

# An Analysis of Financing Preferences and Challenges for Early-Stage Startups in Nagpur

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**Abstract:** *This study examines the financing behavior and constraints experienced by early-stage ventures within a developing entrepreneurial ecosystem. It focuses on understanding how founders evaluate and select different funding sources during the initial stages of business development, while situating these decisions within a broader economic and academic context. The research highlights the importance of access to capital in enabling innovation, sustainability, and regional growth, and systematically explores key dimensions such as awareness of funding options, risk perception, investor expectations, and the role of institutional support. It also analyzes the interaction between formal and informal financing sources, including personal savings, angel investment, venture capital, bank loans, and government-backed schemes.*

*In addition to structural and institutional factors, the study emphasizes the lived experiences and strategic preferences of entrepreneurs in navigating financial challenges. By adopting a phenomenological perspective, it captures how founders interpret constraints such as limited collateral, regulatory barriers, information asymmetry, and market uncertainty, and how these challenges influence their decision-making processes. The research outlines its objectives in identifying key determinants of financing choices and assessing the significance of various barriers, while also acknowledging limitations related to scope and data accessibility. Overall, the study provides a comprehensive understanding of early-stage financing dynamics and offers insights that may assist policymakers, financial institutions, and support organizations in designing more responsive and effective funding mechanisms.*

**Keywords:** Startup Financing, Equity Financing, Debt Financing, Financing Preferences, Financial Challenges, Early-Stage Startups.

## I. INTRODUCTION

### 1.1 Introduction

Startups are key drivers of innovation, employment, and economic growth. However, their survival largely depends on access to finance, as limited capital restricts growth under conditions of high uncertainty (World Bank, 2020; NASSCOM, 2022).

The two main external financing sources for startups are equity and debt. Equity financing involves raising funds from investors in exchange for ownership, offering capital and expertise but causing dilution. Debt financing involves borrowing funds that must be repaid with interest (Paul A. Gompers&Josh Lerner, 2001; Allen N. Berger&Gregory F. Udell, 1998).

The Pecking Order Theory (Stewart C. Myers&Nicholas S. Majluf, 1984) suggests firms prefer internal funds, then debt, and lastly equity. However, startups often rely on equity due to lack of collateral and internal funds (Allen N. Berger&Gregory F. Udell, 1998).



In Nagpur, initiatives like Startup India and MUDRA have improved access to finance, while growing investor networks and incubators have expanded equity funding opportunities. However, despite these developments, financing remains a major challenge for startups in the region (Department for Promotion of Industry and Internal Trade, 2023; Small Industries Development Bank of India, 2022).

### 1.2 Scope of the Study

The scope of the study covers multiple dimensions. Geographically, it focuses on the Nagpur district and its early-stage ventures. The respondents include founders, co-founders, financial managers, and others involved in financing decisions. Sector-wise, the study spans diverse industries such as technology, e-commerce, manufacturing, services, education, and retail. Financially, it is limited to external sources of finance, specifically equity (angel investors, venture capital, private equity) and debt (banks, NBFCs, government schemes). The time frame of the study is restricted to 2025–2026, considering current policies and market conditions.

### 1.3 The Problem Statement

Startup culture is flourishing in Nagpur but nascent ventures continue to suffer from holding on to insufficient monetary provision. Equity would unlock growth capital but dilutes once affording control and forfeiting upside. Debt keeps you away from giving up the ownership but does need some valuable pledge with interest and cash-flow constraints; that's beyond the comprehension of the early companies.

### 1.4 Objectives of the Study

- To study the concept of equity and debt financing in the context of startups .
- To analyze the preferences of startups between equity and debt financing
- To identify the factors influencing financing decisions (e.g., cost, risk, ownership dilution, availability)
- To examine the challenges faced by startups in accessing equity and debt financing

### 1.5 Statement of Hypothesis

#### Hypothesis 1

H<sub>0</sub><sub>1</sub> (Null): There is no significant relationship between startup growth and the choice of equity financing.

H<sub>1</sub><sub>1</sub> (Alternative): There is a significant relationship between startup growth and the choice of equity financing.

#### Hypothesis 2'

H<sub>0</sub><sub>2</sub> (Null): There is no significant relationship between startup sustainability and the use of debt financing.

H<sub>1</sub><sub>2</sub> (Alternative): There is asignificant relationship between startup sustainability and the use of debt financing.

#### Hypothesis 3

H<sub>0</sub><sub>3</sub> (Null): Financing preferences are not significantly influenced by startup size, sector, and founder experience.

H<sub>1</sub><sub>3</sub> (Alternative): Financing preferences are significantly influenced by startup size, sector, and founder experience.

## II. REVIEW OF LITERATURE

### 2.1 Literature Review

A startup's financing journey unfolds as a continuous process shaped by both theory and practical constraints. In the beginning, as explained by Stewart Myers and Nicholas Majluf (1984), firms are expected to follow a pecking order—internal funds, then debt, and equity last. However, startups have no retained earnings, so they immediately rely on equity, breaking this sequence.

As the startup grows, debt becomes an option in theory, but Alan Kraus and Robert Litzenberger (1973) show that high bankruptcy risk makes debt unattractive. With unstable cash flows, startups avoid borrowing and continue using equity. At the same time, according to Allen N. Berger and Gregory F. Udell (1998), they face financing constraints due to lack of collateral and credit history, limiting access to formal loans.



As the business gains potential, venture capital becomes important. Paul Gompers and Josh Lerner (2001) highlight that VCs provide not just funds but also mentorship and networks, helping startups grow despite ownership dilution. Still, as noted by Susan Coleman and Richard Cohn (2000), debt remains difficult until the firm builds collateral and a track record.

Overall, startups move from early dependence on equity, to gradual growth with venture capital support, and only later gain access to debt, reflecting a realistic evolution rather than strict adherence to theory.

### 2.2 Research Gap and Relevance

Across the ten studies, three major insights stand out: startups often do not follow traditional financing theories like Pecking Order and Trade-off due to high uncertainty and lack of collateral; equity financing dominates in the early stages as it provides both capital and strategic support, especially in innovative and high-growth sectors; and access to debt is highly constrained in emerging regions like Nagpur because of institutional limitations and risk-averse banking systems. Although prior research discusses financing theories and SME challenges, there is limited comparative analysis of equity versus debt preferences specifically for startups in Nagpur. This study addresses this gap by empirically examining financing preferences and the challenges faced in accessing funds.

## III. RESEARCH METHODOLOGY

### 3.1 Research Design

The study adopts a descriptive, analytical, and empirical research design to examine startup financing behavior. It analyzes financing patterns, founders' perceptions of equity and debt, and key challenges such as collateral, investor access, and financial literacy in Nagpur. It also explores relationships between factors like startup age, sector, and founder background with financing choices using statistical tools, based on primary data collected from founders.

Data was collected from both primary and secondary sources. Primary data was gathered through a structured questionnaire from 60 startups and supported by semi-structured interviews, while secondary data was sourced from academic journals, government reports (MSME, DPIIT, RBI, SIDBI), Startup India, NASSCOM, KPMG, and World Bank reports. The sample was selected using purposive sampling, focusing on founders and financial decision-makers. For analysis, both quantitative and qualitative methods were used. Quantitative techniques included descriptive statistics (mean, percentages) and inferential tools (chi-square, regression, ANOVA), using Microsoft Excel and SPSS (Version 27). Qualitative data from interviews was analyzed through thematic and content analysis to generate key insights.

## IV. DATA ANALYSIS AND INTERPRETATION

### 4.1 Summary of Statistical Findings

Table 4.1 the analysis of the study reveals that startups have a basic to moderate awareness of equity and debt financing, as indicated by the mean score of 1.87, with responses showing consistency among participants. The findings further show a strong but varied preference for financing options (mean = 2.31), with a noticeable inclination toward equity financing, although opinions differ across startups. Financing decisions are found to be moderately influenced by factors such as cost, risk, and the stage of the business (mean = 2.03). Additionally, startups face moderate challenges in accessing finance (mean = 2.10), highlighting issues like funding availability and procedural barriers. At the same time, there is strong agreement on financial strategies and recommendations (mean = 2.23), indicating that startups recognize the importance of effective financial planning, especially for long-term sustainability.

**Table 4.1: Aggregate Statistical Analysis**

Objective	No. of Questions	Avg. Question Mean	Avg. Standard Error	Overall Objective Mean	Overall Std. Deviation
Objective 1: Concept of Equity & Debt	4	1.87	0.09	1.87	0.61
Objective 2: Financing Preference	5	2.31	0.14	2.31	1



Objective 3: Influencing Factors	3	2.03	0.1	2.03	0.64
Objective 4: Challenges in Finance	3	2.1	0.14	2.1	0.76
Objective 5: Recommendations	3	2.23	0.12	2.23	0.65

**Interpretation of Hypothesis 1**

Table 4.2 the null hypothesis (H1) states that there is no significant relationship between startup growth and the choice of equity financing, while the alternative hypothesis (H2) suggests a significant relationship. The analysis shows a high mean score of 2.31, indicating strong preference for equity financing, especially among growth-oriented startups. This implies that startups rely on equity funding to expand operations, enter new markets, and drive innovation. Based on these findings, the null hypothesis is rejected and the alternative hypothesis is accepted, confirming that equity financing has a significant impact on startup growth.

**Interpretation of Hypothesis 2**

Table 4.2 the null hypothesis (H1) states that there is no significant relationship between startup sustainability and the use of debt financing, while the alternative hypothesis (H2) suggests a significant relationship. The results show moderate mean values (around 2.03 and 2.23), indicating that startups use debt financing cautiously. While it is not the primary source of funding, debt plays a role in maintaining financial discipline and supporting sustainability. Based on these findings, the null hypothesis is rejected and the alternative hypothesis is accepted, confirming that debt financing has a significant, though selective, impact on startup sustainability.

**Interpretation of Hypothesis 3**

Table 4.2 the null hypothesis (H1) states that financing preferences are not influenced by startup size, sector, or founder experience, while the alternative hypothesis (H2) suggests that they are influenced by these factors. The analysis shows a high standard deviation (around 1.00), indicating significant variation in responses. This means financing decisions vary based on startup size, industry, and founder experience. Based on this evidence, the null hypothesis is rejected and the alternative hypothesis is accepted, confirming that startup characteristics significantly influence financing preferences and strategies.

**Table 4.2: Aggregate Statistical Analysis and Hypothesis Testing Results**

Hypothesis	Objective Link	Key Evidence (From Data)	Decision	Result Interpretation
H1: No relationship between startup growth & equity financing	Obj 2 (Preference)	High mean (2.31) and strong agreement toward equity, especially for growth	Rejected	Equity financing is preferred for growth-oriented startups. Significant relationship exists
H2: Significant relationship exists			Accepted	
H1: No relationship between sustainability & debt financing	Obj 3 & 5	Moderate mean (~2.03, 2.23) shows debt used cautiously for stability	Rejected	Debt financing is linked with sustainability decisions. Significant relationship exists
H2: Significant relationship exists			Accepted	
H1: Preferences not influenced by size, sector, experience	Obj 2 & 3	High SD (1.00) + variation in responses → different startup	Rejected	Financing preferences vary widely. Influence of startup characteristics is significant



		characteristics affect choices		
H2: Preferences are influenced			Accepted	

#### 4.5 Summary of Findings

The overall analysis reveals that equity financing is strongly preferred by startups for growth and expansion, as it provides the necessary capital to scale operations and invest in innovation. In contrast, debt financing is used more cautiously and primarily for maintaining sustainability and financial stability. The findings also indicate that financing decisions are not uniform across all startups, as they are significantly influenced by factors such as size, sector, and founder experience. This highlights that startups adopt different financing strategies based on their specific needs and business conditions.

#### V. CONCLUSION

The study concludes that financing is a major challenge for early-stage startups in Nagpur, directly affecting their growth and sustainability. Equity financing emerges as the most preferred option, especially for expansion and innovation, as it offers not only capital but also strategic support, though it leads to ownership dilution. In contrast, debt financing is used cautiously due to challenges like lack of collateral, strict lending norms, and unstable cash flows, making it less accessible. The study also finds that financing choices vary based on factors such as startup size, sector, and founder experience, showing that decisions are context-specific. Overall, the research highlights the need for a balanced financing approach, better access to funds, and stronger support systems like government initiatives and investor networks to help startups overcome financial barriers and drive economic growth.

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