

The Role of Venture Capital Funding on the Performance of Small and Medium-Sized Enterprises (SMEs) in Lusaka, Zambia: A Case Study

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Abstract

This study investigates how venture capital funding impacts SME performance in Lusaka, Zambia. SMEs are crucial for Zambia's economic growth, but face challenges accessing financing, especially in their early stages. Venture capital offers potential solutions by providing capital and expertise for SMEs to thrive. However, there's a gap in understanding how exactly venture capital influences SME growth and performance, and the contextual factors at play. The research, based on the economic theory of the entrepreneur, used a mixed study design and achieved a 100% response rate from 102 SME owners/managers through questionnaires. Analysis reveals a positive correlation between venture capital funding and SME performance, along with the importance of financial management skills. Challenges include limited access to venture capital, awareness issues, and regulatory hurdles. Recommendations include developing growth-centric business plans and enhancing awareness of venture capital benefits for SMEs.

Keywords

Small and Medium Enterprises (SMEs), Venture Capital Funding, Performance, Development, Start-Up

1. Introduction

Small and Medium-sized Enterprises (SMEs) play a vital role in the economic development of many countries, including Zambia (Kwesiga & Franzel, 2014); (Mwansa & Simbanegavi, 2020). However, access to financing remains a signifi-

cant challenge for SMEs, particularly in the early stages of their development (Ayyagari et al., 2011). Venture capital funding has been identified as a potential solution to this problem, as it can provide the necessary capital and expertise to help start-up SMEs grow and succeed (Chung & Park, 2017).

This study aims to investigate the role of venture capital funding on the growth and performance of SMEs in Lusaka, Zambia. As the country continues to experience rapid economic growth and development (IMF, 2021), there is an increasing need for SMEs to adopt new business models and technologies to remain competitive (Abor & Quartey, 2010). The study will examine how venture capital funding can support these efforts and contribute to the growth and success of SMEs. A case study approach will be used to analyze the experiences of selected SMEs in Lusaka that have received venture capital funding. The findings of this study will contribute to the existing literature on SME financing and offer practical insights for policymakers, investors, and entrepreneurs in Zambia and other developing countries.

The role of venture capital can be seen as an important link to support business continuity. Before investing in start-ups, venture capital analysts or internal parties conduct the analysis and selection of start-up companies and their growth and performance. Ramdhan (2016) stated that the funding mechanism, either financially or materially, undertaken by venture capital is different from other financial industries and is considered to have a high risk, so special analysis is needed before deciding to invest in start-up companies.

According to Muriithi (2012), venture capitalists take different approaches in investing in local companies and are specifically interested in initial stage companies, and these are referred to as angel investors. An angel investor is an affluent individual who provides capital for a business startup in early development or growth stage, usually in exchange for debt or ownership equity (Amis-sah, 2009). A small but increasing number of angel investors organise themselves into fund management groups or angel networks to share research and pool their investment capital, as well as to provide advice to their portfolio companies (Peneder, 2010).

2. Research Significance

This study enlightens sector players, policy and strategy makers, SMEs and private equity firms on the impact of entrepreneurial financing in Zambia, the various forms of funding available to SMEs and how it could be embraced. It would help financiers and investors improve their relations with each other and with the regulator.

The study will be very useful for venture capital firms in providing insight on strategic opportunities in the Zambian SME sector, as well as ways to address the challenges currently facing the sector and for potential private equity firm entrants into Zambia, helping them make a smooth entry into Zambia. This is particularly important as it presents the perspective of an African emerging econo-

my with SMEs as the main drivers of growth.

3. Literature Review

The review commences with the theoretical framework, encompassing three key theories pertinent to comprehending how venture capital financing influences SME performance. Subsequently, it looks into an empirical examination of studies exploring this relationship across diverse countries. These studies consistently illustrate the positive impact of venture capital on SME growth, innovation, and market expansion. Venture-backed SMEs typically demonstrate accelerated growth and stronger market positioning compared to their non-venture-backed counterparts. Lastly, the review identifies gaps in the literature for further exploration.

Overall, the literature underscores the pivotal role of venture capital financing in fostering innovation, growth, and competitiveness among SMEs, making it a critical consideration for entrepreneurs aiming to scale their ventures and achieve enduring success.

3.1. Theoretical Framework

This framework includes three main theories relevant to understanding the impact of venture capital financing on the performances of SMEs: Resource-Based Entrepreneurship Theory, the Trade-off theory and the Economic theory.

The Resource based theory of entrepreneurship argues that access to resources by founders is an important predictor of opportunity-based entrepreneurship and new venture growth. This theory stresses the importance of financial, social and human resources as cited by [Kwabena Nkansah Simpeh \(2011\)](#). Financial, social and human capital represents three classes of theories under the resource-based entrepreneurship theories ([Simpeh, 2011](#)). He asserts that by implication this theory suggests that people with financial capital are more able to acquire resources to effectively exploit entrepreneurial opportunities and set up a firm to do so.

The trade-off theory of capital structure refers to the idea that a firm chooses how much debt finance and how much equity finance to use by balancing the costs and benefits. Firms borrow up to the point where the tax savings from an extra dollar in debt are exactly equal to the costs that come from the increased probability of financial distress. Under the trade-off theory framework, a firm is viewed as setting a target debt-to-equity ratio and gradually moving toward it, which indicates that some form of optimal capital structure exists that can maximise the firm value. The trade-off theory postulated that there is a limit to debt financing and the target debt may vary from one SME's to another depending on profitability, among other factors referring to microfinance.

The Economic theory shows that the motivations for additional financing in an SME are expansion of operations of entrepreneurs by venture capitalists. Therefore, venture capitalists assume some levels of risk when financing start-

ups to expand the activities of an SME in return for higher returns. Start-ups are vital for economic growth and development in both industrialised and developing countries, playing a key role in creating new jobs. According to Ngigi (1997), financing is necessary to help them set up and expand their operations, develop new products, and invest in new staff or production facilities. If SMEs cannot find the financing they need, brilliant ideas may fall by the wayside and this represents a loss in potential growth for the economy (Memba et al., 2012).

3.2. Empirical Review

A qualitative investigation conducted by Aman (2020) explored the impact of Venture Capital Funding on the Performance of Small and Medium-Sized Enterprises (SMEs) in Russia. The study focused on internal organizational structuring and human resources management, revealing that venture capitalists enhance professionalization within firms, which constitutes a primary benefit of venture capital financing. Additionally, the research affirmed that venture capital funding significantly and positively influences the growth and performance of SMEs.

John (2023) conducted a study investigating the influence of venture capital financing on Start-up Success through a comprehensive literature review. This review systematically analyzed peer-reviewed articles, conference papers, and relevant academic publications. It concluded that venture capital financing substantially contributes to start-up success by providing not only financial resources but also valuable managerial expertise, industry connections, and guidance.

In another study by David (2023), the relationship between venture capital and other Sources of Finance was examined through a literature review. Utilizing a systematic approach, this review analyzed existing research on the subject, considering both qualitative and quantitative studies. The findings highlighted the significance of venture capital financing in conjunction with other financial sources.

Additionally, a qualitative study by Baldwin & Rafiquzzaman (2020) explored the role of financial management skills in the performance of SMEs in Malawi. It revealed that proficiency in financial management supports various aspects such as capital raising, profitability, investor confidence, risk mitigation, strategic decision-making, access to credit and financing, and tax compliance. Effective financial management contributes to long-term sustainability while balancing growth objectives with profitability.

3.3. Conceptual Framework

A conceptual framework is a product of qualitative process of theorization which inter-links concept that together provides a comprehensive understanding of a phenomenon or phenomena (Jabareen, 2009). The concepts that constitute a conceptual framework support each other, articulate their respective phenomena, and establish a frame-work-specific philosophy that defines relationships.

Therefore, the conceptual framework is a diagram that illustrates the relationships among relevant factors that can influence the successful achievement of goals and objectives. It helps to determine which factors will influence and how each of these factors could relate to and affect the outcomes. The conceptual framework of this study (**Figure 1**) relates to independent variables; venture capital financing, venture capital funding and other sources of finance for SMEs financial management skills, and key challenges and the dependent variable; performance of SMEs.

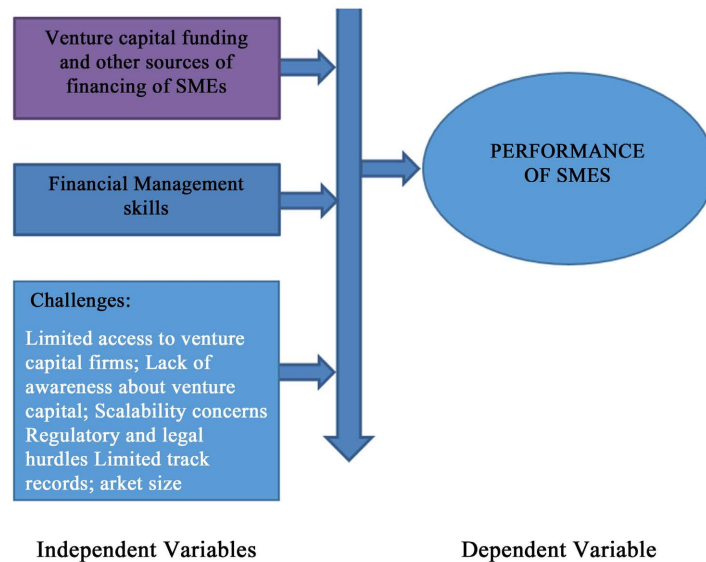


Figure 1. Conceptual Framework of the role of venture capital funding on the Performance of Small and Medium-Sized Enterprises (SMEs) in Lusaka, Zambia.

4. Research Methodology

4.1. Research Design and Methodology

In this study, a comprehensive mixed-methods approach was employed to delve into the impact of Venture Capital Funding on the performance of SMEs in Lusaka, Zambia. This methodological framework incorporated both quantitative and qualitative components to ensure a robust analysis of the research topic.

For the quantitative aspect, a structured survey was conducted to gather data encompassing various dimensions relevant to venture capital funding and SME performance. The survey aimed to assess the influence of venture capital funding on the performance of start-up SMEs, as well as to investigate the effects of financial management skills and challenges encountered on SME performance. Statistical analysis techniques were applied to scrutinize the quantitative data acquired from the survey responses. This analytical approach facilitated the identification of significant trends and patterns inherent in the data, providing quantitative insights into the research domain.

In parallel, qualitative data were collected through immersive focus group

discussions and in-depth interviews conducted with business owners and managers of SMEs situated in Lusaka, Zambia. These qualitative engagements delved into the nuanced aspects of the role of Venture Capital Funding on SME performance. By eliciting the experiences, perspectives, and contextual nuances from the participants, these discussions and interviews offered valuable qualitative insights, enriching the understanding of the subject matter beyond mere statistical analysis.

Through the synergistic integration of quantitative survey data analysis and qualitative insights from focus group discussions and interviews, this research aimed to provide a comprehensive understanding of the multifaceted dynamics surrounding the relationship between venture capital funding and SME performance in the vibrant entrepreneurial landscape of Lusaka, Zambia.

4.2. Study Setting

The research was carried out in Lusaka, Zambia, chosen due to its dynamic entrepreneurial ecosystem, particularly the presence of multi-local headquarters start-ups funded by venture capital. This selection of Lusaka as the study setting was deliberate, considering its significance as a hub for innovative ventures backed by venture capital investment. It's essential to emphasize that all SMEs included in the study were situated within the geographical radius of Lusaka, ensuring a localized focus on the specific entrepreneurial landscape and business dynamics prevalent in this vibrant city.

4.3. Data Collection and Sampling

Patton (2002: p. 5) and Babbie and Mouton (2002: p. 74) outlined three primary data collection methods: indepth, openended interviews, direct observations, and analysis of written documents. The study employed the following data collection methods:

1) Interviews: An interview guide with open-ended questions tailored to the study's objectives was developed. Face-to-face interviews were conducted to gather additional insights from the interviewees based on their responses to the open-ended questions.

2) Purposive Sampling: Purposive sampling was utilized to select 102 startup owners in Lusaka. This non-probability sampling method involved selecting participants who were deemed most likely to provide relevant information for the study (Neuman, 2010; MorraImas & Rist, 2009). The sample size consisted of 102 respondents, including both managers and owners of SMEs. Considering the total population of SMEs in operation in Lusaka, which stands at 171,063 as per PACRA 2022, the chosen percentage was 0.06% of this total.

3) Data Analysis: The study heavily relied on thematic formulations for data analysis. The collected data were cleaned, theorized, and categorized into different thematic areas. Key themes were then coded to facilitate data interpretation and derive meaningful insights.

4) Ethical Considerations: Following Creswell's (2013: p. 95) recommendation, researchers anticipated ethical issues at multiple phases of the research to adequately address them. Ethical clearance was sought and granted by the Research Ethics Committee of the University of Zambia. Respondents were requested to provide consent before participating in the interviews. Privacy and confidentiality of the respondents were maintained by explaining the study's objectives and implications and ensuring accurate reporting of the study's results.

5. Research Findings

The presentation and analysis of the collected data are structured around predetermined themes, which serve as an overarching framework for classifying the results (Wellman et al., 2005: p. 211). These themes encompass various aspects pertinent to the study, namely:

1) The Influence of Venture Capital Financing on SME Performance in Lusaka, Zambia: This theme delves into the impact of venture capital funding on the performance metrics of Small and Medium-sized Enterprises (SMEs) operating in Lusaka. It explores how the infusion of venture capital resources influences key performance indicators such as growth rate, market expansion, innovation adoption, and overall competitiveness.

2) The Relationship between Venture Capital Funding and Other Sources of Finance for SMEs in Lusaka, Zambia: This theme examines the interplay between venture capital financing and alternative sources of funding available to SMEs in Lusaka. It investigates how venture capital funding complements or interacts with traditional financing methods such as bank loans, angel investments, or government grants. Additionally, it assesses the synergistic effects and potential drawbacks associated with combining different funding sources.

3) The Impact of Financial Management Skills, Including Challenges Faced, on the Performance of Start-up SMEs: This theme focuses on the significance of financial management competencies for the performance and sustainability of start-up SMEs. It explores how proficient financial management practices contribute to capital raising, profitability, investor confidence, risk mitigation, strategic decision-making, access to credit, and compliance with regulatory requirements. Furthermore, it addresses the challenges encountered in managing finances effectively and the strategies employed to overcome them.

These thematic areas provide a comprehensive framework for analyzing the research findings and gaining insights into the dynamics of venture capital financing, financial management practices, and their implications for SME performance in the context of Lusaka, Zambia.

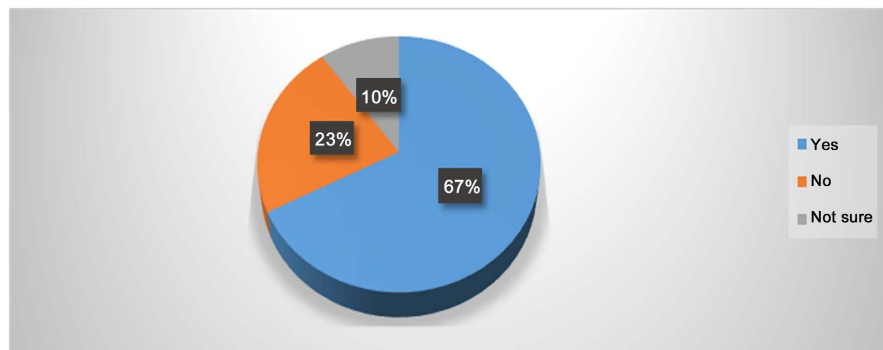
The response rate to the questionnaire and interviews, as presented in **Table 1**, indicates high participation, with 98% of respondents engaging in the study. Out of the total sample size of 102, 100 participants responded, demonstrating a robust level of engagement and data collection efficacy.

Table 1. Response rate to the questionnaire and interviews.

No.	Category	Frequency	Percentage
1	Response	100	98%
2	Non-Response	2	2%
3	Total	102	100%

Key Research Finding Number 1: The influence of venture capital financing on the performance of SMEs in Lusaka, Zambia:

Figure 2 illustrates the impact of venture capital financing on SME performance. The study revealed that 67% of respondents acknowledged the positive influence of venture capital financing on employee performance within SMEs. The majority of participants strongly agreed that venture capital provides essential capital for rapid expansion, facilitates innovation and research, and offers valuable industry expertise and guidance. This positive sentiment was reflected in mean scores of 4.81, 4.74, and 4.58, respectively.

**Figure 2.** Showing venture capital financing impacting on the performance of SMEs.

Key Research Finding Number 2: The relationship between venture capital funding and other sources of finance for SMEs in Lusaka, Zambia:

Figure 3 displays responses regarding the relationship between venture capital funding and alternative finance sources for SMEs. A significant majority (75%) agreed that venture capital complements other funding avenues such as bank loans and government grants. Participants emphasized the diversified funding approach, strategic partnerships, and the optimization of capital structure through the combination of venture capital and debt financing. Mean scores of 4.92, 4.87, and 4.72 underscored the perceived importance of these relationships in enhancing SME performance.

Key Research Finding Number 3: The Impact of Financial Management Skills, Including Challenges Faced, on the Performance of Start-up SMEs:

Figure 4 depicts responses concerning the impact of financial management skills and associated challenges on start-up SME performance. The study found that effective financial management skills are instrumental in strategic resource allocation, cash flow management, and risk mitigation. Strong financial acumen

enables entrepreneurs to navigate financial challenges, optimize cash flow cycles, and make informed decisions, contributing to business resilience and performance. Mean scores of 4.83, 4.76, and 4.55 underscored the critical role of financial management skills in driving start-up SME success.

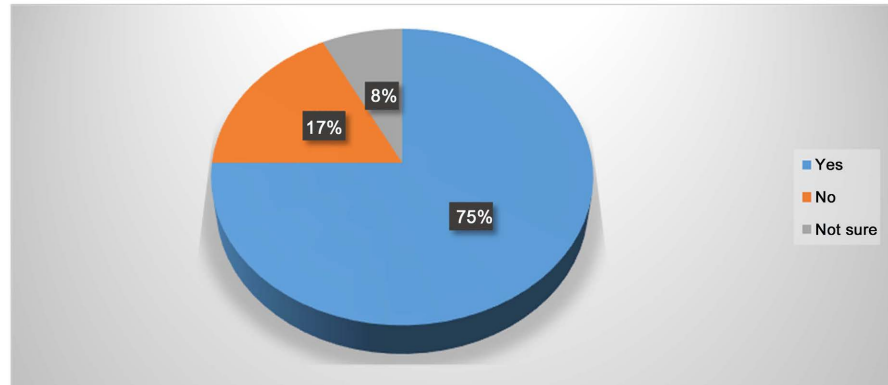


Figure 3. Showing the responses on the relationship between venture capital funding and other sources of finance for SMEs.

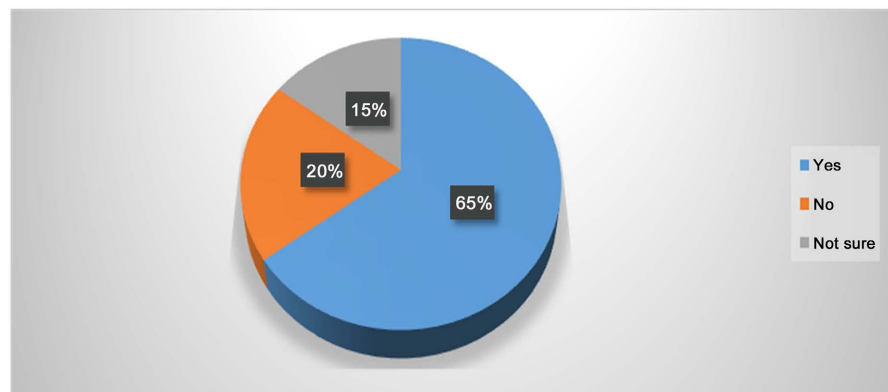


Figure 4. Showing the responses on the impact of financial management skills, including challenges faced, on the performance of start-up SMEs.

These findings highlight the positive influence of venture capital financing, the importance of strategic relationships with alternative funding sources, and the critical role of financial management skills in enhancing SME performance in Lusaka, Zambia.

6. Discussion

The study's findings elucidate the pivotal role of venture capital financing in empowering SMEs in Lusaka, Zambia. By providing essential capital, venture capital enables SMEs to expand rapidly, penetrate new markets, and seize growth opportunities beyond the scope of traditional funding avenues. These outcomes resonate with [Jensen & Meckling's \(2019\)](#) research in Australia, which demonstrated that venture-backed companies exhibit a propensity for radical innovation, resulting in robust growth and performance.

Moreover, the study affirms that venture capital funding not only enhances SME performance but also facilitates their access to additional financial resources. This aligns with the findings of [Murithi \(2020\)](#) in Nigeria, where venture capital-financed firms exhibited superior growth and performance compared to their counterparts without such funding.

The significance of venture capital in driving SME growth underscores its potential to foster economic development in Lusaka, Zambia. Despite existing challenges, proactive measures coupled with strong financial management skills can empower SMEs to capitalize on venture capital opportunities. These insights offer valuable guidance for policymakers, investors, and entrepreneurs seeking to support SMEs and stimulate economic growth in Lusaka, Zambia, thereby contributing to the broader development agenda of the region.

7. Conclusion

The study unequivocally demonstrates the profound and positive impact of venture capital funding on SME performance in Lusaka, Zambia. Venture capital infusion propels growth by furnishing essential financial resources for expanding operations, broadening market presence, innovating new products, and enhancing marketing endeavours.

Furthermore, venture capital funding serves as a catalyst for SMEs to attract additional financing, serving as a robust validation of their business models, management proficiency, and growth prospects. Additionally, the study accentuates the pivotal role of proficient financial management skills in augmenting the growth and performance of nascent SMEs in Lusaka. Effective financial management facilitates efficient resource allocation, adept cash flow management, precise budgeting, and meticulous financial reporting, thereby bolstering capital acquisition, profitability, investor trust, risk mitigation, strategic decision-making, access to credit and financing, and adherence to tax regulations.

Thus, this research underscores the instrumental role of venture capital in fostering SME expansion in Lusaka, Zambia. Despite prevailing challenges, proactive strategies coupled with adept financial management capabilities empower SMEs to harness venture capital opportunities, ultimately contributing to regional economic advancement. The insights gleaned from this study offer invaluable guidance for policymakers, investors, and entrepreneurs seeking to bolster and engage with SMEs in Lusaka, Zambia, driving forward the developmental agenda of the region.

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Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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