Financing YOUR Enterprise

Unlocking the Power of Women Entrepreneurs

FEMININE CAPITAL

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STANFORD UNIVERSITY PRESS

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Gender and external financing

This learning aid will help you to understand different ways to finance YOUR enterprise. Sources of capital and tips for managing external financing are provided. Understanding sources of capital is important. Statistics Canada, for example, has reported that 47 percent of all Canadian business owners applied for some form of external financing in 2017.[i] However, among businesses wholly owned (100 percent) by women, only 37 percent requested external financing.

Why do you think women business owners are, on average, less likely to seek external capital?

Below are reasons why business owners might not request financial capital. According to Statistics Canada (2017), which reason do you think differed by gender of business ownership?

Financing not required

Thought request would be turned down

Applying for financing is too difficult or time consuming

Cost of financing is too high

Unaware of financing sources available to the business

Comparing 100% women-owned with 100% men-owned businesses, women-owned firms were significantly more likely to expect that a request would be turned down.

However, Statistics Canada (2017) also found that 100% men-owned businesses were MORE LIKELY to have requests for loans rejected (10.2 percent of applicants) compared to 100% women-owned businesses (6.9 percent of applicants).[ii]

- Did you know that numerous studies, based on Statistics Canada data, dispute the contention that women are disadvantaged with respect to debt financing?

To learn more about sources of financial capital continue to the next section.

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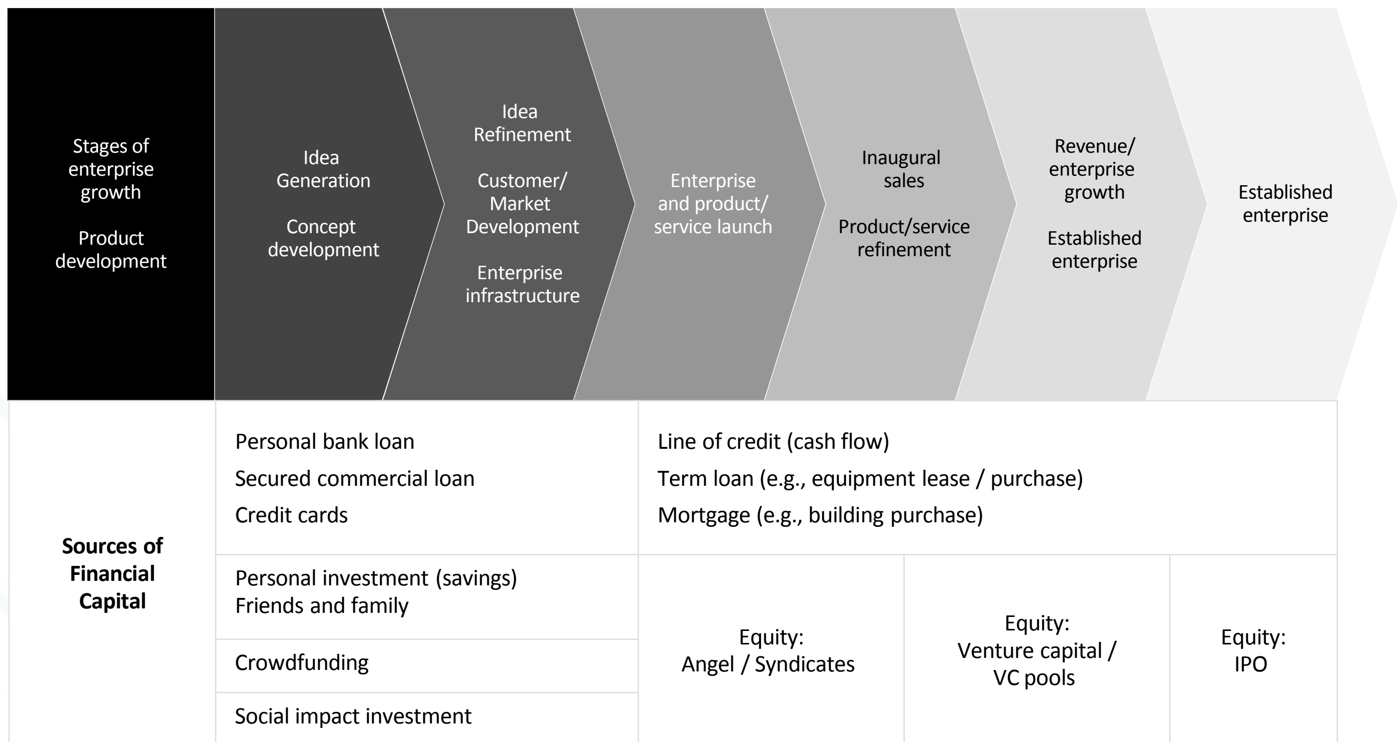
Framework for financial capital

Below is a profile of all sources of capital used to finance businesses at various stages of development.

- One lesson from this is that there are many different ways to finance a business.
- Another lesson is that capital often depends on size and stage of business development.

Are you familiar with these sources of capital? Do you understand the difference between debt and equity financing? If not, definitions about the various sources of capital are found at the end of this learning aid.



Source: Unlocking the Power of Women Entrepreneurs - Feminine Capital, Barbara Orser and Catherine Elliott, January 2019.

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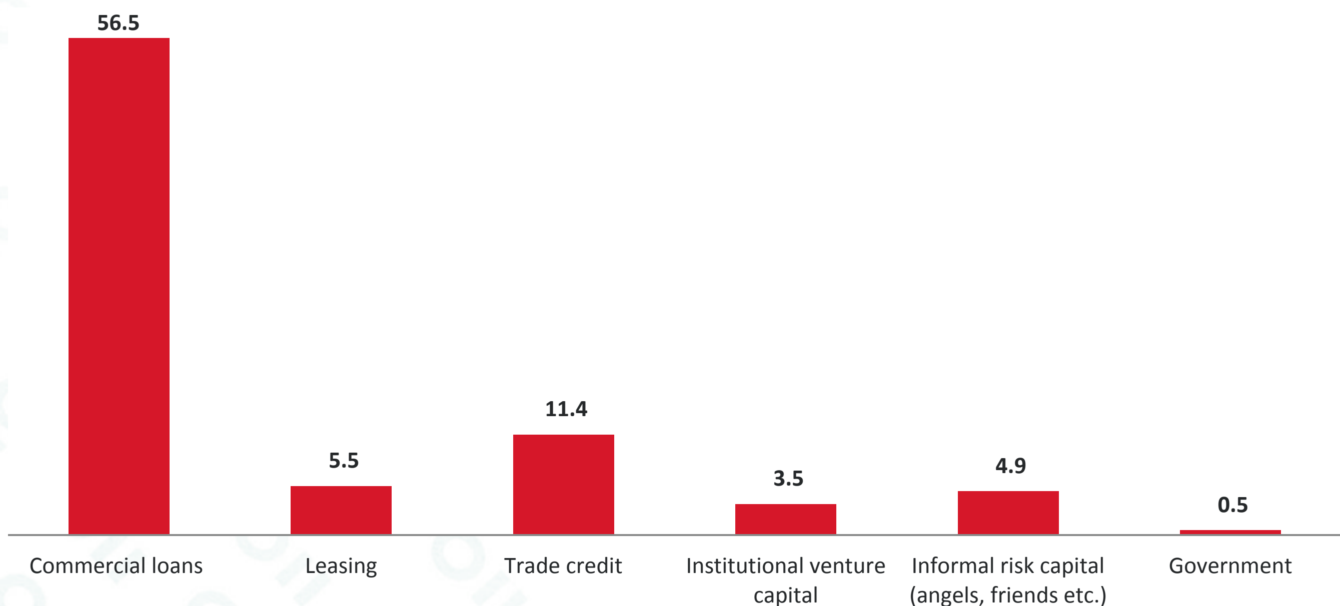
Facts and figures

Below is a second profile of sources of sources financial capital, one that is based on the amounts of capital provided to Canadian SMEs. Commercial loans, by far, are the leading source of small business financing.[iii]

- In 2017, Canadian commercial lenders approved $56 billion in loans to SME employer firms. This represents 68 percent of total capital loaned to, or invested in, Canadian SME employer enterprises.[iv]
- Across all types of equity capital (such as, venture capital, business angels), less than 0.3 percent of majority women-owned businesses requested equity financing in 2017.[v]
- Institutional venture capitalists might garner media attention, however less than 1 percent of all Canadian SMEs requested this type of capital in 2017. Institutional venture capitalists were responsible for only 4 percent of the total amount of capital supplied to Canadian employer SMEs.
- Trade credit is the most underused source of capital among women business owners. In 2017, 17.1 percent of majority women-owned businesses requested trade credit compared to more than 25 percent of majority men-owned businesses.[vi]



Source: Survey of Financing and Growth of Small- and Medium-sized Businesses, 2017; various tables

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Managing YOUR banking relationships

In this section, we suggest ways to strengthen your banking relationships and ideas to improve communications between you and your banker.

It is useful to look at banking relationships from both the borrower and lender perspective.

- From a borrower perspective, some business owners perceive that lenders require excessive collateral, provide insufficient funding, and do not give adequate feedback.
- From a lender perspective, some small businesses are viewed as risky investments.

This table captures different perspectives about banking relationships. Review the factors that influence lending-borrowing decisions.

How might you address, in your business planning and communications with a prospective lender, each of the criteria listed below? To what extent are these factors relevant to your banking relationships?

Determinants of lending	Owners' perspectives on lenders	Lenders' perspectives on owners
Firm age and size	Lenders provide insufficient startup funding, advice, and counsel	Owners' lack of experience is a risk factor
Ability to service debt (e.g., cash flow)	Lenders charge excessive interest, particularly on charge cards	Owners do not realistically appraise firm value or capital needs
Strength of guarantee or security, value of collateral	Lenders require excessive collateral	Owners don't understand lender requirements and risk tolerance
Ratio of debt to equity	Lenders are unwilling to lend on character	Owners invest too little personal equity in the firm
Level and quality of working capital	Lenders local account managers often lack authority to make decisions or do not understand business.	Owners assume banks are the only source of capital
Client risk: client strength, depth and experience	Lenders do not explain turndowns or other sources of capital	Owners communicate poorly, ask for capital in untimely manner (e.g., during and not prior to crisis)

The lenders' perspective

It is also useful to understand what lenders consider during the adjudication of loan requests. Traditionally, lenders draw on the so-called "5 C's of credit" as a framework for credit decisions. The 5 Cs are Character, Capacity, Capital, Collateral, and Conditions.

1. **Character** relates to borrowers' track records in meeting credit obligations, often informed by third-party credit reports. It is a good idea for business owners to know their credit score. This explains why it is also a good idea to develop an ongoing relationship with one's banker, that is, to include them in your inventory of social capital. Read more here.

2. **Capacity** represents the lender's assessment of a client's ability to repay a loan. One way of helping a lender to better understand a client's capacity to meet financing obligations is through a well-reasoned business plan, including cash flow projections.

3. **Collateral** comprises the assets pledged as security for the loan. Collateral assures the lender of an alternative source of repayment.

4. **Conditions** reflect external factors that can affect credit outcomes, such as the state of the economy and the prospects and competitive environment of an industry.

5. **Capital** reflects the extent to which the borrower firm is financed from other sources, particularly owners' equity. Capital is an indication of the type and quantity of financial reserves available to the business. For example, too much reliance on debt is seen as a sign that alternative sources of capital are absent.

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Loan application outcomes

The vast majority of loan applications get approved, either in whole or in part.[vii]

Before applying for a loan, it is helpful to consider why Canadian commercial lenders turn down loan applications. The most frequently cited reasons for loan rejections are listed in this table. Consider using these reasons to frame conversations with prospective lenders. For example, commercial lenders cited `insufficient collateral' as a reason for loan denial in 32.0% of turndowns

How might this information be used to strengthen YOUR financial readiness?

Reasons cited for loan turndown		Strategies to strengthen YOUR financial readiness?
Capacity: insufficient sales or cash flow	**40.7**	
Insufficient **collateral**	**32.0**	
Character: poor or lack of credit experience/history	**28.3**	
Conditions: business operates in an unstable industry	**16.9**	
Other	**30.2**	

Additional sources of capital

Business angels (angel financing): Also referred to as *informal investors*, business angels are typically wealthy individuals who invest personal funds in early-stage businesses in return for a share of ownership. Many have already founded and exited successful businesses. Most seek high growth opportunities and act as mentors to business owners. Ideally angels are *accredited investors.* In Canada, accredited investors earn before-tax income in excess of $200,000 (or with spouse), retain at least $1,000,000 in liquid assets (net of liabilities or with spouse), and retain at least $5,000,000 of net assets.

Crowdfunding is raising financial resources by tapping the public through fundraising campaigns on the Internet through crowdfunding portals in exchange for some form of reward or voting rights. Several models are in use, including:

- Donation campaigns
- Rewards models (including pre-purchasing)
- Lending
- Equity

Equity crowdfunding may be of particular interest to small business owners, however, firms and investors must meet particular criteria. Investors, for example, may be required to qualify as an *accredited investor*. Another issue raised about crowdfunding is that firms' intellectual property is exposed.

Debt and lending: Borrowing is typically structured as term loans or operating loans.

- *Term loans* are usually medium or long-term loans, structured like a mortgage, and used to finance new equipment or a portion of working capital.
- *Operating loans* are essentially lines of credit for bridging cash needs during the time between expenses and income.

Equity financing involves the sale of a portion of business ownership in order to raise funds. Sale of equity is typically used to finance the growth of a business. Equity capital differs from debt financing or borrowing, in that debt financing does not involve giving up a portion of business ownership. Business angels and venture capitalists are usually equity investors. Banks and other commercial lenders are prototypically providers of debt. This is one reason that business owners strongly prefer debt financing to equity investment.

Initial public offering: When firms grow to the point of being able to sell ownership shares through a stock market, the first such sale is called an initial public offering or IPO.

Trade credit arises because suppliers often allow customers time to pay for goods or services after a delivery or service transaction. For example, goods are often provided on terms expressed as "2/10, net 30." This means that if the customer pays for the goods within 10 days, a 2% discount on the price will be offered. Otherwise, the full amount is due in 30 days. In effect, the customer pays 2 per cent of the total to hold on to the money for 20 days, an expensive form of short-term financing.

Learn more here: https://corporatefinanceinstitute.com/resources/knowledge/other/what-is-trade-credit/

Venture capital is financial capital invested in fast-growing enterprises by individuals or venture capital firms when risk and rapid growth are significant aspects of the deal. Initial venture capital investments normally exceed $3,000,000 to $5,000,000 with follow-on tranches of funding based on the investee firm meeting pre-determined milestones. In recent years, a variety of initiatives have emerged that focus on providing venture capital to women-owned businesses, believed by some to be an underserved market. Many of these are for women, by women pools of capital.

Working capital reflects the difference between the firm's current assets and current liabilities.

Endnotes

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[i] Data used in this section are drawn from Statistics Canada (2018). *Survey of Financing and Growth of Small- and Medium-sized Businesses*, *2017*, Table 1. http://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html

[ii] Statistics Canada (2018). *Survey of Financing and Growth of Small- and Medium-sized Businesses*, *2017*, Table 3. http://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html

[iii] Statistics Canada (2018). *Survey of Financing and Growth of Small- and Medium-sized Businesses*, *2017*, various tables. http://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html

[iv] Statistics Canada (2018). *Survey of Financing and Growth of Small- and Medium-sized Businesses*, *2017*, various tables. http://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html

[v] Statistics Canada (2018). *Survey of Financing and Growth of Small- and Medium-sized Businesses*, *2017*, various tables. http://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html

[vi] On average, firms owned outright by women obtained about $30,000 in trade credit financing. In comparison, majority men-owned SMEs obtained, on average, $65,000. Statistics Canada (2018). *Survey of Financing and Growth of Small- and Medium-sized Businesses, 2017*, Table 12. http://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html

[vii] Statistics Canada (2018). *Survey of Financing and Growth of Small- and Medium-sized Businesses, 2017*, Table 5. http://www.ic.gc.ca/eic/site/061.nsf/eng/03087.html

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