An Empirical Study of Quasi Equity of SMEs: Evidence from The Hotels Of Himachal Pradesh

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Abstract

The initial source that an budding entrepreneur explores for the financing its newly set-up business is loan/funds mobilized from his friends and relatives. Following personal resources are the possible sources for meeting the financial requirements of a small scale business-personal savings, provided fund, from friends and relatives, personal asset sales, credit cards, inheritance, stock option sales etc. Since, these funds can be attributed to the family they are almost treated equivalent to equity contribution. These funds are commonly termed as Quasi-Equity (QE) or Equity 'de-facto'. This study is based on the hotels of Dharamshala Tehsil of District Kangra in HP and analyze the factors that prompt the small-scale hotels towards mobilization of such QE. These loans are unsecured in nature and remain dominated to the loans provided by banks and financial institutions.

Keywords: Entrepreneur, Financial, Quasi-Equity, Unsecured, Stock

INTRODUCTION

From a promoter's perspective, financing a firm's operation or acquisition of assets is perhaps the most important dimension of running the business. Now, this involves a decision regarding zeroing on certain sources which will enable the promoter to arrange for the required funds. The capital structure of an enterprise constitutes a judicial mixture of debt and equity capital. The debt capital, usually classified into two portions: the long-term debt portion which is an asset based finance, demands good credentials before it can be raised. The short-term debt is working capital finance but is available only after business starts. The promoter's capital is in the form of equity and new ventures also have access to preference share capital, a major portion of which is mobilized from source close to the promoter.

- Kangra District in Himachal Pradesh is a noted valley in the lap of lesser Himalayas. The place visited most in the District is one famous for three 'D's' i.e. Dharamsala (the name of the place),Dhauladhar (the snow covered Himalayan mountain range overlooking the town) and HH the Dalai Lama (the virtual God in Tibetan clan and winner of noble peace prize in 1989.Dharamsala is a picturesque hill station and winter capital of Himachal Pradesh with its rich potential for tourism industry.Yet,the opportunity the place provides fir tourism sector is not exploited and the place stills lacks even basic facilities like good network of roads ,good hotels, regular air service etc. considered as pre-requisition for attracting tourists to the place. The town is connected by air through only one Gaggal airport which provides air-services from Delhi/Chandigarh twice a week. The nearest railway station is 90 Kms at Pathankot. Thus, the only and mostly preferred way of commuting to the place is by road where it takes around 13-14 hours to reach Dharamsala from Delhi. A common statement heard here from foreign tourists is thus, "I covered first 1300 kms (from New York to Delhi) in 14 hours and it took another 14 hours to cover the remaining 525 Kms (Delhi-Dharamsala).The place as yet has only big-shot tourism company showing its presence i.e. Club Mahindra Kangra Valley Resort. No other big name has thought of venturing into the palace in spite of business potential. The other worth mentioning hotels of the town are :-

- Hotel Asia Health Resort
- Hotel Dhauladhar
- Hotel Tea Bud
- Hotel Honeymoon Inn
- Taragarh Palace
- Hotel Pong View
- Asia Health Resort
- Hotel Tibet
- Hotel Kunal
- Hotel Kashmir Lodge
- Our study will focus on the financing pattern of above mentioned hotels.

This study makes an attempt to analyze the nature of such Quasi-Equity (unsecured loans) as a source of funding and also the factors/situations that may prompt the Hoteliers towards mobilization of such loans.

Financing a small scale Hotel: Issues

1. Mostly first generation entrepreneurs in the Industry.
2. Technology/Single function focused (inadequate appreciation of other functions)
3. Limited financial resources.
4. Inadequate strength/cohesion of management team
5. Control oriented i.e. inadequate delegation
6. Percentage stake issues

Requirements from a capital provider in the form of:-

1. Appropriate capital
2. Patient capital
3. Incentive for performance to promoters
4. Financing of soft expenses
5. Follow-on funding
6. Scope for networking
7. Functions as partners, not just as financial investor

As evident from the above mentioned issues, for financing a business like a small scale hotel, especially in the initial phase the most practically reliable source of capital comes in the form of unsecured loans from close sources.

This unsecured loans come mostly from close sources and help in supplementing the equity contribution by the promoters, especially when financial institutions are not lending. The institutional lending at the initial stages is not very forthcoming. The traditional financing options of loans from Banks, Financial institutions faces problems like:-

(i) Security –As assets are largely intangible as well as inadequate.
(ii) Lack of financial contribution from the promoter-Financial institutions is not comfortable with the promoter's role of a mere idea giver with little or no financial commitment.
(iii) Servicing capacity uncertain-Due to volatility in cash flows.
(iv) High risk profile-Due to
    a. No established model
    b. Technological obsolesce
    c. Dependence on human capital
    d. Service industry where there is no concrete production
(v) Business control-
    a. Promoter's attitude to have a 100% control and the power to make decisions.
    b. Long term plans for succession and the impact on family traditions.

In Indian context, many organized lending institutions like banks and financial institutions in order to spread their risk demands capital contribution by the promoters by way of equity capital and also by way of interest-free unsecured loans from friends and relatives. Since, this loan is garnered from family sources; many lenders treat this as a proxy fro the promoter's own funds and term it Quasi-Equity.

IMPORTANCE

.Importance of this study is that how the small and medium enterprises initially arrange their funds to run the organization. After that what are the changes they adopt in the organizational policies to turn the organization into a growing organization. And as the organization grows in size, how its capital structure also transforms with the share of equity capital growing eventually to become the major source of fund for such an organization. In the earlier growth stage what are the different resources from where they are funding there small projects

REVIEW OF LITERATURE

DD Mukherjee and SK Bose has done "**A study on quasi equity of SMEs: evidence from the auto ancillary manufacturing units of Jiharkhand".** Now I will be reviewing this study on hotels.
In India, the study in respect of various elements of capital structure has mostly focused on the corporate sector. The study suggested that either as a sole sources of funds or in combination with other sources, personal saving were used by over one half the small businesses studied by them and loans from friends and relatives were found to be quite common and provided either large levels or low levels of debt.

In a study on the "**determinants on the small business growth constraints in Nigeria, and other sub-Saharan African economy**", **Opkara and Pamela** concluded that amongst the most important factors in this regard was a lack financial support. They suggested that business owners should source cheap low interest loans from bank and other financial institution, borrow from friends and relatives with the intent to repay the money, negotiate advance payments from customers, and seek loans from micro financial institutions.

According to **Kallon K M** in his article "**The Economics of Sierra Leonean Entrepreneurship"** It was observed by Kallon that in about 65.6 percent of the firms are under the study, capital needs were entirely met from personal savings of the promoters. About 10.9 percent of the firms are dependent on the family savings for the capital need s. Commercial bank provide loan in case of 9.4 percent of the firms. About 7.8 percent of the firms mobilized saving from the shareholder and partners.

Objectives

The main objectives of this study with specific reference to the financing pattern of small scale Hotels existing in the hill station and tourist destination of Dharamshala in Kangra District of Himachal Pradesh are:

- Whether the following factors prompt an enterprise to mobilize unsecured loans from friends and relatives:
  Business level-Occupancy rate
  Profit generation/cash accrual capacity

- In cases where unsecured loans from friends and relatives have been mobilized, whether in such cases the level of unsecured loans has any distinct correlation with the level of business (Hereby taken as occupancy rate.)

Research Methodology:

1. In respect of our database of 10 hotels, we've computed the level of unsecured loans from friends and relatives of the promoters as a percentage of total value of capital introduced at the inception stage. This forms the core part of our general database for the analysis. Regression analysis of unsecured loan has then been carried out against variables like (cash inflow) revenue earned and profit after Tax (PAT).

2. A trend analysis of this ratios vis a vis the revenue generated by the hotels was then done over a period undertaking linear regression as regression model. Both the values a R2 (coefficient of determination) and R (correlation coefficient) were computed in respect of all these three models. Though the R value indicated both the direction of the correlation between the two variables (positive and negative) as well as the degree of such correlation, we've relied on the R value for the direction of correlation and on the R2 value or the degree of such relationship. It is because the value of R ranges between +1 and -1 and therefore, a higher value of R2 would provide a stringent comparison and a higher degree of comfort while determining the degree of

relationship.

Explanation of the Statistical Tools used in the Analysis

In a regression analysis,R2 is called the coefficient of determination, which gives the fraction of the total variation of Y that is explained by the regression line. It is an important measure of the degree of association between X and Y.

In a linear regression, the sample coefficient of determination is given by:

$r^2 = 1 - (Y - Yr)2 / (Y - Y_{av})2$

where Y represents the estimated values of Y from the estimated equation that correspond to each Y value, and the square root of the above value given by r= r2 is called the correlation coefficient. Its sign determines the direction towards which the correlation is aimed.

Analysis and observation

1. The R2 frequency distribution in respect of unsecured loan vs. cash accrual is given in Table 1:1.The corresponding R value frequency distribution in respect of Unsecured vs.cash inflow is presented in Table 1:2.

Table 1:1 R2 frequency Distribution in respect of USL vs. Occupancy rate

Range	Frequency	Cumulative Percentage
Upto 0.3	4	40%
>0.3 to 0.5	2	60%
>0.5 to 0.7	3	90%
>0.7 to 0.9	-	-
>0.9 to 0.10	1	100%
Total	10	

Source: Primary data

International Journal of Scientific Research in Engineering and Management (IJSREM)
Volume: 08 Issue: 06 | June - 2024 SJIF Rating: 8.448 ISSN: 2582-3930

Observation

Out of the 10 units in the sample, maximum units i.e. 9 showed a positive linear correlation which ranged between 0.7 to 0.9.

2. General Statistical analysis of the USL pertaining to various levels of cash Accruals:

Table 1:3 presents the frequency distribution of the variable USL. This contains one data containing a high value of the variable which renders the distribution highly skewed. We have therefore trimmed this data from the table and have undertaken a general statistical analysis on the basis of the trimmed data (Table 1:4)

The following observations can be made from Table 1:3 & 1:4

Table: 1:3: The frequency distribution of the USL vs. Cash Accruals

Range	**Frequency**
Upto 0.1	4
>0.1 – 0.2	2
>0.2 – 0.3	1
>0.3 – 0.4	2
>0.4– 0.5	0
>0.5 – 0.6	0
>0.6 – 0.7	1
Total	10

Source: Primary data

Table 1:4: General Statistical Analysis

USL Grouped as per cash accruals (in Range)	**< Rs.1 Cr**	**> 5 Cr**	**Total Trimmed Sample**
Mean	0.144	0.090	0.123
Standard Error	0.019	0.023	0.021
Median	0.078	0.032	0.053
Standard Deviation	0.113	0.121	0.112
Coefficient of variable	0.483	0.621	0.531
Total	**7**	**3**	**10**

Source: Primary data

- As seen from the above data, 7 out of 10 units (70%) have the above variable within the range of 0.3.There are 9 units (90%) which have a higher USL value. The mean of the sample is 0.123 which is reasonably supported by the above data. However, the standard deviation is quite high compared to the mean, with the coefficient of variation (SD/Mean) of 53%.This suggests that the data is highly scattered.

- The sample has therefore been classified into two categories. The variable pertaining to the units of sale of less than Rs.1 crore shows a coefficient of variable of 48.3% which is slightly better than the total sample figure. On the other hand, the variable pertaining to the units of sale more than Rs.1 crore shows a much higher coefficient of variation of 96.26%.

- Both the above data suggest that the level of business/cash accruals is not a deciding factor behind mobilization of unsecured loans from friends and relatives.

Conclusions

The following concluding points emerge from the above empirical analysis:

- Quasi-Equity or unsecured loan from friends and relatives is commonly employed in small-scale hotels of Dharamshala town specially those with a relatively lower sales turnover.

- The decreased percentage of USL in hotels with better occupancy rate or cash accruals can be attributed to :-

  (i) Relatively more sources of funds available with such units.
  (ii) The promoter's inclination to invest such funds in avenues that would give them better returns.

- For small turnover hotels, the owner's decision to mobilize USL does not depend on the cash earning capacity of the enterprise. It indicates that infusion of USL into the total capital of the enterprise is depended on factors other than profit earning.

- However, in cases where hotels have mobilized USL its proportion reduces with the growing volume of occupancy rate or as the level of business grows. This is probably because with increased business comes increased security, internally as well as externally and this leads to growth in the external lender's confidence also who now feel secure enough to finance the fund requirements of growing hotels.

The findings are, however, empirical in nature and more studies in this context are required.

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