

# [Financing a new venture on entrepreneurs point of view finance essay](https://assignbuster.com/financing-a-new-venture-on-entrepreneurs-point-of-view-finance-essay/)

## Introduction

Starting a business is the dream of many people and the sole option to others. There are many reasons why a person would be willing to start-up their own company but independently of the reason, many of the new entrepreneurs get stuck right in one of the first and very important steps when it comes to start its venture: financial funds to do the jumpstart, also known for the term “ seed funding”. It is vital to any type of company to have funds enough to start the business and hold the cash flow positive for the starting months until the company is able to finance itself.

Many entrepreneurs are luckily enough to hold financial aids from personal savings or from the well known 3F’s: Family, Friends and Fools. Others need to lend money from outer financial sources, such as banks and government agencies. By lending money from others[1], the entrepreneur is doing a commitment to pay the money back plus interests over the borrowed money. Other newer alternatives are the concept of business angels and venture capitalists whose invest in the start-up with the required amount of capital but they expect a portion of the company in return.

Cite previous research in the area. It needs a bit more text to introduce the reader to the concepts we are going to present in the document.

## Background

Financial institutions became an important mechanism of injecting money into all stages of businesses; from start-ups to expanding companies. Many literatures have written about available options in financing new business ventures and some interesting conclusions have been released; however due to the geographic focus of this work, there have not been found any similar work in which could replace this study.

There are many available options widely used for entrepreneurs in developed countries to get money for start-up their businesses, but in the developing nations most people lack knowledge about new venture financing, therefore limiting available sources. Hence, this thesis will examine the most common options available in Brazil and Thailand and compare such options with the most used in the developed nations expecting to provide more insights to the entrepreneurs in the studying countries that out there are other available options.

## Definitions

## Limitation of the study

Due to time constraints, it has been necessary to scope down the object of research to a narrowed picture. The study is focused on the financing of new venture in newly start-up product oriented business as it is in the field which match the writers personal interests. Additionally, there is a limitation in size that paper must accomplish. Moreover, the writers have intention of focus their study in developing nations attempting to find the pitfalls that prevent such countries to grow. Therefore been Brazilian and Thai, it is their personal willing to base the thesis in their nationalities.

This study might not reflect the entire population of the countries due to the size of both nations. However, this thesis is an empirical study which tries to be as closest as possible of the reality.

## Countries

## Brazil

Brazil is a developing nation South America, been the 5th largest country in the World both in territory and in population. It is a land of great biodiversity where lies the Amazon rain-forest which accounts for 20% of the word’s fresh water and oxygen generation.

Brazil started to rise as a major economic power in the world stage after been nominated as part of the BRIC countries (Brazil, Russia, India and China) as the great powers of the globe by 2050. In terms of growth, currently Brazil is the 7th largest economy[2]in the planet in which main exporting areas are agriculture, mining, oil, manufacturing and services.

Recently, its middle and higher classes overtook the number of poor setting the mark of 65% of the entire population[3]. The country is predicted to grow in fast pace, achieving in 2030 a quality of life of the population similar to the current in the major European countries.

## Thailand

## Thailand is located in South East Asia, been the 50th largest country and 21st most populous country in the world with approximately 65 million people[4], and been the second largest economy in South East Asia after Indonesia. Thailand’s economy is mainly based on exports of rice, rubber, sugar cane and corn even though tourism plays big role. Because of its richness in natural resources[5], Thailand have its own charming to attract foreign investors, and once had been called as the coming fifth Asian’s tiger.

## Initial financial aid

To any new company, assets are mandatory. Even the simplest company would need some sort of asset, been human or other resources. Assets would be acquired in many manners, but the most common and easy way is to buy, lease, rent or hire, thus, paying in cash. Additionally, money is needed to keep cash flow positive and some spare for savings in case of an emergency. Furthermore, money is also needed in order to keep the company competitive in the industrial landscape. Therefore, for the great majority of companies, seed money is required in order to satisfy these needs.

## Focus on small business start-ups

Small businesses are responsible for employing more people in developing nations than bigger corporations (show some study here). Additionally most of the developing countries have small businesses owned by nationals, hence leading to keep the money and profit of the company within the origin country. Moreover, most successful entrepreneurs has small businesses as a starting point, hence this study is rewarding in terms of possible usage by business owner’s aspirants in the referenced nations.

## Concentration in product oriented businesses

Nowadays, businesses are mainly split between two major categories: services and product oriented. Services account for the biggest chunk of the pie, however products oriented business are the spark plug to trigger innovation and lead to further development.

The choice for studying product oriented business over services is led by the desire of the writers in bringing innovation and entrepreneurship to their home countries. Additionally, there are personal interests in pursuing such business field in the near future.

## Surveyed entrepreneurs’ profile

As part of the study, an online survey was conducted with product oriented manufacturing companies in Brazil and Thailand in which have survived from at least 5 years.

A sample of 20 companies of each country spread onto different states were selected to take part of the survey, in order to make a more concise picture of the nation, not only focusing on particular regions.

By selecting companies with at least 5 years in business, the authors ensures that the chosen entrepreneur has a successful business as it is known to be the baseline to consider the company successful.

## Objective

This study has the main objective to elucidate the possible options of seed financing the entrepreneurs have, outlining the pros and cons of each given option and providing a basic guideline on how to obtain such investments.

The outcome of this study should have enough information to the entrepreneur be able to select the most viable option of financing based on the nature of the business, required amount of investment and for how long it is expected to have the loan fully paid.

## Goals

Review this text and merge with the above to shrink everything

The final results which writers expect from this thesis are to obtain the knowledge based on the financial entrepreneur which related to the program study. Additionally, this paper would provide the reader information and statistical data regarding the available sources of financial institutions, pros and cons of each available sources, the trends of entrepreneur and their behaviours on financing new business venture in both Brazil and Thailand. Due to the analysis in this paper, writers are expected to summarize all data and provide the new possible method which could be match with people in both countries. The aim of this work is to show the various financing options to entrepreneurs whose want to form product oriented companies in Brazil and in Thailand and provide insights of the most financially viable options available in the studied markets.

## Literature Review

## Brief about entrepreneur and job creation

It is widely known that the word “ entrepreneur” comes from the French word “ emprendere” which means “ to undertake” in English. Joseph Schumpeter, an Austrian economist in summary has defined an entrepreneur as a person who “ creates wealth by combining various input factors in an innovative manner to generate value to the customer with the hope that this value will exceed the cost of the input factors”. Additionally to that, it is understood nowadays that the entrepreneur is someone able to undertake challenges, innovate and create an organization out of it.

Entrepreneurs have the power of creating companies. By starting point, normally the ventures created start small and expand along the way. Micro and Small companies employ the major part of the labour force within a country in the majority of the countries. As an estimation of the potential of the Micro and Small businesses in terms of job creation, 52% of all regularly employed people in Brazil in 2010 were employed by such companies’ size which accounts for approximately 13 million people, according to an employment study done by a governmental agency[6]. World Bank shows the very same percentage of employment for Small and Medium sized enterprises in Thailand according to a study done in 1997[7].

Figures can vary greatly on each nation, but normally numbers favours Micro and Small organizations than Medium or the bigger ones, thus showing the great importance Small and Micro business have in any country, specially in developing nations such as the ones part of our study.

## Forms of business entities

Choosing the correct form of business entity is an important decision when starting a business. Not all entities are suitable for raising substantial amount of capital or are flexible enough to allow growth within the expected level. With a little forethought and the ability to understand the advantages and disadvantages of the different types of entities, the venture might have the capability to achieve the expected goals.

The most common business forms are sole proprietorships, corporations, limited liability companies and partnerships which are briefly explained below.

## Sole Proprietorship

From a literature written by Willam et al. (2000, page 5)[8], “ a sole proprietorship is a business owned and controlled by a single person and paying the applicable taxes on his or her personal income tax return”. A sole proprietor has unlimited personal liability for the debts and obligations of the business and cannot sell equity to fund operations or expand the business. As a sole proprietor, one can use debt to finance operations, but will be personally liable for the repayment.

## Corporation

“ A corporation is a legal entity or person created to conduct business by acquiring assets, hiring employees, paying taxes and facing pertinent legal issues”[9], according to William et al, 2000, page 7. The corporation carries on business in its own name and shareholders, officers and directors, and the employees are not personally liable for its acts. A corporation has appropriate structure for long term life-time as the model allows a wide variety of financing options, hence allowing existence’s continuity.

## Partnership

“ A partnership involves two or more people carrying on a business together and sharing the profits and losses”[10]William et al, 2000, page 6. Depending on the level of ownership and/or agreement, all partners are expected to have similar liabilities, obligations and responsibilities.

All profits and losses are passed through to the partners according to their percentage of ownership, even if the profits remain in the business to fund continuing operation or expansion.

## Stages of a regular business

Business professors have different views in terms of which the stages of a company are. It can be argued as several or some however, it is concisely known that they vary from 3 to 6 stages, depending on each scholar point of view.

Markova & Petkovska-Mircevska, 2009[11]points us to 4 brief but yet well developed major stages in which a regular company may have in its life-time, which are explained below.

## Start-up stage

The business is in the conceptual phase, yet in the entrepreneur’s mind – a precious diamond to be lapidated.

In this phase, the entrepreneur has as main challenge to convince people. He or she needs to demonstrate his/her idea to potential investors and to potential human resources or employees that the company will succeed. Usually, at this stage, there is no company formed yet.

## Seed stage

Here the venture starts to takes shape. Normally, production has not started at this point, however planning, sketches, prototypes and alliances are been created at this stage. Even though if the company has actually started producing or selling, the product/service still needs to prove it is sellable and profitable, thus still entering to the market.

In this stage, the entrepreneur needs to ensure the venture will not run out of money as key resources (personnel or assets) are required. Human resources can be high skilled workers or a marketing professional, which are known to be key factors to a success story.

Normally, the company is up to 1 year old since its foundation.

## Early stage

In the early stage the firm is usually expanding, and producing and delivering products or services. It is often less than 5 years old and it may not yet be profitable.

## Expanding stage

In the later stage, also called the expansion stage, at this level of development the firm is mature and profitable, and often still expanding. With a continued high-growth rate, it may go public within 6 months to a year.

## Types of firms

Available start-up funding depends on its long term potential. There are three types of start-up firms[12]: lifestyle, middle-market, and high-growth potential firms; according to Markova & Petkovska-Mircevska, 2009.

Lifestyle firms provide only a living for their founders and accounts for approximately 90% of all start-ups. Due to their limited nature, they are unlikely to attract external financial funding, thus tending to be funded by the entrepreneur.

Middle-market companies ranges on 8-9% of all start-ups. This type of firm start to attract external funding as the average growth rate is 20% annually.

High-potential organizations are 1% or less of all start-ups. They are very likely to grow over 50% annually and their initial five year revenue projections are very high. Usually such firms demand multiple rounds of external funding from angels and venture capitalists.

## Financing stages of a new venture

Financing may be injected at different stages of a business, per its demand of extra funds. As different businesses might have dissimilarity in growth pattern, many literatures have the stage of financing differently set. According to Singh, 2000[13], the classification of stages of financing are as follow:

## Early Stage Financing

## Later Stage Financing

Seed Capital

Start-ups

Second-round finance

Expansion finance

Replacement capital

Turn-arounds

## Early stage financing

Due to its high risk of failure (related to uncertainty of business), many private investors invest in this phase expecting high returns in the business profit. In addition, as the company is still conceptual, smaller amount of investment is needed which attracts investors.

## Seed Capital Stage

Seed capital stage happens when the business start from the conceptual idea. Lucas & Peraquito, 2009[14]give the description of seed capital funding as “ early stage where concept or product is under development and the business is not operational. “ In this seeding stage, there is great chance of failure. I. e.: the product fails to materialize into workable model or the market is not ripe for the product”[15]as pointed out by Singh, 2000. Due to high risk and uncertainty on this stage, investors are very scarce and normally it is financed by the entrepreneur. However one of the main objectives of this study is to assess it.

## Start-ups

After the idea or product’s prototype is proved possible for commercialization and there are some indications of potential market for the product, a business plan is developed in this phase as usually here the needs for investors becomes more prominent. Hence, capital investors will look for evidences of entrepreneur’s track record and previous experience before join the venture.

If there are funds enough, a prototype is developed and tested and feasible production line on initial samples lots is tested. By launching the first sample batch, initial sales can start. In addition, business owner and investors can take a market research on the first batch sales to predict more precisely the amount of investment needed for a full production. In this start-ups stage, risks are higher than seed capital stage because the investments are substantially higher.

## Second round phase

In this stage, the product is in full production and available in the market. As the company is entering into the market and fighting for its market share, competition would start showing its face, forcing the company to strive for survival. Quite often, to survive in a competitive market, new business demands extra injection of equity-alike funding to maintain or exceed its advantages over the competitors.

## Later Stage financing

According to Singh, 2000[16], “ Later finance is a term used for funding established businesses, which have passed through the hazards of early stage financings”, hence, usually less risky. On the other hand, the amount of investment is typically higher due to the company’s profile and product’s value.

## Expansion finance

After the company’s core product is strong in the market and continuously profitable, an established business might decide to expand by organic growth or by acquisition. Organic growth means expansion of business into new product line or new markets. Acquisition implies to expansion in the same business field but increase in volume of line production. (It does not seem to be right. Give me this reference) Hence, business plan with effective future development is important to attract venture capital funds in this expansion stage.

## Replacement Capital

Some venture capital companies invest into this replacement capital stage by purchasing existing shares from the entrepreneurs due to potential profit. The fund expects a reasonable income yield to those who sell shares to the fund. The funds are not directly financing the business but there is a possibility for future financing to assist company’s expansion.

## Turn-arounds

“ A turn-around refers to a recovery situation”[17]. The recovery situation can occur in both early stages and later stage of a business development. Turn-around which occurred in early stage financing usually happen due to lacking of entrepreneur managerial skills or slow respond of market to the product. Later stage turn-around rarely occurs if experienced venture capitalists or business angels are involved. Investors who are willing to invest in companies in turn-around situations have to weigh whether the business has future prospects of profitable growth and if it worth the effort.

## Needs for external funds

business finance option. pdf -> Check it to rephrase and quote the text below

There are countless reasons why small businesses seek finance. It is also known that extra money can boost company’s ability to deal more confidently, improve processes, quality, reach new markets, etc. Independently from the reason extra cash is necessary, three main phases of business needs more extra finance; which are:

New businesses that are being formed – these can be either started up from “ the ground” or acquired by another firm.

Existing businesses that have a trading history and simply require additional finance for expansion and growth.

Companies with financial difficulties to keep in business. This can happen to any type or size of venture and the reasons why it happen is not in the scope of this study.

A business can grow by either using internal or external sources of finance. Internal sources of finance include all net cash flows generated by the business, such as retained profit or sale of assets. External sources of finance include bank loans, sale of a part of the business to investors (e. g., venture capital firms, business angels), and leasing (long-term renting of equipment). External sources of finance have a number of big advantages over the internal financing options, however drawbacks do exist also.

## Starting up the business

When the entrepreneur decides to start-up its venture, there will always be a time when he or she will go through the financial aspects of opening a new company. Lack of financial resources is quite often the main reason why great companies are dreamed but never leaves the papers in developing countries.

With no money, the entrepreneur is normally unable to go much further than its initial plans as it is very difficult to gain resources[18](not impossible though) with no cash at all.

## Expansion

A business needs investments to grow. Even the most profitable companies cannot rely solely on reinvested profits to finance their expansion. Accordingly, a business needs to secure bank credit, partner with venture capital firms or in any other way to secure external sources of finance. External finance provides the room for faster growth, allowing the company to operate on a far bigger scale, capturing new markets and providing products and services to an ever greater number of customers.

## Greater Economies of Scale

Large businesses are generally more efficient than small ones. They have a greater bargaining power with suppliers and they can spread their fixed costs, such as administrative expenses, over larger sales. This results in lower costs per unit of production, which, in turn, gives the company a competitive edge in the marketplace. External sources of finance help a company grow faster, achieving the economies of scale necessary to compete with the rival firms on regional, national, or even international levels.

## Financial crisis recovery

Any company at any stage is susceptible to get into financial trouble. The reasons why it might happen is infinite. It can be an outer issue happening in the government level, market level or even globally level. It can be due to an internal flaw committed by the higher management or a key employee that decides to leave the company. It could even be due to a machine that breaks down and turns to major issue, leading the enterprise to trigger a financial crisis.

Thus, when such things happen, extra money (if not saved) is required to bring the organization back to its rails making it profitable again.

## Financing options trends

## Most common financing options

## Debt or equity

When entrepreneurs consider to start or to expand their business, quite often external funds are pursued. It might come from individuals or companies that can provide a loan or direct investment to the venture, always looking for a future compensation. Investors or other financial sources can get return by two distinct ways, by debt or equity.

## Debt financing

“ Debt financing usually occurs when you make a loan from a lender” has been written by Duncan M. Chembezi (page 1). The loan will be used as capital injection in the business and need to be repaid over a period of time. The loan from each financial sources would have different terms and condition in clear repayment schedules and a set interest rate.

## Advantages

“ The primary advantage of debt financing is that the entrepreneurs still retain total ownership of their businesses”[19]. The benefit from having full ownership is that the entrepreneur can make strategic decisions, keep profit and reinvest it in the business. Other major advantages is that debt obligation will limit only in the repayment period which differently from equity finance where a percentage of ownership will not end until the investor sell its shares on the businesses.

## Disadvantages

The major disadvantage of debt financing is the requirements which the entrepreneur needs to address before filing to a loan plus the interest rates to be paid on regular instalments to the lender. Hence, small business which has low cash flow might face difficult to re-pay the debts regularly. Most lenders might charge penalties for late payments which include charging fees, taking possession of collateral, or calling the loan due early.

Moreover loans are usually available only for established companies. Start-up business might find it difficult to get a loan granted due to their business high risk and low (or no) company profile.

## Equity financing

“ Equity capital implies to money that you and any of your business associate(s) inject directly into the operation”[20]– Chembezi. Contributors of equity capital would receive shares in the business as a compensation for the investment made.

## Advantages

Equity financing provides extra capital into the business without the requirement of repayments and payment of interests as compensation. Hence, the equity is added into company’s net value, improving the financial stability of business and its ability to obtain debt financing if still required.

It can also result in outside expertise being added to the enterprise’s management or board.

## Disadvantages

Equity financing is a permanent investment which reduces entrepreneur’s ownership, thus its ability to control the business.

Additionally, profits of the business are shared among the shareholders or equity investors.

## Internal and external sources of funding

Funds can be acquired from a variety of sources however all of them will always be from two different types of sources: internal and external funding.

Internal funding are funds available within the organization such as: personal savings, retained profits, bootstrapping and Family Friends and Fools (3F’s).

External funding is money that comes from a source which is outside the company. External sources of funding can be countless, however the most common are: bank loans, Angel investors, Venture Capitalists, Government Agencies and general partnership.

## Internal funding

## Advantages

Possibly internal funding would be the best option to any entrepreneur. Keeping your finances internally and controlling it yourself or within the organization means that one will keep ownership of your business without external unwanted interference. Moreover, by keeping the financing internally, the entrepreneur has the opportunity to grow sustainably and consistently.

## Disadvantages

Although the many advantages of using internal funding, some drawbacks do exists.

By using internal money for start and grow the company, it is inevitable that more money will be needed to keep the organization financial healthy. Such money is always needed to keep a balanced cash-flow and allow growth; therefore, using internal money either from the entrepreneur’s savings or from the company’s profits might constraint growth or imbalance the financial stability of the venture.

## External funding

## Advantages

By taking external money the entrepreneur is possibly bringing more expertise to the company as if money is secured from business angels, venture capitalists or general partnership people with similar interest in having the company succeeding will try to help the entrepreneur, been many of them very well known in the market the entrepreneur is pursuing the venture. Moreover, by getting funding from the mentioned sources or from government agencies, one will need to get well prepared for presenting and pitching the idea, therefore leading to a better preparation of the entrepreneur in terms of the business itself by elaborating a more concise Business Plan and getting extra knowledge that shall be necessary when presenting.

## Disadvantages

It is known that getting other entities along with the new company a payback to these must be done someh