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Ethnic Discrimination in the Market Place of Small Business Transfers

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Abstract

This paper presents the first field experiment regarding ethnic discrimination in the market place of small business transfers. We let two fictitious prospective buyers, one with a typical Swedish name and one with a typical Arab/Muslim name, respond to advertisements of small business transfers on the Internet in Sweden. We then recorded the number contacts achieved by each fictitious buyer with sellers. We found that sellers discriminated against the buyer with an Arab/Muslim name in the sense that the buyer with an Arab/Muslim name obtained fewer contacts with sellers than did the buyer with a Swedish name.

1. Introduction

Civil rights laws prohibiting discrimination against ethnic minorities exist for many domains and in most western societies. Research concerning ethnic discrimination has, however, been mainly focused on the labor and housing market where discrimination has been perceived to be particularly acute and harmful. Ethnic discrimination in much broader range of markets has been left uncovered in the literature of discrimination. Employment and housing may be the two most important markets in which people participate, but ethnic minorities may also be susceptible to discrimination in other significant markets. This paper examines whether the process of buying and taking over a small business disadvantages ethnic minorities.

It is a well known fact that ethnic minorities often suffer from higher unemployment rates than the native population and have a hard time entering the labor market. One important way out of unemployment for these exposed groups of minorities has been to start up their own business or take over an existing business and become self-employed. This is reflected by the fact that many OECD countries have experienced an increase in immigrant self-employment rates during recent years. As a result, ethnic minorities are over-represented in self-employment in several countries today.[1]

Research regarding immigrant self-employment has often focused on its determinants, and possible explanations to why immigrants should prefer self-employment to wage-employment have been put forward in the literature. Furthermore, research has also shown that self-employed immigrants in many countries have lower earnings than self-employed natives. The low earnings among self-employed immigrants are often explained by the existence of consumer discrimination (Borjas and Bronars, 1989).

Research regarding immigrant self-employment has, however, neglected the fact that people can become self-employed either by starting a brand new business or by buying an already existing business. There are several reasons for why buying an already existing business may be a more favorable way to become self-employed compared to starting a brand new business. For instance, buying an already existing business gives the possibility to take over the existing business customer potential. Further, if it is a profitable business, the new owner gets an income stream right away. Also, banks would probably finance buying an existing business, but are more cautious to finance starting a new business. Thus, among individuals who decide to become self-employed, there are good reasons to believe that individuals who are buying an already existing business have an advantage compared to those who are starting a brand new business.

We then ask the following question: Do ethnic minorities have the same opportunities to buy an existing business in the market place of small business transfers? To address this question we study ethnic discrimination in the market place of small business transfers in Sweden with the help of a field experiment on the Internet. We conducted our field experiment by letting two fictitious prospective buyers, one with a typical Swedish name and one with a typical Arab/Muslim name, respond to advertisements of small business transfers

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[1] For studies from the United States, see Borjas (1986), Yuengert (1995), and Fairlie and Meyer (1996). For studies from European countries, see Clark and Drinkwater (2000), Constant and Zimmermann (2006), and Hammarstedt (2001, 2006). For studies from Asia and Australia, see Fernandez and Kim (1998) and Le (2000).

on the Internet in Sweden. The outcome variable in our experiment was the number contacts that each fictitious buyer achieved with business sellers. We found that sellers discriminated against buyers with an Arab/Muslim name in the sense that the buyer with an Arab/Muslim name obtained fewer contacts with sellers than did the buyer with a Swedish name.

Sweden happens to be a suitable testing ground for conducting a field experiment like this since Sweden has a relatively sizable immigrant population. About 12 percent of Sweden's population is made up of immigrants. There are different reasons for choosing an Arabic/Muslim and a Swedish name when conducting the experiment. First, a relatively large part of the immigrant population in Sweden is made up of immigrants from the Middle East. About 20 percent of the immigrant population is originating from countries in the Middle East or Northern Africa. Second, immigrants from Arabic/Muslim countries in Sweden, just as in many other OECD countries, suffer from high rates of unemployment and often have a hard time entering the labor market. Third, immigrants from countries in the Middle East are over-represented in self-employment compared to natives as well as compared to other immigrant groups in Sweden today. But it is well known that especially self-employed immigrants from the Middle East often have low earnings and that their businesses have lower survival rates than businesses established by natives (Andersson-Joona, forthcoming). Therefore, if we can document ethnic discrimination in the market place for small business transfers we have identified a barrier for successful ethnic self-employment and one explanation for the low earnings and low survival rates often observed among self-employed Middle Eastern immigrants.

It is relevant to ask why there is reason to expect differential treatment of people on account of their ethnicity in the market place of small business transfers. For incumbent owners, the business to be transferred is often the achievement of their life. They are therefore likely to attach emotional value to the business. Some researchers have stressed that the inability of a seller to "let go" of the business is a significant obstacle to effective business transfers.[2] It is therefore reasonable to believe that incumbent owners are careful when choosing a successor for their business. Incumbent owners may therefore discriminate buyers from an ethic group if they possess prejudiced attitudes toward that group of people. They will then discriminate those buyers to avoid dealing with them and handing over the business to them. Another reason for incumbent owners to discriminate is because of the prejudiced attitudes of the group of customers that supplies most of their business. These two hypotheses about the causes of discrimination by sellers are derived from the preference-based theory of discrimination (Becker, 1957).

Another hypothesis for differential treatment by sellers can be derived from the statistical theory of discrimination (Phelps, 1972). In this case discrimination may exist if incumbent owners treat potential buyers from different groups differently because they believe that easily observable attributes, such as ethnicity, are correlated with some unobservable characteristics that are known to differ among groups. For example, an incumbent owner may believe that certain ethnic minority groups are less successful in running businesses or have less capacity to obtain finance for a business transfer and therefore

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[2] See, for example, Barach and Gantisky (1995) and Sharma et al. (2001).

disregard them as potential buyers. The remainder of the paper is organized as follows: The methodology of the experiment is discussed in section 2, results are presented in section 3, and the conclusions are drawn in section 4.

2. Methodology

To test whether there is disparate treatment by sellers on the basis of ethnicity in the market place of small business transfers, pairs of fictitious prospective buyers, one with a typical Arab/Muslim male name and one with a typical Swedish male name, used similar approaches to establish a contact with business sellers who had advertized their businesses on the Internet. Hence, our test measured differences in contact rates between the buyer with an Arab/Muslim name and the buyer with a Swedish name. Using the Internet gave us the advantage of being able to use written response letters rather than personal approaches, such as, telephone calls, thereby avoiding the potential problems that may arise from personal appearances (Heckman, 1998). Experiments with written correspondence have previously been used to test for discrimination in the labor and housing markets.[3]

The experiment was carried out in September and October, 2008. During this period we responded to all adverts with small businesses for sale on Blocket.se. This is one of the largest buy-and-sell sites in Sweden where the market place for business transfers is an active segment. Business owners can announce their businesses for a negligible advertisement cost and there is no charge for interested buyers to respond to an ad. If a buyer is interested in a particular item, he or she can send a message to the seller through an email form. The only information that is required to fill is his or her name, email address, and a short message of interest. Thus, the purpose of this website is to initiate a first contact between sellers and prospective buyers.

Without any restrictions regarding location and price, we responded, as a buyer with an Arab/Muslim name and as a buyer with a Swedish name, to all advertized businesses during the period. We recorded the time, date, heading of the ad, city, the gender of the seller, whether the seller had a foreign-sounding name, and the selling price. As outcome variables we recorded whether sellers emailed back or not. If they emailed back, we the also recorded whether the sellers were positive, in the sense that they invited to and welcomed further contacts and asked for more information about the buyer.

Before we could run the experiment, we needed to create identities for two fictitious buyers, one with an Arab/Muslim name and one with a Swedish name. There was no need for telephone numbers and postal addresses since all correspondence was accomplished through email. The only information required when answering an ad was a person's name and an email address to which a seller could reply. For the Arab/Muslim buyer we used the name Mohammed Rashid which is a typical Arab/Muslim male name, and for the Swedish buyer we used the name Fredrik Svensson which is a typical Swedish male name. Next we registered email addresses for the sellers.[4]

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[3] See, for example, Bertrand and Mullainathan (2004) for an experiment in the labor market and Ahmed and Hammarstedt (2008) for an experiment in the housing market.

[4] Email accounts were created under the addresses mohammed.rashid@spray.se and fredrik.svensson@yahoo.se.

Another important part in the experimental design was to generate response letters. In order to let both buyers respond to all ads and to minimize the risk of being exposed we generated two different formulations of a response letter with similar content. We put together concise letters that only stated a notification of interest. For example, one of the letters was formulated as following:

> *Hi, my name is Mohammed Rashid (Fredrik Svensson). I saw your advertisement of a business transfer. It sounds interesting and I would like to establish further contact with you. Look forward to your response. Mohammed Rashid (Fredrik Svensson)*

The only thing that differed between buyers was whether they had an Arab/Muslim or Swedish name.[5] Obviously, the two buyers never responded to the same ad with letters that were identical in the wording. Each of the two formulations was used half of the time for each buyer. We also controlled for the order of the responses from our two buyers. Thus, half of the time the buyer with an Arab/Muslim name was first to respond to an ad and half of the time the buyer with a Swedish name was first to put in a respond.

Before we turn to the results of the experiment we want discuss some of its limitations that the reader should keep in mind when interpreting the results. First, our outcome variable is quite simple. Ultimately, one wants to know whether a prospective buyer gets to buy a business and about the price paid conditional on that the business is transferred. We simply measure a contact rate, i.e., whether or not sellers reply to our fictitious buyers' responses. One could expect that reduced contact rates could render into reduced business transfer offers. However, we are unable to interpret our results into differences in the number of businesses transferred or gaps in prices paid for businesses.

Second, we did not directly indicate ethnicity, but signaled it through the names that we had created for our fictitious buyers: this could cause problems. Some sellers who we responded to may not have noticed the names or recognized the ethnic content of the names of the fictitious buyers. Third, it was difficult for us to record the full identity and characteristics of the business sellers. Even if information had been available, it would not have been fully reliable since the anonymity granted by the Internet means that buyers advertising businesses could have created artificial identities. A related problem is that sellers might have discussed their decisions with others so that, in some cases, the decision-maker may not have been an individual, but more than one person.

Finally, the Internet is only one of several channels that could be used for a small business transfers. Other common channels are newspaper ads and social networks that we clearly did not include in our study. This exclusion could have qualitatively influenced our results, if the reality is that Arabic/Muslim buyers typically use other search channels than Swedish buyers. Also, the results might have been affected if business sellers who advertise on the Internet discriminate either more or less than business sellers who use other channels for advertising business transfers.

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[5] The other response letter is available from the authors upon request.

Table 1

Percent (fraction) of responses that led to a contact and percent (fraction) of responses that led to a positive contact

	Arab/Muslim	Swedish	Ratio	Paired difference test
Contact	67.4	75.5	1.12	$p < 0.001$
	(368/546)	(412/546)	(412/368)	
Positive contact	64.7	73.8	1.14	$p < 0.001$
	(353/546)	(403/546)	(403/353)	

Note: The *p*–values are reported for a two-sided paired sample *t*–test for differences in average contact and positive contact rates.

3. Results

Does discrimination exist in the market place of small business transfers? We devote the following section to this question. Both of our fictitious buyers responded to 546 ads. Table 1 presents the average contact rates for the buyer with an Arab/Muslim name and for the buyer with a Swedish name, given in percentages. Included in the brackets beside each rate is the actual number of cases out of the total 546. The first row in Table 1 (Contact) presents the percentage of responses that resulted in a contact, regardless of whether it was a positive or a negative. The second row (Positive contact) gives the percentage of responses that resulted in a positive contact from the seller, that is, cases where the seller invited our buyers to further contact.

In Table 1 shows that the buyer with an Arab/Muslim name had a 67 percent chance that their responses to sellers' ads resulted in a contact. The corresponding percentage for the buyer with a Swedish name was about 76 percent. Similarly, 65 percent of the responses from the buyer with an Arab/Muslim name and 74 percent of the responses from the buyer with a Swedish name led to a positive contact (meaning that the sellers invited the buyers to provide more information and welcomed further contact). The paired differences test rejects the null hypothesis of no ethnic discrimination in the market of small business transfers at better than the 0.1 percent level.

In Table 1 we tabulated the distribution of contact rates at the buyer level. In Table 2, we computed the percentage of sellers that did not contact either of the buyers (given by the column None), the percentage of sellers that contacted both of the buyers (given by the column Both), the percentage of sellers that only contacted the buyer with an Arab/Muslim name (given by the column Only Arab/Muslim), and the percentage of sellers that only contacted the buyer with a Swedish name (given by the column Only Swedish). What is of interest in Table 2 is to observe if there is symmetry between the proportion of sellers that only contacted the buyer with an Arab/Muslim name and the proportion of sellers that only contacted the buyer with a Swedish name. If p_a equals the probability that the sellers only contacted the buyer with an Arab/Muslim name, and p_s equals the probability that the sellers only contacted the buyer with a Swedish name, then, the null hypothesis of symmetric treatment is $p_s/(p_s + p_a) = \frac{1}{2}$.

Table 2
Distribution of contact rates in percent (number of cases within parentheses)

	None	Both	Only Arab/Muslim	Only Swedish	Symmetry test
Contact	18.7 (103/546)	61.7 (337/546)	5.7 (31/546)	13.7 (75/546)	$p < 0.001$
Positive contact	2.1 (7/337)	95.3 (321/337)	0.6 (2/337)	2.1 (7/337)	$p = 0.180$

Note: The *p*–values are reported for a two-sided McNemar test of symmetry between the proportion of sellers that favored the Arab/Muslim buyer and the proportion that favored the Swedish buyer. We also conducted the binomial sign test, resulting in the same *p*–values.

As Table 2 indicates, we reject the hypothesis of symmetry for the outcome variable Contact but not for Positive contacts. This suggests that discrimination against the buyer with an Arab/Muslim name occurred in the first stage, meaning that those sellers who discriminated against the buyer with an Arab/Muslim name did so by simply ignoring his responses. Sellers who chose to contact both buyers did not discriminate against the buyer with an Arab/Muslim name in respect to positive contacts.

Finally we end this section by calculating the net incidence of discrimination for the outcome variable Contact. This can be done in two ways depending on whether the cases where none of the buyers were invited (given by the column None in Table 2) are treated as observations of equal treatment or as non-observations. If we treat these cases as observations of equal treatment net incidence of discrimination is equal to the percentage of *all* sellers that only contacted the buyer with a Swedish name (13.7) minus the percentage of *all* sellers that only contacted the buyer with an Arab/Muslim name (5.7). Hence, net incidence of discrimination in this case becomes 8 percent. Yet, if we treat the cases where none of the buyers were invited as non-observations we end up with 546 – 103 = 443 total usable cases. Net incidence of discrimination is then found by subtracting the number of cases where only the buyer with an Arab/Muslim name was contacted (31) from the number of cases where only the buyer with a Swedish name was contacted (75) and then dividing by the total usable cases (443). Net incidence of discrimination in this case becomes 10 percent. Consequently, it is reasonable to say that the net incidence of discrimination lies between 8 and 10 percent. The latter measure has, however, become conventional in the literature.[6]

4. Conclusions

This paper has investigated whether the process of buying and taking over a small business places ethnic minorities at a disadvantage. A field experiment on the Internet in Sweden was conducted in which we had two fictitious prospective buyers, one with a typical Swedish name and one with a typical Arab/Muslim name, respond to advertisements of small business

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[6] See Riach and Rich (2002) for a further discussion about the measurement of net incidence of discrimination.

transfers. Our outcome variables were the number of contacts and positive contacts that each fictitious buyer achieved with sellers. We found that the buyer with an Arab/Muslim name obtained fewer contacts with sellers than did the buyer with a Swedish name in the experiment. Thus, ethnic discrimination exists in the marketplace of small business transfers.

The result that ethnic minorities may face difficulties and discrimination in the marketplace of small business transfers leads to the conclusion that ethnic minorities have difficulties in succeeding in self-employment since we have good reasons to believe that self-employed individuals who are buying an already existing business have an advantage compared to those who are starting a brand new business.

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