The Kauffman Foundation and LegalZoom

CHALLENGES FACING NEW ENTREPRENEURS IN 2014

February 2015
Introduction

One of the most troubling findings in entrepreneurship research is the persistent, thirty-year-long decline of new business formation in the United States. Troubling in and of itself, to be sure, but doubly so because we do not understand *why*.

There are many plausible culprits: the rise of big-box retailers, increased occupational licensing requirements, rent-seeking by incumbent firms, and numerous other hypotheses. All of these explanations, however, are lobbed from the outside—few (if any) studies seek the direct voice and opinion of the entrepreneurs themselves.

Each method has its place. Scientific rigor will be required to establish, with authority, the true mix of causes underlying America’s entrepreneurship decline. When those potential causes are so numerous, however, we can benefit from a more direct (if less scientific) initial approach that can guide and inform our eventual research focus.

In that exploratory role, we have a good tool at our disposal in this annual survey.

Continuing the work started by a 2012 inaugural effort, the Kauffman Foundation and LegalZoom recently finished collecting data from 1,242 responses to a third annual survey, which was sent out in 2014 to business owners newly incorporated through LegalZoom.

This year, our analysis will try to illuminate some of the challenges facing entrepreneurs in 2014, thereby (we hope) spotlighting some of the underlying causes of declining business creation over the last thirty years.

Demographics

We begin with a broad description of the sample. By every demographic category we measure, the 2014 cohort remains very similar to the previous two years’, and therefore closely resembles statistics on the population of U.S. entrepreneurs more generally.

With regard to gender (Figure 1), the ratio has barely moved at all from previous survey years. As we have noted in earlier reports, this mark is precisely what we would expect given the extant literature on women entrepreneurs. While we do not yet know why women are so under-represented in

![Figure 1: Gender Distribution](image-url)
entrepreneurship, it is a vital question and an active area of research.

As with gender, the age distribution of the 2014 cohort (Figure 2) aligns both with previous years of this survey and with our knowledge of the overall entrepreneur population. Unlike with gender, this distribution accords with common sense (if not pop culture)—typical entrepreneurs are in their thirties or forties, an age by which one has acquired the industry experience, network, and financial capital that are all instrumental in starting a successful company.

Moving from ascribed to achieved characteristics, we first take a look at educational attainment (Figure 3). Expectedly, the numbers are again similar to previous years. However, our sample does differ in this category from other studies of entrepreneurs’ educational attainment. Specifically, our cohort is more educated than we might expect given broader surveys.¹

With regard to previous entrepreneurial experience (Figure 4), about 40 percent of the 2014 cohort had previously started a business, down slightly from previous years. Breaking down that category further, into number of businesses previously started before this one, we see that our sample matches up well with the Kauffman Firm Survey.

To review: our 2014 cohort’s individual characteristics are broadly in line with previous versions of this survey, as well as with our expectations given the entrepreneurial population as a whole. The one notable deviation is in educational attainment, where our sample’s educational levels are higher across the board as compared to the Kauffman Firm Survey. Roughly one-third of the sample are women, and the average respondent is likely to be middle-aged, fairly well-educated, and moderately likely to be a serial entrepreneur.

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Challenges I: General

Having established that our sample is relatively stable with relation to previous years of the survey and reasonably representative of the entrepreneurial population as a whole, we can look at some of the difficulties these entrepreneurs face and try to draw some lessons. While this work should not guide policy directly, it can be one valid resource (among many) in helping to determine a direction for further, more rigorous academic research.

First, we asked the very general question: “Did your business face any of the following challenges in 2014? Select all that apply.”

- “Lack of access to credit”
- “High cost and/or undesirable terms of credit available”
- “Underperforming company sales”
- “Falling real estate values”
- “Unpredictability of overall business conditions”
- “High rate of delinquent or uncollectable customer debt”
- “No difficulties”

Encouragingly, 49 percent listed no difficulties, up from 37 percent in 2013 (and 40 percent in 2012). Continuing the good news, only 46 percent of this year’s cohort cited unpredictability of business conditions, as compared to 57 percent in 2013 and 55 percent in 2012. Along with February’s jobs report, this is perhaps telling—the economy finally looks to be regaining steam.\(^2\) In light of these improvements in sentiment, we might finally expect entrepreneurship rates to recover from the huge hit they took during the recession.

Despite this positivity, one category did not see any improvement: “Lack of access to credit,” which held steady at 45 percent for the third straight year. As this metric seems immune to the overall economic recovery, it could be a piece of the long-term business creation puzzle. We must be careful, however, since these survey data only stretch back to 2012—the credit issue could yet be a remnant of the Great Recession and its effect on the housing-collateral channel.\(^3\) That would still be an issue to address, to be sure, but not necessarily an explanation for the thirty-year decline in entrepreneurship rates.

Challenges II: Government

Beyond these general business challenges, we asked four questions focusing on government regulation and its effect on these entrepreneurs. The first of these questions stood by itself, and asked, “Which policy below is the biggest barrier to the growth of new businesses in your state?” As per the table below, the leading answer was “None,” followed by licensing and tax issues, and then a steep drop-off.\(^4\)


\(^4\) All responses not shown in the table below notched three responses or fewer, largely split up among original responses to a fill-in option.

**Table 1**

<table>
<thead>
<tr>
<th>“Which policy below is the biggest barrier to the growth of new businesses in your state?”</th>
</tr>
</thead>
<tbody>
<tr>
<td>None</td>
</tr>
<tr>
<td>High tax rates</td>
</tr>
<tr>
<td>Licensing forms and fees</td>
</tr>
<tr>
<td>Complexity of taxes</td>
</tr>
<tr>
<td>Vulnerability to lawsuits</td>
</tr>
<tr>
<td>Labor regulations</td>
</tr>
</tbody>
</table>
Next, we asked a series of three questions, with participation in the latter two dependent on the answer in the first: “Has government regulation been a problem for your business?”

According with the initial question on regulation, these responses show very clearly that government regulation, broadly construed, is a non-issue for the vast majority of new business owners (Figure 5). Fully half of respondents encountered absolutely no problems with government regulation, and an additional 33 percent encountered no significant problems.

The 50 percent of respondents who encountered any problem at all (even “No, not a significant problem”) went on to answer two additional questions. First, we asked about the specific types of regulation that were causing the greatest difficulty. Among these 617 individuals, the most commonly cited issue was “Tax-related,” accounting for 41.49 percent of those responses. The next most-popular response was “Operational, such as licensing” issues, accounting for 30.63 percent of responses among those listing any problem at all. The remaining categories appear to be niche concerns, with none breaking 10 percent.

Table 2

<table>
<thead>
<tr>
<th>“What types of regulations create the greatest difficulty for your business?”</th>
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<tbody>
<tr>
<td>Tax-related</td>
<td>41.49%</td>
</tr>
<tr>
<td>Operational, such as licensing</td>
<td>30.63%</td>
</tr>
<tr>
<td>Health or safety</td>
<td>9.08%</td>
</tr>
<tr>
<td>Land use and zoning</td>
<td>8.59%</td>
</tr>
<tr>
<td>Employment conditions</td>
<td>7.94%</td>
</tr>
<tr>
<td>Environmental</td>
<td>2.27%</td>
</tr>
</tbody>
</table>

Fully half of respondents encountered absolutely no problems with government regulation, and an additional 33 percent encountered no significant problems.
Cross-tabulating these specific responses with the self-reported severity of the problem yields some interesting results (although we interpret cautiously, as the n gets low here). Most notably, as the perceived severity of the problem increases, we see a steady rise in respondents citing operational/licensing concerns and a steady drop in respondents citing tax-related concerns (Table 3). That is to say—operational/licensing issues may actually be a substantive problem for some businesses, but tax-related concerns are more likely to be a smaller thorn in entrepreneurs’ sides.

Finally, we wanted to find out if those reporting problems with government regulation were encountering issues at the local, state, or federal level. Mayors across the country can breathe a sigh of relief; respondents’ ire was split between state and federal governments, with “Local” coming in a distant third.

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### Table 3

**Self-Reported Severity of Regulation**

<table>
<thead>
<tr>
<th></th>
<th>Employment conditions</th>
<th>Environmental</th>
<th>Health or safety</th>
<th>Land use and zoning</th>
<th>Operational, such as licensing</th>
<th>Tax-related</th>
</tr>
</thead>
<tbody>
<tr>
<td>No, not a significant problem</td>
<td>8%</td>
<td>1%</td>
<td>10%</td>
<td>9%</td>
<td>29%</td>
<td>44%</td>
</tr>
<tr>
<td>Yes, a problem</td>
<td>7%</td>
<td>3%</td>
<td>9%</td>
<td>8%</td>
<td>34%</td>
<td>40%</td>
</tr>
<tr>
<td>Yes, a major problem</td>
<td>9%</td>
<td>11%</td>
<td>6%</td>
<td>7%</td>
<td>39%</td>
<td>28%</td>
</tr>
<tr>
<td>Grand Total</td>
<td>7.94%</td>
<td>2.27%</td>
<td>9.08%</td>
<td>8.59%</td>
<td>30.63%</td>
<td>41.49%</td>
</tr>
</tbody>
</table>

### Table 4

<table>
<thead>
<tr>
<th>Level of Government</th>
<th>Percentage</th>
</tr>
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<tbody>
<tr>
<td>Federal</td>
<td>38.57%</td>
</tr>
<tr>
<td>State</td>
<td>45.71%</td>
</tr>
<tr>
<td>Local</td>
<td>15.72%</td>
</tr>
<tr>
<td>Grand Total</td>
<td>617</td>
</tr>
</tbody>
</table>

“Which level of government creates the most serious regulatory problems for your business?”

So what does all this tell us about the challenges facing entrepreneurs, and could any of it be relevant to the long-term secular decline in entrepreneurship? The headline result, across all of our questions, is that entrepreneurs often appear to be unconcerned with governmental barriers or constraints—roughly half our respondents encountered no problems whatsoever in that regard. Among those who did, two issues stood out.

First, there were tax-related issues. On the one hand, we should be skeptical of entrepreneurs complaining about high taxes—every entrepreneur, in every city, can always use more money, and anyone would enjoy being taxed at a lower rate. On the other
hand, we might be more sensitive to claims about
the complexity of taxes—a bipartisan issue, and one
that makes intuitive sense. If it takes a lawyer to parse
through a business’ tax obligations, then incumbent
firms will be at a natural advantage as compared
to new ventures. It is unlikely that tax complexity
has been a large factor in the secular decline of
entrepreneurship, but it may be a low-hanging fruit
nonetheless.

The other oft-cited governmental barrier in this
survey also relates to bureaucratic processes: licensing
regulations. As the Kauffman Foundation has covered
elsewhere, occupational licensing has its place, but
there is a great deal of room for reform. Fortunately,
this issue already is being addressed at the federal
level, and perhaps already has earned enough national
attention to see movement. Unlike tax-related issues,
licensing actually could be a substantial contributor
to the long-term decline in entrepreneurship, as an
increasing web of regulatory barriers to entry would
favor incumbent firms.

Conclusion

Before we wrap up this year’s annual survey,
we once again emphasize that these results are not
the definitive look at entrepreneurs, entrepreneurial
sentiment, or the challenges they face. There are
numerous issues of sample selection, and the analysis
above is of the simplest, most descriptive nature.
Nonetheless, we believe that this survey still can
say something useful about entrepreneurship and
act as one additional source of information in a
broader array.

That being said, where do the 2014 results point?
For one, these responses help reaffirm the need
for more research on occupational licensing and, in
particular, its effects on entrepreneurship. Continuing
on the thread of governmental regulation, this year’s
survey also indicates a need not just for tax-complexity
reform at the individual level, but for businesses
as well. Finally, after three years of conducting this
survey, the consistently high level of concern over a
lack of access to credit indicates that, although the
economy may be coming back, entrepreneurs still
might be suffering from the devastation wrought by
the Great Recession on housing wealth.

Together, more research on these issues may not
completely solve the puzzle of a declining business
creation rate, but they are likely to prove fruitful.
