

Solving the Financial Barriers of New Innovative Startups in Jordan

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Abstract

In this study, the authors aimed to examine the role of the informal financial sector financing new innovative startups projects. It is popular that the formal financial sector including banking and other financial institutions always try to avoid financing new innovative startups especially in their early stages where the risk is classified as very high.

This study was based on descriptive analytical approach with reliance on statistical instruments in order to test the hypotheses of this study. Thus, 120 survey questionnaires were distributed over the study's sample. One hundred of those questionnaires were retrieved and used for the analysis. Results revealed that there are many barriers for financing new innovative startups, and that the formal financial sector, including banking institutions, tends to avoid financing new innovative startups especially at the first phases. This study contained implications and recommendation for academics and practitioners.

Keywords: new innovative startups, informal financial sector, funding, banking, Business Angels

1. Introduction

Under economic challenges that sweep most of the countries worldwide, new innovative startups are considered to be one primary supporter for economic development and the creation of job opportunities. Thus, it minimizes unemployment rates and its economic, social and political consequences. In most nations, small businesses constitute in average about 90 percent of total establishments. Particularly, small businesses in Jordan that employ four people or less each, account for 93 percent of total Jordanian projects (DOS-Jordan, 2006).

Therefore, such projects have a significant role in increasing GDP and in the creation of new job opportunities. Above all, small businesses contribute significantly to the social and economic development. This primary role becomes more critical when it comes to innovative startup projects. Thus, non-innovative startups are easier to fund than innovative startups because those classic projects provide known products and services, and produce goods and services through the use of known technology. They work under minimum risk. However, such non-innovative projects have insignificant role in pushing the wheel of economic development forward (Audretsch & Thurik, 2000, Seyfart, 2004).

2. Study Data

2.1 Objectives of the Study

The objectives of the study are as follow:

- 1) Investigating the role of financial and banking institution in funding and developing new innovative startups.
- 2) Disclosing the nature of new innovative startups (entrepreneurial projects), its importance, and the degree of its success according to its funding needs.
- 3) Exploring the efficiency level of the informal financial sector such as "Business Angels" for new innovative startups as a synonym to formal financial sector.
- 4) Examining the problems and challenges which face new innovative startups, especially the financial ones.
- 5) Accentuating the effect of new innovative startups on the national economy.

2.2 The Significance of the Study

The significance of the research comes through examining the role of the unofficial financing sector in funding new innovative projects, and what these projects contribute in achieving economic development, creating job opportunities and addressing unemployment and poverty. Thus, this unofficial financing sector such as Business Angels positively affects the funding and supporting of new innovative projects in long run perspective.

2.3 The Hypothesis of the Study

This study addresses the following assumptions:

- 1) The formal financial sector such as banks and other official financial institutions play an efficient role in developing and funding new innovative projects.
- 2) New innovative startups considerably contribute to the social and economic development, due to their role in increasing domestic production and creating job opportunities.
- 3) What distinguishes innovative projects from small non-innovative projects is that innovative projects produce new goods and services, new business models, new organization structure or new markets.
- 4) New innovative projects do not face any obstacles in Jordan. In opposite, the economic legislation in Jordan simplifies the creation and establishment of new innovative startups.

2.4 Methodology of the Study

This study followed descriptive analytical approach to study the nature of new innovative startups and their role in the development of the economy and the increase of domestic production. In addition this study aims to study and to analyze the role of formal and informal financial sector in funding and supporting new innovative startups.

2.5 Scope of the Study

In addition to the role that formal financial sector plays in the development and the establishment process of the new innovative projects, this study also focused on the examination of the funding obstacles of new innovative startups and the ability of reducing these obstacles by the informal financing sector. The model in this study focuses on the role of "Business Angels", which is considered as the main funding resource of new innovative startups.

3. Theoretical Framework of the Study

3.1 The Concept of Entrepreneurial Projects

According to Shumpeter (1964, pp. 100-101), innovative projects are projects that:

- 1) produce new goods or services,
- 2) create new production method,
- 3) develop new source of raw materials,
- 4) develop new market, and/or
- 5) develop new organization form.

Based on the identified concept, essential elements must exist in entrepreneurial projects, which are (Sakarneh, 2008):

- 1) Creativity will not exist without entrepreneurs,
- 2) Organizational dimension relevant to the vision, full confidence, creativity, taking precautions against failure, ambiguity and internal censorship,
- 3) Environmental dimension related to the diversity of markets that entrepreneurial projects deal with.

In this context, we can mix small projects with medium projects on one hand, and between innovative projects on the other hand, so it is necessary to differentiate between small projects and innovative projects, in that small projects do not have to be innovative at the same time. However, every innovative project is originally a small project. In order to make small projects innovative ones, qualities such as: creativity, risk taking and initiative spirit must be available.

Entrepreneurial Activities are usually based on essential and important axials, which are (Sakarneh, 2008):

- 1) New business ideas. Through this ideas new products will be produced,

2) Current ideas and new actions. Here a new business will be established based upon old concepts (Simi innovation).

3) Opportunity based entrepreneurial and innovative activities. The creation of a new innovative project results from an opportunity of entrepreneurial activity and not as a result of some necessity or unemployment (Global Entrepreneurship Monitor, 2007, p. 19).

New innovative startups are considered as tools for economic and social development and an element of strategy for economic growth and development in most industrialized countries as well as developing countries.

In 2007, the number of registered entrepreneurial projects in Jordan reached up to 21,780 (Ministry of Industry and Trade, 2008, p. 14). These are classified as projects that have been created as a result of opportunity entrepreneurial activity. In other words, the entrepreneurial element is present and at high level in Jordan (GEM, 2007, p. 29). However, there are obstacles that stand in the path of innovative projects. Therefore, the world economic forum in 2006 (World Economic Forum, 2006, p. 13) pointed out in a relevant study that the following obstacles are the most persistent that face innovative projects.

- 1) High level of bureaucracy in governmental institutions (14.9%)
- 2) Access to financial markets (13.1%),
- 3) Shortage in qualified and skilled labor (10.4%),
- 4) Weakness in organizational process (8.9%),
- 5) Weakness in work ethics and work principles (8.2%),
- 6) High tax rates (7.7%),
- 7) Reasons relevant to taxation law (7.1%) and
- 8) Insufficient appropriate infrastructure (6.95%)

Bureaucracy constitutes are seen as the first and most important obstacle that faces new innovative projects. However, this obstacle can be handled by a single political decision, or to exert some effort and time by project's owner. In regard to the second obstacle "financing a project" which is considered to be the most significant obstacle for being a real obstacle that stands persistently in the way of establishing an organization based on new innovative idea.

Austrian economist Joseph A. Schumpeter, hundred years ago, had focused on the role of the entrepreneurs, arguing for playing a primary role in the economic development process and new job creation. Furthermore, he emphasized that entrepreneurs in general face in most of their investments funding problems. Entrepreneurs usually invest all their available resources, therefore, and in case of new innovative idea, they have to borrow money in order to finance their projects. They start their new project as borrower (Schumpeter, 1993).

This paper attempts to deal with this financial obstacle by proposing solutions and recommendation. Hence, an emphasis is being made on the role of funding in the developmental process and the problems of funding of new innovative startups. Furthermore, this study focuses on the role of the informal financial sector such as Business Angels in solving these problems and pushing economic development forward. Despite of the significance of innovative projects, such projects are still suffering many problems and challenges especially in Arab countries.

3.2 The Finance Problems of New Innovative Startups

In this context this study focuses on the funding problem of the new innovative startups problems. This study focuses on:

- 1) The insufficiency of information and the high cost of data collection to explore a business problem.
- 2) The problem of time difference between finance and repayment
- 3) The problem of product and entrepreneur behaviors
- 4) State failure in entrepreneurial projects finance

3.2.1 The Insufficiency of Information and the High Cost of Data Obtaining Problem

Banks and financial institutions in general focus on project finance in advanced stages, in other words, a finance with low risk because the market in such stages had already accept the project. In most cases, formal financial sector finance an expansion of current successful project. Due to this, the insufficiency of data and not to reveal all data on entrepreneur's part (Asymmetric Information Allocation), hinder reaching an agreement to finance the new innovative project (Agent-Principle Problem) (Spreemann, 1990).

This situation reflects the first problem between entrepreneur and banking and financial institutions. The main aim for banks and formal financial institutions is to choose and finance the right project which suits their finance policy (Stiglitz, 1992). The problem is in choosing the right project for the institution which ensures a low rate of risk and repayment in timely manner. This problem is called hidden information.

3.2.2 The Problem of Time Difference between Finance and Repayment

The repayment is made with a specific time difference. This is why the project is subject to many studies in order to evaluation and examination process, if the project is able to repay or not. In new innovative projects with no history, there are no sufficient ideas or data about project's future and the probability of finance repayment, moreover, there are fears from entrepreneur and his intention to payback or to keep data that can lead to non-repayment, or having delays.

This situation reflects the second problem in the relation between entrepreneurs and financial institutions which is called moral hazard (Stieglitz, 1992). Entrepreneur can work to achieve and support his/her personal objectives, but not the objectives of the financial institutions. This problem comes from the unequal data distribution between entrepreneur and financial institution.

Since financial institution risks are being hold by institutions and the entrepreneur objective is to increase profits, it is potential that entrepreneur take a high risk in order to achieve a higher profit and put the project at risk, thus the institution hold the responsibility of these risks and the losses arisen from them.

3.2.3 The Problem of Product and Entrepreneur Behaviors

According to the insufficiency of data distribution between entrepreneur and financier, we deal here with the product problem on one hand and entrepreneur behavior on the other hand. The product problem is described as follows: despite the intensive studies on the potentiality of product marketing success in a reasonable profitably, the failure risk of this product is still present. However, the behavior of the entrepreneur in respect of the real information he/she gives about the project and its progress caused a kind of doubt and unexpected risk by funding institutions. The entrepreneur may act in a way to serve his own personal goals away from financial institution desire (rapid and assurance of paying back the funding principle). Thus, the imbalance state in obtaining data and hide such information from the financier is considered to be a problem that leads to not funding the project.

This situation reflected the third problem in relationship between entrepreneur and funding institutions. This case is called "hold up" (Stieglitz, 1992). In the other aspect, holding up in repayment is called (hidden intention). In addition, entrepreneur does not own what financial institution requires such as: Credit worthiness, annual reports or cash flow statement or historical data.

3.2.4 State Failure in Entrepreneurial Projects Finance

Economists such as: Bruederl, Preisendoerfer, & Ziegler (1996) point out that obstacles that deprive new innovative projects from being funded are obstacles in the dynamism of creating new job opportunity, enhance economic growth and development. Due to the importance of such a problem, it can be solved through supporting economic policies. In Jordan, there are many initiatives that could support entrepreneurship, such as "Queen Rania Center for entrepreneurship", the "Jordanian Center for entrepreneurship", "Jordan network for entrepreneurship" and others. These centers play a role in the success of innovative ideas and transform such ideas into projects (Jordan Innovation Center, 2009). Below are the Members of Entrepreneurial Network in Jordan.

- 1) Jordan Forum for Business and Professional Women
- 2) El Hassan Industrial Estate JIC
- 3) IPARK-Jordan's Technology Incubator (the Higher Council on Science and Technology)
- 4) JIC for Engineering and Industrial Enterprises-RSS
- 5) Agro-Business Incubator / University of Jordan
- 6) Jordan Innovation Center / Philadelphia University
- 7) Jordan Innovation Center

Overall, there are political strategies and many initiatives to support entrepreneurship and innovative ideas in Jordan. However, there are still obstacles which still exist in front of the adoption of entrepreneurship projects, especially at their early stages. For instance, market failure in finding a mechanism with which the problem of financing can be resolved, information insufficiencies, difficulty in gathering needed information, employee

insufficient experience in assessing new innovative projects and being reluctant in decision making and accountability towards lenders or capital owners. Thus, the government often finds itself in a situation that prioritizes its interference, and the attempt to support innovative projects because many governments know well the positive role of such projects in economic developmental process and the creation of jobs.

4. Business Angels to Solve the Financing Problem of New Innovative Projects

Business Angels are part of the unofficial finance sector. In the 1980s and beyond, scientific studies have been conducted on unofficial finance sector which is concerned with innovative entrepreneurial projects financing, and the number of studies are increasing due to the increasing importance of economic growth in different countries.

A German economist Assmann indicates that the dynamic U.S.A economy and the informal financial sector are considerably related to each other. In U.S.A, there are millions of informal financiers with a capital exceed 20 billion Dollars per year; this situation is applied to other industrial countries such as: Italy, Germany and other industrial advanced countries (Assmann, 2003).

Regarding the Business Angels: Who are they, what are their motivations and how do they conduct their business? In comparison between business angles and financial institutions, it will be noticed that “Business Angels” in the first place focuses on personal qualities of entrepreneur (entrepreneurial characteristics, innovative behavior, managerial knowledge, general science and vision) whereas financial institutions focus on facts, numbers, measured statistics, analysis and follow certain policies and instructions, where the decisions are being made based upon these data in regard to project finance.

Business Angels usually are usually retired persons (managers) with a high level of experience and conducting their business similar to entrepreneurial persons (Röpke, 2000). Through their effective role in the finance of new innovative projects, this method of financing has become a big academic interest taking into consideration government developmental programs (Assmann, 2003).

Business Angels: how do they think and conduct Business? Going back to main problems that face banking and financial institutions, we emphasize how Business Angels conducts their business and how they deal with these problems:

First stage, the choice stage: how do Business Angels reach a financial agreement with entrepreneurs? Many studies showed that Business Angels are concerned with project profitability and entrepreneurial personal qualities (Coveney & Moore, 1998). Röpke’s study in the year 2000 emphasizes that informal finance sector is mainly concerned with entrepreneurs experience and personality. The following characteristics are considered to be the most important characteristics that Business Angels are concerned with prior to the proceeding at finance:

- 1) The nature of entrepreneur in dealing with knowledge and science. Does this entrepreneur act in accordance with the instructions and fixed knowledge or renew his science, business style?
- 2) Does entrepreneur have data and experiences out of his work scope? What are the energies and the nature of entrepreneur in regard to communication with others?
- 3) Can confidence exist and constitute a basis for a relation based on mutual respects and honesty?
- 4) Is entrepreneur’s nature suitable for making friendship with the financier?

These points are considered to be logical factors to choice and to finance a project, because other factors such as product, used technology, numbers and figures, statistical data, company’s policies and other data reflect the Businesses style and characters of the business owner or business manager. Consequently, in case of innovative projects that lack of annual budget, business reports, good in market or the like, the most important thing remains is entrepreneur’s personality that can increase success probabilities or decrease failure possibilities as well. Therefore Business Angels are left with nothing except entrepreneur’s personality to evaluate the project and project owner.

In this case when Business Angles use entrepreneur’s personality as an alternative for required warrantees from banking and financial institutions, it can be said that individual’s personality is the important information in these cases. However, a question if the personality is transparent enough and Business Angels can take real data from it? (Röpke, 2000)

Second stage: Control and Consulting Stage. In order to ensure the success after projects finance, Business Angels do not totally relay on the data they got from business owner, but they also resort to control and consulting activities.

Banking and financial institutions consider monetary element as negative for entrepreneur where the financier can interfere in project policies and administration, thus this can lead to losing entrepreneurial drive for entrepreneur and threatening project (Assmann, 2003). In contrast, Business Angels according to their personal evaluation of entrepreneur, they do not have problems such as hidden information or holding up in repayment or non-repayment. In addition, Business Angels stay in constant touch with entrepreneur, because they exist in a geographic area near to financed project and build a strong relation with entrepreneur based on confidence, consultation and assistance for entrepreneur (Röpke, 2000).

Third stage: Business Angels' Benefits. Accordingly, Business Angels' benefits in comparison with banking and financial institutions in entrepreneurial projects finance can be summarized as following:

- 1) Business Angels can evaluate project in a better way,
- 2) Business Angels can use and utilize their experiences and social relations,
- 3) Business Angels deal with choice, behavior, holding up repayment problems better than banking and financial institutions, due to their emphasis on the approximation of personal characteristics between them and the entrepreneur,
- 4) Business Angels utilize their relations and social communications that help them to control the project and reduce cost,
- 5) Business Angels can make decision of finance automatically, directly and without taking the permission from other person, because they use their internal capital in contrast to banking and financial institutions which use investors' capital. Therefore banking and financial institutions are more reserved and cautious.

5. Reliability and Hypothesis of the Study

5.1 Reliability of Study's Instrument

Cronbach's Alpha is used in order to be sure of study's instrument reliability. The result on this scale was 0,067. This value proves that reliability of study's instrument is acceptable, even though it reaches up to a high level of reliability.

5.2 The Study's Hypothesis Testing

5.2.1 The First Hypothesis

Null Hypothesis: The formal finance sector such as banks and financial institutions do not play an effective role in finance and support of new innovative startups.

Alternative Hypothesis: The formal finance sector such as banks and financial institutions play an effective role in finance and support of new innovative startups.

Through conducting one sample T-test it has been revealed value of computed T- is higher than schedule value thus, we accept that hypothesis which indicates that banking and financial institutions do not play effective role in financing new innovative projects.

5.2.2 The Second Hypothesis

The Null hypothesis: new innovative projects do not play a significant role in economic and social development process.

Alternative Hypothesis: The Null hypothesis: new innovative projects do not play a significant role in economic and social development process.

T-Value	Scheduled T-Value	Level of Abstract	Accepting or Rejecting.
8.33	1.67	0.00	Null hypothesis accepted

5.2.3 Third Hypothesis

Null Hypothesis: New innovative projects are not distinctive from other small projects in providing new products, new production method, new organization form and new markets.

Alternative Hypothesis: New innovative projects are distinctive from other small projects in providing new products, new production method, new organization form and new markets.

T-Value	Scheduled T-Value	Level of Abstract	Accepting or Rejecting
12.7	1.67	0.00	Accept

We reject null hypothesis and accept the alternative hypothesis due to the difference of the entrepreneurial projects from others, which has been indicated in the calculated T Value whereas it is higher than scheduled T.

5.2.4 Fourth Hypothesis

Null hypothesis: there are no obstructions in front of the entrepreneurial projects in Jordan and the economic legislations facilities the entrepreneurial building and development.

Alternative hypothesis: there are obstructions in front of the entrepreneurial projects in Jordan and the economic legislations facilities the entrepreneurial building and development.

T-Value	Scheduled T-Value	Level of Abstract	Accepting or Rejecting
21.19	1.67	0.00	reject

Null hypothesis is rejected while the alternative hypothesis is accepted.

This means that there are many obstacles in front of new innovative projects in Jordan in both legal and economic legislation. These are restricting the development of the projects.

6. Results and Recommendations

6.1 The Results

- 1) New innovative projects play significant role in the economic and social development process due to the increasing GDP and creating new jobs, reducing poverty and unemployment.
- 2) New innovative startups are different from other non-innovative projects because they contribute in a higher level in economic and developmental activity qualitatively and quantitatively,
- 3) There are many obstacles that new innovative project are facing in Jordan such as financing, marketing and economic legislations,
- 4) The term of "Business Angles" is unfamiliar term in relevant sectors.

6.2 The Recommendations

Based upon the above results, the study recommends the following:

- 1) The necessity of financing new innovative startups in Jordan by formal financial institution,
- 2) To work hard for the purpose of eliminating the legal and managerial obstacles that face the establishment and financing of new innovative,
- 3) Create and find a mechanism in governmental institutions towards supporting new innovative projects,
- 4) Introducing of Business Angels culture throughout society by showing their benefit for all,
- 5) To enhance the presence of Business Angels and motivate them to increase their finance efforts of new innovative projects.

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