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The State of Access to Capital for Entrepreneurs:

From Barriers to Potential

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The Barriers

The Ewing Marion Kauffman Foundation believes every entrepreneur should have the supportive conditions necessary to envision, start, and grow a business. Entrepreneurship plays an important role in economic dynamism in the United States, contributing to the economy by creating jobs, innovations, and productivity growth. Lack of capital access is often cited as one of many barriers to individuals who want to turn an idea into an organized entity to deliver services, create a profit, or solve a problem.

The following information is excerpted from a forthcoming report exploring the current capital landscape to identify barriers facing underserved entrepreneurs.

What Do We Know?

Private institutional capital – bank lending and venture capital – dominate the capital landscape and receive the greatest attention in the research. Yet at least 83 percent of entrepreneurs do not access bank loans or venture capital. Almost 65 percent rely on personal and family savings for startup capital and close to 10 percent carry balances on their personal credit cards. [1]

- Top three sources of capital used by businesses for startup or initial capital are personal/family savings of the entrepreneur (64.4. percent), business loans from banks or financial institutions (16.5 percent) and personal credit cards (9.1 percent).
- Venture capital is used by 0.5 percent of entrepreneurs, supporting a small fraction of new businesses that can have outsized economic impact.

Existing capital market structure does not support the majority of entrepreneurs.

- Lack of credit availability is reported to be a top business challenge among 26 percent of startups, compared to 6 percent of mature firms[2].

Gender Barriers in lending and equity

- Women have been shown to use significantly less capital at start-up than men (in 2004: $54,375 for women vs. $80,285 for men)[3].

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[1] Kauffman Foundation (2019), using Annual Survey of Entrepreneurs 2016 data.
[2] Small Business Credit Survey (2014).
[3] Coleman and Robb (2009).

- Women are less likely to apply for bank loans, despite research showing they are no less likely to be approved[4].
- Private venture capital data showed that all-women founding teams raised about 2.2 percent of total VC funding in 2017 (accounting for under 5 percent of deals), compared with all-male teams raising about 79 percent and mixed teams raising about 12 percent[5]. Only about 9 percent of proposals submitted to angel investors came from women entrepreneurs[6].
- A recent study found that men were significantly more likely to secure funding than women when pitching the same business content.[7] Another study found that investors ask gendered questions, whereby men are asked about growth-oriented gains facilitated by capital and women are asked about non-losses.[8]

Race Barriers in lending and equity

- A recent study found that new black-owned businesses start with almost three times less in terms of overall capital ($35,205) compared with new white-owned businesses ($106,720). This disparity in capital investment declines but does not disappear even by the seventh year after startup[9].
- Median wealth (assets minus debts) fell between 2005 and 2009, and by 2009, median net worth of the typical black household was $5,677, compared with $6,325 for the typical Hispanic household and $113,149 for the typical white household.[10]
- Close to 15 percent of black entrepreneurs and 12 percent of Hispanic entrepreneurs report using a personal credit card, compared to a little over 9 percent for white and Asian-American entrepreneurs, to fund a new business or acquire an existing business[11].
- Racial bias persists in decision making processes in business and about investments[12]. Black entrepreneur's loan requests are three times less likely to be approved than white entrepreneurs. This difference persists even after accounting for credit scores and net worth of founders[13].
- A "mystery shopping" study in sixteen bank branches revealed discrimination against black business owners in bank lending practices: black testers were asked to provide more information about the business

[4] Coleman (2002); Treichel and Scott (2006).
[5] Zarya (2018), using Pitchbook data.
[6] Becker-Blease and Sohl (2007).
[7] Brooks et al. (2014)
[8] Kanze et al. (2017).
[9] Fairlie et al. (2017), using Kauffman Firm Survey data.
[10] Taylor et al. (2011).
[11] Kauffman Foundation (2019).
[12] Jost et al. (2009).
[13] Fairlie et al. (2017).

than white testers with nearly identical business profiles, including personal information that was not relevant to the business[14].

- The data show that minority entrepreneurs are disproportionately hurt by lack of access to capital. More than 1 in 5 (22.3 percent) of African-American entrepreneurs report that a lack of access to capital negatively impacted profitability. This is considerably higher than the rates for Hispanic (15.1 percent) and Asian-American (13.3 percent) owned businesses, and 2.5 times the rate of White owned businesses (8.9 percent)[15].

Historic Efforts to Help Entrepreneurs Access Capital

Few funding efforts to date have created systemic change.

Most efforts to increase firm formation and success have focused on supporting small business lending and venture capital.

- **People forming new and innovative capital vehicles are themselves entrepreneurs – termed as "capital entrepreneurs".** These capital entrepreneurs develop financial innovations that can reduce barriers entrepreneurs face in accessing capital. Some capital entrepreneurs are innovating with existing tools, such as venture capital and microlending. Others are creating new ways to deploy capital, from unorthodox fund structures to data-driven investment practices.
- **Capital entrepreneurs often lack community and best practices.** Many of these innovations, such as revenue-based investing or employee ownership, are showing promise, but capital entrepreneurs often lack professional standards, public awareness, communities of practice, and other basic market infrastructure elements.
- **Capital entrepreneurs face business challenges themselves.** Many efforts to support capital formation have failed because those seeking change have not recognized that capital entrepreneurs are entrepreneurs themselves who face their own particular barriers to entry, business model challenges, opportunities, and risks. While interventions have been developed to support entrepreneurs that need capital, few efforts have been developed to support new and innovative capital entrepreneurs.

[14] Bone et al. (2017).
[15] Kauffman Foundation (2019).

Infrastructure efforts have shown promise and could serve as interesting models for field-building efforts.

- **The creation of new industry standards and categories** could mitigate friction that limits the flow of capital to entrepreneurs (e.g., the impact of SWIFT codes and FICO scores in other financial markets).
- **Professional communities of practice** can serve as a way for practitioners to share knowledge more effectively, reduce transaction costs of doing business, and organize and clarify goals and objectives related to increasing access to capital.
- **New technologies may help increase the flow of capital and close market gaps.** Innovations that use technology and other strategies to make more and faster investments and develop new ways to select investments could expand the pool of capital for entrepreneurs.

Emerging Solutions

One potential area to improve entrepreneurs' access to capital is the building of capital markets infrastructure. This approach means that rather than creating and growing specific investment vehicles to invest directly into entrepreneurs, organizations with influence – such as large institutions, foundations, and governments – instead build market infrastructure that enables the marketplace of entrepreneurs and capital entrepreneurs to solve problems. The Kauffman Foundation has identified five types of infrastructure that show promise:

Capital infrastructure. Greater diversity of investment vehicles and intermediary financial institutions can be developed to successfully bridge the gap between money centers and the spectrum of entrepreneurs seeking capital.

People infrastructure. Capital entrepreneurs have the opportunity to develop new investment vehicles that provide access to the 83 percent of entrepreneurs who are not served by private institutional capital.

Information infrastructure. Enhanced data and technology can create stronger infrastructure and clearer standards for efficient market operations, speeding the flow of capital to a greater number of entrepreneurs.

Knowledge infrastructure. More targeted research can better inform efforts to improve capital access for entrepreneurs, by providing insight on the origins of capital market gaps and the effects of capital constraints on firms.

Policy infrastructure. Entrepreneurs and capital entrepreneurs need to be at the table to assert their voices when lawmakers and regulators are forming policies that affect the functioning of capital markets for entrepreneurs.