Chapter 4

Entrepreneurial Finance for Vulnerable Communities:
The Case of an Associative Initiative in Colombia

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ABSTRACT

This study presents the financial progression of an associative initiative of a vulnerable community in Colombia, from early stages to growth. Initially, basic financial concepts are presented, together with the phases traditionally defined by previous literature. The case is then presented in terms of funding alternatives for entrepreneurs in Colombia, stages followed by the association and funding throughout such stages. Results show that even though the case under analysis presents similar features to those of new ventures started by non-vulnerable individuals, its specificities make it unique; concepts anticipated by existing literature were not fully applicable in this case. A set of issues and solutions are presented regarding entrepreneurial finance for vulnerable communities and in particular, for the case under analysis. Finally, further avenues of research and conclusions are presented.

INTRODUCTION

In terms of entrepreneurship funding, Colombia is below the world average, above the Latin American average and in the same position to Eastern Europe (GEM, 2014). However, exclusion from formal financial institutions and lack of knowledge related with financial services are common features that affect access and use of formal sources of funding by entrepreneurs.

Those that have access to services of formal financial institutions use personal loans and credit cards; these entrepreneurships are usually opportunity-driven. This is not the case for necessity-driven

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entrepreneurships from vulnerable individuals that live in remote rural areas; at most they have a savings account activated through branches or through mobile platforms.

Informal investors continue to be an important source of funds for entrepreneurs. They usually provide funds to relatives and friends instead of strangers (GEM, 2014).

Another common source is to fund new ventures with personal savings; once the business generates income, they might obtain loans for growth funding (Carrillo, 2016). Moreover, informal lenders have become a usual alternative for vulnerable communities that lack access to formal lending institutions and acquaintances that might be willing to but cannot afford to invest in a new venture.

A concept that is closely related with funding new ventures is the lifecycle of companies. Existing frameworks base their definitions on a variety of variables that include age, size, information opacity and financial features (Berger & Udell, 2011; Cumming & Johan, 2013; GEM, 2016a). Yet there is no single definition for business stages for entrepreneurial finance analysis purposes. Informality, a distinctive feature of vulnerable communities, is an additional element that needs to be considered.

The facts mentioned above justify the study of the evolution of an initiative of a vulnerable community in Colombia, from an entrepreneurial finance perspective. This chapter is organized as follows: First, basic business finance and entrepreneurial concepts are presented. Second, funding alternatives in Colombia are presented together with the case under analysis. Third, a set of issues and solutions identified from the study are presented. Finally, a set of conclusions is presented in response to the research questions that motivated this study.

BACKGROUND

1. Basic Business Finance Concepts

Companies generate revenues by using a set of resources known as assets. Such assets include fixed assets (property and equipment), current assets (e.g. inventories and receivables), financial investments and intangible assets (e.g. patents and trademarks) (Damodaran, 2015).

Assets are usually funded via liabilities and equity, which are the components of the capital structure of the Company (Myers, 2001). Liabilities correspond to claims from third parties who include capital suppliers and goods/services suppliers. The former refers to loans granted by third parties and the latter to liabilities derived from the provision of goods or services in credit. Equity belongs to shareholders or those that invested funds in the Company (Leon Garcia, 2009).

Assets, liabilities and equity are presented in the Balance Sheet, which shows the closing balance of assets, liabilities and equity. Other financial reports are the Income Statement and the Cash Flow Statement, which contribute to provide a holistic financial perspective of companies (Magni, 2015). Specifically, the income statement presents revenues, costs, expenses and profits obtained usually during a fiscal year. The Cash Flow Statement (CFS) sequentially presents the cash generated by operations, inflows and outflows of cash; this view contrasts with that of the Income Statement, which recognizes revenue and matches expenses to revenues (Dichey, 2008) usually based on accrual accounting.

It is important to note that the three financial statements are interrelated as the net profit (loss) reported in the Balance Sheet strengthens (weakens) a company's equity and the cash flow calculated in the CFS is included in a current asset in the Balance Sheet.

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