

The Development of Entrepreneurial Finance Research

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ABSTRACT

The development of research in entrepreneurial finance is apparent in the proliferation of work focusing on the financial aspects of entrepreneurship; a field of management science which is beginning to organise itself along the same lines as other existing fields such as strategy, marketing or finance. British/American style entrepreneurial finance can be easily confused with the field of venture capital in its broadest sense (integrating the different categories of investors such as business angels or corporate venture, and institutional aspects which could have a bearing on this type of investment). But our study shows that over time the field of entrepreneurial finance has expanded. Researchers are now interested in other phases of company development, before venture capitalists come on the scene, or after they have left, but there is also interest in firms which are not financed by this type of investor.

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I. INTRODUCTION

The development of research in entrepreneurial finance is apparent in the proliferation of work focusing on the financial aspects of entrepreneurship; a field of management science which is beginning to organise itself along the same lines as other existing fields such as strategy, marketing or finance. This surge in interest is reflected not only by the increase in the number of research papers on entrepreneurial finance being published in the main financial journals but also by the appearance of scientific magazines, books and conferences dedicated to this field such as *Venture Capital journal* (1999), *The Journal of Entrepreneurial Finance and Business Ventures* (2000), or the annual conference of *The Academy of Entrepreneurial Finances* (1989).

According to Denis (2004), entrepreneurship had long been regarded by finance researchers as a separate field from corporate finance due to the presupposition that problems encountered in entrepreneurial finance are sufficiently different from those faced by listed companies as to limit the applicability of traditional financial theory. However, more recently, financiers have recognized that entrepreneurial situations are characterized by the two same fundamental problems which are at the root of financial theory: agency dilemmas and asymmetric information. Entrepreneurial finance differs from traditional corporate finance only in that the importance of these problems is greater, necessitating recourse to contractual solutions distinct from those put in place in larger, more established companies. Initially confined to the study of four main fields (alternative sources of capital, financial contracting issues, public policy issues, risk and return in private equity investments), entrepreneurial finance now explores a broader range of fields.

In order to better understand the importance of financial fact in entrepreneurship, it is advisable to first define entrepreneurship itself. Several authors such as Schildt *et al.* (2006) have defined entrepreneurship by its paradigms such as: business opportunity, the creation of an organization, value creation, innovation, and entrepreneurial risk. But whatever the paradigm selected, entrepreneurship and finance are inevitably dependant because entrepreneurial projects require resources. The acquisition of these resources depends on the capacity to finance them. This involves looking into the financial dimension of entrepreneurial projects.

Faced with the obvious links between entrepreneurship and finance, several questions arise. What is entrepreneurial finance exactly? What are the issues surrounding it? What research has been or is being carried out in this area?

To answer these questions, we will approach them from two different angles. Firstly we will try to specify the scope of entrepreneurial finance by identifying the issues surrounding them which have already featured in published research work. Then, we will attempt to structure the studies done in this field and suggest some lines of research.

II. HOW IS THE FIELD OF ENTREPRENEURIAL FINANCE DEFINED?

How can one define the field of entrepreneurial finance? Several studies have attempted to present the different themes and topics, or to summarize results obtained in the field of entrepreneurial finance (or within the narrower area of venture capital). On initial analysis, examining these works closely can help identify the chosen lines of research

and thus gain a greater understanding of the field of entrepreneurial finance. Three studies have been retained. They are studies by Brophy & Shulman (1992), Saint-Pierre and Mathieu (2003) and Denis (2004) which provide details of more recent developments.

Brophy & Shulman (1992) consider that venture capital is a field which provides the hub between finance and entrepreneurship. They identify several specific areas of research:

- the characteristics of investors in new ventures: the company creator and his team, informal investors (business angels), and formal investors (venture capital).
- the characteristics used by investors as selection criteria for new projects and the ex-post factors associated with the success or the failure of the new firms, whether concerning operational success or financing;
- the investment process, including the negotiations and the structuring of the deals, the appraisal of new ventures and monitoring participation;
- the issues involved with the exit of investors, including the sale of all or part of the firm, whether through strategic alliance, merger, divestment, organization of a LBO or by going public.

Saint-Pierre and Mathieu (2003) published a very detailed synopsis of the results of research relating to venture capital. They identified six themes:

- The role of venture capital in economic development, legal frameworks and investor sources.
- How the venture capital market works: financing decisions, measuring risk, contractual aspects.
- The comparison between firms financed by venture capital and those which were not (performance, sales, job creation, level of innovation, etc).
- The impact of the venture capital company on the company they financed.
- The impact and the rate of survival of the firms financed by VC after divestment by the venture capital company.
- New trends.

Denis (2004), in a summary focusing on entrepreneurial finance published in the *Journal of Corporate Finances*, chose the following themes:

- Contributors of capital, including venture capital, business angels and corporate venture.
- The problems surrounding financing contracts, including signaling and agency dilemmas.
- The influence of public policies, including the development of financial markets and fiscal policy.
- Returns on investment and risks involved when investing in new ventures.
- Other lines of research.

Table 1
Main themes in the field of entrepreneurial finance

	Brophy & Shulman (1992)	Saint Pierre and Mathieu (2003)	Denis (2004)	Authors' definition
GENERAL THEMES				
Behavioural finance and SME				X
SME finance issues				X
Alternative source of capital	X		X	X
INVESTORS CHARACTERISTICS				
Business angels	X	X	X	X
Venture Capital	X	X	X	X
Other investors (LBO funds, public funds...)		X	X	X
INVESTMENT				
Investment criteria	X	X	X	X
Investment decision process	X	X	X	X
Business models and firm evaluation	X	X	X	X
Financial contracting issues	X	X	X	X
RELATIONSHIP VENTURE CAPITAL/FIRM				
Governance and control	X	X	X	X
Determinants of venture capital activity	X	X	X	X
Impacts of venture capital activity	X	X	X	X
EXIT STRATEGIES				
IPO, MBO, LBO...	X	X	X	X
RISK AND RETURN				
Performance of firms financed by private equity	X	X	X	X
Performance of private equity	X	X	X	X
Success/failure criteria	X	X		X
OTHER THEMES				
Influence of technology		X		X
Public policy incentives and issues	X	X	X	X
Rule of stock markets		X	X	X
Start-up business development				X

Source : summary carried out by the authors.

As a starting point, we used the three contributions above; studies which have been published since, and themes chosen by the Academy of Entrepreneurial Finance for its annual conference (<http://www.aof.org/>). In the table below we have summed up the different themes encompassed by the field of entrepreneurial finance.

This summary requires two comments. Firstly, British/American style entrepreneurial finance can be easily confused with the field of venture capital in its broadest sense (integrating the different categories of investors such as business angels or corporate venture, and institutional aspects which could have a bearing on this type

of investment). Secondly, one can notice that over time the field of entrepreneurial finance has expanded. Researchers are now interested in other phases of company development, before venture capitalists come on the scene, or after they have left, but there is also interest in firms which are not financed by this type of investor.

III. OBSERVATIONS AND LINES OF RESEARCH

In this section, by defining the field of entrepreneurial finance we will suggest a framework for organizing the work done in this research area. Then, we will suggest new lines of research.

A. Structuring the Work Done in the Field of Entrepreneurial Finance: A Double Tropism

Firstly, we proceeded with an analysis of the distribution of work on entrepreneurial finance according to the main themes, which enabled us to highlight a double orientation in this field of research.

Our analysis of the distribution of academic works relating to the main themes of entrepreneurial finance used as a starting point the bibliographical databases from SSRN.com (listing mainly unpublished articles and writings) and EBSCO (primarily articles published in academic peer review journals). The themes retained were the following: small business finance, SME finance, private companies finance, start-ups, entrepreneurial finance, corporate venture, venture capital, private equity, IPO, and Business Angels (Table 2).

Table 2
Cartography of research in entrepreneurial finance

Keyword	Abstract All journals	Abstract Scientific journals	Titles Scientific journals
Small business finance	86	35	21
SME finance	5	4	4
Private companies finance	0	0	0
Start-ups	10 916	1 569	375
Entrepreneurial finances	33	13	9
Corporate Venture	238	89	48
Capital venture	14 053	1 286	557
Private equity	19 873	771	263
IPO	9 586	1 086	564
Business Angels	188	61	54

Source: extraction from Ebsco Database on May 29th, 2008 carried out by the authors.

It appears from this analysis of published works that research in entrepreneurial finance shows a double orientation. The first orientation is a focusing of works on venture capital financing. Indeed, the results show a strong concentration of research work on venture capital. This is despite the fact that figures from the Global Entrepreneurship Monitor (GEM 2007 Report) measuring the entrepreneurial phenomenon worldwide, show that overall financing by venture capital only represents \$21.2 billion invested in 2514 firms, compared to \$1078 billion of informal investment in millions of newly created companies.

It becomes clear that there is a significant gap between the preoccupations of researchers and realities on the ground, characterized by the prevalence of 'ordinary' companies, for which a more informal financing prevails. Moreover, the bulk of research in entrepreneurial finance looked at American firms and American investors. However, venture capital is also well developed in many other countries.

The second orientation refers to a concentration of works on the later stages of the entrepreneurial adventure. An examination of the literature shows that researchers show greater interest in the later stages of the development of new ventures. The results of the extraction of EBSCO data testify to the number of works devoted in particular to venture capital financing and to the comparative performance of new ventures which have depended on this type of financing as opposed to those which have not. Many studies have been devoted to issues surrounding new ventures which go public. Comparatively little work has been devoted to financing early stages of the entrepreneurial adventure (what financial contribution do entrepreneurs need to launch their projects? Does it depend on their age, training, professional experience? Does it depend on the type of project?). The lack of work devoted to Business Angels is also regretted (Denis, 2004).

B. Future Lines of Research

This analysis of research in entrepreneurial finance highlights several lines of research which deserve to be developed further given their contribution to the understanding of the entrepreneurial phenomena.

1. Financing needs of new firms

Saint Pierre and Mathieu (2003) remark on a lack of knowledge about new firms' financing requirements, according to the type of business, the degree of risk, the stage of development, the financing alternatives, the development potential (export, expansion, innovation), etc. These lines of research could be linked to other researches on the merger of personal and professional assets, belonging to company creators, and CEO entrenchment.

2. Sources of alternative financing

Denis (2004) estimates that up until now the bulk of research in entrepreneurial finance related to companies financed by venture capital. Studies on the role of sources of alternative financing, such as Business Angels, corporate venture or from individual operators (such as the business incubators) would make it possible to improve our overall knowledge of the funding of new ventures. This research will allow us to look

into the optimal balance between the sources of funding for early stage companies and to better understand how corporate venture or business incubators can be integrated in this balance.

3. Contracts between creator(s) and financier(s)

Although many studies have already been devoted to it, the question of the optimal contract between creator(s) and financier(s) (in particular venture capital) still needs to be looked into more deeply. Information asymmetries which can occur between the different parties could cause conflicts of interests (Denis, 2004). This issue encompasses the nature of contracts, restrictive clauses, the costs of financing, monitoring the investment, etc. (Rassoul, 2006).

4. The role of the legal and institutional environment

The role of legal and institutional environments deserves to be looked into more closely, in particular the establishing of optimal financing contracts (Denis, 2004), but also the intervention of the State in high-risk firms despite their strong potential (innovation, start up,...), or about the existence of a stock market for SMEs with strong growth (Saint-Pierre and Mathieu, 2003).

5. Innovating firms

Another line of research is to make an in-depth analysis of the characteristics of innovation projects and firms with a high level of intangible assets: their development phases, risk, contract, rate of success, etc. (Saint-Pierre and Mathieu, 2003).

At the end of this presentation, several conclusions can be drawn. Entrepreneurial finance is developing as a field of research with two main focuses. For researchers in entrepreneurship, it means taking the financial element more into account as it is indissociable from entrepreneurial fact. For financiers', the specific requirements of entrepreneurial situations have been better recognized and an increasing amount of work is being dedicated to this area. However, the analysis of studies on entrepreneurial finance reveals a double tropism or orientation: on the one hand, a focusing of publications on topics related to financing by venture capital, on the other hand a concentration of works on the early stages of the entrepreneurial adventure (entrance of investors, IPO). However, this type of questioning only concerns a very small portion of new ventures. The new lines of research which we suggested would enable a better understanding of the indissociable links between finance and entrepreneurship.

This issue aims to explore these lines of research in entrepreneurial finance. It includes the four following contributions:

- “The Impact of Business Model Characteristics on IT Firms’ Performance” (Rédis, 2009)
- “International Comparison of Entrepreneurial Sub-Cultures within Cultures: Effect of Territory on Entrepreneurial Strategies for Fundraising” (Rantanen and Bernasconi, 2009)
- “Active Financial Intermediation and Market Efficiency: The Case of Fast-Growing Firms Financed by Venture Capitalists” (Lantz and Sahut, 2009)

- “The Impact of Corporate Governance on the Performance of U.S. Small-Cap Firms” (Switzer and Tang, 2009)

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