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Low debt entrepreneurs: in financing matters, women entrepreneurs play it safe

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After equity and internal financing, external capital is the second most important source of finance for firms. The present analysis, which was conducted on the basis of the KfW SME Panel, shows that women entrepreneurs in Germany finance their investments more often from their own funds and less often with external capital than their male counterparts. In particular, when women entrepreneurs have negative or neutral sales expectations for the future they are more inclined to abstain from applying for loans. Yet women who apply for credit are just as successful in loan negotiations as men.

What distinguishes women- from men-managed firms?

Roughly one out of five small or medium-sized firms in Germany has a female owner-manager or managing partner. We know of women-managed SMEs that they are usually smaller than men-managed firms and have lower growth rates on average.[1] In addition, previous surveys conducted on the basis of the KfW SME panel showed that women entrepreneurs invest less often, and when they do, that they invest lower amounts on average in proportion to their firm's sales volume.[2] These differences in investment behaviour can be explained neither by structural business features such as industry, size or age, nor by the financial strength of an firm (measured by cash flow).

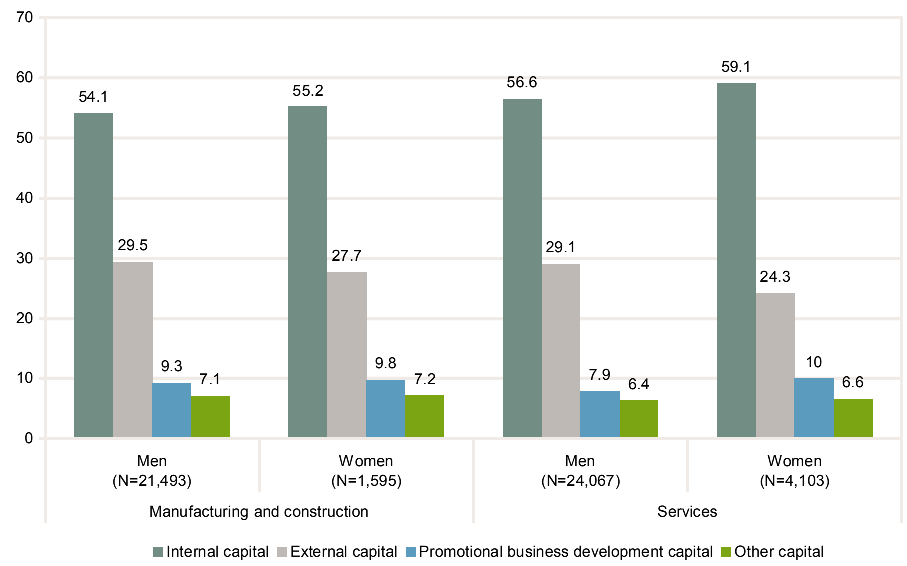
Financing behaviour of women entrepreneurs in an international comparison

A study of US data has shown that women draw less on external sources of capital right from the start of their business foundation and contribute relatively more equity to the business.[3] Women use external financing sources less frequently in follow-up investments as well.[4] Another study with an international database confirms that women-owned firms have a higher share of equity and finance a smaller proportion of their business through loans.[5] In the USA, for example, women-owned firms have a 5 % lower debt ratio than comparable men-owned firms.[6]

At the same time, no or only few indications of gender-specific discrimination in lending have been found for industrialised countries. Surveys with data from the USA have revealed that credit applications from women are not declined significantly more often than from male business owners.[7] For Italy there are indications that women entrepreneurs are disadvantaged in accessing loans in that they have to provide higher collateral on average than men.[8] A study conducted across 34 countries revealed that credit applications from women entrepreneurs are more likely to be either declined or approved only at an interest rate that is higher on average.[9] However, most of these differences can be observed only in countries with less developed financial markets. The study found only weak evidence that when it comes to asking for loans, women are more easily discouraged from applying for credit than men.[10]

Nevertheless, we can identify certain differences in the gender-specific per-

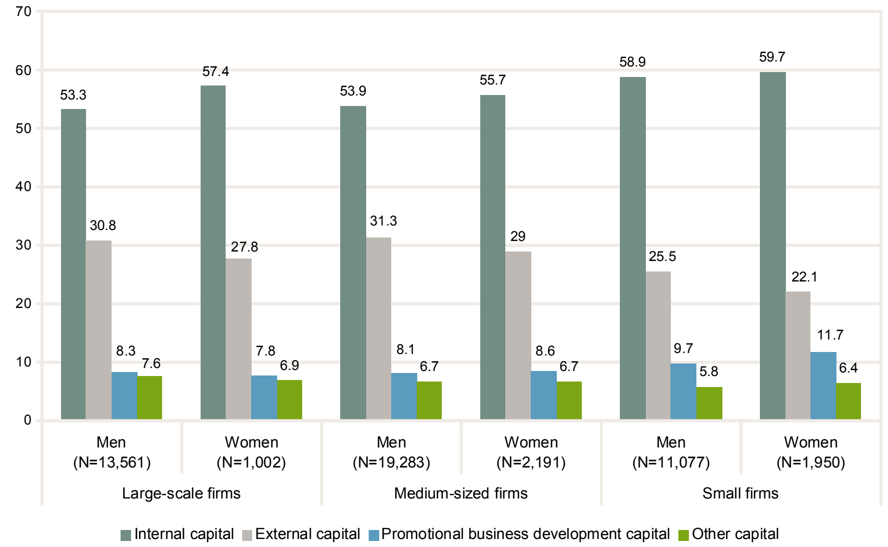
Figure 1: Composition of investment financing by industry in percent on average for the years 2004–2011



Source: KfW SME Panel

ception of financing restrictions. Women entrepreneurs in the start-up stage in the UK report difficulties in accessing finance more often even though they are actually not placed at a disadvantage in comparison with their male counterparts.[11] Women on average may be more inhibited about asking for loans or already anticipate a negative outcome of the loan negotiations. Older studies demonstrate that women on average are more risk-averse and less overconfident than men. Furthermore, on average women report more often that they feel more nervous and anxious in situations with an uncertain outcome.[12] These gender-specific behaviour differences may explain why female entrepreneurs tend to be less willing to borrow or refrain from applying for a loan in the first place as they anticipate a negative outcome.

Figure 2: Composition of investment financing by firm size in percent on average for the years 2004–2011



Source: KfW SME Panel

Female entrepreneurs use equity more often in Germany as well ...

In Germany, too, female entrepreneurs finance slightly more of their investments through internal capital and, accordingly, less through external funds (see Figures 1 and 2, based on the data from the KfW SME Panel[13]), although the differences in the service sector (equity share 59.1 % for women vs. 56.6 % for men) and for large-scale firms are somewhat more pronounced than in the manufacturing sector (including construction).

In order to establish the purely gender-specific effects in the financing of capital expenditure, we estimate a Random Effects Tobit Model for each type of financing.[14] In this analysis of the four types of financing we also control for the following other factors that may also be associated with the capital expenditure financing: number of employees, sales volume, investment rate, cash flow, growth rate, firm age, number of managers / directors and business owner's age and education. The results of this multi-variant analysis confirm the descriptive pattern of Figures 1 and 2. Significant differences in capital expenditure financing can be observed between male and female business owners even when all of the above factors are controlled for. Businesses owned by women finance a higher proportion of their capital expenditure through internal funds and a lower share through external funds irrespective of the relative amount of the expenditure.

These differences can be explained, on the one hand, by the fact that women are less willing to borrow, that they anticipate the credit institutions will decline the loan, or that they see few prospects for a worthwhile investment. On the other hand, women may indeed have more difficulty accessing credit, that is, loan applications from women may be declined more often.

... and are less inclined to ask for loans

Debt capital carries with it the risk that the cost of the borrowed funds may be unaffordable in the future. The more positive a person assesses the business prospects, the more they are willing to risk incurring debt. The KfW SME Panel asks the surveyed firms to estimate their sales expectations for the respective coming year using three categories (positive, neutral or negative expectations). This self-assessment of sales expectations is examined in a further analysis as a suitable variable for assessing the overall business prospects.

Obviously, individuals may have realistic, overoptimistic or pessimistic expectations as to how sales will develop. For our analysis, however, only gender-specific differences in the likelihood of applying for credit that are associated with these expectations, are relevant. Hence, we again estimate the likelihood of applying for credit with an additional explanatory dummy variable for positive sales expectations, with the result that both male and female entrepreneurs with positive expectations submit credit applications significantly more frequently.[15] It turns out that female entrepreneurs who have positive sales expectations do not differ significantly from their male counterparts in their likelihood of applying for credit. However, when women entrepreneurs assess their future sales growth as neutral or even negative, they apply for a loan significantly less often – specifically, with a likelihood of around seven percentage points lower than male entrepreneurs.

This approach can be described using the following metaphor: when the sun shines, both men and women entrepreneurs go out without an umbrella. But when clouds appear on the horizon, male entrepreneurs are more likely to leave the house without an umbrella than female entrepreneurs. Female entrepreneurs prefer to play it safe.

Women entrepreneurs are just as successful in loan negotiations as men entrepreneurs

The public debate repeatedly claims that female entrepreneurs often face difficulties in obtaining bank loans. However, a further regression demonstrates that women who apply for credit are not more likely to be credit denied than men. They are just as successful in conducting loan negotiations. But this result must be put into perspective with the fact that women, as shown above, are more likely to apply for loans when they have a positive view of their business prospects and therefore may represent a positive selection from the group of all firms applying for credit.

Conclusion

In general, borrowing is not more difficult for female entrepreneurs than for male entrepreneurs. Thus, there is no need for promotional policy action with respect to the offer of particular financing instruments for women. Nevertheless, women are more hesitant in regard to borrowing as soon as sales prospects turn neutral or negative. Unfortunately, the current analyses do not allow a conclusive assessment of whether the more offensive approach of men or the more cautious approach of women is more promising for firms.[16] Overoptimistic borrowing may lead to more frequent loan defaults, but conversely, a rather less assertive investment and financing behaviour may also translate into lost growth opportunities. Female (and male) entrepreneurs are therefore encouraged to reassess their patterns of financing behaviour against the entrepreneurial goals they have set for themselves. ■

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[13] The KfW SME Panel is the first and so far the only representative longitudinal data section for all small and medium-sized firms in Germany which, as one of the few German business surveys, also captures the gender of the business owner. In firms with more than one owner it is assumed that the gender indicated refers to the most important business owner.

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[16] The KfW SME Panel does not contain any data on loan repayment behaviour or the profitability of investments.