SURVIVAL AND FINANCING OF BLACK OWNED START-UPS IN THE U.S. (INTERACTIVE PAPER)

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INTERACTIVE PAPER

SURVIVAL AND FINANCING OF BLACK OWNED START-UPS IN THE U.S.

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Principal Topic

In spite of an overall increase in minority self-employment, the difference between the percent of self-employed black and white Americans is still striking (11.6% vs 3.8% respectively). We examine whether the availability and types of financing are related to these observed differences, and whether the relative importance of financing methods changes when different stages of the entrepreneurial process are considered.

Our paper contributes to the existing literature by confirming that constraints in commercial financing are a likely cause of racial differences in business ownership. Differently from previous studies, our paper provides evidence based on a panel sample of startups rather than cross sectional data on established businesses and distinguishes between alternative forms of financing. Our paper also stresses the importance of human capital by adding owners’ efforts and correct for endogeneity issues between financing options and probability of failure.

Methods

We use data from the Kaufman Foundation which include 2,399 startups that were interviewed in 2005, 2006 and 2007. We focus on single-owner startups and have information on commercial financing, non-commercial financing, race, age, education, years of experience, hours of work per week, and startups’ distribution across industries and across regions. The panel structure of our data allows us to use a survival model describing the relationship between startups’ survival, financing, and other independent variables. Specifically, $\theta(t, x_{it}) = \theta_0(t) e^{\gamma x_{it}}$ is the hazard function describing the relationship between startup survival (hazard rate) and time, and the set $x_{it}$ of independent variables including financing resources.

Results

Our results suggest that, after controlling for the owners’ socio-economic background and business information, race is not a statistically significant factor for startups’ survival. Age and education, on the other hand, emerge as important. We also look at the effect of owners’ efforts (as a measure of human capital) by including the number of hours the owner devotes weekly to the startup. We find consistent results across different models showing that more hours to be linked to lower probabilities of going out of business. Finally, our results suggest that the use of commercial financing is associated with lower odds of going out of business. Among the various alternative, trade credit and business credit cards emerge as the two most important methods of financing.

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