

Module 2

Entrepreneurship Development and Leadership

Entrepreneurial Motivation : motivating factors

Meaning

The entrepreneurial motivation is the process that activates and motivates the entrepreneur to exert higher level of efforts for the achievement of his/her entrepreneurial goals. In other words, the entrepreneurial motivation refers to the forces or drive within an entrepreneur that affect the direction, intensity, and persistence of his / her voluntary behaviour as entrepreneur. So to say, a motivational entrepreneur will be willing to exert a particular level of effort (intensity), for a certain period of time (persistence) toward a particular goal (direction).

Definition

Motivation is regarded as "the inner state that energizes activities and directs or channels behavior towards the goal".

Motivation is the process that arouses action, sustains the activity in progress and that regulates the pattern of activity.

Nature of Motivation

The nature of motivation emerging out of above definitions can be expressed as follows:

1. Motivation is internal to man

Motivation cannot be seen because it is internal to man. It is externalized via behavior. It activates the man to move toward his / her goal.

2. A Single motive can cause different behaviors

A person with a single desire or motive to earn prestige in the society may move towards to join politics, attain additional education and training, join identical groups, and change his outward appearance.

3. Different motives may result in single behaviour

It is also possible that the same or single behaviour may be caused by many motives. For example, if a person buys a car, his such behaviour may be caused by different motives such as to look attractive, be respectable, gain acceptance from similar group of persons, differentiate the status, and so on.

4.Motives come and go

Like tides, motives can emerge and then disappear. Motives emerged at a point of time may not remain with the same intensity at other point of time. For instance, an entrepreneur overly concerned about maximization of profit earning during his initial age as entrepreneur may turn his concern towards other higher things like contributing towards philanthropic activities in social health and education once he starts earning sufficient profits.

5.Motives interact with the environment

The environment in which we live at a point of time may either trigger or suppress our motives. You probably have experienced environment or situation when the intensity of your hunger picked up just you smelled the odour of palatable food.

You may desire an excellent performance bagging the first position in your examination but at the same time may also be quite sensitive to being shunned and disliked by your class mates if you really perform too well and get too much of praise and appreciation from your teachers. Thus, what all this indicates is that human behaviour is the result of several forces differing in both direction and intent.

Entrepreneurial Motivating Factors

Most of the researchers have classified all the factors motivating entrepreneurs into internal and external factors as follows:

Internal Factors

These include the following factors:

1. Desire to do something new.
2. Become independent.
3. Achieve what one wants to have in life.
4. Be recognized for one's contribution.
5. One's educational background.
6. One's occupational background and experience in the relevant field.

External Factors

These include:

1. Government assistance and support.
2. Availability of labour and raw material.
3. Encouragement from big business houses.
4. Promising demand for the product.

Types of startups

When most people think of a startup, they picture a Silicon Valley tech startup like Facebook or Google. However, not every startup is built to dominate an industry — nor do they all operate in the tech sphere. There are **six types of startups** that range from growth-oriented tech startups to mom-and-pop grocery stores. Find the right startup

Contrary to popular belief, not all startups are tech companies in Silicon Valley. From lifestyle startups to social and environmentally impactful organizations, there are many types of startup possibilities. At its origin, a startup is not a permanent business model but rather **a crucial beginning stage of a business's life**.

In general, the purpose of a startup company is to create a product that targets an untapped market or improves on existing options. The first step to launching a startup of your own is understanding the **six types of startups** and which is right for

Startup Type 1: Scalable Startups

Scalable startups take an idea or concept — typically in the tech sphere — and work to rapidly grow the company's top-end revenue to achieve the highest return on investment (ROI) possible. This type of startup requires thorough market research to identify exploitable market opportunities. Two of the most relevant examples of scalable startups are Google and Facebook. Both of these companies started with the intent to dominate their industry through a scalable startup model and were successful in doing so.

A Scalable Startup May Be Right for You If:

- Your startup idea has an extensive market available and vast growth potential.
- You're an innovator ready to challenge the status quo.
- You want to be the leader of an industry.

Startup Type 2: Large Company Startups

With technology, customer interest, and markets changing every day, large companies need to adapt their business model to survive. This is where large company startups come in. Backed by the support and capital of the already successful company, these offshoot startups aim to reach new audiences, diversify product offerings, and keep large companies tapped into the ever-changing market.

A Large Company Startup May Be Right for You If:

- You already own a large, successful company.
- You're looking to diversify or tap into a new market that isn't in your company's current wheelhouse.
- You need a way to compete with new businesses and keep up with the changing market.

Startup Type 3: Small Business Startups

The priority of small business startups is longevity instead of scalability. These small startup companies are built to provide enough capital for financial stability by catering to a small target market. Common types of small business startups are family-owned and operated barbershops, grocery stores, and retail shops.

A Small Business Startup May Be Right for You If:

- You plan to hire locals and family to operate your business.
- You want to focus on adding to your community.

Startup Type 4: Social Entrepreneurship Startups

Unlike other types of startups, [social startups](#) are not created to gain wealth for the founders; they are created to make a positive social or environmental change. Social entrepreneurs shouldn't expect a big payout from their startup; however, it is possible to make money with this startup model if it is not a nonprofit organization.

A Social Entrepreneurship Startup May Be Right for You If:

- You want to build a company that will make a positive social or environmental impact.
- You aren't interested in starting a company for the profit.
- You have an idea that can solve a widespread problem, specifically for disadvantaged communities.

Startup Type 5: Lifestyle Startups

Lifestyle startups are born out of passion and desire for independence, with the founders putting their time and energy toward making a business out of their favorite hobby or activity. This can range from an avid traveler starting a tour guide business to a web developer starting a freelance coding business.

A Lifestyle Startup May Be Right for You If:

- You have a hobby you could do all day, every day.
- You're self-motivated and disciplined enough to be your own boss.
- You're passionate and creative.

Startup Type 6: Buyable Startups

Unlike other startups, buyable startups are not built to become billion-dollar companies; alternatively, they are built to be sold to a larger company for millions of dollars. Buyable startups are commonly tech-focused, and many of them are specifically in the app development industry.

A Buyable Startup May Be Right for You If:

- You want to build a company but not commit to operating it long-term.
- You have a startup idea with tremendous growth potential.
- You're a "serial entrepreneur."

Startup Types Summary

The startup world is home to more than Silicon Valley tech companies, and there are various startup types for every kind of entrepreneur and business idea. Whether you're interested in starting a charitable organization, diversifying your current company, or creating a small business in your community – [launching a startup](#) is an exciting, beginning stage toward your entrepreneurial goals.

Characteristics of entrepreneurial leadership

Capabilities of Entrepreneurial Leaders

In 2008, the Center for Creative Leadership joined forces with Tata to research leadership in fast-growth companies. They discovered that Entrepreneurial leadership is the result of a combination of strong motivation to achieve something and the capabilities to achieve it.

Those capabilities fall into three areas:

Leading self. Entrepreneurial leaders need effective ways to manage their thoughts, emotions, actions, and attitudes. Specific capabilities include confidence; self-awareness; understanding and committing to life goals; and integrity.

Leading others. Entrepreneurial leaders need interpersonal and social skills to influence people. Specific capabilities include managing and motivating subordinates; developing subordinates; and team management/development.

Leading the business. Entrepreneurial leaders need the skills and behaviours to run a business and deliver results. Specific capabilities include execution and operational management. Also, innovation, creativity, and entrepreneurship; functional knowledge; and gathering information, knowledge, and insight.

Top 11 Characteristics of Entrepreneurial Leaders

Let's look in more detail at what the leaders themselves judged to be the most important lessons they learned illustrated by some of the world's most famous entrepreneurs.

1. **Confidence**

Entrepreneurial leaders are in a situation where they are trying something new and they're not sure of success. They're constantly stretching themselves and that requires confidence. Confidence is equal to or even more important than competence to succeed as a leader.

2. **Self-Awareness**

Self-Awareness is essential for Entrepreneurial Leadership. Leaders who have an understanding of their own emotions, personality, strengths and weaknesses can better engage with employees and clients

Oprah Winfrey says you need a level of self-awareness that only comes from connecting with your inner voice. She calls it your emotional GPS system.

3. **Understanding and Committing to Life Goals**

Entrepreneurial leaders allow their strong sense of passion and purpose to drive themselves and inspire those around them. This helps them stay focussed and motivates employees and partners to produce their best efforts to help make it a reality.

Before Harry Potter was a success, J K Rowling was a single mother struggling to make ends meet and battling severe depression. Despite all her personal hardships, Rowling kept pursuing her dreams of becoming a writer.

4. Integrity

Integrity is one of the most important qualities of entrepreneurial leadership. It is about remaining true to one's own values and vision and standing up for what they believe in, even in the face of opposition.

As Benjamin Franklin said, *"I grew convinced that truth, sincerity and integrity in dealings between man and man were of the utmost importance to the felicity of life and I formed written resolutions to practice them over while I lived."*

5. Managing and Motivating Subordinates

Managing and motivating people is probably one of the most important entrepreneurial leadership skills. It directly influences productivity because of its impact on staff morale.

6. Developing Subordinates

Entrepreneurial leaders are committed to developing the people who work for them. They help employees develop their own talents and skills. They know it's essential to help employees grow so that the business can flourish into the future.

Larry Page became famous for co-founding Google, a company that literally changed the way the world learns. He continues to drive and innovate by training and delegating. He is able to put his ego aside and does not feel threatened by sharing authority. He realises that he cannot do everything alone and that giving others authority will benefit the company over the long term.

7. Team Management/Development

The cornerstone of a successful enterprise is strong and effective teams. Entrepreneurial leaders ensure that team morale remains high.

In the early days of Amazon, Jeff Bezos instituted a rule that every internal team should be small enough that it can be fed with two pizzas. The goal wasn't to cut down on the catering bill. It was focussed on two aims – efficiency and scalability.

8. Execution and Operational Management

Execution and Operational Management play a vital role in the success of a company. Entrepreneurial leaders need strategies that maximize productivity and effectively respond to fluctuations in demand.

The Walt Disney Company has been able to build an Operating Model that enables them to deliver on the promise *"to make magical experiences come alive."*

9. Innovation, Creativity and Entrepreneurship

Entrepreneurial leaders are constantly being creative and innovative to get better.

Steve Jobs built one of the world's most lucrative companies out of his garage and introduced the world to technology it never knew it needed. 7 years after his death, he still has a lot to offer. When he returned to Apple after a 12-year absence, Apple was close to bankruptcy. That didn't stop him from launching one innovative product after another. He made the bold statement *"The cure for Apple is not cost-cutting. The cure for Apple is to innovate its way out of its current predicament."*

10. **Functional Knowledge**

Entrepreneurial leaders need to have some basic functional knowledge.

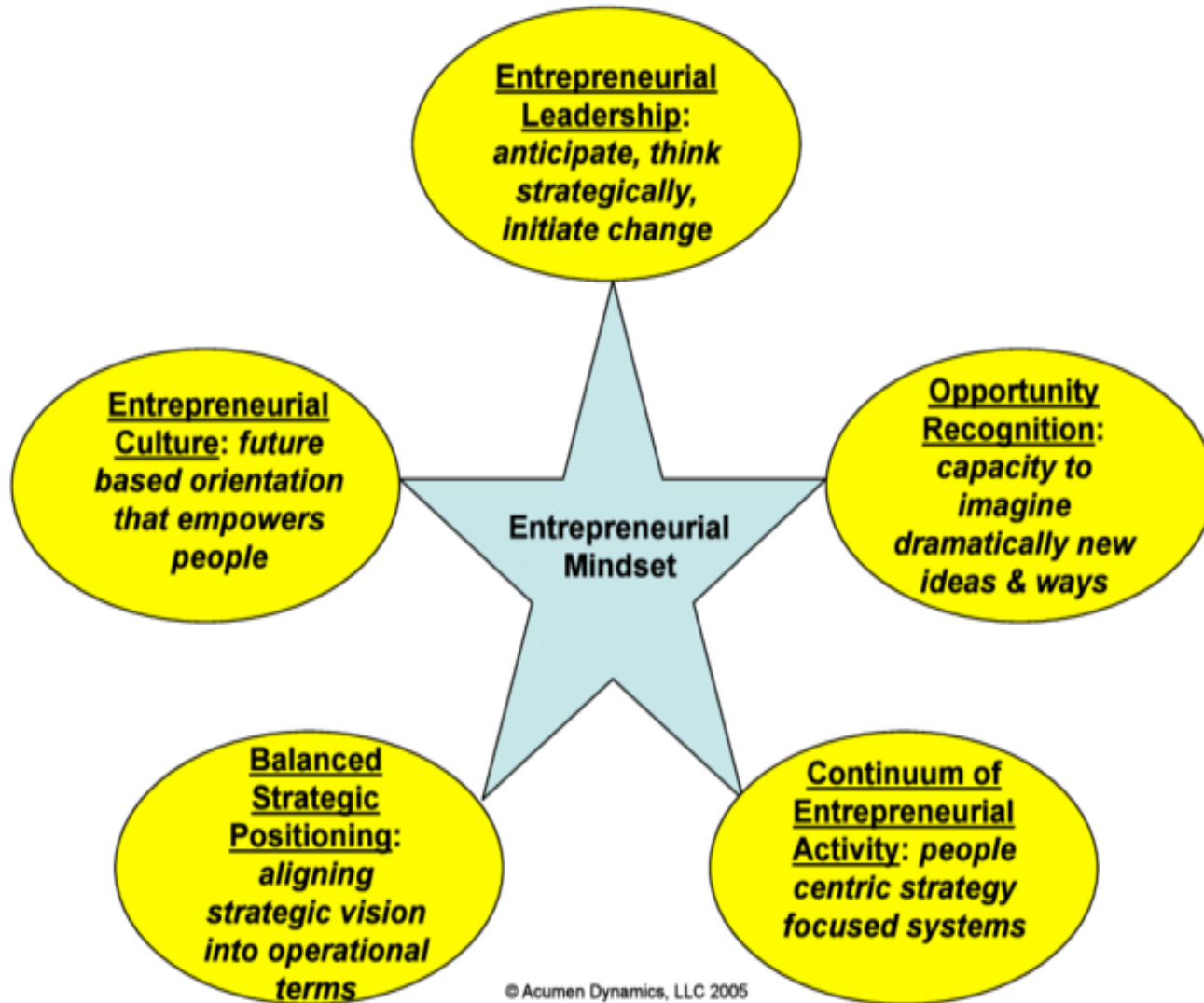
Bill Gates frequently works with inventors and industry disrupters and reads books about the future of humanity. He concludes that people with knowledge of science, engineering and economics will be the future agents of change. He says *"It's not necessarily that you'll be writing code, but you need to know what engineers can and can't do"*.

11. **Gathering Information and Insight**

Before an entrepreneurial leader is able to take action they need good information. It is vitally important to have information from different perspectives. It is equally important to quickly draw insights and make decisions.

Mark Zuckerberg's love of data has got him into a bit of trouble recently. But he knows the power of information. And it's how he's grown Facebook to its current success.

Components of Entrepreneurial Leadership



Factors influencing entrepreneurial development and motivation

Economic Factors

Economic factors can play an interesting and formative role in the development of future entrepreneurs. For those who are raised in a more desperate situation, with less access to capital and fewer opportunities to achieve financial success, their desperation could actually urge them to pursue entrepreneurship to seek out a more comfortable life and create their own opportunities. This has been the case with entrepreneurs like [Daymond John](#), who's talked about how his financial struggles growing up pushed him to be the hustling and hard-working successful entrepreneur that he is.

Capital

Access to capital is one factor that can facilitate and accelerate entrepreneurship, as capital is often required for research and development, production or manufacturing, and marketing. This is the reason venture capitalists, angel investors, entrepreneurial incubators, and accelerators are around - to help connect the aspiring entrepreneurs in need of capital with the supportive investors, who have the necessary capital and believe in the ideas they're funding.

That said, with crowdfunding, equity crowdfunding, and the new developments in technology over the past decade, it's become a lot easier to start and build a company, even without venture capital funding. In fact, there are affordable and efficient options for getting many products created, which can make the barriers to entry in entrepreneurship a lot lower and allow many more people to pursue this route. These days, you can even start chasing your dreams while you're still in high school.

Labor

The availability and affordability of good labor is another factor that impacts entrepreneurship, as it can be difficult to find qualified employees to work for a new startup. However, like access to capital, this is another factor that is much less problematic these days, largely due to sites like UpWork and Fiverr.

It has become much easier, faster, and cheaper to connect with highly skilled and qualified potential employees from all over the world through these freelancer marketplaces, and no matter where you are located, you can likely find the necessary labor to carry out your idea for a reasonable price.

Market

The one factor that applies as much now as it did decades ago is the market: it's necessary to find the ideal target market for your idea, service, or product if you have hopes of selling it and making any money. However, while a market for an idea must still exist to ensure its success and profitability, finding and accessing that market has become much easier in recent years, as well.

Social Factors

Social factors can have a significant impact on a person's likelihood to pursue entrepreneurship or to do so successfully, but they aren't guaranteed to steer a person in one direction or another. That said, social factors in terms of the family background of entrepreneurship or encouragement from family towards an entrepreneurial path can play a great role in guiding a teen towards an entrepreneurial future.

Family background

A family background in entrepreneurship is one of the best and most direct ways to immerse a child in the entrepreneurial mindset and to exemplify the benefits of starting and running one's own business. For those who have a positive experience with their own family business, they may be more likely to pursue their own ventures in the future, and they may see the entrepreneurial route as more customary and less unconventional or risky.

However, the family background in entrepreneurship isn't the only way to influence a child towards pursuing their own ventures; education and encouragement is another option. Families who do not have firsthand entrepreneurial experience, but who do introduce their children to entrepreneurship through educational entrepreneurship programs like Beta Bowl can similarly influence their children towards an entrepreneurial path and equip them with the necessary skills to succeed.

Cultural Value

Though it may seem to have a less direct impact on our kids, the cultural views and value of entrepreneurship do impact the prevalence of an entrepreneurial focus among the youth. The good news here is that our culture in the U.S. has come to highlight and reward entrepreneurship, especially in the past two decades.

From the “dot com boom” to shows like Shark Tank and the rise of [unicorn startups](#) (those with over 1 billion dollar valuations) with apps like Uber, Airbnb, and Snapchat to the social media influencer millionaires, we have seen a great rise in entrepreneurship over the past two decades, and we’ve seen the financial reward for those involved.

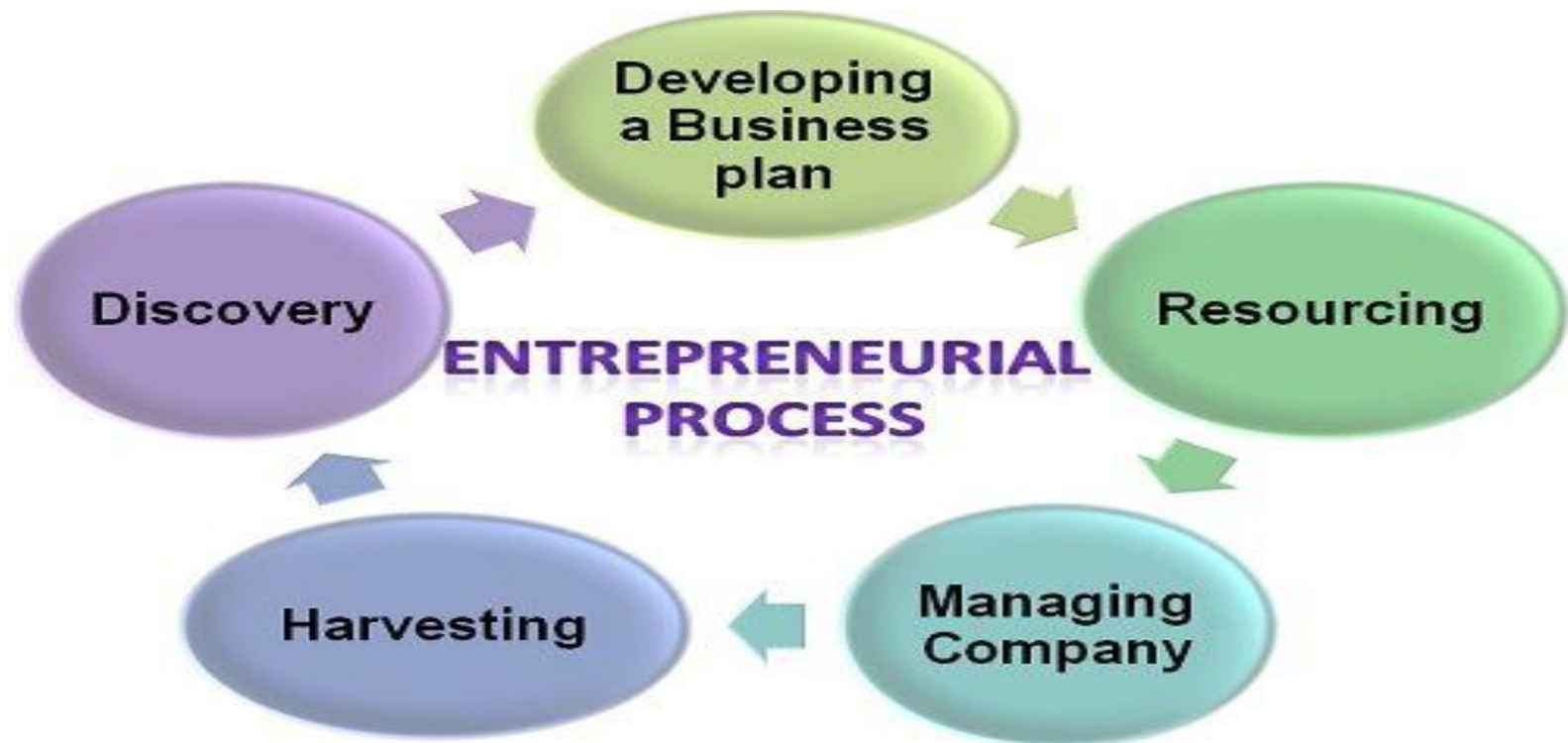
This increase in the popularity of entrepreneurship has also contributed to its increased focus at universities, and it has become more accepted, applauded, and revered in our society. For this reason, our culture has placed a great value on entrepreneurship, and this is a wonderful factor that can encourage young kids and teens to become future entrepreneurs.

Psychological Factors

Perhaps the most direct factors impacting a person's likelihood to become an entrepreneur or at least a successful one, are in fact psychological and may be inherent or instinctual in certain people. While a person's upbringing can influence their psychological factors like creativity, risk tolerance, drive, and leadership, these can also be personality traits that are deeply rooted in who a person is, regardless of outside factors. Parents can try to instill those traits that would be beneficial, but at the end of the day, people are independent people, and it's impossible to control which skills and traits they truly master and embrace.

Entrepreneurial Process

Definition: The **Entrepreneur** is a change agent that acts as an industrialist and undertakes the risk associated with forming the business for commercial use. An entrepreneur has an unusual foresight to identify the potential demand for the goods and services.



1. Discovery: An entrepreneurial process begins with the idea generation, wherein the entrepreneur identifies and evaluates the business opportunities. The identification and the evaluation of opportunities is a difficult task; an entrepreneur seeks inputs from all the persons including employees, consumers, channel partners, technical people, etc. to reach to an optimum business opportunity. Once the opportunity has been decided upon, the next step is to evaluate it.

An entrepreneur can evaluate the efficiency of an opportunity by continuously asking certain questions to himself, such as, whether the opportunity is worth investing in, is it sufficiently attractive, are the proposed solutions feasible, is there any competitive advantage, what are the risk associated with it. Above all, an entrepreneur must analyze his personal skills and hobbies, whether these coincides with the entrepreneurial goals or not.

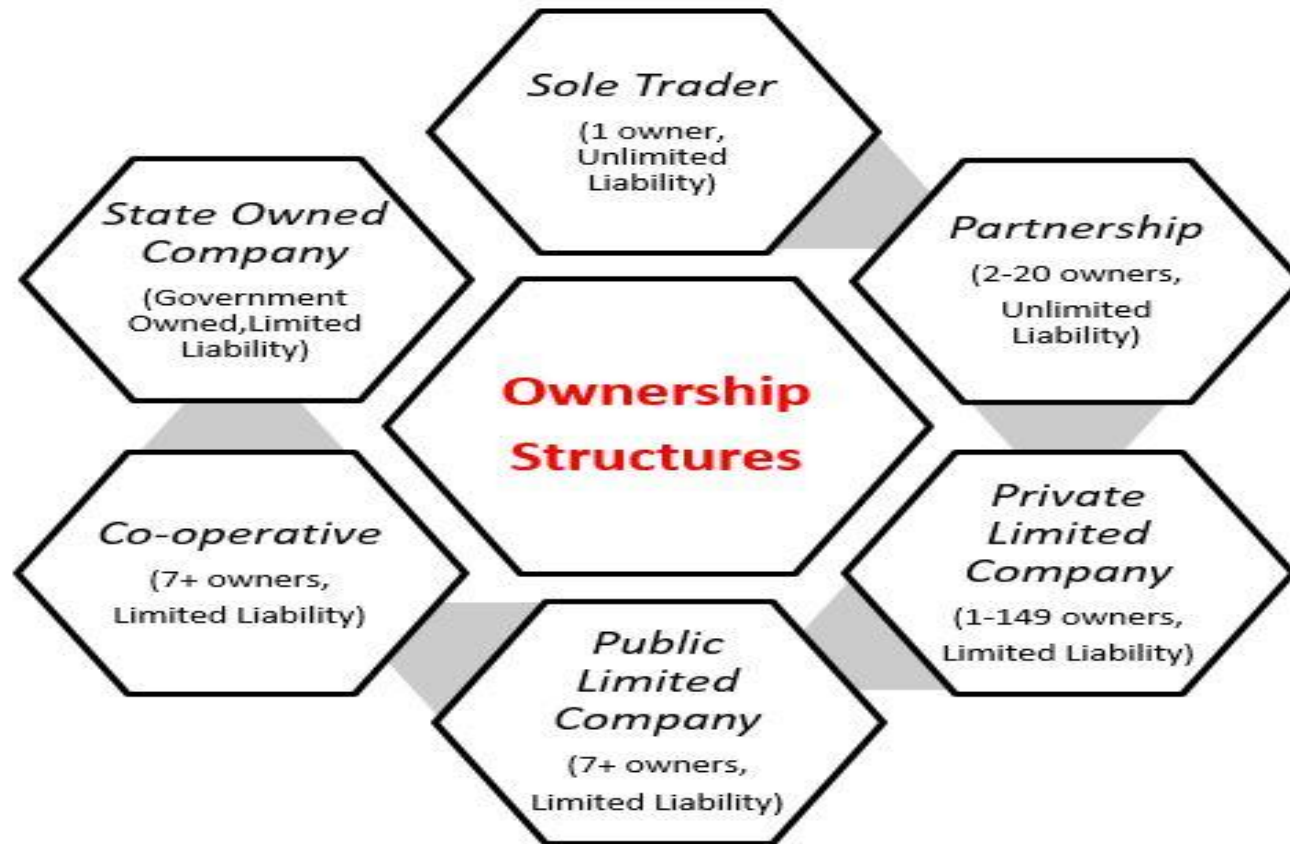
2. Developing a Business Plan: Once the opportunity is identified, an entrepreneur needs to create a comprehensive business plan. A business plan is critical to the success of any new venture since it acts as a benchmark and the evaluation criteria to see if the organization is moving towards its set goals.

An entrepreneur must dedicate his sufficient time towards its creation, the major components of a business plan are mission and vision statement, goals and objectives, capital requirement, a description of products and services, etc.

3. Resourcing: The third step in the entrepreneurial process is resourcing, wherein the entrepreneur identifies the sources from where the finance and the human resource can be arranged. Here, the entrepreneur finds the investors for its new venture and the personnel to carry out the business activities.

4. **Managing the company:** Once the funds are raised and the employees are hired, the next step is to initiate the business operations to achieve the set goals. First of all, an entrepreneur must decide the management structure or the hierarchy that is required to solve the operational problems when they arise.
5. **Harvesting:** The final step in the entrepreneurial process is harvesting wherein, an entrepreneur decides on the future prospects of the business, i.e. its growth and development. Here, the actual growth is compared against the planned growth and then the decision regarding the stability or the expansion of business operations is undertaken accordingly, by an entrepreneur.

Types of Enterprises and Ownership Structure



<https://www.oecd.org/corporate/ownership-structure-listed-companies-india.pdf>

<https://www.clearias.com/micro-small-and-medium-enterprises-msme/>

Role of small enterprises in economic development

1. SSI Increases Production

India is one of the world's fastest growing economies in the world. Consequently, its production output is massive. It is pertinent to note that SSIs contribute almost 40% of India's gross industrial value.

These industries produce goods and services worth over Rs. 40 lakhs for every investment of Rs. 10 lakhs. Furthermore, the value addition in this output increases by over 10%.

Here is another interesting statistic about Small scale industries. The number of Small Scale Industries in India increased from around 8 lakhs in 1980 to over 30 lakhs in 2000.

2. SSI Increases Export

Apart from producing more goods and services, SSIs have been able to export them in large numbers as well.

Almost half of India's total exports these days come from small-scale businesses.

35% of the total exports account for direct exports by SSIs, while indirect exports amount to 15%.

Even trading houses and merchants help SSIs export their goods and services to foreign countries.

3. SSI Improves Employment Rate

It is important to note firstly that Small Scale Industries employs more people than all industries after agriculture.

Almost four persons can get full employment if Rs. 10 lakhs are invested in fixed assets of small-scale sectors.

Furthermore, SSIs employ people in urban as well as rural areas.

Consequently, this distributes employment patterns in all parts of the country and prevents unemployment crisis.

4. SSI Open New Opportunities

Small-scale industries offer several advantages and opportunities for investments.

For example, they receive many tax benefits and rebates from the government. The opportunity to earn profits from SSIs are big due to many reasons.

Firstly, SSIs are less capital intensive. They even receive financial support and funding easily.

Secondly, procuring manpower and raw materials is also relatively easier for them. Even the government's export policies favour them heavily.

5. SSI Advances Welfare

Apart from providing profitable opportunities, Small Scale Industries play a large role in advancing welfare measures in the Indian economy as well.

A large number of poor and marginalized sections of the population depend on them for their sustenance.

These industries not only reduce poverty and income inequality but they also raise standards of living of poor people. Furthermore, they enable people to make a living with dignity.

Policies governing SMEs

1. Atal Incubation Centre (AIC)

Atal Incubation Centre is a funding scheme that Started in the year 2016. Envisioned by the NITI Aayog, this aims at supporting entrepreneurs by covering their operating costs of capital. The approved business ventures can avail up to Rs. 10 crore over a five-year term. Atal Incubation Centre allows researchers, students, and startup owners to apply for the scheme across different verticals and sectors. The entrepreneurs can set their company as a Public-private partnership, Public organisations, or as a completely private organisation. The entrepreneur needs to set up space of around 10,000 sq. ft. and should set up the physical infrastructure within six months of disbursement of financial assistance.

2. MSME Business Loans in 59 Minutes

Right now, the MSME Business Loans in 59 Minutes is undoubtedly the most discussed business loan scheme. This program was introduced in the year 2018 by the Government of India. This scheme is introduced to provide financial assistance to micro, small, and medium enterprises. The entrepreneurs can avail of loans of up to one crore under this scheme. This scheme is very quick and, within 59 minutes, you will know about your eligibility. Disbursement of the financial assistance happens within 1-2 weeks. A majority of the public sector banks are a part of this scheme.

3. National Small Industries Corporation Subsidy

NSIC subsidy offers two forms of financial benefits for small businesses: Raw Material Assistance and Marketing Assistance. Raw Material Assistance helps to purchase raw materials from abroad and from India. Marketing Assistance, on the other hand, helps to improve the sales of products and services with an efficient marketing process. The program is introduced to provide loans to SMEs who are looking for growth or rapid expansion.

5. MUDRA Loans

The Government of India initiates MUDRA loans for providing business finance for micro-business units. This program was launched with the single motive of 'paying the unfunded'. Since most of the time, the small-medium enterprises suffer from lack of funds, the government launches this program to encourage participation and growth of the startups across different sectors like trading, manufacturing, services, etc.

6. Swarojgar Credit Card

Swarojgar Credit Card was initiated to provide loans to small-time businessmen like fishers, homemakers, travel operators, shopkeepers, etc. Under this scheme, the small-time business owners can take a loan of Rs. 25000 in terms of credit card facilities. A passbook is also provided to keep track of the financial transactions. The card will be valid for five years and can be renewed upon satisfactory results from the initial investments.

7. Coir Udyami Yojana

The primary objective of this scheme is to build coir units throughout India. This Coir Board oversees this system which provides financial assistance up to Rs. 10 lakh to eligible units. However, the credit term should not exceed one-quarter of the project value. Individual entrepreneurs, joint ventures, private institutions, the public-private enterprises can avail of benefits under this scheme.

8. Refinancing by NABARD

This program launched by NABARD focuses on providing refinancing to lending institutions in agricultural areas. This aims to provide growth to rural enterprises based in diverse areas. Various handicraft manufacturing industries, rural institutions, agricultural setups have taken part in this scheme and made rapid growth.

9. The Women Entrepreneurship Platform

The Government of India introduced the Woman Entrepreneurship Platform to promote women's entrepreneurship. The NITI Aayog is the primary driver behind this program and aims to boost the morale of young and dynamic woman entrepreneurs. This scheme has got three divisions: Gyaan, Iccha, and Karma Shakti. Iccha Shakti aims to empower women to start a company. Gyaan Shakti offers a favourable environment for setting up a business.

10. Stree Shakti Package

The Stree Shakti Package is provided in India by most branches of the State Bank of India (SBI) and focuses on providing women in business with a business loan. The biggest benefit of this startup business loan for women is that loans up to Rs. 5 lakh need no protection. In addition, some concessions are made by the bank, such as having a reduced interest rate in the event of the loan exceeds Rs. 2 lakh. But the main downside of this loan is that it is only open to women who hold a 51% or greater share in the business.

11. Venture Capital Scheme

This Venture Capital Scheme is a program run by Small Farmers Agribusiness Consortium. This program aims to improve agricultural production. Under this program, the Small Farmers Agribusiness Consortium helps in the development of the agricultural market and improvement in the marketing of agricultural products. The minimum value of the business should be 50 lakhs to become eligible for this program.

12. End to End Energy Efficiency Scheme

The End to End Energy Efficiency scheme was launched in the year 2016. The SIDBI initiates this program in collaboration with the Government of India. Any micro, small, or medium enterprise that is in the business for three years and earning revenue for two years can avail of benefits under this scheme. However, this scheme is designed to support only energy-efficient units that need to do an energy audit through an auditor affiliated with the Bureau of Energy Efficiency. The startups can also purchase equipment using this line of business finance.

Capital structure and source of finance.

Capital Structure

From a technical perspective, the capital structure is the careful balance between equity and debt that a **business** uses to finance its assets, day-to-day operations, and future growth. Capital Structure is the mix between owner's funds and borrowed funds.

- *FUNDS = Owner's funds + Borrowed funds.*
- *Owner's funds = Equity share capital + Preference share capital + reserves and surpluses + retained earnings = EQUITY*
- *Borrowed funds = Loans + Debentures + Public deposits = DEBT*

Debt vs Equity

Cost of Debt is lower than the cost of equity but Debt is riskier than equity. The reasons for this are

- Lender earns an assured interest and repayment of capital.
- Interest on debt is a tax-deductible expense so brings down the tax liability for a business whereas dividends are paid out of profit after [tax](#).

Debt is more dangerous for the business as it adds to the financial risk faced by a business. Any failure with reference to the payment of interest or repayment of principal amount may lead to the liquidation of the company.

Factors Affecting Capital Structure

1] Cash Flow Position

A firm's ability to pay expenses and loans determines debt capacity. Some firms operate in volatile financial environments affecting their ability to meet financial obligations. The company may raise funds by issuing debts if it has a fluent cash flow position, as they are to be paid back after some time.

It must cover fixed payment obligations with regards to,

- Normal business operations
- Investment in fixed [assets](#)
- Meeting debt [services](#) commitments as well as provide a sufficient buffer period

2] Interest Coverage Ratio

Interest Coverage Ratio is the number of times earnings before interest and taxes of a company covers the interest obligation. High-Interest coverage ratio indicates that company can have more of borrowed funds.

$$\text{Interest Coverage Ratio (ICR)} = \text{Earnings Before Interest and Tax (EBIT)} / \text{Interest}.$$

3] Control

Public issues damage the reputation of the firm and make it vulnerable to takeovers. Debt generally does not cost dilution of control. To have **control**, the firm must issue debt. So there is a constant struggle over whether to give up control or pay more for capital.

4] Return on Investment

It will be beneficial for a firm to raise finance through borrowed funds if the return on investment is higher than the rate of interest on the debt. But if the return is uncertain and the company is not sure if it can cover the fixed cost of interest, they should opt for equity.

5] Floatation Cost

Flotation cost must be understood while selecting the sources of finance. Cost of the Public issue is more than the floatation cost of taking a [loan](#). The cost of issuing securities, brokers' commission, underwriter's fee, cost of prospectus etc is the flotation cost.

6] Flexibility

Issuing **debenture** and preference shares introduce flexibility. A good financial structure is flexible and sound enough to have scope for expansion or contraction of capitalization whenever the need arises.

7] Stock Market Conditions

Conditions of the stock market influence the determination of securities. During the depression, people do not like to take a risk and do not take interest in the equity shares. During the boom, investors are ready to take a risk and invest in equity shares.

8] Tax Rate

Interest on debt is allowed as a deduction; thus in case of the high tax rate, debts are preferred over equity but in case of low tax rate more preference is given to equity.

Self Study Topic

<https://www.ncert.nic.in/ncerts/l/lebs213.pdf>