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U.S. WOMEN ENTREPRENEURS AND THE FACTORS THAT DRIVE THEIR BUSINESSES

Highlights

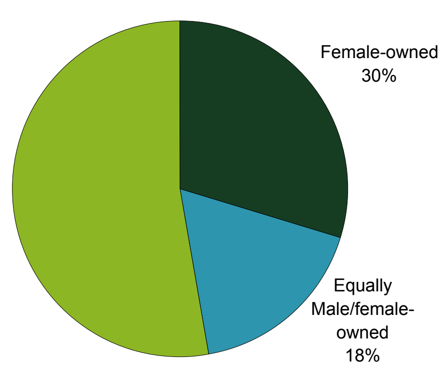
- Women represent a growing force among the nation's entrepreneurial class. Yet women-owned businesses earn a disproportionately small share of overall sales receipts relative to their numbers.
- This is partly due to the fact that women are motivated differently than men when it comes to starting a business. Women-owned firms also tend to be smaller in scope, are concentrated in different industries, and exhibit more risk averse financing behavior -- leading them to raise less financial capital for their ventures.
- Keeping a business at a mangeable size is prudent for profitability and longevity. However, the lower funding level may actually heighten risk, rather than reduce it.
- External financing can provide a degree of stability for many female-owned firms by disentangling the reliance on personal debt and providing a bigger cushion during volatile and uncertain times.

One thing strong economies have in common is an extensive entrepreneurial class. The firms they create expand the offering of goods and services that people demand, push the boundaries of innovation, and help drive productivity growth. The vast majority of entrepreneurs establish businesses that are small in scope. In a previous report *Small Businesses Will Reclaim the Driver's Seat Behind the Economic Engine*, we detailed the role such small-and medium-sized firms play in generating jobs and economic growth. In this report, we look at the characteristics of the entrepreneurs themselves, with a focus on women.

Over the years, women have shown an increased tendency towards self-employment. Between 1997 and 2007, the number of women-owed firms increased by 44%, compared to 22% among male-owned firms.

Although the entrepreneurial spirit is alive and well among women, the sales receipts earned by women-owned firms are disproportionately small relative to their numbers. The root cause seems to be related to firm size, which is dictated by differences in motivation, financing behavior and industry concentration relative to men. With financing decisions instrumental to a firm's performance, women demonstrate more risk aversion. Such behavior may not only hinder female-owned firms' ability to grow, but it may actually prove counterproductive and lead them to internalize risk to a greater degree than their male counterparts.

OWNERSHIP OF U.S. FIRMS BY GENDER



Source: Survey of Business Owners, U.S. Census Bureau. Data for 2007.

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The size of the matter

In 2007, the last year for which data is available, there were nearly 8 million women-owned businesses in operation, pulling in more than $1 trillion in sales receipts. This is certainly nothing to scoff at, but their performance is overshadowed by their male counterparts. Less than double the number of male-operated firms (14 million) generated 8.5 times the sale receipts.

From the perspective of generating jobs, roughly 88% of women owned firms do not take on employees. The numbers are high for male operated firms too, but stand at 77%.

What accounts for the difference?

There are a number of reasons that account for the difference, but we've simplified them down to three: motivation, financing, and industry choice.

Many women entrepreneurs march to a different beat when it comes to the motivation for starting a business. A number of surveys have shown that males are more likely to be motivated by profits and growth prospects, while women are more apt to prioritize flexibility for personal and family life, personal fulfillment and greater autonomy.[1] By extension, women are more risk averse than their male counterparts and we believe this manifests itself in financing decisions.

A recent study analyzed three years of data for nearly 5,000 newly established firms and discovered that male and female financing patterns had a number of similarities.[2] Over three-quarters of both male and female firm owners reported using internal equity (i.e. personal savings) to fund their startups. Around half of the firms in each gender group used debt financing of some kind.

FIRMS BY NUMBER OF EMPLOYEES

Source: Survey of Business Owners, U.S. Census Bureau. Data for 2007.

FIRMS BY RECEIPT SIZE

Source: Survey of Business Owners, U.S. Census Bureau. Data for 2007.

This is where the similarity ends. Women entrepreneurs raised less startup capital for their ventures, were less likely to have commercial bank loans, and were more reliant on credit cards to finance their nascent operations. Women had an average of $54,375 worth of total financial capital invested in their business, while men averaged $80,285. In addition, men used twice as much business debt as women (i.e. bank loans and credit lines), while female entrepreneurs relied more heavily on credit card debt. Once their businesses were off the ground, women raised less incremental financing in subsequent years. In the first three years of operation, the study found that women-owned firms raised roughly $120,000 compared to more than $200,000 by men. These results held even after controlling for variables such as age, ethnicity, and education. This financing gap can significantly impact a firm's ability to expand operations, develop new products or services and, hence, increase profitability.

Industry and motivation influence financing

Industry concentration may partially explain the lower financing needs of start-ups among women-owned firms. Firms that have some type of intellectual property are significantly more likely to obtain new financial investments, new equity, and new debt.[3] Women tend to be more heavily concentrated in retail, personal services and health/social assistance, while men have higher concentrations in the transportation, construction, engineering, and technology fields. With regards to the latter two fields in particular, barriers to entry related to intellectual property and start-up costs are often higher.[4]

In addition to this, the financing decisions of women are consistent with some of the unique motivations for starting a business. Since women in general embody greater risk aversion, some may see larger amounts of debt as carrying heightened risk. Women may also fear that external financing constrains their autonomy, a key reason for becoming self-employed in the first place.[5] This could be the case, for example, if they have to submit business plans and financial statements to their bank for periodic review. Studies also show that the preference to accommodate family or lifestyle priorities also means that self-employed women with children tend to work fewer hours than men.[6] Owners who had prior start-up experience and those who worked more hours in an average week were significantly more likely to secure additional financing.[7]

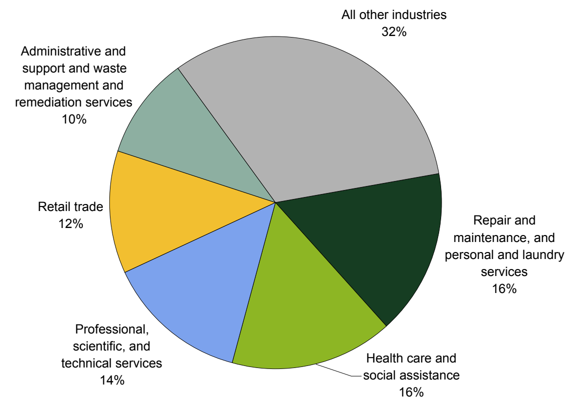
Because men and women enter self-employment with different objectives, and these objectives manifest themselves through financing decisions, the characteristics of the businesses they start tend to differ in two key aspects: women-owned firms tend to be smaller and hire few employees. Putting the pieces together, we get a clearer picture of why sales receipts are under-represented relative to their male counterparts.

Does the end justify the means?

At first glance, the financing behavior of women-owned businesses seems consistent with their objectives. Since some women intentionally keep the scope of their business small so as not to take away from time with their family, their financing needs may be sufficiently small enough to be covered by a personal credit card or personal savings. Keeping a business at a manageable size is prudent for profitability and longevity. However, the lower funding level may actually heighten risk rather than reduce it. Capital offers a financial buffer in times of adversity. Increased financial capital should be viewed as a form of insurance that helps maintain self-employment as a viable option when the going gets rough. External sources of credit – even if they largely go unused – ensure that promising startups have a lifeline in tough times. One study conducted in 2004 that interviewed women entrepreneurs who used angel investment noted that the participants wished they had sought funding sooner and raised more capital.[8]

Extra capital also allows women to keep personal and business finances separate. Because women-owned ventures rely more heavily on personal debt, the success (or failure) of their business is intricately linked to their family finances. If the business runs into trouble, the family is directly and immediately impacted. To some extent, women are taking on more risk in relying more on internal financing sources – which may go against an initial objective.

WOMEN-OWNED FIRMS BY INDUSTRY



Source: Survey of Business Owners, U.S. Census Bureau. Data for 2007.

It's important to recognize that more leverage does not create a loss of autonomy, but rather the opposite. Open credit lines, for example, can remain dormant and only used in times of need. And, when drawn upon, they offer a much cheaper source of financing than credit cards. Having more credit today allows women to more easily pursue a growth strategy should their objectives and goals change later on. In addition, research shows that women tend to have shorter credit histories with lending institutions, and this could impact financing decisions down the road.[9] Establishing formal relationships with lending institutions early on in a venture can help lower risk perceptions in the future.

Finally, those women pursuing a more aggressive growth strategy, particularly in male-dominated fields, should buttress their capital positions by engaging networks that serve as sources of new financing.[10] Venture capital is notoriously difficult to secure – less than one-tenth of 1% of all women-led businesses receive such funds according to one study.[11] However, industries with high start-up costs and fixed investments means that women should embrace external financing that can help them stay competitive in a male-dominated area.

Conclusion

For women, self-employment can offer an attractive means of striking a balance between household obligations and career aspirations. Many women are drawn to self-employment for its work-life flexibility, often citing their desire to be more involved with raising their children as a motivating factor. Self-employed men, by contrast, are more likely to cite money as a motivating factor, and tend to harbor more ambitious growth goals for their new ventures.

While women-owned firms on aggregate generate fewer sales receipts than male operated firms and employ fewer workers, the motivation behind engaging in a venture seems to be one root cause. We believe this, in turn, manifests itself through financing decisions. However, attempts to keep a business small, manageable, and lower on the risk profile may be undermined by the commitment of personal finances and less precautionary access to funds. External financing can add a degree of stability, particularly in volatile and uncertain macroeconomic times.

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Endnotes

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