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Financing Strategies for Entrepreneurship

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Abstract

Successful entrepreneurship is universally acknowledged as the catalyst for the rapid economic development of a nation. However, the effective financing of entrepreneurial enterprises has always been a poignant issue considered a vital necessity for entrepreneurial success. The paper highlights some of the ways in which entrepreneurship contributes to economic development and then briefly reviews the characteristics for entrepreneurial success. Finally, it discusses the variety of financing strategies available to entrepreneurs which they could access for entrepreneurial success and recommends greater government support of entrepreneurship in order to realize the nation's desire for rapid economic development.

Keywords: Entrepreneurship, financing strategies, small- and medium-scale enterprises, entrepreneurial success, economic development

1. Introduction

The catalytic role of entrepreneurship in the economic development of any given society is a universally acknowledged fact. For example, some of the specific, vital roles played by entrepreneurs, through the creation of new ventures, include the following:

1. Employment generation
2. Development and utilization of the varieties of abundant local raw materials
3. Rural development through the dispersal of industries
4. Development of indigenous technology
5. Import substitution and export promotion
6. Generation of industrial and inter-sector linkages through the production of raw materials and semi-finished products that serve as inputs for large-scale enterprises, and
7. Rapid industrial development

As a result of these and other such vital roles played by entrepreneurs, today more than just a passing interest is devoted by nations to issues affecting entrepreneurs and entrepreneurship. Indeed, it has become a national policy to integrate entrepreneurial studies into the curricular of our tertiary education and in some advanced countries specialized, whole doctoral programs in entrepreneurial studies are even on offer.

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The universal interest in entrepreneurs and entrepreneurship is obviously borne out of the realization of the massive, positive impact they have on a nation's economic development and, by extension, the world's economic development, since the world is increasingly becoming a global village, a development which is being propelled by giant strides in information and communication technological advancements.

2. Definition of Entrepreneur and Entrepreneurship

The word entrepreneur derives from French and it literally means between-taker or go-between (Hisrich, 1986). This means someone who arranges business deals between two interested parties. Hisrich pointed out that from this original meaning, the concept has undergone different, though restrictive, meanings over time, including actor and person in charge of large-scale production projects (in the Middle Ages), a person who bore risks of profit or loss by entering into a contractual arrangement with the government to perform a service or supply stipulated products in a fixed-price situation (17th century), a person who needed funds for his operations (18th century), a person who organizes and operates a business for his personal gain, and an innovator (19th and 20th centuries), until today when the concept is used in a much more inclusive sense and is generally associated with a person who does all the above and much more.

Thus, an entrepreneur is someone who has a "third-eye" that enables him or her to see opportunities that others cannot perceive; an innovator who creates something new (a product, a service, an idea, a business, etc.) that is of value both to himself and to society, by obtaining and organizing the relevant factors of production (land, labour, capital, etc.); one who devotes substantial time, efforts, and other commitments to nurture that "something new" and makes it functional or operational; one who assumes a variety of risks(e.g., financial, emotional, psychological, social, etc.) associated with his pursuit or enterprise; and one who obtains the rewards of his efforts (including monetary rewards, personal independence, personal satisfaction, being one's own boss, etc.).

"Entrepreneurs are people who have the ability to see and evaluate business opportunities, to gather the necessary resources to take advantage of them, and to initiate appropriate action to ensure success." (Meredith, Nelson, & Neck, 1982). Thus, entrepreneurs are the people that drive the development of an economy; they make things happen and without them nothing actually happens. Entrepreneurs are the drivers of economic, social, cultural, and political change, although they are most often commonly thought of in connection with the creation of economic enterprises.

Many of the scientific, socio-economic, and technological advancements in the world today are the creations of entrepreneurs. This is amply exemplified in the advanced economies of the world such as the US and Western Europe in such creations as the internet, facebook, twitter, search engines, the personal computer, the microprocessor, information and communication technology, transportation, new marketing and distribution techniques, biotechnology, robotics, etc. In fact, entrepreneurs are found in all areas of human endeavour that one could think of.

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From the foregoing analyses of who an entrepreneur is, we may define entrepreneurship as the process of identifying viable opportunities in any area of human endeavour, obtaining and organizing the relevant resources to create something new to take advantage of those opportunities, deploying the necessary time, efforts, and other commitments, bearing all the associated risks, and obtaining the rewards associated with such enterprise. According to Timmons, Smollen, and Dingee (1977), "Entrepreneurship is the marshalling of people and resources to create, develop, and implement solutions to problems to meet people's needs." Entrepreneurial development, therefore, describes all efforts aimed at engendering, developing, and fostering an entrepreneurial spirit and culture in the society.

3. Characteristics of successful entrepreneurs

Research evidence indicates that certain characteristics are important for successful entrepreneurship. Timmons et al. (1977) described fourteen such dominant characteristics which they believe to be the most important aspects of entrepreneurial behavior, though no one entrepreneur is likely to possess all of them to an extremely high degree. These characteristics are summarized as follows:

1. **Drive and energy** Successful entrepreneurs have been observed to possess high levels of personal energy and drive and hence have a large capacity to work for very long hours in spurts of several days with less than a normal amount of sleep.
2. **Self-confidence** Successful entrepreneurs have a very strong belief in themselves and their abilities to vigorously pursue and achieve their own set goals, believing that events in their lives are mainly self-determined, and that they have a major influence on their personal destinies with little or no belief in fate. This characteristic is a major propellant in entrepreneurs' achievement motivation.
3. **Long-term involvement** Entrepreneurs are creators and builders of businesses or ventures and so they make long-term commitments to projects, working diligently and patiently towards goals that may be quite distant in the future.
4. **Money as a measure** Entrepreneurs see and value money (in the form of salary, profits, capital gains, and net worth) as a measure of success in the pursuit of their self-established goals. Hence they are very astute in managing funds and other scarce resources.
5. **Persistent problem solving** Successful entrepreneurs are never intimidated by difficulties as they possess an intense level of determination and desire to overcome hurdles and obstacles on their way to achieving their self-established goals.
6. Goal Setting Successful entrepreneurs have the ability and commitment to set clear, challenging, realistic, and attainable goals.
7. **Moderate risk taking** Successful entrepreneurs are not gamblers, hence they take moderate, calculated risks where their chances of winning are neither too small as to be a gamble nor so large as to be a sure thing. They prefer risks which provide a reasonable and

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challenging chance of success, and situations whose outcomes are influenced as much by one's ability and effort as by mere chance.

8. **Dealing with failure** Successful entrepreneurs possess the ability to use failure experiences as a way of learning and to better understand their own roles and those of others in causing failure, in order to avoid similar problems in the future. Hence, they are realistic enough to expect such difficulties and so do not allow themselves to be disappointed, discouraged, or depressed by a setback or failure.
9. **Use of feedback** As high achievers, successful entrepreneurs value feedback about their own performances as it enables them to gauge or measure how well they are doing in working towards achieving their set goals. Hence they demonstrate a clear desire for information or feedback on their performances in order to make corrections or improvements where necessary.
10. **Taking initiative and seeking personal responsibility** Successful entrepreneurs actively seek and take initiative without any external prompting, willingly putting themselves in situations where they are personally responsible for the success or failure of their operations.
11. **Use of resources** Successful entrepreneurs know when and how to seek help both within and outside their operations in building their enterprises. They are not egoistic.
12. **Competing against self-imposed standards** Successful entrepreneurs continuously compete against themselves whereby they aim to better their own last best performances.
13. **Internal locus of control** Successful entrepreneurs believe that their own accomplishments and drawbacks are things that are within their own influence and control and are not externally determined or imposed by luck or fate or other external, personally controllable factors.
14. **Tolerance of ambiguity** Successful entrepreneurs have a special tolerance for ambiguous situations and for making decisions under conditions of uncertainty.

4. Financing strategies for entrepreneurship

From the foregoing discussions, it could be seen that successful entrepreneurs concretize their perceived business ideas or opportunities through the creation of ventures or enterprises which they then nurture and develop into successful businesses through the deployment of vital resources. One such vital resource for a successful venture is adequate finance. However, because of the general paucity of finance, some potential or beginning entrepreneurs often are overwhelmed by financial considerations to the extent that they allow this to negate or diminish their thoughts about generating, articulating, and developing excellent and viable business ideas which, in fact, is much more important than any morbid fear about the unavailability of financial resources. As successful entrepreneurs would attest, being armed with an excellent and viable business idea rather than being loaded with adequate financial resources is the beginning of entrepreneurial success. This is because they have found out that an excellent and viable business idea could be nurtured and developed with what has come to be known as OPM (other people's money). For example, in answer to a question in a recent

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interview, Aliko Dangote said he was not a rich man when he was so described by the interviewer. This, he said, was because it was the interviewer's and other people's money which they have kept in the banks that he was using to develop his business ideas. In other words, the interviewer and other savers were the real "rich people" who were lending him their money! Hence, although the natural, beginning financial port is one's own savings, not having enough money of one's own should never be a hindrance to entrepreneurship. Having said that, however, there are various financing strategies available to entrepreneurs which they could access to grow their businesses. These may be divided into private and informal sources, official sources, and formal sources.

Private Sources

The private sources consist of the entrepreneur's own personal savings, inheritances, loans and gifts from relatives, friends, and acquaintances, and money from fortuitous occurrences (Awaiko, 2004).

Entrepreneurs' own personal savings include funds accumulated over time, perhaps in the course of their careers in paid employment or in the course of other economic pursuits, and postponed consumption. It also includes retained earnings (funds ploughed back into the business when the business starts earning profits), provisions for depreciation (which are funds set aside for depreciation of assets which result in reducing stated profits without actually paying out any cash), provision for taxation (which are amounts set aside for the payment of taxes when due at a future time period and which are similar to provisions for depreciation), and reductions in current assets (which involve reducing the levels of inventory and accounts receivables, thus releasing cash into the business).

Entrepreneurs' own personal sources constitute the easiest, the least expensive, and the most common sources of funding for small businesses in Nigeria. Apart from providing entrepreneurs with crucial seed capital, these personal savings become significant in seeking external funding (OPM). For example, some commercial banks demand that owners of small businesses contribute personal funds to the business venture as a condition for extending credit and, in the case of financed purchases, to pledge their personal funds to pay for a portion of such financed purchases. This serves as the bankers' own way of reducing their risk exposure that could arise from potential default and of securing assurance of how committed the entrepreneurs are to their businesses. A major limitation of entrepreneurs' own savings as a source of funding is that the funds are limited. However, the advantages include there being no interest payments, no burden of prolonged repayments, and no costs being involved.

Inheritances include monies, property, assets, etc. bequeathed by parents or other relatives or forebears. In some instances, these have constituted significant sources of funds for entrepreneurs for starting and running small businesses in the first few years of their establishment.

Loans from relatives, friends, and acquaintances also constitute important sources of private funding for Nigerian entrepreneurs. However, the problems with these sources are that as with entrepreneurs' personal savings, the funds are limited and, in the event of default in repayment, might jeopardize personal relationships and ties.

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Money from fortuitous occurrences includes such things as employment benefits, winnings from jackpots, lotteries, contests, and the like. There are instances where entrepreneurs are known to have started and funded their businesses from such sources.

Informal Sources

Private money lenders: These are private individuals who loan funds to micro entrepreneurs, especially in the rural communities. Most petty traders obtain funds from such sources. The major drawback of private money lenders is that they charge ridiculously high interest rates which makes funds from these sources very expensive and which severely affects the profitability of their clients, and they could be merciless and utilize crude means in recovering their funds and interest in the case of default.

Community associations/tribal unions/religious groups/social clubs/savings and thrift associations (esusu), etc.: In our rural communities especially, these various associations are veritable sources of funding, particularly for micro entrepreneurs. Their modes of operation are similar, usually involving the establishment of a revolving loans scheme. However, a beneficiary has to be a member of the particular group before he or she can obtain a loan facility. Their interest rates are quite low with very liberal repayment terms and many entrepreneurs have taken advantage of such arrangements to start and grow their businesses.

Cooperative societies: Cooperative societies are business organisations formed by persons and operated to achieve efficiency either in production or consumption. Hence the two basic types of cooperatives are producers' cooperatives and consumers' cooperatives. The members pool their resources through contributions to the share capital and other regular contributions as deemed necessary. Cooperative societies, apart from sharing profits or surpluses (usually on the basis of patronage), also provide loan facilities to members, and an entrepreneur wishing to take advantage of such facilities first has to be a member of the particular cooperative. Many entrepreneurs have found cooperatives to be good sources of funding.

Accepting partners into the business: Financing can also be obtained by opening the door of your business to others to become partners. This enables you all to pool resources for the running of the business. Bringing on partners, however, will dilute your ownership and control of the business.

Existing and potential customers: Some customers, such as wholesalers and large retailers, are often willing to make large payments in anticipation of the production and delivery of goods to them. This is yet another financial strategy that could be judiciously exploited by an entrepreneur.

Official Sources

These consist of government intervention schemes or programmes through its various agencies to provide financial assistance to small- and medium-scale enterprises (SMEs). The Central Bank of Nigeria (CBN), in particular, has played a leading role in providing funding to SMEs through its various initiatives and policy guidelines to the banking sector.

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Such official sources include the Bank of Industry which arose from a merger of the former Nigerian Bank for Commerce and Industry and NERFUND in 2001, with a mandate to provide funding to the industrial sector as well as to SMEs generally. It has since been struggling to meet the funding needs of the industrial sector. Another official source is the Nigerian Export-Import Bank (NEXIM) established in 1991 to boost the nation's non-oil exports in order to diversify the nation's sources of revenue away from over-dependence on crude oil.

The objective of NEXIM is to provide funding, trade information, risk coverage, and general advisory services to Nigerian entrepreneurs in the export industry and to provide similar support to farmers and SMEs. A third official source is the Small and Medium Industries Equity Investment Scheme (SMIEIS), an initiative of the CBN launched in August 2001 and designed to improve funding to SMEs. The scheme calls for each bank setting aside10% of its annual pre-tax profits for equity investment in SMEs. The specific objectives of the scheme include the facilitation of funds flow for the establishment of new SMEs, especially in the real sector of the economy, including manufacturing, agro-allied, information technology and telecommunications, educational establishments, services, tourism and leisure, solid minerals, and construction. In addition to these and other federal official sources, various state governments have a variety of schemes established to provide financial support to entrepreneurs.

Formal Sources

The formal sources available to entrepreneurs include the following:

Bank Credit: This comes in the form of overdraft extended by commercial banks to their customers. The facility allows a beneficiary to overdraw his account up to an agreed amount for a short period of time, and it is relatively cheap and flexible as it could be liquidated before maturity. It is, therefore, excellent for working capital purposes.

Trade Credit: This is also a form of short-term financing by which one business unit buys goods from another business unit or individual but instead of making payment immediately, is allowed to defer payment until a mutually agreed time. Unlike bank credit which attracts an interest charge, trade credit does not and in normal day-to-day business transactions, entrepreneurs have found trade credit to be an important and cheap source of funding.

Factoring: This involves a business selling its accounts receivables to another business, known as a factor, at a discount. Thus the selling business gets cash much earlier than the maturity date of the receivables. It is the factor that is then saddled with the responsibility of collecting the debts in its own name and account and bears any losses contingent upon default. Thus factoring enables a business to obtain cash immediately and many entrepreneurs have found it to be an important source of funding, especially those that are cash strapped.

Hire purchase: This is a method of funding which enables entrepreneurs to purchase plant and equipment immediately and conveniently, without necessarily having all the requisite funds for the full cost of the assets. A hire purchase firm buys the asset and makes it available to the entrepreneur

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for his use. The entrepreneur then makes regular payments towards liquidating the full cost of the asset plus regular interest charges for the use of the equipment. When the full cost of the asset is settled, the asset becomes the property of the entrepreneur. Many entrepreneurs have received funding for their vital equipment and machinery in this way.

Receivables financing: This involves an entrepreneur pledging his accounts receivables to a lender who then agrees to lend up to an agreed percentage of the receivables to the entrepreneur. The entrepreneur puts the debtors on notice that their debts have been pledged as collateral. However, unlike the case of factoring where the debtors pay directly to the factor, in the case of receivables financing, the debtors make payments to the entrepreneur directly and not to the lender.

Equipment leasing: This is a method of financing that enables an entrepreneur to obtain the use of expensive assets such as plant, machinery, and equipment without necessarily having to purchase them. The owner of the equipment (known as lessor) makes the asset available to the entrepreneur (known as the lessee) who then makes regular rental payments to the lessor for making use of the equipment during the lease tenor (the period covered by the lease agreement). However, the legal title to the asset remains with the lessor.

Sale and leaseback: As the term implies, this involves an entrepreneur, who is perhaps cash strapped, selling an expensive asset to another party and then immediately obtaining it back on lease from the buyer. The entrepreneur thus becomes the lessee and the buyer the lessor. The advantage of sale and leaseback is that the entrepreneur obtains the much needed funds immediately and still continues the use of the asset, although the ownership of the asset has changed. The entrepreneur then only pays the lessor regular rental charges which are not large outlays and which are tax deductible expenses.

Sale of securities: The Nigerian Stock Exchange facilitates funding for SMEs through the sale of shares on its second-tier securities market established in 1985. However, SMEs wishing to avail themselves of this facility must first meet certain conditions known as listing requirements, which include being registered as a private limited liability company and submission of audited financial statements covering the immediate past three years, among others.

5. Requirements of lenders

Using other people's money in the form of loans, especially from the official and formal sources, calls for the exhibition of financial discipline and certain good behaviours on the part of entrepreneurs. Loan applicants should therefore bear in mind some of the following important requirements and behaviours expected of borrowers:

1. Know how much money they need.
2. The kind of financing that is good for one's business.
3. The precise purpose for which the loan is being sought.
4. The source(s) of repayment of the loan.
5. An indication of a secondary source of repayment

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6. The loan repayment schedule.
7. Adequate and good record keeping.
8. Good housekeeping – a potential lender may plan an unscheduled visit to the loan applicant's business premises to appreciate the exact location vis-à-vis its suitability, the types, adequacy, and condition of facilities; the types, adequacy, and condition of equipment and machinery; the quantity and quality of inventories; business records; employees, with respect to their general morale, disposition, appearances, how motivated they appear to be, etc.
9. Guarantor
10. The five traditional C's of credit, namely, i. character (the loan applicant's personal factors such as honesty, moral character, determination to meet obligations, willingness to cooperate with lenders, the goals of the business, etc.); ii. capacity (ability to repay the loan which could be determined from income statements of the business, etc.); iii. capital (the amount of the loan applicant's own funds has been invested in the fixed assets and working capital of the business); iv. collateral (any personal or real property against which the lender takes a lien, i.e., legal claim upon it until the loan is repaid); and v. condition (the prevailing conditions in the economy and their impact on the loan applicant's ability to repay the loan).
11. Emotional readiness for the loan.

6. Conclusions and recommendations

A variety of financial strategies abound which present and potential entrepreneurs could explore and exploit in order to obtain the vital funding needed to develop and grow their businesses. Each has its own advantages and disadvantages which the prospective borrower must be aware of. Lenders also have their own minimum expectations of potential borrowers which entrepreneurs must be conscious of in order to be prepared adequately for any loan facility. However, in view of the fact that government's financial support has much greater impact than other financing sources, it is recommended that the government should provide more funding to entrepreneurial activities of small- and medium-scale enterprises through its numerous support agencies in order to stimulate entrepreneurial development towards the realization of the nation's desire for rapid economic development.

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