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Financing Young Entrepreneur through Venture Capital: Preliminary Research Report

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Abstract

The trends of the economy of every nation are changing rapidly. People want to become more and more independent in the context of business because of economic instability. Everyone wants to be the head of their own work. So, Entrepreneurship is the need of time. Considerable research has been carried out in the developed countries within the discipline of entrepreneurship, venture capitalism and angel investment; however, no such study is carried out for Pakistan. This research work attempts to identify and analyze the factors of growth and risk associated to bridge the gap between Young Entrepreneur and Venture Capitalists in Pakistan during their startup phase. An extensive literature review was carried out to develop a structured questionnaire. Factors affecting the entrepreneurial inclination and communication between young entrepreneur and venture capitalist in the form of business plans/ ideas were identified through interviews with entrepreneurs having their businesses established in Pakistan. The impact of their response is analyzed in this study using Statistical Package for Social Sciences. Through this research it is intended to present a guideline viable for entrepreneurial culture in Pakistan.

Keywords: *Venture Capital, Angel Investors, Seed money*

1. Introduction

Pakistan is a unique country with a strong potential to be an entrepreneurial nation. According to Economic Survey 2010-11, the population of the youth of Pakistan in age bracket 20-44 is 31.77 million in 1998 and it has grown double in 2010 which is 63.66 million, showing that the country is being enriched with the youth potential. The estimated youth population is 74.41, 83.69, 90.98 and 97.28 million for the year 2015, 2020, 2025 and 2030 respectively. One of the success factors of every nation depends upon its youth. So, it can be assumed that Pakistan has the capacity to face any kind of challenge for development by promoting its youth.

According to the economic survey 2010-11, Pakistan has a moderate urbanization growth rate and every year it is growing constantly. The urban annual growth rate of Pakistan in 2010 is 2.97 % and its projected growth rate in 2030 is 2.97% depicting the moderate level in the development

of cities. The civilian labor force participated in the economy of Pakistan is 45.5 million which has been undeniably increased in 2009-10 with 54.92 million. The Employment participated in the country was 42 million in 2003-04 and now it has increased to 51.87 million in 2009-2010 which is slightly better. So, it has proved to some extent that the economy of Pakistan has no capacity of self-employment because of the increase in the labor force, so the trend should have to be changed now. Because the Employment Status for the year 2009-10 for both rural and urban has supported employers by 0.65 million, self employed by 17.75 million, unpaid family helpers by 15.10 million and employees with 18.37 million with a total of 51.87 million greater than 2008-09 which was 50.79 million.

While both male and female employed participants have driven the economy of the country. According to the economic survey 2009-11, the employment status of male employer is 1.6 million and female is 0.1 million. While male self employed are 40 million and female 13.6 million. The male employees contributed 39.7 million and female, 20 million in the economy of the country. So, stated these facts and figures, it should be emphasized that Entrepreneurship should be encouraged. There is a need to develop entrepreneurial culture in Pakistan.

Lahore and Islamabad are the two main urban cities of Pakistan where the educated potential has existed. Self-employment lacks over the period of time. People want to be the head of their own work so they are planning to establish some business. Most of them are unable to do so due to lack of capital or seed money, they need some investors to invest in their business ideas/plans.

These investors are called Venture Capitalists or Angels. In current business world, it is very difficult for the new or young entrepreneur to get their ideas financed through venture capital because of the growth and risks involved in the business. Many studies have been conducted in Asia to bridge the gap between both sides.

A major portion of Young Entrepreneur in Pakistan fails to get the perfect funding for their projects and financial capital similarly VCs fail to get perfect human capital. However this study would investigate the identification of those factors which are the key elements in the decisions on both the sides as well as survival of young entrepreneurs in Lahore and Islamabad.

A) Problem Statement

A majority of educated young individuals in Pakistan are graduating every year but unfortunately majority of them are not familiar with the venture capital and angels of their region and they don't even know how they can be known to them, resulting failure to finance their ideas. Many studies have been conducted to identify the solution for this problem. But the review of these studies is in process.

The main problem identified from the current scenario is:

- Conflicts between VC and Young Entrepreneur
- Communication gap

B) Scope and Objectives

- To investigate to what extent the ideas of young entrepreneur matter in the business world without capital.
- To propose measures to bridge the gap between Venture Capital and Entrepreneurs.
- To intimate the policy makers about the inefficiency of Human Capital within Lahore and Islamabad.

C) Research Questions

- How the ideas of young entrepreneur matter in the business world without capital?
- Why Venture Capitalists have inefficient allocation of human capital?
- What measures should be taken to bridge the gap between Venture Capital and Entrepreneurs?
- How policy makers should be intimated about the inefficiency of Human Capital?

2. Review Of Literature

A study has been done on “what makes a true entrepreneur”, just motivation factor makes the potential entrepreneur? It was found by Vivarelli et al (2004) that business ideas with reliable information and motivation can lead to potential entrepreneur. This was done with the help of interview from 365 potential Italian entrepreneurs and then related their characteristics to actual decision to start a new firm. Wincent, Thorgren, Bergh (2011) indicated that how building and trust can be developed in entrepreneurial activities. This was analyzed with the help of qualitative data which was based on commitment, companionship and competencies. A theoretical framework was designed for the interpretation of results. This study can be beneficial in the startups regarding seed capital from venture capitalists. Because venture capitalists don't trust on young entrepreneur's ideas, so this study has proved beneficial in this context.

As it is a known fact that exporters play a vital role in boosting of economy so this study basically emphasizes the financing of small sized entrepreneurs and firms. The results are drawn by taking a couple of samples, one of exporters and other of non exporters, analyzing their financing needs with the help of a survey and concluding results from these hypothesis. And the results are in the favor of exporters because they are actually in a need (Riding, A et al 2010). So, the results have stated that not only young entrepreneur but small sized firms are also not only in the need of capital but also trust from the investors/ venture capitalists.

Praag (2003) revealed that with the help of descriptive statistics, duration analysis model, we can better estimate the duration of survival in the business along with the risks and moral hazards concerned with the duration. This study was proved beneficial for the quantification of perfect duration of business survival to the young entrepreneurs about their startups. Approximately similar study by Davila, Foster & Gupta (2003) argued that the relationship between venture capital and employee growth of startups like timely funding etc can be easily estimated with the

help of signaling theory. His results identified those signals which are responsible for the growth of the startups.

Entrepreneurial Behavior matters in such situations. William, Norton, Moore, (2006) studied the influence of entrepreneurial decisions on the risk assessment of the growth of venture growth decisions by proposing a test on model of risk assessments predicted through entrepreneurial behavior. Risk is an important factor in the entrepreneurial decisions; hence this study is proved helpful in understanding risk attributes of the entrepreneurs.

Guidice and Mero (2007) determined the results of another side of the picture which is the logic behind the decisions in corporate governance backed by parents when issues of power generate in this dilemma. So, to investigate this, the study was conducted with the help of propositions, which helped in better understanding of this whole scenario.

3. Research Design and Methodology

It is an exploratory study and reports the findings of the Questionnaire Survey and Interviews of key participants. This study would give a clear picture to the young entrepreneurs about their current position and expected future in the new business world.

On the other hand, it would give an understanding to Venture Capitalists on how to utilize perfect human capital from the young ideas. This would address them the real issues of the young entrepreneurs and the possible expected outcomes.

This study would also be intimated to the policy makers about the inefficient allocation of human and financial capital and the possible solutions.

The key participants involve the Venture Capitalists, Entrepreneurs and the Potential Business, Economics and Finance students of the graduating batches. The study is conducted within the vicinity of Lahore and Islamabad as the large number of entrepreneurs and venture capitalist are available there.

1) Questionnaire

The questionnaire is developed keeping in view the important research work done by the researchers in the related field of Entrepreneurship taken from the students.

- The questionnaire is divided into two parts, first part included questions about respondent's name, name of the University, No. of years in the University.
- Second part consisted of their entrepreneurial inclinations, mindset and their future decisions regarding it. Along with their recommendations.

After reviewing the literature, the questionnaire has been chosen as the Principle Survey Method.

2) Interview guide

The interview guide is designed for the Venture Capitalists and the potential investors in Lahore and Islamabad to explore their opinions in this context. (Appendix 1)

4. Preliminary Data Analysis

Statistical Package for Social Science (SPSS-17) has been used to analyze collected data. The study follows the level of significance i.e. 0.05 with, 0.01 being highly significant.

Questionnaire survey is one of the most important primary sources of data collection. So this primary data has been collected on the basis of some variables which have been identified with the help of review of literature and theoretical background which states the main theme of the research that:

The basis is the prior knowledge, entrepreneurial inclinations, and mindset of graduating business students influencing the potential opportunities, potential to grab knowledge, capability of selling ideas, business plans, managing risk attitudes lead them to recognize themselves as an emerging entrepreneur for the development of entrepreneurship in the country.

After collecting data from 200 samples, consisting of the graduating business students studying in HEC recognized universities of Lahore and Islamabad, the following statistics have been analyzed on the basis of questionnaire survey.

According to the survey, 77.7% of the sample is going to choose their career as an entrepreneur, from which 23.8% are actively concerned. They preferred to start their own business rather than employee in the country which is going to be a good trend in the country as unemployment is ruining the capabilities of the young people. A portion of 23.3% people have a strong intention to start and run the business once they will be free from studies. The results indicate a pretty much high entrepreneurial inclination and mindset in them.

So, from the above facts, the entrepreneurial inclination has been existed among the youth but the question here is that can their prior knowledge and skills help them to initiate their business?

The answer concluded from the survey states that 60% of the sample trusts their prior knowledge in starting their venture which shows their confident attitude towards the startups but unfortunately 95.1 % of them don't even know about how to finance their business, in true sense they don't even know what venture capitalist is. Similarly, they don't have any idea about them in their cities. So, they have no clear idea about how to grab the opportunity from them, how to sell their ideas. They lack all these qualities to cash their idea which need to be addressed to the academicians. The issue is not with their mindset but their educational content which need to be strictly overlooked.

The statistics from the survey have shown the entrepreneurial intentions, strong potential, intensity to grab opportunities among the young individual but a very little knowledge about on how to get finances. About 34.9 % thinks that this problem should be addressed to the government of the country to take some measures to spread the word on national level.

This leads to the question that what should do in this context to get them recognized to the venture capitalists of the region and how to approach them? Because the young potential is there, efficient human capital is also existed, the only need is to give them entrepreneurial education and address these issues at national level in order to promote the Entrepreneurship in Pakistan.

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