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Financial Constraints and Funding Solutions for Small Startups in Emerging Markets

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ABSTRACT

This paper aims to analyse the challenges that small startups experience in emerging markets when accessing finance, the feasibility of non-traditional sources of funding, and the relevant policies that can help enhance funding. Intensified poverty and a lack of physical infrastructure that factors traditional banking solutions derive their effectiveness from means small startups in these areas have low access to credit, high interest rates, and underdeveloped venture capital markets. These constraints limit their advancement, expansion, and capacity to operate and maintain their businesses and thus are characterised by high failure rates. Others are; crowdfunding, microfinancing, and digital lending which can be considered as crucial methods used in bridging the gap in funding. Crowdfunding equalises capital access since Startups can issue funds directly from the public while microfinance offers small and flexible credit to non-mainstream business people. Digital lending comes with the assistance of technology which enables fast and convenient access to the loans and, therefore, supplements the funding challenge that startups with no credit pasts face. However, each of these solutions has restrictions in terms of fees, the maximum loan amount, and problems with regulation. This paper emphasises the need for appropriate policies to support the improvement of access to finance among startups. Other measures proposed are the development of credit guarantee schemes, reduction of bureaucratic rules and regulations, encouragement of FDI through tax incentives, and the use of technology in the provision of financial services. Besides, enlarging the financial literacy of intending and existing businessmen and enhancing the credit information infrastructure can very much enhance financing. From the study, it becomes clear that it will need to employ diversified strategies that put into practice various non-conventional funding paradigms alongside positive policies to facilitate a vibrant and progressive entrepreneurial culture within emerging markets. In other words, by overcoming such factors as financial limitations and improving an environment for such start-ups' evolution, their key influence is being capable of promoting regional developments with the help of innovations in emerging *small start-ups. The dissertation is useful to anyone interested in developing policy and practice that can encourage financial liberalisation and foster entrepreneurship for the growing economies.*

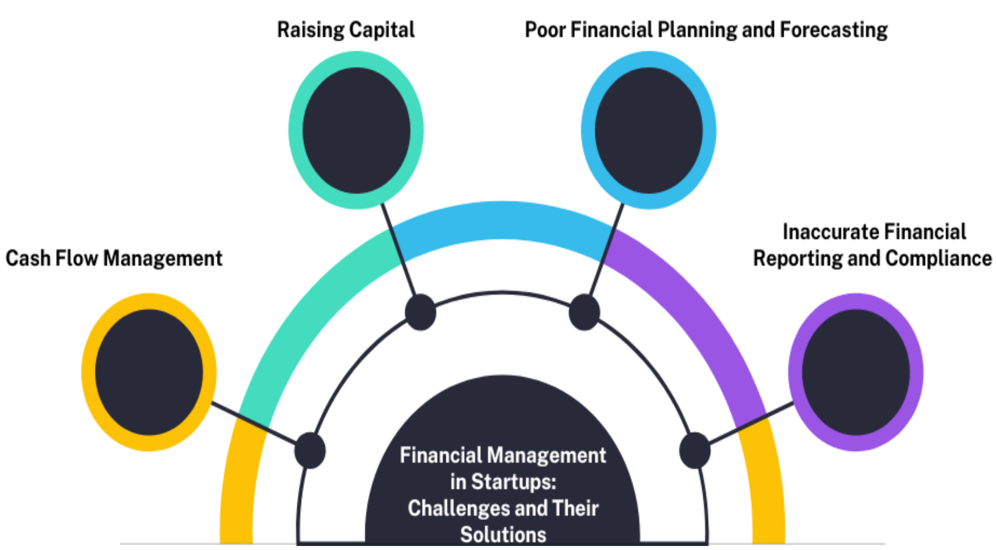
Keywords: Financial Constraints, Small Startups, Emerging Markets, Crowdfunding, Microfinance.

Chapter 1: Introduction

Research Background

Small startups in emerging markets struggle with various issues, the most prominent of which are lack of adequate resources to support their operations. Such markets have certain nuances, namely, restricted opportunities for financing, undeveloped financial infrastructures, and economic riskiness for new ventures (Cecere, Corrocher, & Mancusi, 2020). Bank loans, venture capital and private equity to finance projects are normally out of the question as they are expensive, come with a lot of conditions, and the view that these regions are high-risk investment arenas. Also, because of the nature of most startup enterprises in the emergent markets, they often cannot offer collateral, credit references and more importantly, proper legal structures to the financial markets; hence, the limited access to finance. Funding opportunities in the above markets have transformed with the availability of new funding models such as crowdfunding, microfinance, angel funding, and government funding among others.

Figure 1: Financial Management in Start-ups



Source- (Cecere, Corrocher, & Mancusi, 2020)

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

However, these options still have an irregularity in the rate of success and availability for many start-ups, leaving many in difficulty acquiring the relevant funding. The increased prominence of digitization and the expansion of fintech have also brought new financial solutions into the market; however, challenges such as regulation and a limited level of digitalisation remain. It is equally important for the growth of such economies, eradication of poverty and creation of employment to understand the financial limitations and discover potential funding options for these startups. The purpose of this research is to understand these constraints and explore viable solutions to increase FI and ensure the effective sustainability of small startups in these areas.

Research Rationale

This research is crucial because small startups are some of the main catalysts of growth, creativity, and employment in emerging markets where traditional job offerings may be lacking. Nevertheless, funding challenges hinder their growth, the development of new products, and their impact on the overall economy. Solving these difficulties is crucial for the stabilisation and further growth of these economies as well as for the survival of individual enterprises (Panda, 2018). This research could help to achieve the following goals: The study intends to contribute to the existing body of knowledge by examining the financial constraints faced by emerging market new ventures and discussing the conventional and innovative funding models. This research will provide information that can be useful for policymakers, investors, and entrepreneurs on how the accessibility of credit can be improved. By highlighting best-practice funding models, as well as pointing to areas of potential improvement, the study will contribute to the process of creating a better financial environment that would allow small startups to develop under difficult circumstances.

Research Objectives

- To analyse the key financial constraints faced by small startups in emerging markets
- To evaluate the effectiveness of alternative funding solutions for small startups in emerging markets
- To provide policy recommendations for enhancing access to finance for startups in emerging markets

Research Questions

1. What are the primary financial constraints faced by small startups in emerging markets?
2. How effective are alternative funding solutions, such as crowdfunding, microfinance, and digital lending, in addressing the financial challenges of startups in these markets?

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

3. What policy measures can be implemented to improve access to finance for small startups in emerging markets?

Research Gap

Although the extended appreciation of the potential of small startups for economic development especially in the developing nations, there is a research void in the area of the financial difficulty that these businesses encountered and the feasibility of the fund enhancement solutions. Indeed, the majority of many previous studies were conducted in the context of new ventures originating in developed economies where VC, angel investors' capital, and efficient stock markets are quite well developed. Nevertheless, research on startups in emerging markets is scarce, especially as to how they manage financial resources and the applicability of innovative financing models (Block et al. 2021). It is also crucial to note the absence of extensive research into digital financial interventions, microfinance, and crowdfunding concerning the identification of innovation and non-conventional financing sources in these areas. Moreover, much-published research lacks consideration of the policy conditions and their impact on the availability of financial resources in startups. This research gap requires a timely and sector-specific investigation to offer relevant data that will let stakeholders learn about the best funding strategies for EMs based on the conditions prevalent in those regions. It is equally important to note that filling this void is critical for developing the financial landscape, encouraging small business creation, and stimulating the economies of regions that can afford innovation but cannot support it with the established financial systems.

Chapter Summary

This chapter also presents the investigation of the limitations in small startups' first-round funding selection and the funding strategies in emerging markets. These issues include but are not limited to inadequate access to conventional sources of capital, weak financial structures, and volatile economic conditions. However, emerging modes of financing such as crowdfunding, microfinancing, and fintech innovations present alternative solutions, which have had mixed efficacy and experienced challenges concerning regulation and digitization. The research rationale is based on the need to focus on these financial challenges since startups play a crucial role in economic development, innovative solutions, and employment generation in emerging economies. The chapter outlines three main objectives: examining fiscal limitations, assessing prospective funding options, and offering guidelines to improve funding services. The specified research gap supports the absence of specialised studies dedicated to startups in emerging markets and further emphasises the need for a careful assessment of the effects of various sources of funds and policy implications. This study intends to address the indicated scarcity and support the improvement of an appropriate and favourable environment for these startups.

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

Chapter 2: Literature Review

2.1. Theme 1: Financial Constraints Faced by Small Startups in Emerging Markets

As per Panda, S. (2018), the availability of funds for small startups in small emerging markets is a huge problem since it limits, hinders and challenges their operations and sustenance. There is a problem of exclusion from mainstream formal financial entities because of the perceived risk of such activities. Start-ups are considered too risky by banks and other traditional sources of finance due to lack of security, and volatile cash flows, credit is either granted at very high interest rates or rejected. Also, emerging markets have weak financial systems that heighten these problems, thus creating a demand and supply gap in the financial markets. Startups are discouraged by the high costs that are entailed in the process of obtaining formal finance. The interest rates are usually high, the loan options are offered with a lot of restrictions, and the application process is complex, why bank financing is unviable for most Small Businesses (Rao et al. 2023). In addition, there is a major problem, namely, many of these founders are still a long way from being financially literate which in turn limits their ability to manoeuvre financially. Most business owners are often unaware of the available funding sources and appropriate financial management skills and hence miss good potential for expansion.

As per Salamzadeh & Dana, (2021). Equity financing is another constraint since there are few sources of venture capital and angel investors willing to venture into risky terrain typical of emerging markets. Managers are usually conservative, and this is why they focus more on mature businesses with stable strategies. This caution keeps equity funding for start-ups in its early stages only. This alongside the underdeveloped capital markets discourages the startups from accessing funding through the public float. Informal fine structural restraint; however, the final sets of fines contain cultural beliefs towards borrowing and patent fondness. Small business owners in emerging economies use internal funds, and informal funds, which are not appropriate for scaling up. Collectively these constraints define a difficult climate, which makes it difficult for the start-ups to access the capital that they need for growth and development most of which result in high failure rates.

2.2. Theme 2: Alternative Funding Solutions for Startups in Emerging Markets

As per Ullah, B. (2020), due to the challenge of inadequate capital among emerging market startups, other sources of funding have emerged as feasible alternatives. Such an alternative includes microcredit which gives small credit facilities to individuals who cannot get credit facilities from conventional commercial banks. Through flexible loan contracts where borrowers are demanded to offer minimal security and formal business plans Microfinance institutions play a middle link by availing finances for startups. These institutions tend to specialise in lending

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

based on community, which enhances the accessibility of credit for the business persons in the disadvantaged regions. Another relatively new tool can be considered crowdfunding, which helps use technologies to search for investors among potential users from all over the world for startups. Places like Kickstarter and Indiegogo help entrepreneurs to funds through public funding, not a conventional bank or any lending institution. Therefore, crowdfunding not only offers funding but also generates external approval of business propositions that can help attract more funding. However, the usefulness of crowdfunding in emerging markets may be constrained by the technology, and low internet connection.

As per Ndiaye et al. (2018), equity financing is another external source of funding that involves angel investors and venture capitalists. While they have been rare previously in emerging markets, those investors have been appearing gradually as the ecosystems expand. Angel investors add not only money but also share their experience, which is helpful for startups that face many challenges on their way. The funds from the VC Sources have also reached more regional participants involved in high-growth sectors such as technology and fintechs and have made equity financing accessible to the startups.

Atiase et al. (2018), stated that government and development finance institutions are indeed central in plugging the funding gap. Public schemes like the governor's loan guarantee, grants for startups, and seed capital programs reduce risks associated with funding new business ventures. International development agencies and NGOs also provide financial support, technical assistance and other capacity-building initiatives in other areas such as financial management that are available to startups. Altogether these innovative funding sources comprise a harmonious financial platform that helps embrace new small startups. Nevertheless, there are issues regarding the expansibility and longevity of these funding modes that require concern and innovations as well as friendly policies.

2.3. Theme 3: Policy and Regulatory Environment Influencing Access to Finance

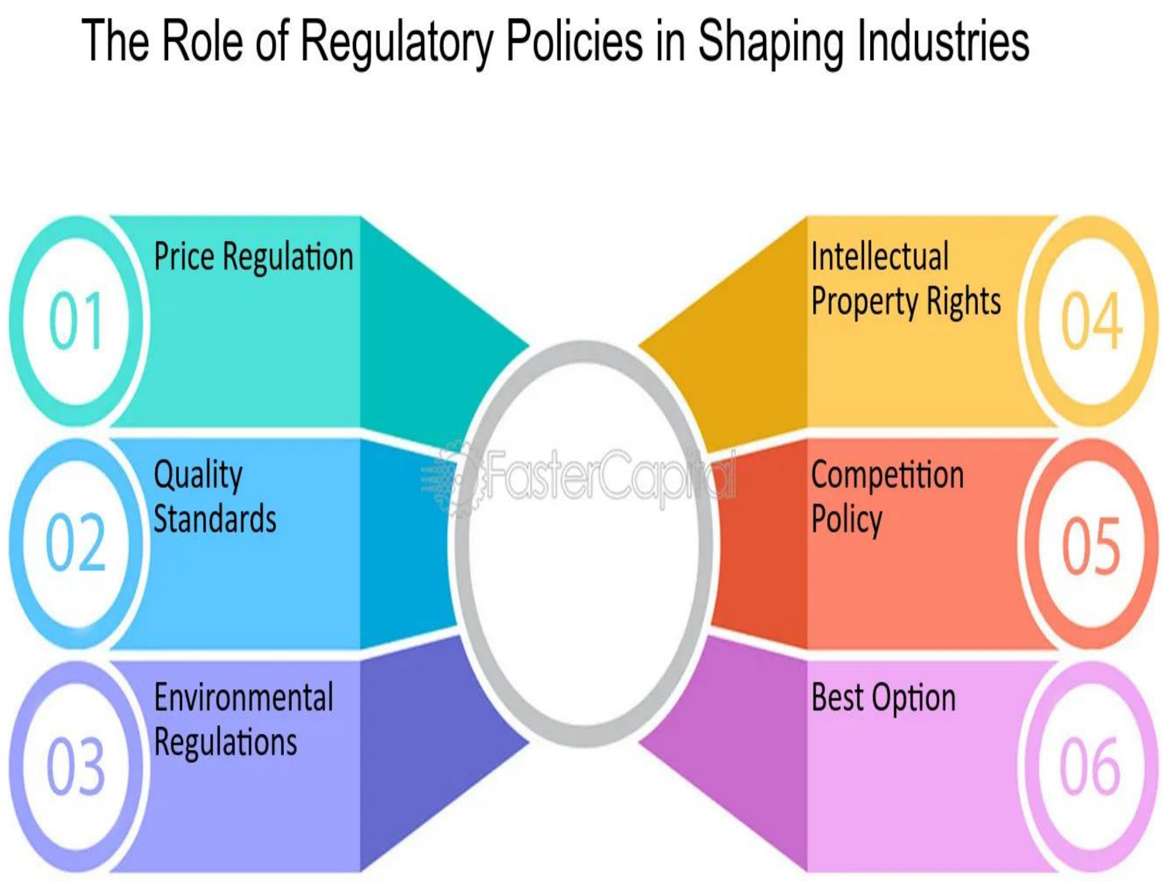
According to Hussain et al. (2018), the policy and regulatory system in emerging markets define the conditions affecting access to finance by new firms and innovation. Some of the social institution costs, which include business formalities, high political risk, high costs of compliance, bureaucratic formalities, and high taxation hurt investment. This is especially so because in most emerging markets there is a weak legal framework to support investors and to enforce most contracts, thus enhancing perceived risks and costs of capital. This aspect of regulation affects access to credit, especially among newly established businesses. High capital adequacy ratios made mandatory for the banks, act like a constraint over the flow of funds to small businesses since banks prefer to lend only to minimum-risk debtors. Also, one of the constraints that negatively affect the development of a sound credit market includes the absence of credit

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

information systems and the poor implementation of creditor rights. Limited access to credible information further limits access to formal finance since most startups can't produce records necessary to demonstrate creditworthiness.

Figure: Regulatory Principles



Source- (Nizam et al. 2019)

As per Bollaert et al. (2021), the policies directed towards financial inclusion seem to have the capabilities to enhance access to finance for startups. Some of the regulatory changes/ legislations include mobile banking and other electronic payment systems which have helped increase financial services through increased availability and reduced cost. For instance, mobile money services available for sub-Saharan Africa have created enhanced access to financial services, especially by enabling startups to conduct payments and access loans without formal banking facilities. Another way in which governments have an impact on the availability of funds is through fiscal policies. Nizam et al. (2019) argued that market incentives for investors,

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

funding for new ventures, and subsidies for small enterprises can encourage enterprise creation. However, governments rarely get a balance in implementing these policies and most of the time, bureaucracy hampers the efforts. Corruption and political volatility compound the operational environment and regulatory uncertainties hence discouraging investment both domestic and foreign.

Thus, Akomea-Frimpong et al. (2022) argued that to enhance the role of finance in development, it is necessary to coordinate the basic strategies that ensure a supportive policy framework. This includes reducing the bureaucratic restraints on business, increasing the awareness of the population on issues to do with money and markets and establishing and improving good legal systems that give proper protection to investors and other business entities. Such collaborations ensure that governments, financial institutions, and international organisations create a relevant solution to support startups in emerging markets.

2.4. Theoretical Framework

The theoretical background of this research is based on the Resource-Based View (RBV) and Financial Constraint Theory that allow for the analysis of the financial difficulties and funding models for startups in emerging markets. The RBV holds that a firm's assets; the financial capital, for instance, define its competitive advantage and performance (Lubis, 2022). The current literature identifies that the lack of these core financial assets impedes emerging market startups from innovating, growing, and performing to the optimum level. Taking this into consideration, Financial Constraint Theory expands on the constraints of the existing bigger picture, especially the firms that cannot secure financing based on conventional methods because of market imperfections, high-risk activities, and lack of collateral (Hamilton et al. 2019).

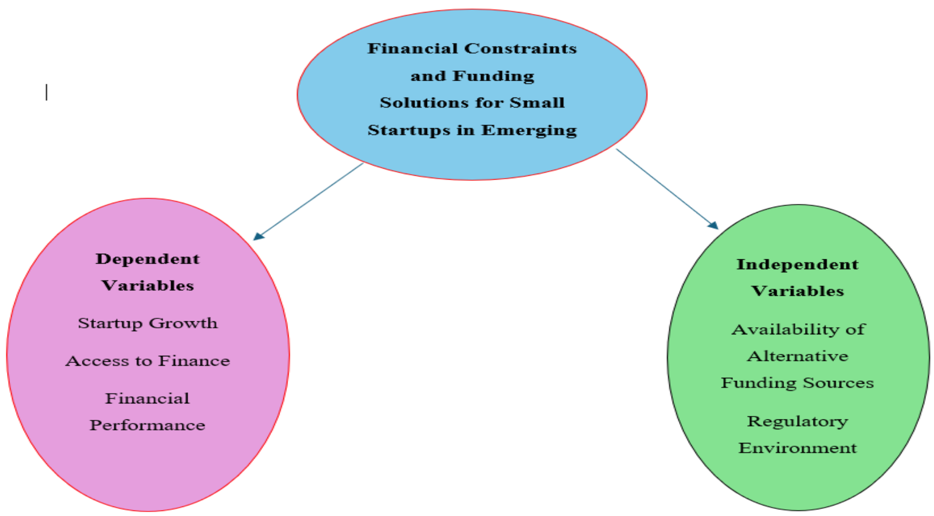
As applied to emerging markets, these theories highlight the importance of solutions like micro credit, crowdfunding, and angel financing as crucial interventions to fill the funding void. Such funding facilities are very crucial in boosting the resource endowment of startups so they can clear the financial hurdles that impede growth. The theoretical frameworks used also include Institutional Theory which sheds light on the effect that the regulatory and policy context has on financial access. This perspective underlines that investor confidence and market entry conditions depend on the availability of a supportive regulatory framework, which affects the environment in which startups operate. Altogether, these theories offer a systematic view of the inefficiency factors of startup financing in emerging markets and the possible effects of flexible funding sources and favourable policies on them. It is within this context that further examination of financial problems and prospects occurs based on this framework.

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

2.5. Conceptual Framework

Figure: Conceptual Framework



Source: (Created by Self)

2.6 Literature Gap

Table 1: (Literature Gap)

Author	Title	Findings	Literature Gap
Cecere, Corrocher, & Mancusi (2020)	Financial constraints and public funding of eco-innovation	Explores how public funding affects eco-innovation in European SMEs.	Focuses on eco-innovation; lacks insights on broader financial constraints in startups.
Panda (2018)	Constraints faced by women entrepreneurs in developing countries	Reviews and ranks challenges faced by women entrepreneurs.	Limited to gender-specific constraints; does not address financial issues in detail.

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

Haddad & Hornuf (2019)	The emergence of the global fintech market	Identifies economic and technological factors driving fintech growth.	Does not directly address how fintech impacts access to finance for startups.
Block et al. (2021)	The entrepreneurial finance markets of the future	Compares crowdfunding and initial coin offerings.	Focuses on specific funding mechanisms; lacks broader analysis of financial challenges.
Rao et al. (2023)	A systematic literature review on SME financing	Reviews trends in SME financing and highlights future directions.	Provides a broad review but lacks in-depth focus on specific financial constraints.
Ma et al. (2020)	Methodological quality assessment tools for medical studies	Discusses bias assessment tools in medical studies.	Not directly related to startup financing; context is limited to medical research.
Snyder (2019)	Literature review as a research methodology	Provides an overview of literature review methods and guidelines.	General methodology guidance; does not specifically address financial constraints.
Armat, Assarroudi, & Rad (2018)	Inductive and deductive: Ambiguous labels in qualitative content analysis	Examines inductive and deductive approaches in qualitative analysis.	Focuses on methodological aspects; not related to financial constraints or solutions.
Vears & Gillam (2022)	Inductive content analysis: A guide for beginning qualitative researchers	Offers guidance on inductive content analysis for qualitative research.	Provides methodological insight without addressing financial issues for startups.

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

Suri (2020)	Ethical considerations of conducting systematic reviews	Discusses ethical aspects of systematic reviews in educational research.	Focuses on ethics in research, not relevant to financial constraints in startups.
Fleming & Zegwaard (2018)	Methodologies, methods and ethical considerations for work-integrated learning	Covers research methodologies in work-integrated learning.	Focuses on research methods, lacking relevance to financial challenges or funding solutions.

Source- (Created by Learner)

Chapter 3: Methodology

In this chapter, the procedures and strategies utilised to identify the financial challenges and funding opportunities of small startups in emerging markets are elucidated (Haddad & Hornuf, 2019). Due to the nature of financial problems as well as the changing funding environment in these regions, this study uses a survey and secondary data. This chapter highlights the culture, style, decisions, duration, tactics, methods, and concerns about the study's research philosophy, approach, strategy, choices, time horizon, data collection methods, and ethical concerns.

3.1 Research Philosophy

This research is therefore anchored in the interpretivist research epistemology, which holds the view that one has to expound understanding of actuality and truth from the perception of occurrence hence, emphasising meaningful patterns of conduct as well as identifying the actual realities underlying human practices in social and economic life (Ma et al. 2020). Thus, the interpretivist approach proves conducive to this study since it enables a fine-grained analysis of the financial challenges affecting startups in EMs and the suitability of the key funding strategies. Thus, interpretivism is better than positivism because it embraces a variety of circumstances and pays attention to context factors which could be crucial for startups experiencing difficulties in various and rapidly evolving emerging markets (Snyder, 2019). Such a philosophical approach helps the researcher in critically analysing relevant literature with the view of identifying various factors that could delay access to finance as well as analyse the implications of other funding models.

3.2 Research Approach

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

The research methodology is therefore inductive, meaning this study will not be formulated from hypothesis but from interpreted observations (Armat et al. 2018). This is applicable since the study is qualitative as it provides the researcher the opportunity to examine the patterns, themes, and relationships within the literature. The inductive research approach is preferred for this study as it allows for the revelation of primary funding challenges and sources of finance without presuppositions of pre-existing theories (Vears & Gillam, 2022). In this way, this approach to secondary data analysis allows an understanding of how startups function in their financial environments and how the various forms of funding are effective for the given context.

3.3 Research Strategy

The research method used in this paper is an analytical review of the literature, and this may be described as the overarching research method for this study as it involved the identification of prior academic works on the financial woes and funding options for startup firms in emerging economy nations (Rashid et al. 2019). This strategy is suitable since this study uses secondary data sources which include scholarly journals, industry reports, government publications and case studies (Hancock et al. 2021). The literature review strategy makes it easier for the researcher to gather, evaluate and even argue on existing information about the issue of concern, note implicit and even explicit gaps in the existing literature, and infer from the same for the development of subsequent research activities and even policy formation. The review also speaks about the thematic synthesis of the literature which aids in categorising findings into meaningful themes that are in line with the objectives of the study.

3.4 Choices

This ongoing research utilises only the qualitative data and exclusively relies on the secondary sources; therefore it is a mono-method qualitative case. The rationale behind the use of the mono-method is that the study's goal is to offer a rich insight into the multifaceted context of financial constraints as well as funding options in emerging markets (Mamabolo & Myres, 2019). The use of a qualitative approach is most suitable because it affords an understanding of contextual factors and experiences of the key stakeholders which are inconceivable in quantitative terms. The decision is made to use a single source of data in the study because developing a mono-method qualitative study ensures that the assessment and conclusion of the study rely heavily on the interpretation of gathered data and not the numbers, as supported by the research philosophy and objectives of the study.

3.5 Time Horizon

The study employs a cross-sectional time perspective that deals with resources and information gathered and written up to the present time as a source of data and literature (Mamaysky, 2018).

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

A cross-sectional study collects information at one time and therefore the information gets a snapshot of the current conditions of financial pitfalls and funding strategies in emerging economies. This time horizon is convenient for this study as it allows us to identify current trends in the funding area, including emerging technologies like fintech or digital lending, and the recent policy updates that affect startups. Even though the study can benefit from the longitudinal design in terms of revealing tendencies, the cross-sectional study is more helpful in understanding the issues that take place in the contemporary environment of startups.

3.6 Data Collection

The data collection approach used in this study is of secondary sources, which include journals, research articles, reports like industry reports, government reports, and case studies (Moser & Korstjens, 2018). This was done to ensure that any analysis conducted about financial constraints and funding solutions was based on the most relevant, quality, and recent literature available. The data was collected with the help of Google Scholar, JSTOR, and more specialised resources and sources. The research method used in this work was thematic analysis which helped in grouping results in themes concerning the aspects of finance limitation, other funding approaches, and policies. Such an approach to data collection is suitable for qualitative research particularly the theoretical review section since it incorporates different forms of opinions and research findings from other works.

3.7 Ethical Considerations

As a secondary analysis study, the primary ethical issues to consider are those that relate to why and how the gathered data is used (Suri, 2020). The researcher accustomed that source is cited properly and none of it is copied and pasted from any other work or person in the whole course of the study. The work also honours the original context and conclusions of all the reviewed sources and recreates their interpretations and conclusions faithfully. One of the limitations is that there is no primary data collection and no direct contact with the participants; hence the concepts like the informed consent and privacy of participant's information do not apply directly (Fleming & Zegwaard, 2018). Nevertheless, the ethical consideration to scrutinise and make the report clear prevails to reach a rational conclusion of the study with a clear conscience against the unfair bias of the various studies being reviewed.

Chapter 4 Data Analysis

4.1 What are the primary financial constraints faced by small startups in emerging markets?

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

Emerging market small startups encounter the following five significant financial challenges that hamper their growth and viability: These are internal constraints as well as external conditions in the market affecting their performance through inadequate funding and operation malfunctions.

1. Limited Access to Formal Financial Services

The harshest and most comprehensive restriction is the cutoff of prisoner's access to traditional banking and finance. The new startups are considered as a high risk by emerging market banks primarily because such firms are unable to come with collateral, and lack credit histories or guaranteed income. For instance, most of the African fintech startups including Flutterwave were denied credit facilities by banks due to perceived risks associated with the technology industry in the developing market environment (Salamzadeh & Dana, 2021). This implies that some of these sources of funding that stem from banks" inability to provide funding to start-ups are some of the major turn-offs that compel entrepreneurs to look for funding that is either substandard or entirely non-existent.

Figure: (Financial Constraints and Lack of Funding)

Source- (Haddad & Hornuf, 2019)

2. High Cost of Borrowing and Unfavourable Loan Conditions

In emerging markets, the cost of borrowing is generally high as a result of inflation, macroeconomic volatility and higher country risk. Loans are expensive, interest rates are high,

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

repayments short and loan conditions rigid leaving startups unable to afford loans (Ullah, 2020). For instance, the Nigerian retail start-up, Paystack encountered problems of getting cheap credit because of high domestic rates; the company had to seek funds from VCs and angel investors.

3. Underdeveloped Capital Markets

The lack of established capital markets in many emerging economies further limits the ability of startups to tap equity funds from VCs, angels, and PE firms. There are few investor networks in these regions and a scarcity of exit opportunities makes investment ecosystems in these regions relatively less developed (Hyun, 2018). For example, the emerging digital startups especially in South East Asia, early-stage Grab was a challenge to source for Venture Capital because there are limited Venture Capital firms willing to back high-risk, high-return ventures, especially in emerging markets.

4. Low Financial Literacy Among Entrepreneurs

A big challenge that many startup founders face especially in emerging markets is poor financial management skills, knowledge of funding opportunities, and business propositions. There is limited knowledge of the effects of the phenomenon on funds and consequently on the poor management of these funds. For instance, Indian small retail start-ups have challenges accessing conventional financing because of poor business planning and record keeping; they show protruding profiles to investors or financing institutions.

5. Dependence on Informal Funding Sources

Early sources of funds for new ventures in emerging economies are personal savings, and family, and friends' funding, which often can't support growth. While using formal sources of information may be effective and efficient, it is argued that such information is often secondary to the kind of information businesses depend on from informal sources and, as such, businesses become financially exposed (Nguyen & Canh, 2021). For instance, it was revealed that most Latin American startups start with money from friends and family – a constraint that hinders their growth and leaves them with no option but to look for more capital in very uncomfortable circumstances. A Colombian-based on-demand delivery startup known as Rappi used informal sources of funding before they could be able to secure venture capital.

6. Regulatory and Policy Barriers

The established regulations in the emerging markets are a key factor that the startups experience austere financial issues. Cumbersome procedures for registering a business, expensive compliance requirements, unpredictable shifts in the legal environment, and unfavourable tax

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

policies contribute to raised operating challenges and discouraged investment. For instance, tax and regulation have become the major challenges that affect startup Brazil; Nubank for example struggled with so many taxes that surrounded the new business environment in Brazil.

4.2 How effective are alternative funding solutions, such as crowdfunding, microfinance, and digital lending, in addressing the financial challenges of startups in these markets?

In emerging markets, startups struggle with financial issues such as poor institutional users or creditor access, high interest rates for loans, and underdeveloped capital markets. Other financing models like crowdfunding, micro-financing and fintech lending have therefore proved to be potential sources of addressing these challenges (Yasar, 2021). The above alternatives offer cheaper, more flexible and inventive means of financing the startups thus overcoming these challenges. The funding models outlined above are not equal in the manner they perform and each has its strengths and weaknesses depending on market forces and the start-up requirements of a business.

Figure: Financial Instruments

Source- (Chandna, 2022)

1. Crowdfunding: Democratising Access to Capital

Online crowdfunding sources like the famous Kickstarter or Indiegogo let startups gather funds from everyone interested in investing, thus freeing them from established financial mediators like banks and venture funds. This democratisation of capital enables them to solicit funding from potential investors across the globe implying that they not only receive capital to work on their ideas but also market approval and public interest in their ideas.

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

This has particularly applied to consumer-focused ventures where potential customers can be attracted towards the product or service an entrepreneur is offering. For instance, Mellowcabs, an electric mini-cab firm from South Africa which produces 'green' vehicles – turned to crowdfunding to build initial capital. It was an effective way of taking the company to the global market and sourcing funds as traditional funding was hard to come by (Chandna, 2022). It also offered an opportunity for exposure thus boosting the credibility of Mellowcabs among local investors. Nonetheless, crowdfunding looks more effective in emerging markets, yet it has some constraints. These include low Internet connection, lack of access to electronic payment methods, and little knowledge of the concept of crowdfunding. Moreover, legal regulation of equity crowdfunding in some markets implies a high degree of difficulty for start-ups to provide basic financial incentives to backers, which is not positively affecting the popularity of such platforms.

2. Microfinance: Enhancing Access for Underserved Entrepreneurs

MFIs are institutions that offer microcredit to the needy who cannot access funding from a conventional bank because of credit status, security or because the activity is informal. Microfinancing has been widely used in the development of small businesses and new ventures for it provides small amounts of money at manageable repayment plans. Microfinance is particularly relevant in the context of such markets as they are known to have limited-size start-ups often categorised under community-based businesses. The following is an example: Zoona is a Zambian fintech startup that is in the business of providing mobile money and financial services and uses microfinance to increase the number of agents. When Zoona offered the working capital loans to the agents, this allowed the firm to expand immediately and access the unreachable rural communities. By doing so this case illustrated how micro banking is a useful tool for scaling up distribution channels and enhancing outreach for financial products.

However, there are certain drawbacks of microfinance as well. The amounts borrowed are relatively small and cannot be considered sufficient to finance Startups which plan further expansion or need significant amounts of capital equipment. Also, the interest rates on microloans are comparatively high because the risks are also high, and this may be a burden to small businesses.

3. Digital Lending: Speed and Accessibility

The various online lending sites have embraced technology in providing easy, convenient and flexible access to capital to startups with little formalities and delays in approval. These platforms rely on non-traditional data including the frequency and type of calls made by borrowers' mobile phones, how they use social media, as well as previous transactions. This

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

approach is especially useful in emerging markets where it is common to find credit scoring mechanisms that are either not well-developed or are even unavailable (Nour, 2022). Tala, a digital lending mobile application that is already in operation in Kenya is a typical example of how digital lending has impacted small businesses. With the help of embracing mobile money technology, Tala considers the creditworthiness of borrowers and disburses the loans at the same time. To many emerging startups, who have no access to structured credit markets, this digital approach offers the working capital needed to balance cash flows, procure stock or expand. Digital lending is also preferred because operations are faster than traditional lending, a factor that is useful to start-ups in changing markets where time is of the essence. However, digital lending has the following weaknesses. Quick loans entail high interest rates and fees that go a notch higher when repaid in a comparatively lower period, for example, financing a loan for one year with complete repayment in a month; this applies pressure on new startups, especially those that have not firmly established and cemented their revenue sources. Also, group loans can at times increase the chances of giving credit to the wrong clients due to the wrong rating from the other data, thereby denying the loans or putting clients under pressure due to the stringent loan terms that they receive.

4. Angel Investors and Venture Capital: Providing Capital and Expertise

Angel investors and venture capitalists have continued to play an active role in funding start-ups, especially those in emerging markets, but this they do in a twin role of also offering managerial assistance. These investors are considerably riskier compared to conventional banks, which makes them very important for such innovations in the case of young Startup companies. Andela, a Nigerian technology startup that trains software developers, was positively impacted by angel funding and venture capital. The initial funding of Andela by experienced investors such as the Chan Zuckerberg Initiative helped the company to increase its operations' efficiency and cover various African countries. This funding model offers more than the necessary capital for growth; It also brings the partners and advisors which are very vital for Andela. Still, angel investors and venture capital firms are comparatively less in the emerging markets as compared to the developed markets. There are still many investors that act this way because of the risks involved, exit market opportunities that are not well developed and regulatory issues that might limit the amount of funds that can be injected into a certain number of high-growth firms.

Crowdfunding and microfinance, digital lending, and venture capital funding are some of the different methods which have helped solve the financial problems of startup businesses in emerging markets. They provide relatively cheap and/or easy-to-access funding that is not easily available within conventional banking channels thus enabling the growth of the business ventures. However, each of the two models has its drawbacks, first, high costs, then, restricted coverage, and last, legal issues that need to be overcome to enhance the impact of chosen

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

models. Therefore, advancing the availability of such funding solutions as a component of a supportive ecosystem can make a big difference in promoting the financial environment for startups in emerging markets and further economic development.

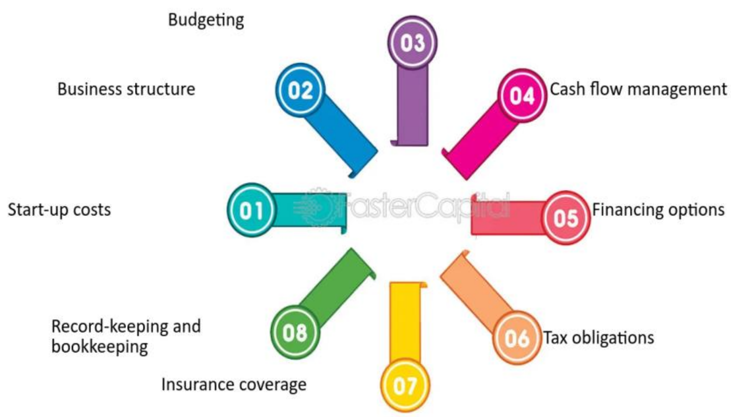
4.3 What policy measures can be implemented to improve access to finance for small startups in emerging markets?

Small startups, especially in emerging markets, must achieve the goal of enhancing finance accessibility through policy interventions that fit their context. The mentioned political interventions can help to improve financial accessibility and decrease the limitations to funding to support the growth of entrepreneurial initiatives. The following are some of the policy measures that when implemented will enhance access to finance for startups in emerging markets;

1. Development of Credit Guarantee Schemes

The credit guarantee schemes (CGS) thus provide partial guarantees on loans to be made by the banks to the startup ventures thus motivating the lenders to give out credit to the small businesses which would otherwise be considered high risk. These schemes can go quite a long way in increasing the cash available to part-fund the startups by reducing some of the perceived risks in funding new ventures in this context, new business. Example: Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in India – This has been the major driving force of Non-recourse financing or unsecured credits for micro & small enterprises. With such evident benefits as securitization and risk mitigation, CGTMSE has in a way provided formal finance for several startups in India that would otherwise not be possible in the absence of collateral.

Figure (Financial Considerations for a Start-up)



Source- (Pradhan et al. 2021)

2. Simplification of Regulatory Frameworks

Policies and measures that are oppressive and complicated act as de-initializers to a startup because they foster high compliance costs and other unnecessary formalities. The following are some recommendations which can reduce the barriers to formal finance: The business registration procedures should be made easier; bureaucratic hitch should be removed; and transparency of numerous regulations should be enhanced. ***Example: Rwanda's Business*** Reforms Rwanda has also embarked on several reforms to ease the Business Registration and Business Licensing procedures to enhance the availability of funding to startups. This has resulted in an increased business environment as the country has featured among the best countries to do business in Africa.

3. Promotion of Digital Financial Services

Mobile payment, digital money, and other forms of online financing can increase financial inclusion since any person can get connected easily and get funds without necessarily being from a specific region. This can be achieved by the government approving policies on the regulation of digital finance for the growth of the sector whilst protecting consumers. Example: (Kenya) M-Pesa The success of M-Pesa, a mobile money service, in Kenya, can be attributed to the country's friendly regulations towards innovation. One way that is worth looking at how mobiles have impacted the economy of Kenya is through the experiences of many small businesses, Carly enabling payment, loans and expansion of businesses without necessarily involving brick-and-mortar banking systems.

4. Tax Incentives for Investors in Startups

The government can provide incentives for investors in startups. For instance, it can lower the capital gains taxes, allow capital investments to be deducted from taxes or provide credits for investment in startups. These incentives can motivate both local and international investors to provide funding for early-stage companies and thus increase capital accessibility. Example: SEIS and EIS Schemes (UK) – SEIS refers to the Seed Enterprise Investment Scheme while EIS refers to the Enterprise Investment Scheme in the UK that offers investors tax relief when they invest in young firms. While not in an emergent economy, these schemes form a model which can be duplicated in an emergent economy to spur the development of investments in startups.

5. Establishment of Government-backed Venture Capital Funds

One of the mechanisms that can be employed is a direct or indirect government investment in venture capital funds focusing on startup companies in one or several sectors of high growth potential. They can offer the required amount which is needed for expansion and can mobilise

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

private finance by decreasing the risk associated with the first stake. For example: The fund of Funds for Startups FFS in India through the Small Industries Development Bank of India SIDBI it invests in venture capital funds which in turn help startups improve the availability of equity capital. The initiative has managed to attract private capital into the startup environment (Pradhan et al. 2021).

Chapter 5 Result

5.1 Financial Constraints Faced by Small Startups in Emerging Markets

The major challenge that innovative ventures face especially from emerging markets is that they are financially constrained, especially because they cannot access conventional banking services. Lenders dislike extending credit to such businesses because they are deemed high-risk, have little or no security, have poor credit history or have abnormal cash flow. High costs of borrowing, high interest rates, and unfavourable loan conditions make traditional financing sources inaccessible to most startups. Besides, due to the limited access to capital markets in these countries, equity financing from venture capitalists and angel investors who are wary of volatile markets due to their risk-bearing nature are out of reach. Business people are financially illiterate thus making it difficult for them to access funding products and manage their financial resources. Most start-ups use friends and family funding which is mostly limited and is not appropriate for expansion. In addition complex regulatory systems high costs of compliance and unfriendly tax policies burden operations and discourage investment. These combined constraints therefore form a very stringent financial landscape within which startups can lawn and this is the cause of the high failure rates.

5.2 Effectiveness of Alternative Funding Solutions

Other models including crowdfunding, micro-financing and digital financing, though not a panacea for all the financial problems confronting startups, have been realistic in facing some of them. Crowdfunding is deemed to be a way of sourcing funds from the general public without involving traditional financial institutions. For instance, Mellowcabs in South Africa was able to obtain initial funding through crowdfunding which proves the fact that this model can both fund and validate a business. Nonetheless, crowdfunding's presence is still fairly constrained, due to low internet connectivity and restrictive policies in some emergent markets. Micro-finance institutions provide credit facilities in the form of small amounts with cheaper and more convenient conditionalities to needy entrepreneurs, thereby improving the finance base at the lower level. Zoona, a Zambian-based financial technology firm, utilised micro-finance to grow its agency network and enhance coverage in rural centres.

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

Microfinancing is indeed helpful in the funding of small-scale start-ups, however, it has long come with a small amount of funding available and expensive interest rates. Technology firms such as Tala in Kenya offer loans based on digital data and therefore yield fast and easy credit to the startups that have had no credit score since their establishment. Another advantage that comes with digital lending is the fact that the whole process does not take so much of the business owners' time and energy as most of it is done on the World Wide Web. Nonetheless, high fees and interest charges may be painful and hugely expensive for viability-starved start-ups.

5.3 Policy Measures to Improve Access to Finance

To enhance the funding position of startups following policy measures can be adopted by the governments; Programs like India's CGTMSE assure credit risks for banks thereby compelling them to provide credit to Small enterprises. As Rwanda has done, the reduction of complicated regulations lessens the burdens of doing business and compliance expenses. Digital Financial Services, M-Pesa from Kenya is an example of increasing financial access by extending to the unserved people. Government incentives for investment help to increase capital inflows into the startup space and government-backed venture capital funds serve as early-stage funding. These programs are among the financial tools that can be used to enable any entrepreneur to manage his/her financial affairs efficiently. Enhancing credit information systems with additional data can enhance credit risk evaluation so that even start-ups can extend loan facilities even without classical credit records.

Chapter 6 Conclusion and Recommendation

6.1 Summary

Startups in emerging markets are financially challenged in many ways, including a lack of access to conventional funding, expensive credit, and relatively underdeveloped capital markets. Crowdfunding, microfinancing and digital lending have been known to partially solve these challenges by offering more flexible and affordable funding sources. However, each funding model has some drawbacks, and that is why it is so important to use a more diverse approach. Potential policy actions to support the growth of startups are credit guarantee schemes, streamlining of the applicable regulations, the expansion of digital money platforms, and tax benefits for shareholders interested in investing in startups. The above policies if harmonised with the attempts of expanding the overall financial literacy as well as the construction of sound credit information infrastructures should go a long way in improving the quantity and quality of finance available for SMBs in the emerging markets. Altogether, these approaches can help build

ISSN: 2455-8834

Volume:09, Issue:09 "September 2024"

a vibrant and pluralistic entrepreneurial environment that contributes to economic development and advancement.

6.2 Recommendations

To enhance the availability of funds for startups in emerging markets, governments and other financial institutions need to extend credit guarantee programmes that help reduce risks in loans and stimulate banks to provide credit to small enterprises. Cutting compliance burdens and streamlining the legislation for the startups will help them legalise and get funding. Mobile money and other digital lending services can act as a solution for the credit gap to reach out to as many micro-entrepreneurs as possible. The governments have to put in place tax havens for local and international investors to make funding more attractive for potential private investors. Also, to address the lack of financial management skills, training will be provided to entrepreneurs focusing on aspects of financial management and sourcing of funds. Enhancing credit reporting systems through the incorporation of alternative information sources can enhance the quality of credit risk evaluations and extend credit services to new start-ups with little or no credit records. All these recommendations are intended to build an environment of encouragement and support for micro-entrepreneurs and economic growth.

6.3 Future Scope

Further research should then seek to establish whether financing solutions proposed in emerging economies will have a long-term positive effect on start-ups' performance once they have been scaled up. Digital lending innovations as well as regulatory reforms should also be explored concerning the impact it has on the provision of financing. Further research is required to illuminate the many nuances influencing regional dynamics and to design new financial models for growth startups, relevant to different emerging markets.

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