FINANCING THE EMERGING BUSINESS THROUGH MONITORED AND UNMONITORED SOURCES OF FUNDING (SUMMARY)

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SUMMARY

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Principal Topic

This study tests hypotheses about the relationships between expected and acquired funding sources, founder and firm characteristics, and success at starting a business. We devise a rationale for categorizing emerging startup efforts based on an entrepreneur’s expectations of using two broad kinds of financial resources: unmonitored and monitored. Examples of unmonitored sources of funds would be: a 2nd mortgage, credit cards, spouses, friends, and family. Unmonitored funds are provided to entrepreneurs with little ongoing overview of the business plan or operations. Monitored sources of funding include: loans from a bank, finance company, current employer, the Small Business Administration, and venture capital. Monitored funds are provided after a thorough and ongoing overview of the business plan and operations. We control for firm characteristics such as industry, business legal form, expected growth rate, expected size; and individual characteristics such as: education, industry experience, age, gender, and income.

Method

To account for survivor bias, we used a sample of 146 respondents from the Panel Study of Entrepreneurial Dynamics (PSED) who initiated their firm startup process within two years of the first interview. We generate descriptive and simple comparative statistics on individual and firm characteristics that influence the type and amount of financing these entrepreneurs expected to receive at the initial interview, and then acquired (or not) during the next three data collection waves.

Results and Implications

Nearly all entrepreneurs (94.6%) use personal funds and 34.2% use personal funds only during the startup process. While over half of the respondents expected to use unmonitored funding, 27.2% actually acquired this source. Business legal form, expected size of the firm, and intended growth rates were not correlated with expected uses of monitored or unmonitored sources of financing. Entrepreneurs who expected to use monitored sources of funding were not more likely to start a firm than others, but entrepreneurs who acquired external financing (monitored and unmonitored) were more likely to have started businesses or still be active in the startup process (60%), compared to only 39.6% of those using personal funds only. Founders using external financing used less of their own money as a proportion of overall funding.

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