ENTREPRENEURIAL FINANCE: AN OVERVIEW OF FUNDING SOURCES TO STARTUPS

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ABSTRACT

The success of any venture or start up and economic development of nation does not just happen they are the outcomes of the combination of flexible business environment, government policies, planning, efforts and innovations of an entrepreneurs a right combination of all the factors results in achievement of entrepreneurs. The factors contributing to the development of any economy are labor, land, technology, natural resources, capital and entrepreneurship. Among all the factors key component is entrepreneur and Capital. In practice an entrepreneur faces many hurdles while setting up his enterprises. Financing is a major problem faced by most of the entrepreneurs hence it is essential to consider the various sources of entrepreneurial finance available to start a new business. In this research article author has made an effort to trace out the sources of entrepreneurial finance potentially makes it easier to raise the funds and develop the startups. The objective of the study is to identify the financial sources to start new ventures, and to understand the capitalization theories. To look over the literature carried in the domain of entrepreneurial finance and also to offer principle findings of the study in entrepreneurial finance.

Key words: Economic development, Entrepreneurial finance, Capitalisation theories, financing sources, ventures.

Introduction:

Finance is considered as life blood of any business it is considered as one of the important factor for starting a business or an undertaking. Before setting up of any business units, entrepreneurs should be clearly understood about the nature of the business, need and extent of their financial requirements. It is also very much important to know about the alternative sources of financing the operations of new startups.

Availability of funds facilitates an entrepreneur to bring all the factors of production i.e, Land, labor, capital, technology, natural resources and so on. The importance of finance in production process is considered as a lubricant to the production function. Financing enterprises whether large or small sized firms found to be crucial element in development of business units. Many startups though potentially viable and successful, failed because of their financing decisions i.e, undercapitalization and overcapitalization. Hence, it is necessary for an entrepreneur to chalk out the financial requirements before setting up the venture. The decisions made by an entrepreneur in advance with respect to funding and future financial aspects associated with his or her business is called as entrepreneurial financial planning. Financial planning encompasses with futurity of decision making in terms of financing the new ventures.

Financial planning of an entrepreneur should provide answer to the major questions such as

1. Quantum of finance required while starting new venture or business units?
2. How those funds can be raised?
3. When do the funds need to be available?

Statement of the problem:

Entrepreneurs should consider the factors before financing the new venture such as funds to pay purchase considerations and the funds required in beginning 3-6 months of enterprise setup and also funds required to meet the contingencies and unplanned expenses. Hence every firm should maintain 10-15% of purchase consideration to meet the financial expenses of the startups. So finance is considered as a pre-requisite for setting up a new business. It is inevitable to know about the various sources of funding

ISBN: 978-81-955611-5-5

new business units.

Objectives of the study:

1. To look over the literature of entrepreneurial finance.
2. To identify the sources of Entrepreneurial finance.
3. To study the capitalization theories.

Research Methodology:

The present study is purely conceptual and descriptive in nature. The secondary data has been collected from various sources like peer-review articles, books and online source. The author has followed inclusion and exclusion criteria to collect pertinent information related to the present study,

Inclusion Criteria:

The literature related to entrepreneurial finance is only considered and the theories of capitalization, financial aspects were considered and the information should be available in English language were considered.

Exclusion criteria:

The author has considered only conceptual facts, theories and quantitative data has been excluded from the study.

Review of Literature:

Cole, Cumming and Li(2016) in their study compared the impact of venture capital funding and bank finance on firm growth and business operations and the results of the study revealed that stronger impact on growth through venture funds rather than bank finance.

Hanssens, Delo of and Vanacker (2016) opines debt policies changes along with the passage of firm age, the entrepreneurial firm debt policies comprises of leverage, debt specialization and debt maturity comprises an important component in startup funding patterns. The debt policies adopted by the firms in initial stages are found to be major determinants of future debt policy of the business units.

Bruton et.al (2015) opined that the entrepreneurs should consider the amount of finance required to meet the requirements of business operations

ISBN: 978-81-955611-5-5

in order to survive for longer period. Over the decades entrepreneurial finance considered on venture capital and angel funds. In recent days a whole set of new sources of finance has been emerged.

Fraser, Bhaumik and wright (2015) has identified the importance of entrepreneurial firms in overall development of economic system and they focused on the various sources of funding and its impact on performance of startups.

Hanseens, Deloof and Vanacker (2015) opines entrepreneurial finance focus almost exclusively on single source of financing. Exhaustive literature has been emerged from bank finance, lease finance, business angel finance, venture capital, equity capital and most recently crowd funding How ever in practice entrepreneurs use multiple sources and they have made an attempt to understand the sources of finance and its impact on new ventures and how the combination of funding new business will help entrepreneurs.

Sources of Entrepreneurial finance:

1**. Angel Investors:**

Angel investors are wealthy people who are looking to invest their funds in profitable ventures, they have experience in the business but still they require more hands on venture capital and more challenging to please other sources of funds. The important feature of business angels is they invest part of funds and time in newly started ventures and angel investments are three times more to venture capital investments.

2. **Venture capital:**

Venture capital is a popular method of financing enterprises in which investors participate in firm capital against cash and holdings. Venture capitalists look out for profitable and fast growing ventures where they can leverage operational efficiency and performance. The objective of venture capitalists is to make profit by selling the stake of the firm in middle term. They expect high profits and also invest their funds in risky ventures. Corporate venture capitalists seek strategic benefits from investments. Venture capitalists invest their financial resources in growth stages of business units.

3.**Financial bootstrapping:**

Financial bootstrapping is majorly concerned with investing own funds by owners or entrepreneurs which provides the owners to make free decisions in order to develop their ventures and external finance is avoided in

ISBN: 978-81-955611-5-5

bootstrapping. Bootstrapping comprises of joint utilization, sweat equity, owner finance, personal debt and delayed payment etc.

4. **Accelerators and incubators:**

The accelerators and incubators assist the new ventures with advisory services, shares financial resources majorly they offer physical space to entrepreneurs and also financial resources. They expect portion of equity stake from the new venture. Accelerators and incubators are government or non government institutions who support ventures and startups.

5. **Crowd funding:**

Crowd funding is the source of financing startups as a way of alternative sources of accessing funds it is an innovative method of financing new projects and businesses. Crowd funding is majorly concerned with raise of capital from large number of individuals to finance new businesses. Crowd funding make use of social media to establish a network of investors and entrepreneurs together with potential to increase entrepreneurial activities by expanding pool of investors beyond the traditional circle of investors such as family members and relatives.

Crowd funding is basically classified into four broader types as given below:

a. **Investment based crowd funding:**

It is a kind of equity based crowd funding where entrepreneurs make an open call on online platform the major objective of this crowd funding is to sell or offer a specific portion of equity to individual investors and potential entrepreneurs.

b. **Reward based crowd funding:**

In this crowd funding the financiers of business receives the reward in form of product or services against their investments sometimes they expect customized products and services it is similar to financial bootstrapping. The investors have a right to make free decisions of their choice.

c. **Donation based crowd funding:**

It is a type of crowd funding usually NGO's or individuals use donation based crowd finance for a social cause.

d. **Lending based Crowd funding:**

It is a crowd funding where an entrepreneurs collect funds in the form of loans at certain percentage of fixed interest on total value.

6. **Corporate venture capital:**

These are the venture capital investments established firms they invest in start

ISBN: 978-81-955611-5-5

up and growth firms they concentrate on major stake in young firms and assist them to grow in market place usually these firms will invest in early stage or late stage of venture.

7. **IP Backed debt funding:**

These are the firms they exploit their economic value of intellectual property in order to raise funds from financial institutions. The intellectual property rights act as collateral security to raise funds and those IP usually comprises of high structural costs and other crucial components in funding of startups.

8. **IPO's:**

Initial public offerings can help firms to raise capital. Large amount of capital have been raised by small and medium firms through IPO many young entrepreneurs have a goal of completing successful IPO as early as possible for their enterprise.

Internal source

For every enterprise, capital is arranged from the two major sources such as internal and external sources. Internal source comprises of owners fund known as equity and external source of funds is financed through financial institutions and commercial banks. Internal sources are financed within an enterprise. The internal source of finance is generally called as equity finance popularly known as owners capital it includes deposit and loans given by owners, partners and directors. One of the major sources for raising internal funds is personal loans received by an entrepreneur on his personal assets such as building, land, investments, provident funds etc. In case of existing business retained earnings is the major source or converting some physical assets in into funds.. The major principle of financial management states that an entrepreneur should judiciously use or plough back earnings into his or her business itself.

External source of finance:

External source of finance comprises of the following:

1. Borrowings from financial institutions and commercial banks.
2. Term loans and mortgage loans
3. Leasing or hire purchase
4. Deposits from relatives and friends.

For every enterprise finance is considered as life blood to operate its production activities an entrepreneur should determine the proportion of funds to be raised from internal and external sources which represents the capital structure of an

ISBN: 978-81-955611-5-5

enterprise. Capital structure of the firm represents the debt-equity proportion in the capital. It is very significant to determine the capital structure and financial structure of an enterprise. Financial structure of the firm determines the long term and short term financing patterns of an enterprise. An entrepreneur should always focus on establishing optimum capital structure for smooth functioning of business by reducing overall cost of capital and maximizing value of firm.

Capitalization represents the total capital employed in business, Gestenberg defines capitalization encompasses ownership capital which includes capital stocks and surplus in other forms and borrowed capital in the form of long term debts, bonds, debentures etc. The theories of capitalization for new enterprises include:

1. **Historical costs theory**
2. **Earnings theory**

As per the historical cost theory capitalization of new business is equivalent to the costs actually incurred in setting up of new enterprises. In simple words, amount of capitalization of new enterprise is the total amount of cost upon fixed assets, working capital and cost occurred in setting new enterprise. The historical cost theory majorly focuses on current outlay than on future requirement of business.

Earnings theory describes the basic determination of value of an enterprise on its earning capacity The theory suggests that new firms should estimate its average annual future earnings and it is capitalized by normal earnings rate i.e prevailing business. The theory suffers from limitation in determining the exact capitalization of new enterprises since it is very difficult to determine the future earnings of the company. If an entrepreneur fails to estimate earnings correctly capitalization of the business becomes more risky. Hence it is suggested that an entrepreneur should consider historical cost theory over earnings theory.

Major financial challenges faced by entrepreneurs:

1. Short fall of funds:

Without sufficient cash flows a firm cannot operate its business smoothly finance is the lubricant that allows firm to meet the business obligations such as payroll expenses, rents and taxes, raw materials and inventory management etc the best way to avoid cash flow deficits is only possible with tight control over cash flow cycles in order to control the cash flow cycle an entrepreneur should

ISBN: 978-81-955611-5-5

collect receivables faster and stretch out the payables further.

2. Capital Access:

Startups or any business requires funds in order to meet the working capital requirements an entrepreneur should plan ahead and arrange the finance before he or she actually needs the fund.

3. Wrong financial decisions:

Usually firms have no financial resources to accomplish the goals finance is the key to growth of business lack of knowledge about capacity is also a major reason that leads to financial problem. Faulty budget estimation may also leads to financial crisis of an enterprise or any business.

Principle findings of the study:

1. Entrepreneurial finance is a fundamental concept which blends the Entrepreneurship with financial decision making of an entrepreneur.
2. Finance is essentially required at all stages of the business life cycle similarly for a new startup to discover the possibilities, commercial and operational activities. An entrepreneur should also consider the value creation to his or her business.
3. It was also observed that it is very difficult to estimate the earnings and sourcing funds to the new ventures due to the risk profile of the startups.
4. Start up generally draws different sort of investors during the initial stages of developing business it may use different sources of financial instruments to meet the financial obligations of the business.
5. The business environment is becoming more competitive hence the startups should closely monitor the business situations and markets although there are different sources of finance available for an entrepreneur he or she should select the best source of finance to sustain for a longer period.

Conclusion:

Entrepreneurs play a prominent role in economic development of any nation entrepreneurs act as catalyst in the process of industrialization and economic growth. He or she is the key to creation of new startup or any undertakings which energise the economy and make the economic structure. A new business require finance to function smoothly entrepreneurs have to decide the sources of

ISBN: 978-81-955611-5-5

financing business. The major sources of financing business operations includes internal and external sources such as Equity capital, debt finance, boot strapping, venture capital, crowd funding, incubators and accelerators and so on these sources of finance may have peculiar advantages and disadvantages and each source of funding can be accessed during the different stages of the business cycle . these sources of finance may pose strategic challenges to the entrepreneurs and also provides wide range of opportunities. An entrepreneur may enter incubators during the early stages of business and if an entrepreneur wants to access individual investors and general public for finance may go with crowd funding these sources may offer costs and benefits to entrepreneurs. The present study concludes with financing of enterprises still there are other issues remain unexplored in the area of entrepreneurial finance.

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ISBN: 978-81-955611-5-5