



Entrepreneurial Financing in a Knowledge Based Economy

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Abstract: Funding is critical; to the smooth take-off and, ensures the effective functioning and guarantees the continued existence of any new venture. Financing entrepreneurial ventures has particularly been challenging in all kinds of economies including knowledge-based economies. The inability to overcome funding problems has forced many people with ambitious ideas that would have been launched audaciously towards economic emancipation and development to forcefully discard them. The objective of this paper is to identify different sources of entrepreneurial financing, and review extant literature associated with the various sources of financing. The study is qualitative in design. Consequently a total of ninety articles considered useful were retrieved from various sites for the study. The discovered numerous avenues available for entrepreneurial financing. while, the study concludes that every aspiring entrepreneur must prepare to launch out first with founders, family, and relatives capital and thereafter explore a catalogue of other sources mentioned in this paper depending on the firm's capabilities and peculiarities to continue with the financing of the firm. The research recommends that every entrepreneur should be skillful at bootstrapping.

Keywords: Entrepreneurial financing, knowledge-based economy, new ventures, startups.

1 Introduction

Entrepreneurial firms play critical roles in modern knowledge-based economies. These firms provide majority of the new jobs, are sources of radical innovations, increase in productivity, and serve as a

disciplining device for the behaviour of established firms. These firms are helpful at achieving economic growth by combining resources, increasing competitive pressures (Valliere & Peterson, 2009) and, by way of purely

imitating ventures have the exploited underutilised resources gainfully (Minniti & Levesque 2006). However, raising funds to pursue their visions, expand and seek avenues that guarantee survival and subsequently profitable operations has been an uphill task. Considering the central role entrepreneurial firms perform in economies around the world, many multilateral organisations such as OECD, UNDP, and national agencies like US' Small business administration (SBA) and Nigeria's (SMEDAN) have prioritise the financing of their organisations.

2 Literature Review

2.1 Entrepreneurial Financing

Entrepreneurial financing entails the understanding of the importance along with the distribution of resources and its application to startups (Maleki, 2015; Kerr, Lerner & Schoar, 2014; Cumming, 2007). The domain of entrepreneurial finance has helped in resolving significant questions that confront all entrepreneurs in respect of how much finance to raise; when should it be sourced and where, as well as how much will be considered appropriate for the new venture; and how should the financing be structured? (Maleki, 2015; Salamzadeh, 2015a, b; Winton & Yerramilli, 2008). Indeed, majority of new venture promoters have realised that except adequate funding is obtained, their dreams will largely remain on the drawing boards. This is why entrepreneurs draw out a long list of likely financiers including their own employers, banks, angel investors, venture capitalists, equity or some other source of funding (Chen, Miao, & Wang 2010; Jafari, Salamzadeh,, & Yousefiyar, 2014). Many traditional avenues for financing that entrepreneurs

approach for funding are skeptical about the business and financial plans, demand for high equity participation, exert firm control and managerial influence and have little knowledge of the characteristic growth process that start-ups go through (Mason, 2006; Salamzadeh & Kawamorita Kesim, 2015).

2.2 Knowledge Based Economy

Tocan (2012) asserted that the volume of knowledge available for our use had always doubled every five years and has served as the major motivation for the transition from the industrial society to knowledge society. The noticeable effect of knowledge is felt among many of our organisations, democracies, employees, politics, companies, educational institutions and the way we live.

The knowledge based economy is severally defined. Archibugi and Lundvall (2001) said that a knowledge economy is an economy influenced globally by the speed of information and communication technology's real time irrespective of the distance involved.

Tocan also cited Nicolescu (2006) who opined that knowledge based economy is typified by the transformation of the knowledge into base material, capital, products, production factors that is important for the economy and with the aid of the transformation process produce, sale, acquire, learn, stock, develop, distribute and save the knowledge for sustained competition and profit making in the future.

APEC (2000) on the other hand, opined that a knowledge based economy is dependent on the production and fruitful use of knowledge. APEC averred further that though knowledge seems to be the main driving force for economic

growth, wealth creation, and employment at all industries levels, APEC's economic committee cautioned that this knowledge should not be based only on a small number of high technology industries responsible for economic growth and wealth creation but should encompass all the knowledge needed including cultural, social and managerial knowledge which is much more comprehensive than technological knowledge.

3 Methodology

The research is essentially conceptual and qualitative in nature. It is descriptive by design. Thus, it is aimed at providing information that will explain the sources and other fundamental issues associated with entrepreneurial finance. Numerous websites were visited and a total of ninety articles were collected and perused and those found most relevant were used for the study. Generally the whole sources of financing entrepreneurial ventures were considered.

4 Sources of Financing Entrepreneurial Ventures

4.1 Internal Sources

4.1.1 Funds Provided by Founder and Relatives

This source of financing consists of the owner's 'personal savings, including money collected from relatives known as "love money". At this embryonic stage, the equity capital made available by the founder is the major source of funding (Mitter, & Kraus, 2011). These kinds of funds facilitate the earliest working capacity of enterprise. It also serves as an indicator of commitment and a display of seriousness on the part of the owner of the new venture. In this startup level, the capital needs of the new venture are moderately diminutive

((Mitter, & Kraus, 2011). However, the longer the entrepreneur is capable of surviving on owner's capital, coupled with the long hours of work (sweat equity) and the cash flow of the firm definitely minimises the risk associated with external funding. Besides, avoiding external financing greatly reduces undue pressure from financiers and this gives the owner more independence and the latitude to manage the organisation better (Markova & Petkovska-Mircevska, 2009).

4.1.2 Bootstrapping

Neeley (2005) explains that bootstrap financing are creative techniques used in identifying and obtaining resources, optimizing its utilisation, and reducing the real costs accompanied with applying these methods to source for finance irrespective of where they are identified; whether it is within the business, or sourced from different people, or offered by various companies and organizations (Bhide, 1992; Winbor & Landstrom, 2001). It can also mean highly creative means of obtaining and utilising resources devoid of debt or sourcing for equity financing from traditional fountains like business alliances (Van Auken & Neeley, 1996). Bootstrap financing approaches inspire entrepreneurs to utilise private savings or other private temporal debt, to solicit for capital from relatives, to barter for services, to obtain funding from quasi equity also known as unsecured loans with flexible loan repayment schedule. Examples of these kind of loans include mezzanine debt and subordinated debt, to cooperate for better customer access, to negotiate for client-based funds, to manage assets effectively, to reduce the length of accounts receivable, to share resources with other organisations, to forgo salary, to achieve effective cash

management, to delay payments provided it does not affect firm reputation, to lease equipment, to outsource production, and to seek subsidies, incentives or grants (McMahon & Holmes, 1991).

4.1.3 Crowdfunding

The funding of projects using multiple sources where little sums of money are raised from a considerable number of persons by means of the Internet through virtual platforms is known as crowdfunding (Otero, 2015). Crowd funding has developed rapidly since 2009 (Liu & Liu, 2016). Crowd funding got its ideas from notions like micro-finance (Morduch, 1999) and crowdsourcing (Poetz and Schreier, 2012). However, crowdfunding stand in its own distinct class of sourcing for funds through the increasing number of people who use the internet and visit sites that have interest in the topic regularly. The field of crowdfunding has advanced considerably. In spite of this monumental achievement, consensus about what it means is not immediately in sight. That is why Schwienbacher and Larralde (2010) consider crowdfunding as a clarion call that is fundamentally done using the internet with the sole aim of obtaining funding for a an important cause by encouraging people to donate in return for a kind of reward and/or voting rights or just to help humanity.

Mollick (2013) opined that as much as the above definition can be said to be comprehensive, It has been found to be deficient in what researchers in different domains have named crowdfunding including internet-based peer-to-peer lending (Lin & Viswanathan, 2013) and fund sourcing campaigns started by enthusiasts of the musical band (Burkett, 2011). However, for the sake of entrepreneurship, the next definition

is precise and sufficient enough to permit further development of the concept. Thus, crowdfunding denotes any endeavour that is carried out by entrepreneur as a person or group that may be cultural, social, and profit orientated to finance some of its ventures by pulling from comparatively little donations from a reasonably significant number of people that uses the internet devoid of standard financial intermediaries (Mollick, 2013).

4.1.4 Business Alliances

Entrepreneurs at the startup level may resort to forming cooperative agreements with other firms to procure funding, improve its cash flow and minimise costs (Gulati, 1998; Chesbrough, 2007; Dyer, & Singh). Many benefits used in justifying the formation of business alliances are: easy access to existing or emerging markets and regions, effective utilization of sales personnel and distribution channels, access to customer lists, product endorsement by bigger firms, lack of capital to do it independently, customer orders, expedited product development, economies of scale, cooperation instead of competition, increased business expertise, joint venture arrangements on projects, and others. Business alliance members are creative and commit to extensively looking out for most compatible and complementary members on the basis of industry experience, professional associations, industry networks and contacts, lawyers, trade fairs, accountants, bankers, friends, investments fora, and others. Functional business alliances are very useful to a new venture that is limited by resources to do it alone. However, alliances become unfashionable immediately the firm has grown, and accumulated competent human

resource, and has attained self-sufficiency.

4.2 External Sources

4.2.1 Business Angels

These are accomplished and wealthy persons, past entrepreneurs, or senior executives who put in their own money essentially in dynamic new ventures (Mitter & Kraus, 2011) in exchange for ownership equity. Prowse (1998) argues that angels come in as the second round of funding to salvage the firm when the entrepreneur has exhausted his personal savings and other capital that were raised from relatives prior to formally approaching the venture capitalists.

Ernst and Young (2014) assert that one of the stipulations to their client firms to access their capital is to engage partners who will function energetically in managing the firm. Angels normally put their money in technologies or in businesses they have experience in. Besides, the provision of risk capital, Brettel, Rudolf, and Witt (2005) has demonstrated that angels often put to the disposal of the entrepreneur their management prowess (know-how). That is, angel investors offer entrepreneurial knowledge and wide contacts to their client firms. They are well known and are helpful at propping-up new ventures using countless number of methods such as assisting in the writing of the business plan, supporting in the distribution and marketing programmes while collaborating in the financing and the accounting function. Politis (2008) also revealed that angels assist new ventures with their network and personal links (*know-who*) which is instrumental at establishing linkages with resellers, fostering collaboration with partners and other investors. This is the main reason why angels invest in organisations within their catchment

areas. Firms that are sponsored with angel capital also enjoy gaining mentorship and industry expertise from those who are knowledgeable and are willing to guide you along the path of your business (Ernest & Young, 2014)

4.2.2 Venture Capitalists (VCs)

Mitter and Kraus (2011) explain that venture capitalists are organizations that provide capital funding to institutions. They are private or subsidiaries of publicly quoted companies or corporate venture capital firms. Venture capitalist can be said to be proficient asset managers known for investing capital got from institutional investors, or wealthy persons, into encouraging entrepreneurial firms that are likely to grow (DaRin, Hellmann, & Puri, 2011). Venture capital can be made available as venture firm enters different levels in its growth process. Conventionally, venture capitalists concentrated on the provision of funds needed for the take-off the business. However in some knowledge based economies there is a gradual shift to bigger and later growth phases of the business (Aernoudt, 2005). Venture capital is particularly important in funding the early-stage (known as seed stage) of the entrepreneurial firm as the equity capital of the entrepreneur is expended and debt instruments are difficult to be accessed. At this time, most entrepreneurial firms are approximately 10.5 months old from the time the businesses received their first angel financing and to a greater degree have not earned income (Wong, 2002). Venture capital supported businesses are usually above one year old (Gompers, 1995) as at the time they received their first funding. It is estimated that a little below forty percent of them do not earn revenues

within the period (Kaplan & Stromberg, 2003, 2004).

4.2.3 Corporate Investors

Entrepreneurial firms had consistently considered corporate investors as a divestment option, other than as a means of funding. Many corporate investors acquire entrepreneurial firms to complement their product or service offerings. The firms now see the new capital window as a strategic avenue to improve on the business' operations. Though these are typical occurrences in bigger businesses, many new venture promoters see this practice as a big source of funding especially when what is at stake has huge potentials. Most currently, Yahoo sold its internet business to Verizon. Corporate investors stop entrepreneurial firms from building cooperation with competitors or competing openly with the corporate investor. A good number of entrepreneurs currently are initiating firms fundamentally to be bought over by successfully huge companies some day in the future (Markova & Petkovska-Mircevska, 2009).

4.2.4 Bank loans

Banks are external finance that takes the form of loans that are borrowed by an entrepreneurial firm to help its business activities (Mitter & Kraus, 2011). After, founders, family and friends capital come bank loans which stand as a basic source of funding to entrepreneurial firms (Fatoki, 2014). While, Winton and Yerramilli (2008) have hypothetically demonstrated that venture capital funding is preferred over debt financing especially under conditions of high risk and uncertainty, DeBettignies & Brander (2007) on the other hand, argued that entrepreneurs' preference for debt over equity occurs most especially when the interest of the

entrepreneur is aligned and the cost of capital is lowered for the entrepreneur.

Ernst and Young (2014) argued that though bank loans are considered as the most traditional form of funding for new ventures; it is also observed that naturally, banks like limiting their risk by lending to firms that offer some form of collateral. While bank loans serve as an important source of external financing for small firms, the challenge most young entrepreneurs face when exploring this source of funding are: limited business and industry experience, limited credit history, volatile profit and cash flow, the likelihood of having huge debt outstanding, limited equity in the business, the probability of earning marginally when the firm is publicly placed and there is a tendency to lose it all (principal and interest) at liquidation (Markova & Petkovska-Mircevska, 2009).

4.2.5 Government grants and loans

There are many sources of funding that are available to young entrepreneurs to access that are offered by government organisations. Some of these schemes are provided by Nigeria export processing council, Nigeria export processing zones authority, Bank of Industry, and Central bank of Nigeria. However, experience has shown that meeting up with the requirements has been an uphill task and must have accounted for the reasons while a large number of new venture owners/promoters have been prevented from accessing such facilities (Ernst & Young, 2014).

5 Other Sources of Funding new Ventures

5.1 Trade credit

One way entrepreneurs finance their activities is to get customers/consumers to pay before actual supply is made. This is called prepayments. However, this situation is especially possible when the product/service of the firm is in high demand. In many advanced and knowledge-based economies, it has been projected that slightly above 80 per cent of every industry to industry sale is done on credit. Consequently, left with little working capital, entrepreneurial firms have to ask suppliers for twice as much short-term credit as they obtain from banks, demonstrating its importance to the sector (Jones-Evans, 2013). In the United Kingdom, it is considered normal for new ventures to owe their suppliers an amount equal to 20 percent of their total assets which is a key support expected of big corporations to give smaller firms (Independent taskforce on non-bank lending, 2012). Thus, the relative dependence of entrepreneurial firms on large firms has created a friendly relationship in the supply chain that has encouraged firms with sufficient cash flows to oblige debt to companies in need which has helped lending firms to exercise enormous control over recipient firms. More so, by changing and simplifying procurement procedures, this has eased contractual agreements for new ventures that are likely to create sufficient business and revenues with attendant reduction of bank funding (Jones-Evans, 2013). However, Mitter and Kraus (2011) argues that interest rates on trade credit are high and should only be considered as a source of financing where bank loans are lacking,

5.2 Factoring and Invoice discounting

Motivated by the desire to sale and improve revenue base, many venture firms sale on credit. With the passage of time, scores of these account receivables are not paid on time. Challenged by the paucity of funds, a venture firm (borrower) approaches a lender to buy over the accounts receivables. The factor (lender) agrees to do so at a discount. The factor advances as much as 70-85 percent of the total receivables at the inception of the agreement and promises to pay the balance on collection of the balance outstanding with the purchaser after an interest and fee has been deducted. The practice is that the asset must be more than the amount requested. Factoring and Invoice discounting is a kind of asset based financing that is useful to startups and gives them the leverage to use their working capital effectively. Factoring is typically undertaken by financial institutions such as banks or private factoring brokers (Bakker, Klapper, & Udell, 2004; Jindrichovska, 2009).

5.3 Asset financing

This is another method that venture firms use to finance their plants and equipments (vehicles, machinery, and equipment). It includes:

5.3.1 Hire purchase entails gradual payments which eventually write off what was left of the balance and the interest charged on the plant and equipment and the firm owns the asset (Jones-Evans, 2013).

5.3.2 Operating leases: involves the borrowing of a particular asset needed by a firm for its use over a period of time. The firm undertakes to pay an agreed amount of money known as lease payments during the period up to the time the asset is returned. where, the

asset falters in performance, the supplier either fixes it or replace the existing one with a new one (Jones-Evans, 2013).

6 Conclusion

What is most dreadful to many people about venturing into entrepreneurship is first, how and where to raise funds? Second, there is the fear of failure. Third, is the fear of managers 'unscrupulous behaviour when the owner is not personally doing it. Fourth, is the fear of such disdainful looks that comes from friends, classmates, neighbours and sometimes, from family members. The question is what is your own fear? Most of these fears could be precipitated by the ambition every young man harbours, especially those aspiring for a degree education or had already acquired one and are hoping of someday knotting their tie and working for dream job hopefully with a blue-chip company. Now, those aspirations are turning into despair and despondency. Hope is not lost though. However, it is important to audaciously state that because many illiterates are persuaded first by the desire for survival, they venture into business and keep it sustained, become successful eventually as years' passes by, and end up employing the most educated. Yet the educated do not challenge themselves with questions such as why?

Now that economies are contracting, and organizations are shrinking in sizes, the only viable alternative left to be

explored is entrepreneurship. It is the question of raising finance that prompted this paper. Having enumerated the many sources of financing, their benefits and drawbacks, it is significant to state that first, you start with your savings. Anybody who did not start with his/her savings may give little attention to the venture. When the attention is lacking, the venture's chances of survival may become very low. All the sources of financing earlier mentioned are critical to the success of a venture. What remains key is the relative ease with which various sources can be accessed. However, entrepreneurs should note that when you are privileged to be introduced to any bank by its respectable customer: the chances of you getting a loan from the bank become higher. Additionally, entrepreneurs should know that having the character, the capacity and collateral endears a firm to any bank. Most importantly, the paper recommends that bootstrapping skills should be the ready companion of any entrepreneur who wants to succeed.

Finally, just like any other contest places demand on you, entrepreneurship is no exception. The challenges are myriad but the benefits finally are huge. Consequently, you should not be deterred by the financing challenge facing your desire of launching out or your entrepreneurial firm presently.

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