Startup Financing Trends by Race: How Access to Capital Impacts Profitability

Annual Survey of Entrepreneurs Data Briefing Series

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This briefing explores startup financing trends and how access and cost of capital impact profitability. To do so, we use data from the Annual Survey of Entrepreneurs (ASE). The ASE, conducted by the U.S. Census Bureau, is the largest annual survey of American entrepreneurs ever done, and exists thanks to a public-private partnership between the Census Bureau, the Kauffman Foundation, and the Minority Business Development Agency.

The ASE samples approximately 290,000 employer businesses across all U.S. geographies and demographics, and tells the story of the American entrepreneur. Below are key findings for this briefing:

Sources of Startup Capital

- Entrepreneurs of all racial backgrounds rely on three primary sources of startup capital: 1) personal and family savings (63.9 percent of all employer businesses), 2) business loans from banks (17.9 percent), and 3) personal credit cards (10.3 percent).
- However, different racial groups rely on these sources in different ways. Asian entrepreneurs rely the most on personal and family savings (73.2 percent of Asian-owned businesses); white entrepreneurs rely the most on business loans from banks (18.7 percent); and black entrepreneurs rely the most on personal credit cards (17.6 percent).

Seeking Follow-on Financing

- Most businesses reported neither needing nor seeking additional financing—aside from startup capital—in the survey year.
- However, certain businesses reported not seeking additional follow-on financing beyond startup capital, despite needing it. The top two reasons were 1) not wanting to accrue debt (63 percent of businesses), and 2) thinking the businesses would not be approved by a lender (47 percent).
- Whites and American Indians were the demographic groups most likely to avoid additional financing in order to not accrue debt (64 percent and 63 percent, respectively). Native Hawaiians and Blacks were the most likely groups to avoid financing because they believed their businesses would be rejected by lenders (60 percent and 58 percent, respectively).

Access and Cost of Capital Impact on Profitability

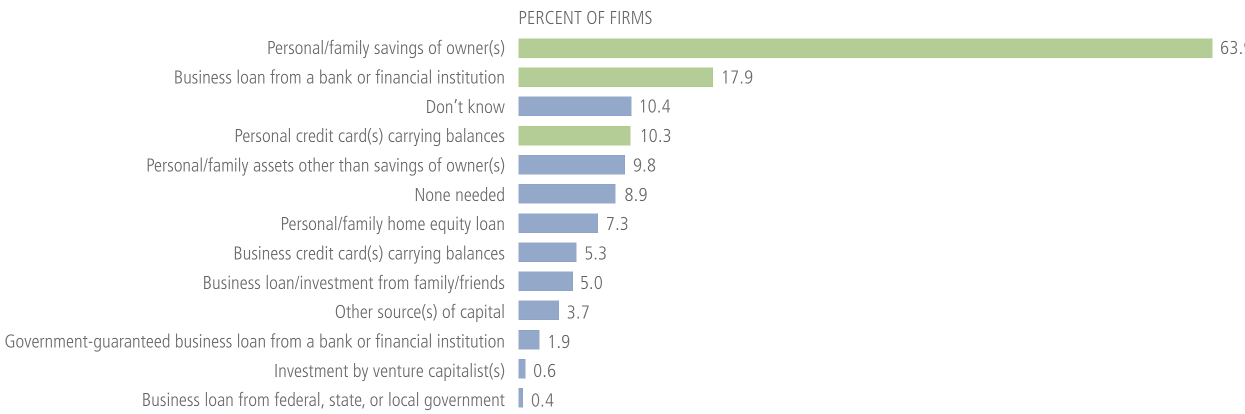
- Minorities are disproportionally hurt by the cost of and lack of access to capital. While approximately 16 percent of minority-owned businesses report profits being negatively impacted by the cost and lack of access, only about 10 percent of non-minority-owned businesses report the same.
- Black entrepreneurs, in particular, are almost three times as likely as whites to have profitability hurt by lack of access to capital and more than twice as likely as whites to have profits negatively impacted by the cost of capital.

Sources of Startup Capital—
How Entrepreneurs Fund Their Businesses

The top three sources businesses use most for startup capital or initial acquisition capital are (Fig. 1):

- Personal/family savings of owners: 63.9 percent of all employer businesses
- Business loan from bank or financial institution: 17.9 percent of all employer businesses
- Personal credit card(s) carrying balance: 10.3 percent of all employer businesses

Figure 1: The top three most-used sources of startup capital are personal savings, businesses loans, and personal credit cards.

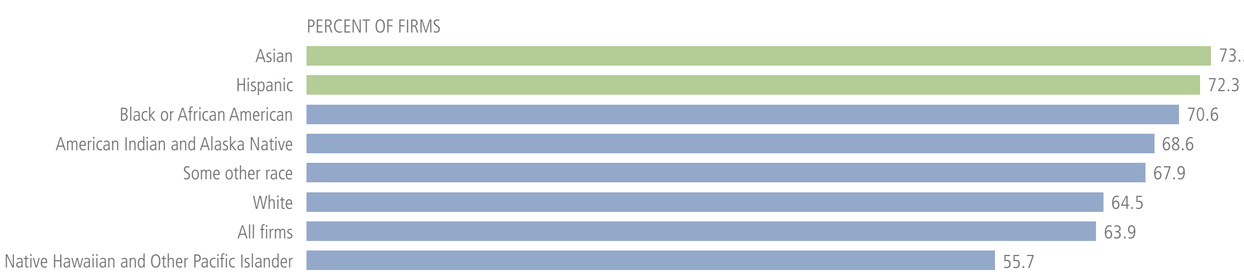


Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

For an interactive profile of sources of startup capital for each racial group, please look for "Annual Survey of Entrepreneurs" at growthology.org.

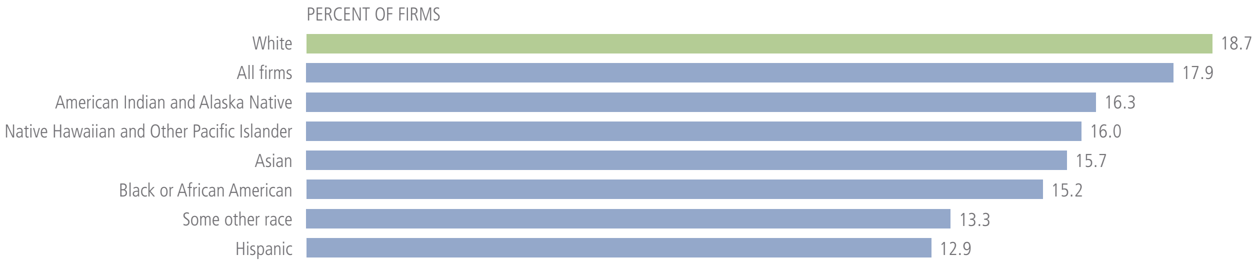
While all racial groups use these top three sources of capital extensively, they rely on them to different extents.

Figure 2: Asian and Hispanic entrepreneurs rely on personal and family savings the most as a source of startup capital.



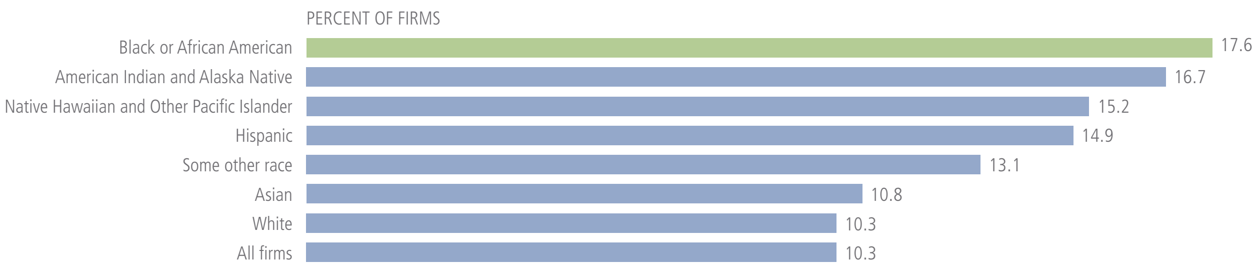
Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

Figure 3: White entrepreneurs rely the most on business loans from banks or other financial institutions as a source of startup capital.



Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

Figure 4: Black entrepreneurs rely the most on personal credit cards to fund new companies or acquire existing ones.



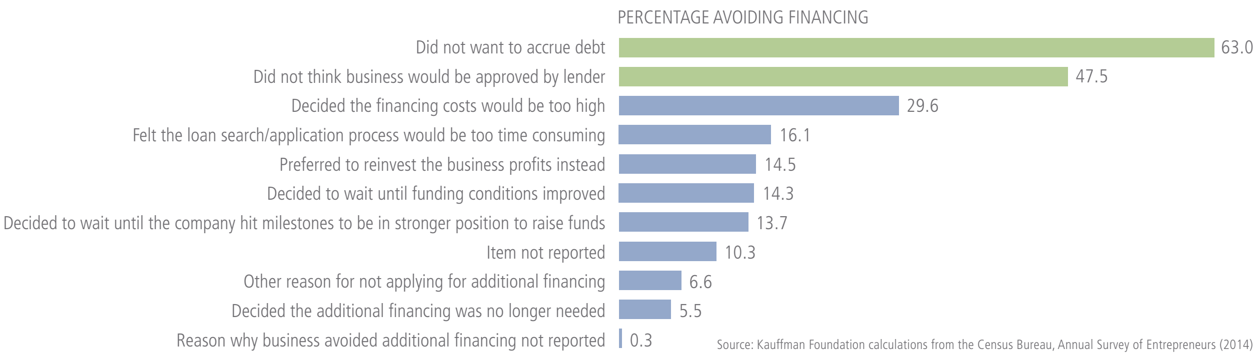
Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

For an interactive side-by-side comparison of how each group of entrepreneurs uses different sources of capital, please look for "Annual Survey of Entrepreneurs" at growthology.org.

Follow-On Funding—Financing a Business's Post-Startup Phase

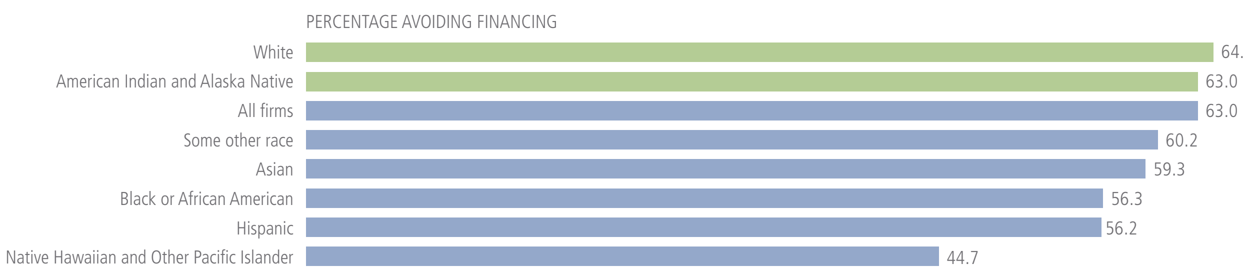
Of the businesses that needed additional capital but chose not to pursue it, the two most common reasons were 1) not wanting to accrue debt and 2) not thinking the business would be approved by the lender. You can see the full list in Figure 5 below. A breakdown by racial groups on these two top reasons is shown in Figures 6 and 7.

Figure 5: Not wanting to accrue debt and not thinking the business would be approved by a lender were the two primary reasons businesses that needed additional financing did not apply for it.



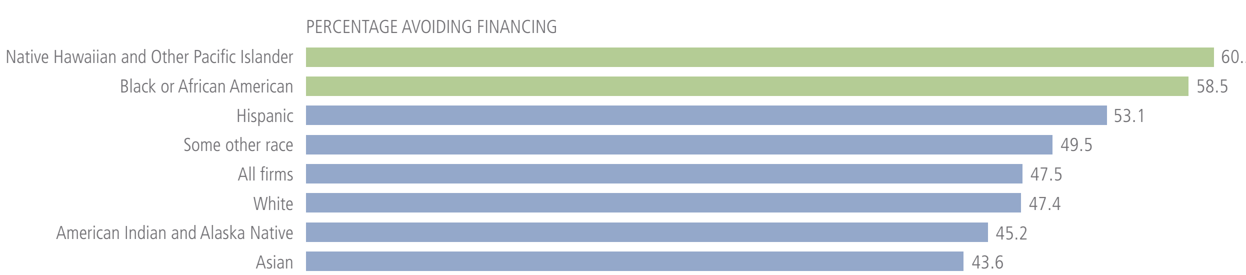
Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

Figure 6: White and American Indian entrepreneurs were the two most likely groups to avoid seeking needed additional financing in order to not accrue debt.



Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

Figure 7: About six in ten Native Hawaiian and Black entrepreneurs who did not seek additional financing despite needing it did so because they thought the business would not be approved by a lender.

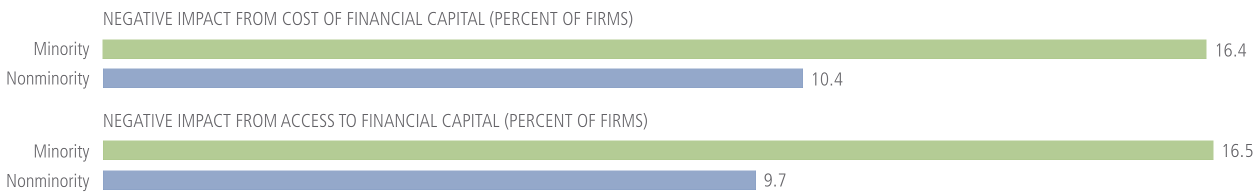


Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

Access and Cost of Capital—Impact on Profitability

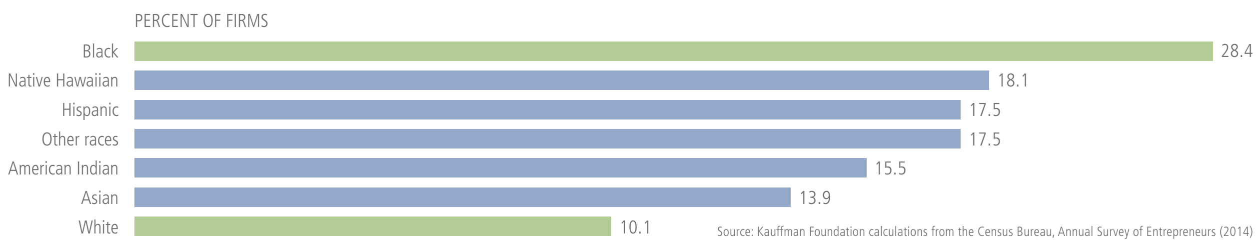
Business owners reported many drivers negatively impacting profitability. Two drivers were associated with capital formation: 1) access to financial capital and 2) cost of financial capital. The data show the profits of minority-owned businesses being disproportionally impacted by access and cost of capital.

Figure 8: Sixteen percent of minority-owned businesses report profits being negatively impacted by lack of access to and cost of capital, compared to only about 10 percent of non-minority-owned businesses in the same period. Black entrepreneurs, in particular, are most affected.



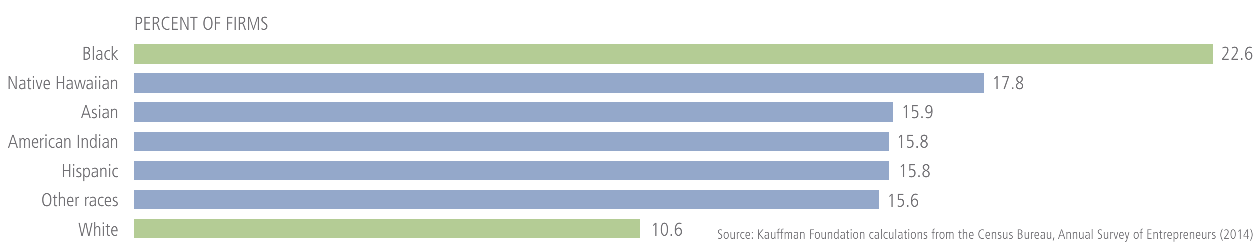
Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

Figure 9: Black entrepreneurs are almost three times more likely than whites to have profits negatively impacted by access to capital.



Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

Figure 10: Black entrepreneurs are more than twice as likely to be negatively impacted by the cost of capital.



Source: Kauffman Foundation calculations from the Census Bureau, Annual Survey of Entrepreneurs (2014)

About the Data

The Annual Survey of Entrepreneurs is the largest annual survey of entrepreneurs ever done in the United States. It documents the story of American entrepreneurs, providing more frequent and extensive data than previously available. The survey, conducted by the Census Bureau, exists thanks to a major public-private partnership among the U.S. Census Bureau, the Kauffman Foundation, and the Minority Business Development Agency. The Annual Survey of Entrepreneurs will supplement the Survey of Business Owners (SBO), conducted every five years.

The Annual Survey of Entrepreneurs provides a timely, more frequent socio-economic portrait of the nation's employer businesses by gender, ethnicity, race, and veteran status. It includes a relevant topic not found in the SBO: the number of years a firm has been in business. It also includes extensive geographical coverage, with data at the national level, all fifty states, and the fifty largest metropolitan areas in the country.

This survey collected data from a sample of approximately 290,000 employer businesses that were in operation anytime during the survey year. The collected data in a sample survey are subject to sampling variability, as well as nonsampling errors. Sources of nonsampling errors include errors of response, nonreporting, and coverage. For more information about the survey, including design, methodology, and data limitations, see www.census.gov/programs-surveys/ase.html.

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