

# **The Effect of Wealth and Race on Start-up Rates**

by

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Newark, NJ 07103**

for



Under contract SBAHQ-05-M-0416

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### Purpose

The notion that it “takes money to make money” is commonplace in public discourse. Indeed, some researchers find that the ability to start a business would be greatly impaired without some form of financial assets or net wealth. Others, however, have found that some businesses do not require large amounts of start-up capital, and therefore, one’s financial position has little to do with whether or not an individual is able to start their business.

Understanding the role of wealth in predicting the likelihood of becoming self-employed may be particularly relevant for nascent minority entrepreneurs.

This research uses the Panel Study of Entrepreneurial Dynamics (PSED) to uncover whether wealth affects the start-up outcomes of minorities and nonminorities differently

### Overall Findings

At first glance, net wealth is not found to be related to the likelihood that an entrepreneur will start a company. However, a more fine-grained analysis shows that net wealth is positively correlated with the probability that a nascent entrepreneur will start a new company if the nascent entrepreneur is in the top 25 percent of the wealth distribution. This research also shows that wealth affects the outcomes of minority entrepreneurs slightly differently than it influences the outcomes of their white counterparts.

### Highlights

- The results show that Black and Hispanic nascent entrepreneurs face greater odds in opening a business than do their nonminority counterparts.

Race is a significant predictor of opening a business, and the odds of a minority person opening a business are found to be 55 percent lower than those for a nonminority.

- Female nascent entrepreneurs in the sample were also less likely to start a business than males.
- Having a parent who was or is an entrepreneur has no influence on the likelihood of opening a business.
- Those individuals who sought start-up dollars from financial institutions were more likely to operate their business successfully than those who did not seek financial assistance.
- Nascent entrepreneurs with no experience in the industry of their start-ups were less likely to open a business than those with experience.
- Other factors for which the researcher tested hypotheses were also not as important in influencing the likelihood that a nascent entrepreneur will open a business. These include the existence of a business plan, locating in a “high technology state” (California, Massachusetts, or Texas, as defined by the author), the size of the nascent entrepreneur’s household, the number of partners in the start-up, or the level of educational attainment.
- Having a parent who was or is an entrepreneur has no influence on the likelihood of opening a business.

### Scope and Methodology

The authors analyzed the impact of wealth on business creation using a multi-year sample from the PSED where nascent entrepreneurs were interviewed in 1998, 1999, 2000, and 2001. Several decisions were made regarding truncating the data sample for the analysis. First, any respondent who reported that a firm would be sharing over 50 percent of the start-up was removed from the

sample to ensure that the entrepreneurial activity of individuals (and not firms) is being assessed. In addition, based on other studies using the PSED dataset, only respondents between the ages of 25 and 45 were examined. Respondents not within this range were excluded from the sample, as very few were involved in entrepreneurial activity.

To study the relationship between the likelihood of opening a new business and underlying factors including race, net wealth, and other personal characteristics, the author estimated a logistic regression specification with the binary outcome of whether or not an entrepreneur opened a business at any point during the evaluated years of the study.

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 at [advocacy@sba.gov](mailto:advocacy@sba.gov) or (202) 205-6533.

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## **Abstract**

This paper, using the PSED, examines the role of net wealth in predicting whether a nascent entrepreneur will open his or her own business. Net wealth is found to increase the likelihood that a nascent entrepreneur will start a new company. The influence of wealth in predicting self-employment nearly doubles if the nascent entrepreneur is in the top 25 percent of the wealth distribution. This research also demonstrates that net wealth affects the start-up rates of minority nascent entrepreneurs and white nascent entrepreneurs differently. These results show that wealth as a predictor of the likelihood that a nascent entrepreneur will open a business may be more complex than previously thought.

## INTRODUCTION

By and large, history shows that self-employment is achieved less by racial and ethnic minorities than by nonminorities. Historical trends of self-employment across racial and ethnic groups in America illustrate this point very well. Ethnic minorities are those groups who have shared unique cultural traditions and a heritage that persists across generations, and that differ from the majority population. Racial groups are determined by visible features, such as color. White, black, and Indian are examples of racial groups (Gibbs and Huang, 1989). Quite often, race and ethnicity may overlap (DeVos, 1982). In any case, the differences in rates of self-employment persist today between racial and ethnic minorities and their majority counterparts in the United States. For example, the percentage of employed black and Hispanic people that work in their own businesses is one-third less than the percentage of self-employed nonminorities (Fairlie, 1999).

The differences in the historical trends of self-employment between racial and ethnic groups and in rates of entrepreneurship between minorities and nonminorities call for further investigation. This paper begins to examine these differences by investigating the role of net wealth in predicting self-employment among a sample of nascent entrepreneurs, or adults who are attempting to start a new business.

Several competing theories attempt to explain the differential rates of self-employment between blacks and whites. Some scholars argue that a higher rate of intergenerational transmission of self-employment in one group compared with the other may be one potential explanatory factor (Blau and Duncan, 1967; Western, 1967). However, Fairlie and Meyer (1996) show that having a parent who is an entrepreneur does not explain the current black/white gap in the self-employment rate.

Another explanation is that the differences in self-employment rates among racial and ethnic groups reflect how much disadvantage each racial or ethnic group faces in the rest of the labor market (Aurand, 1983). The logic behind this argument is that when faced with times of high unemployment, the discouraged worker could turn to entrepreneurship as a way to establish financial security (Boyd, 2000). Becoming self-employed has been proposed as a means of social and economic mobility, providing an opportunity for people to improve their quality of life (Glazer and Moynihan, 1970; Light, 1979). Using this explanation, theorists have explained how Asians have compensated for low levels of education and their resulting disadvantage in the labor market by opening their own businesses (Conley, 1999). However, this theoretical explanation seems to hold only for particular ethnic and racial groups. For example, when we consider that black Americans also face labor market discrimination in the form of lower wages, we might also expect high rates of entrepreneurship, but this is not the case. Thus, this explanation for different rates of entrepreneurship holds only for some populations.

A third explanation offered for the differences in self-employment rates between racial and ethnic minorities and nonminorities is that racial and ethnic minorities have faced institutional barriers. Discrimination faced by some racial or ethnic groups in the housing and credit markets could have a negative impact on rates of self-employment. Moreover, the past discrimination that ethnic and racial minority groups have experienced may explain current differences in self-employment. Prior to the civil rights movement, ethnic and racial minorities were not allowed equal access to opportunities (Oliver and Shapiro, 1995). Following the civil rights movement, discrimination may still

have been a barrier to accessing education, work, or wages (Conley, 1999; Oliver and Shapiro, 1995). Barriers to accessing opportunities, experienced more by minorities than by nonminorities, are likely to be part of the reason minorities have fewer businesses.

Differences in net wealth may be another explanation. Net wealth is the value of all assets minus the liabilities, or debt owed (Conley, 1999). Understanding the role of wealth in predicting the likelihood of becoming self-employed may be particularly relevant for nascent minority entrepreneurs, because black Americans and other minorities tend to have lower levels of wealth than whites, even after controlling for a number of other socioeconomic factors (Oliver and Shapiro, 1995). Given that black and Hispanic nascent entrepreneurs are also likely to have lower levels of net wealth than their white counterparts, it may be expected that becoming self-employed is substantially more difficult for them.

Net wealth is most likely to be the primary financial resource used to fund start-ups (Conley, 1999). For this reason, net wealth is the preferred financial variable to consider, over income, in predicting whether an aspiring entrepreneur will open a business. It is not likely that income or the flow of money an individual has from his or her salary, wages, or tips, will be used to start a business, because people do not tend to figure start-up money into their household budget. Rather, a nascent entrepreneur is likely to draw from sources of net wealth, including liquid assets from bank accounts, deposits and stocks as potential start-up money. The importance of net wealth motivates us to further examine how it is related to the possibilities of a nascent entrepreneur opening a business.



The motivation to examine the role of wealth in determining the likelihood of starting a business is largely drawn from the idea that it “takes money to make money.” Without net wealth, it is likely to be very difficult for a nascent entrepreneur to successfully start his or her own business (Conley, 1999). Difficulty securing money from banks is one institutional barrier that has been thought to deter minority entrepreneurs from starting their own businesses (Bates, 1997). With lower levels of wealth, it can be argued that minority entrepreneurs have had a difficult time reaching the credit approval standards set by banks and even some governmental business loan initiatives (Fairlie, 1999).

In support of this argument, some researchers argue that a significant amount of money is required to purchase the materials necessary to open a business. They argue that without money, the start-up process will be greatly inhibited (Evans and Jovanovic 1989; Bates 1997; Blanchflower and Oswald 1998; Fischer and Massey 2000). Support for this liquidity-constraint perspective is also found in studies showing that individuals are more likely to become self-employed when they have high net wealth or money from inheritances (Evans and Leighton, 1989; Fischer and Massey, 2000).

In contrast, other researchers find that financial capital is not the critical element in predicting the likelihood of starting a business. In particular, Meyer (1990) demonstrates that the lack of net wealth is not an important barrier to self-employment for blacks or whites. He reports that 63 percent of nonminority males and 78 percent of blacks in this sample of business owners responded that they needed less than \$5,000 to start their businesses. Aldrich, Renzulli and Langlon (1998) add to this argument by demonstrating that nascent entrepreneurs with zero or negative net wealth and nascent

entrepreneurs with high net wealth seem equally likely to be approved for loans. Based on these results, these researchers argue that the credit market is willing to fund individuals who do not have significant wealth because of the small size of the financial investment needed to open a small business.

The two sides of the liquidity debate indicate that the role of financial resources in determining whether or not an individual opens a business is unclear. To elucidate our understanding of the relationship between wealth and entrepreneurship, this study selects a different sample than has been used in previous work and also explores different ways that wealth may influence the performance of minority and nonminority entrepreneurs.

Meyer (1990) draws strong conclusions from his results, but his analysis has limitations because his sample consisted of individuals who had already started their own businesses. The consequence is that his results were heavily biased by the sampling frame of entrepreneurs with successfully opened firms. This study, in contrast, will use a sample of nascent entrepreneurs, or individuals who are putting effort toward opening a business, but have not yet done so. The benefit of studying nascent entrepreneurs rather than business owners is that the influence of wealth on start-up rates can be examined during the process of business creation.

Not using a sample of successful firms and entrepreneurs is particularly important for uncovering the differences in performance between minority and white entrepreneurs. Previous research using the Panel Study of Entrepreneurial Dynamics (PSED) has shown that blacks and Hispanics express the desire and intent to start their own businesses at far greater rates than nonminorities. However, in the PSED a larger proportion of whites compared with blacks and Hispanics actually own their own businesses (Greene, 2004).

These results provide reason to believe that black and Hispanic entrepreneurs are “falling out” during the start-up process, resulting in their much lower rate of self-employment compared with their white counterparts. Even more startling is the fact that this finding persists, even though most of the respondents were interested in opening small businesses that did not require the large amount of start-up capital needed for a larger enterprise.

These findings suggest that it is important to study the effect of wealth on the likelihood of nascent entrepreneurs opening their own businesses using a sample that includes entrepreneurs who also drop out or do not achieve the goal of becoming an entrepreneur. Without including these “failed” entrepreneurs in the research sample, it is difficult to confidently explain the differences in self-employment rates between minority and white entrepreneurs because the focus is on a biased successful sample.

We will add to previous work by examining how wealth might affect the start-up rates of minority and nonminority nascent entrepreneurs. Examining two entrepreneurs, one black and one white, with the same levels of wealth, will contribute to an understanding of the effect of wealth on self-employment. It is expected that wealth will influence the self-employment rates of black and Hispanic entrepreneurs differently from those of white entrepreneurs. More specifically, we propose that wealth will be *used* differently by minority entrepreneurs than it will be used by nonminority entrepreneurs.

The different uses of wealth may stem from the distinct historical experiences that minority entrepreneurs and white Americans have had in trying to accumulate wealth in the United States. While ethnic minorities have dealt with low wages and institutional and legal barriers in their attempts to accumulate net wealth, their white counterparts have not. Wealth may also be perceived to have different values based on whether the

person who possesses the wealth is a minority or nonminority, because of racial stereotypes and biases people may have.

The analysis of the relationship between wealth and entrepreneurship will go beyond previous work and examine this relationship using a sample of nascent entrepreneurs who are aspiring to open their own businesses. This study will also attempt to uncover whether wealth affects the self-employment rates of minorities and nonminorities differently.

## **DATA AND METHODS**

We conducted this research using the Panel Study of Entrepreneurial Dynamics (PSED). The PSED is a longitudinal dataset developed by the Entrepreneurial Research Consortium (ERC). The ERC was interested in understanding entrepreneurship and new business creation in the United States. Over a period of four years, the ERC created and administered the PSED, a dataset that identifies and provides insight about the experiences of nascent entrepreneurs in the process of creating new businesses. Collected in four different waves or time periods and generating information about the types and amounts of resources involved in the start-up process, the PSED dataset is particularly helpful and relevant for examining the role of wealth in the likelihood of a nascent entrepreneur starting a business.

To identify individuals who were pursuing the creation of a new business, the ERC researchers used random digit dialing to conduct telephone interviews and to collect data from a representative sample of the United States population. If participants were willing to provide their names and contact information, they were offered \$25 for both their participation in the telephone interview and the completion of a follow-up mail survey questionnaire. After a year of phone calls from 1998 to 1999, an initial sample of 31,261 individuals was established. Within this sample, the researchers working to develop the PSED established two populations of people: nascent entrepreneurs and a control group of nonnascent entrepreneurs.

Two questions were randomly inserted at different points in the survey and were used by the ERC to determine whether the respondent qualified as a nascent entrepreneur. The two questions were: (1) “Are you, alone or with others, now trying to start a

business?” and (2) “Are you, alone or with others, now starting a new business or new venture for your employer?”

If the respondent answered yes to either of these questions, two additional questions were used to determine whether the respondent was actively involved with the start-up process, and whether he/she would share ownership in the business. Participants in the PSED screening were also asked if the start-up had had a positive monthly cash flow that covered expenses and owner-manager salaries for more than three months. If the answer was yes, the respondent was considered to be engaged in activity in the infant stages of an established business and not the start-up of a business. Consequently, this participant was not included in the dataset used in this study to reflect nascent entrepreneurs. Respondents who answered no to the questions were included in the study as nascent entrepreneurs.

In total, more than 800 nascent entrepreneurs were identified through the PSED. Each participant in the detailed interview process of the PSED was asked a single question about ethnic identification—if they considered themselves to be white, black, Hispanic, Native American, or other. In the second wave of data, particular efforts were made to oversample blacks and Hispanics from the original screening of the United States population. This oversampling effort enhanced the quality of the data in the respective groups. The PSED data used in this study, after appropriate weighting, included 247 respondents who identify as being white and 64 respondents who identify as being black or Hispanic. Because of the small number of Asian and American Indian respondents in the sample, they are not included in this analysis.

This multi-year sample, which included nascent entrepreneurs interviewed in 1998, 1999, 2000, and 2001, permitted an analysis of the impact of wealth on business creation, and allowed sufficient time for a business to open. Such a longitudinal methodology is preferred to one that considers net wealth and the likelihood of starting a business at a static point in time because it strengthens the argument that there is causality from one time period to the next. Moreover, the multi-year sample is appropriate because starting a business is a process that takes time.

For the purposes of answering the research questions in this study, several decisions were made about the PSED dataset sample to be used. To begin, the control group that was identified in the initial interview was not included in this analysis because they were not starting a company. Any respondent who reported that a firm would be sharing more than 50 percent of the start-up was also removed from the sample. For example, respondents opening a business that was half owned by a franchise or other corporate sponsor were not included. The reason for this decision is that we are interested in the entrepreneurial activity of people, not firms. Based on other studies utilizing the PSED dataset, we made the decision to include only individuals between the ages of 25 and 45 (Gartner et al, 2004). Respondents not within this range were excluded from the sample, as very few were involved in entrepreneurial activity.

To study the relationship between the likelihood of opening a new business and underlying factors including race, net wealth, and other personal background characteristics, we estimate a logistic regression specification with the binary outcome of whether or not an entrepreneur has opened a business at any point during the study. The

probability of opening a business is estimated as a function of a number of entrepreneurial characteristics.



## VARIABLES AND HYPOTHESES

The variables used in this analysis, described below, were all analyzed using the weights that correspond with the wave that they were asked in.

*Net Wealth.* Net wealth is the financial value of household assets minus liabilities. The components of net wealth were ascertained by asking respondents questions such as “what is the value of your savings and investments?” and “what is the value of other tangible assets such as real estate, cars, home furnishing?” To increase the reliability of the answers to these questions, respondents were asked the questions several times in various ways. By subtracting the value of the mortgage and other liabilities from the value of the respondent’s home, savings, investments, and other assets, it was possible to calculate net wealth. We used the same decision rules as Kim, Aldrich and Keister (2003) to deal with missing asset or liability information. This calculation of net wealth is consistent with prior research that has used the PSED dataset.

Following the calculation of net wealth for each respondent, the researchers divided the values of net wealth for each participant by 1,000 in order to more easily view the variance in the distribution. Next, the wealth distributions of Hispanic, black, and white nascent entrepreneurs and the differences between them were examined. Because many families, particularly minority families, have zero or negative net wealth regardless of income, examining the net wealth distribution for the black and Hispanic respondents was of particular importance (Radner, 1989a). In examining the wealth distribution of the sample, we found that among both white and minority nascent entrepreneurs there were individuals with zero or negative net wealth. One striking

difference between these two groups is that only 7 percent of the white nascent entrepreneurs had net wealth equal to or below zero compared with 20 percent of minority nascent entrepreneurs. Thus, a much larger proportion of the minority entrepreneurs were likely to have very low levels of net wealth. In analyzing the data, we did not adjust the distribution of wealth to be greater than zero. In other words, we used the distribution with negative wealth values for both minority and nonminority participants.

*H1: The likelihood that a nascent entrepreneur starts his or her own business will be positively related to the amount of wealth he or she possesses.*

*Net Wealth Quartiles.* This research aims to analyse the effects of wealth on becoming self-employed by examining the impact of wealth at all different levels of the wealth distribution. To do this, we analyze the effect of wealth at the 25<sup>th</sup> and above the 75<sup>th</sup> percentile or the first and fourth quartile of the wealth distribution. Each quartile variable is made by creating a dummy variable that will capture all of the values above a particular quartile. The purpose of using the 25<sup>th</sup> and 75<sup>th</sup> percentile measurements of wealth is to more closely understand the impact of wealth at different levels. We use the dummy variables as indicators of wealth levels above the particular quartile breakpoints. We are able to understand how having wealth above each of these breakpoints influences the likelihood of becoming self-employed. The fine-grained analysis estimating how the different levels of wealth influence the likelihood of becoming self-employed indicates that the impact of wealth does vary depending on whether or not an individual is above the 75<sup>th</sup> percentile in the wealth distribution. It may be possible that wealth has a stronger

effect in predicting self-employment when an entrepreneur is in the top quartile in the wealth distribution (Hurst and Lasardi, 2004).

*H2: Wealth in the 4<sup>th</sup> quartile, or above the 75<sup>th</sup> percentile, in the wealth distribution will have a greater influence on starting a business than lower levels of wealth.*

*Minority Status.* The sample includes 444 white nascent entrepreneurs, 125 black entrepreneurs and 69 Hispanic entrepreneurs. The small sample of black and Hispanic respondents made it difficult to be confident in the results comparing these two groups and the white group of nascent entrepreneurs. Thus, we decided to group Hispanic and black nascent entrepreneurs together to capture the broader experience of being a minority entrepreneur. Although grouping black and Hispanic nascent entrepreneurs together is problematic given that these two groups vary on many different cultural and social dimensions, the similarities between them relative to white nascent entrepreneurs validate the decision for grouping. A dummy variable was created to identify whether a nascent entrepreneur is a minority or a nonminority. To do this, it is necessary to underwrite the variable and give the dummy variable the value of +1 and -1, rather than 1 and 0. Thus, a white nascent entrepreneur was coded as a -1 and a minority entrepreneur was coded as a 1.

*H3: A white entrepreneur is more likely to open a business than a minority entrepreneur.*

*Minority Status\*Net Wealth.* This independent variable is constructed by interacting wealth with the minority dummy variable to see if wealth affects entrepreneurship at different rates for different groups. We now show the equivalence

between two apparently different specifications that differ in how the interaction term is defined, given the dummy variable coding for minority entrepreneur status.

The first specification is defined as

$$Y = \alpha + B_1(\text{Wealth}) + B_2(\text{Wealth}) * (\text{Race\_Model1}),$$

where Race\_Model1 takes the value '1' for white entrepreneurs, and '-1' for minority entrepreneurs. Since there are only two groups, this unweighted coding system will yield the same results a contrast coding system will (Aiken and Krull, 1996).

The second specification is defined as

$$Y = \alpha + B_1(\text{Wealth}) + B_2(\text{Wealth}) * (\text{Race\_Model2}),$$

where Race\_Model2 takes the value '1' for white entrepreneurs, and '0' for minority entrepreneurs. To show the equivalence, we just compare the value of the effects. In the first model, the wealth effect for a white entrepreneur is  $B_1 + B_2$ , the wealth effect for a minority entrepreneur is  $B_1 - B_2$ , and the wealth effect for an arbitrary entrepreneur is  $B_1 + B_2 * \text{Average}(\text{Race\_Model1})$ . In the second model, the wealth effect for a white entrepreneur is  $B_1 + B_2$ , the wealth effect for a minority entrepreneur is  $B_1$ , and the wealth effect for an arbitrary entrepreneur is  $B_1 + B_2 * \text{Average}(\text{Race\_Model2})$ . For a large enough sample, OLS consistency assures that each of these effects is the same, independent of how the interaction term is defined. More precisely, for large enough samples, OLS consistency assures that the following equalities hold:

$$B_1(\text{Model1}) + B_2(\text{Model1}) = B_1(\text{Model2}) + B_2(\text{Model2}),$$

$$B_1(\text{Model1}) = B_1(\text{Model2}) - B_2(\text{Model2}) \text{ and}$$

$$B_1(\text{Model1}) + B_2(\text{Model1}) * \text{Average}(\text{Race\_Model1}) =$$

$$B_1(\text{Model2}) + B_2(\text{Model2}) * \text{Average}(\text{Race\_Model2})$$

*H4: Wealth will influence the start-up rates of minority and white nascent entrepreneurs differently.*

*Parent is an Entrepreneur.* The family background of an individual may shape his or her occupational choices. This basic idea is founded in the belief that the presence or absence of an entrepreneurial role model may influence the choices an individual makes about whether or not to pursue self-employment. The link between family influence and occupational choices was first tested by Blau and Duncan (1967) when they measured family background by asking respondents if their fathers were self-employed. In the PSED, the link between family background and occupational choice was explored by asking respondents, “Did your parents ever work for themselves or run their own business, alone or together?”

The influence of having a parent that is self-employed may be of particular importance in explaining the differences in self-employment between minority and white nascent entrepreneurs. Given that fewer entrepreneurs are black and Hispanic relative to nonminority entrepreneurs, we might expect that there are fewer entrepreneur role models in these communities as well. The lack of “similar” role models who have successfully opened their own businesses may be a barrier to black and Hispanic aspiring entrepreneurs. If this difference in access to role models does exist, the findings of this research may shed light not only on the differential rates of starting a business among nascent entrepreneurs, but also on why there are so few minority entrepreneurs, compared with white entrepreneurs.

*H5: Having a parent who owns or owned their own business will increase the likelihood that a nascent entrepreneur will open his or her own business, regardless of the racial background of the individual.*

*Formal Business Plan.* A business plan is a written document that evaluates all aspects of the economic viability of a business venture and includes a description and analysis of the business prospects. Having a formal business plan may increase the likelihood that a nascent entrepreneur will establish a new business. Latham and Yukl (1975) argue that the psychological processes of rationalizing, analyzing, and establishing cause and effect connections underlie the process of making formal business plans. More important, business plans entail opportunity analysis and goal-directed behavior that has the possibility of leading to improved performance. A dummy variable will be used to measure whether or not an entrepreneur in the sample has a business plan. Among the minority nascent respondents in the sample, 65 percent had business plans. In comparison, 58 percent of white nascent entrepreneurs had business plans.

*H6: The relationship between having a formal business plan and opening a business will be strengthened if the nascent entrepreneur has a business plan.*

*High Technology States.* From 1998 to 2000, particular areas around the United States experienced an economic boom because of the performance of high technology industries. Areas like Silicon Valley in California may have experienced more economic growth, resulting in a higher rate of firms being established there. Entrepreneurs who engaged in the start-up process in the states that experienced the most economic growth may have found it easier to start their own businesses. To capture this geographic effect, dummy variables were created for states most affected by the high technology industries.

States considered high technology growth states included California, Massachusetts, and Texas. After an analysis of the PSED sample, it appears that 9 percent of minority nascent entrepreneurs live in any of the three high technology states, compared with 14 percent of white nascent entrepreneurs.

*H7: White and minority entrepreneurs will have higher rates of opening a business in California, Massachusetts, or Texas.*

*Household Size.* The household size of respondents was measured by asking the question, “How many people live in your household, including yourself, all your children and any other adults?” This variable is included in the analysis because it is expected that the structure of the household will directly influence the endowments and resources available for starting a new business (Brush and Mandolova, 2004, p.40). In the PSED, the smallest household had 1 person and the largest was a household of 13 people. The mean household size was 3.4 people.

*H8: Nascent entrepreneurs with a smaller household size will be more likely to open a business than nascent entrepreneurs with a large household size.*

*Ask Other or Financial Institutions for Funds:* Where nascent entrepreneurs do not have the financial assets necessary to start a business, they may seek out both informal and formal sources of financial start-up capital. They may ask their friends and family for money or they may go to a bank. There may be differences between minority and nonminority entrepreneurs in the ways capital is raised. In fact, previous research has documented that ethnic minorities are likely to use informal sources of financial capital, such as borrowing money from friends and family or practicing bootstrapping methods rather than seeking formal capital (Tienda, 2001). Despite these potential differences

between minority and majority entrepreneurs in the sources of financial capital used, it may be predicted that seeking funds from others or from financial institutions may increase the likelihood of opening a business.

*H9: Seeking funds from others or from financial institutions will increase the likelihood that a nascent entrepreneur will open a business.*

*Experience in Industry of Start-Up.* We anticipate that nascent entrepreneurs who have prior work experience in the industry in which they plan to open their start-up will have a greater chance of opening their business than nascent entrepreneurs who do not have prior experience. The nascent entrepreneur with prior experience might have an advantage in his familiarity with the industry that allows him to identify arbitrage opportunities (Harper, 2003). The entrepreneur may also have built previous relationships with suppliers able to help get the business open and running. The ability to draw on past experience causes us to believe that the nascent entrepreneur who attempts to open a business in the industry they have experience in will be more likely to accomplish the goal of becoming an entrepreneur.

*H10: Nascent entrepreneurs with previous experience in the start-up industry are more likely to operate a business than are nascent entrepreneurs without previous experience.*

*Organized Start-up Team:* Nascent entrepreneurs who were respondents in the PSED were asked if they intended to or had already organized a start-up team. The pursuit of starting a business alone may be more challenging than starting a business with the help of teammates. Gathering resources might be much easier to accomplish if a nascent entrepreneur is working with others. Based on this argument, we predict that solo



nascent entrepreneurs will be less likely to operate a business than nascent entrepreneurs who are part of a team.

*H11: Solo nascent entrepreneurs are less likely to operate a business than are nascent entrepreneurs working as part of a team.*

*Education.* Education is a form of human capital. Education has been found to be positively correlated with the founding of new businesses (Cooper and Gimeno-Gascon, 1992). However, the influence of education on entrepreneurship is not straightforward (Bates, 1998). In this study, we predict that having more education will increase the likelihood of starting a business. In the PSED dataset, we used a variable that categorized the degree of education into three different groups. Individuals were grouped as having their highest degree of education from high school, post-high school/college, or post-college. This result is anticipated for both minority and white nascent entrepreneurs.

*H12: Starting a business will be positively related to the level of education of a nascent entrepreneur.*

*Gender.* Differences between men and women in their likelihood of opening a business may be related to the wealth gap that exists between them (Conley and Ryvickes, 2005). Conley and Ryvickes (2005) demonstrate that women may have lower net wealth because of their lower savings rate. They attribute the lower rate of savings to the increased consumption by women. Based on this finding, it is likely that women will have a lower rate of founding new businesses. To measure gender using the PSED, a dummy variable, “ncgender,” was used. Female nascent entrepreneurs in the sample are coded as a 1 and male nascent entrepreneurs in the sample are coded as a 0. There are 193 males and 118 females in the sample.

*H13: Women will be less likely to operate a new business compared with men.*

*Dependent Variable: Status of Business.* This variable is the dependent variable used in the binary logistic regression estimation. To complete this analysis, a dichotomous dependent variable was formed by assessing the likelihood that a nascent entrepreneur will go on to start a business. More specifically, if an entrepreneur reported that he or she was opening her own business in wave r, s, or t, the status of the business would be coded as a 1. If not, the status of the business would be coded as a 2. Again, these categories are based on questions asked during follow-up interviews that took place 12-18 months after the initial respondent interviews.

## RESULTS

The logistic estimation is found to be statistically significant and accurately predicts a large proportion of the outcomes correctly. The Hosmer and Lemeshow Test with significance of  $p=.063$  demonstrates that the model fits the data well because the significance value is greater than .05. The pseudo r-squared value for the model based on the Cox and Snell R Square is  $p=.13$ . This low value indicates that there is not a large amount of variability in the dependent variable. These results of the logistic regression are presented in Table 1. The two outcomes of the binary logistic regression were whether a new firm had been created or that a new firm had not yet been created in any of the waves of the PSED.

Hypothesis 1 was not supported. Net wealth is not found to influence the likelihood that a nascent entrepreneur will become an entrepreneur. The coefficient of net wealth in this model is not significant ( $p=.40$ ). A similar coefficient is also found when estimating the model using the 25<sup>th</sup> percentile of net wealth ( $p=.22$ ). The effect of the dummy variable separating those entrepreneurs with wealth above the 75<sup>th</sup> percentile from those below this quartile was found to be significant ( $p=.00$ ). This result supports hypothesis 2. These results imply that a person in the top quartile in the wealth distribution is about four times ( $\text{Exp}(B)=4.01$ ) as likely to operate a business as a person in the lower part of the distribution, all other factors being equal. Although the effect of wealth at the 75<sup>th</sup> percentile and above is strong, the results show that the net wealth variable does not have a strong influence on the likelihood of opening a business.

Using the negative values of net wealth in the distribution demonstrates a significant relationship between opening a business and minority status. The results show

that black and Hispanic nascent entrepreneurs are less likely to open a business than their nonminority counterparts. The negative wealth values of black and Hispanic people in this dataset are likely to be driving this effect.

If a nascent entrepreneur is white, the likelihood of opening up a business increases, even when controlling for net wealth ( $p=.001$ ). This result implies that among a sample of nascent entrepreneurs, race is still a significant predictor of opening a business, regardless of the level of wealth. Results support hypothesis 3 and show that the odds of a minority person opening a business are 55 percent lower than those for a nonminority individual.

The interaction of net wealth and minority status was also found to be significant ( $p=.09$ ). The interpretation of this finding is that wealth influences the outcomes of nonwhite nascent entrepreneurs differently than it does white nascent entrepreneurs. The results suggest that white nascent entrepreneurs with high levels of wealth will be less likely to open a business and that minority nascent entrepreneurs with low levels of wealth will also have difficulty becoming self-employed. The slopes representing the interaction between minority and nonminority people and wealth are demonstrated graphically in Figures 2 and 3.

Among white nascent entrepreneurs, the relationship between the likelihood of starting a business and net wealth does not appear to be monotonic. Although wealth does help nonminority nascent entrepreneurs start a business, increasing wealth does not predict an increase in the probability of opening a business. Rather, at high levels of wealth the likelihood that a white entrepreneur will open a business decreases. In

contrast, among minority nascent entrepreneurs the association between wealth and starting a business continues to be positive.

Hypothesis 5 was not supported. Having a parent who was or is an entrepreneur also has no influence on the likelihood of opening a business ( $p=.20$ ).

Having a business plan does not significantly influence the likelihood that an entrepreneur will open his or her own business ( $p=.75$ ). Thus, our predictions about hypothesis 6 were not supported.

The results also demonstrate that being in a high technology state does not significantly increase the chance that an entrepreneur is actively or inactively taking steps to own his or her own business ( $p=.86$ ).

The size of the household of a nascent entrepreneur also has no effect on whether or not he or she would open a business ( $p=.93$ ). Hypothesis 8 was not supported.

Hypothesis 9 was supported. Our results demonstrate that nascent entrepreneurs who asked others or asked financial institutions for funds are more likely to start a business than those who do not ( $p=.06$ ). In fact, nascent entrepreneurs who ask for funds are 54 percent more likely to start a business than nascent entrepreneurs who do not ask for funds from others.

Contrary to what might have been expected, nascent entrepreneurs who have experience in the industry they intend to start their firm in are less likely to open a business ( $p=.06$ ). More specifically, nascent entrepreneurs with no experience in the industry of their start-up were 1.6 times more likely to start a business than nascent entrepreneurs with experience in the industry of their start-up. Thus, experience does matter, but not in the way that we had expressed in hypothesis 10.

An entrepreneur starting a business alone also was found to have no greater chance of opening his or her own business than an entrepreneur who was working along with a team ( $p=.86$ ). Hypothesis 11 was not supported.

Hypothesis 12 was not supported. The level of education of the entrepreneur has no effect on whether or not he or she will open a business ( $p=.386$ )

Gender was found to be slightly related to the likelihood that a nascent entrepreneur would start a business during one of the waves of the PSED. Although only significant at the 10 percent level ( $p=.09$ ), the results demonstrate that a female nascent entrepreneur will be .62 times less likely to open a business compared with a male nascent entrepreneur. Hypothesis 13 was supported.

## DISCUSSION

This research examined the role of wealth in in the different rates of self-employment of minority and white nascent entrepreneurs. Previous findings about the effect of wealth on starting a business have been inconclusive, with some researchers arguing that liquidity constraints do not exist, even for individuals with less wealth, while others make contradictory arguments.

This analysis found that net wealth has a statistically significant association with being a business owner, contrary to the assertions of the proponents of liquidity constraint theory. In addition, including wealth in the model does not eliminate the significance of the minority status of the entrepreneur. Being a minority or a white entrepreneur continues to influence start-up rates, regardless of net wealth.

The fine-grained analysis breaking wealth into quartiles proved to be a fruitful exercise. By examining the effect of wealth at different levels, we are able to demonstrate that different levels of wealth predict different start-up rates. More specifically, entrepreneurs who have wealth in the top 25 percent of the wealth distribution are much more likely to open a business regardless of their racial background. Wealth does not seem to have an effect on the likelihood of opening a business, as the bottom quartile of wealth was found to have no predictive power on the dependent variable. This finding implies that wealth as a predictor of the likelihood of creating a business may not vary much within the lower points in the wealth distribution.

Most surprising is the finding that wealth affects the start-up rates of minority nascent and white nascent entrepreneurs in different ways. Among white nascent entrepreneurs, having a low level of wealth was found to be positively associated with

starting a business. One might have thought that white nascent entrepreneurs with even higher levels of wealth would be as likely to open a business. However, this was not the case. In fact, the finding that white nascent entrepreneurs with high levels of wealth are not likely to operate a business is not a straightforward one. One would expect that high capital resources would directly lead to successfully opening a business.

The opposite was found to be true for minority nascent entrepreneurs. Minority nascent entrepreneurs with low levels of wealth were found to be more likely to fail in their attempts to start a business. However, minority entrepreneurs with higher levels of wealth were found to be likely to open their own business.

An explanation for this counterintuitive finding may be that wealthy nonminority nascent entrepreneurs may use their wealth during the start-up process less cautiously than do minority entrepreneurs, because they have more financial resources to fall back on if they encounter difficulties. In contrast, nascent minority entrepreneurs are likely to have fewer financial resources to fall back on, and may make more careful use of the resources they have at their disposal.

Being in a high technology state did not have a significant influence on the likelihood that an entrepreneur would start a business. This finding may indicate that some small business entrepreneurs may not benefit from the high levels of business growth in these areas. The large number of new firms may have increased the competition, thus making it more difficult for start-ups to be successful in these areas.

Having a formal business plan was not found to be related to starting a business. One reason for this finding is that a formal business plan may serve as a symbol of intent, but may not accurately predict actual performance. Thus, a formal business plan may



provide other people with an idea of whether or not the nascent entrepreneur might be successful, but there is no guarantee. Moreover, there may be considerable variation in the quality of business plans. This variation may make it difficult for financiers to judge which business plans actually indicate the quality of the start-up and which do not.

Nascent entrepreneurs with parents who were entrepreneurs were no more likely than nascent entrepreneurs whose parents were not entrepreneurs to start a business. Previous research has suggested that education can eliminate the positive influence of having a parent as an entrepreneur (Crosa et al, 2002). It is possible that education eliminated the significance of having a parent who was an entrepreneur in this study as well.

The results demonstrated in this study are not without limitations, including the various problems encountered in the dataset. One problem was attrition. A biased estimator can result if the reason an entrepreneur leaves the sample is correlated with idiosyncratic error, like the unobserved factors that change over time and affect whether an entrepreneur opens a business successfully.

## CONCLUSION

This paper examines the role of net wealth in predicting if a nascent entrepreneur will open a business. At first glance, net wealth is not found to be related to the likelihood that an entrepreneur will start a company. However, a more fine-grained analysis shows that net wealth is positively correlated with the probability that a nascent entrepreneur will start a new company if the nascent entrepreneur is in the top 25 percent of the wealth distribution. This research also shows that wealth affects the business rates of minority entrepreneurs slightly differently than those of their white counterparts.

These findings imply that the experiences of white and minority nascent entrepreneurs are different and that the presence of the same resources does not always result in identical outcomes. Although speculations are made about what factors may cause the interaction effect of wealth and minority status on the likelihood of opening a business, further research is needed to uncover the drivers of this effect. In particular, datasets with a larger sample of minority nascent entrepreneurs may be preferable to the dataset used here, given the limited sample size. Such a dataset would provide insight into the relationship between wealth and race that this study only begins to extrapolate.

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## TABLES AND FIGURES

Table 1: Binomial Logistic Regression Results  
DV: Status of Business (including Wave r, s, t)

Independent Variables	B	S.E.	Wald	df	Sig.	Exp(B)	95.0% C.I. for EXP(B)	
							Lower	Upper
Business Plan	-.090	.286	.099	1	.753	.914	.521	1.602
Team or Solo	.050	.285	.031	1	.860	1.051	.601	1.838
Hitech State	.079	.474	.027	1	.868	1.082	.427	2.741
Gender	-.467	.281	2.766	1	.096	.627	.362	1.087
Parent Entrepreneur Experience in Start-up Industry	-.360	.283	1.610	1	.204	.698	.400	1.216
Ask for Funds	.506	.273	3.423	1	.064	1.658	.970	2.834
Net Wealth* Minority	-.616	.330	3.476	1	.062	.540	.283	1.032
Education Level	.003	.001	2.858	1	.091	1.003	1.000	1.005
Minority Status	.001	.001	.823	1	.364	1.001	.999	1.002
HH Size	-.585	.209	7.793	1	.005	.557	.370	.840
Net Wealth	-.001	.002	.222	1	.637	.999	.995	1.003
Net Wealth, 75%	-.071	.085	.711	1	.399	.931	.789	1.099
Net Wealth, 25%	1.388	.525	6.973	1	.008	4.005	1.430	11.218
Net Wealth, 25%	.445	.367	1.467	1	.226	1.560	.760	3.203

Table 2: Correlation Matrix

	Constant	Business Plan	Team or Solo	Hitech State	Gender	Parent Entrepreneur Experience	Industry Experience	Ask for Funds	Net Wealth * Minority	Education	Minority	HH Size	Net Wealth	Net Wealth 75%	Net Wealth 25%
Constant	1.000	-.129	-.083	-.558	-.122	-.113	-.060	-.417	-.046	-.663	.140	-.188	.004	.034	-.094
Business Plan	-.129	1.000	-.189	-.017	.022	.077	.017	.157	.010	.039	-.051	-.023	-.020	.035	-.059
Team or Solo	-.083	-.189	1.000	.001	-.050	.087	-.026	.097	-.082	-.020	.061	.009	-.137	.131	-.047
Hitech State	-.558	-.017	.001	1.000	.003	.028	.000	.030	.125	.042	-.181	-.079	.059	.029	-.050
Gender	-.122	.022	-.050	.003	1.000	.031	-.041	.134	.024	-.034	.015	.103	.127	-.030	-.059
Parent Entrepreneur Experience in Start-up Industry	-.113	.077	.087	.028	.031	1.000	-.010	.096	-.096	-.066	.112	-.002	-.007	-.114	.101
Ask for Funds	-.060	.017	-.026	.000	-.041	-.010	1.000	-.022	.069	-.006	-.013	.105	.114	-.036	-.079
Net Wealth* Minority	-.417	.157	.097	.030	.134	.096	-.022	1.000	-.008	-.015	-.025	.130	.061	-.088	-.066
Education	-.046	.010	-.082	.125	.024	-.096	.069	-.008	1.000	-.017	-.635	-.042	.569	-.086	-.060
Minority	-.663	.039	-.020	.042	-.034	-.066	-.006	-.015	-.017	1.000	-.069	.085	-.101	.009	.058
HH Size	.140	-.051	.061	-.181	.015	.112	-.013	-.025	-.635	-.069	1.000	.047	-.344	.061	.006
Net Wealth	-.129	1.000	-.189	-.017	.022	.077	.017	.157	.010	.039	-.051	-.023	-.020	.035	-.059
Net Wealth, 75%	1.000	-.129	-.083	-.558	-.122	-.113	-.060	-.417	-.046	-.663	.140	-.188	.004	.034	-.094
Net Wealth, 25%	-.083	-.189	1.000	.001	-.050	.087	-.026	.097	-.082	-.020	.061	.009	-.137	.131	-.047
Net Wealth, 25%	-.558	-.017	.001	1.000	.003	.028	.000	.030	.125	.042	-.181	-.079	.059	.029	-.050

Table 3: Descriptive Data

Variable	Coding	N
Business Status	Not opening	157
	Opening	134
My experience in a particular industry o	Checked	130
	Not checked	128
ORGANIZED START-UP TEAM	YES	135
	NO	123
Gender	Male	193
	Female	118
R PARENTS: SELF-EMP OR OWN BUSS	YES	163
	NO	147
Hi Technology State	Hi Tech State	30
	Low Tech State	280
HAS A BUSINESS PLAN BEEN PREPARED	YES	144
	NO	114
Education Level	UP TO HS DEGREE	83
	POST HS+COLL DEGREE	187
	POST COLL EXPERIENCE	40
Minority	No	247
	Yes	64
Household Structure (mean=3.4)	1 PERSON	40
	2 PEOPLE	65
	3 PEOPLE	51
	4 PEOPLE	73
	5 PEOPLE	47
	6 PEOPLE	18
	7 PEOPLE	8
	8 PEOPLE	2
	9 PEOPLE	2
	11 PEOPLE	3
	13 PEOPLE	1
Top Quartile of Net Wealth	Yes	75
	No	224
Bottom Quartile of Net Wealth	Yes	74
	No	224
Ask Others or Financial Institutions for Funds	No	247
	Yes	64

Table 4: Net Wealth

N	Valid	299
	Missing	12
Mean		\$121,000
Sum		\$36,141,000
Percentiles	25	\$10,890
	50	\$51,973
	75	\$132,000

Figure 1:

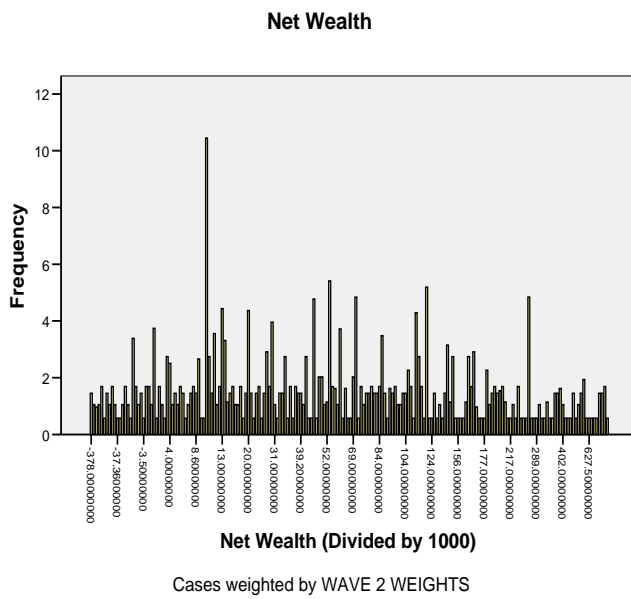




Figure 2: Interaction Race\* Wealth: Nonminority Nascent Entrepreneur

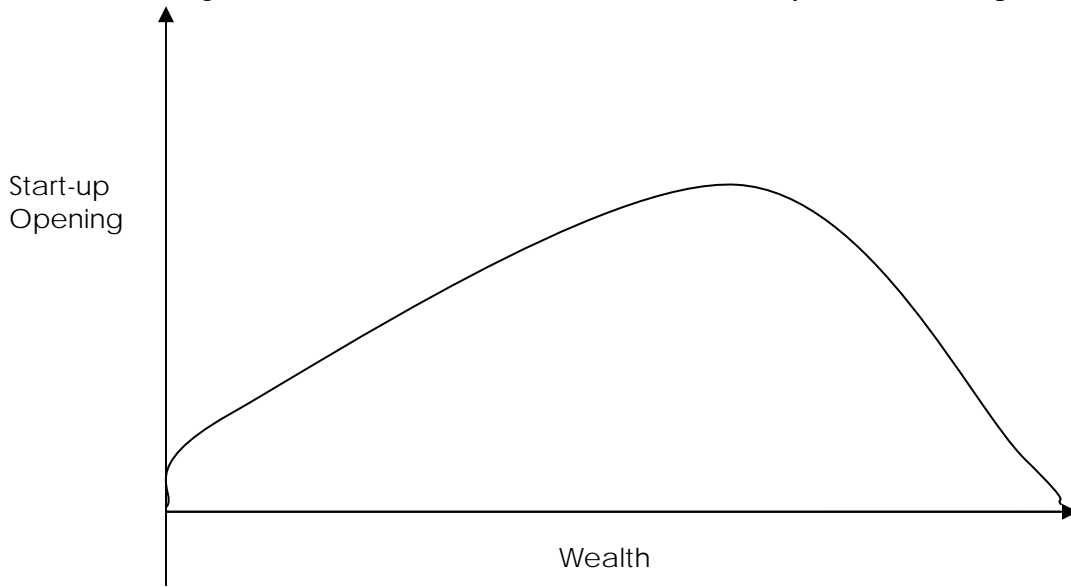


Figure 3: Interaction Race\* Wealth: Minority Nascent Entrepreneur

