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Black entrepreneurs 4 times more likely to be refused credit than white businesses

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A research paper, by Dr Stuart Fraser of Warwick Business School at the University of Warwick, has found that many Ethnic Minority owned Businesses (EMBs) in the UK struggle to obtain credit in comparison to White owned businesses. Black and Bangladeshi owned businesses are the most likely to be refused credit, facing up to four times as many refusals as white owned businesses.

Warwick Business School researcher Dr Stuart Fraser examined the small business credit market using data from the UK Survey of Small and Medium Finances (UKSMEF).

He found that in particular Bangladeshi and Black owned firms are several times more likely to be denied loans than Indian and White owned businesses. The survey found that 36% of Black African firms had been denied loans compared to 29% of Black Caribbean, 20.6% of Bangladeshi, 12.2% Pakistani, 7.3% Indian, and 8.2% white owned businesses.

At face value, these results would seem to be an indication of ethnic discrimination, however Dr Fraser found that a further analysis of the loan denials and interest rates pointed to differences in creditworthiness rather than ethnic discrimination as an explanation for poorer EMB credit outcomes. In particular, more than half of Black African firms (55.7%), and 40.6% of Black Caribbean firms, exceeded their overdraft limit or missed loan repayments versus about one in four (23.3%) of White owned firms. – and it is this factor that appears to account for their higher loan denial rates.

The research found that one clear reason for this much higher incidence of missed loan repayments and exceeding overdraft limits (financial delinquency) was the much younger age of the Pakistani, Bangladeshi and Black owned firms compared to Indian and White firms. Black African owned businesses averaged 6 years, Black Caribbean 6.9, Bangladeshi, 6.5, Pakistani 8.3, Indian 14.2, and White owned 18.7 years. Other key reasons for financial delinquency include the business owner lacking a financial qualification or suitable financial advice and the business already having too much debt. In the case of Black African firms the research also points to cultural differences as a possible explanation for higher delinquency rates.

The research also found that Black Caribbean firms in the UK are less likely to apply for loans than White owned businesses due to fears of rejection based upon discrimination.

Dr Fraser points to the increasing use of 'arms length' credit and behavioural scoring systems, which do not allow transactions to be tainted by dubious judgements based upon ethnic perceptions by loan officers. He notes that scoring systems may explain the absence of racial bias, but ironically, they may also be responsible for misperceptions of racial bias since the reasons for rejection are not usually made clear to the applicant in these cases.

Dr Fraser says "Improvement in information flows between finance providers and businesses about the criteria used to make credit assessments including providing the reasons for rejection would help tackle the misperceptions of discrimination. In particular, finance providers should make it more clear to EMBs that defaulting on a loan or exceeding an overdraft limit could have adverse consequences for future credit."

This research highlights a number of factors which need to be addressed in order to reduce ethnic variations in loan denial rates: lack of financial skills and advice; poor financial performance; and ethnic and cultural differences. Targeting EMBs for assistance with skills advice may help reduce delinquency rates and improve access to finance. This, together with finance providers investing more in their relationships with Black firms could cause significant reductions in dissatisfaction.

Source: University of Warwick

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