



## The Financing Preferences of Entrepreneurs in India

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**ABSTRACT:-** This paper discusses the perception of Aspiring Entrepreneurs and the experience of Entrepreneurs in regards of Financing options available for an new enterprise, namely for Seed Capital, Working Capital and Growth Capital. This paper finds that Aspiring Entrepreneurs would like to seek external funding like Bank Debt, Government Loans, etc whereas the Entrepreneurs have experienced that such sources are difficult to access given that there is no or negligible history of the enterprise. Most Entrepreneurs have had to put their own personal savings or personal borrowings to start.

### I. INTRODUCTION

Entrepreneurship is gaining quick popularity among the masses then before. It is time that most of the young talent wants to test their sails in the open undiscovered ocean of opportunities. However to that requires a lot of courage and an idea. It doesn't stop at that. Another important aspect of pursuing this dream of Entrepreneurship is Capital. Many people have a brilliant idea for a Startup and a feasible Business Model but are struggling with this important aspect of arranging Finances. Many dreams are killed in this phase, as most of them are novices to the concepts of Capital Structuring.

Most belong to the working class of Individuals who will have to give up their regular secured monthly income if they want to pursue their dreams. Limited personal savings are also a major concern for these Entrepreneurs. Requirement of capital is not limited to Seed Capital. Entrepreneurs require Capital when the operations start (Working Capital) and if the Enterprise needs to Scale up (Growth Capital). Each of these requirements has their own scope and challenges and is necessary in their own right.

The dilemma of the Entrepreneurs of structure their finances is a herculean tasks. At times they may have to pool in all their savings in the Seed Capital and in the early stages of operation. External finances are difficult due to collateral constraints and procedural requirements.

#### Options available to source the funding

There are various options that the funding can be arranged. Most of Entrepreneurs/Aspiring Entrepreneurs are unaware of some and are skeptical of the rest. Given below are some such options :-

1. Personal Savings
2. Borrowed from Family and Friends
3. Borrowed from Public Banks
4. Borrowed from Private Banks
5. Borrowed from Financial Institutions

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6. Government Subsidies and Loans
7. Incubators
8. Bootstrappers
9. Angel Investors
10. Venture Capitalists
11. Revenue and Sales\*
12. Retained Earnings\*
13. IPO\*

\*available after the operations start.

#### **Financers dilemma**

Most of the Financial Institutions require ensuring prudence while lending Capital as they need to control their NPA's from rising. At the same time for the business of Lending to function they have to take the leap of faith. The struggle between these two principles makes it difficult for the Entrepreneurs to access the Capital from these sources. Some Investors will seek Operational Inclusion so as to monitor their investment first hand. And some may seek ease of exit if needed.

## **II. LITERATURE REVIEW**

Massimo G. Colombo and Luca Grilli from the Department of Economics, Management and Industrial Engineering, Italy, note that bank debt-financed firms are not larger than firms created only through founders' personal savings, while firms that received external private equity financing have greater start-up size.

Colombo and Grilli (2005) in their paper develop a search model of venture capital in which the number of successful matches of entrepreneurs and venture capitalists (VCs) at any moment in time is a function of the number of entrepreneurs searching for funds, the number of VCs searching for entrepreneurs, and the number of vacancies posted by each VC.

Blanchflower and Oswald (1990) discover the benefits of Entrepreneurship as below

- Entrepreneurship may promote innovation and thus create new jobs.
- There may be a direct effect on employment if new young entrepreneurs hire fellow youths from the dole queues.
- New small firms may raise the degree of competition in the product market, bringing gains to consumers.
- Young entrepreneurs may be particularly responsive to new economic opportunities and trends.
- Greater self-employment among young people may go along with increased self-reliance and well-being.
- Economists have little evidence, however, on whether these hypothetical benefits exist in practice.

Hamilton and Fox (1998) note that Small owner-managed firms typically operate with levels of debt, much of it short-term, which are higher than those found in large companies.

## **III. METHODOLOGY**

#### **Scope of study**

This study tries to understand the financing patterns/options available to Entrepreneurs situated in Goa, India. The study also captures the understanding of financing option available to the Aspiring Entrepreneurs in the same geography.

#### **Surveys and questionnaire**

Surveys were carried out by email and by personal visits to the Entrepreneurs and Aspiring Entrepreneurs.

The survey had 5 parts

1. Demographic Details and Enterprise Details
2. Seed Capital for Entrepreneurs
3. Working Capital for Entrepreneurs
4. Growth Capital for Entrepreneurs
5. Factors you consider regarding your financing/investment decisions.

### **Personal Interviews**

Personal Interviews of Financers, Bankers, Incubators, Government Bodies, Angel Investors/Venture Capitalist were also taken, to understand the financing options that are available to the entrepreneurs.

## **IV. RESULTS**

### **Entrepreneurs prefer to employ Personal Savings**

Most of the Entrepreneurs who responded to the survey preferred to use 100% personal savings to start their enterprise, as that was the easiest accessible option available to them. Many didn't believe that the Government or Banks would lend them capital to start their enterprise.

Many even chose to use Personal Savings to supplement their Working Capital need. There were a few who went to explore growth Capital, but they too restricted themselves to Retained Earnings and Revenue and Sales. Seldom did approached private Banks.

There is a very evident consensus among the entrepreneurs that it is very difficult to access funds from the Government or Public Banks, due to procedural, bureaucratic and political overheads. Most of the Entrepreneurs are coming from families that were in business circles and hence had prior knowledge of Business and access to family savings.

### **Aspiring Entrepreneurs seek support from external sources**

Unlike the Entrepreneurs, those aspiring to be Entrepreneurs seek support from Government and Banks to meet their Seed Capital. Many even claimed zero knowledge of how to arrange the capital and the procedures that are required to follow.

The fear to lose secure monthly income is seen evident and hence the aspiring Entrepreneurs are hesitant to use their Personal Savings. This makes them seek help from external sources of finances.

Also to be noted, those who have come from families who are not into business find it all the more difficult to start with their enterprise with their personal savings.

### **Financers claim to have a lot of options too offer.**

Financers, Incubators, Government Agencies, Angel Investors and Venture Capitalists claim that they are open to new ideas and business proposals, provided that the return is realistic and time bound.

Government Agencies claim to have numerous schemes to encourage local Entrepreneurs, thereby increasing local employment. However lack of visibility and clarity has rendered the schemes to be inaccessible to many.

Incubators provide mentorship and easy access to office spaces. Like the Government Schemes even these lack the reach that is needed. The limitation on the availability for office spaces and funds with the incubators is also a concern. Angel Investors and Venture Capitalist look for more involvement or inclusion in the enterprise and seek easy and early exit.

## **V. CONCLUSION**

### **Self-Savings as Seed Capital and Early Working Capital**

The easiest access to capital is for the Self-Savings, and most Entrepreneurs have used their Savings and at times 100% of the Savings to start their Enterprise. Even during the gestation period and early operations the Personal Savings were needed to be roped in to meet the Working Capital needs, as the Banks were reluctant to provide loans, especially to start-ups like of IT which has nothing to offer as collateral as it owns heavily depreciable assets like the laptops or computers.

### **Aspiring Entrepreneurs dilemma**

Aspiring Entrepreneurs find it difficult to decide when and how to start the Enterprise. Limited Personal Savings and losing the regular guaranteed income are main reasons for the dilemma. However, if the schemes of the Government and other Financial institutions are liberal towards supporting small businesses there could be many Entrepreneurs in the State.

**Financial Institutions could extend more help.**

Given the pressure of controlling their NPA's the Financial Institutions use conservative approach when it comes to supporting small budding businesses. These Institutions could derive a mechanism by which more and more entrepreneurs are encouraged and at the same time their NPA's do not increase. The Government should play a pivotal role is helping the local economic scenario to improve by encouraging Entrepreneurs and thereby creating jobs.

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**ANNEXURES**

All results below are the averages of the survey results.

**Factors concerning Investment**

The results below are on a scale of 1 to 10. 1 being the least significant and 10 being the most significant.

Factors you consider regarding your Financing Decisions	Aspiring Entrepreneurs	Entrepreneurs
Ease of Access	6	6
Term of Investment	7	6
Return on Investment Expected	7	6
Collateral/Guarantee Requirement	6	3
Operational Independence	7	6
Mentorship available	7	5
Ease of Exit	9	5
Profitability Margin	8	7
Project Feasibility	7	6
Market potential/environment	7	7
Current Financial Health of your firm	6	5
Total Principle amount to be funded	6	6
Experience of the Financer	6	4
Track Record of the Financer	6	4
Other188	4	1

Seed Capital

	Aspiring Entrepreneurs	Entrepreneurs
<b>How did you Source your Initial Seed funds? (in %)</b>		
Self-savings	33	59
Borrowed from family/friends	13	8
Public Banks	30	19
Private Banks	6	5
Other Financial Institutions	0	0
Incubators/Bootstrappers	0	0
Angel Investors/Venture Capitalists	0	2
Government Subsidies/Loan	11	4
Other	8	4
<b>Sum Total</b>	<b>100</b>	<b>100</b>
<b>Ease of Access to Initial Seed Funds you think is from respective Sources (Scale of 1 to 10)*</b>		
Self-savings	7	7
Borrowed from family/friends	5	5
Public Banks	4	3
Private Banks	4	3
Other Financial Institutions	3	3
Incubators/Bootstrappers	3	4
Angel Investors/Venture Capitalists	3	4
Government Subsidies/Loan	3	3
Other	0	3
<b>What will be the Return on Investment/Rate of Return expected by the following sources? Respond as per your understanding (in %)</b>		
Self-savings	40	69
Borrowed from family/friends	35	23
Public Banks	23	13
Private Banks	14	15
Other Financial Institutions	11	19
Incubators/Bootstrappers	25	0
Angel Investors/Venture Capitalists	50	25
Government Subsidies/Loan	30	7
Other	0	0
<b>What will be the term of investment/Term of Loan these sources look for? Respond as per your understanding (in no of Years)</b>		
Self-savings	4	21
Borrowed from family/friends	2	2
Public Banks	7	6
Private Banks	8	7
Other Financial Institutions	5	7
Incubators/Bootstrappers	0	10
Angel Investors/Venture Capitalists	0	10
Government Subsidies/Loan	6	6
Other	0	10
<b>If you shall use Self-Savings, What percentage of the self-Savings will you use to fund your enterprise? (in %)</b>	<b>38</b>	<b>39</b>

Working Capital

	Aspiring Entrepreneurs	Entrepreneurs
<b>How will you Source your Working Capital Funds? (in %)</b>		
Revenue/Sales	41	45
Retained Earnings	19	11
Self-savings	9	19
Borrowed from family/friends	3	3
Public Banks	13	9
Private Banks	9	9
Other Financial Institutions	0	0
Incubators/Bootstrappers	0	0
Angel Investors/Venture Capitalists	4	1
Government Subsidies/Loan	0	0
Other	3	4
<b>Sum Total</b>	<b>100</b>	<b>100</b>
<b>Ease of Access to Working Capital you feel will be from respective Sources (scale of 1 to 10 )*</b>		
Revenue/Sales	6	7
Retained Earnings	6	7
Self-savings	4	6
Borrowed from family/friends	3	3
Public Banks	5	4
Private Banks	5	6
Other Financial Institutions	2	5
Incubators/Bootstrappers	2	5
Angel Investors/Venture Capitalists	3	4
Government Subsidies/Loan	4	5
Other	1	5
<b>What will be the Return on Investment/Rate of Return expected by the following sources? Respond as per your understanding (in %)</b>		
Revenue/Sales	55	60
Retained Earnings	64	88
Self-savings	39	59
Borrowed from family/friends	17	4
Public Banks	14	12
Private Banks	15	13
Other Financial Institutions	10	0
Incubators/Bootstrappers	50	15
Angel Investors/Venture Capitalists	50	0
Government Subsidies/Loan	10	0
Other	0	0
<b>What will be the term of investment/Term of Loan these sources look for? Respond as per your understanding (in no of Years)</b>		
Revenue/Sales	2	2
Retained Earnings	3	2
Self-savings	2	4
Borrowed from family/friends	1	2
Public Banks	4	5
Private Banks	4	5
Other Financial Institutions	8	10
Incubators/Bootstrappers	2	10

<b>Angel Investors/Venture Capitalists</b>	2	10
<b>Government Subsidies/Loan</b>	10	10
<b>Other</b>	0	10
<b>If you shall use Revenue/Sales Earnings, what percentage of Revenue/Sales Earnings will you use to fund your working capital? (in %)</b>	31	50
<b>If you shall use Retained Earnings, what percentage of Retained Earnings will you use to fund your working capital? (in %)</b>	29	33
<b>If you shall use Self-Savings, What percentage of the self-Savings will you use to fund your working Capital? (in %)</b>	20	25

**Growth Capital**

	<b>Aspiring Entrepreneurs</b>	<b>Entrepreneurs</b>
How will you Source your Growth Capital Funds? (in %)		
IPO/Stock Option	3	1
Revenue/Sales	28	24
Retained Earnings	13	12
Self-savings	7	13
Borrowed from family/friends	2	1
Public Banks	14	8
Private Banks	9	14
Other Financial Institutions	0	0
Incubators/Bootstrappers	0	0
Angel Investors/Venture Capitalists	6	4
Government Subsidies/Loan	4	1
Other	14	22
Sum Total	100	100
Ease of Access to Growth Capital you think is from respective Sources (scale of 1 to 10)*		
IPO/Stock Option	3	3
Revenue/Sales	7	7
Retained Earnings	5	8
Self-savings	6	6
Borrowed from family/friends	4	3
Public Banks	4	4
Private Banks	4	3
Other Financial Institutions	4	1
Incubators/Bootstrappers	3	1
Angel Investors/Venture Capitalists	4	3
Government Subsidies/Loan	4	2
Other	1	1
What will be the Return on Investment/Rate of Return expected by the following sources? Respond as per your understanding (in %)		
IPO/Stock Option	12	10
Revenue/Sales	52	38
Retained Earning	44	35
Self-saving	54	40
Borrowed from family/friends	34	0
Public Banks	16	9



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Private Banks	12	11
Other Financial Institutions	6	0
Incubators/Bootstrappers	25	0
Angel Investors/Venture Capitalists	60	50
Government Subsidies/Loan	10	0
Other	0	0
What will be the term of investment/Term of Loan these sources look for? Respond as per your understanding (in no of years)		
IPO/Stock Option	2	2
Revenue/Sales	2	2
Retained Earnings	2	2
Self-savings	3	5
Borrowed from family/friends	3	10
Public Banks	5	6
Private Banks	5	6
Other Financial Institutions	7	10
Incubators/Bootstrappers	1	0
Angel Investors/Venture Capitalists	2	0
Government Subsidies/Loan	6	0
Other	1	0
If you shall use Revenue/Sales Earnings, what percentage of Revenue/Sales Earnings will you use to fund your working capital? (in %)	62	40
If you shall use Retained Earnings, what percentage of Retained Earnings will you use to fund your working capital? (in %)	23	23
If you shall use Self-Savings, What percentage of the self-Savings will you use to fund your working Capital? (in %)	5	20

*\* The results are on a scale of 1 to 10. 1 being the least significant and 10 being the most significant.*