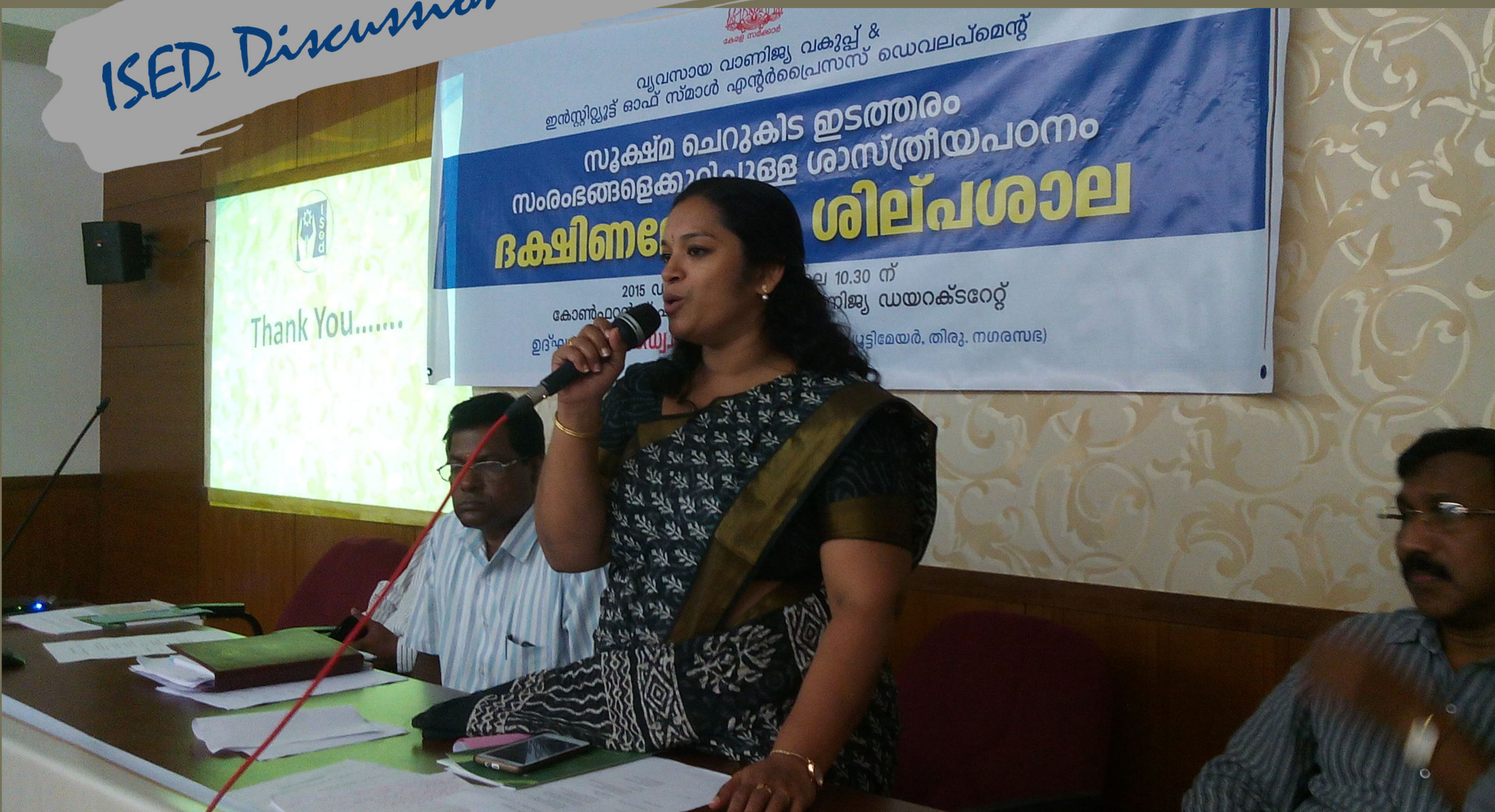
Gender, Enterprise and Finance: Leading Issues

ISED Discussion Paper



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by

ISED Small Enterprise Observatory

jointly with

ISED Centre for Social Development

Institute of Small Enterprises & Development

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This monograph forms part of the '*ISED Discussion Paper*' series of the Institute. Brought out by ISED Small Enterprise Observatory (ISED-SEO), the Institute's knowledge platform, titles under this Series are meant to offer a platform for discussion on some of the latest developments in the economy and society. The contents of this document may be used for debates and discussions, as also for preparation of course materials, but with due acknowledgement only.

PREFACE

The entrepreneurship route to women empowerment has now been widely debated around the world. There are two key aspects that form the compass of such debates: 1) entrepreneurship; 2) gender. Unless these two aspects come together in a synergic manner, the objectives of social policy relating to gender sensitive development are not likely to be fulfilled. While such an integrated approach to development need to be designed and taken forward, fundamental questions come to the fore: 1) Does women entrepreneurship differ from entrepreneurship in general?; and 2) Is the problem of finance essentially gender-specific, or, a more visible reflection of a general problem of all SMEs? A realistic answer to these two questions is crucial from the point of view of design and implementation of programmes meant for economic empowerment of women.

While there are several studies in India that deal with the question of women entrepreneurship, an integrated view of entrepreneurship in a gender setting, and its implications for the domain of finance, are still badly neglected areas. This paper provides a global overview of the literature in this area, and more specifically, to the context of India. I wish to thank the research team of the ISED Centre for Social Development for taking up this vital issue of policy relevance. I hope, this study will contribute to a lively debate in the subject area.

Kochi
March 05, 2017

P.M.Mathew
Project Director

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Abstract

The entrepreneurship route to women empowerment has now been widely debated around the world. There are two key aspects that form the compass of such debates: 1) entrepreneurship; 2) gender. Unless these two aspects come together in a synergic manner, the objectives of social policy relating to gender sensitive development are not likely to be fulfilled. While such an integrated approach to development need to be designed and taken forward, fundamental questions come to the fore: 1) Does women entrepreneurship differ from entrepreneurship in general?; and 2) Is the problem of finance essentially gender-specific, or, a more visible reflection of a general problem of all SMEs? A realistic answer to these two questions is crucial from the point of view of design and implementation of programmes meant for economic empowerment of women.

Keywords :Entrepreneurship, women empowerment, gender, finance

1.0.Introduction

The entrepreneurship route to women empowerment has now been widely debated around the world. There are two key aspects that form the compass of such debates: 1) entrepreneurship; 2) gender. Unless these two aspects come together in a synergic manner, the objectives of social policy relating to gender sensitive development are not likely to be fulfilled. While such an integrated approach to development need to be designed and taken forward, fundamental questions come to the fore: 1) Does women entrepreneurship differ from entrepreneurship in general?; and 2) Is the problem of finance essentially gender-specific, or, a more visible reflection of a general problem of all SMEs? A realistic answer to these two questions is crucial from the point of view of design and implementation of programmes meant for economic empowerment of women.

2.0. MSME Finance: Its Nature

Finance, in a gender setting, is essentially related to that for micro, small and medium enterprises(MSMEs). Finance, in the MSME context, has a dual character: a). as a product traded in the market; and b). as a key to business opportunities. Thus, finance means and impacts different things to different stake holders in the constituency of MSMEs. The interests of different stake holders often conflict. The entrepreneurs look forward to credit at cheaper rates, and of a specific volume and at a particular time. Banks, on the other hand, as business entities, look forward to higher rates, prompt repayment, and enhanced volumes. Government, above all, is keen on visibility of public programmes for which finance is a necessary concomitant.

A discussion on why finance is critical for MSMEs, should start from an understanding of the role of MSME finance itself. There are two key concepts: a) business finance source; and b) business finance start-up. A 'business finance source' is the way a business can obtain funding, either for start-up or operating expenses. There are many different types of sources, including sales, loans, and investors, each having different terms, benefits, and disadvantages. Business owners tend to use two or more different sources in order to fund their business.

Business finance sources fall into two main categories: internal and external funding. Internal funding comes from the profits made by the business by sale of products or assets. The sources of external funding are lenders and investors. In addition to loan financing, MSMEs can collaborate with venture capital investors. Other forms of financing are: leasing, trade credit, and fiscal incentives in the form of tax breaks. The most common external source of finance is loans. Small and long-term loans require borrowers to repay funds at an interest rate for a set period of time. Overdraft loans allow a borrower to spend a certain amount of money, and the lender charges interest on the overdraft amount. Debentures are loans that need to be paid at a specified time at a set interest. Business owners consider a variety of factors before choosing a method, but cost of business finance source usually is the most vital factor considered. Entrepreneurs consider the interest rates and payment plans while taking decisions on borrowing. Businesses that have a history of financial stability may want to consider an internal source of revenue before opting for an external source. It's also vital to determine how long the business will need additional funding. A small- term loan would be best for projects that would only take a small time to complete.

'Business finance start-up' implies the cost to start a new business. It includes determining, calculating, and obtaining start-up costs, as well as managing those finances effectively to ensure the profitability of a new business. Although there have been numerous schemes and programmes in different economic environments, there are a number of distinctive recurring approaches to MSME finance. Collateral- based lending: offered by traditional banks and finance companies, is usually made up of a combination of asset-based finance, contribution based finance, and factoring based finance, using reliable debtors or contracts. Information based lending; usually incorporates financial statement lending, credit scoring, and relationship lending. Viability based financing; especially associated with venture capital, is a more recent form of financing

There are several theories on how MSMEs choose among various forms of finance. The 'Pecking Order theory' claims that the cheapest source of finance is used first. The Static Trade-off Theory states that marginal financing costs drive financing decisions; as a result additional financing is used from various sources in parallel. The Asset side Theory argues that the use of funds (i.e. a firm's asset side) matters for the optimal source of finance. Bartholdi and Mateus (2008) use data on Portuguese firms to test for the relevance of these three theories and do not find support for the first two theories, but some support for the third theory.

In the Indian context, choice of forms of finance by MSMEs is a badly neglected area of research. Indian data generally makes a dichotomous distinction between formal and informal finance, the former often being described as access to bank finance. Disaggregated data would be much helpful in order to have insights into the policy and practice of MSME financing.

3.0. Key Problem: Supply- Side Vs. Demand –Side

While finance is a terrain of conflicts, actual flow of finance into the MSME sector, is the outcome of two types of perceptions: (1) bankers perspective; and (2) borrowers perspective

3.1. The Bankers' Perspective

The 'bankers perspective' is based on the implicit business case of a loan product. They are keen on greater number of accounts, as also, volumes. Hence, the focus on credit flow (new business opportunities) and their prompt recovery. In India, both the new thrust on MSME financing, and the drive for 'financial inclusion', has important implications for the financing opportunities available to MSMEs.

One of the main factors often cited that hampers SME financing is "opaqueness". By opaqueness the literature means that it is difficult to ascertain if firms have the capacity to pay (have visible projects and/ or the willingness to pay (due to moral hazard). This opaqueness particularly undermines lending from institutions that engage in more impersonal or arms-length financing that requires hard, objective, and transparent information.

To the extent that opportunities have received special attention in the literature on SME financing, so has "relationship lending." The conventional view is that relationship lending is the obvious- (if not the only) – way to cope with opaqueness. Relationship lending can mitigate opacity problems, because it realize primarily on "soft" information gathered by the loan officer through continuous, personalized, direct contact with SMEs, their owners and managers, and the local community in which they operate (Berger and Udell, 2006).

3.2. Borrower's Perspective

The borrowers are keen on greater access to credit. The "conventional wisdom "on SME finance argues that "supply-side" factors are not the root of in adequate financing of SMEs. In particular, the way in which financial institutions operate, is biased against offering SME financing. Thus, many banks and other financial institutions are not often interested in servicing SMEs.

While these perspectives conflict, they need to coexist also. Herein lies systems that regulate the behavior of stake holders, either by regulatory or voluntary norms.

4.0 Scope of MSME Financing

While the access of MSMEs in India to capital markets is very limited, they largely depend on borrowed funds from banks and other financial institutions. While investment credit to SMEs is provided by other financial institutions, commercial banks extend working capital. In the recent past, with growing demand for universal banking services, term loans and working capital are becoming available from the same source. Besides the traditional needs of finance for asset creation and working capital, the changing global environment has generated demand for introduction of new financial and support services by SMEs.

Credit delivery to small enterprises in India takes place mainly through 27 public sector banks, other commercial banks in the private sector, and foreign banks. The Regional Rural Banks and Local Area Banks supplement the efforts of the scheduled commercial banks. As per the RBI's directive, the