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ENTREPRENEURIAL PROJECTS' DEVELOPMENT: ALTERNATIVE SOURCES OF INVESTMENTS

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Abstract. This study aims at researching the possibilities of using alternative sources for financing small and medium-sized business projects. The main study method is a survey of 275 experts who are heads of small and medium-sized enterprises of the Republic of Kazakhstan. According to the obtained results, the access to financing is an urgent problem for most enterprises. Bank loans and overdrafts remain the main sources of attracting investments for the implementation of development projects. At the same time, a considerable number of companies that need financing were not able to obtain a bank loan or failed to obtain the full amount of the requested funds, and only a small part of the companies managed to raise the required bank financing. Companies face particular difficulties when attracting investments in startups. Despite the fact that nowadays there are many new options for financing startups, Kazakh entrepreneurs do not use them actively. In order to increase the chances for obtaining funds, companies must more actively attract alternative sources of financing for new projects. According to the survey, the most relevant sources of alternative startup financing for Kazakh entrepreneurs have been identified. These are grants, business angel financing, and crowdfunding. When implementing startups, companies can choose the most suitable financing option, or use several options.

Keywords: investments; financing; financial resources; credit, financial services market; small businesses

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1. Introduction

All entrepreneurs know that one of the biggest risks of owning and managing their own business is a financial risk. The first two years of a new business are crucial because almost two-thirds of the established companies fail during this critical period and stop their activity (Batashev et al., 2020). A new business cannot pay for personnel, materials, inventory, or marketing without a sufficient cash flow. If an entrepreneur does not have the resources to personally finance a business, financing needs to be arranged.

The sufficient access to the capital is one of the most important obstacles to overcome when establishing and developing a new business. Taking into account the important role of the entrepreneurship in ensuring the economic growth of the country, it is still not surprising that the strive to dilute the financial constraints faced by potential entrepreneurs is an important goal for central bodies around the world (Mazurina et al., 2020; Tarkhanova et al., 2020; Biryukov et al., 2020; Karshalova et al., 2018).

For example, in order to solve the problems of attracting financing, the government of the Republic of Kazakhstan pursues the policy aimed at developing and supporting the entrepreneurship. The measures of financial support for the entrepreneurship include loans from second-tier banks and microbanking, loans from the budget funds, partial guaranteeing of loans, leasing, etc.

At the same time, there is still a considerable gap between the need of business in investments and their actual offer. The lack of access to loans is one of the most important problems faced by Kazakh entrepreneurs because they are limited by the lack of collateral, the absence of the past experience of business valuation, and the occasional lack of the related experience.

Although bank lending is the most common source of external financing for many entrepreneurs, subject to considerable dependence on investment needs, traditional bank financing often creates problems for new, innovative, and rapidly growing small and medium-sized enterprises (SMEs) that have higher risk-return profile.

At the same time, in the world practice, there are alternative sources of investments that create an additional opportunity to raise funds. The strive of SMEs to improve the capital structure and reduce their dependence on borrowed funds substantiated the reasonability of studying alternative sources in financing entrepreneurial projects (Dudin et al., 2020; Auyezkhanuly et al., 2019).

Alternative sources of financing have not yet become widespread in the Republic of Kazakhstan due to the lack of active sites and investors, as well as the lack of government regulation instruments. At the same time, the use of alternative instruments will ensure the required financing of entrepreneurial projects by attracting private and currently inactive capital.

2. Literature review

The world of banking and financial services continues to change rapidly, and alternatives to traditional products and services are introduced more and more often (Daskalakis et al., 2013). Previously, financial technologies could be considered as applications of traditional financial services to the existing technologies, but today there are financial innovations with the involvement of previously unused markets (Abdulsale & Worthington, 2013).

Over recent years, the increasing number of financing options has become available for SMEs, although some of them are still at the early stage of development or are available only for few SMEs.

Alternative financial strategies are more and more important in assisting enterprises to meet their financial needs in the growth and contributing to the economy (Block et al., 2018; Serikbaeva et al., 2019).

Since the debt financing provides moderate return for lenders, and therefore it is suitable for low-moderate risk profiles, i.e., the companies that are characterized by stable cash flow, moderate growth, proven business models and access to collateral or guarantees, alternative financial instruments change this traditional risk sharing instrument (Eniola & Entebang, 2015).

These instruments consist of numerous and competing sources of financing for SMEs, including asset-based financing, alternative forms of debt, hybrid instruments, and equity instruments.

The transition to alternative financing channels is a reorientation to appropriate restructuring of debt and equity capital by providing the hybrid capital structure with a different degree of risk and return (Lawal et al., 2018).

The reasonability of using alternative sources of project investment depends on the risk-return profile, the stage of the business life cycle, management structure, and financial skills (Table 1).

Table 1. Suitability of Alternative Financial Instruments for Various Profiles and Stages of the Company's Activity

	Type of financial instrument	Company's Profile and Stage
Low risk/return	Asset-based financing (Kolpak et al., 2016; Bilgin & Dinc, 2019; Mol-Gomez-Vazquez et al., 2018; Zhang et al., 2019) – Asset-based lending – Factoring – Financing a purchase order – Warehouse certificate – Leasing	Startups Limited credit and no collateral firms Fast growing and strapped companies Companies with a solid customer base but high investments in intangible assets Venture and information-opaque companies Companies that often change their capital assets Commodity Producers and Traders
	Alternative financing (Parnes & Nippani, 2019; Gürtler & Neelmeier, 2019; Carbó-Valverde, Rosen & Rodríguez-Fernández, 2017) – Corporate bonds – Securitized debt – Mortgage bonds – Private placement	Large and medium-sized companies with stable profits and relatively low cash flow volatility Companies investing or using growth opportunities Companies that do not want the dilution of ownership and control Small companies with limited public market opportunities
Medium risk/return	Hybrid instruments (Svědík & Tetřevová, 2015; Tetrevova, 2009; Swedick & Tetrevova, 2014; Franke & Hein, 2008) Subordinated loans/bonds Quiet investor participation Profit sharing rights Convertible bond Warrant bonds Mezzanine financing	Young fast-growing companies strive for cheaper expansion capital than venture capital, and for the weakening of control Created companies with new growth opportunities Companies undergoing the transition period and restructuring Companies striving to strengthen the capital structure Companies with well-established and stable profitability and market position
High risk/return	Direct investments	
	Business angel financing (Granz et al., 2020; Block et al., 2019; Ang et al., 2018) Crowdfunding (Mollick, 2014; Gruzina et al., 2016; Lehner et al., 2015) (equity)	Companies at the initial and early stage Innovative enterprises requiring investment and business building skills
	Venture capital (Repullo & Suarez, 2004; Rutskiy et al., 2020; Frank et al., 2008)	Companies at the initial, early and late stages of investment Companies with high growth potential that can generate high profits in a short time

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	Other private investments (Brown et al., 2017)	Mature companies restructuring or changing ownership Companies in troubles with the rescue potential
	Public capital (Macaulay, 2019; Aust et al., 2020)	
	Specialized platforms for public listing of SMEs	Young, innovative, and risky small companies Companies with highly structured management systems and extensive disclosure

Source: Compiled by Authors

Thus, scientific references rather adequately cover the theoretical aspects related to the development of alternative sources of financing. However, there is insufficient number of studies on financial and nonfinancial barriers that hinder their use in investing entrepreneurial projects.

This study aims at investigating the barriers to financing entrepreneurial projects and identifying the possibility of attracting alternative sources of investment in the Republic of Kazakhstan.

The hypothesis of the study is the assumption that a more diversified set of financing options will allow SMEs to attract additional financial resources for the implementation of business projects.

3. Methods

The study is based on qualitative indicators obtained as a result of surveying 275 companies in the Republic of Kazakhstan.

The sample companies were randomly selected from the business register of the Republic of Kazakhstan (Businessnavigator, 2020). The sample was formed in order to ensure the comparable data accuracy for 155 small (21 – 30 employees) and 120 medium-sized (101 – 150 employees) Kazakh companies.

Typical SMEs included in the sample were SMEs with different business experience: 21.8 % of the surveyed companies had been operating for less than six months, 23.6 % – from six months to one year, 48 % – from one year to three years, and 6.6 % of the respondents had more than three-year experience.

The industry sample structure was as follows: trade enterprises – 38.2 %, construction companies – 23.3 %, transport and warehousing companies – 17.1 %, accommodation and food companies – 13.1 %; and industrial enterprises – 8.4 %.

The answers were given by the senior management (as a rule, the business owner or managing director) that could directly talk about financing the business under consideration and were either fully or partially responsible for financial decisions in their company.

The survey was carried out as a questionnaire with ten questions. In questions No. 1, 2, and 5, the respondents were asked to indicate the relevance of a particular problem according to the scale from one (not relevant) to ten (extremely relevant). After the survey, each response was analyzed and processed.

4. Results

According to the survey, the access to financing as the main obstacle to business development is identified by more than 70 % of the surveyed experts (Figure 1).

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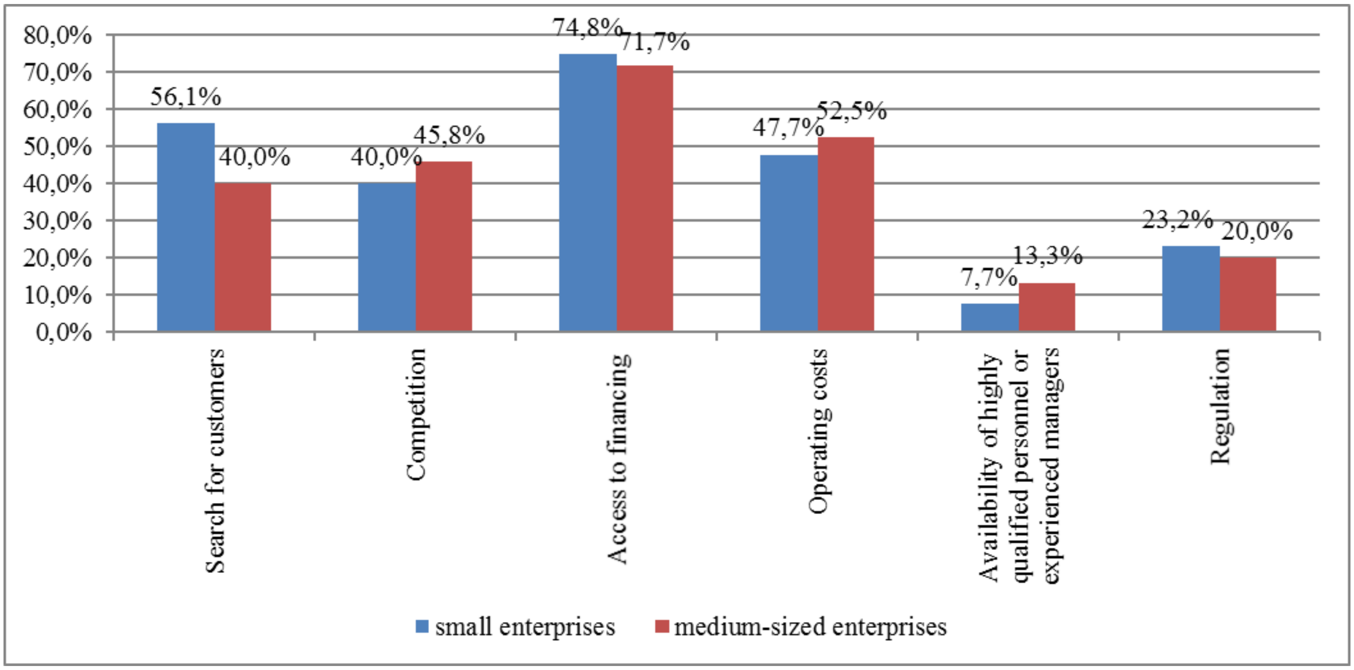

Fig. 1. The most important problems faced by Kazakh SMEs
Source: Compiled by Authors

The access to financing was a more relevant problem for small enterprises (74.8 %). The access to financing as an important problem was noted by the experts from medium-sized enterprises a little less frequently.

Over the past 12 months, 73 % of the surveyed companies had used external financing. Approximately one quarter of the companies' representatives noted that they had not used external financing.

The experts called bank loans and overdrafts as the most relevant sources of attracting investments (Figure 2). About 54 % of the surveyed SMEs representatives considered bank loans, and 56 % considered bank overdrafts as relevant.

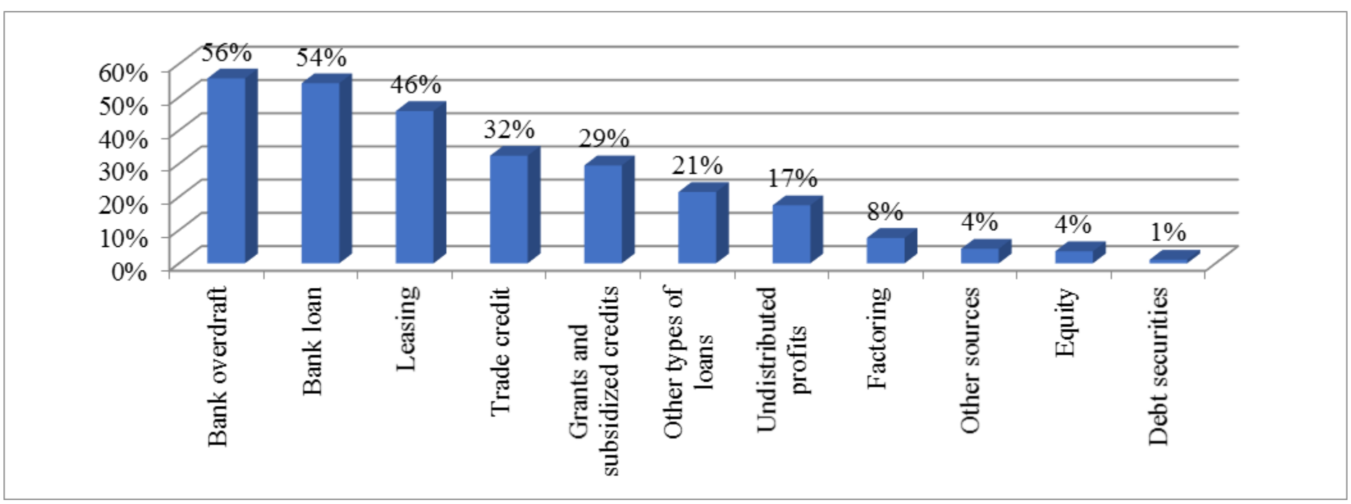

Fig. 2. The structure of financing of the Kazakh SMEs
Source: Compiled by Authors

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Leasing and trade credit were also relevant for 46 % and 32 % of SMEs, respectively. In addition, 29 % of the respondents indicated that grants and subsidized loans, which involved support from government sources in the form of guarantees or other interventions, were important in financing their entrepreneurial projects.

Other loans, e.g., from the family, friends, or related companies, were important sources of financing for 21 % of the Kazakh SMEs. Internal funds were important as an alternative source of financing. This was indicated by 17 % of the experts. The share capital, factoring, other sources, and debt securities had impact on the access to financing of companies (safes) mentioned as relevant by less than 10 % of the SMEs.

About 46 % of the respondents (126 experts) believed that bank loans were not relevant. Sixty-two experts out of them (49.2 %) believed that their companies did not need this type of financing, and 11 % indicated that bank loans were not relevant due to high interest rates and other costs. Other experts reported other reasons of the inexpediency of bank loans (Figure 3).

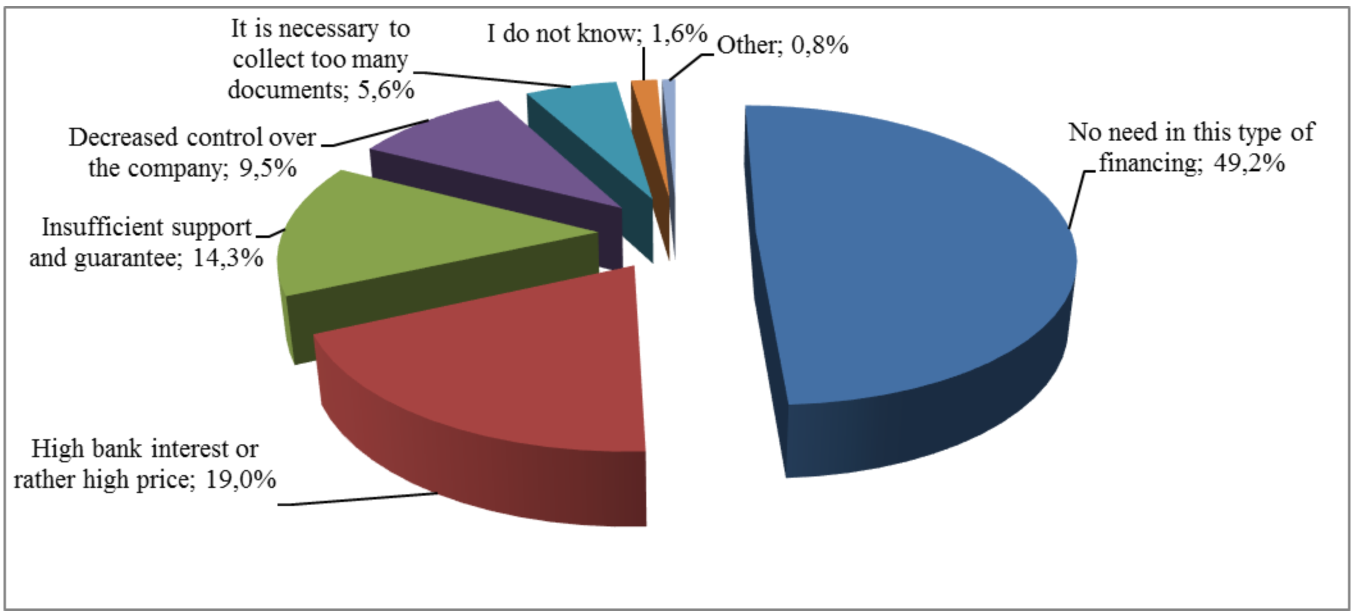

Fig. 3. Reasons why bank loans are not relevant for Kazakh SMEs
Source: Compiled by Authors

About 42.5 % of the surveyed experts said that over the past year the needs of their companies in bank lending (with the exception of overdraft and credit lines) had increased.

28.7 % of the experts reported the decrease in the need in this type of project financing, which caused the net increase in needs by 13.8 % (Figure 4).

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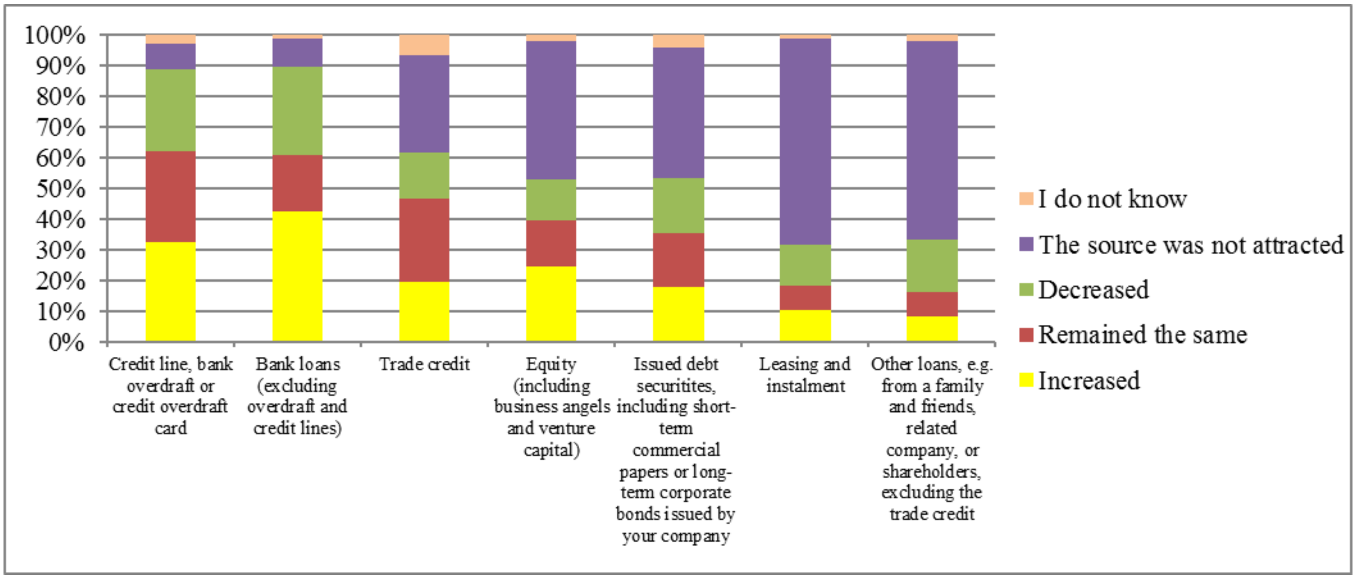

Fig. 4. Changes in the need for various types of financing to implement entrepreneurial projects in the Republic of Kazakhstan
Source: Compiled by Authors

The net increase in financing needs was noted on credit lines and overdrafts, trade loans, as well as in raising the capital by selling shares, including financing of business angels and venture financing.

The number of the companies that noted the decrease in need for such financial sources as leasing and other loans, including loans from friends and family, related companies, etc.

According to the expert survey, the largest investments were directed towards the implementation of projects related to the acquisition/renovation of fixed assets (36 %) and the replenishment of the working capital associated with the business expansion (34.2 %) (Figure 5).

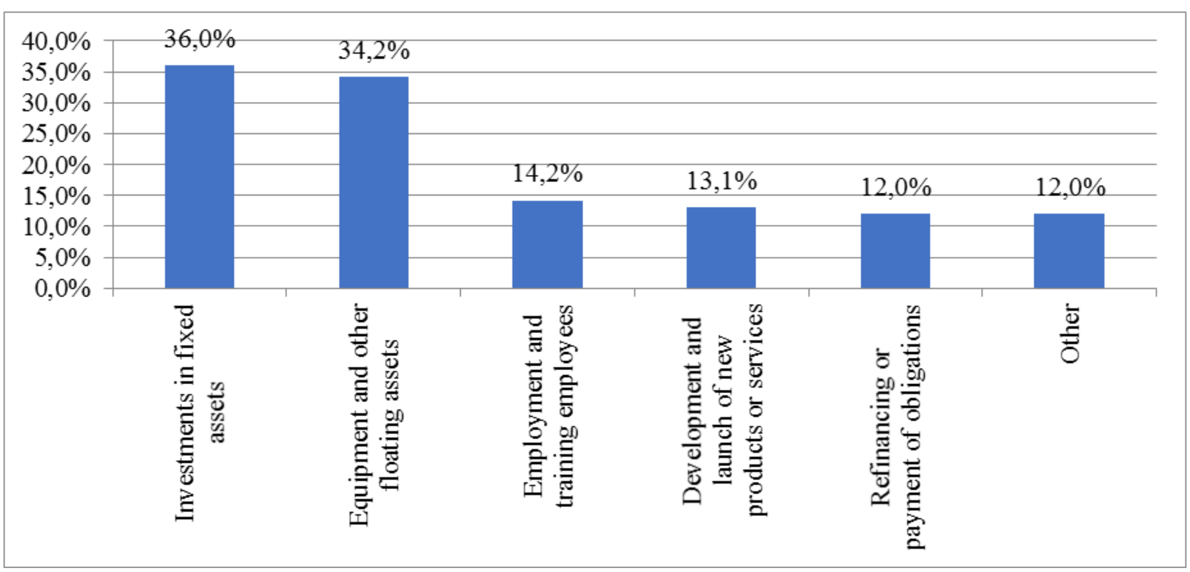

Fig. 5. Objectives of using external financing over the recent six months
Source: Compiled by Authors

Other specific categories included the development and launch of new products or services (13.1 %), hiring and training of employees (13 %), and refinancing or repayment of obligations (14.2 %).

The survey results show that the percentage of the companies that need bank financing but did not obtain loans from financial institutions of Kazakhstan, is quite high and amounts to 25.8 % (Figure 6).

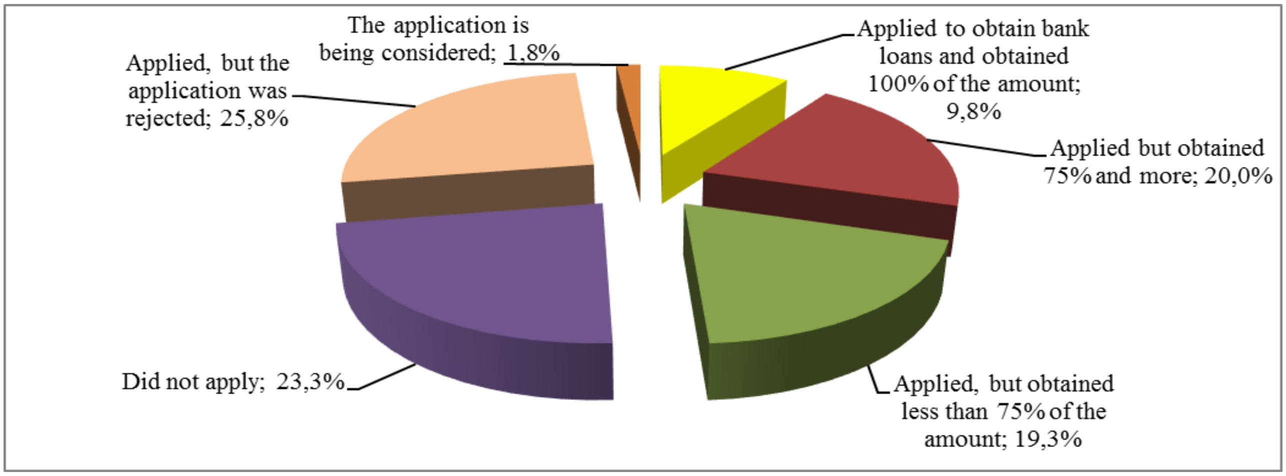

Fig. 6. Assessment of the availability of bank financing for Kazakh SMEs
Source: Compiled by Authors

According to the survey, almost half (49 %) of the SMEs had applied for bank loans, but were not financed as planned.

The experts noted that over recent years their companies had had more opportunities to use a wide range of alternative financing instruments, although some of those instruments had still been at the early stage of their development or in their current form had been available only to a small part of the SMEs (Figure 7).

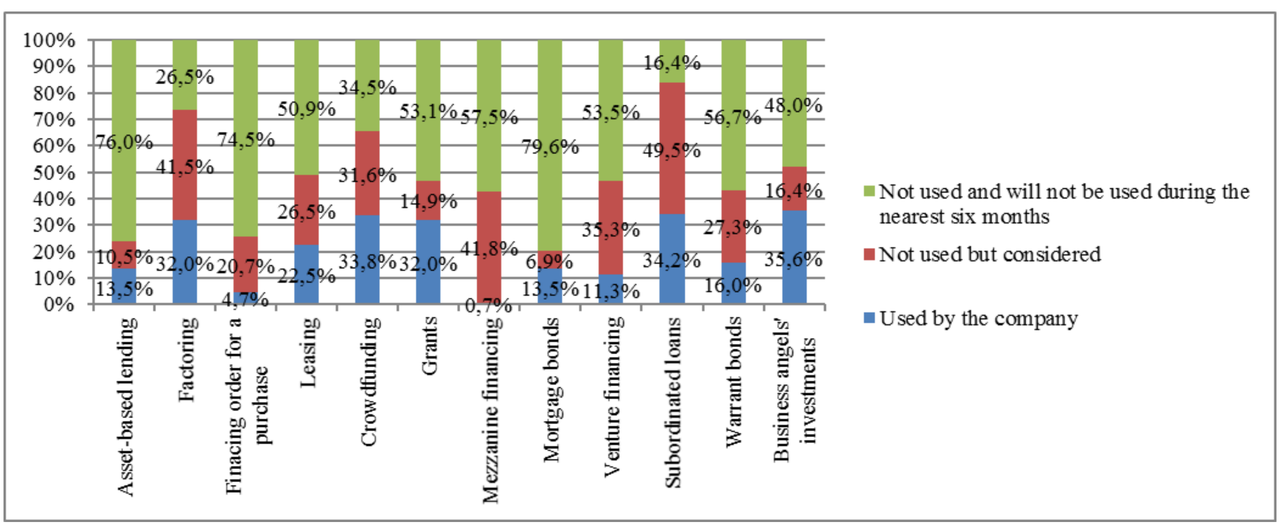

Fig. 7. Use of alternative sources of financing by Kazakh SMEs
Source: Compiled by Authors

Thus, the results of the study show that, despite the relatively high need of Kazakh SMEs in external financing, alternative sources of investment are poorly used. This is largely due to the lack of financial literacy about the possibility to use these types of investments when implementing entrepreneurial projects.

5. Discussion

According to the study results, nowadays companies are sufficiently informed about the possibilities of using such alternative sources as leasing, crowdfunding, grants, subordinated lending, venture and business angel financing.

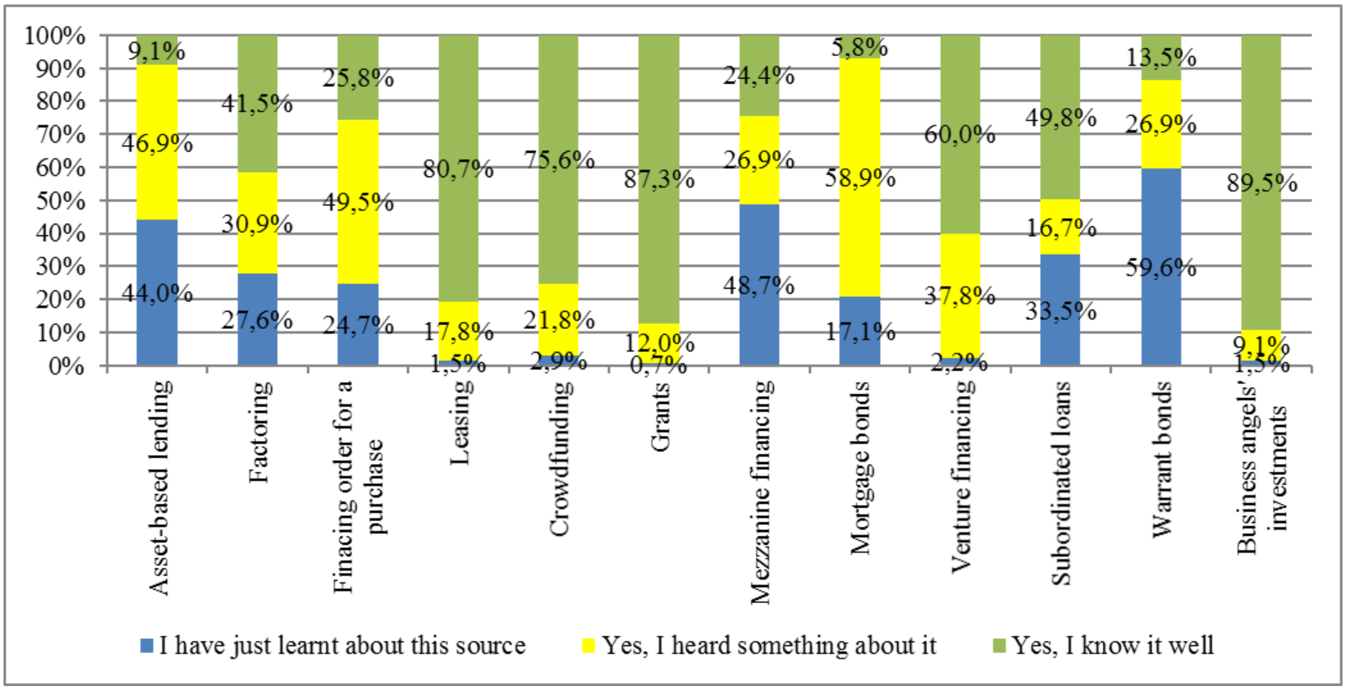

Fig. 8. Awareness of entrepreneurs about alternative sources of financing projects in the Republic of Kazakhstan
Source: Compiled by Authors

At the same time, rather high percentage of the respondents stated that they had had no idea about such financial sources as asset-based lending, mezzanine financing, warrant bonds, and subordinated loans.

According to more than half of the experts (53.5 %), the most promising sources of project financing for new and growing companies were grant financing (Figure 9).

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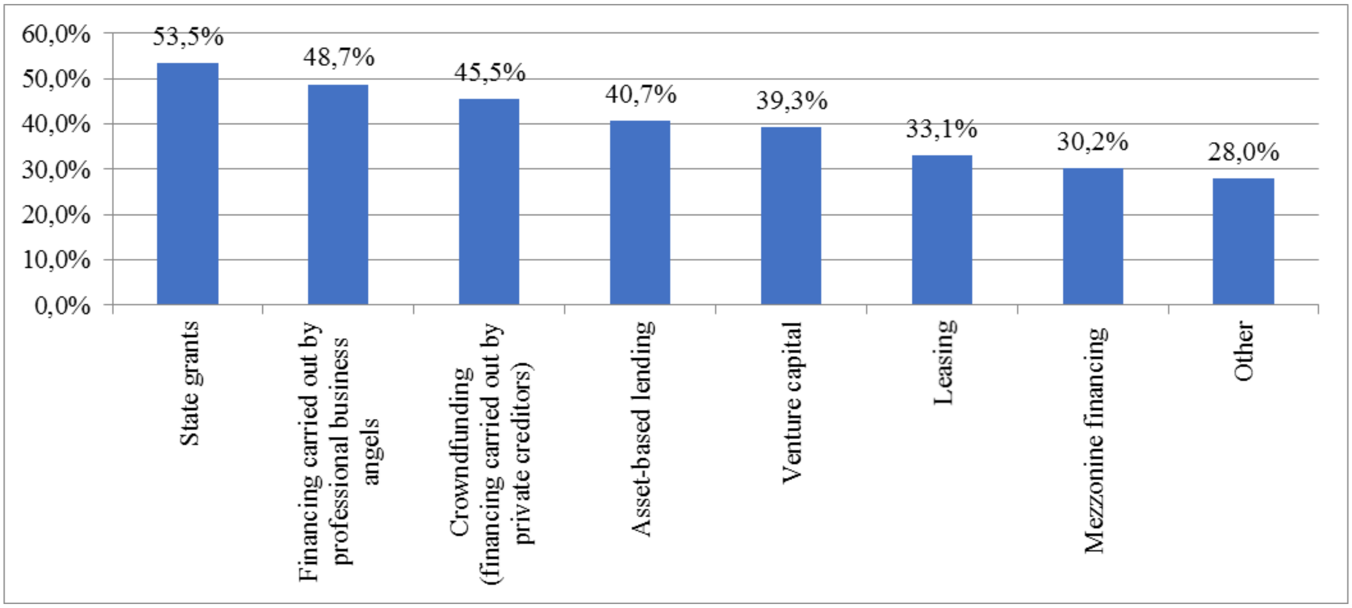

Fig. 9. Promising sources of project financing for new and growing SMEs
Source: Compiled by Authors

State grants for entrepreneurial purposes are provided for by the *Enbek Program for the Development of Productive Employment and Mass Entrepreneurship for 2017 – 2021* and the *Business Roadmap* 2025 Unified Business Support and Development Program (BR-2025). According to the *Enbek Program*, state grants are provided in the amount of 200 MCI (monthly calculation index, 1 MRP – 2,651 tenge), i.e., this year it is 530,200 tenge. According to the BR-2025 Program, state grants are up to 3 mln tenge. According to the *Enbek Program*, the persons who have not previously obtained a grant under this program, including young people, members of low-income families, employable persons with limited liability, migrants and repatriates, can apply for a state grant. According to the BR-2025 Program, the applicants may be citizens who have an innovative business idea.
Business angel financing (48.7 % of the respondents) and crowdfunding (45.5 %) can become considerable sources of attracting investments for newly created companies.

According to the study carried out by the European Trade Association, for business angels, seed funds, and early stage market players (EBANs), the main reason that reduces the willingness of business angels to invest is the high risk of failure (EBAN, 2018). Therefore, in the Republic of Kazakhstan it is necessary to create the relevant conditions for private investors. The mitigation of risk is a key element in achieving the goal, and the government of the Republic of Kazakhstan can use two instruments for this. In addition to creating a tax incentive scheme for investors investing in startups that allows them to deduct their taxes directly when investing, the creation of co-investment funds is an important political opportunity.

The launch of joint investment funds with business angels has proven to be an efficient way to attract “new money” in many countries, as well as expert knowledge from the market, helping to finance thousands of innovative companies (European Commission, 2016). Schemes of joint investment with business angels are of additional value to government bodies as compared to grants because their leverage is higher. Co-investment schemes are also valuable for angels because they reduce risk and allow more investments.

Usually, two scenarios arise as a result of creating the co-investment funds of business angels:

1) Public-private investment funds help to create investment communities at the early stages and, thus, create a favorable cycle. Private and public entities do not invest alone anymore. The investment risk is diluted on both sides, and also contributes to the perception of "political" risks.

2) It is possible to attract more funds for the ecosystem and more investments by combining several parties into a common financing mechanism. Management fees are also lower as compared to venture capital funds.

Some of the key features of co-investment funds that have impact on the community's successful understanding of business angels include asymmetric exits, tax incentives, and management fees.

In order to create conditions for the development of business angel financing in the Republic of Kazakhstan, it seems reasonable to consider the international experience in implementing measures to support this type of SEMs financing in some European countries (France, the United Kingdom, and Italy).

These incentives include government guarantees, lowered tax rates, or tax credits. It is necessary to note that wherever there are tax incentives, there is also considerable activity of business angels.

In France, business angels benefit from the reduction of income tax in the amount of 18 % of the investments. A new incentive measure for business angels to finance innovative companies, similar to PEAs adopted in other countries of the world is the SMEs innovation account (ICC). The SMEs innovation account aims at facilitating the financing of SMEs by deferring taxation on capital gains for the entire investment term.

In Italy, the capital gain obtained by business angels (residents and nonresidents) that is not related to the entrepreneurial activity is exempt from taxes if

a) The shares held had been personally renewed during the three years preceding the disposal,

b) The company the shares were granted to had been established not earlier than seven years prior to the disposal, and

c) The capital income is invested in acquiring shares in companies that are not older than three years old, and provided that they carry out the same entrepreneurial activity as the company whose shares were distributed.
The UK benefits from two schemes.

1) Assistance to entrepreneurs: it is mainly focused on entrepreneurs and provides for the first 10 mln pounds of the growth in lifetime income from the relevant business assets with the tax of 10 %.

2) Enterprise investment scheme (EIS):

In order to meet the requirements of venture capital funds, income tax benefits were increased, while the amount of advance tax benefits on income tax increased from 20 % to 30 %. In addition, the law provides for deferred capital gains tax (CGT).

According to 45.5 % of the experts, crowdfunding is a relevant source of financing. It is necessary to pay attention to its development.

Crowdfunding is a new source of financing startups that includes open calls to the public, usually via the Internet, to finance projects by making cash contributions in exchange for remuneration, pre-order of a product, lending, or

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investing. Due to new information and communication technologies, crowdfunding lending-based platforms are a new way of financial intermediation by directly connecting lenders and borrowers through online platforms.

One of the biggest obstacles crowdfunding platforms face in their efforts to offer their services is the lack of common rules. This increases compliance and operating costs and prevents the expansion of crowdfunding platforms.

According to the analysis of the current practice of regulating crowdfunding lending platforms in the world, countries choose various regulatory approaches for crowdfunding lending-based platforms. A number of countries (France, Great Britain, and Israel) adopted special legislation that directly regulates the activities of credit crowdfunding platforms.

Other countries have introduced the crowdfunding regulation that is either applied to both credit and investment crowdfunding, or does not distinguish between the two business models (Austria, Belgium, Finland, Mexico, and Portugal).

In the countries where there is no lending-based crowdfunding regulation, platforms are adapted to the existing regulation of securities trading, banking or payment institutions. For example, in the Netherlands, consumer-business platforms must obtain individual permission for brokering from the Dutch Authority for Financial Markets, while consumer-consumer platforms require a lender license.

In Sweden and Denmark, credit platforms function as payment institutions, while in Norway they are registered as credit intermediaries. In France, where there is still a banking monopoly on consumer loans, a consumer-consumer platform had been licensed as a credit institution. In Estonia, consumer lending platforms are regulated as consumer lending by the financial supervisory authority, while consumer lending to businesses is not regulated. In Ireland, platforms operate without any legal status as a financial intermediary.

The experts recommend the following as priority measures that should be taken into account when developing the regulatory framework for the functioning of crowdfunding platforms in the Republic of Kazakhstan:

– To set minimum requirements to the capital. About 56.7 % of the experts believe that it is necessary to set minimum capital requirements to platforms. This is necessary for the platforms to be able to cover operating or compliance costs in case of a financial crisis.

– About 53.5 % of the experts noted that when determining requirements for the platforms, they should be obliged to maintain such systems and control means that would allow identifying, managing, tracking, mitigating, and reporting risks within and for their business. Risks may include operational risk, cybersecurity, personal data protection, and the risk that the platform can be used to commit financial crimes.

– According to 44.4 % of the experts, it is necessary to regulate the issues of platform responsibility for identifying, managing, mitigating, and reporting on conflicts of interest.

– More than 35.7 % of the experts mentioned that specific business conduct requirements should be regulated to ensure the proper disclosure of information to investors and issuers/borrowers for them to understand how the platform worked, especially the information about the methods of how the platform earned its income.

– According to 32.4 % of the experts, the law must guarantee that platforms can, but are not required to, offer automated instruments related to diversifying investor portfolios.

The above recommendations are an incomplete list of the best practices the experts should take into account when developing the regulatory framework that regulates the activities of crowdfunding platforms in the Republic of Kazakhstan.

Conclusions

The results of the study have confirmed the hypothesis set herein about the possibility of using alternative sources of financing in order to attract investments in the implementation of entrepreneurial projects.

The results obtained during the study make it possible to conclude that for 40 % of the surveyed companies, the access to financing is a limiting factor in their business development. At the same time, 42.5 % of the experts mentioned the increasing need for external financing. At the same time, for new start-up companies, the availability of bank lending remains low.

At the present time, there are many sources of financing that are a real alternative to bank lending. However, they have not yet been widely used in the Republic of Kazakhstan.

According to the experts, for the Republic of Kazakhstan, the most relevant sources of financing entrepreneurial projects, especially start-ups, include state grants, business angel financing, and financing from private lenders through crowdfunding platforms.

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