FINANCIAL ISSUES IN NEW VENTURE CREATION

Entrepreneurship & New Venture Creation

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Executive Summary

This report examines the forms and sources of the various capital available to new ventures with some perceptions into the approach essential for the entrepreneur to harness them. Although the report emphasizes mainly the financial capital, it also describes the various options of capital that can be of helpful to create a new venture.

The five forms of capital (Economic, social, cultural, Human and natural capital) are separately explained.

The report further describes debt and equity financing in the form of commercial banks, account receivables financing, trade credit factor and finance companies and different forms of equity instruments. Even though huge amount of money from public offerings can be raised within short period of time, the entrepreneur should be able to dedicate some level of control and ownership. In line with this, private placement can also be considered as alternative means of raising equity capital for new ventures.

The report further highlights that venture capitalists employ four criteria while evaluating new venture proposals. Entrepreneurs who are not capable of securing funds from banks or from public or private share offerings, can seek opportunities from business angel markets by looking for friends, associates and other contacts to get information on individuals who may have money to invest in a new venture.

It also describes alternative forms of finance including micro-credit, Islamic banking, socially responsible investors.

Finally, the report explains how to sustain the growth rate of a company, and the relationship between entrepreneur's activity and how to raise the natural resource base.

1. Introduction

The global financial crisis had significant impact on access to wealth for new start-ups and business development. In line with this, entrepreneurs must prove understanding of the demand from consumer side and the capacity to warrant the provision of products deliver on their value.

Both in developed and developing economies, entrepreneurs face several problems and difficulties while setting up their new ventures, and these may include, general economic environment in the country, infrastructural facilities, training and guidance facilities and government regulation (Krystyna Brzozowska, 2015).

The availability of capital for starting a new venture can be considered as the main constraint for an entrepreneur to transform innovative ideas into creative business plan and hence into innovative product or services.

In most cases of the time, family or the community does not make capital available to the entrepreneurs, they must depend upon financial organizations or public/private offerings.

Hence, this report assesses and presents the forms and the various sources and options of entrepreneur's capital and how to sustainably raise and manage the natural resource capital while entrepreneurs change business ideas into innovative products or services.

2. Objectives

- To assess the various forms and sources of capital requirements of new ventures and provide some financial option new ventures
- To describe the new emerging entrepreneur capitals sources for new ventures
- To examine on how to sustain the growth rate of a company and the relationship between an entrepreneur's activity and its impact on the natural resource base and appreciate the need for raising natural capital as part of an entrepreneurial venture

3. The Five Forms of Entrepreneurial Capital

Capitals are factors of production or resource which includes (Human made or natural) that are utilized to generate other goods or services. The five different forms capitals are described below:

3.1. Economic Capital

Economic capital refers to the financial and manufacturing capital. It is the main capital where entrepreneurs employ it to transform other resources in the process of making goods/services for the product market (Madsen et al., 2008). Economic capital also includes manufacturing capital which includes properties, equipment and machineries (Anheier et al., 1995).

3.2. Social Capital

Social capital stands for the assets obtained through membership in networks. It assists entrepreneurship (Chong & Gibbons, 1997) and the creation of start-up firms by increasing people's alertness of start-up actions and resource acquirement via social interactions (Hills, et al., 1997).

Social capital is frequently regarded as key for new venture start-up achievement since it emerges from changes in relations among people. Such active, changing relationships with others allow action. Social capital is key in resource-acquisition needed for new venture creation and achievement (Amy. Et al., (2014).

3.3. Human Capital

Human capital is the skills, experience, knowledge, motivation and capacity for relationships and health of people. Entrepreneurs use to improve firm value. The larger the amount of human capital, the better the Entrepreneur achieves in the business (Becker, (1993).

Entrepreneurs with greater human capital are more prospective to involve in the process of starting a new venture (Davidson & Honing, 2003) and the venture is more expected to survive. Hence, human capital is a vital part of entrepreneurship start up and achievement (Coleman, 2007).

3.4. Cultural Capital

Cultural capitals refer to non-financial social assets. The worthiness of cultural capital can be determined by the entrepreneur's capacity to access and utilise cultural institutions and societal products (De Clercq and Voronov, 2009a).

3.5. Natural Capital

It is the natural resource used by the venture. It includes, the resources that can easily be recognize and measured such as minerals and energy, minerals, water, fisheries, timber and agricultural land.

Nature's many key services are often "imperceptible" to people. These include water, air, flood protection, purification, carbon storing, and home for wildlife and fisheries. The values of these resources cannot be voluntarily valued in markets, hence their involvement and contribution to the economy and lively income is rarely documented (World Bank, 2012).

Figure 1. Shows a model of the Five forms of Entrepreneurial Capital

4. Sources of Financial Capital

Entrepreneurs have several sources of financial capital as the business ventures grows.

The level of risk and the stage of the firm's growth stage assist to regulate the appropriate source of financing for entrepreneurial ventures. It is also better to understand not only the finance sources but also the expectations and requirements of the sources (Plummer, et al., 2015; Frederick et al. 2012).

After new ventures have exhausted the limited financial resources of founders, family, and friends, frequently look for initial external capital. To safeguard investment, entrepreneurs use their hidden potential and line up themselves with dependable third parties. Such associations can sustain the new venture's legality and offer practical benefits in the form of

admission to resources and management (Plummer, et al., 2015). An entrepreneur has got various financial option to harness which depends on the level of maturity of the business.

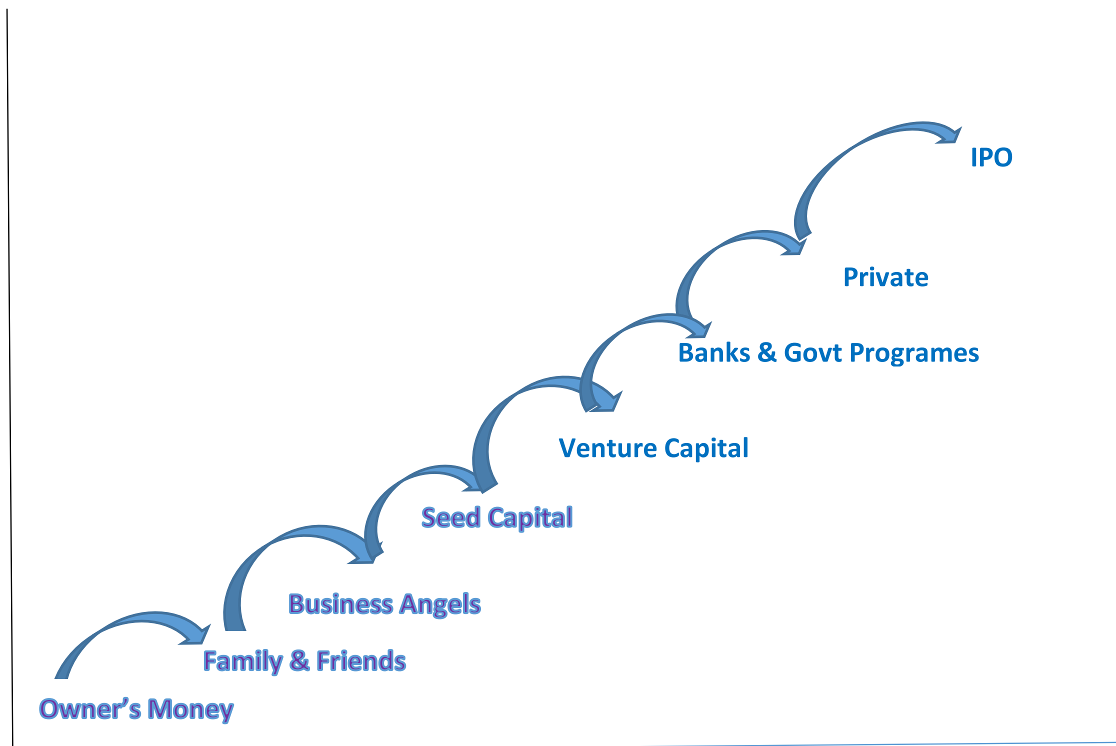

Figure 2 Shows the financial sources of an entrepreneurial start-up companies

4.1. Starting up with Informal Capital

Many new ventures often do not look for their start-up capital from banks or venture capitalists, but source from founders of the business, friends, family and fool hardy investors (neighbours & work colleagues). These individuals are informal investors, who might be close family relatives of the entrepreneurs (Frederick et al. 2012).

4.2. Debt financing

Debt can be either short term or long term borrowing of money to finance a new venture which involves a pay back of the fund and an interest for the use of the money. Several new ventures find debt financing essential to be used for working capital as well as for purchase of properties and machineries with the purchased asset to assist as collateral for the loans. For small business, commercial banks are the main source of debt financing (Frederick et al. 2012).

4.3. Equity Financing

It is money invested in the venture without legal requirement for the entrepreneur to pay back the borrowed money and the interest.

Equity capital can be created through two main sources, these include: public share offerings and private placements

Equity financing requires sharing the proprietorship and profits with the funding source, it is a safer source of finance for new ventures than debt financing (Frederick et al. 2012).

4.3.1. Initial Public Offering

Represents the recorded public offering of a company's securities initially on the public markets. It will be the first time people outside the company have the chance to buy its shares.

4.3.2. Private Placement

Money financed and utilized in a company frequently from private investors in the form of shares/bonds. Usually, it is appropriate for a venture needing injection of capital to move to the next level growth through expansion with a proven track of record of profitability (Frederick et al. 2012).

4.4. The Venture Capital Market

For some new ventures, Venture capitalists are resourceful and influential source of equity financing. They are knowledgeable experts giving a complete variety of financial services for new and growing ventures. These include: capital for start-up and expansion, seed financing, market research and business strategy, management consulting.

Venture capital is a specific form of finance well appropriate to the requirements of new technology based firms.

Venture capital firms characteristically increase their capital not on a continual basis but through periodic funds. They have to maintain relationship with investors who provide them with capital.

It should be distinguished that the level of risks and the stage of the firm's expansion should decide the right source of financing for the entrepreneurial venture. Figure 3 shows several funding stages of the business venture (Constantin & liver 2001; Frederick et al. 2012).

The seed stage refers when an idea need to be developed and confirmed whereas the start-up phase shows when products/services are developed and preliminary marketing takes place. The third phase is early stage progress where the venture started producing but normally unprofitably. At the stage of expansion, the venture reaches mature level and might go public in a short time (Mayer, 2002; Krystyna, 2015). Depending on the stage of development various sources of finance can be involved (see figure 3 below).

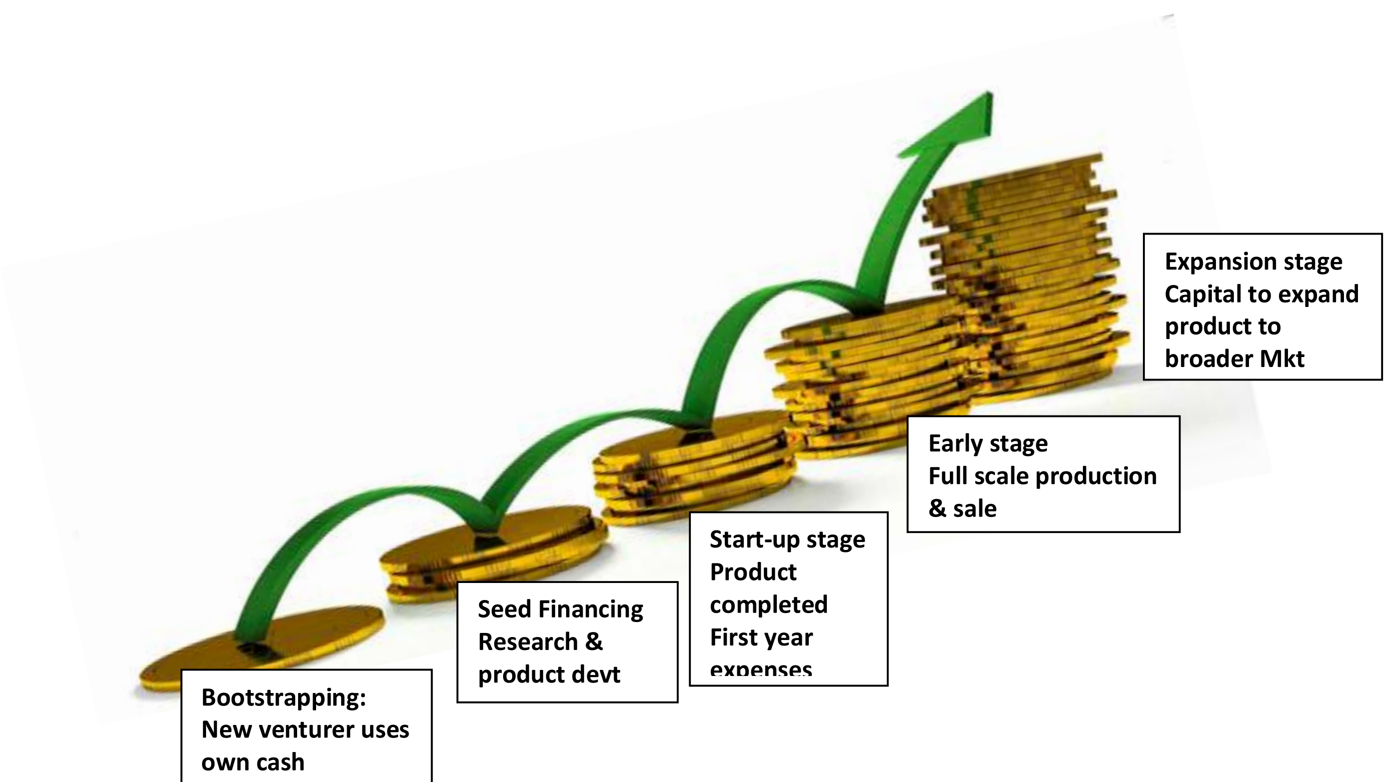

Figure 3 indicates the various funding stages of a venture capitalist Business

4.4.1. Evaluating New Venture Capitalist

Venture capitalists focus on generating large return on investment cautiously measuring the product/services and the management as well.

They evaluate the products, ideas, and management strength of business proposals based on pre-set criteria to appraise the new ventures proposal and these criteria include:

- Initial screening: a rapid assessment of the basic venture
- Assessment of the business plan
- Oral presentation
- Final evaluation for decision

4.5. Business Angel Financing

These are wealthy people looking for investment opportunities, many of them are entrepreneurs and may be more apprehensive shoring up their companies, hence they may be looking for more control as well as lower valuation. They tend to have no relationship with entrepreneurs and take more of an objective approach to decide for investment (Frederick et al. 2012; Krystyna B., 2015).

There are different types of business angels, these include: Corporate Angels, Entrepreneurial angel, Enthusiastic Angel, Micro-Management Angels and Professional Angels (Frederick et al. 2012; Krystyna B., 2015).

The strategic resolution which can lead to getting a mature innovative firm is a venture capital involvement in the form of business angels (Krystyna B., 2015).

4.6. New Systems of Entrepreneurial Capital

4.6.1. Islamic Finance

It is based on Islamic law which stresses justice and partnership, where unfair business operation from the borrower and lender side are discouraged, moreover in any financial undertakings, risks are shared, in essence. It is comparable to western idea of ethical or green investing.

4.6.2. Socially Responsible Investors(SRI)

SRI operate based on the principles for Responsible Investment on situation that a frame work for integrating environmental, social and governance into decision making and proprietorship practice. They are selectively fund in the areas of environmental protection, wind power, energy conservation, social equality, educational improvement.

4.6.3. Micro-Credit

Provide small loan to aspirant entrepreneurs that do not have collateral to offer as security to lending institution. These may include: informal finance service providers, member-owned

organizations, Non-governmental organizations and formal finance institutions (Frederick et al. 2012).

5. Sustaining Growth Rate of a company

Sustainable growth rate of a firm can offer managers and ventures with vision into the levers of corporate growth (Pandit and Tejani,2011).

The maximum rate of increase in firm's sale without decline in financial resources is sustainable growth rate, and this can be analyzed and determined using the four reasons listed below (Higgins ,1989).

- **Profit margin**: an increase in the profit margin upsurges the firm's ability to create funds internally and thus raises its sustainable growth.
- **Net asset turnover**: a rise in the firm's net assets turnover increases the sales generated for each asset; this decrease the firm's need for assets as sales grow, thus increase the sustainable growth rate.
- **Financial policy**: a rise in the Debt / Equity ratio raises growth of the firm's financial power; and this creates extra debt financing available, increasing the sustainable growth rate
- **Dividend policy**: A reduction in the percentage of net profit after tax paid out as dividends raises the retaining ratio, in turn increasing internally generated equity and thus improving sustainable growth (De Wet, 2004).

Similarly, Figure 4 below also shows that revenue (profitability) risks levels are inversely related as the business venture expands and progresses up.

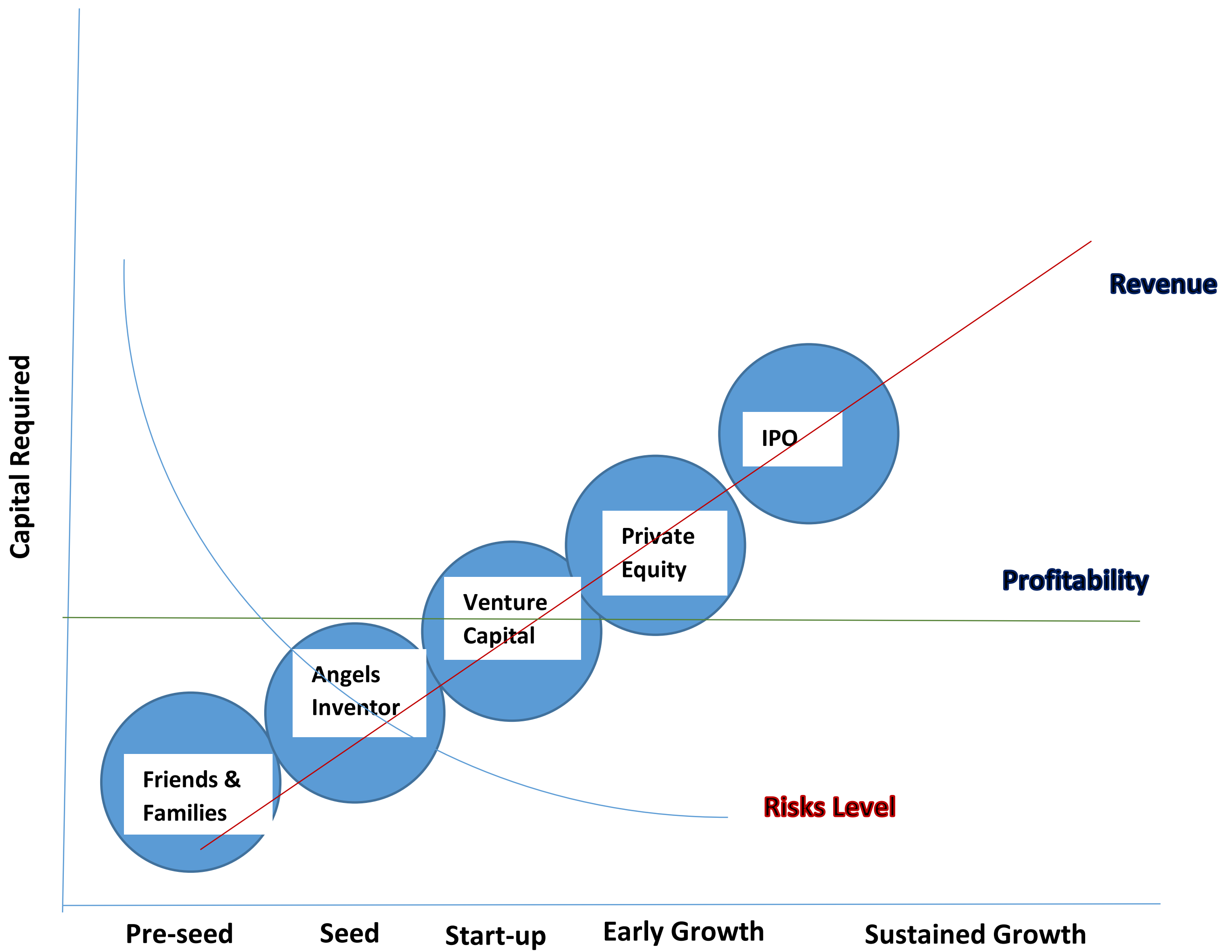

Figure 4 Shows the various sources of Entrepreneurial finance, funding stages and the natures of revenues, profitability & the associated risk level for business venture

6. Pulling the Levers of Growth

Pulling the levers of growth can be achieved by regulating and controlling the following levers:

- Lever 1: Rapidly moving the Cash Flow by persuading and promoting customers to pay quicker, reducing collection periods. Swift turnover of inventory
- Lever 2: decreasing costs - reducing the quantity of cash it requests to invest; for instance, negotiate better with suppliers
- Lever 3: Increasing prices, this can be decided if the market is tolerant and produces the same effect through pulling multiple levers

7. Conclusion

- To crystalize innovative ideas into business products & services, there are several financial opportunities & options for Entrepreneurs and new ventures
- The 4Ps' (Founder of business, family, friends and foolhardy investors) need to be given priority to start-up the new venture
- The changing of innovative ideas into products including the commercialization process has to be financially, socially & Environmentally Sustainable

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