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# Discrimination, Social Capital, and Financial Constraints: The Case of Viet Nam

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SUMMARY

This paper examines the relationship among gender, social capital, and access to finance of micro, small, and medium enterprises in the manufacturing sector in Viet Nam. Our dataset is from the 2011, 2013, and 2015 results of the Micro, Small, and Medium Enterprise Survey in Viet Nam. Using the Heckman technique to control for sample selection bias, the estimates do not provide evidence for discrimination against female-owned enterprises in the formal lending market. Specifically, female entrepreneurs have a higher probability of getting a loan and they pay lower interest rates in comparison with male entrepreneurs. No discrimination in formal credit markets may arise from the preference for informal loans over formal loans as entrepreneurs tend to borrow informal loans before applying for formal ones. Further analysis shows that social capital could facilitate loan applications: firms that have a closer relationship with government officials and other business people can get loans of longer duration.

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## 1. Introduction

Access to finance is considered as one of the main drivers of firms' growth. However, firms, especially small and medium enterprises (SMEs), often report a lack of access to finance. This prevents firms from growing to their full potential and slows down economic development. Furthermore, if firms fail to gain loans from formal sources, they have to use their own funds or informal credit sources, which results in limited credit and paying higher interest rates. The issue of financial constraints is even more pronounced among female-owned enterprises because of gender-based stereotypes (Godwin, Stevens, & Brenner, 2006). Thus, a growing literature on female entrepreneurship has examined gender differences in credit markets and factors that can facilitate women entrepreneurs' access to finance.

However, results from systematic literature review have shown that the existing studies on female entrepreneurship face a number of challenges (e.g., De Bruin, Brush, & Welter, 2006, 2007). The first challenge is related to methodological shortcomings such as the issue of sample selection bias (Blanchard, Zhao, & Yinger, 2008). Although several studies have attempted to address this problem (e.g., Cavalluzzo, Cavalluzzo, & Wolken, 2002; Cavalluzzo & Wolken, 2005), choice of instruments is still one of the key challenges. We aim to contribute to the literature by introducing the alternative instruments accounting for the household and family background of female entrepreneurs which is an important factor in entrepreneurial research (Ahl, 2006; Brush, De Bruin, & Welter, 2009).

Secondly, existing studies conducted within a single-country context are limited to the US where there are strong anti-discriminatory policies. Hence, results from these explorations might not be relevant to other countries such as developing economies where gender inequality remains a problem in the society. Given the increasingly important role of emerging markets, there is a need for research on female entrepreneurship and gender differences in these countries (Hughes, Jennings, Brush, Carter, & Welter, 2012). This study is designed to meet this demand by investigating financial constraints faced by female entrepreneurs in the context of an emerging country.

Viet Nam represents an appropriate field of study for a number of reasons. First, despite the significant growth of SMEs in the economy, many SMEs in Viet Nam face difficulties in raising external finance, especially funds from formal sources. According to the World Bank's Enterprise Surveys for Viet Nam (World Bank, 2015), access to finance is one of the top business obstacles for firms. Second, Viet Nam is a network-oriented economy, where social capital plays an important role in running business (Meyer & Nguyen, 2005). Collectivism and the value of group membership are more

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important than individualism in Vietnamese culture (Swierczek, 1994). This therefore makes Viet Nam an interesting case for investigating the impact of social networks on obtaining finance. Third, although the gender gap in Viet Nam has been narrowed, gender inequality still remains in the society and in the economy (World Bank, 2016).

This study offers an in-depth understanding of obstacles in the financing of SMEs in Viet Nam in general and female-owned SMEs in particular, which may help firms get better access to finance in the future and guide policy implications. First, firms could invest in their social capital, particularly in their relationship with government officials, bankers, and business networks, to facilitate loan applications. Second, women-owned firms could extend the partnership with male-owned firms to benefit from male entrepreneurs' social capital. Third, credit programs targeting SMEs with low interest rates and longer loan maturity terms might be expanded. This is because the current lending programs for SMEs are limited to specific sectors and conditions that discourage SMEs from borrowing from the formal sector.

Our paper provides new evidence for the issue of financial constraints regarding the effect of female ownership and the role of social capital in a developing country context. More specifically, we do not observe the presence of discrimination against women entrepreneurs by Vietnamese financial institutions. This result is in line with previous studies which found that there is no difference in loan approval rates between male- and female-owned firms (Blanchflower, Levine, & Zimmerman, 2003; Cavalluzzo & Cavalluzzo, 1998; Madill, Riding, & Haines, 2006). This study also sheds light on the relationship between social capital and access to finance that better social capital may partially help firms relax their financial constraints (e.g., Ahlstrom & Bruton, 2006; Le, Venkatesh, & Nguyen, 2006; Talavera, Xiong, & Xiong, 2012). For instance, firms with better social networks are more likely to have access to longer loan terms.

The remainder of the paper is organized as follows. The next section reviews the related literature about discrimination, social capital, and access to finance. Section 3 provides an overview of institutional frameworks of SMEs in Viet Nam. Section 4 presents the descriptive statistics and the identification strategy. Section 5 provides the main empirical results and robustness checks. Section 6 concludes and provides the policy implications.

## 2. Literature review

### *(a) Studies on discrimination*

#### *(i) Gender discrimination*

The economics of discrimination has been well developed in the past few decades and can be divided into two main models: a taste-based model and a statistical model. These models can be distinguished through the causes, nature, and economic effects. The taste-based preference model, or Becker-type model of discrimination, has suggested that discrimination arises from a personal prejudice, or taste, against certain individuals or groups (Becker, 1957). Thus, individuals who hold a taste for discrimination against a particular class of people are willing to pay a financial price to avoid interactions with that class. In the lending market context, this can be implied by higher interest rates charged to the disadvantaged group, i.e., lenders require an interest rate premium to compensate for having to associate with the disadvantaged group. Discrimination in the lending markets can also be demonstrated through fewer loans being held by disadvantaged borrowers.

From the statistical perspective, discrimination against women might arise from the fact that women-owned firms tend to have smaller amount of equity capital (Riding & Swift, 1990; Verheul & Thurik, 2001). Consequently, loan approval is problematic as banks are often reluctant to lend to low-capital firms (Coleman, 2000). Further, statistical discrimination can also be the result of imperfect information. Lack of information leads to stereotypes that group-level characteristics can be proxies for characteristics of individuals belonging to that group (Arrow, 1973; Phelps, 1972). Hence, individuals can be treated differently depending on what groups they belong to. Regarding lending markets, statistical discrimination may be induced when lenders are imperfectly informed about some borrower characteristics that are relevant to decision making. Moreover, acquiring information is costly. Thus, lenders tend to use characteristics of the applicants' groups when making loan decisions.

Recent research on discrimination has employed the intersectionality approach that considers both between- and intra-group differences in documenting gender inequality. It is suggested that discrimination against women might be a combination of gender bias and other demographic characteristics such as race, ethnicity, or social status. For example, Beal (2008) has found that Black women face a higher level of discrimination compared to White women because they face both gender and racial biases. Additionally, working-class Black females suffer from triple discrimination including race, gender, and poverty. The interaction between gender and ethnicity could also lead to more harassment at work experienced by minority women as they belong to both disadvantaged groups (Berdahl & Moore, 2006).

#### *(ii) Gender discrimination and access to finance*

A growing economic literature investigates the presence of gender discrimination in the credit markets in the context of developed countries and provides an ambiguous picture. For example, Cavalluzzo *et al.* (2002) have acknowledged that female-owned firms in the US tend to have higher loan denial rates in comparison with male-owned peers. Further, men-owned businesses are more likely to get larger loans and pay lower interest rates compared to women-owned businesses (Alesina, Lotti, & Mistrulli, 2013; Coleman, 2000; Treichel & Scott, 2006). However, other studies did not observe discrimination against women in lending markets (e.g., Blanchflower *et al.*, 2003; Bostic & Lampani, 1999; Madill *et al.*, 2006). Asiedu, Freeman, and Nti-Addae (2012) have found that White women-owned firms pay lower interest rates compared to White men-owned peers. Additionally, despite the lower number of loans held by female entrepreneurs, there is no difference in loan denial rates between female- and male-owned firms (Cavalluzzo & Cavalluzzo, 1998). Moreover, female-owned businesses located in more concentrated banking markets indeed have more benefits in relation to loan applications compared to their male-owned counterparts.

Limited studies about gender discrimination in the context of developing countries also provide mixed results. For example, there is no evidence for gender discrimination in access to finance in Trinidad and Tobago (Storey, 2004). Documenting women's disadvantages in raising external capital in Sub-Saharan Africa, Aterido, Beck, and Iacovone (2013) have suggested that the gender gap in lending markets can be explained by firms' characteristics and selection bias rather than by pure gender discrimination. More specifically, women-owned firms tend to be smaller, resulting in lower probability of getting loans. Further analysis shows that female entrepreneurs face higher barriers in loan applications in the first place compared to male peers. Focusing on credit access differentials between men- and women-owned manufacturing enterprises, Hansen and Rand (2014) have found evidence for gender discrimination against women for medium-sized firms in Sub-Saharan Africa while the opposite results are found for small enterprises. Furthermore, female-owned firms in Sub-Saharan Africa are

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