

Gender And Banking with the Small Business Client

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Cet article analyse les résultats d'une étude effectuée pour évaluer si les institutions financières font preuve de discrimination sexuelle envers les chefs de petites entreprises. Quoique

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l'étude ne rapporte aucune différence sur le plan du crédit, les femmes chefs de petites entreprises ont ressenti un plus grand manque de respect de la part des agents préposés aux prêts que leurs homologues masculins.

Do Canadian financial institutions discriminate between female and male small business clients? This question is fraught with emotional overtones and findings that, to date, are inconclusive. It is a question that has received considerable attention in the media as well as in academic research. This paper reports findings that seek to shed further light on this issue.

If differences in access to, and terms of, credit do exist by gender it remains to determine the extent to which structural differences in borrowers' eligibility are accountable. Conversely, the role (if any) of systematic gender discrimination needs to be separated from systemic structural differences. To this end, this study has three objectives.

The first is to identify factors that are most closely associated with credit terms. Potential risk measures include the form, size, industry, and track record of an enterprise. The second objective is to determine if factors such as these risk measures are also correlated with gender of the owner. Gender-related disparities in business attributes, quite independently of systematic gender discrimination, may lead to discrepancies in credit terms, discrepancies that may appear *as if* gender-related. The third objective is to investigate whether or not credit terms differ between female-owned and male-owned enterprises *after* accounting for structural differences in business attributes. This study investigates five credit terms: rates of loan turndowns, rates or requests for spousal co-signature, ratios of collateral to line of credit, ratios of amount received to amount applied for, and interest rates.

Literature review

Three streams of research literature may be identified that relate to the topic of this study: the general literature on lending criteria; the literature on women and small business; and, the integrated literature.¹

The general literature on bank lending reveals financial institutions to be low risk lenders (Thornton; Poapst; Grant), a finding of little surprise! One of the few consistent findings was that firm size plays a central role in determination of access to terms of credit (Haines *et.al.*; Wynant and Hatch). In addition, Thornton found that the quality of financial management was a factor in lending decisions. In general, however, this literature has not explicitly allowed for the possibility that gender might be one of several factors which, acting jointly, determine terms of credit.

The singular increase in women-owned businesses in recent years has also given rise to a burgeoning literature on business problems that are specific to women. This second stream of the literature has identified legal status, age, industrial sector, level of sales, and rate of sales growth as some factors that differ systematically between men and women business owners (Schwartz; Hisrich and Brush, 1986a and 1986b; Litton; Collom).

This stream of literature, however, has not determined whether or not the credit experiences of female and male business owners actually differ. Many of the studies in this stream of the literature, while citing gender-related problems with respect to credit, are suspect because they did not compare the experiences of women business owners with benchmark samples of men business owners.

A third segment of the literature not only identified gender as a potential determinant of credit terms but also attempted to control for factors that may confound the analysis of differences in the credit experience of female and male owners.²

This study differs from previous research in two ways. First, it is based on the largest sample of lending experiences of women owners reported to date. This large sample admits the use of methodologies that were not available for previous studies. Second, the study employs powerful and easily interpretable techniques which are robust against statistical assumptions.

Research design and data

The results of this study were based on data collected from a national survey conducted by the Canadian Federation of Independent Business (CFIB) of its members in late 1990. This population may not be representative of

the population of all Canadian small business owners. Firms which join the CFIB have reached a point in their development such that they are able and interested in joining this organization. Accordingly, the findings of this study might not be generalizable to particularly small or newly-formed firms; however, the findings are probably representative of the population of established small businesses.

A total of 14,980 questionnaires were mailed on June 1, 1990, with a cut-off date for returns of September 15, 1990. The sampling procedure was a stratified one: questionnaires were sent to all 5,246 women-owned businesses

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in the CFIB membership list; 9,734 men-owned businesses were selected randomly. In total, 2,763 (759 female and 1,974 male) responses were received, a response rate of 18.44 per cent. Firms in the agricultural sector were excluded from this study, yielding an overall working sample of 758 and 1,907 responses from female and male respondents, respectively. As is normally the case with survey research, not all respondents answered all the questions.³

A first glance differences in terms of lending

Access to credit was measured by two variables. The turn-down rate (defined as the ratio of rejected loan applications to the total number of loan applications) and the approval rate (defined as the ratio of the dollar value of loans approved to the total dollar value of loans sought).

The terms of credit were also measured by two variables: the interest rate on loans (expressed as the number of percentage points above the prime rate) and the requirements, if any, for spousal and/or other co-signature. Additional data of interest were: the expressions of satisfaction with the terms of lending and the frequencies of defaulting on loans and of exceeding the limits of lines of credit.

Data was compiled for term loan applications, new line of credit applications, and applications for increases in existing lines of credit, respectively. The terms of, and access to, credit was further broken down by size of firm and by gender of the principal owner. Only those firms that had applied for credit within the three years previous to the survey are reported.

Findings demonstrate that smaller businesses (firms with less than \$200,000 annual sales and fewer than three employees) appear to have less access to bank credit than

do larger firms. Moreover, credit that is received by the smallest firms seems to be on terms that are more severe than the terms of credit accorded relatively larger small businesses (firms with annual sales of \$200,000 to \$500,000 or, if reported sales of less than \$200,000 have three or more employees). With few exceptions, turn-down rates, approval rates, interest rates and requirements for co-signatories are consistently least favourable for the smallest firms. Firms with annual sales in excess of \$500,000 appear to have easier and more reasonable access to bank credit. This is particularly evident in applications for increases in lines of credit.

The level of dissatisfaction with banks felt by all small business owners is also noteworthy. The data shows that women business owners are, in general, less satisfied than men owners. This is an issue to which this study will return. Again, the smaller the firm, the more often the owners' expressed dissatisfaction about the terms of lending.

These findings, however, are not unequivocal about whether or not gender of the owner is a partial determinant of the terms of credit, even within the micro-business sector. This is because the gender of the principal owner is highly correlated with the size of the firm: women business owners tend to be associated with smaller firms. Even within the micro-business sector, this confounding of size with gender continues: 58 per cent of the firms with annual sales of less than \$100,000 were owned by women compared with 38 per cent of firms with annual sales of \$100,000 to \$200,000. Therefore, methodologies that are able to disentangle the potential confounding of firm size and gender are required. Likewise, business attributes that are also correlated with gender need to be identified.

Gender-related differences in business attributes

According to the findings, women business owners when compared with men owners are more likely: to have applied for term loans; to be found in retailing; to be their own financial managers; to have completed more years of education; to be sole owners; and, to have personal real estate, bonds, and securities available as collateral.

In addition, relative to businesses owned by men, women-owned businesses tend: to have lower sales volume; to have fewer years of managerial experience; to be less likely to report having either business real estate or machinery available as collateral; to be less likely to report that their products or services are of the high technology genre; to be less likely to report having a personal automobile available as collateral; and to be less likely to have an employee, rather than an outside accounting firm, perform the financial functions.

Factors influencing terms of credit

The variable which proved to be most closely associated with loan turn-downs were: depth of financial manage-

ment, age of business, and rate of growth in sales. The finding that firms in the manufacturing sector had better access to capital is intuitively pleasing (manufacturing firms tend to have real assets available as collateral) but is at variance with past research (Haines *et.al.*). No main effect of gender was found. The likelihood of loan rejection was highest for firms that lacked professional financial management, that were relatively young, and whose annual rate of growth had been declining.

Variables which seemed to be more closely associated with ratio of amount of credit received to amount of credit requested were number of owners and type of assets

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available as collateral. Firms that were most likely to receive less than 90 per cent of the amount of credit they requested were those with more than two owners and those which cited having other business assets available as collateral. It was a rather surprising finding that firms with fewer than three owners were more likely than their counterparts to be given 90 per cent or more of the amount of credit they requested. This contradicts the suggestion of past research (Thornton; Wynant and Hatch) that banks would be more willing to provide credit to firms with more than two owners or to those which do not exhibit the characteristics of 'Ma and Pa' stores.

Factors most closely associated with requests for spousal co-signature included: the employment status of the financial manager; the type of financial institution approached for credit; whether or not personal real estate or other business assets were available as collateral; the age of the firm; and the level of education of the principal owner.

Requests for spousal co-signature were more likely for firms that reported having part-time financial managers; approached either Canadian chartered banks or Trust Companies for credit; reported having personal real estate, other personal assets, and other business assets available as collateral; were unequally owned; and reported having an employee or a principal owner as financial manager, at least part-time. However, the older a firm, and the more education its owner has, the less likely that it would be requested to provide spousal co-signature.

Across the three different samples of firms examined, variables most closely associated with interest rates were number of full-time equivalent workers, rate of growth, and level of sales. The more full-time equivalent workers a firm had, the lower the rate of interest charged on its loan. Likewise, the higher the volume of sales of a firm, the lower the rate of interest charged. However, firms with

declining rates of growths were charged higher rates of interest than their counterparts. None of the other variables were related with interest rates. These results concur with past research findings which indicated that capacity, as represented by size, has a strong influence on rate of interest charged on loans.

From these findings, it is seen that while measures of the so-called "5 C's" of commercial credit correlated with access to and terms of credit, the gender of the owner(s) of the firm was not a statistically significant factor. (The "5 C's" are traditionally defined as capital, collateral, conditions, capacity, and character. Respectively, these refer to: the owner's investment in the firm; the amount of collateral; business conditions; cashflow; and a subjective assessment of the owner.) The results revealed no appreciable difference in credit terms after structural factors were controlled.⁴ Credit terms did not differ between female and male business owners.

Interpersonal dimensions of the banking relationship

In order to test the importance of interpersonal factors and to assess the satisfaction felt by small business owners, factor analysis was employed to help identify which attributes of the banking relationship were important to small business owners. The survey asked respondents to rate, on a three-point scale ("not important", "important", "very important"), each of nine specific aspects of their banking experiences.

In order to identify the causes underlying these feelings of what is important, a factor analysis was carried out, revealing two significant factors.⁵ The first attribute of the banking relationship with small business owners was associated with responses to the "business-related" aspects of the banking relationship. The second factor was associated with the interpersonal relationship with the loans account manager.

In addition to being asked to rate the *importance* of the nine items, respondents were also asked to rate the *performance* of their respective bankers on each of the items. Again, a three-point scale was used ("poor performance," "acceptable performance," "good performance").

It was clear from these results that women business owners, when compared with men counterparts, come away from the banking experience with much less of a sense of having been treated with respect and are less comfortable about their banking experience. It also appeared that these feelings pervade their satisfaction with the "business" dimension; women owners seem to be less satisfied, on average, than male business owners with both aspects of the banking relationship.

Summary and conclusions

Previous research and anecdotal evidence has suggested that financial institutions treat female and male small

business owners differently. This study found that, after accounting for structural differences between male and female business owners, no difference remained in the rate of loan rejections; nor did any differences persist in other objective measures of terms of credit.

This study has shown that measures of business risk are closely associated with credit terms: firms with declining rates of growth are more likely to have their loans rejected; depth of financial management and the track record of the firm seem to be the variables which are most closely related with loan turn-downs. The entry of variables representing industrial sector and geographical location may be an indication that conditions faced by the firm also play an important role in credit decision-making. To secure access to credit, owners should strive for professional management of their financial function.

Firm size, the existence of liquid assets, professional financial management, type of financial institution approached for credit, average rate of annual sales growth, capacity (sales), conditions (rate of growth), and collateral (type of assets) seem to play important roles in determining terms of credit.

It was found that gender is closely related with most, if not all, of the above factors. In general, women-owned businesses are smaller (that is, they have lower volumes of sales). Women small business owners have (on average) less capacity, less capital, a narrower range of collateral, and an unproved track record or character relative to male counterparts. This may have an adverse effect on their perceived capacity to service or to repay their loans. Hence, they may in fact experience greater difficulty in obtaining credit, on average. In general, *all* firms with low volumes of sales, etc., both men-owned and women-owned, are likely to encounter such difficulty and to face high interest rates.

Various analyses also indicated that women small business owners are over-represented in retailing compared to men-owned businesses. With little variation, firms in retailing are known to have few assets. In case of liquidation, the assets of a retailing concern have low resale value. That is, the amount realized may not suffice as security for a new line of credit.

It was also found that women small business owners have less managerial experience than men owners. Most small firms fail before their fifth year. While numerous factors may lead to demise, lack of managerial experience plays a role. The experience which, on average, women business owners lack may have an adverse effect on how their character is judged. Their firms might be perceived as being more risky or prone to failure.

Women tend to have completed more years of education than male counterparts. This could have a positive effect on their character, possibly a balance to their lack of managerial experience. However, women business owners were less likely than men to have professional degrees. Lack of specialization may raise perceived risk associated with women-owned businesses.

Women small business owners are more likely than men to be sole owners, firms generally known to be under-capitalized relative to firms with more owners. However, in addition to financial capital, human capital is often a problem for such firm. Firms with several owners have access to a diversity of skills and talents which may elude other firms.

Women were more likely than men to report having personal assets as collateral. In contrast, men were more likely than women to report availability of business assets as collateral. Personal assets are more likely to be shared than business assets. Consequently, owners with personal assets may be more likely to be requested for spousal co-signature than owners with business assets.

Of particular concern were the findings that women were more likely than are men to perceive that they were not given due respect by financial institutions, that they do not think that their account managers were easy to talk to, and that they were more likely than men to report that they were not made comfortable by financial institutions. This dissatisfaction with the interpersonal dimension of the banking relationship may explain the dilemma that confronted Buttner and Rosen in their 1992 study. This finding explains why women business owners tend to express feelings of gender bias when, in fact, the terms of lending were not significantly different from those advanced to men business owners.

Banking institutions, through standardization and centralization of the lending decision, appear to have mitigated successfully the potential role of discrimination in relation to firm size and gender of ownership. To improve relations with their female business clients, financial institutions may need to reassess their marketing strategies to women as well as their policies regarding the hiring and training of account managers. Also, a better understanding of *why* women-owned businesses are less profitable and smaller is worthy of more study. This information would assist female business owners in growing their firms if desired.

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¹A comprehensive survey and discussion of the literature is available from the authors on request.

²A tabular listing of the findings of this stream of literature is available from the authors on request. One of the attributes of this segment of the literature is the variety of methodologies. Inconsistencies arise because of other methodological approaches. These include: the tendency to ask leading questions; lack of male controls; conclusions based exclusively on the subjective perceptions of women small business owners.

³It is worth noting that the response rates from men and women businesses differed to a statistically significant extent. As noted in previous research (and confirmed by the findings of this work), aggregate women-owned businesses tend to be smaller and newer than businesses owned by men. In general, women-owned businesses do not make as much use of financial professionals.

⁴The findings of the entire analysis are reported in Fabowale.

⁵Statistical details of this and other procedures are available on request and may be inspected in the thesis of one of the authors.

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