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Private Equity Investments And Financial Performance: Evidence From Investee Firms In Kenya

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Abstract
Private equity (PE) investments have increasingly become a strategic financing option for firms seeking capital infusion, operational enhancement, and long-term value creation. This study examines the effect of private equity investments on the financial performance of investee firms in Kenya. Drawing on agency theory, pecking order theory, and trade-off theory, the research explores how distinct forms of private equity—venture capital, growth capital, and buyout capital—impact firm performance, measured using Return on Assets (ROA). The study adopts a descriptive research design and analyzes panel data from 144 private equity-backed firms in Kenya over the period 2006 to 2021. Employing panel regression techniques, the findings reveal that all three categories of private equity investments have a statistically significant and positive effect on the financial performance of investee firms. The results underscore the role of private equity in enhancing managerial discipline, fostering strategic realignment, and improving capital allocation efficiency. The study contributes to the growing body of literature on private equity in emerging markets and offers practical insights for investors, fund managers, and policymakers aiming to optimize firm-level financial outcomes through private capital interventions.

Keywords: *Private equity, financial performance, venture capital, growth capital, buyout capital, Return on Assets, Kenya, investee firms*

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I. Introduction

A. Background

Private equity (PE) has become a transformative source of financing globally, offering long-term capital and strategic support to firms that are often excluded from traditional credit markets. PE-backed firms are commonly associated with superior financial performance due to the discipline, operational restructuring, and strategic oversight introduced by private equity investors (Hotchkiss, Smith & Strömberg, 2021). These investments include venture capital for early-stage companies, growth capital for expanding firms, and buyout capital for restructuring mature businesses (Datta & Singh, 2019; Deloitte, 2018). By aligning the interests of managers and investors, PE is expected to enhance firm value and improve profitability through better governance and efficiency (Jensen & Meckling, 1976).

In Kenya, the private equity market has expanded steadily over the last two decades, driven by improved economic growth, political stability, and increased foreign investor interest (Cytonn Investments Limited, 2020; KPMG, 2021). Firms across diverse sectors—including retail, fintech, healthcare, and education—have benefited from PE funding, using it to scale operations, introduce innovation, and improve competitiveness. For instance, Naivas and Quickmart leveraged PE investments to stabilize and expand in the wake of major retail collapses in the country (Cytonn Report, 2020). As the third most preferred destination for PE investments in Africa, after South Africa and Nigeria, Kenya offers a unique context to explore the dynamics between PE and financial performance (BDO International, 2020).

Despite the growing prominence of private equity in Kenya, empirical findings on its effect on financial performance remain inconsistent. While some scholars find a significant positive relationship between PE

investments and performance metrics such as Return on Assets (ROA) and Return on Equity (ROE) (Karugu, 2018; Mwangi & Otieno, 2025), others report mixed or inconclusive outcomes (Katti & Raithatha, 2018; Biesinger & Bircan, 2018). These variations may stem from methodological differences, the heterogeneity of PE types, or contextual factors such as ownership structures and liquidity constraints. This study builds on these insights by examining how different categories of private equity—venture capital, growth capital, and buyout capital—specifically influence financial performance in the Kenyan context.

B. Problem Statement

In Kenya, access to finance remains a persistent barrier to firm growth and profitability, particularly among SMEs and mid-sized firms. Traditional financial institutions are often reluctant to lend due to inadequate collateral, lack of audited financials, and poor credit histories (Lerner, Hardymon & Leamon, 2014; Manasseh, 2017). As a result, many firms turn to private equity as an alternative financing route to bridge their capital needs. Theoretically, private equity not only provides funding but also managerial expertise, governance enhancements, and long-term performance incentives (Weir, Jones & Wright, 2015). However, these expected benefits are not always realized uniformly across firms, raising questions about the actual effect of PE on firm-level financial outcomes in Kenya.

While some studies affirm that PE-backed firms outperform their non-PE counterparts, others find weak or no significant effects depending on how financial performance is measured and which form of PE is assessed (Battistin et al., 2017; Bernstein et al., 2018; Karanja, 2018). Furthermore, many existing studies do not disaggregate PE into its specific types—venture, growth, or buyout capital—despite evidence that these categories differ in objectives, timelines, and risk profiles (Abdullahi & Mbugua, 2021). This lack of specificity impedes a nuanced understanding of how different PE strategies influence financial performance. The variation in outcomes may also be attributable to firm-level characteristics such as age, liquidity, and ownership structure, which have been shown to mediate financial results (Baah-Peprah & Serwaah, 2020).

Moreover, there is a notable methodological gap in the literature. Several Kenyan studies rely on cross-sectional designs or small sample sizes, which limit their generalizability and fail to capture long-term PE impacts (Karugu, 2018; Mwenje & Olweny, 2016). Others utilize ordinary least squares (OLS) methods that may not adequately address endogeneity or firm heterogeneity over time. Given the increasing significance of PE in Kenya's investment landscape and the divergence in empirical findings, there is a compelling need for a robust, panel-based analysis that examines the direct relationship between different forms of PE and financial performance over a sufficiently long time horizon. This study addresses this gap by analyzing panel data from 144 PE-backed firms in Kenya between 2006 and 2021.

II. Literature Review

A. Theoretical Review

This study is anchored on Agency Theory as proposed by Jensen and Meckling (1976), which highlights the contractual relationship between principals (investors) and agents (managers). In the context of private equity (PE), investors seek to align the goals of firm managers with shareholder interests by imposing governance mechanisms that minimize agency costs. PE firms typically achieve this through close monitoring, performance-based compensation, and active board participation. The theory posits that when PE investors become part of a firm's ownership, they mitigate the risks of managerial opportunism, thus enhancing financial performance. This alignment of incentives is critical in ensuring that PE-backed firms pursue sustainable profitability and value creation (Mathuva, 2014).

The Trade-Off Theory, developed by Modigliani and Miller (1958) and expanded by Myers (1984), further supports this study by explaining how firms balance the costs and benefits of equity and debt financing. In the PE context, the trade-off involves weighing the benefits of capital injection and managerial support against the potential costs of ownership dilution and loss of control. The theory advocates for an optimal capital structure that minimizes financial distress while maximizing firm value. In the Kenyan setting—where many firms face credit constraints and undercapitalization—PE provides a viable path to attaining this optimal balance, improving financial performance by alleviating liquidity pressures and enabling strategic expansion (Ashhari, 2012; Sheikh & Wang, 2011).

The Pecking Order Theory, initially proposed by Donaldson (1961) and refined by Myers and Majluf (1984), contends that firms prefer internal financing, followed by debt, and resort to equity financing only as a last option. This financing hierarchy is influenced by information asymmetry between internal managers and external financiers. In relation to PE, the theory explains why firms may delay seeking PE funding until internal resources and debt options are exhausted. The entry of PE investors, therefore, often occurs at critical inflection points—such as during expansion or turnaround phases—where the need for external equity becomes inevitable. The theory also suggests that firms accepting PE investments signal confidence in their long-term prospects, which may positively influence financial performance (Boivin, Kiley & Mishkin, 2010).

Finally, the Finance-Growth Theory by Bagehot (1973) underpins the broader economic rationale for private equity investments. This theory posits that access to finance is a catalyst for firm-level and macroeconomic growth. A well-functioning financial system mobilizes savings, facilitates capital allocation, and supports innovation—all of which are essential for enterprise development. In the Kenyan context, PE firms not only bridge financing gaps but also enhance investees' creditworthiness and financial discipline, making them more attractive to future lenders and investors (Demirgüç-Kunt & Levine, 2008). By providing both funding and strategic direction, PE serves as a growth engine for firms, thereby reinforcing the theoretical link between finance and performance in developing economies.

B. Empirical Review

A growing body of international research has explored the effect of private equity (PE) investments on financial performance, with most studies reporting a positive relationship. De Carvalho, Ferreira, and Matos (2025), using a global panel of over 4,000 PE-backed firms, found that such firms experienced superior revenue growth, profitability, and innovation compared to their non-PE-backed counterparts. These outcomes were attributed to strategic realignment and operational restructuring imposed by PE investors. Similarly, Bernstein et al. (2018) analyzed PE investments across OECD countries and found that industries with high PE activity registered significantly faster growth and productivity improvements. However, both studies focused on developed economies, limiting their applicability in emerging markets like Kenya, where financial systems and regulatory frameworks differ.

Regionally, studies have also established a generally positive link between PE and performance but with sector-specific nuances. Banda and Chikuta (2022), focusing on Southern Africa, found that growth capital significantly improved firm valuation and profitability, particularly among medium-sized firms. Likewise, Ochieng and Mutua (2024) analyzed PE-backed firms in Kenya's ICT and manufacturing sectors, reporting enhanced Return on Equity (ROE) and market valuation after PE funding. However, these studies often relied on narrow samples or failed to control for firm-specific variables, such as liquidity and age, which could moderate performance outcomes. Additionally, most regional studies did not disaggregate the effects of different PE strategies, such as venture capital, growth capital, and buyouts.

In Kenya, several empirical studies have investigated the relationship between PE and firm performance with mixed results. Karugu (2018) found that PE funding, especially in the form of venture capital, had a statistically significant positive effect on ROE among SMEs. Abdullahi and Mbugua (2021) further established that venture capital enhanced early-stage growth while buyouts were associated with efficiency gains. However, these studies relied on cross-sectional data and basic regression techniques that may not fully account for time-related effects or firm heterogeneity. Karanja (2018), using a sample of 25 firms, also reported a positive relationship between PE and performance, but the small sample size limited the generalizability of findings. These methodological gaps necessitate more robust empirical designs.

To address these limitations, the current study utilizes panel data spanning 15 years (2006–2021) from 144 PE-backed firms across diverse sectors in Kenya. It disaggregates PE investments into venture capital, growth capital, and buyout capital, and applies panel regression to evaluate their distinct effects on financial performance measured by Return on Assets (ROA). This approach builds on past studies while offering more comprehensive and generalizable insights. Moreover, by focusing on a developing country context and incorporating a broader range of PE strategies and performance indicators, the study contributes to closing the contextual and methodological gaps prevalent in existing literature.

III. Methodology

This study adopted a descriptive research design to examine the effect of private equity investments on the financial performance of investee firms in Kenya. The research was grounded in positivist philosophy, emphasizing empirical measurement and hypothesis testing through objective observation and statistical analysis. The target population comprised 152 firms that received private equity funding between 2006 and 2021, with complete data obtained from 144 firms, yielding a panel dataset spanning 16 years.

The study used secondary data sourced from private equity fund reports, investee firms' audited financial statements, and industry publications. Private equity investments were disaggregated into three components—venture capital, growth capital, and buyout capital—based on classifications adopted in previous studies and industry standards (KPMG, 2021; Deloitte, 2018). The dependent variable, financial performance, was measured using Return on Assets (ROA), a reliable indicator of profitability and asset utilization, consistent with previous studies (Karugu, 2018; Wang & Clift, 2009).

Data analysis was conducted using panel regression techniques in Stata, allowing the study to control for both time-invariant firm characteristics and firm-level heterogeneity over time. Several diagnostic tests were conducted to validate the robustness of the regression models, including tests for multicollinearity, stationarity, autocorrelation, normality, and heteroskedasticity. The Hausman specification test guided the choice between

fixed effects and random effects models, ensuring appropriate model selection based on the characteristics of the data. The final models estimated the direct effects of each type of private equity investment on ROA, providing empirical insights into how PE funding influences financial outcomes in the Kenyan context.

IV. Results And Discussion

A. Descriptive Results

To arrive to the conclusion of the general understanding of the secondary data obtained from 144 investee firms in Kenya between January 2006 and December 2021, the researcher calculated the mean, standard deviation, minimum and maximum of the study variables. Table 1 presents the descriptive statistics for the variables involved in the study. The descriptive statistics provide a summary of the central tendency and variability of each variable.

Venture capital, growth capital, and buyout capital exhibit significant variations, with standard deviations reflecting the extent of dispersion around the means. The mean values provide insights into the central tendencies of these capital types. Venture Capital, having the highest mean, suggests that, on average, investee firms received substantial venture capital funding over the studied years. Growth Capital and Buyout Capital, with slightly lower means, still indicate considerable financial injections, albeit at different scales.

Return on Assets (ROA), with a mean of 0.374825 and a standard deviation of 0.096542, indicates the average profitability and efficiency of investee firms. The standard deviation reflects the dispersion of ROA values around the mean, suggesting that some firms achieve higher returns on their assets, while others may have lower efficiency and profitability.

Table 1: Summary of Descriptive Statistics

stats	Venture capital	Growth capital	Buyout capital	ROA
N	2448	2448	2448	2448
min	4987.758	2846.302	1974.603	0.016122
max	151947.3	45998.74	43106.48	0.560669
mean	67537.9	21352.74	17233.25	0.374825
sd	41566.05	13335.5	11673.64	0.096542
se(mean)	840.104	269.5279	235.9394	0.001951

B. Hypothesis Testing

The study examined the effect of private equity investments measured by venture capital, growth capital and buy out investment on the financial performance of investee firms in Kenya. Hausman specification test indicated that the FE model was suitable. The results are as shown in Table 2

The results in Table 2 provide insights into the association between private equity investments and the financial performance of investee firms in Kenya, addressing the first goal of the study. The fixed-effects model was chosen based on the Hausman test results, which suggested that it is more appropriate for this analysis. The coefficients for each private equity investment indicator (Venture capital, Growth capital, and Buyout capital) are statistically significant at the 0.05 level, indicating a significant impact on Return on Assets (ROA).

Specifically, the coefficient for Venture capital is 0.047226 ($p = 0.015$), suggesting that a one-unit increase in venture capital is associated with a 0.047226-unit increase in ROA, holding other variables constant. Growth capital exhibits a more substantial effect, with a coefficient of 0.409957 ($p = 0.000$), indicating a more pronounced positive impact on ROA. Similarly, Buyout capital has a positive and statistically significant effect on ROA, with a coefficient of 0.08728 ($p = 0.003$). These findings collectively suggest that different forms of private equity investments contribute positively to the financial performance of investee firms in Kenya. The overall model's R-squared value of 0.1768 indicates that around 17.7% of the variability in ROA can be explained by the private equity investment indicators.

The intercept term, represented by the constant (-4.71495, $p = 0.000$), signifies the baseline ROA when all private equity investment indicators are zero. The model summary, with an F-statistic of 164.07 and a p-value of 0.000, suggests that the overall model is statistically significant. The number of observations (2,448) and the unique IDs (153) reinforce the robustness of the analysis. In conclusion, the results from Table 5.3 provide empirical support for the hypothesis that private equity investments significantly influence the financial performance of investee firms in Kenya, with each type of investment showing a distinct impact on ROA.

Hypothesis one (H_{01}) evaluated the association between private equity investments and financial performance of investee firms in Kenya, asserting no significant relationship between private equity investments and financial performance of investee firms in Kenya. According to the findings, there is a significant relationship between private equity investments and financial performance. Hypothesis one was rejected because the whole model was statistically significant ($p< 0.05$).

Table 2: Effect of Credit Risk Management on Financial Performance

ROA	Coef.	Std. Err.	P>t
Venture capital	0.047226*	0.02338	0.015
Growth capital	0.409957*	0.04779	0.000
Buyout capital	0.08728*	0.026956	0.003
_cons	-4.71495*	0.35955	0.000
Model Summary			
R-squared	0.1768		
F(3,2292)	164.07		
Prob > F	0.0000		
Observations	2,448		
ID	153		

p<0.05*

V. Conclusion

This study set out to investigate the effect of private equity investments on the financial performance of investee firms in Kenya. Drawing on panel data from 144 private equity-backed firms over a 15-year period (2006–2021), the analysis revealed that venture capital, growth capital, and buyout capital each had a statistically significant and positive effect on Return on Assets (ROA). These findings affirm the theoretical proposition that private equity enhances firm performance by injecting not only capital but also strategic management expertise, governance oversight, and operational efficiency.

Among the three private equity types, venture capital had the strongest influence, reflecting its role in supporting early-stage firms with high growth potential. Growth capital and buyout capital also yielded positive impacts, indicating that private equity remains effective across different stages of the firm lifecycle. The results reinforce the relevance of agency theory, pecking order theory, and trade-off theory in explaining how PE investments reshape firm behavior and optimize performance outcomes. Overall, the study provides robust empirical evidence that private equity is a viable strategy for improving financial performance in Kenya's dynamic business environment.

VI. Recommendations

Based on the findings, several practical and policy recommendations emerge. First, entrepreneurs and firm managers should consider private equity not just as a source of capital, but as a strategic partnership that can drive long-term performance. Firms at different stages—start-up, growth, or restructuring—should tailor their engagement with PE funds depending on their capital needs and strategic goals.

Second, private equity fund managers should continue diversifying their investment strategies across venture, growth, and buyout capital to match the heterogeneous needs of Kenyan firms. By aligning investment approaches with firm-specific conditions, fund managers can maximize value creation and returns.

Finally, policymakers and regulators should strengthen the institutional and legal frameworks that support private equity activity in Kenya. Enhancing transparency, reducing regulatory bottlenecks, and incentivizing local participation in PE funds can promote a more vibrant private equity market. As Kenya continues to position itself as a financial hub in the region, fostering an enabling environment for PE can significantly enhance enterprise competitiveness and economic growth.

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