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Financing Small Business Creation: The Case of Chinese and Korean Immigrant Entrepreneurs

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ABSTRACT

Prevailing scholarly literature misrepresents the realities of how immigrant Korean and Chinese entrepreneurs finance entry into small business. Supportive peer and community subgroups are not major sources of startup capital; the majority of all loan funds are raised by borrowing from financial institutions. The major single funding source is equity capital, which derives almost entirely from family household wealth holdings. Controlling for firm and owner traits, comparison groups of nonminority and Asian American nonimmigrant self-employed borrowers are shown to have greater access to loan sources than Korean and Chinese immigrants. High equity capital investment offsets this disadvantage. Absent rotating credit associations, and other minor debt sources, the average Korean/Chinese startup possesses substantially more financial capital than its nonminority counterparts.

Keywords: Korean/Chinese Immigrants, Rotating Credit Association, Small Buisnesses, Start-up Capital

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INTRODUCTION

Self-employment is feasible in most lines of small business only if the potential entrepreneur assembles sufficient financial capital to purchase the requisite equipment and supplies to begin operations. Evans and Jovanovic (1989) demonstrate that capital constraints effectively kill the plans of numerous potential small business owners. Those with high net worth are more likely than others to enter self-employment (Evans and Leighton, 1989; Bates, 1995).

This study examines how self-employment entry was financed by Chinese and Korean immigrants who started businesses between 1979 and 1987. The number of Asian-owned small businesses operating in the United States has grown spectacularly in recent years, from 187,691 in 1982 to 355,331 in 1987 (U.S. Bureau of the Census, 1991). This growth has been largely immigrant-driven (Bates, 1994a). Self-employment incidence is highest among Koreans, and Chinese rank second, among Asians. Where has the financial capital come from to finance such rapid business formation?

Conventional wisdom suggests that immigrant Asian entrepreneurs residing in the U.S. benefit from their high propensity to help each other. Social histories of early Chinese and Japanese immigrants residing on the West Coast indicate that their poverty, combined with discrimination in the labor market, often drove them into self-employment (Light, 1972). Despite their humble economic circumstances, cooperative self-help institutions made small business creation feasible: "Immigrants to the United States from southern China and Japan employed traditional rotating credit associations as their principal device for capitalizing small business" (Light, 1972, p. 23). The notion that poor immigrant groups, with the help of group solidarity, could bootstrap their way to economic success by operating small businesses continues to have wide acceptability today (Bonacich and Light, 1988; Aldrich and Waldinger, 1990). If appropriate social support networks do generate business ownership for Asian immigrants, their applicability to indigenous minorities becomes an issue: "the logic of Asian-American business development raises questions about the absence of parallel development among American blacks" (Light, 1972, p. 6). Aldrich and Waldinger point to "the fragmented social structure of black communities, which inhibits resource mobilization," in their analysis of "the underdevelopment of black business" (1990, p. 62).

Findings of this study reveal that since 1979, Korean/Chinese immigrant-owned firms began operations with an average initial capitalization of $57,191; nonminority startups began with $31,939, and cohort firms created by nonimmigrant Asian Americans started with $43,186. The mean Korean/Chinese firm began with a financial investment that was 79.1 percent higher than nonminority startups, and 55.5 percent higher than Asian nonimmigrant-owned new firms.

Startup capital comes from both equity and debt sources, and greater equity investments tend to make debt capital more accessible (Bates, 1990a). Rotating credit associations (RCAs) provide debt. Equity comes almost entirely from family wealth holdings. Less than 2 percent of small business startups attract equity from outside investors (Bates and Bradford, 1992). The Korean/Chinese firms relied more heavily upon equity capital to finance their businesses than Asian nonimmigrant and nonminority cohort firms. For the firm groups under consideration, mean equity at startup was:

Korean/Chinese	$31,472
Nonimmigrant Asian	$22,932
Nonminority	$14,195

Debt provided 45.0 percent of the startup capital that financed creation among Korean and Chinese immigrant-owned firms. The largest debt source was loans from financial institutions. Debt is not easily accessible: per dollar of equity investment, the Korean/Chinese owners raised less debt than nonminority borrowers. Looking at borrowing firms only, the aggregate startup debt to equity ratio was 2.75 for nonminorities, versus 1.18 for Korean/Chinese immigrants (i.e., $1.18 in debt per dollar of equity).

Irrespective of loan source, immigrant Korean/Chinese generate relatively few dollars in loans per dollar of equity invested in small business. Friends and family provide even less leverage than financial institutions. Controlling for owner and firm traits, even African American owners borrowing from friends and family generate significantly more debt capital than the Korean/Chinese. Facing reluctant banks and tight-fisted family and friends, the Korean/Chinese nonetheless exhibit the highest mean firm capitalization at startup: $57,191. With an equity investment that is 2.2 times larger than the amount invested by startup nonminority cohorts ($31,472 vs. $14,195), limited debt use need not handicap the typical young firm owned by Korean/Chinese immigrants.

Scholarly literature tends to misrepresent the realities of how aspiring Korean/Chinese entrepreneurs finance entry into small business. Ivan Light sums up: "Obtaining loan capital poses an obstacle for all small business ventures, but the problem is especially severe for immigrant or ethnic minority entrepreneurs, who lack credit ratings, collateral, or are the victims of ethno-racial discrimination. Rotating credit associations reduce the severity of this financial obstacle." (Light, Kwuon, and Zhong, 1990). Light's statement is literally correct. Yet people often interpret such statements to mean that nontraditional credit sources (family, friends, RCAs) are the main financing sources for small business creation among Asian immigrants. This is incorrect: equity capital is the most important source; loans from financial institutions rank second. Although not terribly significant in the aggregate, nontraditional types of credit are important for the smaller scale, less profitable, more failure-prone operations (Yoon, 1991a).

SOCIAL CAPITAL AND CLASS RESOURCES

Ivan Light and others suggest that the economic attainment of Asian immigrants residing in the U.S. is inextricably linked to the structure of their communities. The entrepreneur is seen as a member of supportive kinship, peer, and community subgroups that assist new firms by serving as sources of customers, financing, and loyal employees, (Aldrich and Waldinger, 1990). The RCAs typify the process whereby supportive peer and community subgroups assist in the creation and operation of firms by providing loan funds.

Light (1972), Bonacich and Light (1988) have argued that Asians (Chinese and Koreans specifically) entering business have benefitted from their participation in RCAs. These associations commonly were set up by groups that shared some important common trait, such as former residence in the same village in their homeland. The members of a RCA were likely to be well acquainted, quite irrespective of their association membership. Capital access constraints on small business formation were overcome by these associations, which were operated by groups of close associates. Each member of a RCA made regular cash contributions, thereby creating a pool of savings that members could borrow for such purposes as small business formation (Light, 1972).

One problem with the RCA as an example of social resources is that there is little concrete evidence that they are a major force in financing Asian-owned businesses (Waldinger, 1986). However, Light, Kwuon, and Zhong (1990) report that at least 11 percent (and perhaps as many as 30 percent) of the Korean-owned garment manufacturers in Los Angeles received loans from RCAs. Yoon (1991a) collected data on the financing sources used by 199 Korean merchants to capitalize their current business. While 27.6 percent utilized loans from Korean rotating credit associations (Kye), other popular debt sources were loans from kin (34.7 percent) and bank loans (27.1) percent. Yoon's survey covered only merchants operating in Chicago minority neighborhoods and was not representative of the Korean business community. Small samples focusing upon specific industry sectors do suggest RCA utilization, but data describing the startup financing of broader Asian immigrant entrepreneur groups have been unavailable to date. Despite this paucity of data, conventional wisdom still claims that Asian immigrants have created their own institutional arrangements for generating loan funds to capitalize small business formations.

The Characteristics of Business Owners (CBO) database, compiled by the U.S. Bureau of the Census in 1992, contains comprehensive data on the sources of debt capital utilized to finance small business formation.[1] Table 1 summarizes firm and owner

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[1] Firms analyzed in this study are weighted to be representative of small businesses operating in the U.S. in 1987 that a) generated 1987 revenues of at least $5000, and b) filed a small business income tax return (proprietorship, partnership, or corporation) with the Internal Revenue Service in 1987. Thus, many of the firms under consideration are zero employee operations run by persons whose main labor force status was "employee." See Nucci (1992) and Bates (1990b) for additional details.

traits for a large, representative nationwide sample of immigrant Korean/Chinese small businesses and comparison groups of Asian American nonimmigrant and nonminority-owned firms. All of these firms were operating in 1987; all were formed over the 1979-1987 period. The CBO data base is explained, in detail, in Nucci (1992) and Bates (1990b).

Table 1 highlights the substantial class resources (human and financial capital) that Korean/Chinese immigrants have invested into their small business ventures. In addition to the higher levels of financial capital, Korean/Chinese owners are much more likely to be college graduates than cohort nonminorities and Asian American nonimmigrants. Despite their higher human and financial capital investments and their longer hours worked in the small business, Korean/Chinese immigrant-owned firms are less profitable than cohort firms (Table 1).

Looking solely at the Table 1 firms that used debt capital, Korean/Chinese had the lowest debt amounts. Average loan sizes were:

Korean/Chinese	$50,997
Nonimmigrant Asian	$56,398
Nonminority	$53,443

The Korean/Chinese owners were also more likely than others to borrow money (debt) to invest in business entry; percentages of firms using debt capital to finance formation were:

Korean/Chinese	53.4%

Nonimmigrant Asian	40.4%
Nonminority	37.2%

Part of this greater propensity to borrow is rooted in the unique industry distribution of Korean/Chinese firms. These firms are heavily concentrated in retailing, while those of young Asian nonimmigrants and nonminorities are more frequent in the skill-intensive service industries. Table 2 reveals that retailing firms

TABLE 1

Traits of Selected Groups of Asian and Nonminority-Owned Young Firms that were Operating in 1987 (firms started since 1979 only).

	Immigrant Korean/Chinese	Nonimmigrant Asian American	Nonminority
1. Business traits			
1987 gross sales (mean)	$127,188	$119,678	$154,274
# employees (mean)	1.5	0.9	1.5
Financial capital *(mean)	$57,191	$43,186	$31,939
Equity capital *(mean)	$31,472	$22,932	$14,195
Debt capital *(mean)	$25,719	$20,254	$17,744
% of firms still operating, 1991	81.9%	80.5%	76.9%
2. Owner traits			
% college graduates	53.2%	46.4%	37.7%
% with less than 4 years of high school	13.2%	10.0%	10.4%
Annual owner labor input hours (mean)	2,210	1,906	1,960
3. Before tax profits, 1987			
All firms (mean)	$15,740	$17,789	$15,838
Owners working full-time in the business only (mean)	$18,308	$23,214	$21,611

Source: Characteristics of Business Owners data base.

*invested in the firm at the point of entry are heavily capitalized and more frequent borrowers than skilled-service firm startups. In <u>each</u> of these industry sectors, however, Korean/Chinese are more likely to use debt capital than cohort groups. For all borrowing firms, Table 3 describes major debt sources, average loan sizes, and leverage obtained from each important type of lender.

Considering average loan size as well as borrowing frequency by source, financial institutions provide the largest amount of debt that is financing business startups. Dominance of debt from financial institutions typifies all of the groups, immigrant Korean/Chinese, nonimmigrant Asian American, and nonminority (Table 3). The pattern of relying heavily upon family and financial institutions for debt capital typifies all groups: family consistently ranks second in terms of amount of debt provided. <u>This borrowing pattern does not support the conventional wisdom that rotating credit associations are a major source of credit for immigrant Asian small businesses</u>. Multiple source borrowing is particularly common among Korean/Chinese entrepreneurs: a) 21.5 percent of bank loan recipients also borrow from family sources; b) 14.5 percent of bank borrowers also received loans from friends. Multiple source borrowing from family and friends typifies a distinct subset of Korean/Chinese immigrants, the firm owners who have not attended college.

Overall, immigrant Korean/Chinese startups exhibit the most unique borrowing pattern (described in Table 3). Family borrowing is actually more frequent than bank borrowing, even though the

TABLE 2

Capitalization of Firm Formations in Selected Industries (firms started in the 1979-1987 period)

	Immigrant Korean/Chinese	Nonimmigrant Asian	Nonminority
Retailing only			
Financial capital (mean)	$70,014	$68,885	$51,828
% of firms utilizing borrowed capital	66.1%	58.1%	48.0%
% of all firms operating in this line of business	40.5%	20.9%	16.4%
Skill-intensive services only*			
Financial capital (mean)	$33,783	$30,542	$24,952
% of firms utilizing borrowed capital	30.5%	22.4%	24.3%
% of all firms operating in this line of business	24.7%	36.4%	31.5%

Source: Characteristics of Business Owners data base.

*Skill-intensive services include business services, finance, insurance, real estate, and professional services.

latter source provides the most loan dollars overall (reflecting larger loan sizes). Family and former owners are roughly equals in terms of the dollar amount of debt raised, while friends are a distant fourth for Korean/Chinese owners. This group has difficulty leveraging their equity investments: note that Korean/Chinese have both the highest mean equity investments and the lowest debt amounts of any group under consideration. Considering all firms and all sources of capital, Korean/Chinese are the <u>least</u> reliant upon debt, and the <u>most</u> reliant upon owner equity investment.

While the Table 3 data are inconsistent with the hypothesis that RCAs are a major source of credit to finance business entry, they may nonetheless be a factor in some instances. Since RCAs are not listed as an option on the CBO census form questionnaires, businesses utilizing this source may indicate "friends" as the credit source, or "other" may be checked. While "other" was an infrequent choice, Korean/Chinese immigrants indicated that "friends" were a loan source for 21.7 percent of all borrowers. Corresponding figures for nonminority firms were 6.4 percent. Asian owner groups are roughly 3 times more likely to finance business entry with loans from friends than nonminorities. Greater borrowing from friends (some of which represent rotating credit associations) is consistent with the hypothesis that social resources available from group support networks disproportionately benefit Asian immigrant firms. Yet the two major sources of institutions) capital (owner equity capital and loans from

TABLE 3

Debt Sources Used by Borrowing Firms (firms started in the 1979-1987 period)

	Immigrant Korean/Chinese	Nonimmigrant Asian	Nonminority
1. Major debt sources- % borrowingfrom:			
Family	41.2%	37.6%	26.8%
Friends	21.7%	21.9%	6.4%
Financial institution	37.4%	52.6%	65.9%
Former owner	17.8%	8.4%	6.1%
2. Loan size by source (mean)			
Family	$34,787	$39,137	$35,446
Friends	$36,198	$34,255	$30,907
Financial institution	$75,267	$67,299	$56,784
Former owner	$67,535	$64,557	$97,225
3. Leverage: (total debt for all borrowers divided by total equity for all borrowers)			
Family	1.16	2.07	2.32
Friends	0.96	2.06	2.03
Financial institution	1.43	2.23	3.10
Former owner	1.28	1.97	3.69

Source: Characteristics of Business owners data base.

financial provide over $46,000 to the average young Korean/Chinese immigrant-owned firm.

Considering the entire Korean/Chinese sample (including nonborrowers), debt from friends was a source of initial capitalization for 11.6 percent of the startups. The striking thing about using friends as a debt source is the small amount of leverage achieved by Korean/ Chinese borrowers: whereas nonminorities borrowing from friends received loans that were, on average, 2.03 times borrower's equity, Korean/Chinese borrowing from friends raised 0.96 in debt per dollar of equity. In all debt categories, Korean/Chinese had less success than any other group in leveraging their equity. These firms stand out as well capitalized because of their large owner equity investments, rooted in substantial accumulations of household wealth. Loans from friends are a minor source of new firm capitalization.

EXPLAINING SIZE OF LOAN

Past studies have shown that having maximum access to debt is directly associated with being highly educated, and investing a substantial sum of equity capital into one's business (Bates, 1990a; Bates, 1991). Financial institutions tend to skim off the most attractive loan recipients among Korean/Chinese (Table 4):

	All Borrowers	Bank Borrowers	Non-Bank Borrowers
Debt (mean)	$50,218	$75,267	$36,516
Equity (mean)	$42,517	$52,656	$36,089
% who attended graduate school	20.6%	31.1%	14.3%

All bank borrower groups receive larger loans than non-bank borrowers, partly because the loan recipients usually have larger equity investments and higher educational attainments, and partly because financial institutions commonly leverage each equity dollar more highly than family and friends. It follows that the lower loan sizes typifying Korean/Chinese borrowers are rooted partially in the fact that they rely more upon non-bank loan sources than other borrowers. Within the Korean/ Chinese group, bank loans often flow to the highly educated owners, while those who have not attended college are heavily dependent upon friends/family/former owners for loans. Considering the total financial capital raised by all of the firms described in Table 4, the ratio of all debt to all equity capital is 2.75 for nonminorities and 1.18 for Chinese/Korean immigrants.

All of the above loan, firm, and borrower characteristics suggest the financial institutions are a superior loan source because more loan dollars are forthcoming from them. This hypothesis (financial institutions provide more loan dollars than other sources) is tested in an OLS regression model where loan amount is the dependent variable.

Past studies have shown that small business startups with access to debt capital are commonly those well endowed with equity capital as well as owner traits associated with firm viability (Bates, 1990a). College-graduate owners investing large amounts of equity into small business creation enjoyed greater loan access than other owner groups (Bates, 1993). OLS regression equations (summarized in Table 5) explain dollar amounts of debt used to finance small business startups for the Korean/Chinese immigrants, Asian American nonimmigrants, and nonminorities. Four types of independent variables are used to explain loan amounts: owner equity capital investment, owner human capital traits, loan source, and owner demographic traits; firm traits are used as control variables.

Considerations of supply by the lender and demand by the borrower are relevant to loan amount decisions. The stronger borrower is hypothesized to get the larger loan, where borrower strength is measured by owner human and equity capital investments in the business startup, and lender aversion to weak borrowers is expected to limit their loan access. While Table 5 explains loan dollar amounts for all borrowing firms, later OLS regression exercises separate borrowers by type of lender. Family and friends, in particular, may be guided by lending motivations unlike those of financial institutions.

TABLE 4

Access to Bank and Nonbank Debt Sources Among Borrowing Firms (firms started in the 1979-1987 period).

Owner group	Financial institution borrowers	Nonbank borrowers
1.ImmigrantKorean/Chinese		
Debt (mean)	$75,267	$36,516
Equity (mean)	$52,656	$36,089
% who attended graduate school	31.1%	14.3%
2. Nonminority Asian		
Debt (mean)	$67,299	$44,313
Equity (mean)	$30,174	$35,801
% who attended graduate school	34.0%	14.1%
3. Nonminority		
Debt (mean)	$56,784	$46,991
Equity (mean)	$18,299	$21,623
% who attended graduate school	17.6%	14.6%

Source: Characteristics of Business Owners data base.

Loan amount and equity capital variables used in the econometric exercises are expressed in dollar amounts. Units of measurement for other explanatory variables are defined below:

Education 2: for owners completing four years of high school, education 2 = 1, otherwise, 0.

Education 3: for owners completing at least one but less than four years of college (and those not attaining a bachelor's degree), education 3 = 1; otherwise, 0.

Education 4: for owners awarded a bachelor's degree, education 4 = 1; otherwise, 0.

Education 5: for owners who attended graduate school, education 5 = 1; otherwise, 0.

Management exper: for those working in a managerial capacity prior to owning the business they owned in 1987, management exper = 1; otherwise, 0.

Gender: for male owners, gender = 1; females, 0.

Wed: for married owners living with their spouse, wed = 1; otherwise, 0.

Equity: dollar amount of equity capital invested at the point of small business entry.

Loan: family: if the startup received loans from family, loan: family = 1; otherwise, 0.

Loan: friends: if the startup received loans from friends, loan: friend = 1; otherwise 0.

Loan: bank: if the startup received loans from financial institutions, loan: bank = 1; otherwise, 0.

Loan: former owner: if the startup received loans from a former business owner, loan: former owner = 1; otherwise, 0.

Retail firm: for firms operating in retailing, retail firm = 1; otherwise, 0.

Skill-intensive firm: for firms operating in professional services, business services, or finance, insurance, real estate fields, skill-intensive firm = 1; otherwise, 0.

Ongoing: if the owner entered a business that was already in operation, ongoing = 1; if the owner was the original founder of the business, ongoing = 0.

In the Table 5 regression equations, loan size for all groups is heavily influenced by the equity capital variable: Korean/Chinese borrowers receive an extra $1.05 debt per equity dollar, well below the $1.26 and $1.27 debt increments associated with each equity dollar invested by nonimmigrant Asian Americans and nonminorities. Loan sizes associated with various loan sources behave similarly for all of the Table 5 groups: financial institutions extend significantly larger loans, while friends and family in no instances extend significantly larger loans, relative to the excluded group, miscellaneous loan sources.[2]

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[2] Control variables identifying a) retail, and b) skill-intensive service industries are not reported in Table 5 because they had no impact upon the reported Table 5 results.

The greatest difference in loan size determination involves human capital variables: college-educated nonminorities and those with managerial experience consistently received larger loans than

TABLE 5

OLS Regression: Explaining Loan Amount for Borrowing Firms (firms formed 1979-1987 only).

A. Regression equations	Immigrant Korean/Chinese Regression coefficient (st'd error)	Asian American Nonimmigrant Regression coefficient (st'd error)	Nonminority Regression coefficient (st'd error)
Constant	-5,220.78 (13,798.97)	-61,267.20* (27,350.67)	-2,687.33 (9,469.01)
Education 2	1,467.84 (10,628.53)	6,862.10 (21,444.95)	8,336.75 (7,323.24)
Education 3	-13,520.59 (10,915.61)	25,482.14 (21,507.40)	20,855.12* (7,724.02)
Education 4	-5,711.36 (9,974.62)	34,945.71 (22,437.11)	33,548.37* (8,260.36)
Education 5	13,340.80 (10,793.23)	44,957.74* (22,863.37)	26,366.69* (8,330.06)
Management exper.	9,960.98 (6,845.19)	-4,035.09 (11,459.72)	14,426.66* (4,679.52)
Gender	9,960.98 (8,916.39)	-4,035.09 (12,271.87)	14,426.66* (5,164.12)
Wed	3,207.05 (8,581.55)	1,810.34 (12,506.17)	4,850.44 (5,439.03)
Equity	1.05* (.02)	1.26* (.04)	1.27* (.03)
Loan: family	2,947.09 (6,595.46)	15,740.71 (11,396.57)	-14,023.80* (5,199.23)
Loan: friends	-7,131.66 (7,244.11)	4,878.78 (14,971.25)	-13,524.21 (8,656.05)
Loan: bank	22,026.32* (6,823.50)	44,299.76* (12,242.10)	8,866.35* (4,644.16)
Loan: former owner	24,338.37* (8,593.55)	14,252.60 (19,645.63)	30,577.52* (9,317.59)

TABLE 5 (continued)

Ongoing	-1,554.98 (6,606.99)	12,622.03 (12,390.98)	11,274.50* (4,955.94)
R^2	.604	.588	.325
F	176.4	93.7	131.0
n	1,515	866	5,882

*statistically significant at the 0.5 level.

B. Mean values, explanatory variables

	Immigrant Korean/Chinese	Asian American Nonimmigrant	Nonminority
Education 2	.196	.201	.309
Education 3	.179	.231	.237
Education 4	.296	.240	.178
Education 5	.206	.246	.166
Management exper.	.275	.406	.376
Gender	.770	.749	.790
Wed	.858	.771	.817
Equity	$42,280	$32,842	$19,433
Loan: family	.412	.376	.268
Loan: friends	.217	.219	.064
Loan: bank	.374	.526	.659
Loan: former owner	.178	.084	.061
Ongoing	.387	.261	.277

Source: Characteristics of Business Owners data base.

other nonminority borrowers, other things equal. Among Korean/Chinese immigrants, in complete contrast, none of the human capital variables had significant impacts upon loan amount. Asian American nonimmigrant borrowers represent a middle ground; human capital variables were generally insignificant but the most highly educated owner subgroup received an incremental $44,957 in loan dollars, relative to the excluded group (owners not completing high school). Lenders, it appears, do not recognize the human capital of Korean/Chinese seeking to finance small business creation. This finding complements the observation by Kim, Hurh, and Fernandez (1989) that American employers often do not recognize the education and work experience that immigrants have accumulated in their native countries. Min (1984) claims that college-educated Koreans often confront serious language barriers that hamper their prospects, especially in jobs requiring college education and contact with the public. Professionals with specific skills (pharmacists for example) are often unable to pass applicable licensing exams because of "inappropriate" training and work experience, as well as limited English fluency. <u>Thus, Asian immigrants may be denied the opportunity to utilize their training and professional skills</u>. This sort of blocked mobility has been identified as a key cause of small business formation among Asian immigrants (Aldrich and Waldinger, 1990). Their inability to leverage their human capital when they finance small business creation can also act as a barrier to Asian immigrant self-employment in cases where significant household wealth holdings are absent.

In summary, the Table 5 regression exercises indicate that the larger loans accrue to the Korean/Chinese immigrants investing the greater equity capital amounts and those borrowing from financial institutions. In sharp contrast to nonminorities, Korean/Chinese are unable to leverage their strong human-capital characteristics. Loans from former owners, furthermore, are significantly larger than loans from other nonbank sources. These findings are consistent with the hypothesis that loan dollars accruing to Korean/Chinese immigrant owners are held down by their heavy reliance upon family and friends debt sources. Table 3 indicated that the Korean/Chinese actually receiving loans from financial institutions were less highly leveraged than other borrower groups, suggesting that differential bank treatment may further reduce their debt reliance. This hypothesis is tested by re-estimating the above OLS regression model explaining debt, including only those firms receiving loans from financial institutions, for a pooled sample of borrowers (Table 6). Binary variables identifying 1) Korean/Chinese immigrants, and 2) Asian American nonimmigrant borrowers are introduced in the Table 6 regression analysis of loan sizes extended by financial institutions. The OLS model explaining loan size for financial institution borrowers is then compared (Table 6) to a companion OLS model analyzing borrowers receiving loans from family and friends.

Nonminority borrowers dominate Table 6, because the firms being analyzed are weighted to represent their relative frequency in the U.S. small business universe.[3] The key finding is that Korean/Chinese borrowing from financial institutions do not receive significantly smaller loans than nonminority borrowers. Their small business startup loans emerge as significantly smaller, other things equal, when they borrow from family and, or friends: the applicable Table 6 regression coefficient indicates a loan size penalty of $25,321.86 for the Korean/Chinese immigrant, relative to nonminorities borrowing from family or friends.

While Table 6 clearly demonstrates that Korean/Chinese immigrant borrowers are receiving small loans from family and friend sources, reasons for this parsimonious behavior are unclear. Table 7 investigates this issue: OLS regressions are used to explain loan sizes received by two groups of borrowers receiving loans from family and, or friends 1) Korean/Chinese immigrants, and 2) African Americans entering self-employment.[4] The African American

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[3] Weights attached to CBO observations by Census Bureau statisticians are used in this study. The CBO very heavily oversampled minority-owned firms, necessitating the use of weights; firms having paid employees were similarly oversampled.

[4] African American-owned firms were selected for inclusion in the CBO data base utilizing the same procedures that applied to Asian-owned firms (Nucci, 1992).

borrowers (Table 7) received smaller average loans than Korean/Chinese immigrants ($15,593 versus $32,065) but this

TABLE 6

OLS Regression: Explaining Loan Amount for Borrowing Immigrant Chinese/Korean, Nonminority, and Asian Nonimmigrant Firms (firms formed 1979-1987 only).

	Financial Institution Loans Only	Loans from Family/Friends Only
A. Regression equations	Regression coefficient (st'd error)	Regression coefficient (st'd error)
Constant	10,651.11	-21,292.25
	(9,624.20)	(12,156.5)
Education 2	5,835.18	6,500.31
	(7,674.59)	(7,657.06)
Education 3	24,378.48*	12,690.68
	(8,343.53)	(7,890.79)
Education 4	32,900.85*	30,345.30*
	(8,895.11)	(8,190.08)
Education 5	34,352.31*	21,147.34*
	(9,289.30)	(8,733.25)
Management exper.	4,031.44	5,919.65
	(5,131.01)	(4,477.47)
Gender	-3,350.38	2,418.78
	(5,836.91)	(4,808.79)
Wed	7,016.21	2,787.91
	(6,150.63)	(4,696.87)
Equity	1.24*	1.25*
	(.03)	(.05)
Loan: family	-10,600.13	7,073.61
	(6,572.83)	(8,535.14)
Loan: friends	673.09	933.86
	(12,670.25)	(7,329.64)
Loan: bank	--	9,368.91*
	--	(4,291.63)
Loan: former owner	50,186.97*	38,453.61*
	(11,767.53)	(9,073.63)

TABLE 6 (continued)

Retail firm	-9,250.18 (5,671.62)	4,584.88 (5,074.34)
Skill-intensive firm	-15,436.04* (6,308.57)	2,955.05 (3,542.74)
Ongoing	18,044.46* (5,328.78)	10,008.08* (4,882.18)
Asian American nonimmigrant	-12,560.85 (26,557.90)	2,590.86 (15,822.04)
Korean/Chinese immigrant	-26,363.14 (21,937.57)	-25,321.86* (11,171.28)
R^2	.248	.256
F	96.9	52.3
n	4,713	2,598

*statistically significant at the .05 level.

B. Mean values, explanatory variables

	Financial Institution Loans Only	Loans from Family/Friends Only
Education 2	0.303	0.301
Education 3	0.223	0.24
Education 4	0.176	0.221
Education 5	0.178	0.155
Management exper.	0.39	0.357
Gender	0.806	0.777
Wed	0.84	0.768
Equity	18863.7	15720.64
Loan: family	0.141	0.858
Loan: friends	0.034	0.222

TABLE 6 (continued)

Loan: bank	--	0.332
Loan: former owner	0.041	0.053
Retail firm	0.248	0.251
Skill-intensive firm	0.241	0.216
Ongoing	0.273	0.231
Asian American nonimmigrant	0.007	0.015
Korean/Chinese immigrant	0.011	0.031

Source: Characteristics of Business Owners Database difference is rooted in differing owner endowments of the various explanatory variables.[5]

Analysis of the Korean/Chinese immigrant subset borrowing from family and friends reveals that their low loan sizes are rooted in the small amount of incremental debt generated by a dollar of equity-capital investment. Coefficients of equity variables in Tables 6 and 7 indicate that a dollar of equity is associated with a debt increment of $1.25 for the broader firm group borrowing from family and friends. For Korean/Chinese borrowers only, the corresponding debt increment is 67 cents. African Americans financing business entry by borrowing from friends and family generated $0.83 in debt per dollar of equity, other factors constant (Table 7). While lack of equity may hold down loan size, African Americans are clearly suffering no disadvantage, relative to Korean/Chinese immigrants, when they leverage that equity by borrowing from family and friends.

The Korean/Chinese immigrant-owned firms analyzed in Table 7 are particularly concentrated in retailing: 58.9 percent ran retail operations, versus 40.5 percent of all Korean/Chinese firms (Table 2). In fact, average profits in retailing are low relative to

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[5] Mean values of variables appearing in OLS regression tables sometimes differ slightly from corresponding values appearing elsewhere. Item nonresponse patterns make samples used in regression analyses slightly smaller than corresponding samples used for generating summary statistics in Tables 1, 2, 3, 4, and 8..

other lines of small business. Thus, their heavy concentration in a low-yielding field could possibly account for the small loan

TABLE 7

OLS Regression: Explaining Loan Amount for Borrowing African-American and Immigrant Chinese/Korean Firms Borrowing from Family and Friends (firms formed 1979-1987 only).

A. Regression equations	Korean/Chinese-Owned Firms only Regression coefficient (st'd error)	African American-Owned Firms only Regression coefficient (st'd error)
Constant	-28,615.90* (13,434.70)	-13,417.98 (9,333.31)
Education 2	8,658.10 (8,422.06)	1,224.47 (5,617.54)
Education 3	5,772.69 (8,721.24)	8,095.68 (6,213.18)
Education 4	2,517.80 (7,784.84)	2,145.45 (7,023.30)
Education 5	14,160.90 (9,278.84)	14,809.59* (7,656.49)
Management exper.	10,686.57* (5,485.50)	4,056.49 (4,451.78)
Gender	-6,271.37 (5,661.95)	-868.30 (4,045.63)
Wed	13,214.09* (7,435.06)	-1,317.51 (4,347.61)
Equity	.672* (.04)	.832* (.07)
Loan: family	14,799.34 (7,830.59)	14,867.66* (6,607.61)
Loan: friends	8,157.39 (7,082.56)	8,652.77 (5,995.29)
Loan: bank	26,679.48* (6,709.76)	12,475.69* (4,442.48)
Loan: former owner	9,764.52 (8,629.92)	5,438,37 (9,751.79)

TABLE 7 (continued)

Retail firm	5,901.27 (5,476.36)	700.93 (4,777.44)
Skill-intensive firm	-10.26 (9,768.24)	-2,157.17 (5,606.49)
Ongoing	502.34 (5,522.52)	5,809.09 (5,261.24)
R^2	.350	.250
F	27.0	14.8
n	770	592

*statistically significant at the .05 level.

B. Mean values, explanatory variables

	Korean/Chinese-Owned Firms only	African American-Owned Firms only
Education 2	.206	.344
Education 3	.169	.220
Education 4	.288	.133
Education 5	.189	.140
Management exper	.287	.263
Gender	.755	.670
Wed	.854	.739
Equity	30,602.38	7,553.41
Loan: family	.716	.746
Loan: friends	.429	.379
Loan: bank	.207	.271
Loan: former owner	.107	.041
Retail firm	.589	.228

TABLE 7 (continued)

Skill-intensive firm	.115	.196
Ongoing	.369	.162

Source: Characteristics of Business Owners Database sizes accruing to Korean/Chinese borrowing from family/friends sources. Yet, Table 7's regression exercise shows that operating in retailing produces no loan size penalty, nor does business operation in the high yielding skill-intensive services produce a loan size increment. Industry of operation and loan size show no clear-cut relationship for either Korean/Chinese or African Americans borrowing from family, and friends.

FINANCING FOR THE LESS VIABLE BUSINESS STARTUPS

The lower loan sizes of Korean/Chinese immigrant borrowers are caused, in part, by their heavier reliance on family and friends as loan sources (Table 3). Size of startup capitalization has been linked positively to subsequent firm size, profitability, and survival prospects (Bates, 1994a; Bates, 1993). This pattern is consistent with Yoon's observation that Korean-owned firms in Chicago utilizing nontraditional types of credit were smaller-scale, less profitable, more failure-prone operations (1991a). In fact, small business startups owned by Vietnamese immigrants rely more heavily upon loans from family and friends than any other major Asian group.[6] Relative to their Asian cohorts, Vietnamese nationwide run the smallest firms, earn the lowest returns from self-employment and suffer the highest discontinuance rates (Bates,

[6] This calculation is based upon CBO data base samples of firms created in the 1979-1987 period.

1994a; Fratoe, 1986). Self-employed Asian Indians, in contrast, rely most heavily upon loans from financial institutions to finance business creation. Relative to their Asian cohorts, Asian Indians rank highest in self-employment mean income and lowest in firm discontinuance rates (Fratoe, 1986; Bates, 1994a). These patterns do not necessarily imply that borrowing from family and friends undermines firm viability.

Table 8 examines a subset of Korean/Chinese immigrant borrowers who relied heavily upon friends and family to finance business startup: the subset includes firms in retailing headed by owners who did not attend college. Although few of these firms had access to loans from financial institutions, 67.1 percent of these owners borrowed money to finance their entry into retailing. This incidence of borrowing is substantially higher than the 53.4 percent borrowing rate typifying the entire Korean/Chinese owner sample (Table 1). Of the loan sources described in Table 8, financial institution loans were most common among the nonminorities but least common among the Korean/Chinese. It is likely that many of the Korean and Chinese immigrants owning retail firms would have been unable to assemble the requisite start-up capital in the absence of nontraditional debt sources. In terms of leverage, indebtedness of the Korean/Chinese borrowers is low ($1.16 in debt per dollar of equity, versus $2.10 among nonminorities). However, leverage is only one aspect of credit availability; the higher overall incidence of loans utilized by

Korean/Chinese immigrants, including these in the low-yielding retailing field, consistently delineates them from other groups. Firms that might not otherwise exist are one outcome of their high propensity to borrow from friends and family.

Profitability of retail firms operated by Korean/Chinese immigrants lacking college educations appears to be competitive with cohort nonminorities, but this is misleading. Profitability reflects returns to the owner labor and capital invested in the firm, and the immigrant groups have, on average, invested more of their labor and capital in retailing than cohort nonminorities (Table 8). Allowing a 10 percent return to owner equity investment and expressing the residual profits as a return per hour of owner labor input, Korean/Chinese immigrants were earning a profit of $3.82 per hour, versus $4.89 for nonminorities. Among Table 8's cohort African Americans in retailing, average hourly return was $4.00.

Greater loan availability from family and friends appears to expand the pool of marginal Korean and Chinese immigrant-owned firms operating in low-yielding industry niches. Oddly, <u>sociologists commonly equate high rates of self-employment with immigrant success in the small business realm</u>. Yoon (1991b), for example, asserts that "small business has been an avenue for disadvantaged minorities to achieve upward social and economic mobility in the United States," but his study contains no analysis (or definition) of success or upward mobility. Are the Korean/Chinese immigrant owners of retail operations described in Table 8 successful? Among this group, 42.7 percent reported total household incomes under $15,000 in 1987, versus 29.5 percent of

TABLE 8

Retail Firms Operating in 1987 whose Owners have not Attended College (firms started since 1979 only).

A. All	Korean/Chinese Immigrant	Nonminority
1. Firm traits		
1987 gross sales (mean)	$139,177	$217,621
Financial capital (mean)	$52,968	$40,519
% started with debt capital	67.1%	43.2%
1987 before-tax profit (mean)	$12,978	$12,217
2. Owner traits		
Owner labor input hours in 1987 (mean)	2,634	2,131
% with less than four years of high school	54.7%	26.4%
B. Borrowers only		
Startup equity (mean)	$27,497	$20,268
Startup debt (mean)	$31,782	$42,531
Sources of debt:		
Family	52.9%	24.2%
Friends	22.9%	7.2%
Financial institution	22.7%	69.6%
Former owner	23.6%	9.6%

A. All	Korean/Chinese Immigrant	Nonminority
Leverage (debt/equity)	1.16	2.10

their nonminority cohorts. Their returns from self-employment may be viewed, not as evidence of success, but as a reflection of the paucity of opportunities available to Korean and Chinese immigrants in the U.S. labor market (Borjas, 1994). Whether or not the pattern of loan availability forthcoming from family and friends is promoting success in the Korean/Chinese immigrant small business community is a value judgement. Do the 20 percent (and higher) interest rates charged Korean store owners by RCAs in Chicago promote success among marginal retail operations (Yoon 1991b)? "Success," in the context of self-employment, is a concept sorely in need of elaboration.

CONCLUDING REMARKS

Empirical studies to date have commonly sought to explain variations in the rates of self-employment that immigrant groups exhibit (Borjas, 1986; Evans, 1989; Kim, Hurh, and Fernandez, 1989). Descriptive studies often focus upon owner traits as well as the operating environment of the immigrant firms (Min, 1986-'87; Fratoe, 1989; Bonacich and Light, 1988). Out of this literature has emerged the conventional wisdom that entrepreneurship among Asian immigrants has been substantively promoted by RCAs and supportive social networks generally.

The immigrant Korean and Chinese small business startups examined in this study generated lower sales and profits than cohort nonminority-owned small businesses, despite their larger investments of human and financial capital. The majority of startup capital for all business groups came from financial institutions (debt) and family wealth (equity). Use of loans from family and friends typified the firms receiving the smaller loans. Controlling for firm and owner traits, loans from family and friends were shown to be smaller than loans from financial institutions for nonminority, nonimmigrant Asian Americans, and Korean/Chinese immigrant borrowers. Looking solely at firms borrowing from family and friends, loans extended to Korean/Chinese borrowers were significantly smaller than loans of comparison groups. African Americans borrowing from friends and family received 83 cents in debt per dollar of equity, versus 67 cents for Korean/Chinese firms, controlling for owner and firm traits.

High levels of startup capital typifying Korean/Chinese immigrant-owned firms reflect their heavy reliance upon equity capital to finance small business creation. Retail firms headed by owners who are not college educated represent one niche in which loans from family and friends are a major capital source for Korean/Chinese small businesses. Proliferation of such marginally profitable firms indeed appears to be an outcome of Korean/Chinese utilization of nontraditional sources of startup capital.

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