

The Kauffman Foundation and LegalZoom

STARTUP ENVIRONMENT INDEX

2012

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Overview

The financial crisis and Great Recession of 2008 and 2009 have left an indelible stamp on the American economy. Labor markets, educational attainment, and household wealth will carry the marks for many years, and tracking diverse measures of economic health like these will be crucial in monitoring the recovery. Business creation is no exception and, given its vital importance to innovation and job creation, the extent of the crisis' impact on new venture formation is of central interest for both policymakers and the general public.

Yet, one of the great frustrations of entrepreneurship research is the difficulty of obtaining current data. Most official statistics on business creation are several months or years old by the time they are released. This frustration with data collection is compounded by the inability of policymakers and others to get a grasp on who is starting companies and the challenges they face. To make headway against these challenges, LegalZoom and the Kauffman Foundation surveyed 1,431 individuals who formed businesses through LegalZoom over the past year.

While this survey does not constitute anything resembling an entrepreneurship barometer, the resulting sample does provide a thumbnail picture of businesses that began operation last year.¹ It offers a collection of fresh voices of early-stage business owners.

Who Started Businesses in 2012?

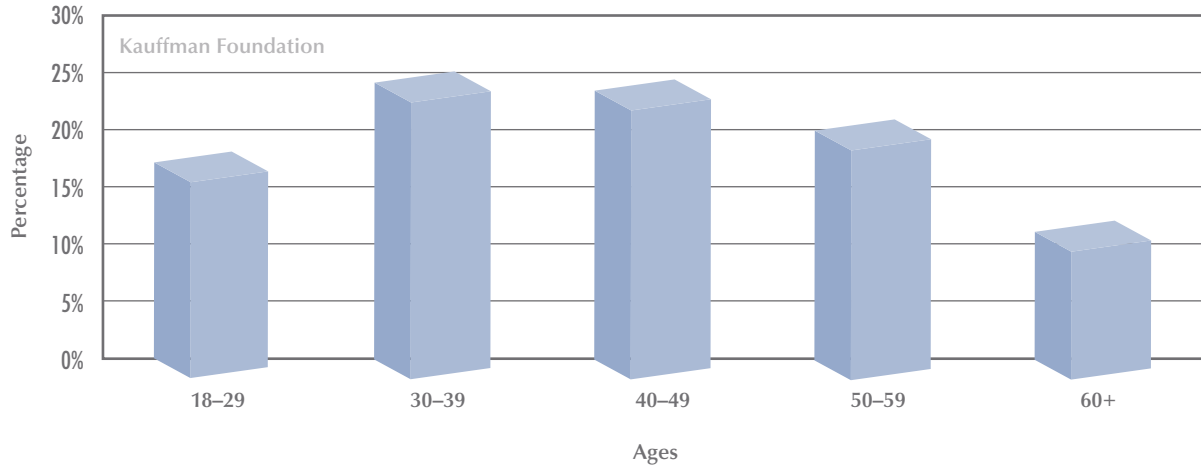
For starters, the gender diversity of LegalZoom respondents generally accords with other samples. Thirty-one percent of the respondents are female, which sounds small compared to women's share of the general population, college degrees, and the labor force. But, it is roughly in line with findings from other studies. A survey conducted by the Kauffman Foundation and Thumbtack.com found 36 percent female representation, while the overall women's share of business ownership is slightly less than 30 percent.² Female representation in these surveys, including LegalZoom's, is larger than among samples of high-growth firms.³ As will be shown below, however, the male-female ratio is more skewed toward males among companies reporting higher revenues.

1. Actually, as explained in more detail below, to call them "new" in 2012 is not necessarily accurate.

2. See Kate Maxwell and Yasuyuki Motoyama, "Voices of Small Businesses: Discussions and Policy Implications," Kauffman Foundation, October 2012, at http://www.kauffman.org/uploadedFiles/DownloadableResources/Voices_of_small_businesses_report.pdf; Susan Coleman and Alicia M. Robb, *A Rising Tide: Financing Strategies for Women-Owned Firms* (Stanford, 2012).

3. We don't know, of course, whether the 31 percent is truly representative of those who started businesses through LegalZoom in 2012 or whether, for example, female business owners were simply more likely to respond to this survey.

Figure 1
Age Distribution

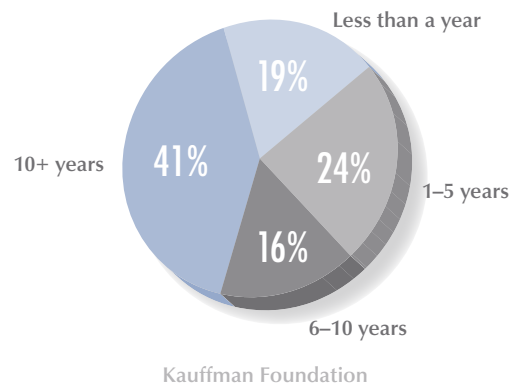


As for the age distribution, the LegalZoom results generally confirm what most other studies and samples find—the majority of individuals who start companies are in their thirties and forties. Indeed, in this sample, half of respondents are between the ages of thirty and forty-nine (Figure 1).

The age distribution of business owners is somewhat reflective of the general population in the United States: 40 percent of the working age (18–64) population is between the ages of thirty and forty-nine. The male-female ratio is roughly consistent across age categories. Compared to the overall sample, women have higher representation among the eighteen to twenty-nine and fifty to fifty-nine age categories, while men, relative to the total sample, have greater representation in the forty to forty-nine and sixty-plus categories.

Given this age distribution, it is perhaps unsurprising that the majority of survey respondents report having at least half a dozen years of prior industry or work experience before starting their present businesses (Figure 2).

Figure 2
Prior Industry or Work Experience



The majority of survey respondents report having at least half a dozen years of prior industry or work experience before starting their present businesses.

Table 1
Companies Started

Number of Companies Previously Started	Total Responses	18–29	30–39	40–49	50–59	60+
5	42	1	1	14	12	14
4	32	2	7	10	8	5
3	80	3	11	24	22	20
2	178	14	35	45	50	34
1	307	38	83	82	70	33
0	792	197	222	175	137	60
Totals	1,431	255	359	350	299	166
Total, Have Previously Started Company	639	58	137	175	162	106
Percentage of Total	44.7	22.7	38.2	50.0	54.2	63.9

As it turns out, a good deal of this prior experience reflects respondents' remarkable tendency to have started multiple companies. Indeed, 44 percent of the entire sample had previously started a company, with the most frequent response being that they had started one prior business. But, 52 percent of those who had previously started companies had started more than one (Table 1).

While we certainly should expect the patterns of serial business creation to follow age, the skew

here is remarkable. Forty-two percent of those who previously had started companies were older than age fifty, with this result especially pronounced among those who had started the most businesses. And, in the two older age categories, majorities of the respondents had established prior businesses.

Educational attainment provides another interesting look at the survey results (Figure 3).

More interesting findings emerge when we combine age, gender, and educational attainment.

Figure 3
Highest Degree Attained among Respondents

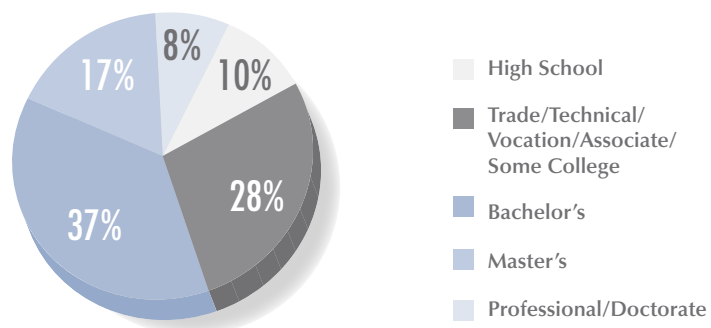
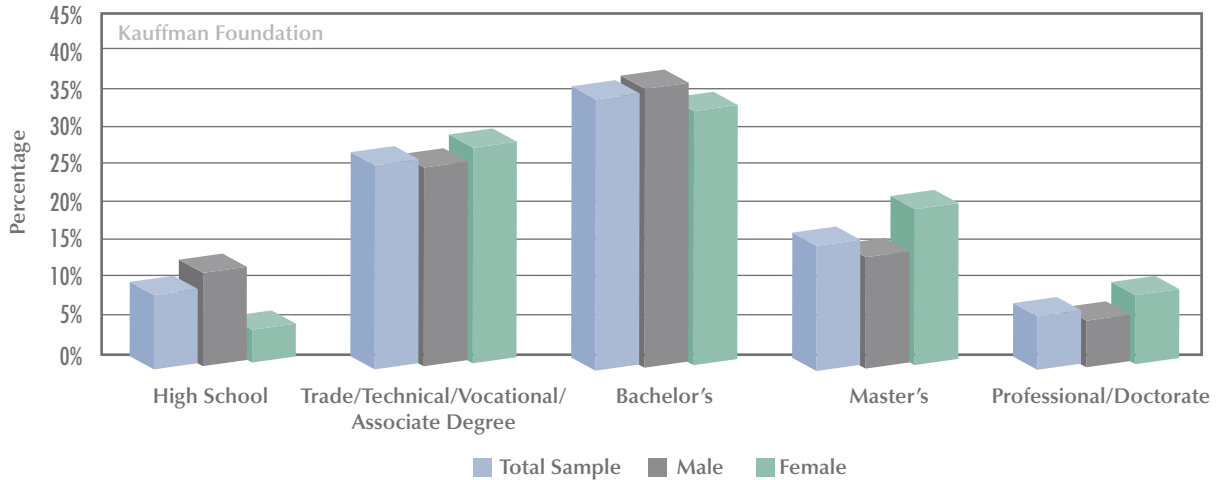


Figure 4

Highest Degree Attained among Business Owners, by Gender



A higher percentage of men in the sample have no more than a high school (or equivalent) degree, while greater shares of the female business owners have master's and professional or doctorate degrees (Figure 4).

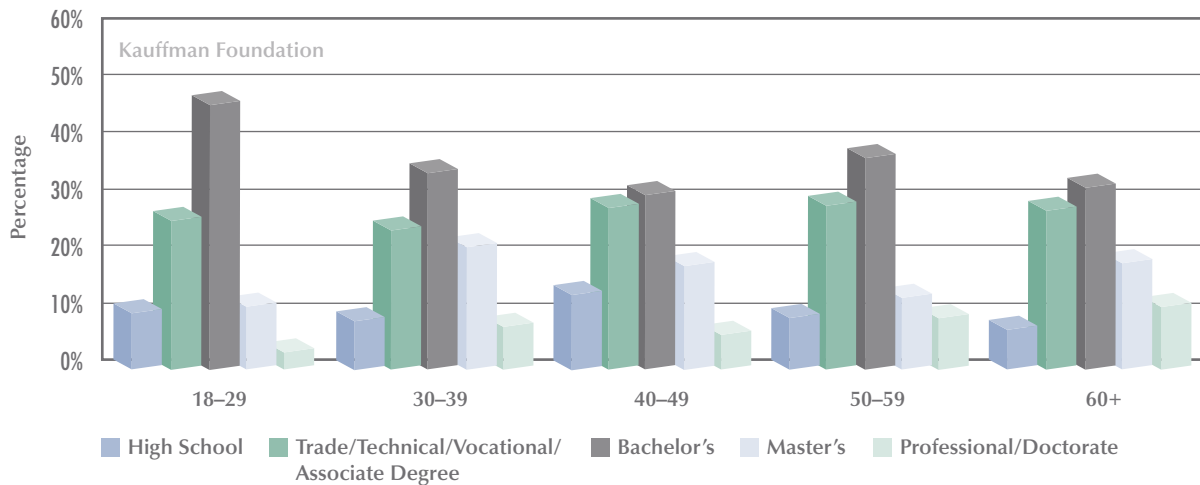
Equally interesting is the breakdown of educational attainment by age: the share of

respondents reporting trade school, technical school, vocational education, associate degree, or some college (all classified in one category) is really the only education group that is broadly consistent across age categories (Figure 5).

Relative to the total sample, high school graduates were slightly overrepresented in the forty to

Figure 5

Educational Attainment among Business Owners, by Age Group



forty-nine age group, and slightly underrepresented in the sixty-plus age group. A much higher share of the eighteen to twenty-nine age group has bachelor's degrees than other groups, while bachelor's degrees are below the total sample share in the forty to forty-nine group. Not surprisingly, master's degrees and professional or doctorate degrees are lower in the eighteen to twenty-nine category—master's degrees are slightly overrepresented in the thirty to thirty-nine group, while professional or doctorate degrees are much higher, compared to the total sample, in the sixty-plus group.

Characteristics of the Businesses

Keeping in mind that all of the respondent business owners started their businesses within the last year, we should expect that most of the companies represented are small in terms of employment. Seventy percent of the businesses report no employees other than the owner, while one-quarter have between one and four employees (both full-time and part-time).

Forty-eight types of businesses were categorized among the responses, with the largest, Consulting, representing 11 percent of the sample. The top ten business activities reported are shown in the table below.⁴

Among those businesses that had more than five employees, the most common business activities are:

- Food & Beverage (service)
- Service: Business Services
- Consulting
- Entertainment
- Health Care
- Manufacturing
- Service: Other Services
- Technology: Internet (eCommerce, website)

The heavy skew toward small employment is paralleled in the distribution of reported revenues. Eighty-two percent of businesses in the sample reported revenues below \$50,000, while 8 percent had revenues above \$100,000 (including eighteen

Table 2
Business Activity

Type of Business Activity	Frequency	Percent of Total
Consulting	166	11.6
Service: Other Services	95	6.6
Technology: Internet (eCommerce, website)	78	5.5
Real Estate	77	5.4
Service: Business Services	74	5.2
Retail Store	73	5.1
Construction/Contractor	56	3.9
Service: Home Services (plumbing, landscaping, cleaning)	47	3.3
Entertainment	45	3.2
Sales	43	3.0

4. A category of "Other" had 136 responses, or 9.5 percent of the sample, but is excluded from the table.

businesses reporting revenues of more than \$1 million). The gender imbalance of the entire sample is not only reflected in the revenue numbers, but worsens with higher revenues.

Table 3
Revenue

Revenue Group	Number of Businesses	Share of Total
\$1 million+	18	1.26%
Female	3	16.67%
Male	15	83.33%
\$500K-\$1 million	16	1.12%
Female	1	6.25%
Male	15	93.75%
\$250K-\$499K	22	1.54%
Female	4	18.18%
Male	18	81.82%
\$100K-\$249K	94	6.57%
Female	15	15.96%
Male	79	84.04%
\$50K-\$99K	112	7.83%
Female	30	26.79%
Male	82	73.21%
0-\$49K	1,169	81.69%
Female	390	33.36%
Male	779	66.64%
Grand Total	1,431	100.00%

As shown, while female business owners represent one-third of respondents in the lowest revenue category, their share decreases to half of that in the higher revenue categories.

The businesses represented in this sample used a small range of funding sources to get started, with

personal funds and savings by far the largest category used—two-thirds of respondents used their own money to start their businesses. Nearly 14 percent (13.7 percent) reported using credit cards, while 7.5 percent used their retirement savings, including borrowing against their 401(k) accounts. Nearly 8 percent (7.5 percent) received money from outside investors, 6.6 percent got loans from family members, and 6 percent reported using bank or home equity loans.⁵ The financing breakdown among this sample of business owners differs somewhat from other patterns of new business financing, where formal debt from banks has been a more significant source.⁶ The legal entity choice can shape the type of funding that is raised. For example, the share of corporations that used investor money in this sample is twice that of LLCs.

Operations

One of the most sought-after pieces of information from researchers and policymakers is what types of challenges or barriers entrepreneurs face that might be alleviated by public policy. The LegalZoom survey sample offers a chance to see what brand-new business owners (and many serial entrepreneurs) have to say on this topic. At a general level, 40 percent of respondents said they did not face any of the general business difficulties listed in the question. Of those that selected one, 55 percent cited the “unpredictability of overall business conditions” as a major difficulty, while 45 percent cited lack of access to credit.

When they were asked about policy barriers—rather than general business difficulties—facing their companies, respondents cited a range of issues.

5. Respondents were able to mark more than one source for this section of the survey.

6. See Yasuyuki Motoyama, “Startup Financing—How Much? From Whom?” Growthology, September 6, 2012, at <http://www.growthology.org/growthology/2012/09/startup-financing-how-much-from-whom.html>. It may also be the case that the financing environment for the firms in the Kauffman Firm Survey—all of which were legally formed in 2004—differed significantly from that of newly organized businesses in 2012. Bank financing, in particular, has not fully recovered from the financial crisis, and credit card use among new and small businesses has risen.

Table 4
Policy Barriers

Policy Barrier	Number
High Taxes	309
Complexity of Taxes	182
Licensing Forms and Fees	177
Vulnerability to Lawsuits	82
Labor Regulations	46

In terms of government policy and regulation in particular, the business owners in this survey showed little fondness for taxes and licensing regulations (which, in many cases, are privately imposed with government's imprimatur).

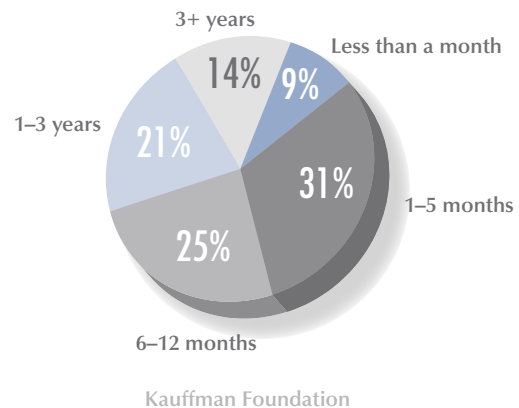
General

As mentioned at the beginning, this paper reports results of a survey of 1,431 businesses formed through LegalZoom in 2012, from March to the middle of December. Yet, to call the 1,400 businesses in this sample "newly formed" in 2012 is somewhat misleading and underscores a hole in the research literature on business creation. Official data, whether collected by the government or a researcher, almost exclusively captures businesses once they have been officially formed as legal entities: corporations, partnerships, LLCs, and sole proprietorships.

There remains a large black box of entrepreneurial activity prior to legal organization when ideas are fleshed out, teams are formed, and decisions are made regarding whether or not to keep one's current job, how to finance a new business, and whether and when to take the leap. The LegalZoom survey results highlight just how large that black box is—more than one-third of respondents reported spending over a year, and in some cases more than three years, working on their business ideas prior to forming a legal entity. In fact, only 9 percent spent

less than a month on the idea before legally forming their businesses (Figure 6).

Figure 6
Time Spent Working on Business Idea Prior to Legal Formation



Only 9 percent spent less than a month on the idea before legally forming their businesses.

Finally, as a matter of geographic representation, the state-by-state breakdown of survey respondents by state of incorporation and business location is shown below. Importantly, many companies reported two states for business location and state of incorporation, with Delaware, Nevada, and Wyoming the three most common states for such a bifurcation (Table 5).

Conclusion

This short paper has provided an overview of findings from a sample of businesses that started (or were legally organized) in the United States in 2012. The companies represented here showed diversity in terms of the founder characteristics, the types of businesses operated, and the businesses' geographic

locations. Personal funds, including savings accounts, were the largest source of initial financing for this sample and, while most of the businesses remain small in employment and revenue size, a few companies have grown quite rapidly.

Of interest to policymakers, most of the business owners surveyed here reported facing no policy or regulatory barriers. For those that did, the back-and-forth nature of the American economy in 2012 was the leading issue cited. Taxes were reported to be a burden for many business owners, while licensing regulations were another source of contention.

Perhaps most interestingly, substantial shares of the LegalZoom sample spent considerable time developing their ideas prior to establishing their companies as legal entities. While this may not be of immediate significance, it highlights the blurry boundaries between paid employment and self-employment and the necessity of public policy (as well as research) to be flexible in recognition of the messy, but economically vital, nature of business creation.

Table 5
States of Incorporation and Business Location

States	State of Incorporation, with Business Location Subfields	Share of Total
CA	227	15.87%
CA	225	15.73%
TX	1	0.07%
WA	1	0.07%
TX	110	7.69%
OR	1	0.07%
TX	108	7.55%
UT	1	0.07%
FL	89	6.22%
FL	86	6.01%
GA	2	0.14%
NH	1	0.07%
NY	77	5.38%
NY	77	5.38%
PA	67	4.69%
PA	67	4.69%
NC	53	3.71%
NC	53	3.71%
OH	51	3.57%
OH	51	3.57%
NJ	48	3.36%
NJ	48	3.36%
NV	47	3.29%
AZ	1	0.07%
CA	11	0.77%
IA	1	0.07%
ID	1	0.07%
MD	2	0.14%

States	State of Incorporation, with Business Location Subfields	Share of Total
MI	1	0.07%
NC	2	0.14%
NV	20	1.40%
NY	1	0.07%
OH	2	0.14%
PA	1	0.07%
TX	2	0.14%
WA	2	0.14%
VA	43	3.01%
VA	43	3.01%
MI	40	2.80%
MI	39	2.73%
OH	1	0.07%
DE	38	2.66%
CA	6	0.42%
CT	1	0.07%
DE	4	0.28%
FL	1	0.07%
GA	1	0.07%
ID	1	0.07%
IL	5	0.35%
KS	1	0.07%
MA	4	0.28%
MD	1	0.07%
NC	1	0.07%

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