

## **Study of Financial challenges faced by Small Entrepreneurs**

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**Abstract:** India is the second densely populated country in the world having a population of 1.3 billion. High population means a pool of talent, knowledge, skills which can generate new ideas for improving productivity in number of fields. To implement the innovative ideas, entrepreneurs need to have a strong technical, financial and other support. However big entrepreneurs are able to manage all the above mentioned resources but small entrepreneurs have to face a number of obstacles in the startup stage. The challenges for developing countries are numerous rather than developed countries, as they have to deal with problems of raising funds under diminishing financial and institutional constraints. This paper examines the financial challenges faced by small and budding entrepreneurs.

**Keywords:** Venture Capital, Angel Investment, Crowd funding, Crowd lending

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### **1. Introduction**

Small enterprises are often cited as a major driver of Indian economy due to its significant contribution in output and employment generation. According to a report given by Confederation of All India Traders, small enterprises contribute 45% on India's GDP which is around three times of what corporate India contributes. This sector employs approx. 46 crore people and is earning a growth of 11.5% annually. But it is still deficient in securing proper finance to prosper.

### **2. Objective of This Paper**

This paper makes an attempt to study the financial problems faced by small entrepreneurs. The area under study is

- To know the various sources of funds available for small entrepreneurs
- Financial challenges faced by small scale entrepreneurs
- Methods to reduce the financial gaps faced by these innovative small firms

### **3. Finance Function in Small Enterprises**

Finance is the life blood of an organization and no organization can function properly in the absence of adequate funds. The major cause of this problem is insufficient capital and inadequate availability of credit facilities. The small entrepreneurs are struggling with the problems of weak economic base and low credit worthiness.

#### **3.1 Main finance resource for small entrepreneurs in India**

Usually a small entrepreneur can use personal investments, borrowed funds from commercial banks in form of loans, bank overdrafts and credit cards. There are some new sources available such as venture capitalist and Angel investors. Venture capitalists are the firms which provide funds to the businesses with exceptional growth potential. They pool funds from investment companies, pension funds, large corporations and wealthy private individuals' uses these funds to invest in high-risk start-up companies that they think will be profitable. They take equity and ownership stake in the company and want an access in financials of the company.

Angel investors are the wealthy individuals or group of individuals who provide funds to early stage entrepreneurs. They provide less finance as compared to venture capitalists. Three of the most famous companies that start their operations with Angel investing are Amazon.com, Starbucks, Inc., and Apple.

Both Venture capitalist and Angel investors expect a very high return due to high rate failure of small businesses. Small business owners have to make several rounds of presentations to the Angel investor and Venture capitalists to procure funds.

### **3.2 Financial challenges faced by small entrepreneurs in India**

- Low credit scoring creates problem in raising funds. Small entrepreneurs have to face the problem of low credit rating and are ignored by credit rating agencies. It creates problems in attaining funds from banks as banks demand acceptable credit rating to provide loans. Banks are unwilling to increase the credit facility without increasing the collateral from the part of small entrepreneurs.
- High cost of financing. As small enterprises are considered to be more risky and more likely to fail than larger firms, banks and other financial institutions charge a very high rate of interest from small entrepreneurs as compared to big and established companies
- Lack of equity financing. It is one of the major issue because stock market may not have confidence in small businesses. Moreover small firms cannot provide easy exit route for investor who wishes to sell his stocks.
- Problem of low cash flow. Slow paying invoices, high overhead expenses, low gross margins, too much bad debt and high inventory are the main reasons which leads to low cash inflows to small entrepreneurs.
- Problems with venture capital funds and Angel investors. Venture capitalists expect a sound, experienced, mature and capable management team of the business being financed. As they provide funds to risky businesses, they expects above average rate of return. On the other hand, Angel investments are at nascent stage in India. A small entrepreneur must have a strong professional network to raise funds from angel investors.

### **3.3 Methods to reduce the financial gaps faced by these innovative small firms**

Remedies that can be used by small scale entrepreneurs other than bank loans for the purpose ailing are mentioned below

- **Online lending.** The advent of e- business has made everything easier and faster, and the lending process is also untouched. It is also known as p2p lending (Peer-to-peer lending)/crowd lending, a practice of lending money to individuals or businesses through online services that match lenders directly with borrowers. There are various companies are now providing p2p lending services. They act as an intermediary and facilitate the lending process. The differentiating factor between this and traditional method of lending is that the borrowers can borrow money at lower interest rates and lenders earn higher returns compared to savings and investment products offered by banks. The p2p company charges a fee and provides a match-making platform to borrowers and lenders. Thus the small entrepreneurs having deficient funds can take an advantage of this lending so as to raise the funds and can prosper their business.
- **Crowd funding.** It is the latest trend of funding a project or venture by raising monetary contributions from a large number of people that is crowd. In these practice professional lenders like venture capitalists, banks and business angels are replaced by crowd. The main advantage of this funding method is that an entrepreneur who does not have rich professional network can easily raise funds through this source(which is the main loophole of venture capitalists and business angels). This model is facilitated through internet-mediated registries. For successful implementation of this practice, three parties are involved viz the project initiator who proposes the idea and/or project to be funded, individuals or groups who support the idea, and a moderating organization that brings the parties together to launch the idea. A small entrepreneur can refer the websites like Kickstarter and Indiegogo to commence the lending process.
- **Factoring.** It is the boon to small scale entrepreneurs having deficit working capital. The factoring service is very helpful for those small business models where average collection period is very high. This is the best solution to deal with the problem of working capital financing. In factoring, a financial institution (factor) buys the invoices of a company (Client) and pays up to 80% to 90% of the amount immediately on agreement. Factoring company pays the remaining amount (Balance 20%-finance) to the client when the customer pays the debt. The collection of debt from the customer is either done by the factor or the client depending upon the type of factoring. The entities providing factoring services are HSBC India, SBI Global and HDFC bank etc.
- **smallB.in.** This is an initiative for promoting small budding entrepreneurs done by SIDBI. The facilities provided by smallB.in include educating the young and inexperienced entrepreneurs about cash flow management, tax management and accounting and insurance. The budding and new entrepreneurs do not have adequate knowledge required to carry out the business operations. Thus this service of SIDBI resolves this problem by providing significant information on various issues.

#### **4. Literature Review**

**4.1 Omid Sharifi, Bentolhoda Karbalaei Hossein (2015)** examined the main difficulties faced by startups in India, and discuss the financing resources of startups in India by using a literature-based analysis. This paper is focused on problems faced by fresh graduates and who are willing to start their own business. In recent years the self-employment consciousness among college students are increasing and the students are less likely to rely on parents or schools or wait for opportunities. Instead, they tend to take initiative to look for new chances for themselves.

**4.2 Jaskaran Singh, Davinder Singh (2014)**, studied the problems related to financing of small firms in India. This paper studies the problems of medium and small enterprises. This paper is the combined study of type of Industrial Finance required, various Financial Sources of MSMEs, Own financial Resources for Innovation, difficulty in access to finance and government Policies.

**4.3 Daniel, Agbenyo (2015)**, The general objective of this research work is to access the challenges facing SMEs in accessing credit in the Kumasi Metropolis of the Ashanti Region of Ghana. Also it investigates the requirements for Micro financing SMEs and its effects on SMEs operations in the Kumasi Metropolis. It examined challenges SMEs face when accessing micro-credit in the Metropolis.

**4.4 Karen Gordon Mills, Brayden McCarthy (2014)**, the paper throws a light on the financial crisis faced by small entrepreneurs in USA which resulted in liquidity crunch. The paper focused that small businesses were impacted more than large businesses which is the main source for employment generation. At the time of recovery of economy too, small firms were facing huge problems to assess loans.

**4.5 Sanjay Manocha (2012)**, looked over innovation and entrepreneurship in today's scenario. The paper reviewed the famous entrepreneurs who have earned a good name in the industry. The study also reveals the role of innovative entrepreneur in economy.

**4.6. K. Shashikala, Dr. SP Mathiraj (2016)**, paper gives insights about financing to small scale industries in India with the help of data. The contribution provided by State financial corporation, SIDBI, and commercial banks to small scale industries in India has been discussed in the paper year wise.

#### **5. Summary**

A number of alternatives that can be used by small scale entrepreneurs to tackle the problem of financing are online lending and crowd funding. Factoring is used to solve the problem related to working capital management. Government is also taking good initiatives by educating the inexperienced entrepreneurs in the form of programmes like smallB.in. Such initiatives are blessing to youth for starting the new venture.

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