difficulties. At this stage, all the final documents are signed. Examples are shareholders agreements, subscription agreements and loan agreements depending on the term sheet. Norfund primarily invests equity, taking shares up 35% in companies. Norfund is also able to provide loans to companies, and often a combination of loan and equity.

4.4.5- Active Ownership and Exit

Norfund is more active post-investment than a minority stake would indicate. There are a number of things the investee company can not do without Norfund´s consent. Activities that affect the major business like hiring senior managers or buying large capital equipment need approval. That is called minority protection clauses and is found in the shareholder agreement.

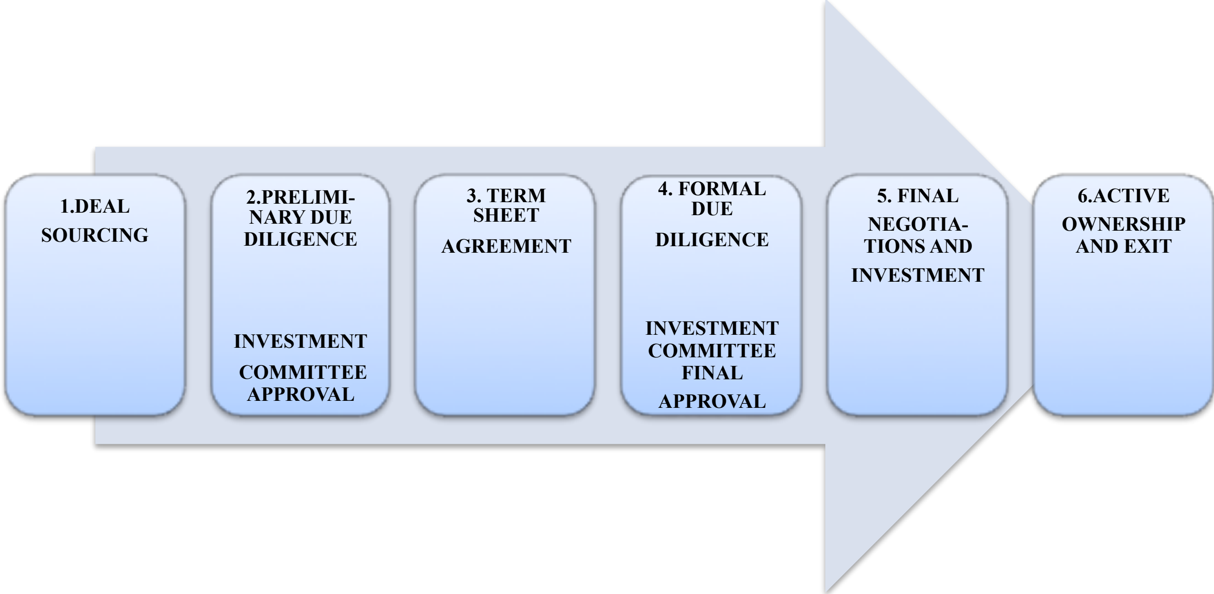
Norfund aims at exiting investments within 5 to 10 years in order to re-invest its funds. In many cases, an exit is achieved by selling the shares to existing owners so they can control the investment and expand at their own pace. Another option is to sell the whole company to another bigger corporation, or list the company at a stock exchange. The interviewee reports that infrastructure projects like energy investments often have a longer investment timeframe of 15-20 years.

5- Discussion

This research seeks to find the essential characteristics a company in Rwanda must have in order to receive private equity and venture capital financing. The underlying theoretical framework is based on two models: Tyebjee & Bruno´s (1984) five stage model of VC investment activity and Fried & Hisrich´s (1994) six-stage model of VC investment decision-making. Tyebjee & Bruno (1984) described VC´s activities as a process involving five sequential steps; deal origination, screening, evaluation, deal structuring and post-investment activities. The follow up study by Fried & Hisrich´s (1994) extended the model to six-stages: origination, venture capital firm-specific screen, generic screen, first-phase evaluation, second-phase evaluation, and closing.

In this study, four private equity and venture capitalist firms that invest in Rwanda were interviewed. Those are Fund Management Company (FMC), the Rwandan fund BDF, Kaizen Venture Partners and the Development Finance Institution Norfund. Based on the information gathered from the respondents, a six-stage model of the private equity and venture capital investment process is developed.

Figure 11: Developed Investment Process Model



5.1- Deal Sourcing

The first step in the investment process is the deal origination or deal sourcing. The access to information about potential investment deals is imperative to any private equity and venture capital firm. Tyebjee & Bruno (1984) and Fried & Hisrich (1994) found that potential deals originated from three sources.

The first of those sources are referrals from the VCs network (e.g. prior investees, personal acquaintances, banks and investment brokers). All respondents of this study confirm this finding and name several examples. First, there are investors looking for co-investors. As Tyebjee & Bruno predicted, syndication is relatively common in the private equity and venture capital industry. Kaizen´s Vice President reports that they are always open to co-invest, as there are some real advantages to syndication. Another example of referrals is through banks in Rwanda. Kaizen has a close relationship with local banks as they focus on distressed companies and turnaround investment. Consequently, local banks will make referrals if they are aware of clients that are having difficulties servicing loans, and looking for outside finance. BDF reports referrals from Rwandan banks as a major source for deal origination as well. Next, Norfund cites other Development Finance Institutions (DFIs) as sources for potential deals. Lastly, respondents reported investment prospect referred to them by other professionals, lawyers, accountants, financial brokers in equity firms, individuals in the government and local businessmen/women.

The second source of deal origination in Tyebjee & Bruno (1984) and Fried & Hisrich (1994)´models are cold calls or unsolicited calls from entrepreneurs. Norfund´s interviewee reported that a couple of proposals were personally brought to him at the hotel or office during his stays in Rwanda. Furthermore, unsolicited calls in Tyebjee & Bruno (1984)´s model can be paralleled to the online applications reported in this research. It is however important to note that those are not unsolicited. At BDF, potential investments are selected from the application pool and the fund works towards obtaining a large number of applicants through promotions of the product. Similarly, the investment manager in FMC reports that leveraging the fund´s online presence is an important aspect in the search for potential transactions. Next to personnel networks, investment prospects submitted on the fund´s website is one of the major sources of deals in FMC.

Finally, the third source of deal origination in Tyebjee & Bruno (1984) and Fried & Hisrich (1994)´models is the active search for deals by the VCs. That can be done through an informal network and attendance at conventions, trade shows and special conferences. Norfund´s interviewee reports international meetings as a source for potential deals. In addition, investment prospects can originate from seminars arranged by governments. An example is The Rwanda Development Board that organized a workshop in Kigali Rwanda for Norfund, and invited companies. Norfund had a presentation and discussed individual project proposals.

To summarize, the findings of Tyebjee & Bruno (1984) and Fried & Hisrich (1994) on deal origination are very similar to the findings in this study. The three sources of deal origination are confirmed, but there are however an important aspect to note. The two models were based on a study of VCs in different regions of the United States of America. The venture capital and private equity industry in the United States is well developed and relatively different from the venture capital and private equity industry in Rwanda. Wells (1974) reported that the annual number of business proposals received ranged between 120 and 1000 with an average of approximately 450. This was later confirmed by several studies like Khan (1987), Klonowski (2007). Although it was difficult for the respondents in this study to give an estimate of received annual business proposals, they all noted that Rwanda has a small market. Consequently, the options available are much smaller in Rwanda and relatively few deals are under consideration.

5.2- Preliminary Due- Diligence

The second step of the investment process model developed in this study is the preliminary due-diligence. Results show that once the private equity and venture capital firm receives a potential deal, it starts by gaging initial interest on the deal based on several criteria. This can be compared to the screening stage in Tyebjee & Bruno (1984) and Fried & Hisrich (1994)´s models. If the investment prospect is deemed interesting after the initial screening, the fund proceeds with a thorough evaluation. This second phase of the preliminary due-diligence can be compared to the evaluation phase in Tyebjee & Bruno (1984)´s model and the generic screen and first-phase evaluation in Fried & Hisrich (1994)´s model. If a potential investment passes through the evaluation phase, a presentation is made to the fund´s Investment Committee. Following is a more detailed description of this research model´s second stage.

5.2.1- Initial Screening

The second step in Tyebjee & Bruno (1984) and Fried & Hisrich (1994)´s models after deal origination is a screening process that is based on four criteria. Those are of the size of the investment and the investment policy of the VC, the technology and market sector of the venture, the geographic location of the venture, and the stage of financing. The purpose of the screening process is to reduce the number of potential investments to a manageable size. Although Rwanda has a small market, respondents cited the same criteria to gage initial interest on a deal.

1. *The investment policy of the venture capital fund:* In this research, four different private equity and venture capital firms are studied. Depending on the investment policy and investment strategy of the funds, target companies and investment mandate varies. FMC adopts a growth and expansion strategy through minority stakes in target companies. BDF is a Rwandan fund focused on SMEs with high growth and export potential. It offers 10-90% of the total funding need through a flexible equity and debt financing solution. Unlike the two previous funds, Kaizen Venture Partners has a focus on distressed companies. Kaizen makes controlling-stake turnaround investments. The last company Norfund is a development Finance Institution that aims at reducing poverty by contributing to the development of local businesses, jobs and economic growth. Norfund investment strategy is to invest in profitable and sustainable companies with a maximum of 35% ownership share.

2. *Investment size:* All respondents in this study cited the investment size as an important criterion. Kaizen investments range from approximately $3million to $10 million while Norfund invests in the range between $3million to $20 million. FMC is able to invest at a minimum of $4 million. The needed investment size tends to be a hurdle for companies in Rwanda seeking private equity and venture capital financing. As the investment manager from FMC points out, Rwanda has a small market thus very few companies can absorb capital of that magnitude. Some of the opportunities in Rwanda tend therefore to be too small for consideration. BDF has taken that into account and invest in a range between $ 25 thousands to $1.5 million dollars.

3. *Geographic location of the venture:* Tyebjee & Bruno (1984) and Fried & Hisrich (1994) cite the geographic location of the venture as a criterion in the screening process. This study confirms that finding. Kaizen Venture Partners has a focus on five target countries, namely Rwanda, Kenya, Nigeria, Ivory Coast and Ghana. Similarly, FMC´s target companies operate in selected countries in West and Central Africa. Norfund´s main invest regions for direct investments are selected countries in Southern and Eastern Africa as well as in South-East Asia and Central America. BDF invests invest in Rwanda. The investments prospects need to be legally registered Rwandan Private Companies limited by shares with at least 71% Rwandan ownership. In this research, none of the respondents specified particular regions within Rwanda as an investment criterion.

4. *Industry of the venture:* Tyebjee & Bruno (1984) report the technology and market sector of the venture as a criterion in the screening process, and VCs usually focus on few sectors. The results from this study are ambiguous. Kaizen Venture Partners is fairly open in terms of sectors, and only few industries are outside the investment mandate. Those are extractive industries and industries with longer-term investments like energy and infrastructure. FMC considers investments in all sectors as well, but with a particular focus on financial institutions, industrial firms, and companies investing in infrastructure and other related sectors. BDF has a focus on companies owned by women and young entrepreneurs as well as investments in agro-processing and agro-value add services. Lastly Norfund´s mandate dictate a focus on a limited number of sectors that yield particularly high development effects, and have high employment potential. Those are renewable energy, financial institutions, agribusiness, tourism, and SME-Funds. For direct investments, the focus is mainly on agriculture, and to some degree tourism.

5. *Stage of financing:* Venture capital investment into a company can occur at several points in the life cycle of the venture. Startup capital generally refers to financing for establishing operations while subsequent rounds of financing are used for expanding operations. Lastly some VCs invest in companies that are in the declining stage. Several studies like Tyebjee & Bruno (1984) and Robinson Jr. (1987) report that investments in start-ups are the most popular followed by expansion stage financing. In Robinson Jr. (1987)´s research, only 3 out of the 53 portfolios had investments in companies that were in the declining stage. As noted in the literature review, risk preferences of VCs differ. In this study, the four participating

funds have different investment policies and strategies. Consequently, the private equity and venture capital companies had different preferences regarding the stage of financing.

BDF invests in companies that are in the start-up/early growth stage, the accelerated growth stage and the expansion stage of their business life cycle. The investments are especially focused on SMEs in the start-up/early growth stage of their development. Norfund may consider start-ups but is more comfortable with expansions. FMC on the other hand has an investment mandate that precludes start-up investments. Target companies are mature and generate revenue and profit with a minimum of 3 years operating history. FMC investment mandate precludes investment in distressed companies as well. Lastly Kaizen Venture Partners invest in mature companies that are distressed. KVP´s Vice President elaborates that Kaizen´s investments are late stage financing, as target companies are typically mature businesses that have gone through the start-up phase, the growth-phase and are now struggling for some reason. Some of the companies have been around for decades. The interviewee notes however that a lot of times, mature distressed companies in Rwanda or Sub-Saharan Africa have a lot of the characteristics of the early stage companies. Often time, especially around family run businesses, more formal processes and procedures will need to be put in place. That is one example of how there might be similarities between investing in a mature distressed business and an early stage business.

5.2.2- Evaluation

Once the investment prospect pass through the initial screen, a thorough evaluation begins. This evaluation stage can be compared to the first-phase evaluation in Fried & Hisrich´s model. Like predicted in Fried & Hisrich´s model, the evaluation process generally includes a meeting with the management team of the investee company. The results of this study indicate that potential investments are evaluated on several aspects. The main categories found in this research are industry, management, company and deal.

5.2.2.1- Industry

Tyebjee & Bruno (1984) reported in their model that VCs evaluate potential deals in terms of five dimensions, one of them being market attractiveness. In Tyebjee & Bruno (1984)´s framework, VCs assess the accessibility of the market, the market size, the growth potential of the market and the market need for the product. Results of this study shows that similar

criteria as well as other criteria are used in the industry analyses. FMC´s investment manager reports that the fund´s target companies operate in industries that have favorable growth trends, and in sectors with high-entry barriers. Results also demonstrated that the industry analysis varies depending on stage and sector. In early stage investments, the focus is for example on the customer base and the market need for the product. For other investments like in the energy sector, country specific factors like political stability is important. This research also reveals that the overall industry stage and capacity needs to be assessed. When analyzing the coffee sector in Rwanda, Kaizen found that it was heavily distressed and most washing stations were operating well under capacity. The results of this study show however that the most important industry aspects that need to be analyzed are the market growth potential and the level of competition.

5.2.2.2- Management

This study confirms that one of the most important aspects in the evaluation of a potential deal is the management team. All respondents in this study pointed out a capable and experienced management team as an essential criterion. In the literature, several management attributes are reported as en evaluation criteria. Table below lists several management characteristic reported in the different studied. In Tyebjee & Bruno´s evaluation process model, management is evaluated based on the entrepreneurs´ capability of managing several business areas. A follow up study by Macmillan et al. (1985) reports that is evaluated in terms of the entrepreneur´s personality, the entrepreneur´s experience and an assessment of the venture team composition. Furthermore, Fried & Hisrich (1994) report several attributes venture capitalists want to see in managers.

Table 12: Management Criteria

Tyebjee & Bruno (1984)	Macmillan et al. (1985)	Fried & Hisrich (1994)
Management Skills	Capability of Sustained Intense Effort	Personal Integrity
Marketing Skills	Ability to evaluate and react well to risk	Good Track Record
Financial Skills	Articulate in Discussing Venture	Realistic
References of the Entrepreneur	Attention to Details	Ability to Identify Risk
	Compatible Personality	Hardworking
	Familiarity with the targeted market	Flexible
	Demonstrated leadership ability	Thorough Understanding of Busine
	Relevant Track Record	General Management Experience
	Source of the Referral	
	Familiarity with the Entrepreneur´s Reputation	
	Venture Team Assessment	

In this study, several of the same evaluation criteria are mentioned. The investment manager from FMC reports that the management team needs to have the necessary skills as well as a vision for growing the company. In addition, the management team needs to have a solid business plan, and the ability to demonstrate a need for capital to assist in the company´s growth. Norfund´s interviewee reported technical skills as well as management experience as important. BDF reported a list of attributes to consider when assessing the management team. In addition to similar criteria as the ones mentioned above, a number of new attributes are reported. Due to the fact the BDF has a focus on relatively smaller companies, criteria like personal security committed and personal and business credit history are used. Like the industry analysis, an evaluation of the management team can vary depending in the stage of investment.

5.2.2.2- Company

A third level of analysis is a company analysis. A summary of the different criteria in the different models is listed below. A list of the criteria found in this research is listed as well.

Table 13: Company Criteria

Tyebjee & Bruno (1984)	**Fried & Hisrich (1994)**	**This Research**
Technical Skills	Potential for Earning Growth	Proven Track Record
Profit Margins	A Working Business Idea	Growth Opportunity
Uniqueness of Product	Competitive Advantage	Product Quality
Patentability of product	Reasonable Capital Requirements	Profitable
Protection from Competitive Entry	Potential for a High Rate of Return	Technical capabilities
Resistance to Economic Cycles	Potential for a High Absolute Return	Unique Expertise
Protection from Obsolescence		Long-Term Contracts
Protection against Down-side Risk		More Advanced Technology
		First-mover Advantage
		Strategic Location
		Recognized Market Leadership
		Strong Local Presence

The participants of this study reported a company´s growth opportunity as very important. A proven track record as well as a high quality product is essential. Depending on the fund´s strategy, profitability can be essential as well. In some sectors like energy, long-term contracts are crucial (Power-Purchase-Agreement).

Other criteria reported in Tyebjee & Bruno (1984) ´s model and Fried & Hisrich are the cash-out potential or exit opportunity. The results of this study suggest that the exit-opportunity is taken into account as well.

5.2.2.3- Deal

Another level of analysis reported in this research is a deal analysis. Although a company has all the characteristics needed, the specific deal has to be assessed. A respondent described cases where the companies were doing exceptionally well but the deal was rejected due to for example a high price. To value the potential investee company, a combination of methodologies is applied. The different methodologies reported by the investment manager include discounted cash flow analysis, and relative transaction multiples such as comparable company analysis, or precedent transaction analysis. Depending on the industry, unique methodologies can also be used like embedded value for insurance companies. If a business is fairly asset intensive, the book value on the value sheet might be a meaningful valuation method.

Investment Committee Approval

If the investment prospect does not get rejected during the preliminary due-diligence, it gets presented to the Fund´s Investment Committee. A document of 3 to 10 pages is prepared during the due diligence process and contains the key findings of the preliminary due-diligence. In order to move forward with the transaction, an approval from the investment committee is needed.

5.3- Term Sheet Agreement

The third step in the investment process model developed in this study is the term sheet agreement. Once the investment committee approves a transaction, the private equity and venture capital firm works to develop and sign a term sheet agreement. As reported by the respondents, the term sheet agreement includes the head terms like price, exit option and deal structure. Similar to the term sheet agreement in this model, the deal-structuring phase in Tyebjee & Bruno (1984)´s model describe the negotiation process between the venture capitalist and the potential investee. Some of the agreed upon terms in Tyebjee & Bruno

(1984)´s models are the price of the deal, covenants, and earn-out arrangement. Although the agreed upon terms are similar in both models, there are some major differences. In Tyebjee & Bruno´s (1984) model, the deal-structuring phase occurs after the evaluation process is completed. Moreover, the agreements signed in the deal-structuring phase are binding. On the contrary, the term sheet agreement is this model is not a binding offer to sell or buy the company, and is subject to the due diligence checking out. As the Vice President at Kaizen Venture Partners reports, there is typically an exclusivity period attached to the term sheet agreement. There might also be a breakout fee if the seller changes its mind. The findings of this study coincide with Fried & Hisrich (1994)´s arguments that VCs wish to have a rough understanding of the deal-structure, including price, earlier in the process before entering the second-phase evaluation.

5.4- Formal Due Diligence

The fourth step of the model is a formal due diligence. The purpose of the formal due-diligence process is to confirm the findings in the preliminary due-diligence and obtain a deeper understanding of the investment prospect. At this stage, all assumptions and claims presented in the business plan are verified. The process includes a review of track records, historical financials, prior operations, company assets etc. The due diligence process is a fairly comprehensive review of the business. Results of this study indicate the formal due-diligence as a thorough evaluation of the legal, operational, technical, organizational, financial and environmental aspects of the investment prospect. Furthermore, a number of factors are assessed to determine the company´s competitive advantage and opportunity for growth.

The formal due-diligence stage in this model can be compared to the second-phase evaluation in Fried & Hisrich (1994)´s model. As predicted by Fried & Hirsch, several activities are undertaken by the VCs in the evaluation process. Activities mentioned by the respondents include numerous meetings with management and owners, touring facilities and locations, and speaking with any partners of the company (e.g. buyers, suppliers, customers). The fund might also conduct a market study to better understand the drivers of the industry. Depending on the industry, various service providers are generally engaged to assist in the process. A team of lawyers are brought in to control assets, debt, licenses needed to operate, whether the company is properly registered etc. Operational consultants are hired to do a total evaluation

of the business plan and technology. Moreover, ESG-consultants assist in the review of the investment prospect from an environment, social and governance point of view.
Lastly, the funds will go into deeper details on the risks and issues covered in the preliminary due diligence and develop mitigation strategies.

Investment Committee Final Approval

After the due diligence, a final approval is needed from the investment committee in order to proceed with the final negotiations and investment.

5.5- Final Negotiations and Investment

The fifth stage in the investment model is the final negotiation and investment stage. Although key terms and conditions are agreed upon earlier in the process, important negotiation might still take place. That depends on what is found the formal due-diligence. Results show however that the initial assessment is correct in most cases, and the agreement is finalized without too much difficulty. Once the final negotiations are concluded, the legal documents are signed and the investment finalized. This stage can be compared to the closing stage in Fried & Hisrich(1994)´s model. The deal-structuring phase in Tyebjee & Bruno (1984)´s model is similar as well but has one major difference. While the final documents are signed at this stage in all three models, the head terms are agreed upon much earlier in the previous two models. In Tyebjee & Bruno (1984)´s model on the other, all negotiations are conducted at the final stage before investing.

5.6- Active Ownership and Exit

The last stage in the developed model is active ownership and exit. The results of this study indicate that private equity and venture capital firms are generally active after investing in a company. FMC report that the fund typically expects to be a part of the company´s governance system. Post-investment, FMC adds value in the investee company in ways ranging from analysis of strategic issues to recruiting senior management if necessary. BDF provides Business Development Assistance in form of trainings, technical assistance, mentoring, coaching, business diagnostics and advisory services. Furthermore, Kaizen is relatively more involved post-investment due to the nature of it´s investment strategy. First, they will normally succumb a professional from Kaizen to work at the company for a certain

period. Next, Kaizen will also look for other ways to support the business. Examples are accounting and finance training at portfolio companies and legal support. Kaizen will also evaluate the need for more permanent management. The findings of this study correspond with Tyebjee & Bruno (1984)´s results on post-investment activities. As Tyebjee & Bruno reports, the VC´s role expands from investor to collaborator once the deal has been consummated.

Tyebjee & Bruno (1984) state that VCs usually want to cash-out their gains five to 10 years after initial investment. That is confirmed by this research. In this study, the following investment periods are reported. FMC targets an investment timeframe of 5 years before exiting the investee company. BDF´s investment period is 7 years. Kaizen normally expect a time frame of 5-7 years. Lastly, Norfund aims at exiting investments within 5 to 10 years in order to re-invest its funds (expect for longer-term investment in infrastructure projects like energy of 15-20 years).

6- Conclusion

The aim of this study is to identify factors investors deem to be important when investing in private equity and venture capital in Rwanda. In order to answer that question, the secondary objective of this study is to *refine the stages of private equity and venture capital investment decision process and identify criteria used in each of these processes*.

The underlying theoretical framework of this research is based on two models: Tyebjee & Bruno´s (1984) five stage model of VC investment activity and Fried & Hisrich´s (1994) six-stage model of VC investment decision-making. Those two models are chosen due to their significant research contributions. In this study, four private equity and venture capital firms that invest in Rwanda are studied. Fund Management Company (FMC) has a focus on growth capital investment. The second firm in the sample is BDF and is the only Rwandan fund. BDF has a focus on SMEs with profit, high growth and export potential. The third private equity and venture capital fund is Kaizen Venture Partners (KVP). Kaizen target distressed companies and focus on turnaround investment. The fourth private equity and venture capital firm is Norfund and is a Norwegian Development Finance Institutions (DFIs).

The research methodology in this study is an inductive, explorative research intended as a step towards additional research. Qualitative methods are used and data is collected through semi-structured interviews. Based on those interviews a 6-stage model of the private equity and venture capital investment process model is developed. The stages are deal sourcing, preliminary due-diligence, term sheet agreement, formal due diligence, final negotiations and investment and active ownership and exit.

The first stage in the investment process is deal sourcing. This study confirms Tyebjee & Bruno´s (1984) and Fried & Hisrich´s (1994) results that deals originate from three sources. The respondents in this study listed referrals from co-investors, other partners, local banks, other professionals, lawyers, accountants, financial brokers in equity firms, individuals in the government and local businessmen/women as a source for potential deal. Next, a major source of deal origination is through application forms. Lastly, potential investments can originate from seminars and workshop.

The second stage is preliminary due-diligence and consists of several steps. First, private equity and venture capital firm gage initial interest of the potential transaction by an initial screen. This study confirms Tyebjee & Bruno´s (1984) and Fried & Hisrich´s (1994) results as it is found that funds screen investment prospects based on the investment policy of the venture capital fund, the investment size, geographic coverage, industry of the venture and stage of financing. Next a thorough analysis of the industry, company, management and deal is conducted. Lastly the potential investment is presented to the investment committee for approval.

The third stage in the investment process model is the term sheet agreement. At this stage, the hear terms of the deal are agreed upon. The fourth stage in the investment process is the formal due-diligence. The due diligence process is a fairly comprehensive review of the business. In order to move forward with the transaction a final investment committee approval is needed.

The fifth stage of the investment process is the final negotiations and investment. At this stage, the final documents are signed. The last stage in the investment process is active ownership and exit. The study confirms that private equity and venture capital firms are active post-investment through board membership and different value-adding assistance. The investment period is 5-10 years.

The study found several essential criteria a company in Rwanda must have in order to receive private equity and venture capital financing. First it needs to have growth potential. Second, a good management team is essential. Third, the investment prospect needs to have a competitive advantage. In addition to those essential criteria, private equity and venture capital firms look for companies in industry with growth potential and high-entry barriers.

This research has several limitations. Very few companies are studied thus the model cannot be generalized. In addition, this research did not describe the investment process in detail. This is due to a combination of time constraint and confidentiality. For further research, a study of the private equity and venture capital industry in Rwanda can be conducted with a bigger sample and a more detailed model can be developed. A study of "Vision 2020" initiative´s impact on private equity and venture capital can also be interesting.

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Appendix

Appendix 1: Interview Guide

- How do you find potential investments in Rwanda? / What are the sources of deal origination?
- Please describe the decision making process/ investment process used in your firm. That is, what is the process from the time a potential investment comes to your attention until you invests in that firm?
- How do your firm initially screen investment proposals? /What criteria are used in the initial screening process?
- After the initial screening process, how do you evaluate the potential deals?
- What are essential characteristics the investee company must have?
- Are there any evaluation activities carried out prior to investing?
- What are important factors in the deal structuring/ negotiation phase?
- What is the role of your firm in the investee company after the funding? Are there post investment activities?
- When does your firm aim exiting the investments?
- What companies in Rwanda do you have investments in, and what are the essential factors that prompted you to invest in those firm?
- In your experience, what are the most common shortcomings of the business opportunities in Rwanda you have reviewed recently?
- Financials: How do you approach valuation in your firm? Do you use debt/equity or a combination of both? What percentage stake do you usually have in your investments in Rwanda?
- Could you please say more about investing in Rwanda in general?

Appendix 2: Real GDP Growth Rates at Constant 2011 Prices, in %, Rwanda

ACTIVITY DESCRIPTION	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
GROSS DOMESTIC PRODUCT (GDP)	8.0	8.3	4.3	5.8	9.5	6.9	5.1
AGRICULTURE, FORESTRY & FISHING	4.0	5.0	5.0	2.5	8.0	6.0	3.0
Food crops	4.0	6.0	7.0	3.0	10.0	6.0	3.0
Export crops	-1.0	-1.0	-1.0	-6.0	14.0	19.0	-9.0
Livestock & livestock products	2.0	3.0	4.0	4.0	5.0	6.0	7.0
Forestry	4.0	3.0	3.0	3.0	3.0	4.0	2.0
Fishing	3.0	3.0	3.0	5.0	-4.0	3.0	5.0
INDUSTRY	9.0	5.0	0.0	13.0	13.0	12.0	6.0
Mining & quarrying	4.0	-22.0	-16.0	23.0	19.0	4.0	15.0
TOTAL MANUFACTURING	4.0	1.0	6.0	6.0	9.0	5.0	5.0
Of which: Food	3.0	4.0	6.0	1.0	11.0	4.0	9.0
Beverages & tobacco	1.0	-1.0	3.0	8.0	4.0	3.0	3.0
Textiles, clothing & leather goods	10.0	-7.0	2.0	1.0	5.0	-1.0	10.0
Wood & paper; printing	21.0	5.0	8.0	-4.0	-2.0	19.0	7.0
Chemicals, rubber & plastic products	-1.0	7.0	-4.0	17.0	7.0	-4.0	-5.0
Non-metallic mineral products	6.0	-7.0	10.0	9.0	18.0	13.0	6.0
Metal products, machinery & equipment	8.0	6.0	34.0	3.0	62.0	1.0	-2.0
Furniture & other manufacturing	8.0	6.0	34.0	18.0	26.0	8.0	11.0
Electricity	9.0	15.0	19.0	10.0	22.0	10.0	8.0
Water & waste management	9.0	15.0	19.0	13.0	12.0	7.0	4.0
Construction	18.0	22.0	-2.0	18.0	15.0	20.0	5.0
SERVICES	12.0	11.0	4.0	7.0	10.0	7.0	7.0
TRADE &TRANSPORT	15.0	18.0	1.0	9.0	14.0	9.0	8.0
Maintenance & repair of motor vehicles	14.0	18.0	0.0	13.0	6.0	8.0	4.0
Wholesale & retail trade	14.0	18.0	0.0	9.0	15.0	8.0	9.0
Transport	19.0	21.0	6.0	5.0	12.0	15.0	8.0
OTHER SERVICES	11.0	8.0	6.0	6.0	8.0	6.0	6.0
Hotels & restaurants	7.0	-5.0	4.0	6.0	5.0	4.0	4.0
Information & communication	19.0	20.0	6.0	2.0	25.0	12.0	5.0
Financial services	14.0	-3.0	0.0	34.0	10.0	15.0	5.0
Real estate activities	14.0	13.0	6.0	1.0	-1.0	-3.0	5.0
Professional, scientific & technical activities	14.0	13.0	6.0	0.0	2.0	3.0	5.0
Administrative & support service activities	14.0	13.0	6.0	-1.0	3.0	5.0	5.0
Public administration & defense; compulsory social security	1.0	9.0	8.0	9.0	31.0	13.0	6.0
Education	11.0	11.0	12.0	13.0	12.0	6.0	6.0
Human health & social work activities	13.0	12.0	17.0	5.0	25.0	3.0	8.0
Cultural, domestic & other services	8.0	-2.0	1.0	3.0	2.0	15.0	14.0
Taxes less subsidies on products	3.0	12.0	9.0	2.0	3.0	-3.0	0.0

Source: National Bank of Rwanda. (2014). *Annual Report 2013/2014, page 30*

Appendix 3: Top 10 Countries in Doing Business in Sub-Saharan Africa 2013-2014

Economy	Ease of Doing Business Rank	Starting a Business	Dealing with Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency
Mauritius	20	2	22	1	7	7	2	1	1	7	2
Rwanda	32	1	14	2	1	1	3	3	31	2	22
South Africa	41	7	1	27	15	5	1	4	7	12	8
Botswana	56	12	11	13	2	11	7	6	23	14	1
Ghana	67	20	37	6	4	5	5	9	8	4	16
Seychelles	80	16	10	25	9	40	9	2	2	13	3
Zambia	83	6	7	29	17	1	12	9	32	20	5
Namibia	98	23	2	4	43	9	12	18	20	10	9
Cape Verde	121	8	28	28	6	14	24	11	4	1	38
Swaziland	123	39	5	34	24	9	21	7	13	41	4

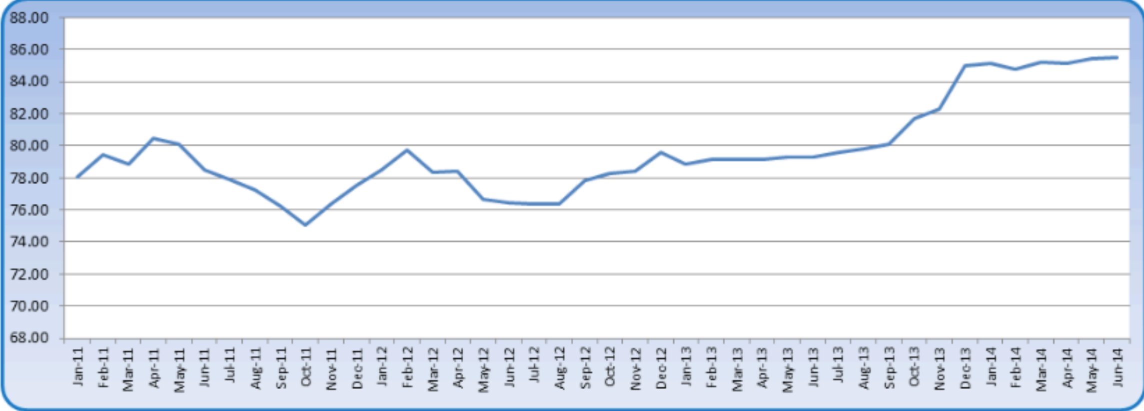
Source: National Bank of Rwanda. (2014). *Foreign Private Capital in Rwanda Year 2013,* page 4

Appendix 4: Inflation Development in Rwanda (Annual % Change)

	Weight	Dec-14	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
Food and non-alcoholic beverages	2.819	11.20%	7.90%	1.90%	4.40%	7.80%	3.90%	5.20%	1.90%
Alcoholic beverages and tobacco	276	3.00%	3.60%	10.00%	1.70%	3.70%	6.70%	6.90%	6.10%
Clothing and footwear	422	8.70%	1.90%	1.20%	1.50%	-0.90%	0.70%	4.40%	4.50%
Housing, water, electricity, gas and other fuels	2.296	6.80%	1.80%	1.40%	0.20%	0.60%	0.00%	0.20%	0.80%
Furnishing, household equipment and routine household maintenance	408	4.90%	5.60%	4.80%	4.30%	0.90%	-0.20%	0.80%	0.10%
Health	91	1.90%	1.40%	-0.50%	0.50%	0.60%	1.20%	11.40%	10.00%
Transport	1.774	9.10%	0.50%	2.20%	0.90%	1.40%	0.90%	0.40%	-3.40%
Communication	278	-6.30%	0.00%	-1.80%	-1.90%	-1.20%	-0.30%	-1.50%	-0.90%
Recreation and culture	213	5.20%	-1.10%	1.40%	1.20%	1.80%	0.60%	-1.30%	1.70%
Education	587	20.70%	1.00%	35.20%	35.20%	35.20%	35.20%	7.10%	7.10%
Restaurants and hotels	430	4.50%	-0.40%	1.00%	3.80%	5.70%	9.20%	10.30%	7.80%
Miscellaneous goods and services	408	5.60%	3.20%	3.50%	3.30%	3.30%	2.80%	1.70%	4.10%
Headline Inflation	10.000	8.30%	3.90%	3.20%	3.70%	5.10%	3.60%	3.40%	1.40%
Fresh	1.739	8.30%	10.00%	-3.80%	6.30%	13.60%	4.90%	8.30%	-0.50%
Energy	775	9.30%	5.70%	4.60%	0.90%	2.80%	0.00%	0.70%	0.20%
Core	7.485	8.30%	2.50%	4.80%	3.40%	3.30%	3.80%	2.60%	2.00%
Domestic inflation	7.429	8.30%	4.10%	3.20%	4.10%	5.70%	4.10%	3.80%	2.10%
Imported	2.571	8.60%	3.20%	3.40%	1.90%	2.50%	1.60%	1.70%	-0.40%

Source: National Bank of Rwanda, 2014, *Annual Report 2013/2014,* page 47

Appendix 5: Real Effective Exchange Rate with 10 Major Trading Partner Countries of Rwanda



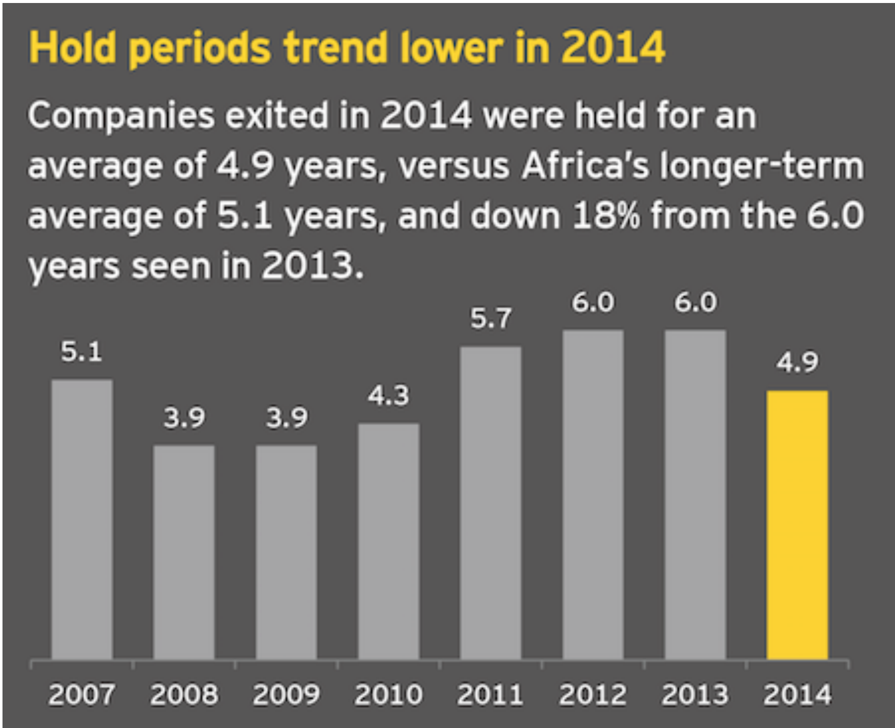
Source: National Bank of Rwanda, 2014, *Annual Report 2013/2014,* page 48

Appendix 6: Interest Rate in Rwanda (percent)

	2013				2014					
	Mar	Jun	Sep	Dec	Jan	Feb	Mar	Apr	May	Jun
BNR Policy Rates										
Key Repo Rate	7.5	7	7	7	7	7	7	7	7	6.5
Discount Rate	11.5	11	11	11	11	11	11	11	11	10.5
Money Market Rates										
Repo rate	7	6.7	5.5	4	4.3	3.7	3.3	3.1	3.6	3.7
T-Bills Rate	12.2	10.8	7.1	5.6	6.36	6.1	6	6	5.9	5.7
Commercial Banks Rates										
Interbank Rate	10	9.6	7	5.6	5.6	5.8	5.8	5.7	5.7	5.7
Deposit Rate	10.4	10.6	9	8.6	8.9	8	8.3	8.1	9.3	8.7
Lending Rate	17.2	17.7	17.8	16.9	17.45	17.1	16.8	17.4	17.2	17.5

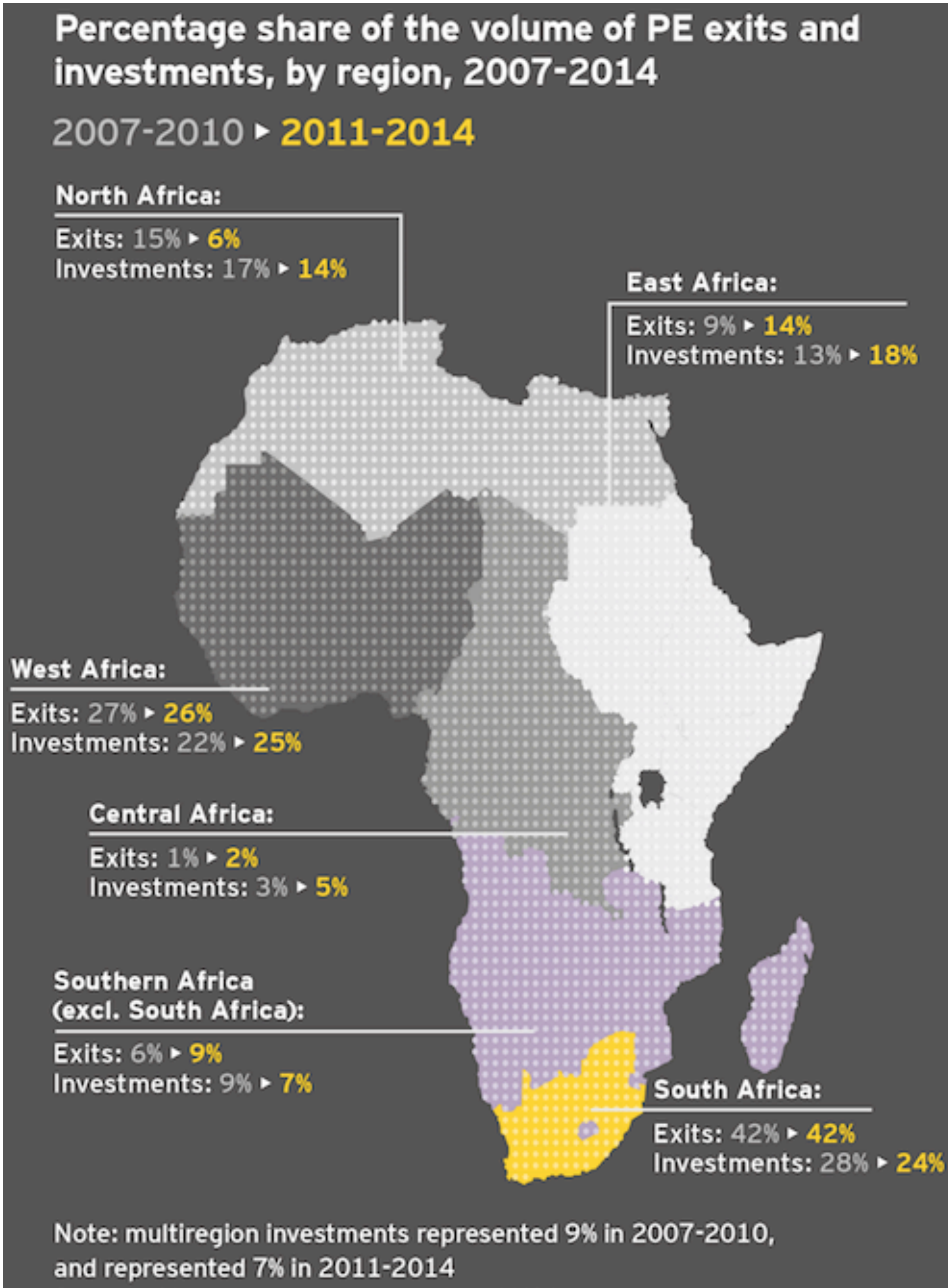
Source: National Bank of Rwanda, 2014, *Annual Report 2013/2014,* page 46

Appendix 7: Holding Period Trends in Africa, 2007-2008



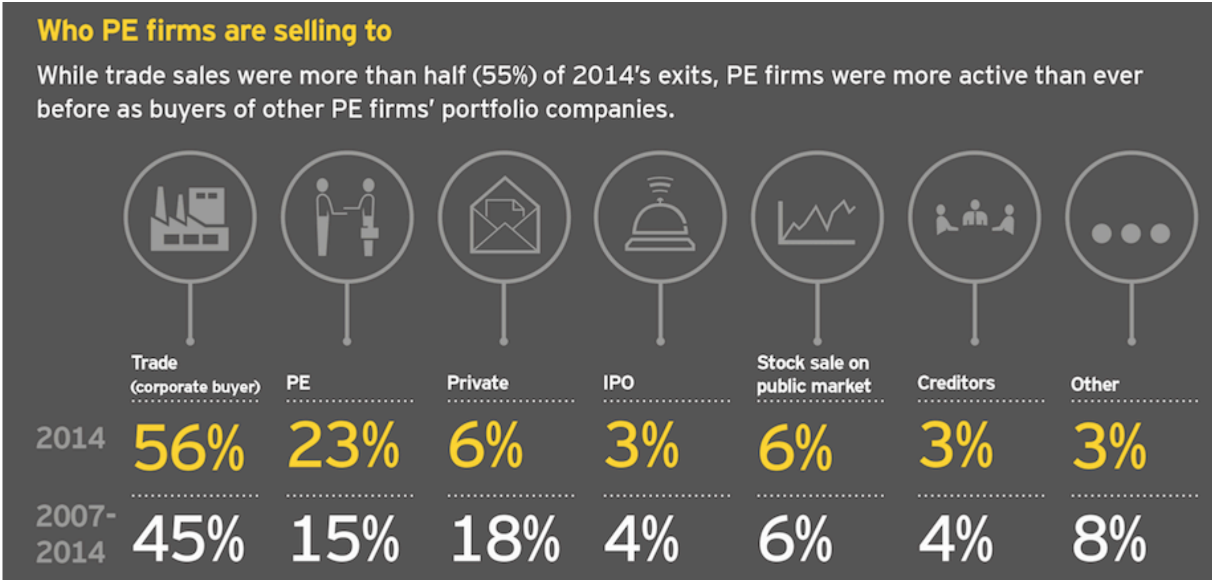
Source: EY & African Private Equity and Venture Capital Association (AVCA) (2014)

Appendix 8 : Percentage Share of the volume of PE Exist and Investments, by region, in Africa 2007-2014



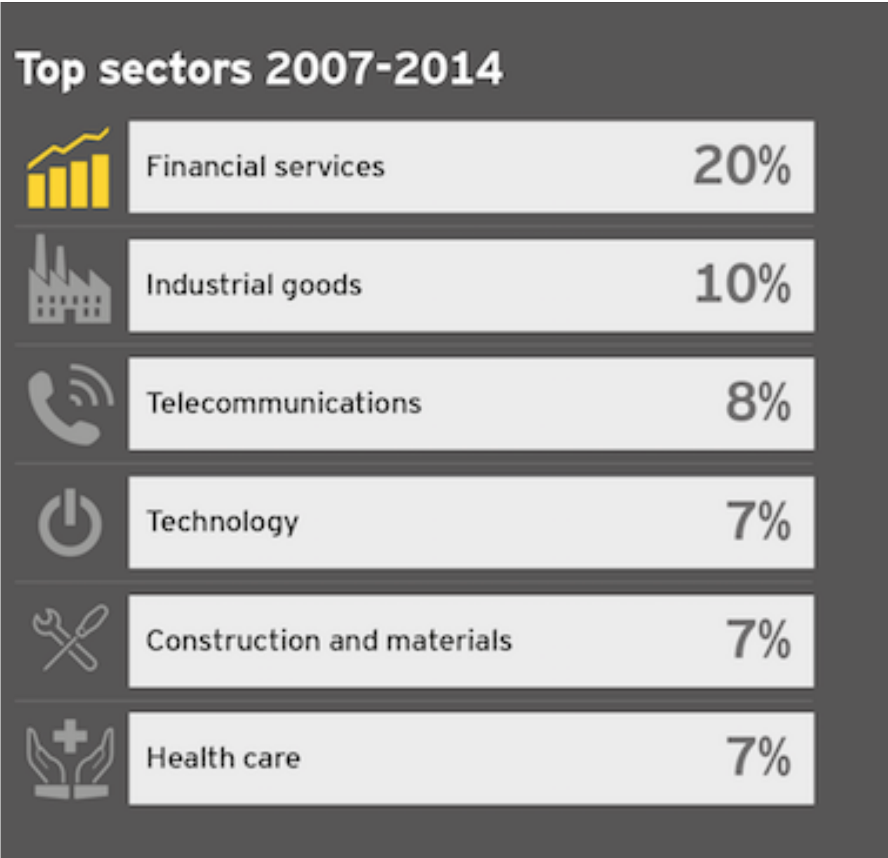
Source: EY & African Private Equity and Venture Capital Association (AVCA) (2014)

Appendix 9 : Who PE firms are Selling To



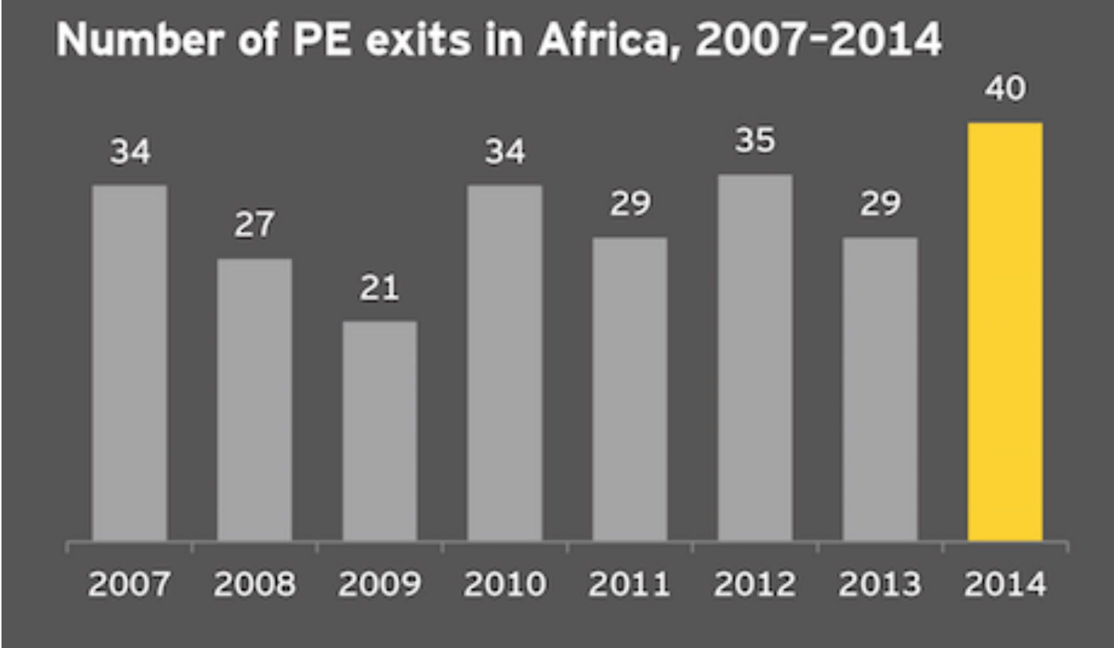
Source: EY & African Private Equity and Venture Capital Association (AVCA) (2014)

Appendix 10 : Top Exit Sectors in Africa



Source: EY & African Private Equity and Venture Capital Association (AVCA) (2014)

Appendix 11: Number of PE exits in Africa, 2007-2014



Source: EY & African Private Equity and Venture Capital Association (AVCA) (2014)