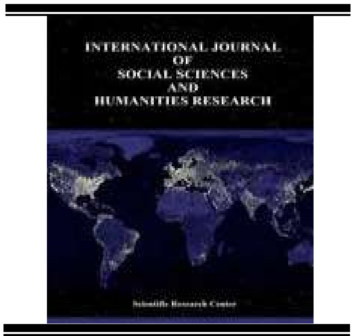

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Desperate borrowers in Armenia and Georgia

Judith Kandafloei[1*]

[1] Universiti Malaysia Terengganu, 21039 Kuala Terengganu, Terengganu, Malaysia

*Corresponding author's E-mail: Kandafloei445@yahoo.com

ABSTRACT

There is a lack of qualitative research which has focused upon information obtained from the entrepreneurs who established or purchased surveyed firms to determine how discouragement occurs and on what criteria alternative routes are taken. This paper seeks to establish the extent to which gender and entrepreneurial experience influence the prevalence of discouraged borrowing by entrepreneurs in the UK and Austria. The paper also aims to see the alternative routes of capital structure which are developed by discouraged borrowers. This paper applies human capital and signaling theory to qualitative research and reports the findings from interviews from 12 UK entrepreneurs and
13 Austrian entrepreneurs. The interview questions were piloted on 5 entrepreneurs and 3 academic experts in January 2013. The main interviews were conducted between February-March 2013. One of the authors is bilingual in German and English and conducted all of the interviews to ensure consistency in asking questions to entrepreneurs. Discouragement seems to take place when a business has not reached level of maturity or has declined from a level of stability. Indeed, the findings suggest that discouragement may be a temporary condition rather than a permanent one. There are differences between UK and Austrian discouraged borrowers. The Austrian participants have a more personal relationship with the loan officers. In the Austrian sample but not the UK sample those discouraged were told in advance that they won't qualify for a loan and had actually spoken to the banks already. Implications for policy makers and practitioners are developed.

Keywords: Desperate, borrowers, Armenia, Georgia

1. Introduction

Access to finance has been recognised as an important topic to academics (Freel et al. 2012) and policy makers alike (Storey, 2004; 1994), and essential for entrepreneurs‟ businesses to be able to grow, provide employment opportunities, innovation, as well as many other widely accepted beneficial facets (Parker, 2002). Acquiring finance is undoubtedly difficult and has intensified in the „credit crunch‟ (Wainwright, 2012) although the extent of the gap before (Cressy, 2002) and after remains highly debated (Wainwright, 2012). Entrepreneurs‟ desire to retain independent control of their businesses means that internal finance is often the only type of finance utilised (Psillaki and Daskalakis, 2009; Martin et al., 2005). Additionally, entrepreneurs are also reticent to provide information to external individuals and organizations which again contributes to the dominance of internal finance, and also makes it difficult for lenders when they evaluate requests for finance. Firms may be viewed as credit rationed where, irrespective of their creditworthiness, they are unable to access credit at any price (Stiglitz and Weiss, 1981). In the presence of imperfect information there are some firms who have a need for finance but they do not apply for external finance (Han et al. 2009). Kon and Storey (2003) coined the term „discouraged borrower‟ to refer to creditworthy (good) businesses who fall in the former category and don‟t apply for external finance because they think that they will be rejected.

Lenders typically find it is difficult to evaluate requests from businesses for finance because there is asymmetric information, and it is time consuming and expensive for lenders to evaluate requests for finance, and if given it is likewise problematic to check that the expenditure and behaviour of the borrower is as anticipated. Lenders face problems of moral hazard and adverse selection, and given the aforementioned problems they ration credit to businesses.

There is less research on discouraged borrowing in comparison to credit rationing but there is an emerging body of research on discouraged borrowers. The qualitative analysis in this paper is based on the Atherton‟s (2009) research on capital structures and financial strategies on new firms. His work will be extended by additionally analysing the financial lifecycle of each entrepreneur and if additionally to examining when discouragement to apply for a loan has taken place in form of presenting their chronological decision structure and in form of case studies of entrepreneurs from the UK and Austria. The aim, therefore, is to identify the underlying factors to better explain discouragement in the UK and Austria. It is suggested that for certain groups of entrepreneurs raising finance is difficult due to specified characteristics that make it more likely that they are less able to articulate their propositions or business proposal effectively and are perceived as too risky by the banks (Irwin and Scott 2010) which leads to discouragement from applying for a bank loan in the first place.

In the next section, the literature review is presented. Subsequently, the methodology is discussed. This is then followed by a section where the findings are discussed. Lastly, a conclusion is presented.

2. Literature Review

Past research on credit rationing or constraints have mainly focused upon those applying for funding and especially on characteristics of those rejected and thus ignoring those in need of credit but who didn‟t apply due to being discouraged (e.g. Levenson and Willard, 2000; Chandler, 2010, Chakravarty and Xiang, 2008; Cole, 2010; Chakravarty and Xiang, 2009; Freel e al., 2012). Cole‟s (2008) three step sequential model presents the loan application process by using three questions: 1) Does the firm need credit? If the answer was ´NO´: Non-Borrower, if it was ´YES´: 2) Did the firm apply for credit? If the answer was ´NO´: Discouraged borrower, Answer was ´YES´ lead to question: 3) Did the firm get credit? ´NO´: Unsuccessful Borrower, ´YES´: Successful Borrower. Attention has been mainly drawn to the last stage of his model and whether or not applicants received loans or not. However, those not applying due to the belief it will be rejected (Freel et al. 2012) although in need of finance and who would be successful borrowers or good borrowers, are known as „discouraged borrowers‟ have been largely under-researched. Freel et al., (2012) noted that traditionally, studies of credit rationing and constraints have been only focusing on those who apply for funding and non-borrowers essentially have been ignored by the existing literature. Discouraged borrowers may show gender differences due to different business activity and financial patterns (Sena et al., 2010). One difference between male and female entrepreneurs is that female owned businesses take a smaller share in comparison to male in self-employment (Sena et al., 2010), business ownership and start-up activity (Roper and Scott, 2007). Wholly or majority women-owned businesses account for between 12.3% - 16.5% of the UK business stock (Small Business Service, 2006) and therefore are well under-represented (Blake, 2006).

The literature has shown conflicting results about whether personal characteristics has an influence on whether owner-managers will seek bank finance and in particular whether finance poses a problem for women starting and running a business (Carter and Rosa, 1998). These differences may be caused due to women experiencing disadvantages related to how gender responds within women's socioeconomic activity. As a result limitations are placed upon women's abilities to accumulate personal savings, generate credit histories attractive to formal lenders, or engage the interest of venture capitalists. It is suggested that the fundamental influence of gender affects the entrepreneur‟s actions and experiences (Marlow and Patton, 2005).

It has been suggested that gender has a direct effect on the usage of access to finance and that female entrepreneurs finance their businesses differently than male entrepreneurs and prior research has also shown differences in the financing patterns of male owned businesses and female owned businesses (Coleman, 2000; Carter et al. 2007; Sena et al. 2010). Sena et al. (2010) found that men are more likely to approach external funders than women, although the difference between the two probabilities is not very large.

Irwin and Scott (2010) investigate whether owner-managers‟ personal characteristics such as gender influence access to finance. Although the results showed that men and women are using a similar level of business bank loans (male 7% and women 8%), and 7 per cent of men and 4 per cent of women used personal bank loans, men who had successfully raised finance more frequently reported difficulties (18%) compared to women (12%). Madill et al. (2006) results show that the majority of both male owned businesses (86.8%) and female-owned businesses (82.3%) did not apply because they did not need financing.

One study shows that one of these differences in financial patterns was that women are more likely to be discouraged to apply for loans than men (Chakravarty and Xiang, 2009). Madill et al. (2006) showed that women owners appear more likely to reply that they expected that they would be turned down compared to men owned businesses (5.6% compared to 3.1%). Another study found that almost 24% of majority-female-owned businesses were discouraged compared with fewer than 14% of firms led by male entrepreneurs (Freel et. al. 2012). The likelihood of being discouraged varies with demographic factors especially ethnic background of the entrepreneur and if the gender of the entrepreneur is female (Cavalluzzo et al. 2002).

3. Methodology

This paper uses qualitative research and reports the findings from interviews from 12 UK entrepreneurs and 13 Austrian entrepreneurs. The interview questions were piloted on 5 entrepreneurs and 3 academic experts in January 2013. The main interviews were conducted between February-March 2013. One of the authors is bilingual in German and English and conducted all of the interviews to ensure consistency in asking questions to entrepreneurs. The case studies were conducted in Vienna, Austria and London, UK. Austria is known for being a more bank-based system rather than a market-based financial system such as in the UK (European Commission 2003, Lehmann and Neuberger, 2001).

The study sample utilises participants from private contacts and network events in both countries. The study population consists of entrepreneurs owning SMEs (German: KMUs) needing or considering bank finance in the UK and Austria. A convenient sample was utilised. The first stage of the interviews asked basic questions on the entrepreneurs, their businesses and their financial situations. The second stage consisted of a semi-structured interview using open-ended questions as these contain more detail. A more semi-structured rather than a structured interview was followed in the questions of stage 2 in this study because it offers sufficient flexibility to approach different respondents while still covering the same areas of data collection but in line of a set of questions arranged with the intention of taking each respondent through the same sequence and questions with as far as possible the same wording. This approach helps to minimize variation in the questions interviewees and also reduces the possibility of bias that comes from having different interviews from different people, including of obtaining more comprehensive data from certain persons than from others (Patton 1990). The importance of having the interview recorded is reminded to the reader, and within one day of each of the interviews they were transcribed by one of the authors whilst the information is fresh in her mind.

Entrepreneurs‟ good will is limited so the need for follow up questions had to be used sparingly. In the last stage after properly reviewing the transcripts it was necessary to contact a small subset of the participants by e-mail and phone in order to ask if the participant could clarify or add necessary information. On occasion this process of reviewing and elaborating the interview revealed a small number of areas of ambiguity or uncertainty and further questions were needed to be asked for clarification. But, obviously, the piloting of the interviews, recording the interviews by tape recorder (with the participants‟ formal approval) and then transcribing the interviews the day after the interview helped to minimize the need for follow up questions.

The study has been conducted ethically, with all the participants given the right to self-determination, anonymity, confidentiality and informed consent. Each participant was informed about the purpose of the study and their consent was obtained before starting the first stage of the interviews. Anonymity (not disclosing the entrepreneurs or company names) and confidentiality (the anonymous information would only be used for academic purposes) has been maintained throughout the study.

4. Finding

Discouragement seems to be more likely to happen at the beginning of the capital structure of the business and less likely to happen in later stages. According to the Pecking Order Theory the firm´s capital structure starts with financing sources that don‟t involve debt or formal investments. It also could be argued that debt finance is only suitable for firm owners when wealth already exists in the form of tangible assets. In other words, a firm with collateral such as tangible assets that needs financing but can‟t use their valuables as direct investment into their firm uses debt finance and may be less likely to be discouraged as they are already in a later stage in the capital structure and may be perceived as successful. Therefore it may be argued that discouragement is an indicator that the business is not ready yet to enter the next stage of the Pecking Order Theory.

In this sample discouraged borrowers chose as an alternative route their own finances or asked family for finances. When this was not available or sufficient financial constraints resulted. As mentioned before discouragement may be a temporary condition rather than a permanent one and therefore entrepreneurs that were discouraged borrowers experience changes that made them start applying again. As the firm matures, the business owner becomes more experienced and therefore the overall situation of a firm becomes more stable and discouraged borrowers become hopeful again and reconsider applying if they feel a bank loan would be appropriate for them.

In this sample discouragement also seems to be a sign of lack of confidence which may be triggered by less entrepreneurial experience. In this research project the participants were asked how entrepreneurship experience has influenced their perception and their decision making. Regarding their perception to bank finance, the participants pointed out that experience makes them have more information, more comfortable as their business was growing and more confident to speak to loan officers being able to pay back, what the preferences of financial sources are and also become more aware of risk factors and debt traps, less naïve about getting loans easily. Prior entrepreneurial experience influences also the decision making process on whether to apply because business owner develop a better knowledge whether it will be efficient or not. Some started to see loans are a less preferred form of financial because of interest rates.

Around half of the sample didn‟t notice a change in their decision making process.The majority of those discouraged lacked prior business experience.

The participants in both countries believe that the gender of the entrepreneur plays an important role regarding financial choices, applying for or receiving a bank loan. A large part of the sample, thinks that men are more risky and women more conservative when it comes to financial choice. Gender differences are believed to exist in this sample also due to social factors that puts women into a worse financial situation. As women are the primary care giver to children, women earn less and are financial worse off. In contrast, the genders of the loan officer didn‟t seem to have been influential to the outcome of the bank loan application to the large majority of the sample. There are differences between UK and Austrian discouraged borrowers. The Austrian participants have a more personal relationship with the loan officer and the loan officer makes the decision. In the Austrian sample those discouraged were told in advance that they won„t qualify for a loan and actually spoke to the banks already. In the UK sample discourage borrowers they were not told prior whether they will get a loan or not.

Discouraged borrowers in the UK

Some entrepreneurs didn‟t feel discouraged as they felt if they needed a loan they would try and apply anyway as they had nothing to lose. While some - Kyu, Endrit and Catherine didn‟t think that the fear of rejection discouragement prevented them to seek loans. Rachel also said „No, never‟ did she feel discouraged and added „If I apply for something I will get it.‟ Yazeed didn‟t apply for a loan for the first business as it went well and didn‟t need to consider it. The second one was failing so badly that even with the loan it wouldn‟t work, so they closed it; however, interestingly also the fear of rejection made him not apply, combined with also a fear of actually getting it. He thought that the later was probably more an overriding concern than the fear of rejection to be honest. In his current business he hadn‟t considered applying for a loan yet. Siripan has felt discouraged to apply for a loan for all businesses in the past. Firstly, Siripan couldn't find too much information about the loan; and, secondly, because, maybe, it was their first business and they felt, it was too good to be true for applying for the loan. Siripan felt discouraged in applying for a loan but then they got a template of their business plan and they also spoke to their bank's business manager and they felt okay. Siripan used alternative routes of capital structure when she felt discouraged, and only relied upon finance from immediate family.

Discouraged borrowers in Austria

Anita, Rainer, Theresa, Arnold, Christian and Hans were never discouraged borrowers. Arnold didn‟t apply for a bank loan because he didn‟t like the idea that the bank would intervene in his start up business and despite being encouraged by the loan officer he thought he had enough resources. Christian hasn‟t been discouraged as he would have applied anyway even when he thought maybe he may not secure the bank loan. Hans never felt discouraged, because he comes from the banking branch/sector and did many conversations with clients when he worked at the bank as a bank assistant. The fear of rejection didn‟t ever stop Birgit to look for or apply for a bank loan for her business. She realized that the final decision is made by the bank officer when she applied for a personal mortgage and that in different branches different decisions are made and therefore where there is a stronger relationship between the two parties. Rudolf was never discouraged and even applied for a bank loan despite fearing his application will be rejected for his businesses, he believes he is persistent enough. Bank assistants tried to influence or discourage his decision to apply but were not successful. The banks never told Rudolf in advance whether he will get the loan or not. Lukas didn"t feel discouraged to apply for a loan due to emotions or fear of rejection to apply for a bank loan but simply rational reasons. Markus discussed the decision to apply for a loan with his wife. They were both thinking positively that they will get the bank loan as it was the last option. At the beginning before Markus applied for a loan bank the officers tried to discourage him as they told him that his application will likely be rejected. Markus believes they look at the income firstly and when they saw his income, they immediately told him at the bank that he probably won"t get the loan, but he didn"t give up and he got the bank loan at the end.

Wolf had a bad experience because the bank officer told him to declare himself bankrupt instead of applying for a loan. Wolf explains when he only needs a 30.000, 40.000 Euro bank loan to invest in a new order of 60.000 Euro, instead of applying for a bank loan as alternative route he gives his customers a discounts of 15.000 Euro for payments in advance. If he applies for a bank loan he has to run after the bank loan officers for 2 months and wait until he gets the finance. He also thinks that he felt disheartened in other businesses in the past, so at some point he asked his daughter to apply for a loan as he knew he won"t get any financing, but didn"t want to give up.

Until 2003 before Johanna got her PhD (Doktorat) and a full-time job she is recognized for her PhD she phoned all big banks (5-6 times) despite worrying to be rejected for a loan. They all told her she won"t get the loan and therefore she didn"t even go there in person and was discouraged. So she delayed the payment for bills and couldn"t pay her service charges for a year and the real estate management said that she can take her time after explaining her situation.

Leon felt discouraged for many years because of the state of the relatively young business and a lack of collateral when he needed bank financing for an EDP/computer system. Bank loan officers discouraged him with all the formal requirements that they have listed when he called the bank without arranging a personal appointment. They told him what the requirements were e.g. collateral etc. and he didn"t want anyone to guarantee for him and pull anyone into a theoretical ruin, therefore, they told him he will be very likely to be rejected. As alternative capital structures he used money from his life partner and prepayment from customers and credit cards. When the firm matured Leon considered bank loans again.

In the research sample discouragement was often linked with poor financial situations of the firm as well as poor financial situation of the firm owner, their lack of collateral and confidence. Those who could prove a steady income were less likely not to get the loan but also less likely to need a loan. Discouragement therefore may be a temporary state which acts as a self-rationing mechanism to the financial situation and a risk indicator at the time. From the samples in this study discouragement for bank loans seem to occur at the earlier stages of the capital structure and may be an indicator that the firm is not ready for the next step in the capital structure. It would be also possible that those discouraged and at the start-up phase lack confidence and are unable yet to present themselves as successful business owners.

5. Discussion & Conclusion

Discouragement seems to be more likely to happen at the beginning of the capital structure of the business and less likely to happen in later stages. According to the Pecking Order Theory the firm´s capital structure starts with financing sources that don"t involve debt or formal investments. It also could be argued that debt finance is only suitable for firm owners when wealth already exists in the form of tangible assets. In other words, a firm with collateral such as tangible assets that needs financing but can"t use their valuables as direct investment into their firm uses debt finance and may be less likely to be discouraged as they are already in a later stage in the capital structure and may be perceived as successful. Therefore it may be argued that discouragement is an indicator that the business is not ready yet to enter the next stage of the Pecking Order Theory.

In this sample discouraged borrowers chose as an alternative route their own finances or asked family for finances. When this was not available or sufficient financial constraints resulted. As mentioned before discouragement may be a temporary condition rather than a permanent one and therefore entrepreneurs that were discouraged borrowers experience changes that made them start applying again. As the firm matures, the business owner becomes more experienced and therefore the overall situation of a firm becomes more stable and discouraged borrowers become hopeful again and reconsider applying if they feel a bank loan would be appropriate for them.

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