Viewpoint

Why So Few Young People Start Businesses

By Scott Shane June 29, 2010

Across almost all industrialized countries, unemployment rates are highest among people just out of college. In the U.S., 17.2 percent of 20- to 24-year-olds are out of work. Clearly we need to do something to remedy this problem now and prevent it in the future.

Policymakers often talk about increasing the number of young people who become entrepreneurs. While I'd like to see that happen too, the problem is very few young people start their own businesses. The share of employed people ages 20 to 24 who run their own incorporated businesses is only 0.3 percent, according to the most recent Bureau of Labor Statistics data. That's lower than in any other age group except 16 to 19, and is 1/25th the rate among those ages 65 to 69.

Developing policy to increase rates of entrepreneurship among young people requires an understanding of why young people tend not to start their own businesses. So why aren't more young people entrepreneurs?

Interest Is There

One common explanation is that today's youth aren't as interested in business ownership as their parents' and grandparents' generations. But there's little evidence to support this. In fact, interest seems to be holding steady. A Kauffman Foundation study of college freshmen found it moved in a tight band between 2.1 percent and 3.7 percent from 1978 through 2008. Moreover, the rate of interest in the 1976-through-1985 cohorts and the 1990-through-1999 cohorts was lower than that among the 2003 and 2004 cohorts, yet the current self-employment rate of people from the 2003 and 2004 cohorts is lower than that of people from the earlier cohorts.

A second explanation is that interest in entrepreneurship increases with age. This argument, too, isn't supported. A 2001 Dartmouth College paper found that as people get older they become less likely to want to be self-employed, but more likely to actually go into business for themselves.

A third explanation, which is supported by data, is that young people don't have enough money to start businesses. Because the vast majority of businesses receive no startup capital from anyone other than the founder, would-be entrepreneurs need to have enough money to cover their startup costs, and are deterred from starting companies if they lack adequate capital. According to the Federal Reserve's most recent Survey of Consumer Finances, the typical net worth of a household led by someone under 35 is $11,800, less than 5 percent of the $253,700 median for a household headed by a person age 55 to 64. Moreover, many of the sources of financing available to entrepreneurs—personal borrowing, personally guaranteed loans, and personal credit cards—are much easier to get if one is older.

A fourth explanation is that a lack of work experience deters young would-be entrepreneurs. Contrary to the popular perception that working for others stifles entrepreneurial drive and ability, at least four studies I reference in my book show that the odds of becoming an entrepreneur increase with years of industry and management experience. Moreover, these dimensions of founder experience also increase the survival and growth of new businesses.

A Direction for Policy

Focusing solely on building awareness and interest in entrepreneurship as the way to increase the amount of young people who start businesses is misguided. Youth entrepreneurship is deterred by lack of capital and work experience, not insufficient interest.

Of the two big constraints on youth entrepreneurship, the access-to-capital problem is easier to solve. Special programs could be designed to provide capital to young would-be entrepreneurs. Perhaps peer-to-peer lenders that take capital from all lenders but lend only to young borrowers could be set up. Maybe networking systems could be established to match young entrepreneurs with equity investors.

The lack-of-experience problem is more daunting. Because much business knowledge needs to be learned by doing, there is no good substitute for experience in preparing people to become entrepreneurs. And because developing experience takes place over time, it's difficult to see how policymakers can provide people ages 20 to 24 with a similar amount of experience as people in their 30s and 40s.

This brings us back to the problem of high youth unemployment. The importance of prior work experience to business success makes it difficult to use entrepreneurship as a long-term, large-scale solution to high rates of youth unemployment.

Scott Shane is the A. Malachi Mixon III Professor of Entrepreneurial Studies at Case Western Reserve University.