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4. A Comprehensive Study on Application of Small Business Finance: Its Importance to The Small Business Sectors

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Abstract:

This article examines the economics of financing small business in private equity and debt markets. Firms are viewed through a financial growth cycle paradigm in which different capital structures are optimal at different points in the cycle. We show the sources of small business finance, and how capital structure varies with firm size and age. The interconnectedness of small firm finance is discussed along with the impact of the macroeconomic environment. We also analyse a number of research and policy issues, review the literature, and suggest topics for future research.

Keywords:

Venture capital, Small business lending, Bank, Mergers.

4.1 Introduction:

Business finance is the cornerstone of every organization. It refers to the corpus of funds and credit employed in a business. Business finance is required for purchasing assets, goods, raw materials and for performing all other economic activities. Precisely, it is required for running all the business operations.

The role of the entrepreneurial enterprise as an engine of economic growth has garnered considerable public attention in the 1990s. Much of this focus stems from the belief that innovation – particularly in the high tech, information, and bio-technology areas – is vitally dependent on a flourishing entrepreneurial sector. The spectacular success stories of companies such as Microsoft, Genentech, and Federal Express embody the sense that new venture creation is the sine qua non of future productivity gains. Other recent phenomena have further focused public concern and awareness on small business, including the central role of entrepreneurship to the emergence of Eastern Europe, financial crises that have threatened credit availability to small business in Asia and elsewhere, and the growing use of the entrepreneurial alternative for those who have been displaced by corporate restructuring in the US.

Accompanying this heightened popular interest in the general area of small business has been an increased interest by policy makers, regulators, and academics in the nature and

behaviour of the financial markets that fund small businesses. At the core of this issue are questions about the type of financing growing companies need and receive at various stages of their growth, the nature of the private equity and debt contracts associated with this financing, and the connections and substitutability among these alternative sources of finance. Beyond this interest in the micro-foundations of small business finance is a growing interest in the macroeconomic implications of small business finance. For example, the impact of the US "credit crunch" of the early 1990s and the effect of the consolidation of the banking industry on the availability of credit to small business have also been the subject of much research over the past several years. Similarly, the "credit channels" of monetary policy – mechanisms through which monetary policy shocks may have disproportionately large effects on small business funding – has generated considerable analysis and debate. Other key issues, such as the link between the initial public offering (IPO) market and venture capital flows, prudent man rules regarding institutional investing in venture capital, and the role of small firm finance in financial system architecture are just beginning to attract research attention.

The private markets that finance small businesses are particularly interesting because they are so different from the public markets that fund large businesses. The private equity and debt markets offer highly structured, complex contracts to small businesses that are often acutely informationally opaque. This is in contrast to the public stock and bond markets that fund relatively informationally transparent large businesses under contracts that are more often relatively generic.

Financial intermediaries play a critical role in the private markets as information producers who can assess small business quality and address information problems through the activities of *screening*, *contracting*, and *monitoring*. Intermediaries screen potential customers by conducting due diligence, including the collection of information about the business, the market in which it operates, any collateral that may be pledged, and the entrepreneur or start-up team. This may involve the use of information garnered from existing relationships of the intermediary with the business, the business owner, or other involved parties. The intermediary then uses this information about the initial quality of the small business to set contract terms at origination (price, fraction of ownership, collateral, restrictive covenants, maturity, etc.). Contract design and payoff structure are chosen on the basis of the financial characteristics of the firm and the entrepreneur as well as the firm's prospects and the associated information problems. High risk-high growth enterprises whose assets are mostly intangible more often obtain external equity, whereas relatively low risk-low growth firms whose assets are mostly tangible more often receive external debt for reasons explored below. Finally, in order to keep the firm from engaging in exploitive activities or strategies, the intermediary monitors the firm over the course of the relationship to assess compliance and financial condition, and exerts control through such means as directly participating in managerial decision making by venture capitalists or renegotiating waivers on loan covenants by commercial banks.

The papers in this special issue were drawn from a conference held at New York University in May 1997 sponsored by the Berkley Center for Entrepreneurial Studies and the New York University Salomon Center. They consist of full-length research papers, discussants' comments on these papers, and shorter contributions based on panel discussions. The topics span a wide variety of key issues, including venture capital and going public (Trester, 1998, Thakor, 1998; Bergemann and Hege, 1998; Lerner, 1998b; Benveniste et al.,

1998; Flannery, 1998), angel finance (Lerner, 1998a; Prowse, 1998; Acs and Tarpley, 1998), the impact of financial institution consolidation on small business lending (Peek and Rosengren, 1998; Strahan and Weston, 1998; Rosen, 1998b; Goldberg and White, 1998; DeYoung, 1998), relationship lending (Berlin and Mester, 1998; Houston and James, 1998; Pagano, 1998; Angelini et al., 1998; Kashyap, 1998; Cole, 1998; Duca, 1998), issues in credit availability (Hancock and Wilcox, 1998; Eisenbeis, 1998; Avery et al., 1998; Mann, 1998), the availability of new data sources for research on small business (Wolken, 1998; Fenn and Liang, 1998; Dunkelberg, 1998), and the future of small business finance (Gompers, 1998; Rosen, 1998a; Meyer, 1998).

This special issue and the conference on which it is based have several motivations. The first is to provide as complete a picture as possible of the nature of the private equity and debt markets in which small businesses are financed based on currently available research and data. The second is to draw connections between various strands of the theoretical and empirical literature that have in the past focused on specific aspects of small firm finance but often have not captured the complexity of small business finance and the alternative sources of funding available to these firms. The third goal is to extend research in key areas related to the markets, contracts, and institutions associated with small firm finance. Finally, we wish to highlight important issues for future research and the relatively new data sources available to address these issues.

We proceed in Section 2with a discussion of the idiosyncratic nature of small business finance, the private markets that provide this finance, and an overview of key research issues. In 3 The role of private equity markets in small business finance, 4 The role of private debt markets in small business finance, we examine more closely the extant literatures on private equity markets and private debt markets, respectively. Section 5discusses the vulnerability of small business finance to the macroeconomic environment. Section 6draws some tentative conclusions and suggests areas for future research.

4.2 Literature Review:

Perhaps the most important characteristic defining small business finance is informational opacity. Unlike large firms, small firms do not enter into contracts that are publicly visible or widely reported in the press – contracts with their labour force, their suppliers, and their customers are generally kept private. In addition, small businesses do not issue traded securities that are continuously priced in public markets and (in the US) are not registered with the Securities and Exchange Commission (SEC). Moreover, many of the smallest firms do not have audited financial statements that can be shared with any provider of outside finance. As a result, small firms often cannot credibly convey their quality. Moreover, small firms may have difficulty building reputations to signal high quality or non-exploitive behaviour to overcome informational opacity.

The private equity and debt markets we study here offer specialized mechanisms to address these difficulties. As noted above, the financial intermediaries that operate in these markets actively screen, contract with, and monitor the small businesses they invest in over the course of their relationships to help resolve these information problems. Indeed, it can be argued that the modern theory of financial intermediation – which motivates intermediaries

as delegated monitors on behalf of investors (e.g., Diamond, 1984; Ramakrishnan and Thakor, 1984; Boyd and Prescott, 1986) – is mostly a theory that applies to the provision of intermediated finance in private markets to small, informationally opaque firms.

Data on Small Business Finance:

The feature of small business finance that makes it the most interesting to study, informational opacity, also has made it one of the most difficult fields in which to conduct empirical research until recently. Small businesses are generally not publicly traded and therefore are not required to release financial information on 10K forms, and their data are not collected on CRSP tapes or other data sets typically employed in corporate finance research. Some data are collected on lending by regulated financial institutions like commercial banks and thrifts, but these data traditionally were not broken down by the size of the borrower. Although a few surveys have been conducted on small businesses, these data were not widely circulated among researchers. The lack of detailed micro data on small businesses and the funds they raise in private equity and debt markets is likely a major reason why – until very recently – small business finance has been one of the most under researched areas in finance.

However, this situation is changing rapidly, as several data sets have recently become available that make it much easier to describe the state of small business finance and to test the extant theories of financial intermediation and informational opacity. Data sets with information on US small firms include the National Survey of Small Business Finances (NSSBF) and National Federation of Independent Business survey (NFIB), both of which canvas small businesses for their balance sheet and income data and their use of financial intermediaries, trade credit, and other sources of funds. These data allow for tests of research questions regarding the cost and availability of different types of external finance and how the cost and availability vary with the characteristics of the small firms. The Survey of Consumer Finances (SCF) collects detailed financial information from households, including their ownership of small businesses, and whether they also lend to these firms or provide support through the pledging of personal collateral or through loan guarantees.

These data allow for tests of the roles of personal wealth and other personal characteristics in financing small businesses. The Survey of Terms of Bank Lending (STBL) provides detailed information since 1977 on the contract terms on some of the individual loans issued by a sample of banks, including the largest banks in the U.S. Beginning in 1997, the STBL includes the banks' risk ratings on their individual loans, and data on loans issued by agencies and branches of foreign banks (Brady et al., 1998). Bank call reports (CALL) since 1993 have provided data on the number and total dollar values of loans issued to businesses with small amounts of bank credit. Community Reinvestment Act (CRA) data that were first collected in 1997 help augment these data by giving more information on the size of the borrowers (annual revenues above versus below $1 million), and their location by census tract (Bostic and Canner, 1998). The STBL, CALL, and CRA data sources allow researchers to test the empirical connections between bank characteristics and the supply of small business credit. Detailed data on private equity markets are considerably sparser than data on private debt markets, but some progress is being made here as well. Venture Economics and Venture

One provide information on venture capital markets, data on both venture capital and angel finance may be gleaned from the NSSBF, some data on angel finance is obtainable from the SCF, and the Small Business Administration (SBA) provides some information on Small Business Investment Companies (SBICs). Details about these data sets, their uses in research, and how to gain access to them are provided in special issue panel discussions by Wolken (NSSBF, SCF, STBL, CALL, CRA, others), Dunkelberg (NFIB), and Fenn and Liang (Venture Economics, VentureOne, others).

Data on small firms and their suppliers of external finance have also been generated recently in other countries and have been used in recent research efforts. These include data from Eastern Europe (Karsai et al., 1997), Germany (Elsas and Krahnen, 1997; Harhoff and Korting, 1997), Italy (Angelini et al., 1998), Norway (Ongena and Smith, 1997), Russia (Cook, 1997), Trinidad/Tobago (Storey, 1997), and the UK (Cressy and Toivanen, 1997; Wright et al., 1997). The problems of small business finance likely apply with even greater force to small businesses in developing nations, but very little data are available from these nations (White, 1995).

4.3 Research Objectives:

a. To know the importance of business finance in business sector.
b. To know the uses or applications of business finance on account of business whether on the level of startup or establishment or expansion or modernization.

4.4 Scope:

a. Now finance has become a natural function and highly impossible partto get split from our day to day lives whether from our personal life or from any business.
b. So, this article or research will yield you the understanding of finance with its reasons why it is so important in today’s business.
c. This study will be helpful for academic researcher or research scholar for doing research or investigation on it and off course to reach out better decision like trading policies, it may be any.

4.5 Research Methodology:

In this, there is “**Descriptive & Conceptual research”**. There is used **“Secondary data”** for conducting research. As an investigator, get this data from text books, journals, articles, published or unpublished, websites, e-journal.

4.6 Data Analysis and Interpretation:

Business Finance Meaning:

Business finance is the funds required to establish, operate business activities, and expand in the future. Funds are specifically required various purchase type of tangible assets such as furniture, machinery, buildings, offices, factories, or intangible assets like patents, technical expertise, and trademarks, etc.

Apart from the assets mentioned above, other things that require funding are the day-to-day operational activities of a business. This activity includes purchasing raw materials, paying salaries, bills, collecting money from clients, etc. It is essential to have sufficient amount of money to survive and grow the business.

Classification of Sources of Funds:

Businesses can raise capital through various sources of funds which are classified into three categories.

A. Based on Period – The period basis is further divided into three dub-division.

Long Term Source of Finance – This long term fund is utilized for more than five years. The fund is arranged through preference and *equity shares* and debentures etc. and is accumulated from the capital market.

Medium Term Source of Finance – These are short term funds that last more than one year but less than five years. The source includes borrowings from a public deposit, commercial banks, *commercial paper*, loans from a financial institute, and lease financing, etc.

Short Term Source of Finance – These are funds just required for a year. Working Capital Loans from Commercial bank and trade credit etc. are a few examples of these sources.

B. Based on Ownership – This sources of finance are divided into two categories.

Owner's Fund – This fund is financed by the company owners, also known as owner's capital. The capital is raised by issuing *preference shares*, retained earnings, equity shares, etc. These are for long term capital funds which form a base for owners to obtain their right to control the firm's management and operations.

Borrowed Funds – These are the funds accumulated with the help of borrowings or loans for a particular period of time. This source of fund is the most common and popular amongst the businesses. For example, loans from commercial banks and other financial institutions.

C. Based on Generation – This source of income is categorized into two divisions.

Internal Sources – The owners generated the funds within the organization. The example for this reference includes selling off assets and retained earnings, etc.

External Source – The fund is arranged from outside the business. For instance, issuance of equity shares to public, *debentures*, commercial banks loan, etc.

Sources of Funds Example

The sources of business finance are retained earnings, equity, term loans, debt, letter of credit, debentures, euro issue, working capital loans, and venture funding, etc.

What is meant by Finance?

The large amount of managing money or cash, basically by huge private and government entities or organization is said to be Finance. It confines with the study and creation of such as –

Money matters.

Banking system.

Credit system.

Investments system.

Assets and Liabilities.

This combination of all together that makes up Financial Systems. Finance can be superseded by the word Exchange. It is therefore said as exchange of available resources or art of managing various types of resources. Finance is so important today, it is said to be as soul of all our economic activities.

Finance is a necessity for acquiring physical resources, which are very important and needed to accomplish productive economic activities and for carrying business functionalism such as–

Sales Promotion.

Pay Compensations.

Unconfirmed Liabilities.

Reason for uncertainty and many more.

Now in today's situation, finance has become the most important natural function and inseparable part of our daily life process. Finance in more specific is solicited with the management issues such as –

Owned funds generated from promoter contribution.

Raised funds generated from equity share, preference share, etc.

Borrowed funds generated from loans, debentures, overdrafts, etc.

Finance also at the same time, confines greater approach of managing the assets generated by the business and other valuable liabilities with better organized fashion. There are 2 main types of finances such as –

Debt finance is money borrowed from external source like bank.

Equity finance were investing your own money from other stakeholders, interchange for partial ownership.

FINANCE CONSISTS OF 3 INTERCONNECTED AREAS SUCH AS –

Management of financial status which involves clarifications and decisions made within the organization.

Credit and money markets which deals with the financial institutions and with business securities.

Investments of money which focuses on made by both institutional investors and individuals decisions.

IN PERTAINING TO ANY ENTITY'S MANAGEMENT DECISIONS THERE ARE 3 TYPES SUCH AS –

Working Capital Management.

Capital Budgeting.

Capital Structure.

Finance is the functional process of business which helps to meet its goals and objectives with responsibilities for acquiring funds for the companies, managing the funds within the companies and planning for the expenditure of funds on various business aspects.

Now 5 reasons why Finance is important in today's business?

Managing finances is a very important business aspect of today, which means having a chance to work toward a stable and rewarding career in financial management field. Financial planning helps in deciding what to spend, when to spend, how to spend and how much to spend according to the funds availability. Here are the below given 5 reasons on importance of finance in today's business such as –

Without financial management business cannot exists

In today's business economy, Small businesses and Entrepreneurship are more on rise that means more positions for financial managers will continue to become much more available. Without an eligible person responsible to manage the incoming and outgoing of money a good business cannot exist.

As good business generates money, through this generated money paying bills for materials, payment of salary for the employees in an organization are done. Good business earnings

happen by selling quality services or products. Managing financial aspects plays a very vital role in progress of any good business.

Adequate funds availability

Sufficient funds are necessary to meet daily expenses to purchase long term assets for the company's requirement accordingly; also funds should be there to deal with future unforeseen over costs which may arise. The company should know from where the funds have to be raised and when it should be needed in emergency to deal the monetary crisis.

Cash flow management system

In an organization, excess cash flow can also become difficult to manage. Having excess amount of funds and not using it in a genuine much useful way is a greater waste of resources. When an organization is having adequate funds they should put it in good yielding investments by thinking very wisely. And also make sure that they have expansion future plans and think about new ventures which will gain them huge profits to earn for the long run.

Always keeping long term goals

Having long term goals in life or business is a very important aspect to keep, once it is done the responsibility has to be fulfilled as per the plan made at any cost to get fulfil the targeted goals to achieve success. In any business entity, financial planning is a process of engaging a proper financial plan to meet its financial goals in a specific time period.

To have long term financial goals in a business is a very important part, were by doing this many upcoming financial crises in future can be resolved without any hassle. It is always a good idea to have an early well planning goal, especially in finance since investing on any good options may earn high returns over the period of time to the company to gain financial stability. So investing money with good thoughtful planning from now will make easier to execute such long term goals.

Financial Planning value and importance in a business

Financial planning creates immense value to the company, without this any of the business entity cannot function properly. It is a major vital venture for all kinds of businesses worldwide. It is done for an entire year to have control over financial activities of the company. The bigger the company, the bigger will be the size of the team working on financial planning and the greater skilled professionals needed.

Financial planning needs the entire support of accurate financial analysis and reporting. It has to be done continuously, with this the outcome of the plan also need to be monitored regularly. In any case the approved plan is not working, then the plan has to be modified instantly or new plan has to be made and adopted with immediate effect to run the business successfully without any kind of hindrance occurring in between.

THERE ARE 6 PROCEDURES WHICH HELPS IN EXECUTING THE FINANCIAL PLANNING OF ANY BUSINESS SUCH AS –

Effect of plans evaluating on stock price and financial quotient.

To raise the funds identifying exact means to execute systematically.

Proper forecasting of sales.

Estimation of assets required for supporting sales.

Estimation of generated funds within the company.

Estimation required for external funds.

Financial planning always should start before the beginning of any project and should be carried throughout its functioning period of time to have strong control over the finance.

Managing business finances is imperative, and mismanagement can lead to a massive threat to the business itself. Business finances are a vital part of any company. And managers need to keep track of their finances and make sure that they are not mismanaged.

One-way business finances can be mismanaged is through a lack of financial transparency among the owners and the employees. Another way it can be mismanaged is by overspending on various campaigns and not assessing the ROI on various campaigns.

This type of overspending and negligence wastes money and can lead to poor ROI in the long term. Having a proper tracking system in place can help to avoid these types of issues.

To know more about business finance and how mismanagement can be avoided, you need to know what business finance is, the definition, the meaning, and how important it is for an organization.

Business finance is the field of finance that deals with the acquisition, use, and management of capital by business entities.

It is a broad term that can describe the financial management of any entity, including corporations, partnerships, sole proprietorships, non-profits organizations, and government agencies.

It covers all aspects of financial management, including accounting, taxation, investments, financing, and the use of debt. The finance for a business comes from various sources. Some of the sources include the company’s profits, investments, and revenue.

The meaning of business finance can vary depending on the context. For instance, it might be about managing cash flow and inventory in a manufacturing company, while in an investment bank, it might be about understanding how to make money from trading.

Importance of Business Finance:

Business finance can be daunting, especially for new businesses and start-ups. But there are some ways that you can use to make the process easier and less time-consuming.

The importance of business finance is essential for every business to succeed and only by knowing its implications on the company's revenue and growth and the various elements it includes can help in understanding its importance.

A. Financial Statements:

Financial statements are a great way to monitor the performance of a company. They provide information about the company's financial standing and how they are doing financially.

They serve as a reliable source of information for investors, creditors, lenders, and other stakeholders. Financial statements also provide insight into how much debt a company has and its future financial outlook.

B. Tactical Planning:

Many businesses have a hard time managing their finances. This is because they have to spend time on things that don't contribute to the company's revenue. However, strategical planning can help businesses make more money by having a clearer vision of what they are doing and where they are going.

This is because strategic planning helps businesses make more money by having a clearer vision of what they are doing and where they are going. It also helps them get rid of bad investments, which often lead to financial losses, and focus on their strengths instead.

C. Promotion and Advertisement:

Promotion is a word that most businesses have heard before. However, not all businesses know what promotion means and why it's good for their finances.

Promotion means advertising your product or service to the public to increase awareness and demand for it. It can also mean spreading the word about your company through social media or hosting events where people can learn more about you and your company.

D. Finance:

Finance is important in strengthening business finance because it helps companies take risks and grow. Businesses could do what they wanted without any financial support in the past.

But now, with the increased use of technology and globalization, businesses are becoming more reliant on money to accomplish their goals. Finance is also important in strengthening business finance because it allows companies to take risks and grow.

With the increased use of technology, people are also becoming more reliant on money to accomplish their goals. Finance is important in strengthening because it allows companies to take risks and grow.

4.7 Conclusions/Findings:

Business finance plays a massive role and can positively impact an organization. If finances are taken care of, they can eventually help any company take a better turn towards success. Educate yourself and let this knowledge assist you in bringing more to your company's table.

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