Funding New Business Ventures: Differences In Minority And Non-Minority Family-Owned Business' Access To Start-Up Capital

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Abstract

Access to start-up capital is important in starting any business venture. In addition, the source of that start-up capital can sometimes affect the prospects for success in the new business venture. This study examines the differences in the source of start-up funds between male minority and male non-minority family business owners. The findings indicate that male minority family business owners more often use credit cards and gifts from family as a source of start-up funds whereas the male non-minority family business owners rely more often on bank loans. The authors propose a more extensive survey of a larger sample of family business owners in order to further identify differences in source of start-up capital between male minority and male non-minority family business owners.

1. Introduction

Entrepreneurship and the related areas of business ownership and self-employment have been studied for decades by social scientists. The Marxist's theory of capitalism places specific emphasis on business ownership and the role it plays in a capitalist society (Steinmetz and Wright, 1989). The last decade has seen an unprecedented resurgence in the number of research studies in the area of entrepreneurship, business ownership and self-employment (Haynes and Helms, 2000; Lee, 1999; Gimeno, Folta, Cooper and Woo, 1997; Uzzi, 1999; Goldenberg and Kline, 1999). The conceptual foundations, research design and findings from these studies are as varied as the areas they explore.

Several of the studies have addressed the area of women entrepreneurship (Oppedisano, 2000; Renzulli, Aldrich and Moody, 2000; Moore and Buttner, 1997). Others have looked at the international perspectives on entrepreneurship, sometimes encompassing a focus on immigrant entrepreneurs (Light and Rosenstein, 1995; Pope, 2002; Lee, 1999; Gorriz and Fumas, 1996). Still others have detailed the importance of continuing to study an area that is often researched – that of male entrepreneurship (Fairlie, 1999; Bates, 1995; Bates, 1997a and 1997b). This study continues in the latter study's vein with an additional analysis on ethnicity of the business owners. It looks at family owned male enterprises and re-focuses on the entrepreneur's access to financial capital. The study performed a comparative analysis of white and minority male business owners and looked specifically at four key areas. Namely, the business owners' initial access to financial capital, the source of the start-up capital, the ability to obtain a bank loan to finance their businesses and the initial dollar amount of start-up capital.

Readers with comments or questions are encouraged to contact the authors via email.

2. Definitions and Clarifications

The businesses analyzed in this research study were family owned businesses. In searching for a definition for a family business owner, one can borrow from definitions of the small business owner since in both entities the owner is heavily involved in the day-to-day operation of the business. The Small Business Act states that a small business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its operation (US Small Business Administration, 1978). A small business owner is thus the person who owns such a business entity. A business owner can also be defined as an individual who has a financial capital investment in a business that is greater than $0 and annual sales/revenue of at least $1000 (Bates, 1995; Devine, 1994).

Carland, Hoy, Bolton and Carland, (1984) have alternatively defined a small business owner as an individual who establishes and manages a business for the principal purpose of furthering personal goals. The business must be the primary source of income and will consume the majority of one's time and resources. The owner perceives the business as an extension of his or her personality, intricately bound with family needs and desires (Carland et al, 1984). In a similar vein, an entrepreneur can be defined as an individual who perceives an opportunity and partakes in the necessary functions, activities and actions associated with the creation of an organization to pursue that opportunity (Bygrave and Hofer, 1991; Gartner, 1988; Sexton and Smilor, 1986).

3. Literature Review

One of the earlier studies to look comparatively at the financial status of minority versus non-minority owned businesses was done by William Scott (1983). The author used data from Dun and Bradstreet to evaluate the comparative performance of minority and non-minority firms in terms of profitability, indebtedness and liquidity (Scott, 1983). The study looked at firms in all industries and takes the data from eight states with the largest concentration of minority firms. The financial ratios analyzed included: return on asset, current ratio and debt/net worth ratio. The author concluded that minority firms that did not receive assistance from the Minority Development Agency had the same performance characteristics as non-minority firms in regards to profitability, indebtedness and liquidity (Scott, 1983).

Timothy Bates, a long-time advocate and researcher of the business owner in general and the minority business owner in particular, has also conducted several studies that performed comparative analyses. Two that appear most relevant to the current research were done in 1989 and 1991. Bates' 1989 study used the United States' Characteristics of Business Owners' Survey for 1987 to analyze three groups of business owners: Asian males, Black males and non-minority males. A survey form was sent to self-employed individuals and by design, minorities were over-represented (Bates, 1989).

The author looked at a numbers of issues for the enterprises, including access to financial capital, profitability and size of the business (Bates, 1989). Bates concluded that of the three groups, Asians had the largest start-up capital, followed by non-minorities and then Blacks. For the total sample of non-minority males, over 32% received bank loans, compared to 26.8% as a corresponding figure for Blacks. In addition, the combined total of all loans from family and friends accounted for 44.9% of all loans to Asian firms, versus 27.1% of loans to non-minority firms and less than 25% for Blacks. Another major finding to emerge from the research data indicated that the firms which had greater access to financial capital at the start-up stage of the business, developed into more profitable enterprises (Bates, 1989).

In a study two years later, Bates looked at commercial bank financing of small businesses owned by blacks and whites (Bates 1991). The author again used the United States Characteristics of Business Owners Survey, analyzing the 1982 version. The results of the study indicated that commercial banks, the largest single source of debt for black business start-ups, extend generally smaller loan amounts to black and that black business start-ups possess, on average, less equity capital and operate smaller and less viable enterprises compared to their white counterparts, (Bates, 1991). The results further indicated that blacks get smaller bank loans when compared to their white counterparts who possessed identical equity capital investment and educational backgrounds (Bates, 1991). The author concluded that blacks were severely limited to credit market access due to discriminatory practices and not their riskier potential or default likelihood (Bates, 1991).

More recent research in the area of business ownership has reached similar conclusions to that above (Bates, 1997a; Bates, 1997b; Light and Rosenstein, 1995). The overall consensus is that minority business owners consistently are at a disadvantage in terms of the amount of start-up capital and access to financial resources, especially of a commercial nature (Bates, 1997a; Bates, 1997b; Light and Rosenstein, 1995).

Other related studies to comparatively analyze two separate groups of entrepreneurs were done by Buttner and Rosen (1988,1989). In both instances, the authors looked at male and female entrepreneurs to see if banks and other lending agencies were biased against the women entrepreneurs. The findings reached were at different ends of the continuum. In the 1988 study that asked bank loan officers to rate male and female entrepreneurs, the results indicated that the loan officers were more likely to rate the male entrepreneurs positively on factors that evaluated business success compared to their female counterparts. In the second study, Buttner and Rosen found that female and male entrepreneurs were not rated differently in regards to preferences for access to financial capital (Buttner and Rosen, 1989).

Studying the access of businesses to financial capital remains an important issue. A few studies have lamented the debt-ridden status and low performance abilities of some start-up businesses in general (Cressy, 1996; Brudel, Ziegler and Preiseendorfer, 1992; Jefferson, 1997) and minority businesses in particular (Bates, 1985; Hisrich and Brush, 1986; Van Auken and Horton, 1994; Fairlie, 1999; Bates and Osborne, 1979).

The current study borrows somewhat from previous research in the area of business ownership, analyzing the financial status of white and minority male business owners. The study conducted and the eventual results are significant in three basic respects. First, the businesses analyzed are concentrated in the personal services and manufacturing industry. Industries found to have the most (personal services) and the least (manufacturing) amount of minorities by the United States Census Data (1997). Analyzing firms on these two different areas can emphasize the sharp differences between the two sample groups. Second, the study looked at family owned businesses and not franchise enterprises or larger corporations. The latter might experience less difficulty in securing access to financial capital. Finally, the study traces the link between access to start-up capital, the amount of start-up capital and the source of the start-up capital.

4. Design of the Study

A questionnaire was designed to obtain information anonymously from family owned businesses associated with the Siena College Family Business Institute and the Albany-Colonie Regional Chamber of Commerce. The survey asked questions about the type of business, percentage of ownership, difficulty in obtaining start-up capital, source of start-up capital, number of employees, education and ethnicity of the owner, gross revenue, net revenue, and personal income. All responses were categorical.

A total of 36 surveys were returned by the family business owners. 18 of the owners were non-minority (Caucasian) and 18 were minority (17 African-American and 1 Hispanic). All respondents, by design, were male.

The nonparametric Mann-Whitney U Test was performed on all questions, using ethnicity as the grouping variable. This statistical test is the nonparametric counterpart of the independent two-sample t-test. It uses a two-sample rank test to compare two population medians. It is used to compute the corresponding point and confidence interval estimates of the difference between the two medians.

5. Results and Analysis

The results indicated that on average the minority male business owners were older (50 years old) compared to their white counterparts (48 years old). However, the difference in ages is not statistically significant. These findings are in keeping with those from Scott (1983) and Bates (1989, 1991). The results of applying the Mann-Whitney U Test indicate statistically significant differences (at the .05 level) between minority and non-minority family business owners for the following:

- difficulty in getting a bank loan
- source of start-up funds
- number of employees
- gross revenue
- net profit
- personal income
- type of business

Most of the minority respondents were engaged in personal service businesses (accounting, hair stylist, photography, funeral services) whereas the non-minority respondents were engaged in manufacturing and distribution.

The minority business owners reported having a “very difficult” time getting a bank loan as compared to the non-minority owners reporting that it was “not difficult” to “somewhat difficult” to obtain a bank loan. The source of funds for start-up differed between the two groups of respondents as well. Table 1 shows the distribution of sources of start-up funds by ethnicity.

Table 1: Source of Start-Up Funds by Ethnicity

Source	Minority	Non-Minority
Personal Savings	4	9
Loan from Family	2	2
Gift from Family	4	0
Credit Card/Personal Loan	4	0
Bank Loan	4	7

There is a statistically significant difference in the number of employees between the two groups. This is mainly due to the difference in the type of businesses that predominate in each group surveyed. The minority owners tended to have personal services business such as accounting practices, hair stylist, photography studios, and funeral director. In addition, these businesses had not grown to include multiple sites and/or practices. The non-minority owners tended to have manufacturing and distribution businesses that grew over the years to include many more employees than when they started.

The statistically significant differences in gross revenue and net profit are mainly a function of the size of the enterprises. Once again, the non-minority owned businesses tended to be much larger than the minority owned businesses (as measured by number of employees). Thus, one would expect gross revenue to be greater. The same could be said for net profit although that is certainly not always the case.

Finally, personal income of the non-minority respondents was significantly higher than the minority respondent’s personal income, probably for much the same reason. Owning a larger enterprise would generally be associated with a larger personal income.

6. Conclusions

One basic conclusion can be reached from this study. This conclusion is based partly on the results of the study and partly on inferring what the results mean. Although we think this conclusion is significant in its own right, we also feel that this pilot study bears a follow-up with a more substantial and directed set of questions designed to shed more light on a number of items related to access to start-up funds, type of business enterprise an entrepreneur chooses, and ethnicity.

The current study mirrors those from Scott (1993) and Bates (1989, 1991). This study has also gone a step further than previous studies, by showing that difficulty in obtaining a bank loan affects the source and thus the amount of the start-up funds for the family business owners. The minority male business owners, who had difficulty in obtaining bank loans, experienced the previously mentioned chain of events and were ultimately seen to operate less profitable enterprises.

The differences between minority and non-minority family business owners in the source of start-up funds could explain why most of the minority family business owners who responded to the survey started personal service businesses. The start-up funds needed for personal service businesses are generally smaller than the funds needed to start a manufacturing or distribution enterprise. Therefore, manufacturing and distribution entrepreneurs must find a source of substantial funds for start-up. This usually means some kind of bank loan.

Perhaps the minority family business owners are starting personal service businesses because this is the only type of business that can be started with the limited start-up funds available to them. While this is an inference based on the results, it bears further study.

7. Future Work

The authors are planning to survey a larger number of family business owners and will focus the survey on questions related to items such as access to start-up funds, type of business enterprise started, and ethnicity. Although previous studies have been made in with regard to these questions, no one has focused exclusively on family businesses. Therefore, the authors feel a further study will add to the literature on small business ownership, specifically family owned businesses. 🕮

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Notes