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Financing Management: A Conceptual Study of Different Types of Sources of Finance

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Abstract—*This paper surveys the necessities and implications of fiscal accountancy in establishing business by entrepreneurs. Constituting an enterprise is not so facile these days , it has its own complications and strategies. Though burgeoning information and communication sector is helping start-ups in a confirmative manner , there still remains gorge between success of firms and their economical assistance. Gubernatorial as well as corporate backing can bridge this gap by persuasive administration and financial help. Planning, funding, operations, valuation and preparing for contingencies are some essential and fundamental applications and adaptations for entrepreneurial venture. Small businesses serve as fuel to economic development of any country , for an instance the informal sector makes up 95% of employment in India. Government policies intend to include the backward and non-creamy layer in drive to attract start ups. In India the assistance provided to entrepreneurs aims at bringing phenomenal increase in per capita income of individuals resulting into increased national income further better standard of living conjointly creating jobs by young guns rather than seeking jobs.*

Keywords*: Entrepreneurs . Finance , Employment , Government*

1. INTRODUCTION

In an era where recession and inflation seems to be the greatest threat to almost every economy, it becomes very pivotal to find a explication where economy can be balanced between deflation and inflation. Developing countries to name a few Brazil, India, China , Malaysia stress more upon the raising entrepreneurs and business . Executives of the business are assets to be cultivated, motivated and remunerated to the greatest possible extent specially in developing countries. Entrepreneurial ventures in addition to jobs also create prosperity and innovations along with better living standards of the people. Colossal demand created by increasing population in the present era makes it an agreeable task for new entrepreneurs to set up their own business. Financing startups is a precarious as well as chance for investment for sponsors. Funding, resource allocation, free cash flow are some very important aspects which are kept in mind by investors. Venture capital is another source of financing start ups with innovative and pragmatic ideas. Financing can be basically divided into two parts – Internal funding and External funding , the former with less scope and higher risk while latter with greater scope and moderate risk. Funding sources in a business can be broadly divided into two parts , basically Internal funding and External funding. Internal funding includes the monetary help obtained from close sources while External funding is obtained from external sources like banks, angel investors and venture capital.

2. OBJECTIVE

- To comprehend channels of start up funding and there by making a clear understanding of entrepreneurship financing.
- To decipher different types of financing tools and techniques.

3. LITERATURE REVIEW

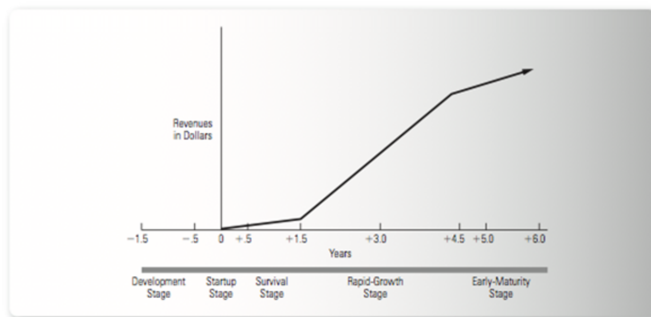
Entrepreneur abilities are the most important determinant to attract investment , says Amit Raphael, Glosten Lawrence and Muller Eitan (1990). Mason Colin believes that business angels contribute to the largest pool of equity capital available for start up. Shane scott and Cable Daniel(1981) quote that investors face high risk when selecting entrepreneurs because in later parts these entrepreneurs make turn opportunists and that entrepreneurs vary in ability to identify and exploit opportunities. Hellmann Thomas and Puri Manju(2003) think that venture capital contributes to the competitive strength of the US economy by promoting the development of innovative set ups. Investments are often made in firms which have not yet registered one single dollar of revenues says Barry B Christopher (1994). Jean Etienne de Bettignies (2008) details more on connections between ventures distinct features and their financial contracts.

4. METHODOLOGY

Framed with research method approach this paper recognizes foremost and decisive procedure towards financing entrepreneurship ventures. With the 'job work' ideology waning, more individuals looking forward for satisfaction by making world a better place , rather then tolerating brain

numbing work to fund enjoyment. Looking at the Kaufman Index of Entrepreneurial Activity (KIEA) the entrepreneurial rate in the US is already above the last 15 years. Analyzing the various stages of constituting a start up , it can be divided into 5 stages mainly Development stage, Startup stage, Survival stage, Rapid growth stage and Early maturity stage. Starting from the first stage , entrepreneur uses his own savings along with friends and or family assets to finance the start up. The next round of funding normally comes from Angels and potentially Venture Capitalists. The survival round of financing, which is typically the largest, comes from bank loans and external sources. The first step in raising capital is to understand how much capital is required. Lucrative businesses anticipate their eventual cash needs, make plans and execute capital attracting strategies before they fall prone to cash crunch. Venture capital as the business of promoting a new or young companies with ingenious ideas emerged as a prominent branch of Entrepreneurial finance in the beginning of the 20th century. Wealthy families such as the Vanderbilt family, the Rockefeller family and the Bessemer family started investing in private companies. One of the first venture capital firms, J.H. Whitney & Company, was laid in 1946 and is still in business presently.

FIGURE 1.2 LIFE CYCLE STAGES OF THE SUCCESSFUL VENTURE



Source - (Entrepreneurial Finance, Leach & Melicher)

Three principles guide fund raising for entrepreneurship ventures -

- As businesses grow, there are several rounds or stages of financing. These rounds are targeted to specific phases of the firm's growth and require different blueprint and types of investors.
- Raising capital is an ongoing issue for every start up.
- Capital funding takes time and needs to be planned accordingly.

Other than this, there are several other acumen which are captivating entrepreneurs to come up with their startups. They can be classified as

- Valuations of successful startups are on all-time high.
- Initial Public Offerings (IPO) are back to power as an exit strategy.
- Funding for development stage startups is more available than ever.
- Cost of entry for a startup is at all-time low.
- Startup incubators and accelerators are coming up everywhere.
- The global platform is now composed of single market, both homogeneous and heterogeneous.
- Social networks are boon for entrepreneurs and startups.
- Most of the large corporations have lost their ability to innovate.
- Females are growing force as entrepreneurs.
- Baby Boomers are joining the in record numbers

The funding available for a start-up depends on its long term run potential. There are three types of start-up firms: Lifestyle, Middle-market, and High-growth potential companies. Lifestyle organizations provide only a reasonable living for their founders. This is the classical and small business, around 90% and more of all the start-ups belong to this category. They are implausible to attract equity funding from outside sources and are primarily funded by internal funds. Middle-market organizations constitute less than 10% of all startups. Theses firms entice to business angels funding and highly depend on bootstrapping for initial startup growth. High-potential companies are less than 1% of all start-ups. They plan to grow to over 50 employees within 5-10 years and expect multiple rounds and stages of external funding from angels and venture capitalists.

Sources of funding are broadly bifurcated into two parts :-

- Internal funding
- External funding

5. INTERNAL SOURCES OF FUNDING

1 - Founder, Family and Friends (3Fs)

This includes founder's personal savings, as well as funds received from family and friends, often called "love money". The longer the entrepreneur is able to survive on personal funds and hard work that is his sweat equity and internally generated funds the lower the cost of external risk capital the more sovereignty the entrepreneur has.

2- Bootstrapping

In this highly creative acquisition use of resources without raising capital from traditional sources or borrowing money from a bank. This prevents the entrepreneur from using different forms of financing leading to greater awareness of

financial risk as well as other forms potential risks. There is a high reliability on: internally generated retained earnings, credit cards, home mortgages, and customer advances. Safer side of bootstrapping are waiting as long as possible to seek capital financing permits getting financing at better terms and retaining more ownership share, greater authority and overall control, the entrepreneur spends time and resources on growing the firm, rather than courting investors, and the entrepreneurs avoids problems associated with raising too much money. Disadvantages of bootstrapping are that it may not generate enough money to grow the firm at the desired rate, the firm competing poorly against its financially endowed competitors, there is limited potential grasp on sales, market share, and overall competitive position, and it offers only limited support for high-growth prospects.

3- Business Alliances

It comprises of forming cooperative agreements with another firm to generate revenues and mitigate costs. Reasons for forming a business alliance are: market infiltrations, accelerate time to market, utilize sales and marketing channels, geographic extension, access to customer lists, build product credibility, inadequate resources to go alone, customer requests, product development, economies of scale, teaming up against competing, gain business experience, joint bidding on projects, and other. Thus alliance partners are found by active search based on industry knowledge, professional associations, industry networks and contacts, attorneys, trade shows, accountants, bankers, friends, investment forums, and other. Effective business alliances can be very beneficial to a startup or early stage firm with inadequate resources to do it alone, but these alliances do not always make sense once the firm has grown, is healthy, and reaches autonomy.

External Sources of Funding

1- Angels

These are extra ordinary successful business people who invest their own money. The term "angel" comes from the practice in the early 1900's of wealthy businessmen contributing in Broadway productions. An angel investor or angel is an affluent individual who invests capital into a business start-up, usually in exchange for ownership capital. Angels typically invest in technologies innovation or in business in the areas that are known to them. They are long haul investors and usually expect to receive a return within 5 to 7 years.

2- Venture Capitalists

These are the financial intermediaries that take the investors capital and invest it directly into portfolio companies. Their main objective is to make a profit by selling the stake and shares in the company in the medium terms. They expect profitability higher than the market to compensate for the ascended risk of investing in young ventures and startups. A venture capital firm invests only in private companies and they take an active role in monitoring and helping the companies in their portfolio management. Their investment is utilized to finance the internal growth of companies and their main goal is to maximize its financial return by exiting investments through sale or IPO. Venture Capital activities are: investing, monitoring, and exiting. Conventionally Venture Capitalist investments have been concentrated in two broad sectors: Health Care and Informational Technology (IT). Silicon Valley is focal point of VC activity, with 30% of total venture capital US investments per year.

3- Corporate Investors

Corporate investors are often seen by small firms as an exit opportunity, rather than a funding source. By acquiring small companies, corporate investors compliment their product or service offerings, and small firms use this new influx of strategic funding to further expand operating areas. An example is Microsoft’s take over to Hotmail for $425 million. Corporate venturing prevents the small firms from allying with the competitors or from competing directly with the corporate sponsor. Many entrepreneurs nowadays are starting ventures with the sole objective of being bought out by a large non-financial organization which in later part can handle every aspect.

4- Banks

Normally banks prefer to limit their risk by lending to firms that offer some form of collateral. It is important source of external financing for small firms once they are established. Reasons banks shy-away from early stage firms are: they lack a track record of reliable information on the entrepreneurs, they have too much debt outstanding, they have volatile profit and cash flow measures, and if the placement is successful, the bank makes only 4-6% in interest. Also that banks are at the lowest risk when it comes to capital investment risk.

6. CONCLUSION

An entrepreneur with him brings investment, innovation, employment, development and amelioration . More and more entrepreneurship should be encouraged and from every segment of the society. Successful firms today are startups of earlier days, then be it Microsoft or Tesla in the technology arena and transcendent endeavor in education sector by Dr. Ashok Chauhan. It is very prominent to up bring entrepreneurs because they are inimitable belongings of a nation and have the capability of changing the economic front of the country . Financing such invaluable assets is like cultivating a better future for upcoming generations.On the other side Entrepreneurs should financially be able to discriminate between investor types, do not take just the first offer, but rather the most appropriate for the firm. For investors the risk and failure rates associated with start-up firms are extremely high and investors seek commensurable return for which they are sanguine.

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