

## Is it more difficult for women to attract informal venture capital?

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## Introduction

During the recent years two remarkable trends occurred in the economic sector. First of all, there was a striking growth of small entrepreneurs in every country on the face of the earth. The second important change was the upcoming number of women participating as employees on the labor market. Among these employed women a notable group started their own business. Although women around the globe are still not the majority of business owners, women's share of business ownership appears to be growing steadily (Carter & Bennett, 2006 as cited in Carter & Jones-Evans, 2006). Due to the increase of small entrepreneurs, in combination with the rising number of women moving into self employment, numerous researchers were triggered to investigate the issue of gender and entrepreneurship (Carter & Bennett, 2006 as cited in Carter & Jones-Evans, 2006).

Many of the major studies contained discussions about the cause of the increased number of female entrepreneurs, whereas others were primarily focused on the differences between female and male entrepreneurs. More recent studies have put more emphasis on the general issues of management in female owned business, in particular with regard to the differences in access to financial resources for female entrepreneurs (Carter & Bennett, 2006 as cited in Carter & Jones-Evans, 2006). One of the main issues discovered is that women setting up their business have been identified as a particular group who face challenges in raising finance for their startups. Women achieve one-third of the funding compared to men when starting up their business (Carter & Jones-Evans, 2006).

On the one hand women obtain less finance such as bank loans, but they also acquire less informal venture capital (Becker-Blease & Sohl, 2007). Some economic specialists argue that female entrepreneurs are not interested in venture capital because they do not aspire the expansion of their company. Others state that women are interested in the capital but are not acquainted with the procedures to get access to these financial resources. As will be discussed later, this may be caused by a lack of network or by gender issues.

Because women are important contributors to our economy and since in many occasions venture capital enables an entrepreneur to move its business to a higher level, it is important that women do get the necessary finance. Hence, the present study investigates investment patterns from venture capitalists on the one hand, and financial preferences in a group of female start-up entrepreneurs on the other hand.

## Venture Capital

Venture capital is finance provided to companies, mostly in exchange for an equity stake of the company or product. These financial resources are vital for an enterprise, since it enables the company to move into the second stage. It may be used for instance as an investment for product innovation or research and development. Venture capital is provided to companies by either specialist financial institutions or by informal venture capitalists (Carter, Jones-Evans, 2006).

Financial institutions such as banks on the one hand offer loans to entrepreneurs. These financial institutions demand the payment of interest on the invested capital. Informal venture capitalists (or informals) on the other hand are mostly wealthy individual investors who are willing to invest in start-ups, early stage businesses or expanding enterprises, in exchange for stocks and bonds of the company (Carter & Jones-Evans, 2006). An informal venture capitalist can have two functions for a company that is refunding venture capital. On the one hand, the informal has the obvious task to perform the actual capital injection. Second, he can offer either his advise or his network. Although this may seem trivial at first sight, it may be even more important than the actual loan. For some entrepreneurs, it is one of the main reasons to solicit for an investment from an informal investor, while having the opportunity to receive a bank loan.

There are several differences between financial institutions and informal investors. One of the major differences with financial institutions is that private individuals are not listed on a stock exchange (Gaston, 1989 as cited in Carter & Jones-Evans, 2006). Second, banks are often reluctant to lend money to small businesses because of low expected profit margins, asymmetrical information and high risks (EIM, 1998). Venture capitalists, however, are more willing to invest in these organizations, and are prepared to be less risk averse than financial institutions. The companies invested in are organizations which often have a limited operating history, are frequently too small to raise capital on the public markets and are too immature to secure a bank loan. In exchange for the high risk venture capitalists often take by investing in smaller and less mature companies, venture capitalists usually get significant control over the decision making process of the company, in addition to a significant portion of the company's ownership. In this particular essay the focus will be on the acquisition of informal venture capital by female entrepreneurs.

### **Women's attraction to money**

Although it may seem odd at first sight, some researchers believe that the differences between men and women acquiring venture capital is caused by a lack of interest of women in financial resources. However, this may be explained first of all by the fact that the start-up size of businesses run by women is smaller than that of men. A notable finding in research is that female entrepreneurs often start in business sectors with low capital requirements such as the service sector (Verheul, 2001). Second, women are believed to make more use of their own resources, with the exception of money borrowed from family and friends, and less of debt financing such as informal venture capital (Carter and Rosa, 1998; Honig-Haftel and Martin, 1986; Neider, 1987; Hisrich and Brush, 1987; Olm et al. 1988; Johnson and Storey, 1993 as cited in Verheul, 2001). Therefore, less informal venture capital needs to be acquired from informal investors, which may lead to the fact that women are less interested in informal venture capital than men.

Other researchers conclude that female and male entrepreneurs do not differ with respect to the amount of their own resources used (Rosa, Hamilton, Carter & Burns, 1994 as cited in Verheul, 2001). Although women are seemingly interested, results from Becker-Blease & Sohl (2007) suggest that the pattern of financing for women-owned businesses in the venture capital industry, where women receive only a small fraction of overall investment finance, is repeated in the informal investment market. This pattern is indicative of the low rate with which women seek financing from informal investors. Conclusively, it is widely held that female entrepreneurs are seeking investment by informal venture capitalist, (Verheul, 2001; Becker-Blease & Sohl, 2007) although data to substantiate this viewpoint is sometimes lacking.

### **Is there a 'gender' or a 'lack of network' issue?**

Assuming that female entrepreneurs are actively acquiring venture capital, based on previously mentioned examples, the question remains why women do not obtain as much venture capital as their male counterparts. There are two main opinions about this fact.

The first presupposes that there is some sort of gender issue involved. Researchers also concluded that the difference in seek rates appears, at least in part, to be driven by "homosexuality" on the part of entrepreneurs in the informal investor market. That is, entrepreneurs demonstrate a strong preference to seek informal funding from informals of the same sex. Moreover, female entrepreneurs often have difficulties convincing male informals because of different management styles of female business owners. Women may be openly discriminated against by informal capitalists who feel women are less capable or trustworthy than men. Buttner & Rosen, 1988; Fay & Williams, 1993 as cited in Becker-Blease & Sohl, 2007, for instance, report that bankers perceive men to have more characteristics associated with successful entrepreneurship than do women. Lucas (2006) suggests that lending decisions are driven by issues of profitability, return on investment and the perception that investments are "relatively" safe. Such determinations can be made by examining the experience of entrepreneurs, information accessibility, liabilities of newness and size, and management style. Most of the time women have either no private start up capital whatsoever as mentioned above, or they have a smaller amount of equity capital available, for instance because of lower salary payment in earlier jobs or because family property is usually registered in the name of their husband (Verheul, 2001), and are therefore less experienced with the acquisition of financial resources. In comparison to their occasional lack of knowledge having a solid business plan and growing potential of their business, this makes that investors do not tend to invest in women entrepreneurs.

The second opinion focuses on the fact that female entrepreneurs are not often in venture networks. Lucas (2006) brings to mind that, although some have suggested that inaccessibility to capital is a result of discriminatory policies, women entrepreneurs are often absent from important networks. Having access to capital markets requires knowledge about who has capital available and for what purposes. In reality however, this knowledge is not perfectly available and female entrepreneurs often find themselves at a disadvantage in this respect, because they are not part of the important networks that play a role in the capital markets (Lucas, 2006).

Furthermore, venture capitalists like to invest in entrepreneurs with a solid innovative business idea, which also has sound financial prospective. Another aspect that is important to investors nowadays is the personality of the entrepreneur invested in. Is the entrepreneur someone with a relevant business network? Does he/she have the right skills to be an entrepreneur, will he or she come up with new ideas when business is going down? Therefore, informal investors will rather invest in someone they know or who is familiar with their business friends or other venture capitalists. Concluding, both issues discussed above, lead to the fact that it is more difficult for women to attract venture capital.

## Conclusion

Venture capital can be of major importance for entrepreneurs in order to take the next step in business. Not only is there a great emphasis on the financial resources themselves, the most important reason mentioned by many entrepreneurs is that most of the informal investors take an active role in the entrepreneurial companies they fund. In particular during the early stages of a company they may give advise on supplier and customer relationships, and provide in-depth knowledge about particular industries. As mentioned above, women do not have equal access to venture capital. Consequently they fail not only to get adequate financial support, but also to get the guidance and the access that venture capitalists can provide to the companies invested in.

Based on research mentioned above, it can be concluded that women are looking for venture capital, although it cannot go unmentioned that female entrepreneurs tend to own business in service oriented market sectors, in which companies tend to stay relatively small. In case women are looking for informal venture capital, question remains whether there is a gender or a network issue with regard to the difficulties obtaining venture capital. The point of view taken in this essay is that it may be caused by a network as well as a gender issue. It may even be argued whether the network issue is a consequence of the gender issue.

A possible solution may be that on the one hand informal venture capitalists will have to explore the market of female entrepreneurs by adapting there investment strategies. Research will have to be done, in order to come to selection criteria explicitly focused on female entrepreneurs, in order to make a right investment decision. On the other hand, female entrepreneurs may have to move closer to the informal venture capitalists, by adapting business strategy to venture capitalists, and go along with new ideas and possibilities.

Finally, it must be noted that participation of women on the labor market is the indispensable next step in the process of both globalization and emancipation. Therefore, women need to take the next step, that may well be created by venture capitalists, either by their financial resources, their network or their advise. Hence, female entrepreneurs and informal venture capitalists have to join forces, in order to get a stronger global economy.

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