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SOCIAL CAPITAL AND ACCESS TO BANK FINANCE: THE CASE OF SMALL BUSINESS OWNERS IN A DEVELOPING NATION

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ABSTRACT
In this paper, we investigate whether the components of social capital are associated with access to financial capital from gender and race perspectives in the context of South Africa. In many developing economies, Small, Micro, and Medium-sized Enterprises (SMMEs) frequently face difficulties in accessing bank finance due to the weak status of their social capital and limited financial resources in South Africa. A quantitative research design focused on 532 SMME owners in the Western Cape, South Africa. A regression analysis was conducted to determine the relationships between the factors of social capital and their association with accessing financial capital. We revealed that social capital has an influence in securing bank finance, but gender does not. From a race perspective, white business owners are more likely to be successful in applying for bank finance compared to other race groups. The findings should guide policymakers, banking institutions, and the government in addressing the inequality relating to race in bank finance.

KEYWORDS: Social capital, bank finance, financial capital, gender, and race

1. INTRODUCTION

The ability and capacity accessing to bank finance are determined as one of the critical success factors in business ventures. Several studies show that financial capital input levels are strong determinants of a new venture's survival prospects (Deng, Jiang, Li, & Liao, 2019; Aziz, 2013; Gray, Saunders & Goregaoakar, 2013; & Seghers, Manigart & Vanacker, 2012). The lack of access to bank finance is a critical impediment to entrepreneurial growth particularly in developing economies. One of the main factors cited is that banks find it difficult to gauge whether SMMEs have the capacity and/or willingness to repay their debts. As a reflection to the credit crunch, regulators across the world have imposed more stringent capital adequacy requirements, which lead to an increasing unwillingness to lend to the personal and business sector during, and even after the crisis (Fraser, Bhaumik & Wright, 2015; Cowling, Liu & Zhang, 2016). This study explores the effect of social capital on the likelihood of businesses to secure bank financing in the context of South Africa, a developing economy. The research follows the lead of Carter, Brush, Greene, Gatewood, and Hart (2003), who investigated whether higher levels of human capital and social capital are associated with financial strategies, in the context of women business owners in the USA.

Social capital is one of the critical initial 'endowments' which shape the entrepreneur's aspirations and choices about the strategic direction of the business (Manev, Gyoshev & Manolova, 2005). Social capital plays an important role in firm development, internationalization, and growth, in the context of an emerging market (i.e., Brazil) (Clarke, Chandra & Machado. 2016). Recent literature in entrepreneurship suggests that small businesses can acquire social capital to improve their access to debt financing and there is a considerable impact of social capital of non-resident family members on small business debt financing (Gill, Maung & Chowdhury, 2016). Social capital may be even more critical for securing scarce financial resources in the context of developing economies, characterized by high overall educational attainment and high reliance on informal networks to countervail institutional voids (Smallbone & Welter, 2001).

This study further explores the differential gender and race effects on the impact of social capital in securing bank finance. Concerning gender, despite the growing body of literature on women-owned businesses, their financing strategies, and the relationship of financing to business growth and performance (Febrian, Maulina, & Purnomo, 2018; Phillips, Moos & Nieman, 2014; Brana, 2013; Gatewood, Carter, Brush, Green & Hart, 2003), extant research has not established a set of relationships or patterns that would be unequivocally attributable to gender.

The research on the effects of gender and race on access to entrepreneurial financing in the context of developing economies has been limited. Moreover, in the entrepreneurial literature, the discourse on gender, networks, and networking has been relatively limited (Leitch & Harrison, 2014). This study, therefore, aims to inform the various stakeholders, including managerial practice and public policy about the differences in how men and women entrepreneurs and the different race groups in developing economies leverage their social capital to secure business finance. The following section will provide a brief background on South Africa.

2. BACKGROUND OF SOUTH AFRICA, AS A DEVELOPING NATION

South Africa is classified as a developing nation (World Bank, 2008). It is regarded as having a productive and industrialized economy but also exhibits many of the characteristics associated with developing countries, such as an uneven distribution of wealth, a high level of poverty, unemployment, and a low Human Development Index rating.

Before being a democratic nation, South Africa was a developing country governed by apartheid policies which resulted in dividing the various race groups. The labyrinth of apartheid laws and policies in South Africa served to perpetuate white labour and political aristocracy, denying the black race group, which then comprised the Coloured, Indian and African groups, the opportunity to participate fully in the economy. According to Statistics South Africa (2011), about 80 % of the South African population is made up of black Africans, most of who can be classified as poor. Coloured and white people each make up 8.9% of the total, and the Indian/Asian/ other population 3%.

South African Women Entrepreneurs (SAWEN, 2005) highlights the fact that women still do not have equal economic rights and access to resources such as formal finance. The International Finance Corporation (IFC, 2006) also maintains that, while access to resources such as financial services continues to be largely racially defined, the gender gap between men and women persists, and is likely to grow unless special efforts are undertaken to address the underlying issues. The next section provides the hypotheses to the study, literature review on access to finance and social capital, research methods, findings and discussions, implications, and conclusion.

2.1. Research hypotheses

The following section gives a brief background to the development of the hypotheses for this study. Securing bank finance is influenced by the social capital variables of the entrepreneur (Manolova, et al., 2006; Ng, Ibrahim & Mirakhor, 2015). Recent studies in a particular environment play a critical role in the intellectual capital and competitive advantage of SMEs assisting in the integration and accumulation of new knowledge and adapting to new situations (Jain, Jain, Vyas, Vyas & Roy, 2017). Thus, if opportunities for business growth and profitable economic activity arise, those entrepreneurs with strong social capital will be better at perceiving such opportunities and capitalizing on them.

Shane and Cable (2002) found that networking, which is part of social capital, can be used to reduce information asymmetry in creditor/debtor relationships. In addition, business networks increase a business's legitimacy, which in turn positively influences the business's access to external financing. Kiggundu (2002) adds that networks contribute to business success and continuity. This suggests that lack of networking can negatively impact the securing of bank finance by both new and established SMMEs. According to Manolova, et al. (2006) and Carter, et al. (2003), networks form part of social capital and can be in the form of strong ties (family and friends) or weak ties (bookkeeper, banker, other business owners, legal advisor, business advisor or financial consultant). Consequently, it is hypothesized that:

Hypothesis 1: Business owner's social capital is positively related to securing bank finance.

Studies by Lee and Denslow (2004) and Orser, Hogarth-Scott, Riding (2000) in industrialized countries reveal that women are more concerned about access to finance than any other business problem and that it is more of a problem during the early stages of developing an enterprise. Similarly, Coleman (2000) found that acquiring financial capital and dealing with financial institutions is particularly difficult for women business owners. Research also shows that women start their businesses with smaller amounts of financial capital and are less likely to raise finance from external sources (Fairlie & Robb, 2009; Constantinidis, Cornet & Asandei, 2006). Moreover, it has been established in several entrepreneurship studies that on average women have access to fewer resources and less knowledge, and in many countries, they have a lower societal position than men (Kelley, Brush, Greene, Herrington, Ali, Kew & 2015; OECD, 2008). In the current economic climate, the number, size, type, and scope of women-owned businesses are less than those owned by men (Kelley et al., 2015).

Currently a democratic nation, South Africa may still not necessarily favour certain race groups or gender in bank loan applications. The hypotheses developed below thus set out to examine gender and race in the bank application context.

Hypothesis 2: Male and female business owners are equally likely to be successful in their applications for bank finance.

Hypothesis 3: Black and white business owners are equally likely to be successful in their applications for bank finance.

3. LITERATURE REVIEW

3.1 SMMEs' access to finance

Numerous studies addressed the difficulties of SMMEs' access to finance (Mukhove, 2014; Ingle, 2014; Steinerowska-Streb & Steiner, 2014). These difficulties include a lack of financial networks, weak support from family members, and restrictions from financial institutions. To deal with these problems, SMMEs need to be provided with an enabling environment, one which encompasses access to financial capital, being one of the greatest obstacles to business start-ups (Green, 2003). Depending on their size and environment, businesses see access to formal finance as more or less challenging. Berger, Klapper, and Udell (2001) point out that developing and emerging economies may, however, be at a disadvantage both in their access to credit and the terms of the loans. In addition, spatial differentiation also plays a role in SMEs accessing finance (Zhao & Jones-Evans, 2016). Notwithstanding the current situation, new businesses are born every day, and/or existing businesses are expanding by increasing their productive assets. This involves an implicit decision to raise capital to finance growth and expansion.

The following sections provide a brief description of bank finance, social capital, resulting in a framework that guides the study.

3.2. Bank finance

Bank finance has been positively associated with SMMEs growth in both the developed and developing countries (Osei-Assibey, 2013; Abe, Troilo & Batsaikhan, 2015; Cowling et al., 2016). The main source of external financing available for small businesses in developed nations is the formal financial institution, with almost half of such finance coming from overdrafts and term loans (Bank of England, 2002; Observatory of European SMMEs, 2003; Feakins, 2005). Furthermore, Feakins (2005) points out SMMEs may turn to alternative sources of bank debt financing if they find themselves unable to obtain traditional or conventional forms of bank credit. The limited extent of bank credit to SMMEs in sub-Saharan Africa is only partly compensated by non-bank forms of credit, namely trade credit, loans from friends and families, business relations, and, to a much smaller extent, loans from savings associations.

3.3. Social capital

Networking creates many forms of valuable social capital including advocacy, introductions, and mentoring that would otherwise require the use of human or financial capital (Simon, 2013; Batistic *et al*. 2017). The success of an entrepreneur in raising external finance may depend on who one knows or the amount of one's social capital. Social capital emerges from the norms, networks, and relationships of the social structure (Levin *et al*. 2016; Batistic *et al*. 2017).

Network ties are an important component of social capital. Having a diverse network, with a mixture of strong and weak ties, also influences access to financial capital. Weak ties are loose relationships between individuals, as opposed to the strong ties that would be found in a family. Weak ties are useful in obtaining information that would otherwise be unavailable or difficult or costly to find. Strong ties, such as those derived from family relationships, provide secure and consistent access to resources. Lindstrand, Melen and, Nordman (2011) use trust and network ties as the dimensions of social capital in their study of the internationalization of 14 small Swedish biotechnology firms. Davidsson and Honig (2003) suggest that the facilitation offered by business networks and associations may provide the most consistent and effective support for emerging businesses. This support may be in the form of business advice or access to financial capital.

In this study, we employ social capital broadly in terms of the social exchange between individuals and groups, to examine the effects of exchange ties on access to financial capital. Exchange effects may range from the provision of concrete resources, such as a loan secured due to strong ties and weak ties, to intangible resources, such as information on business advice. The study is thus concerned with factors related to social relations, which consist of the patterns of ties between individuals, where variations in the network or strength of the ties are meaningful.

4. RESEARCH METHODOLOGY

The study employed a quantitative method, using exploratory and descriptive research. In obtaining primary data from SMME owners, the survey method was found to be the most convenient. This article used some of the constructs devised by Manolova *et al.* (2006), adapted for the South African context. Data for the research study were gathered using a survey questionnaire from 532 SMME owners in the Western Cape, South Africa.

The following rating scales as described by Sekaran (2003) were used: dichotomous questions (to elicit a yes or no answer), a category scale (using multiple items to elicit a single response), a Likert scale (to examine how strongly respondents agree or disagree with statements on a 5-point scale) and a fixed sum scale (respondents are requested to distribute a given number of points across various items). The questionnaire was designed to retrieve information relating to the following sections, as listed in the final questionnaire: Section A: Background on the business; Section B: Biographic data of the entrepreneur and household; Section C: Financing the business and Section D: Networking. The target population was SMME owners who were operating in the main trading areas of the City of Cape Town.

The study engaged the services of research assistants to administer the questions during the fieldwork. Due to the absence of a database of SMMES, random cold contacts were made in the different trading areas to invite participation in the survey. The respondents had to satisfy the following criteria: 1) Own 50% or more of the business; 2) be actively involved in the business, and 3) have fewer than 100 employees.

5. RESULTS AND DISCUSSION

The following section provides summary results of the demographics of the SMME owner, descriptive analysis; Chi-squared analyses, and regression analyses. 532 questionnaires were used in the analysis of the data. The response rate was 42% and 4% of the questionnaires had to be discarded, due to incomplete responses from the subjects. The 42% response rate was well within the international standards, which range between 27% and 51% (Yang, Wang, Su, 2006).

5.1 Access to financial capital

It was noted that 72% of the SMMEs had exclusively non-bank finance in the form of personal equity, 3% had bank finance only, while 25% had a combination of non-bank and bank finance. Concerning non-bank finance, further analyses revealed that 47% of the respondents had only savings as part of their capital structure when starting a business. There were no significant differences between males and females or between the race groups on utilizing savings as the only source of finance. It was also found that 23% of the respondents sourced finance from family or friends. However, there was a significant difference from a race perspective; a higher proportion of black entrepreneurs (25%) than white entrepreneurs (19%) sourced finance from family or friends. There was no significant difference between the type of finance across gender and race.

5.2. Summary using Chi-square analysis on social capital

Social capital variables were cross-tabulated with bank application (respondents who applied to the bank for a loan) and bank success (success in bank application). The variables included strong ties, a diverse network, belonging to a business network, strong assistance from a business network, and a strong bank relationship.

18% of the respondents did not have strong ties, meaning that they did not consult with other stakeholders, such as family and friends, when seeking financial advice. 78% of business owners who had weak ties were successful in their loan applications, compared to 33% who had strong ties. Of the 60% who had a diverse network, 81% were successful in their bank applications, compared to a 74% success rate for those who did not have a diverse network. Having a diverse network was thus associated with success in bank application.

The bank success rate was significantly higher for respondents who belonged to a business network than for those who did not belong to a business network (91% versus 68%). This implies that belonging to a business network is associated with success in bank applications. It was also found that entrepreneurs who had strong assistance from their business networks were, therefore, likely to be more successful in the bank application than those who did not have such assistance. Of the respondents who had a strong bank relationship, 85% were successful, compared to 21% for those who did not have a strong bank relationship, meaning that a strong bank relationship influences the success of a bank application.

In summary, having a diverse network, belonging to a business network, and having strong assistance from the network and a strong bank relationship were associated with applying for bank finance, using Chi-squared analysis. In addition, belonging to a business network and having strong assistance from the network and a strong bank relationship were associated with success in bank application.

5.3. Application and success of bank loan by gender and race

Respondents were required to indicate if they had applied for a bank loan during the past three years and to indicate whether they had been successful in their most recent application. A significantly higher proportion of males (32%) than females (19%) applied for bank loans. In terms of success rate, 93% of the white entrepreneurs were successful, compared with 69% of black entrepreneurs. White entrepreneurs were thus more likely to be successful in bank applications compared to black entrepreneurs, despite the bank application rates being similar. The results thus suggest that white entrepreneurs have a greater chance of success than black entrepreneurs.

5.4. Social capital regressed with bank application and success in application versus bank application

Social capital variables were regressed to assess which variables affected the likelihood of applying for bank finance and of success in the application, as shown in Models 1 and 2 in

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Table 1. The independent variables were strong ties, a diverse network, belonging to a business network, strong assistance from the business network, and a strong bank relationship.

Table 1: Social capital and financial capital

	Model 1				Model 2			
	BANK APPLY				BANK SUCCESS			
Social Capital	B	S.E.	Wald	Exp(B)	B	S.E.	Wald	Exp(B)
Strong Network ties	-1.097	.638	2.961	.334	-2.021	1.041	3.768	.132
Diverse network	.659	.218	9.147	1.933**	.632	.239	7.003	1.881*
Belong to business network	1.117	.380	8.621	3.056**	1.325	.421	9.918	3.761**
Strong assistance from business network	-.638	.421	2.302	.528	-.429	.453	.897	.651
Strong bank relationship	.512	.334	2.345	1.668	2.053	.623	10.853	7.793*
Constant	-1.775	.327	29.446	.169	-3.689	.628	34.569	.025

*p<0.05, **<0.005

As noted in Table 1, Models 1 and 2, containing all predictors, were statistically significant, indicating that the models were able to distinguish between the social capital variables that contributed to applying for bank finance and success in bank application. ‘Diverse network’ and ‘belonging to a business network’ made a statistically significant contribution to Model 1 on bank application. The strongest predictor of bank application was ‘belonging to a business network’, indicating that respondents who had belonged to a business network were more than three times more likely to apply for bank loans than those who did not belong to a business network.

In relation to bank success, as shown in Table 1, ‘diverse network’, ‘belonging to a business association’ and ‘strength of bank relationship’ made a statistically significant contribution to Model 2. The strongest predictor of such success was ‘strong bank relationship’, indicating that respondents who had a strong bank relationship were about eight times more likely to be successful in their applications than those who did not have a strong bank relationship. The implication of Model 1 and Model 2 is that SMME owners who belong to a business network are more likely to apply for bank finance. In addition, having a strong bank relationship greatly increases the chances of success in securing bank finance.

5.5. Gender, race, and financial capital

The variables of financial capital were also regressed with gender and race to establish if there were any relationships. As noted in Table 2 below, the full model on gender (Model 3) containing all the predictors of financial capital (bank application and success of application) was significant. There were no strong predictors of financial capital, implying that gender is not significantly related to bank application. The results suggest that the bank application rates were not related to gender.

From a race perspective, the full model (Model 4) containing all predictors was significant. As shown in Table 2, bank application and bank success made a significant contribution to Model 4. The strongest predictor of the race was bank success rate, indicating that one race group (white) was about five times more likely to be successful in bank application than the other race group (black). The implication of Model 3 and Model 4 is that financial capital was not influenced by gender. Male and female owners were equally likely to be successful in the bank application process. However, access to bank finance was influenced by race. White entrepreneurs were more likely than black entrepreneurs to be successful in their applications.

Table 2: Gender, race and financial capital

	Model 3				Model 4			
	Gender				**Race**			
Financial Capital	B	S.E.	Wald	Exp(B)	B	S.E.	Wald	Exp(B)
Bank apply	-.816	.418	3.817	.442	-1.150	.546	4.439	.317*
Approved	.158	.458	.119	1.171	1.593	.566	7.926	4.917**
Constant	-.497	.105	22.460	.608	-1.002	.115	76.195	.367

*p<0.05; **<0.005

5.6. Results of the hypotheses

Hypothesis 1: Business owner's social capital is positively related to securing bank finance.
Belonging to a business network, having strong assistance from the business network, and having a strong bank relationship were associated with bank application and success in bank application, supporting this hypothesis, that a business owner's social capital is positively related to securing bank finance.

Hypothesis 2: Male and female business owners are equally likely to be successful in their applications for bank finance.
The success of bank applications was not significantly different between male and female entrepreneurs thus supporting this hypothesis.

Hypothesis 3: Black and white business owners are equally likely to be successful in their applications for bank finance.
A significantly higher percentage of white entrepreneurs than black entrepreneurs were successful in their bank applications, thus not supporting this hypothesis.

6. IMPLICATIONS OF THE STUDY

A quarter of the SMMEs applied and was successful in the bank application process. Financial institutions should devise a marketing plan to attract more finance applications and provide support programmes to train black business owners on the process and requirements for the funding process. This may encourage more start-up businesses and grow established businesses. It is therefore incumbent on suppliers of finance and other stakeholders to ensure that the various funding schemes are well-publicized and made available to SMMEs. To improve networking, SMME owners should ensure that they maintain good relationships with commercial banks. In addition, entrepreneurs need to attend seminars and trade fairs and join business networks or business associations.

7. CONCLUSION

This article aimed to investigate if social capital was related to accessing financial capital and used gender and race as added variables in accessing financial capital. A quarter SMMEs sourced finance from a bank. It is also concluded that social capital was associated with bank application and success. Although a higher proportion of males than females applied for bank finance, it was found that gender is independent of success in bank application. From a race perspective, the bank application rates were similar. However, white entrepreneurs were more successful than black entrepreneurs in applying for a bank. The results suggest that white entrepreneurs have a greater chance of success than black entrepreneurs. It is found that having a strong bank relationship greatly increases the chances of success in the bank application process.

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