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Small Business Research Summary

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Access to Capital among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms

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Purpose

The availability of capital is crucial for small business startup, survival, and growth. This study investigates how the youngest small firms operated and were financed during the evolving financial environment of the recent Great Recession, especially high-tech firms and firms owned by women and minorities.

Background

The major constraint limiting the growth, expansion, and wealth creation of small firms—especially women- and minority-owned businesses—is inadequate capital. Because of their size, these small firms typically have almost no access to external funds from public markets and are bank dependent. Small firms have little or no collateral and, as relatively young firms, lack an extensive history from which future firm or management performance can be surmised, even though the firm may have high growth potential. Research also shows that bank lending is adversely affected by a tightening of monetary policy, regulatory changes that tighten capital requirements, and bank capital crunches.

Studies indicate that women entrepreneurs have less access to financial capital or make less use of it than male entrepreneurs. Research shows that the characteristics of women-owned firms may help explain why women obtain smaller loans, pay higher interest rates, must put up higher collateral, and are dissatisfied with the bank loan process.

For instance, younger and smaller businesses, as women-owned businesses typically are, tend to be less favored by bankers, regardless of the gender of the owner.

On the equity side, women typically have limited social interaction with venture capital firms, and are under-represented among fast-growth and high-tech businesses. They also rely more on informal funding methods and self-financing. These characteristics may help explain the gender disparity in access to capital.

For many minorities, starting out at lower wealth levels also acts as a barrier to entrepreneurship.

Policy Implications

- Skill development and training have a critical role in improving the economic performance of women and minority entrepreneurs; targeted initiatives might help them build more viable businesses.
- Encouraging enrollment in science, technology, engineering, and math disciplines is another option for women and minority prospective entrepreneurs.
- Developing and expanding networks can help women and minority business owners access needed resources such as financial capital.

Overall Findings

High tech firms had higher levels of financial capital; surprisingly, they were more dependent on formal debt financing than were similar firms that were not high tech firms at the start-up phase and in subsequent years before and during the financial crisis.

Both women- and minority-owned businesses (African American- and Hispanic-owned firms) showed some similar disparities in their capital structure relative to firms owned by men and non-minorities. They used a different mix of equity and debt capital and were more reliant on owner equity investments. The average women- or minority-owned business operated with much less financial capital, even after controlling for other factors including credit score.

During the financial crisis period, many women and minority entrepreneurs of new startups were less likely to apply for a loan, fearing denial. The researchers controlled for some characteristics that were likely to affect bank borrowing, including legal form of organization, credit score, and type of business. The evidence showed that, compared with nonminority owners, minority owners of young firms were significantly less likely to have their loan applications approved.

Scope and Methodology

This study uses data from the Kauffman Firm Survey (KFS) to examine the financing patterns of young, minority-owned, women-owned, and high-tech firms. The KFS is a cohort of businesses that began operations in 2004 and were followed through 2010. The author used owner demographics at the firm level to define the gender and minority status of the primary owner. For firms with multiple owners, the primary owner was indicated by the largest equity share, and where there were two or more owners with equal shares, hours worked, along with other variables, were rank-ordered to identify a primary owner.

Both univariate and multivariate tests were used to examine the financial environment and capital access of these firms. Three models using logistic regression estimated separately the probability of (1) applying for a loan, (2) not applying for a loan when credit is needed for fear of loan denial, and (3) receiving a loan. Several control variables were utilized.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research by email at **advocacy@sba.gov** or by phone at (202) 205-6533.

Additional Information

The full text of this report and summaries of other studies of the U.S. Small Business Administration's Office of Advocacy are available on the Internet at **www.sba.gov/advocacy/7540**.

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