Abstract--- The purpose of this paper is to investigate the determinants of financing preferences of investment decisions in Micro Small and Medium Enterprises. Methodologically, this paper is based on examining the various relevant review of literature. The key contribution of this paper is to provide a theoretical examination of the financial preferences of Micro Small and Medium Enterprises, which is to examine the major factors influencing investment decision and how they influence the financial decision making. The result found that firm age, size, organization nature, entrepreneur ability, infrastructure, perception, attitude, gender etc are greatly influenced the investment decision of small enterprises.

Keywords--- Financial Preferences, Financial Theories, Investment Decision, Micro Small and Medium Enterprises

I. INTRODUCTION

SMALL and Medium Enterprises (SMEs) play a vital role in the industrial development of any country and have been recognized as an engine of economic growth. These have rightly been treated as the ‘seedbed of entrepreneurship’, as they provide conducive and favourable conditions for the emergence and growth of entrepreneurship, Lalit Mohan Kathuria et al,(2012). The SMEs can be a competitive advantage in emerging market because it has greater flexibility and ability to adjust to changes in the market and it has a potential to raise productivity and performance, Haslindar Ibrahim,(2011). Many countries have directed increasing attention to the development of their domestic SMEs to propel economic growth is a phenomenon especially evident in the developing and newly industrialized economies, Ana Paula Silva(2012).It is widely stated that small and medium enterprises in developing countries are important socially and economically for a number of reasons including: 1) Wide dispersion across rural areas and important for rural economies. 2) Their ability to employ a significant amount of the labour force in their local economies; and their ability to provide an opportunity for entrepreneurial and business skill development, Tulus Tahi,(2011).

The government of India introduced the Micro, Small and Medium Enterprises Development (MSMED) Act, 2006, to broaden the scope of small scale industry (SSI) into Micro, Small and Medium Enterprises by including medium-scale units and classifying enterprises into manufacturing and service, Anju Singla(2012). Micro, Small and Medium Enterprises (MSMEs) play a significant role in social and economic development of a country. This constitute an important segment of the Indian economy in terms of their contribution to the country’s industrial production, exports, employment and entrepreneurial base, Anju Singla(2012). Micro Small and Medium size enterprises (MSME) firms tend to be considerably more creative and innovative than their larger counterparts given the freedom of expression inherent in most MSMEs which facilitates and encourages creative and innovative behavior, Kadri Cemil Akyuz, (2006). Enterprises need financing for investment and working capital during their initial establishment, continuing to operate in their market after they are established, facilitating their adaption to new innovations, and competing with other businesses in their industry, Idil Ozlem Koc,(2008).

This paper presents the determinants of financial preferences of investment decision in micro small and medium enterprise owners. This paper is organized as follows. Section two describes the theoretical basis of the investigation about the factors affecting financing decisions in micro small and medium enterprises. And the third section analyses the financial theories in decision seeking of MSME owners.

II. FACTORS AFFECTING FINANCING DECISIONS

The characteristics of Micro Small and Medium enterprises have an important impact on their ability to raise capital, Kadri Cemil Akyuz,(2006). Both in the developing and developed world small firms have been found to have less access to external finance and to be more constrained in their operation and growth, Thorsten Beck et al,( 2006), and the study...
also suggests that in some cases a poor business environment may affect the performance of the SME sector, because restrictions and market imperfections dampen competition and slow firm growth, Thorsten Beck et al, (2006).

The concept of life cycle financing captures the important relationship between the firm’s stage of development and the most viable sources of capital Kadri Cemil Akyuz, (2006). The most important financing source for SMEs at their inception is their own equity, but they also require support from foreign sources. Start-up firm typically relies on personal equity, friends and relatives, and loans from financial institutions, Kadri Cemil Akyuz, (2006). Firm age largely corresponds to the business cycle of SMEs. Dong Xiang, (2011). The existing evidence suggests that access to finance plays a very important role in the overall business environment, potentially constraining both firm entry and growth. Thorsten Beck et al (2006).

In small firms, ownership and control of capital are typically in the hands of one key decision maker who is able to exert a powerful influence on the way the firm pursues his or her own objectives, Kadri Cemil Akyuz, (2006). Financial barrier is the most effective obstacle to the development of entrepreneurship, Wioleta Samitowska, (2011). SMEs finance is considered to be a separate business line by financial institutions, Tulus Tahı, (2011). Most small firms will never be able to raise all the funding they would like from banks and other institutions. Robert T. Hamilton, (1998). Financial and institutional deficiencies might prevent SMEs from growing to their optimal size and thus explain the lack of an empirical casual link between SMEs and economic development. Thus, it is crucial to understand obstacles to SMEs operation and growth and how they vary with country factors, Thorsten beck et al, (2006). Development of microenterprises is determined by two types of factors, namely external and internal, Wioleta Samotowska (2011).

A higher percentage of the SMEs are growth-oriented firms with the possibility of becoming nationally or even internationally competitive, Tulus Tahı, (2011). The recent increased involvement of financial institutions (mainly banks) in funding new businesses may indicate an improved ability on their part to monitor and control new enterprise lending, Robert T. Hamilton, (1998). The acquisition and efficient management of capital are important for Micro Small and Medium enterprises due to the limited level of financial sources and low information about capital markets, Kadri Cemil Akyuz et al, (2006). Good liquidity management should reduce impediments to growth and lead to higher profitability, Ana Paula Silva (2012).

Other related financial issues, including high collateral requirements and high bank charges were considered to be important obstacles by the firms, Kadri Cemil Akyuz et al, (2006). Haslindar Ibrahim et al, (2011), intends to investigate the relationship between firm characteristic determinants with long term debt of SME. Credit availability to enterprise, but especially to SMEs, depends on the infrastructure that supports financial transactions, including the legal systems and the information environment, Thorsten Beck et al (2006).

The effect of financial and legal development on the constraints-growth relationship is significantly stronger for small firms than for large firms. Financial and institutional development thus helps close the gap between small and large firms, Thorsten beck et al (2006). The results signifies that the size is significantly positively related to long term debt. Efforts targeted at the SME sector are often based on the premises that (i) SMEs are the engine of growth, but (ii) market imperfections and institutional weaknesses impede their growth. Traditionally, relationship banking and thus the presence of small banks have been considered the characteristics of an SME-conducive financial system. The introduction of transaction-based SME financing tools, such as factoring and credit scoring, however, has underlined the advantages of large banks in providing finance to small opaque firms. They find that in addition to many personal characteristics the perception of corruption and government officials’ attitude towards entrepreneurship affects the decision to become an entrepreneur. The MSE owner who voluntarily started business has a relatively good deal of entrepreneurship behavior and relatively higher preferences for external financing schemes, Gebregziabher Haileselasie Gebru, (2009). Educated owners of MSMEs are in a better position to understand the link between finance and firm value. Dong Xiang (2011), study indicated that a large number of SME characteristics, including firm age, size, industry and sales and the declared strategies for operations, profits, growth and exports, significantly affect both finance-seeking behavior and outcomes. More specifically, SME in many developing countries get around Market failures and lack of formal institutions by creating private governance systems in the form of long term business relationships and tight, ethnically based, business networks. Thorsten Beck et al (2006). Gebregziabher Haileselasie Gebru, (2009), study found that ownership type, acquisition type, level of education of the owner/s and reason for business start up are found to be major determinants of MSE owners financing preferences. Innovation is not easy for many SMEs in developing countries that generally lack the necessary capital and skills to expand and develop their business. Tulus Tahı, (2011).

ICT has a positive effect on firm performance not only in terms of productivity, profitability, market value, and market share, but also on intermediate performance indicators such as process efficiency, service quality, cost saving, organizational and process flexibility and customer satisfaction. Sengaloun Inmyxai et al, (2012). Gregory et al, (2005) found that only firm size, as measured by total employees, could significantly determine the decision of whether to use insider financing instead of going for public equity or long term financing. The gender of entrepreneurs influences
operation that can contribute to different performance, Sengaloun Inmyxai et al, (2012). Lack of access to formal credit and financial institutions is indeed a key concern of female business owners, Tulus Tahi, (2011). Another phenomenon that may affect SMEs financing decisions is termed the “discouraged borrowers” phenomenon. Dong Xiang, (2011). Patrick Hutchinson, (2003) study reveals that the growth is not consistently a major determinant of SMEs borrowing either short-term or long term. Profit, asset structure, size and age appear to be much more important.

### III. Financial Theories Affecting Investment Decisions

The traditional concept regarding the financial behavior of companies and defended until the 1950's - revolved around the optimal financial structure of the company and its investment decisions. Jose Lopez. Over 15 years ago, Myers (1984) stated that financial theories do not adequately explain financing behavior, Kadri Cemil Akyuz, (2006). On the demand side of SME financing, a number of studies apply the conventional large-firm theories of capital structure, that is, the pecking order, trade-off, and agency costs theory, to investigate the financing decisions of SMEs. Pecking order theory (POT) by Myers (1984), approach attempts to explain company financial structure and is also based on information asymmetry. Jose Lopez. According to this theory financing is based on personal savings and resources generated internally; secondly, short or long term debt; and thirdly, least preferred of all, new share issues that dilute control. Jose Lopez, Cosh and Hughes, (1994). The Pecking Order Theory holds up well for SMEs suggesting that there is a negative relationship between leverage and debt with the more profitable firms needing to borrow less. The results for growth have been mixed but generally show a positive if not always significant relationship. Ana Paula Silva (2012). The Pecking Order Theory suggests that the relationship between leverage and Profitability will be negatively related. The study show that size influences company self-financing strategies, and that business sector influences short term financial policy, Jose Lopez. And in relation to profitability, there is a statistically significant negative relationship with the long term debt and it is confirmed in that SMEs finance their activities following the financing pattern suggested by the Pecking Order Theory.

Analysis of capital structure employing the life cycle approach assist SME owners, practitioners, and policy makers in planning and providing for appropriate financing and supports at relevant stages in a firm's development. Ciaran Mac an Bhaird et al, (2011). An inappropriate capital structure, a misunderstanding of the characteristics of the financial instrument, or a lack of information about the availability of specific sources of capital can result in suboptimal firm performance and financial distress. Kadri Cemil Akyuz et al, (2006). Initial funding preferences have been the subject of international research and are a useful focus in part because firm age has not yet become a variable capable of influencing this decision. Robert T. Hamilton, (1998).

MSE owners that are established as either sole proprietorships or partnerships prefer to exhaust internal source of finance before going for debt or equity because of the collateral incentives of financing institutions that have bearings on personal assets of the MSE owners thereby following the pecking order. On the other hand, for private limited companies, since investment risk is limited to the amount of capital contributed, owners prefer to choose financing options that could maximize firm value even if internal sources are not yet exhausted, Gebregziabher Haileselasie Gebru, (2009).

The single most important source of capital for firms in the youngest age category is the personal savings of the firm founder, and fund from friends and family. Respondents in older age categories report diminishing reliance on these resources as a proportion of financing over time, due to an increasing dependence on retained profits, which are the single most important source of finance for all firms except those in the youngest age category, Ciara n Mac an Bhaird et al, (2011). In developing countries, finance from friends and family play a much more significant role than industrialized countries, Thorsten beck et al, (2006). Dong Xiang (2011), in this study divide firm characteristics into three categories of potentially influential factors: organizational factors, operational factors and market factors. Characteristics such as ownership, firm size, firm age, employment, registration, are included in the organizational category. The operational category includes business goals, financial objectives, operating assessment, planning, innovation or growth opportunities and profitability, etc. Finally the marketing category includes the state of the market, including primary markets for the firm's output, imports, exports and the like. The scope for growth does vary from industry to industry and this too will have a bearing on financing preferences, ie the greater prospects for growth are perceived to be, the greater the need for external finance and vice versa. Robert T. Hamilton, (1998).

### IV. Conclusion

A number of studies investigate the influences of SME financing decisions such as owner characteristics, including gender, education, age, wealth, business cycle, entrepreneur ability and so on. Our findings shows that SME finance seeking decisions plays an important role in the growth and development of Micro Small Medium Enterprises. This study
is also consistent with other articles with regard to pecking order theory and Capital structure greatly influenced the future prospects of micro small and medium enterprises.

REFERENCES