ENTREPRENEURIAL CONFIDENCE SURVEY BRIEF

Kauffman/LegalZoom Q2 2013 Survey

September 2013

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For the past year, the Kauffman Foundation and LegalZoom have partnered to conduct a quarterly survey of newly incorporated businesses. In the past, the survey focused on the national economic climate, creating a unique barometer of entrepreneurial confidence. For the 2013 Q2 survey, we added a bevy of new questions to flesh out our respondents' perspectives more fully than before.

In doing so, we both gained new insights and overturned some of our previous assumptions about the sample. Additionally, we strove to make the survey analogous to other leading economic indices, allowing us to make first-ever confidence comparisons between a nationally representative sample and nascent entrepreneurs.

This paper begins with a discussion of high-level responses to questions concerning confidence in current and near-future economic conditions. We next look more in-depth at survey responses, starting with our cohort's basic features, including some crucial characteristics newly available this quarter. We then briefly cover some informal theoretical underpinnings, which allow us to make new comparisons with Gallup's economic confidence index. We conclude with some initial thoughts on the gap we find between indices.

CONFIDENCE—ECONOMIC CONDITIONS

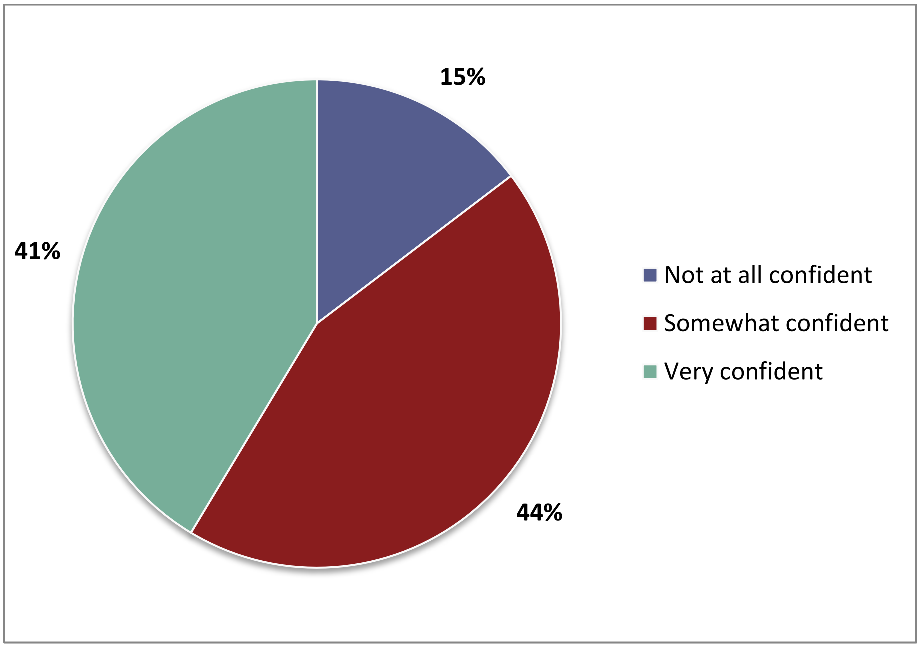
Profitability

From July 15–19, we collected responses on businesses incorporated through legalzoom.com in the past twelve months. From an email sent to 83,100 individuals, 1,876 surveys were started and 1,742 were completed, for a response rate of 2 percent (normal for this method).[1]

Eighty-five percent of respondents are confident or very confident that their businesses will be more profitable in the next twelve months, an increase of 1 percent over the Q1 2013 survey results.

[1] Google Survey's white paper notes some comparisons that are good for context here: "In conducted trials [for Google Survey], the average response rate was 16.75 percent, compared to the latest industry response rates of less than 1 percent for most Internet intercept surveys (Lavrakas, 2010), 7–14 percent for telephone surveys (Pew, 2011. Pew, 2012) and 15 percent for Internet panels (Gallup, 2012)." http://www.google.com/insights/consumersurveys/static/consumer_surveys_whitepaper.pdf.

Q: How confident are you that your business will be more profitable in the next 12 months than it is today?



The overall result masks some differences between age groups. Similar to previous surveys, younger business owners are much more confident about their businesses' potential for increased profit compared to older business owners.

Q2 2013 Survey

How confident are you that your business will be more profitable in the next 12 months than it is today?	Not at all confident	Somewhat confident	Very confident
18–30	6.62%	31.01%	62.37%
31–40	9.35%	44.77%	45.88%
41–50	15.88%	45.73%	38.39%
51–60	20.37%	47.52%	32.11%
61+	24.50%	49.50%	26.00%

However, younger business owners actually are less confident than they were in the previous survey. In fact, the overall 1 percent increase derives largely from an increase in confidence among the 31–40 and 61+ age groups.

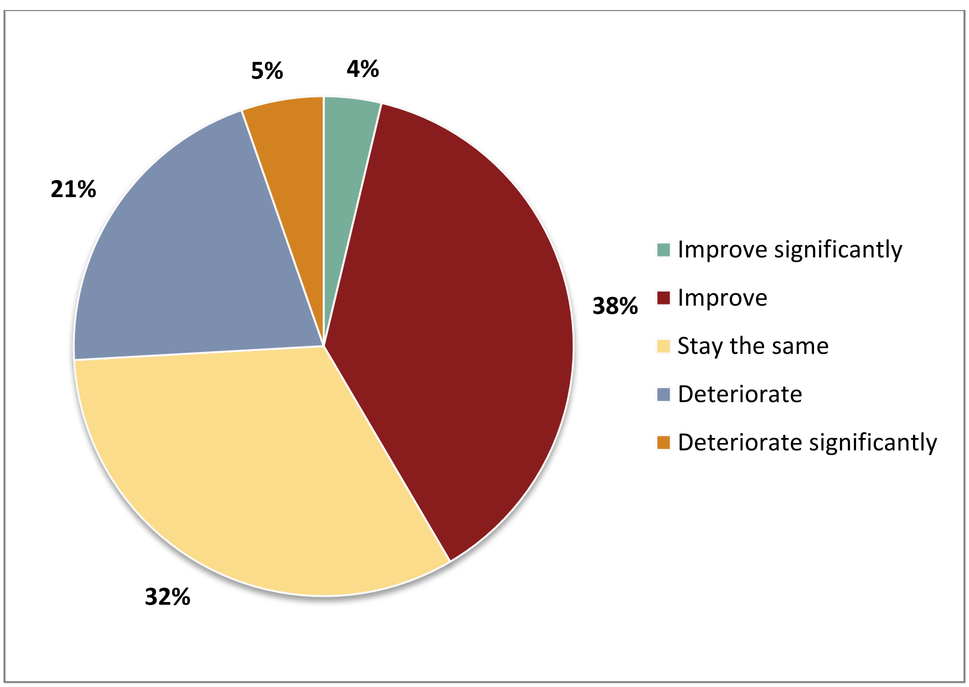
Change from Q1 2013 Survey to Q2 2013 Survey

How confident are you that your business will be more profitable in the next 12 months than it is today?	**Not at all confident**	**Somewhat confident**	**Very confident**
18–30	**2.64%**	**-2.62%**	**-0.02%**
31–40	**-2.19%**	**5.35%**	**-3.16%**
41–50	**1.79%**	**0.66%**	**-2.46%**
51–60	**-0.62%**	**1.84%**	**-1.22%**
61+	**-2.90%**	**4.29%**	**-1.40%**

Direction of the Economy

Confidence in the direction of the economy over the next twelve months is up significantly since the last survey. Sixty-four percent were confident that the economy would improve or stay the same in Q1. In Q2, 74 percent expressed this level of confidence.

Q: What do you think will happen with the economy over the next 12 months?



Similar to the previous question, younger business owners are more confident than older business owners are.

Q2 2013 Survey

What do you think will happen with the economy over the next 12 months?	Deteriorate significantly	Deteriorate	Improve	Improve significantly	Stay the same
18–30	3.83%	13.94%	43.21%	5.23%	33.80%
31–40	3.34%	18.93%	41.20%	3.56%	32.96%
41–50	5.92%	22.27%	35.07%	4.74%	31.99%
51–60	6.53%	21.93%	38.38%	2.09%	31.07%
61+	7.50%	26.50%	26.50%	2.00%	37.50%

For this question, changes from Q1 to Q2 are driven by increases in confidence across all age groups. Notable here are changes in the 61+ age group—respondents migrated to the marginally positive response ("stay the same") away from all other choices, but mostly from the two negative responses.

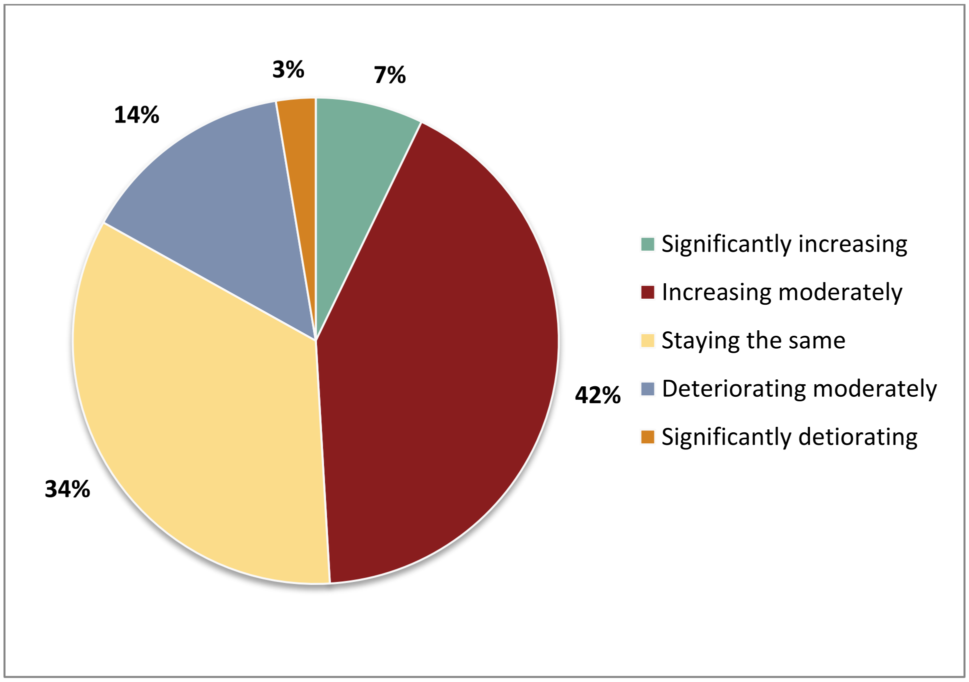
Change from Q1 2013 Survey to Q2 2013 Survey

What do you think will happen with the economy over the next 12 months?	Deteriorate significantly	Deteriorate	Improve	Improve significantly	Stay the same
18–30	-3.69%	-9.07%	5.60%	-0.96%	8.14%
31–40	-2.91%	-1.26%	4.90%	-3.65%	2.91%
41–50	-3.37%	-2.51%	-1.55%	0.23%	7.20%
51–60	-1.87%	-8.44%	5.79%	-2.60%	7.12%
61+	-9.39%	-9.12%	-0.90%	-1.65%	21.06%

Direction of Consumer Demand

Forty-nine percent of business owners expect consumer demand to increase moderately or significantly. This is up from 44 percent in Q1.

Q: What do you see happening to consumer demand over the next 12 months?



Here too, younger business owners are more confident than older business owners are.

Q2 2013 Survey

What do you see happening to consumer demand over the next 12 months?	**Deteriorate significantly**	**Deteriorate**	**Improve**	**Improve significantly**	**Stay the same**
18–30	**1.74%**	**7.67%**	**44.60%**	**13.24%**	**32.75%**
31–40	**0.89%**	**10.47%**	**49.67%**	**8.24%**	**30.73%**
41–50	**3.08%**	**16.82%**	**36.26%**	**6.40%**	**37.44%**
51–60	**3.66%**	**14.36%**	**43.60%**	**4.18%**	**34.20%**
61+	**4.00%**	**25.50%**	**33.00%**	**2.50%**	**35.00%**

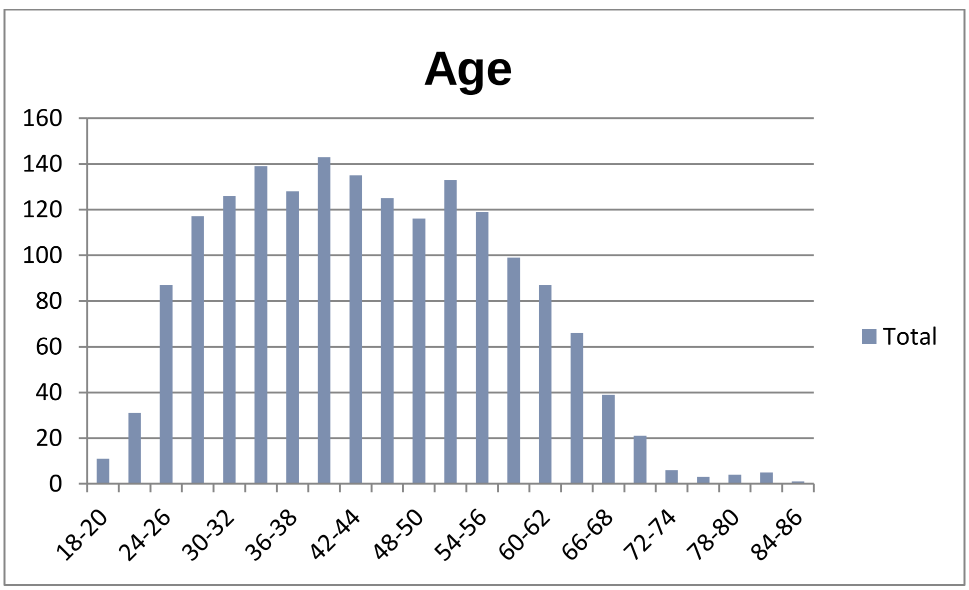
For this measure, changes from Q1 to Q2 are again positive across all age groups. All have moved from the negative to positive responses, though there is some variation in the strength of the positive response.

Change from Q1 2013 Survey to Q2 2013 Survey

What do you see happening to consumer demand over the next 12 months?	Deteriorate significantly	Deteriorate	Improve	Improve significantly	Stay the same
18–30	-0.91%	-5.60%	-3.19%	6.16%	3.55%
31–40	-2.47%	-8.04%	4.71%	3.91%	1.89%
41–50	-1.99%	-7.40%	-5.43%	1.33%	13.50%
51–60	-2.52%	-14.78%	7.55%	1.21%	8.52%
61+	-4.68%	-11.03%	3.78%	-0.24%	12.17%

PROFILE OF RESPONDENTS

In its essential features, the Q2 survey profile resembles both prior quarters and the entrepreneur population at large. The respondent age spread normally is distributed around the thirties, forties, and fifties, with a naturally short tail on the left (as the cutoff is eighteen) and a longer tail to the right (petering out at the mid-eighties).



This falls in line with other descriptive statistics on entrepreneurs' ages. In the Kauffman Firm Survey, the largest longitudinal study of new business owners, 82 percent of founders sampled were 35+ at the time of venture creation.[2]

[2] Page 13, http://www.kauffman.org/uploadedFiles/kfs_fourth_040709.pdf.

We provided forty-five business type categories, but as with our previous quarterly surveys, N/A or Other still dominated the responses. Among our pre-defined categories, Consulting took the top nod, as usual, followed by Real Estate and Other Services. Encouragingly, the rest of the list is filled out nicely by physical businesses like Retail, Construction, and Food & Beverage. In other words, we have a good mix of service businesses easily operated out of a home office and plenty of in-person enterprises. Technology firms, the traditional media darling, represented just 3.6 percent of respondents.

Business Purpose	Percentage of Total
Consulting	11.40%
Real Estate	5.51%
Service: Other Services	5.08%
Retail Store	4.60%
Construction/Contractor	4.12%
Technology: Internet (eCommerce, website)	3.64%
Service: Business Services	3.48%
Other	11.18%
#N/A	8.94%

By the preponderance of Consulting firms in this and previous surveys, we suspected that our sample might be largely defined by individuals operating out of home offices, having incorporated for tax reasons alone. Additional questions in this survey help us determine the accuracy of that supposition.

First, a quick look at the new present-employment profile appears to reinforce such a viewpoint—the businesses are overwhelmingly small, with 87 percent having between zero and three employees (aside from the respondent).

Excluding yourself, how many current employees do you have?	Percentage of Total
0–3	87.21%
4–6	6.14%
7–10	2.90%
11–20	1.45%
20+	2.29%
Grand Total	**100.00%**

However, our new Q2 data also tells us that 37 percent have plans to hire employees, with a stunning 69.5 percent of our entire sample envisioning having six or more employees within the next five years.

Including yourself, what is the maximum number of employees you envision having in the next 5 years?	Percentage of Total
1–5	30.57%
6–10	26.20%
10–15	13.55%
16–20	8.13%
20+	21.54%
Grand Total	**100.00%**

Although not all of these business will achieve such progress, this response demonstrates that a majority of these businesses are incorporating with growth in mind—aspirations that would be absent from our initial expectation of self-employed home-office consultants.

Finally, another new question in Q2 shows 50 percent of the sample describing this business as the primary source of income. And, even among those who do not consider it to be a primary source of income, 40 percent are putting sixteen or more hours per week into the business. Although approximately one-third of our sample is comprised of entrepreneurs that do not expect to engage in significant hiring activities in five years (meaning perhaps that they have lesser expectations of growth), a majority of the cohort either views this venture as its primary financial responsibility or plans to shift to such a position.

In light of this profile, we should expect that such an engagement (or expected engagement) with the economy influences these entrepreneurs' confidence in it. Next we explore how, for which portion of our sample, and possible explanations why this is true.

TYPOLOGY

To discuss how this newly fleshed-out profile affects the discussion of entrepreneurs' economic confidence, we need some terminology to help us sharpen the rough sketches provided by the raw numbers above.

One useful division of entrepreneurs is the intention behind the venture. Four easy (though not necessarily all-encompassing) entrepreneurship demarcations can help us bin our sample:

1) Subsistence, in which the entrepreneur has recently lost a wage/salary job and is starting a business to provide temporary income until another wage/salary job is obtained;
2) Supplemental, in which the entrepreneur maintains a primary wage/salary job but opens a small business on the side to bring in additional income in his or her spare time;
3) Lifestyle, in which the entrepreneur desires the unique aspects of starting a business (e.g., being one's own boss; wearing flip-flops to work; ability to work out of the home) and intends the business to be a primary and steady source of income for a long period of time; and
4) Growth, in which the entrepreneur sees a market niche or opportunity, or has an innovation to exploit, and wishes to scale the business to a significant degree.

These distinctions can overlap, blur, and even miss reasons for undertaking an entrepreneurial venture—but for our purposes, they can help us think about what starting a business means for each entrepreneur's perspective on the economy.

We should naturally expect subsistence entrepreneurs' vote of economic confidence to be negative, as by definition they are not in their preferred employment status (i.e., as a wage/salary worker). Since this type of entrepreneurship usually has its roots in an unexpected layoff, the respondent has a much stronger stake in his or her negative assessment of the economy, having been personally affected by it.

For supplemental entrepreneurs, the stakes logically are lower. They much more closely resemble the (relatively) disinterested respondents found in a more traditional survey's random sample. For such respondents, the sample's stake in the economy should be assumed to be varied, but tending toward a small or unattended-to investment portfolio.

On the flip side, lifestyle and growth entrepreneurs are making personally leveraged bets on an optimistic view of the economy. Since starting a business with a long-term outlook and plan requires a financial bet (in opportunity cost of a higher-paying wage/salary job, and, in most cases, a personal capital commitment), these entrepreneurs are making a much stronger statement about their view of the economy than a typical, randomly-selected respondent would. In short, these entrepreneurs have skin in the game—they are making a staked claim with their time and capital that now is a good time to start a business.

This explanation, viewing the entrepreneurial venture as a bet on the economy, yields an expectation of a linear positive relationship between importance of venture to the entrepreneur and his or her confidence in the economy. Another, simpler explanation yields the same expectation—entrepreneurs could be over-optimistic as a general character trait,[3] which would explain their predilection for both a high-risk/high-reward job preference and a sunnier view on the economy as a whole. As we move along the typology, the entrepreneur must have an increasingly optimistic self-belief, which in turn leaks into the entrepreneur's optimistic economic outlook.

MAPPING OUR SAMPLE TO THE TYPOLOGY

Returning to our breakdown, we want to see how the typology can be applied to our sample, which should tell us what to expect when finally looking at the confidence indicators. Our typology does not map 1:1 onto our respondents, but it can still divide them up in useful ways. The best survey question we have right now to try making these distinctions is: "Is this business your primary source of income?" Below, we try matching our typology with the responses from this question:

Is this business your primary source of income?	Percentage of Total Respondents	Mapping to Typology
i) Yes	41.12%	Growth, Lifestyle, Subsistence
ii) This business is my primary source of income, but I have a supplemental job	8.94%	Growth, Lifestyle, Subsistence
iii) I split time evenly between this business and another job	12.50%	Growth, Lifestyle, Subsistence, Supplemental
iv) This business supplements the income from my primary job	21.44%	Supplemental
v) I work on this business sparingly; the income from it is insignificant	16.01%	Supplemental

[3] Researchers generally have found this to be the case. For a review, see Simon Parker. *The Economics of Entrepreneurship* (Cambridge: Cambridge University Press. 2009), 124–128.

Were the sample weighted toward supplemental entrepreneurs, as we had speculated prior to this quarter's survey, there would not be much reason to compare our sample's confidence to any other—low leverage and low optimism would make them too similar. However, as new questions help us understand and this typology helps us interpret, our sample is weighted toward more highly leveraged and/or more optimistic entrepreneurs—therefore, comparisons with other confidence indicators should prove fruitful.

COMPARISON

For the purposes of just such a comparison, we added questions to this quarter's survey with the same wording as Gallup's economic confidence index questions. Its index is a single number constructed from responses to two questions:

A) How would you rate current economic conditions?
   i. Excellent
   ii. Good
   iii. Only Fair[4]
   iv. Poor

B) Would you say that the economy is getting better or worse?
   i. Better
   ii. Worse
   iii. Same[5]

They then use a simple formula to arrive at the index:

"The Index is computed by adding the percentage of Americans rating current economic conditions (("excellent" + "good") minus "poor") to the percentage saying the economy is ("getting better" minus "getting worse"), and then dividing that sum by two. The Index has a theoretical maximum value of +100 and a theoretical minimum value of -100. Values above zero indicate that more Americans have a positive than a negative view of the economy; values below zero indicate net-negative views, and zero indicates that positive and negative views are equal."[6]

[4] Our wording used "Fair," dropping the "only"—Gallup's wording can be found at the links below.
[5] We did not include a "Same" response for this version of the survey. If we take the most conservative estimate and assume all "Same" responses in Gallup polls would otherwise go to "Better," and use the maximum historical "Same" percentage available (at http://www.gallup.com/poll/1609/Economy.aspx#4), we should take 12/2=6 points off our index. Since the gap is still sizeable (-12 to 5.8 = 17.8) even with this estimate, it remains worthwhile to track its movement, but we will use our forthcoming Q3 index (with identical wording and answers) as the baseline instead for a cleaner comparison.
[6] http://www.gallup.com/poll/123323/understanding-gallup-economic-measures.aspx.

We reconstructed this index with our own sample and produced a figure of (((2.28+22.94)-24.56) + (60.85-39.15))/2 = 11.8, ringing in significantly higher than Gallup's: -12 over the closest time period.

Kauffman/LegalZoom Entrepreneurial Index 7/15–7/19	Gallup Three-Day Rolling Average 7/15–7/18[7]
11.8	-12

Even Gallup's four-year peak, which came in at -1 this May, is a comfortable distance from our measure. Most amazingly, remember that our 11.8 actually understates economic confidence among long-term entrepreneurs—both supplemental and subsistence respondents would have dragged our index down.

Because our sample is dominated by lifestyle and growth entrepreneurs, though, we naturally should expect our index to be higher. To reiterate—the entrepreneurs who make up the bulk of our sample inherently are making a leveraged bet on (or inherently are more optimistic about) a growing or at least stable economy. So, the gap here should simply be treated as a baseline—as we get more data, we can assess the gap's movement, which should tell us more about the economy, entrepreneurs, or both.

We could see a few possible implications once we get more data points in our own index. We may observe that the gap is sticky downward, implying that entrepreneurs are resistant to negative economic forecasts, reflecting their bias toward wanting their own businesses to succeed. We also could see entrepreneurs reacting more quickly to economic shifts, with the gap presaging moves in more general indices. Since entrepreneurs necessarily have to engage more actively with credit markets, competition in the form of other firms, and their consumers, they may be more sensitive to economic tremors. And, of course, we may see the gap hold more or less even, implying that entrepreneurs inherently are higher on the economy than average, but saying nothing more about their relationships to it.

We will have to wait and see if the entrepreneurs favor good news, hold more accurate and sensitive views, or have inflated beliefs simply because such confidence is necessary to start a business. In any case, though, we are well on our way to proving that entrepreneurs not only interact differently with the economy, but that such interaction may inform their confidence in the same.

[7] "Download complete trends," http://www.gallup.com/poll/122840/gallup-daily-economic-indexes.aspx.