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Financing the growth of small to medium enterprises in emerging markets: The role of private capital

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ABSTRACT

Purpose of the study: The purpose of the study was to establish how funding from the three forms of private capital – namely, (i) angel investors, (ii) venture capital, and (iii) private equity – can support the growth of small to medium enterprises (SMEs) in emerging markets, based on insight from publications in the two decades from 2001 to 2020.

Design/methodology/approach: A systematic review of the existing literature on angel investors, venture capital, and private equity was conducted, and relevant publications from the period 2001 to 2020 were selected using a Scopus search. A total of 84 publications were identified, and these were filtered further, leaving 25 publications that were analysed using content analysis.

Findings: The review established that SMEs faced numerous challenges in sourcing and accessing funding for their ventures and that this affected their growth and, to some extent, their survival. Private capital was shown to play a significant role in SME growth, and it goes beyond just providing finance but extends to the provision of other operational support services, and improvement of corporate governance, including engagements with governments to influence SME policy.

Recommendations/value: The review contributes to the body of knowledge by providing (i) an understanding of SME financing challenges, (ii) insight into the role played by private capital to grow SMEs and to address their financing challenges, (iii) a theoretical framework on SME private capital financing that SMEs could use to identify suitable forms of financing; and (iv) a funding pitching guide.

Managerial implications: The review provides insight for entrepreneurs and/or SME owners/managers into the types of private capital and the respective requirements to pitch for funding. The review also presents a theoretical framework on SME private capital financing that frames the sources of financing for the various growth stages that SMEs go through and a funding pitching guide.

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Keywords

Angel investor; Emerging markets; Private equity; SME financing; Venture capital

JEL Classifications: G23, G24

1. INTRODUCTION

Small to medium enterprises (SMEs) are seen as a key economic driver in both developed and developing nations and are a key source of employment, as their formation and development create over 45% of jobs worldwide, and SMEs contribute up to 40% of the GDP in emerging markets (World Bank Group, 2020). The process of creating and managing a start-up or a new business that is classified as an SME is commonly known as 'entrepreneurship', and the success of this process is associated with bringing about the benefits related to the survival and growth of SMEs (Acs, 2006; Soni, 2014). However, there is no single agreed definition of an entrepreneur; there are difficulties in agreeing on such a definition, given the very diverse nature of entrepreneurs' backgrounds, what they do, and the varying opportunities that they pursue, such as early-stage start-ups that commercialise new ideas rather than buying an existing business and building it further (Howorth *et al.*, 2005).

One of the factors that have been raised by numerous SMEs/entrepreneurs as being a key success factor in their growth is access to finance. However, there is a funding gap for SMEs of close to USD 4.5 trillion in emerging markets (World Bank Group, 2020). The GEM report on entrepreneurship activity in South Africa for 2021/2022 stated that one of the challenges that SMEs face is having sufficient sources of finance and thus gaining access to funding (Bowmaker-Falconer & Meyer, 2022). So, this study aimed to analyse the sources of finance for SMEs in the form of (i) angel investors, (ii) venture capital (VC), and (iii) private equity (PE) to provide insight into these funding sources for SMEs in emerging markets. These three forms of finance are classified as private capital.

An angel investor is normally a high-net-worth individual who invests his or her own money in early-stage ventures/businesses or start-ups (Morrissette, 2007; Martino *et al.*, 2022). A VC provider is established as a 'company' or a 'fund' that invests in start-ups or early-stage businesses; thus, it operates with more formal structured arrangements than an angel investor (Divakaran *et al.*, 2014; Martino *et al.*, 2022). A PE is also established as a 'company' or a 'fund'; however, it provides capital to more established businesses that are probably looking at listing on a public stock market or expanding on a larger scale than a VC could support (Prahl *et al.*, 2017; Gilligan & Wright, 2020). A key distinction between an angel investor and the other forms of private capital, such as VC and PE is that angel investors only invest their

own money, whereas VC and PE firms invest other people's or entities' money as well as their own funds (Morrissette, 2007; Cumming & Zhang, 2019).

Private capital is an alternative form of financing for SMEs, other than commercial banking financing. It is usually capital that is advanced for an equity stake and is held for a period of around ten years (Giaquinto & Bortoluzzo, 2020). The aim of the investment is to grow the value of the equity stake during the investment period such that, upon exiting, there would have been significant capital growth, thus giving the private capital investors a positive investment return. However, because of the high risk of failure that is associated with early-stage ventures/businesses, angel investors, VC and PE investors seek higher returns from their investments than they would ordinarily get from other investment platforms such as the stock market or bonds (Martino *et al.*, 2022).

The source of the private capital that is invested is usually investors such as angel investors, pension funds, family-owned businesses, and insurance companies (Giaquinto & Bortoluzzo, 2020). This private capital is then channelled to SMEs through VC and/or PE firms. However, angel investors channel their investments directly to the desired SMEs. VC funding now appears to be a global phenomenon that enables economic growth (Mallaby, 2022). The SME funding firms (VC/PE) usually charge a management fee for investing funds on behalf of other investors, such as pension funds, family-owned businesses, and insurance companies.

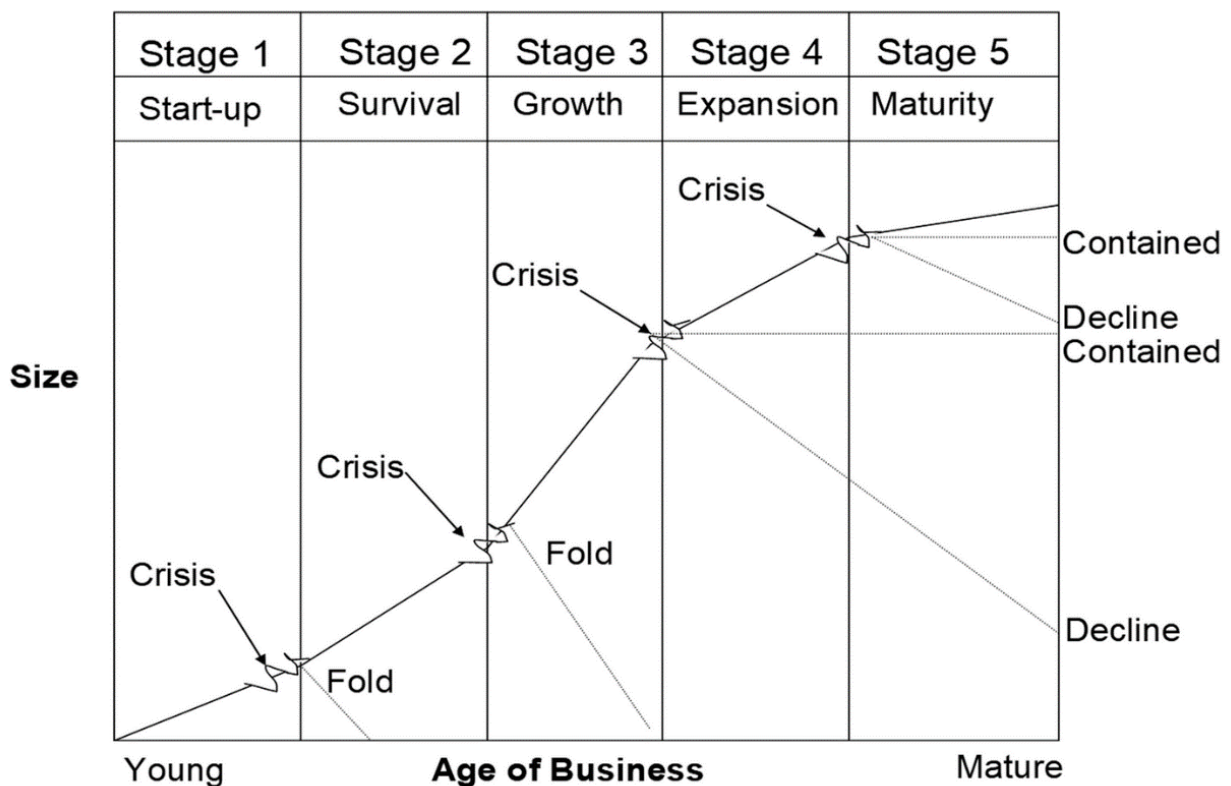
For an SME to attract an investor, there is usually a set of qualifying criteria that it is supposed to meet for each of the SME development stages or funder requirements, depending on the type of funder they are targeting. Early-stage investors – typically angel investors – look at the background of the entrepreneur, the attractiveness of the market, and the characteristics of the product or service (Giaquinto & Bortoluzzo, 2020).

Lewis and Churchill (1983) argue that there are five stages of SME growth: (i) existence, (ii) survival, (iii) success, (iv) take-off, and (v) resource maturity. These were refined by Scott and Bruce (1987) to be (i) start-up, (ii) survival, (iii) growth, (iv) expansion, and (v) maturity (see Figure 1). The growth stages presented by Lewis and Churchill (1983) and by Scott and Bruce (1987) are used by most researchers/authors on SME growth (Davidsson *et al.*, 2010). Scott and Bruce (1987) posit that all SMEs will encounter a crisis or challenges of some sort in each of the five growth stages and that the five stages are meant to assist with the process of managing these challenges. This argument that SMEs face crises or challenges at the various growth stages is supported by Davidsson *et al.* (2010). The primary challenges faced by SMEs in the five growth stages are (i) start-up – crisis of leadership; (ii) survival – crisis of autonomy (being independent of the SME owner/manager); (iii) growth – crisis of control; (iv) expansion

– crisis of red tape (too many policies, processes, and procedures); and (v) maturity – the succession of the SME owner/manager (Scott & Bruce, 1987).

The shape of the growth curve and the speed with which the SMEs pass through each stage are different for each business and depend on the specific characteristics of each SME. Other considerations that could impact the growth of the business include (i) environmental factors, looking at the political, economic, social, technological, environmental, and legal (PESTEL) elements (Yüksel, 2012), and (ii) the five industry competitive forces posited by Porter (1980): rivalry among competitors, threats of new entrants, threats of substitute commodities, customers' bargaining power, and suppliers' bargaining power. Thus, it is important for the SME owner/manager to be familiar with the predicted crises and with the business environment so that they can build capabilities to address these crises as they are encountered or to try to avoid them.

Figure 1: The five stages of growth in small businesses

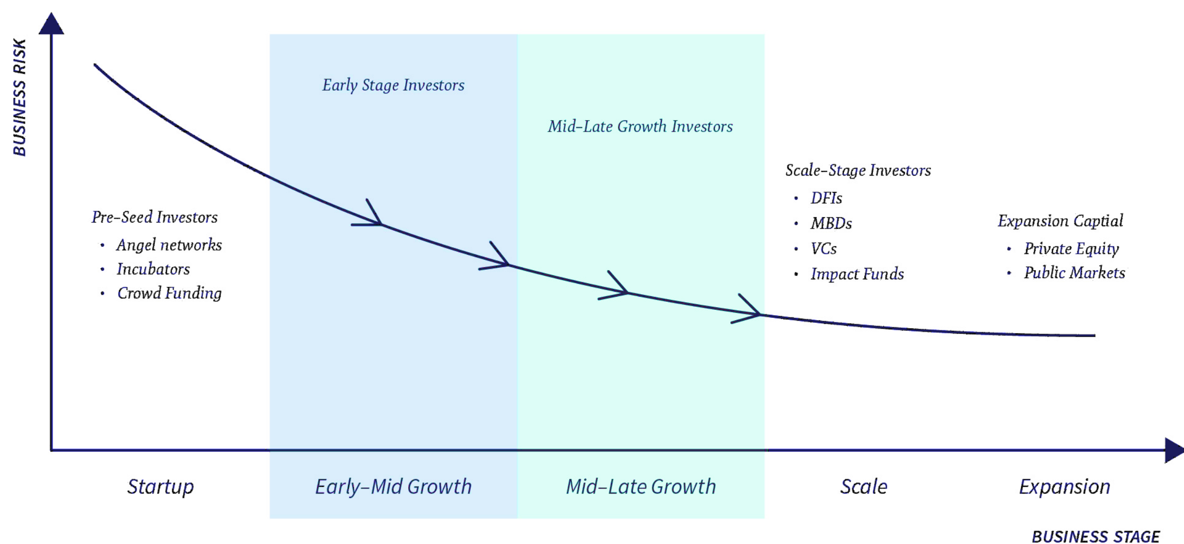


Source: Scott and Bruce (1987)

In a paper by Runde *et al.* (2019), the five growth stages were matched with proposed funding solutions, as shown in Figure 2. The start-up stage was matched with funding from angel investors, business incubators, and crowdsource funding. The survival and growth stages, which were listed as early-mid growth and mid-late growth, were matched with funding from

early-stage investors and mid-late growth investors, respectively. It can be assumed that the early-stage investors and mid-late growth investors are venture capital firms. The funding for the scaling stage was proposed to come largely from VC and development finance institutions (DFIs), whereas funding for the fifth stage (termed 'expansion') would likely come from PE firms and/or public markets.

Figure 2: The five stages of growth in small businesses



Source: Runde *et al.* (2019)

The multiple rounds of fundraising or financing from various funders are classified as Series A, B, C, or D, with 'Series A' being the first round/cycle, when the SMEs raise funds, and Series B, C, and/or D being the successive rounds/cycles when further funds are raised (Mallaby, 2022). Series D is not necessarily the last funding cycle, but most SMEs usually go through four to five cycles of funding before reaching the maturity stage.

1.1 Research questions, aims and objectives

The purpose of this study was to establish how funding from the three forms of private capital – (i) angel investors, (ii) venture capital (VC), and (iii) private equity (PE) – have supported SMEs in emerging markets, based on publications from the two decades from 2001 to 2020, and to establish how SMEs in emerging markets could address the challenges associated with sourcing the funding that they require to fund the growth of their ventures. This research study also built on prior research by Dong and Men (2014), Wang (2016), Quartey *et al.* (2017), and Kato (2021) on the financing of SMEs. They also highlighted the need for entrepreneurs and/or SME owners/managers to have insight into sources of funding and knowledge about how to access it. Thus, the research questions to address the aim of this

study were: (i) How has the funding for SMEs progressed in emerging markets over the past two decades? (ii) What challenges do SMEs face in sourcing funding? and (iii) How can these challenges be addressed? The objectives of the study were to discover (i) the nature of the funding provided/available, (ii) the qualifying criteria for the various forms of funding, (iii) the average investment tenure/timeframe, and (iv) the common exit options for both SMEs and investors.

2. RESEARCH AGENDA

The research agenda below sets out the definitions and activities with respect to angel investors, venture capital, and private equity in general and as they relate to SMEs. Another form of financing for entrepreneurial ventures/SMEs, termed 'crowdfunding', is also presented.

2.1 Angel investors

An angel investor is normally a high-net-worth individual who invests his or her own money in early-stage businesses/ventures or start-ups (Morrissette, 2007; Martino *et al.*, 2022). They are usually fellow entrepreneurs, close friends, relatives, current or former work colleagues, or someone who would have been referred to the entrepreneur (the promoter of the new venture or business) by one of the close relationships listed above (Morrissette, 2007; Cumming & Zhang, 2019). The funding that is provided comes in many different forms, such as loans, equity and/or convertible debt. However, the arrangements are not as formal as those of VCs or PEs (Morrissette, 2007). It is normally provided as 'seed funding' or 'bridging finance' while the entrepreneur is establishing the business formally or is still at the research and development stage, and so still needs to prove the concept (Martino *et al.*, 2022). Because of the private and individual nature of angel investor relationships, the lack of data, the private nature of transactions, and the lack of formality in the process of angel investment – there are no common formalised associations that govern the activities of angel investors – it has been difficult to assess early-stage investments (Morrissette, 2007; Cumming & Zhang, 2019; Giaquinto & Bortoluzzo, 2020).

The risk factor for angel investors is significant, as the failure rate for ventures at the start-up phase is very high; thus, they usually have a high equity holding from the outset (if they opt to take up equity). However, their governance is also usually not very formal, being more advisory and providing network contacts for the growth of the venture (Martino *et al.*, 2022). It is also argued that any form of due diligence performed by angel investors is focused more on assessing the entrepreneur(s) rather than the business plan. The factors that influence whether or not they make the investment (that is, their investment criteria) include (i) the

enthusiasm/passion of the entrepreneur, (ii) the trustworthiness of the entrepreneur, (iii) the potential market for the entrepreneur's product/services; and (iv) the background and expertise of the entrepreneur (Morrissette, 2007; Dat, 2021; Staal, 2022). This is supported by the findings of Giaquinto and Bortoluzzo (2020), who state that early-stage investors (typically angel investors) look at the background of the entrepreneur, the attractiveness of the market, and the characteristics of the product or service.

Some angel investors, however, do not only invest for the potential financial gain but also consider non-financial motivations such as the fun and challenge of the new venture process and a sense of fulfilment from helping the new venture (Morrissette, 2007; Staal, 2022). In this regard, angel investors can be classified into three groups, based on their investment motives: (i) economic investors – investors who are motivated by wealth maximisation and so invest strictly for financial gain; (ii) hedonistic investors, who invest not primarily for the financial gain but for the fun and thrill of investing; and (iii) altruistic investors, who are primarily motivated by the will to do something selfless and to help others without immediate personal gain (Staal, 2022).

It is argued that angel investors are a powerful economic force in funding early-stage ventures/start-ups and thus enabling entrepreneurship to thrive (Morrissette, 2007; Cumming & Zhang, 2019). Establishing start-up ecosystems that facilitate meetings between entrepreneurs and angel investors is helpful in enabling the required investment in early-stage ventures, and so fostering entrepreneurship (Giaquinto & Bortoluzzo, 2020; Dat, 2021).

2.2 Venture capital

Venture capital (VC) is an equity financing mechanism that provides capital to a new or existing early-stage business, usually for an equity stake in the venture/business (Martino *et al.*, 2022). VC is established as a 'company' or a 'fund' that invests in start-ups or early-stage businesses (Divakaran *et al.*, 2014; Martino *et al.*, 2022). VCs invest in early-stage, high-growth businesses, and also provide operational support (Mallaby, 2022). Recently, most of the operational support has been provided through special-purpose enterprises called 'accelerators' or 'business incubators', whose role is to provide the management teams with operational support that includes marketing and sales, financial management and human resources management support, and access to funders (Divakaran *et al.*, 2014; Hewitt & Van Rensburg, 2020). It has been argued that only a small number of the ventures pursued or financed by VC survive and grow. However, their primary goal is to grow the ventures they finance – possibly large enough to be what they term 'unicorns' (ventures that grow to have revenue or valuations in excess of a billion US dollars) (Mallaby, 2022).

The process of identifying, evaluating, and selecting ventures in which to invest in is critical, and results in many engagements with numerous entrepreneurs and/or their representatives, which is very time-consuming (Mallaby, 2022). VC usually invests in a lot of businesses at the same time, using this form of diversification as a way to manage the risk of the high failure rate of early-stage businesses (Martino *et al.*, 2022). However, one of the primary means of risk management is the extensive screening that VC undertakes in selecting businesses in which to invest (Martino *et al.*, 2022).

Another way in which VC manages its risk is by providing the funding in multiple rounds that, in some instances, have conditions attached to them for further successful funding. However, it is important to note that VC's focus is more on developing strategies to grow the value of the targeted or invested businesses rather than on managing the risk (Martino *et al.*, 2022). VC primarily exits from its investments through either an acquisition or an initial public offering (IPO) – a listing of the shares in the business on a publicly traded market called a stock market (Martino *et al.*, 2022).

2.3 Private equity

Well-established and mature businesses can raise capital through loans, issuing bonds, or by issuing shares (equity) in their businesses. Private equity is an alternative form that mature businesses can use to raise capital, using the same three methods mentioned above, but from private investors rather than from the public through public platforms such as a stock market (Prahl *et al.*, 2017; Gilligan & Wright, 2020).

Private equity operates somewhat the same as VC; however, PE partners invest primarily in mature businesses with good cashflows or in struggling mature businesses that could be restructured, and their governance structures or management oversight requirements are more onerous (Prahl *et al.*, 2017). They focus more on ensuring that the business has all the necessary governance structures (that is, sufficient internal controls, compliant financial reporting, and succession planning) in preparation for an IPO to exit and to realise a return from their investment in the business. In some instances, private equity investors invest in a publicly listed company to delist it (taking a public company private), to improve operations/financial performance (to create more value), and ultimately either to sell its stake privately or to list it again while realising a higher value (Divakaran *et al.*, 2014).

The returns expected by PE investors, although high, are not usually higher than those of angel investors or VCs; their investment risk is normally lower since they invest in mature businesses with stable operational business models (Divakaran *et al.*, 2014). PE firms

normally invest for periods ranging between three and seven years before exiting (Divakaran *et al.*, 2014).

The owners/funders of PE firms are classified as either (i) general partners (individuals or companies with a mandate to oversee the day-to-day operations of the PE firm and investment vehicles used to fund the PE investments) or (ii) limited partners (high-net-worth individuals, pension funds, and/or private companies that provide funding to the PE for investment in identified businesses, but that will not have the day-to-day responsibility of managing the PE firm or investee businesses (Gilligan & Wright, 2020). This ownership/funding classification is also followed by VC firms (Prahl *et al.*, 2017).

The usual compensation structure of a PE firm is governed as follows. The PE firm charges an annual management fee of 2% of the total assets under management (AUM), even when the fund has not performed well, and 20% of the profit/return after break-even is achieved by the general partners. In most instances, the general partners only get paid after meeting the terms of the limited partners, achieving a set hurdle rate (a minimum return rate), or the terms could be on a par with those of limited partners for the capital invested by the general partners (Prahl *et al.*, 2017).

It has been argued that PE mostly targets larger and more established businesses. However, while PE could also be very helpful to SMEs, the support available to them from PE firms with technical assistance from governments and development institutions is limited to high-growth ventures, mature SMEs with good cashflows, or struggling mature SMEs that could be restructured (Divakaran *et al.*, 2014). The technical assistance that would be required to enable PE firms to invest in SMEs includes improvements to business functions such as internal controls (governance) and financial and strategic planning (Divakaran *et al.*, 2014).

Despite the benefits that would be available to SMEs if they could access funding from PE firms, funding from PE firms to SMEs in emerging markets is very low (Divakaran *et al.*, 2014). Though PE funding, in general, is useful for SMEs, it is most likely more useful for mature SMEs that are scaling up their businesses and that require capital beyond what VC can provide – especially for those SMEs that intend to pursue an IPO (that is, list the business on a public stock market) – and thus possibly exit the business.

2.4 Crowdfunding

Crowdfunding is a new form of entrepreneurship funding that leverages the wide reach of the internet to invite internet users to fund the entrepreneur's venture (Yasar, 2021; Martino *et al.*, 2022). A sub-concept of crowdfunding that specifically targets entrepreneurship ventures is

called 'equity crowdfunding'. This is the provision of funding by crowdfunders in return for an equity stake in the venture/start-up (Eldridge *et al.*, 2021; Yasar, 2021). Specific or dedicated websites or platforms have been developed to enable crowdfunding, and then fundraising campaigns are managed to promote the websites or crowdfunding platforms. Crowdfunding platforms do not pool funds or lend funds to entrepreneurs; they focus on matching funders or prospective investors to specific entrepreneurial ventures that require funding (Martino *et al.*, 2022).

The advantage to the entrepreneur of this new form of funding is that it is likely to be less onerous than engaging more sophisticated angel investors and/or VC, and the call for funding is normally in the form of small investments from the wider internet population that are then pooled to meet the funding requirements of the entrepreneur (Eldridge *et al.*, 2021; Yasar, 2021; Martino *et al.*, 2022). The forms of returns from the investments or donations from crowdfunding differ, depending on how they are structured, but they could be equity in the venture, loan interest on the funds provided, or a defined reward. However, if it is a donation, no return is provided.

This sort of funding mechanism could be a solution for SMEs in emerging markets to access funding for their early-stage ventures/start-ups, thus addressing the challenges associated with accessing funds or having existing relationships with angel investors or VCs (Yasar, 2021). However, in some countries, this type of funding requires regulation in order to protect investors and to ensure that all stakeholders are aware of the associated risks and benefits of such crowdfunding platforms/mechanisms (Yasar, 2021).

3. RESEARCH METHODOLOGY

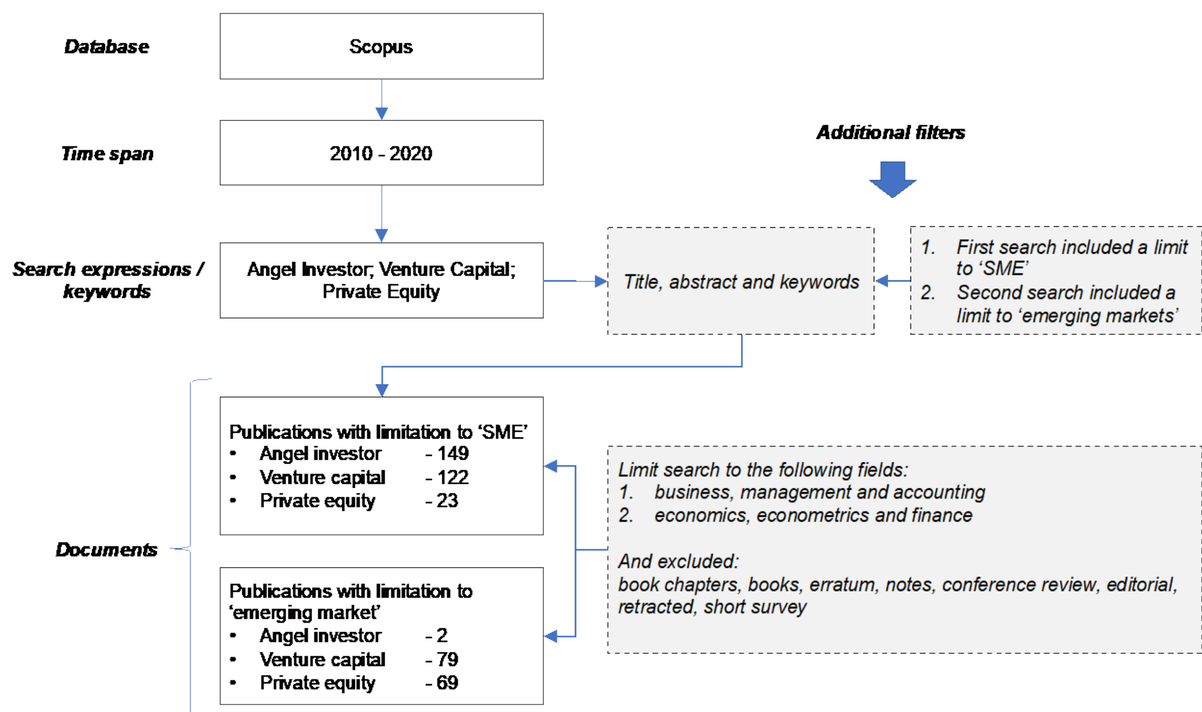
A systematic review of the literature on angel investors, venture capital, and private equity was conducted from an exploratory perspective to identify academic articles and other publications that provide the most relevant content and research on the respective subject areas as they relate to SMEs and emerging markets. This review followed an integrative or critical review approach with the aim to assess, critique, and synthesise the literature on SME funding support from angel investors, venture capital, and emerging markets to understand the practice in the past two decades (Snyder, 2019). The systematic review approach to the Scopus search is illustrated in Figure 3.

The systematic review approach that was followed enabled the selection of publications that contained 'angel investor', 'venture capital', and 'private equity' in their titles, abstracts, and keywords. The searches were conducted in two stages for each of the three listed funding sources. The first searches were limited to those that also included 'SME' in their titles,

abstracts, and/or keywords. The remaining search was limited to identifying publications that had 'emerging markets' in their titles, abstracts, and/or keywords.

In each of the searches, the publications were limited to the following fields: (i) business, management, and accounting, and (ii) economics, econometrics, and finance. The Scopus search was limited to the period 2001 to 2020, and the following publication types were excluded: book chapters, books, errata, notes, conference reviews, editorials and short surveys.

Figure 3: Systematic review approach



Source: Author's own compilation

The results from the systematic review searches are listed in Table 1.

Table 1: Publications by type of financier

Financier type	No. of publications filtered by 'SME'	No. of publications filtered by 'relevance to emerging markets
Angel investor *	149	2
Venture capital	122	79
Private equity *	23	3

Source: Author's own compilation

**Angel investors: they were initially not filtered by 'SME', as the assumption was that most angel investors support early-stage SME activity. When the second iteration was conducted, this*

assumption was considered to ensure that only papers that pertained to 'SME support' were included. When filtered by 'SME', the result was only four publications; limiting it further to 'emerging markets' left only two publications.

**Private equity – when filtered by 'emerging markets', a total of 69 publications were selected. However, only three publications appeared when filtered further by limiting the result to 'SME and emerging markets'. This further filtering was necessary since not all private equity activity in emerging markets would be related to SME activity.*

A total of 84 publications were identified for this study. This is the total number of publications under 'emerging markets' in Table 1. However, there was one paper that appeared under both 'angel investor' and 'venture capital'. This paper was replaced in the final venture capital list of publications that were selected.

All of the papers identified under 'angel investor' (2) and 'private equity' (3) were analysed using content analysis. However, only the top ten publications with the highest number of citations under 'venture capital' from each of the two decades (2001 to 2010 and 2011 to 2020) were analysed using content analysis (see Appendix 1, which shows the 25 publications that were analysed for this study). A similar exploratory and qualitative content analysis was followed by Kivimaa *et al*. (2021). The findings from the content analysis and the insight gained from the research agenda informed the development of the theoretical SME growth financing model set out in Figure 4.

4. FINDINGS AND DISCUSSION

There were three primary forms of private capital funders for SME businesses/ventures in the two decades from 2001 to 2020: (i) angel investors, (ii) venture capital, and (iii) private equity. A new form of private capital funding was introduced called 'crowdfunding'; however, this has not gained much traction in most emerging markets. Research on SME funding (entrepreneurial finance) has grown in recent decades (Cumming & Zhang, 2016; Martino *et al.*, 2022); however, there is limited data on funding from angel investors because of the private nature of the transactions and the lack of formally organised groupings that govern angel investors' funding activities (Morrissette, 2007; Cumming & Zhang, 2016; Cumming & Zhang, 2019; Giaquinto & Bortoluzzo, 2020).

Private capital is a preferable form of funding for SMEs than sourcing bank debt since it is more patient and does not usually require the collateral and the regular repayments of interest that are associated with the servicing of funding through bank debt (Giaquinto & Bortoluzzo, 2020). Close to 70% of the funding applications from SMEs are rejected in the first screening rounds because they fail to present or effectively communicate aspects of their business

models, their financial performance and projections, or to showcase the entrepreneurs' skills and knowledge (Giaquinto & Bortoluzzo, 2020). However, it has been argued that the presentations generally improve in subsequent application rounds (Giaquinto & Bortoluzzo, 2020). This means that SMEs should have the skills to prepare and present a business/funding request pitch to prospective investors in order to increase their chances of accessing the required funding.

Pitching to investors involves a concise presentation that showcases the entrepreneur's business idea, market opportunity, business model, team/key staff members, and financial performance or forecast, and that indicates the 'sum of funds' required, thus highlighting how the funds will be deployed (Van Werven *et al.*, 2019). As previously stated, targeting the right prospective funders and understanding the funders' requirements would help SMEs in preparing their pitches and presentations. The process of pitching also enables entrepreneurs to address some of the due diligence factors that are assessed by angel investors and that are focused not so much on the business plan to make the investment but on the actual entrepreneur(s) (who are the primary investment focus for angel investors). These due diligence factors include (i) the entrepreneur's enthusiasm/passion, (ii) the entrepreneur's trustworthiness, (iii) the potential market for the entrepreneur's product/services, and (iv) the entrepreneur's background and expertise (Morrissette, 2007; Dat, 2021; Staal, 2022). Pitching to investors is also known as the preparation and communication of the business case for the business idea. A business case is an analysis of the business idea or new venture that spells out the benefits of making the investment or return on investment (ROI) in an effort to convince investors to fund the business idea or new venture (Sheen & Gallo, 2015).

Business incubators also play a role in training entrepreneurs/SMEs to pitch to investors by offering them an opportunity to rehearse their pitches and to get feedback from mentors (Van Werven *et al.*, 2019). Business incubators are a support and an enabling system for entrepreneurs/SMEs to increase their chances of success and shorten their learning curve. Some of the services provided are (i) business model development, (ii) networks, (iii) financial management, IT, and HR support, and (iv) access to funders (Divakaran *et al.*, 2014; Hewitt & Van Rensburg, 2020).

It has also been argued that private capital funders prefer to fund ventures with more than one founder, premised on the benefits associated with complementary networking, skills, and industry knowledge. Having multiple founders and a team increases the pool of network contacts, skills, and industry knowledge from which SMEs can draw (Giaquinto & Bortoluzzo, 2020). Some of the determinants that help to address the challenges that SMEs face in their

entrepreneurial journeys are influenced by macroeconomic factors, such as GDP growth, economic freedom, financial development, and national research and development spending (Giaquinto & Bortoluzzo, 2020).

One of the themes that featured prominently in the review period as a practice that could increase the chances of SMEs to raise the required funding was good corporate governance – that is, how an organisation is directed and controlled, taking into consideration the interests of both internal and external stakeholders (Süsi & Jaakson, 2020). This supports the argument of Divakaran *et al.* (2014) about the technical assistance that is required to enable PE firms to invest in SMEs, including improving business functions such as internal controls (governance) and financial and strategic planning. It also supports the assertion by Mallaby (2022) that VC provides other forms of operational support beyond the funding that would have been provided. 'Corporate governance' and 'the protection of investors' rights' were found to be the most important drivers in attracting international VC and PE firms into emerging markets (Groh & Von Liechtenstein, 2009).

4.1 Angel investors

Angel investors are usually the first external funders of most new businesses/ventures (Giaquinto & Bortoluzzo, 2020) and are considered the most important financiers in enabling entrepreneurship (Lindstrom & Olofsson, 2001). In relating to the entrepreneur (as a promotor of the new venture or business), they are usually fellow entrepreneurs, close friends, relatives, current or former work colleagues, or someone who would have been referred by one of the close relations listed above (Morrissette, 2007; Cumming & Zhang, 2019). This means that entrepreneurs of early-stage SMEs need to leverage their existing relationships and networks to reach prospective angel investors in order to raise any required funding. The challenge in emerging markets might be to have a large enough pool of high-net-worth individuals who are willing to take the high risk of investing in early-stage SMEs. It has been argued that early-stage ventures face a high risk of failure if they do not have sufficient finance in the first years of their operation when they are not yet generating sufficient revenue to cover their full operational costs (Giaquinto & Bortoluzzo, 2020). Thus, having access to this type of funding increases SMEs' chances of success. The relationship between business risk and the growth stage of the SME is shown in Figure 2, which highlights the higher risk associated with SMEs in the start-up stage.

Another challenge that has been highlighted is limited access to angel investors since there are no databases or associations that maintain registers of angel investors. Thus, fostering the development of angel investor ecosystems would be helpful in providing networking

opportunities for angel investors and early-stage SMEs (Giaquinto & Bortoluzzo, 2020; Dat, 2021). Although investment from angel investors is an available source of funding for SMEs in emerging markets, there is no widely available database that can be used to confirm the level of availability, access, or use of such funding. Some of the challenges in accessing this type of funding could be that (i) there are not many high-net-worth individuals within the purview or easy reach of most entrepreneurs in emerging markets and that (ii) a fairly high level of trust needs to be established between the entrepreneur and the angel investors to access this sort of funding.

4.2 Venture capital

VC is an important financing mechanism for early-stage SMEs; however, this form of financing is more readily available in developed countries than in emerging markets (Ahlstrom & Bruton, 2006). SMEs in emerging markets mostly seek finance from banks to fund their start-ups/early-stage ventures rather than from VC (Ahlstrom & Bruton, 2006). VC is the most readily available formal source of funding for SMEs in emerging markets outside of funding from banks; however, it is not easily accessible by most SMEs because (i) they do not know the VC firm or they are not known by the VC firm; or (ii) the SMEs do not have good growth prospects as a result of their existing business models or the industry in which they operate; or (iii) they are lossmaking and have limited prospects of being restructured to create value for the SME and the VC. In developed countries, VC usually has both formal and informal institutional support as it relates to selecting investee businesses/ventures, monitoring, value-added support, and exiting processes/options. However, this type of support for VC operating in emerging markets is limited to personal connections with entrepreneurs and public officials (Ahlstrom & Bruton, 2006).

It has been argued that the development and participation of VC in emerging markets are influenced by the presence of formal institutions that can help to ensure adherence to the law relating to the protection of property rights and/or capital. However, VC can still operate in emerging markets with support from informal institutions, such as business incubators, VC associations, or other entrepreneurship associations (Ahlstrom & Bruton, 2006; Mingo, 2013). It has also been argued that the development of entrepreneurial ecosystems that foster network connections among entrepreneurs, VCs, and various private and public institutions could help VCs address the various challenges they might face in emerging markets (Ahlstrom & Bruton, 2006; Mingo, 2013; Sun *et al.*, 2019).

The practice of corporate governance has an influence on the valuations of businesses by investors (Sanders & Boivie, 2004). This is even more the case for SMEs that target VC

funding since this market is private, and valuations can be difficult for both the SME and the VC. Corporate governance also plays a part in enabling the activities on which VC focuses when monitoring the activities and performance of investee companies (Pruthi *et al.*, 2003). Some of the challenges related to corporate governance in SMEs are (i) the quality (accuracy and reliability) of available information (financial and non-financial) for use in any business valuations, (ii) financial reporting and performance measurement; and (iii) the ability to conduct due diligence (Lockett *et al.*, 2002).

Various methods can be used to value businesses. However, despite the availability of these valuation methods, valuing a business is more of an art than a science. The common valuation methods are (i) the discounted cash flow method, which discounts future cash flows over a defined period, using a determined hurdle rate or estimated cost of capital to calculate the net present value; (ii) a comparison of the price versus earnings ratio (also known as the P/E ratio) to those of similar publicly listed entities and then discounting this to the size or development stage of the business being valued; (iii) an assets-based or resources-based valuation, which looks at the total value of the assets owned and/or under the control of the business, less any liabilities, to derive the net asset value; and (iv) a future sales or revenue forecast approach – a very common method for valuing new ventures and/or technology-based businesses that are likely not to have already captured a significant portion of their potential market share (Koller *et al.*, 2015; Marcello & Pozzoli, 2019).

It is important for entrepreneurs and/or SME owners/managers to understand how to value a business (using the valuation methods outlined above) to ensure that they have an appreciation of the valuations placed on their businesses/ventures by the various private capital investors with whom they will engage. This would also allow the SMEs to understand the funds they might be able to raise by issuing equity, and its impact on existing and/or future investors.

4.3 Private equity

It has been argued that PE firms increase the value of the investee companies by focusing on improving their corporate governance (Latini *et al.*, 2014; Süsi & Jaakson, 2020) and that their investment time horizon is usually shorter than that of angel investors or VC, but with a time horizon of five to seven years for a higher value (Süsi & Jaakson, 2020). Another way in which PE firms increase value is by improving investee companies' corporate social responsibility (CSR) – that is, the responsibility that an organisation takes for its impact on society and the initiatives that it undertakes to compensate for this impact (Süsi & Jaakson, 2020). Thus, for SMEs to attract the required investment from PE firms, they need to show their willingness to

improve their corporate governance and CSR activity over and above the ROI expected by PE firms.

The factors on which PE firms focus to improve the corporate governance of investee companies are (i) the board's composition and its communication – that is, its advisory role (on strategic input and industry expectations); (ii) shareholders' agreements; (iii) the selection of the chief executive officer (CEO), given their controlling role (with key performance indicators and with environmental, social, and governance [ESG] reporting); (iv) the respective code of conducts for the board, shareholders, and the CEO (Süsi & Jaakson, 2020); (v) the role of the chief finance officer (CFO); (vi) information transparency; and (vii) management's competence (Latini *et al.*, 2014). There is an increased focus on ESG by some PE firms to the extent that this influences their investment decision-making. If SMEs improve their practice of corporate governance, they increase their chances of accessing finance from outside or international sources for expansion (Latini *et al.*, 2014).

4.4 Theoretical framework

Following the findings from the research agenda and the content analysis of the publications from the past two decades that were identified, a theoretical framework (Figure 4) was developed. The framework could help SMEs determine which type of private capital funder they should approach for funding, depending on their stage of growth/development. It could also provide insight into the requirements or criteria which private capital funders look for so that they can prepare adequately and not waste the opportunity to present themselves effectively if given the opportunity to make a pitch. Securing funding from angel investors at the start-up stage, as shown in Figure 4, is crucial to enabling the entrepreneur's business/venture to start up and/or develop (Lindstrom & Olofsson, 2001). As shown in Figure 4 under 'survival' (stage 2) and 'expansion' (stage 4), it is permissible to have a mix of funders; in practice there are no limitations on which funder to approach, irrespective of the development stage.

Figure 4: Theoretical SME private capital financing framework

Growth stage	1 Start-up	2 Survival	3 Growth	4 Expansion	5 Maturity
Financing mode					

Investor elements / characteristics

Angel Investor	Venture Capital	Private Equity
• No collateral • Formation stage • Product/service development • Proof of concept and/or business model • Business management support required	• Scaling up capital • Business model refinement • Business management support might be required • Inventory/raw materials financing • Debtors financing • Capital equipment acquisition	• Scaling up capital • Mass production / distribution financing • Improved corporate governance • Initial public offering/listing (IPO) support

Key: Angel Investor | Venture Capital | Private Equity

Source: Author's own compilation adapted from Divakaran *et al*. (2014)

4.5 Funding pitching guide

It is important for SMEs to have the skills to prepare and present a business funding request pitch to prospective investors if they wish to increase their chances of accessing the required funding (Sheen & Gallo, 2015; Van Werven *et al.*, 2019). In this regard, a funding pitch guide has been developed to assist SMEs in preparing their pitches or business cases. The list of ten questions presented in this guide has been adapted from the publications of Sheen and Gallo (2015) and Van Werven *et al.* (2019), as well as from insight gained from this review. The questions are meant to guide the SMEs in their pitch preparations: they should endeavour to answer the questions in detail and be able to communicate these answers effectively and concisely to prospective investors.

(i) What problem(s) are you solving, and who are the target customers?

(ii) What products and/or services will you offer these customers?

(iii) What is the market opportunity (and how big is it)?

(iv) What is your business model? (That is, how do you create value for your customers and shareholders? Is the business model scalable?);

(v) What is your current business performance related to this business opportunity? (That is, what is your current financial position? What are your future financial projections? What are the associated assumptions?);

(vi) Do you have a team/staff with the skills and experience to deliver on this opportunity or to run the business venture?

(vii) How will the required funding further develop and grow the venture?

(viii) Will you require any other funding or support beyond what you are requesting now?

(ix) What critical challenges or risks do you currently face or are likely to face? (for example, regulatory, legal, and disruptive technologies);

(x) What are the CSR objectives of the venture, and how compliant is your venture with ESG investing/reporting requirements?

Communicating the pitch effectively (whether by email, print format, and/or verbally) is very important. When presenting verbally, it is important that what is being communicated is aligned with the content that would already have been shared with the prospective investors, whether electronically or in physical print format. Hence, there is a need for the presenter or entrepreneur to rehearse the pitch and familiarise themselves with all the pitch content so that they are well-prepared to answer any questions (Van Werven *et al.*, 2019).

5. CONCLUSION

Providing SMEs with an understanding of the various kinds of private capital funders is very useful in their entrepreneurial journey so that they know (i) who they can approach and (ii) the requirements that private capital funders look for. In this way, they could be better prepared to pitch for the investment they require and ensure that their business operations are aligned to meet the prospective investors' requirements. There have been three primary forms of private capital funders for SME businesses or ventures in the two decades from 2001 to 2020: (i) angel investors, (ii) venture capital, and (iii) private equity. A new form of private capital funding, called crowdfunding, has been introduced; however, this has not gained much traction in most emerging markets. A theoretical framework to guide SMEs and/or entrepreneurs was developed in order for them to determine which type of private capital funder they should approach for funding, depending on their stage of growth/development

(Figure 4). A funding pitch guide was also developed to assist entrepreneurs in their preparation and presentations when pitching for funding from private capital funders.

Most SMEs go through multiple rounds of investment throughout their growth and development, beginning with the 'Series A' investment round and followed by the Series B, C, and D funding rounds (Mallaby, 2022). Series D is not necessarily the last funding round/cycle, but most SMEs go through four or five cycles of funding before reaching the maturity stage. Private capital funders usually invest for about ten years (Giaquinto & Bortoluzzo, 2020); however, most PE funders invest for periods ranging between three and seven years before exiting (Divakaran *et al.*, 2014). Most exits by both entrepreneurs and private capital investors occur when the SMEs raise more funding by disposing of equity in their businesses/ventures or when they do an IPO (Martino *et al.*, 2022).

Over and above gaining access to private capital funders, mastering the ability to pitch to investors is likely to increase the opportunity to secure the required funding. A good pitch will effectively communicate to the prospective investor the rationale for making the investment by providing the necessary information on the business/venture and its potential benefits.

The practice of corporate governance was cited as having an influence on investors' valuation of a business (Sanders & Boivie, 2004). This is even more the case for SMEs targeting VC for funding since this market is private, and valuations could be difficult for both the SME and the VC firm. It was also argued that PE firms increase the value of the investee companies by focusing on improving their corporate governance (Latini *et al.*, 2014; Süsi & Jaakson, 2020). Thus, if SMEs focused on practising and improving their corporate governance, they could increase their chances of raising private capital.

5.1 Limitations of the research

The main limitation that this review faced was using Scopus as the sole database for sourcing the articles for the systematic review.

5.2 Areas for further research

Following the findings that angel investors are a powerful economic force in funding early-stage ventures/start-ups, thus enabling entrepreneurship to thrive (Morrissette, 2007; Cumming & Zhang, 2019) and that there is insufficient data on angel investor activity, it is recommended that future research establish how to build an ecosystem that enables SMEs to know and meet angel investors, and so address the limitation of not having access to angel investors and help to build the necessary relationships. The challenges and the solutions identified by this study relating to SMEs' access to private capital funding were not ranked in

any order, whether based on impact and/or on influence; thus, an assessment of their impact and/or influence could be the focus of follow-up research on this subject.

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Appendix 1: Publications identified for analysis

Stage	No.	References / Titles	Key findings related to access to funding and financing SMEs
Angel investor	P1	Giaquinto, L.H. & Bortoluzzo, A.B. 2020. Angel investors, seed-stage investors and founders influence on FinTech funding: an emerging market context. *Macroeconomics and Finance in Emerging Market Economies*, 13(3):276-294. [https://doi.org/10.1080/17520843.2020.1737169].	• There is a positive relationship between having received investment from an angel investor and follow-on funding, and • A negative relationship with having a single founder
	P2	Cumming, D. & Zhang, Y. 2016. Alternative investments in emerging markets: a review and new trends. *Emerging Markets Review*, 29:1-23. [https://doi.org/10.1016/j.ememar.2016.08.022].	• Research on alternative investments has increased over the years (2000 to 2016)
Venture capital 2001 to 2010	P3	Sanders, W.G. & Boivie, S. 2004. Sorting things out: valuation of new firms in uncertain markets. *Strategic Management Journal*, 25(2):167-186. [https://doi.org/10.1002/smj.370].	• Corporate governance practice/characteristics have a positive influence on the valuation of firms and reduce investor uncertainty
	P4	Ahlstrom, D. & Bruton, G.D. 2006. Venture capital in emerging economies: networks and institutional change. *Entrepreneurship theory and practice*, 30(2):299-320. [https://doi.org/10.1111%2Fj.1540-6520.2006.00122.x].	• There is a positive relationship between the presence of formal and informal institutions in emerging markets with access to funding for SMEs from VC
	P5	Grebel, T., Pyka, A. & Hanusch, H. 2003. An evolutionary approach to the theory of entrepreneurship. *Industry and innovation*, 10(4):493-514. [https://doi.org/10.1080/1366271032000163702].	• Entrepreneurship is fostered because of the entrepreneur's endowments and social network, and the state of the economy • The survival of SMEs in the early stage is dependent on the availability of and relationship between human capital and VC
	P6	Wright, M., Lockett, A. & Pruthi, S. 2002. Internationalisation of Western venture capitalists into emerging markets: risk assessment and information in India. *Small Business Economics*, 19(1):13-29. [https://doi.org/10.1023/A%3A1015729430581].	• International VC entering or funding SMEs in emerging markets places more emphasis on the product's market factors and reports from accountants when assessing the risk and valuation associated with investment in the SME
	P7	Pruthi, S., Wright, M. & Lockett, A. 2003. Do foreign and domestic venture capital firms differ in their monitoring of investees?. *Asia Pacific Journal of Management*, 20(2):175-204. [https://doi.org/10.1023/A:1023840432241].	• Foreign VC focuses more on the strategic level activities, and emphasises restrictions on additional funding and monthly management reporting, whereas local VC focuses more on

			operational activities, looking at accounting policies and industry specialist board membership
	P8	Lockett, A., Wright, M., Sapienza, H. & Pruthi, S. 2002. Venture capital investors, valuation and information: a comparative study of the US, Hong Kong, India and Singapore. *Venture Capital: An International Journal of Entrepreneurial Finance*, 4(3):237-252. [https://doi.org/10.1080/13691060213715].	• Specifies challenges with business valuations and comparisons thereof • There are significant differences in the use of the asset valuation, earnings before interest, tax, depreciation, and amortisation (EBITDA) methods, and the use of the various sources of information used in the valuations
	P9	Lindstrom, G. & Olofsson, C. 2001. Early stage financing of NTBFs: an analysis of contributions from support actors. *Venture Capital: An International Journal of Entrepreneurial Finance*, 3(2):151-168. [https://doi.org/10.1080/13691060110042754].	• Technology-based firms at the forefront experience greater challenges in raising funding than do less technology-based firms; this is the same for high-growth firms compared with low-growth firms
	P10	Groh, A.P. & Von Liechtenstein, H. 2009. How attractive is central Eastern Europe for risk capital investors?. *Journal of International Money and Finance*, 28(4):625-647. [https://doi.org/10.1016/j.jimonfin.2009.01.006].	• Proposes six key drivers that determine an emerging market's attractiveness to venture capital and private equity investments • Corporate governance and protection of investor rights are the most important
	P11	de Lima Ribeiro, L. & Gledson de Carvalho, A. 2008. Private equity and venture capital in an emerging economy: evidence from Brazil. *Venture Capital*, 10(2):111-126. [https://doi.org/10.1080/13691060801946121].	• The lack of infrastructure and security provides opportunities for VC and PE firms to invest in SMEs operating in this space; however, VC and PE activity is limited in Brazil
	P12	Klonowski, D. 2007. The venture capital investment process in emerging markets: evidence from Central and Eastern Europe. *International Journal of Emerging Markets*, 2(4):361. [https://doi.org/10.1108/17468800710824518].	• Confirms a nine-stage process that VC follows when assessing an investee company for investment
Venture capital 2011 to 2020	P13	Klonowski, D. 2012. Liquidity gaps in financing the SME sector in an emerging market: evidence from Poland. *International Journal of Emerging Markets*, 7(3):335. [https://doi.org/10.1108/17468801211237072].	• Lack of access to capital is the biggest challenge (or major obstacle) faced by SMEs
	P14	Groh, A.P. & Wallmeroth, J. 2016. Determinants of venture capital investments in emerging markets. *Emerging Markets Review*, 29:104-132. [https://doi.org/10.1016/j.ememar.2016.08.020].	• M&A activity, legal rights and investor protection, innovation, intellectual property (IP) protection, corruption, corporate tax, and unemployment are determinants that influence VC activity

	P15	Humphery-Jenner, M. & Suchard, J.A. 2013. Foreign VCs and venture success: evidence from China. *Journal of Corporate Finance*, 21:16-35. [https://doi.org/10.1016/j.jcorpfin.2013.01.003].	• An investment from a foreign VC does not necessarily increase the chances of the SME's success
	P16	Stuart, T. & Wang, Y. 2016. Who cooks the books in China, and does it pay? evidence from private, high-technology firms. *Strategic Management Journal*, 37(13):2658-2676. [https://doi.org/10.1002/smj.2466].	• Challenges in financial reporting that shows a significant gap in reported profits from the same organisations reporting to two different stage agencies; this lack of sound corporate governance affects the confidence of private capital funders in the ventures
	P17	Sun, S.L., Chen, V.Z., Sunny, S.A. & Chen, J. 2019. Venture capital as an innovation ecosystem engineer in an emerging market. *International Business Review*, 28(5):101-485. [https://doi.org/10.1016/j.ibusrev.2018.02.012].	• VC is an important intervention in fostering an ecosystem that promotes innovation among SMEs by ensuring that funds are channelled to innovative ventures
	P18	Liao, W.M., Lu, C.C. & Wang, H. 2014. Venture capital, corporate governance, and financial stability of IPO firms. *Emerging Markets Review*, 18:19-33. [https://doi.org/10.1016/j.ememar.2013.11.002].	• VC investment assists in avoiding ownership concentration in SMEs that leads to the problem of excess control • VC provides SMEs with financial stability
	P19	Mingo, S., Morales, F. & Dau, L.A. 2018. The interplay of national distances and regional networks: private equity investments in emerging markets. *Journal of International Business Studies*, 49(3):371-386. [https://doi.org/10.1057/s41267-017-0141-5].	• Institutional and geographic distance from the investee company has an impact on the investment strategies adopted by PE firms
	P20	Gu, W. & Qian, X. 2019. Does venture capital foster entrepreneurship in an emerging market?. *Journal of Business Research*, 101:803-810. [https://doi.org/10.1016/j.jbusres.2018.12.011].	• VC fosters innovation entrepreneurship (IE) in emerging markets. IE is the promotion of technology and management innovation
	P21	Mingo, S. 2013. Entrepreneurial ventures, institutional voids, and business group affiliation: the case of two Brazilian start-ups, 2002-2009. *Academia Revista Latinoamericana de Administración*, 26(1):61-76. [https://doi.org/10.1108/ARLA-05-2013-0040].	• Business group affiliations facilitate the development of SMEs/ entrepreneurial ventures
	P22	Zheng, Y. & Xia, J. 2018. Resource dependence and network relations: a test of venture capital investment termination in China. *Journal of Management Studies*, 55(2):295-319. [https://doi.org/10.1111/joms.12255].	• The decision to terminate an investment in an SME is dependent on the relationship between the VC and the SME, and on the relationship between the VC and other VC firms • VC firms are likely to terminate investments in industries where they have the highest number of investee companies

Private equity	P23	Süsi, V. & Jaakson, K. 2020. Corporate governance and corporate social responsibility interface: a case study of private equity. *Corporate Governance: The International Journal of Business in Society*, 20(4):703-717. [https://doi.org/10.1108/CG-11-2019-0348].	• Corporate governance can be designed to achieve both financial and corporate social responsibility (CSR) • Long-term sustainability supported by CSR increases a firm's value
	P24	Montchaud, S. 2014. The interest of private equity and venture capital for the financing of entrepreneurship in emerging markets. *International Journal of Economics and Business Research*, 7(2):220-240. [https://www.inderscienceonline.com/doi/full/10.1504/IJEBR.2014.060033.	• PE and VC funding has a positive quantitative and qualitative impact on firms in their formation, growth, or transformation
	P25	Latini, E.T., Fontes-Filho, J.R. & Chambers, E.L. 2014. Private equity and corporate governance: managing Brazilian SMEs. *Corporate Governance*, 14(2):220-237. [https://doi.org/10.1108/CG-02-2013-0017].	• PE and VC investment in SMEs improves their practice of corporate governance • Improved corporate governance in SMEs increases their chances of accessing finance from outside/international sources for expansion

Source: Author (2023)