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The Financing Experiences of Nonemployer Firms:

Evidence from the 2014 Joint Small Business Credit Survey

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The Financing Experiences of Nonemployer Firms: Evidence from the 2014 Joint Small Business Credit Survey

Abstract: Businesses without employees—or nonemployer firms—make up the majority of small businesses in the United States, but little is known about their financial lives, including their business financing needs and experiences. In this paper, we discuss findings from data on nonemployer firms in the 2014 Joint Small Business Credit Survey, a new annual survey by the Federal Reserve Banks of Atlanta, Cleveland, New York, and Philadelphia.

Our results indicate that nonemployers use financing less than employers do. They hold less debt and apply for financing at lower rates, even when controlling for revenue size. The lower demand for credit appears to be a combination of a preference to avoid debt and a perception that nonemployers will be denied if they apply. Nonemployer applicants have more difficulty being approved and are likelier to seek financing from online lenders than are employer firms. We believe that the higher denial rates that nonemployers experience are at least partially explained by the differing attributes of the group. Nonemployers are younger, likelier to cite their poor credit score as a reason for denial, and less likely to be turning a profit than are employer firms.

JEL Classification: L25, M13, G20
Keywords: firm performance, new firms, start-ups, financial institutions and services

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Comments to the authors are welcome at Stephanie.Rosoff@ny.frb.org and Ellyn.Terry@atl.frb.org.

More than 80 percent of businesses in the United States are nonemployer firms, meaning that they have no employees besides the owner.[1] Together, they make up just 3 percent of annual business receipts, but they contribute to economic activity in other ways that are not captured in aggregate statistics. From a societal standpoint, self-employment is an important source of alternative income and provides a possible path up the economic ladder. The option can be especially important among those whose employment options are limited due to language barriers, lack of formal education, or a need for flexible work arrangements. Three demographic groups with increasing self-employment rates, for example, are women, minorities, and immigrants (Survey of Business Owners 2002 and 2007). From a macroeconomic perspective, nonemployers are an important starting point for many larger firms. Not only do they serve as a proving ground for ideas (Dunn and Holtz-Eakin 1996), but they also have much higher rates of creation and destruction than employer firms do. High levels of "dynamism" have been linked to both productivity and employment growth in the overall economy (Decker, Haltiwanger, Jarmin, and Miranda 2014).

Although the literature on the economic impact of nonemployer firms is growing, less is known about how businesses are born and financed throughout their life cycles. Having an understanding about how owners finance their businesses has grown in importance in recent years. The Great Recession had an uneven effect on firms. In particular, small firms were hit especially hard and have taken longer to recover (Rosengren 2012, Acs and Carrington 2012, and Williams 2014). While many factors likely contributed to the different experiences of small and large firms, at least some of the differential recovery can likely be explained by how small and large firms are funded. Declines in community bank health (Laderman 2012)—an important source of funding for small firms (Tarullo 2014)—may have been a contributing factor as well. Indeed, the growth of small dollar loans (see figure 1) has been far slower than that of large loans in recent years.

Figure 1. Growth in Loan Balances by Loan Size, Indexed to Q3-2012

Source: Federal Deposit Insurance Corporation

[1] In this paper, we refer to firms without employees as nonemployer firms and the individual owners of these firms as the self-employed. About 6 percent of workers are considered unincorporated self-employed (Bureau of Labor Statistics, Current Population Survey, 2014).

But the recession's effects reached beyond banks. Home values and 401(k)s, funding sources of great importance for the smallest and youngest firms, declined during the recession. In general, tightening lending standards could have affected smaller firms more if they were perceived as riskier than their large counterparts. For example, lenders would be more hesitant to lend to small firms with less access to collateral or a weaker credit history during uncertain times.

Knowing how different types of firms obtain funding helps us better understand the implications of changing financial markets, regardless of whether the change is related to a financial crisis, new credit products or changes in regulations. In this paper, we focus specifically on the smallest type of firm—nonemployers. Using data from the 2014 Joint Small Business Credit Survey (SBCS), a new annual survey by the Federal Reserve Banks of Atlanta, Cleveland, New York, and Philadelphia, we examine how characteristics of nonemployers differ from employer firms and how their financing seeking experiences varies. To date, this paper provides the most recent and comprehensive information on nonemployer and employer firms.

Results and Discussion

The results are broken into two sections. In the first, we provide descriptive statistics on the characteristics of nonemployer firms, noting the ways they differ from employer firms. In the second section, we discuss how the financing needs of nonemployers differ from employer firms and what types of financing they rely on. We find that the nonemployer firms tend to have a more difficult time obtaining credit than do employer firms and that some of the difference can be explained by their differing firm attributes.

Characteristics of Nonemployer Firms

First, we look at the attributes of nonemployer firms in the SBCS and then nonemployer firms more generally.

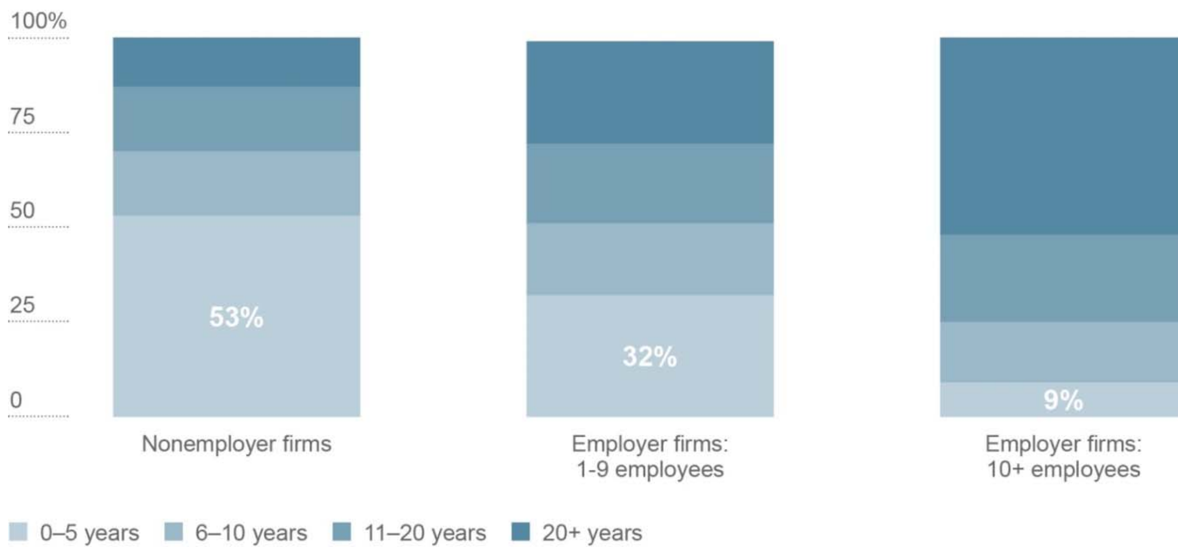
Nonemployer firms are dynamic and young.

Data on business formation and destruction show that nonemployer firms experience far more turnover than do employer firms. Entering self-employment can depend on a number of factors such as wealth, education, and demographics. Aggregate labor demand may influence the decision to start or end self-employment (Schweitzer and Shane forthcoming). Acs, Headd, and Agwara (2009) estimate that between 2003 and 2004, about a third of nonemployer firms were starting up (34 percent) and about another third were dying off (30 percent). In contrast, employer firms have much lower turnover, with birth and death rates of 13 and 11 percent, respectively. As a result, nonemployers tend to be younger than employer firms. The median age for nonemployer firms is about six years old, compared to a median age of about 10 years for employer firms (Headd 2014).

In the SBCS, over half of nonemployer firms were younger than five years. As we might expect, employer firms in the SBCS are older on average, and the age distribution skews older as firm employee size increases.[2]

[2] Older employer firms are overrepresented in the SBCS. According to the 2012 U.S. Census Bureau's Longitudinal Business Dataset, 67 percent of employer firms in our geographic coverage area were in business for at least 5 years. In the SBCS, 80 percent of employer firms were age 5 or older. The age composition of firms in Figure 1 is of raw, unweighted respondents. We use survey weights to correct for age in subsequent analysis of employer firms.

Figure 2. Age Composition of SBCS Respondents by Firm Size (Percent of Firms)



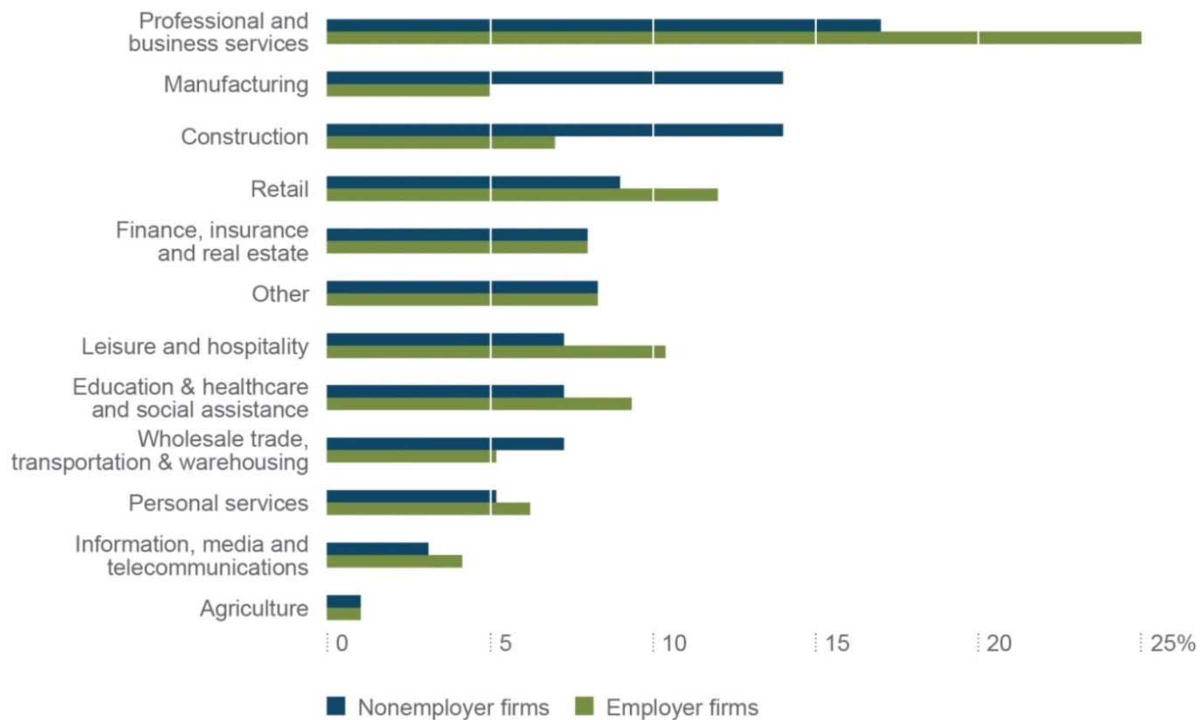
Source: Joint Small Business Credit Survey, 2014. N=2,016

Nonemployer firms in the SBCS cluster in the professional and personal services industries.

More than half of nonemployer respondents are in a "high-barrier' industry."[3] Industries with larger capital requirements, such as manufacturing, or with high-skill requirements, such as professional and business services, finance, and real estate, can be classified as high-barrier industries. A quarter of SBCS nonemployer respondents are in the professional and business services industry. "Low-barrier" industries are those with lower skill and capital needs, such as construction, retail, and personal services (Bates and Lofstrom 2011). About 48 percent of respondents are in low-barrier industries.

[3] Figure 2 displays raw, unweighted survey industry composition. We use survey weights to correct for industry representation in subsequent analysis for both nonemployer and employer firms.

Figure 3. Industry Composition of SBCS Respondents (Percent of Firms)

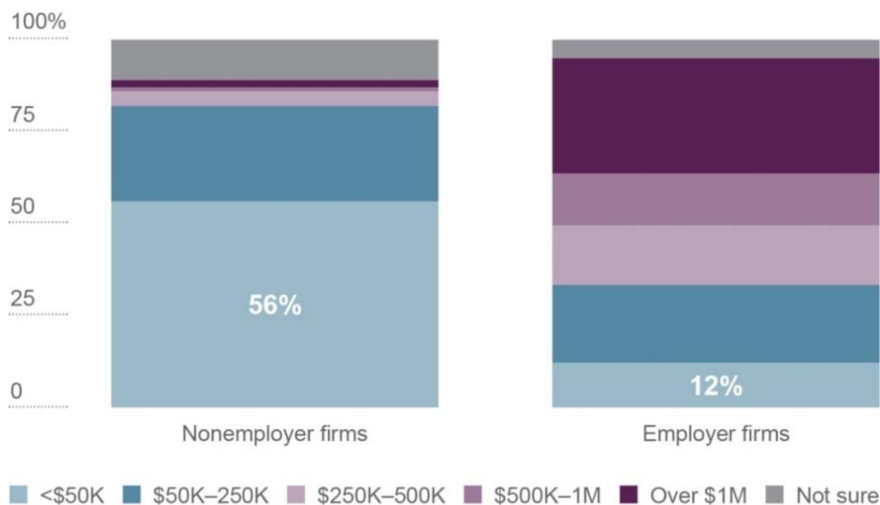


Source: Joint Small Business Credit Survey, 2014. N=2,016

Nonemployer firms have modest revenues.

Not surprisingly, nonemployer firms reported lower revenues than did employer firms. Over 80 percent of nonemployer firms come in under $250,000 annually and over half have revenues of less than $50,000. A third of employer firms reported revenues of less than $250,000, and only 12 percent reported less than $50,000.

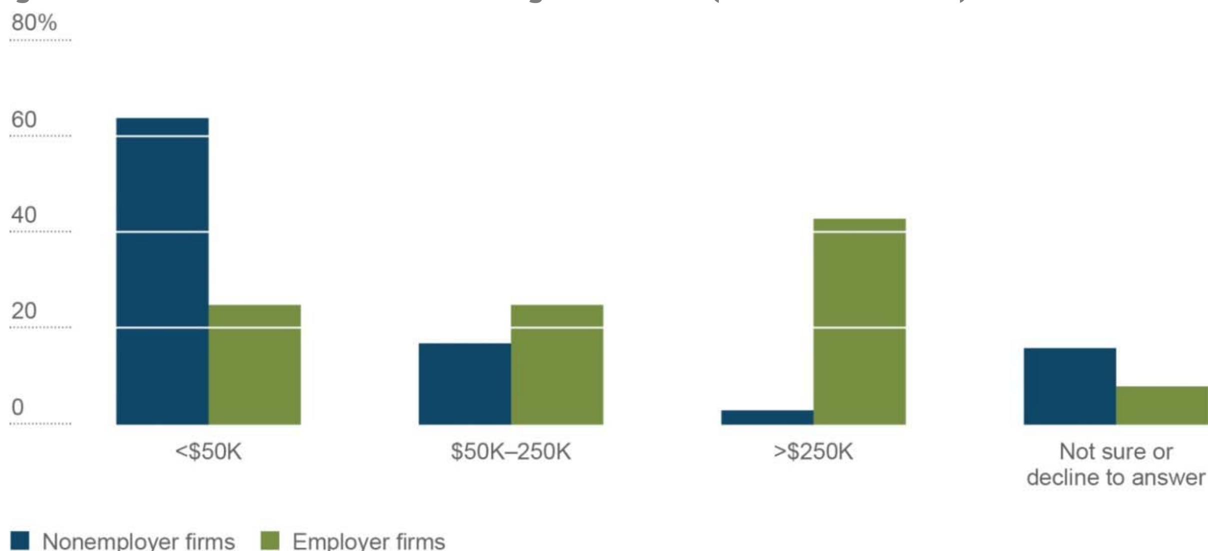
Figure 4. Annual Revenue of Firms



Source: Joint Small Business Credit Survey, 2014. N=2,016

To some extent, the lower revenues of nonemployer firms can be explained by their age. Nonemployers tend to be younger, and younger firms tend to have lower revenues. Still, when broken out, the revenue distribution of young nonemployer firms (0 to 5 years) is lower than employer firms of the same age. Among nonemployer firms that have been in business for less than six years, 64 percent have less than $50,000 in revenues, compared with 25 percent of employer firms. Our analysis of revenues for nonemployers is limited. We did not ask survey respondents if revenues are the sole source of income for the self-employed respondents, nor do we know what salary the owner takes home and if the owner counts salary toward their bottom line.

Figure 5: Annual Revenue for Firms Age 0-5 Years (Percent of Firms)

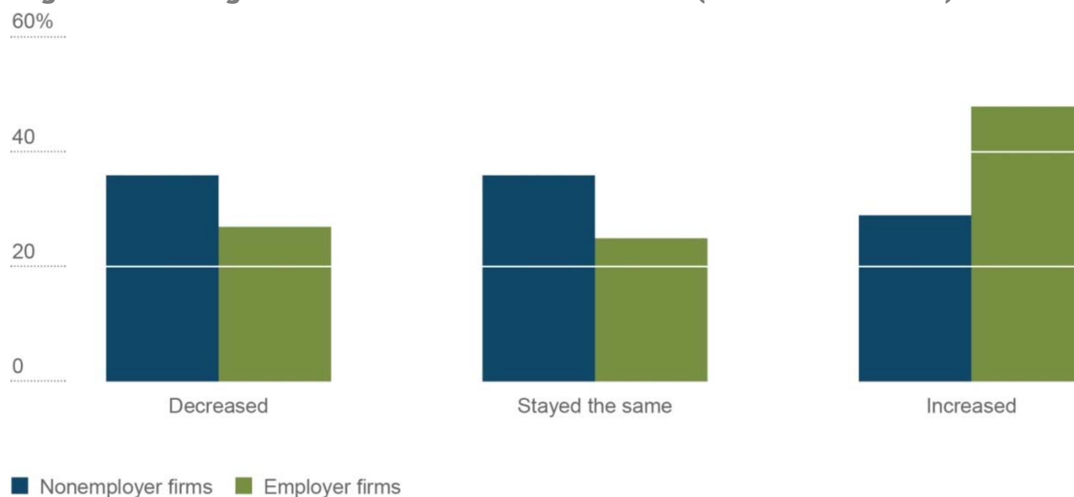


Source: Joint Small Business Credit Survey, 2014. N=627

Nonemployer firms have significant performance challenges but are optimistic about growth.

Nonemployer firms were less likely to have growing revenues or to be operating at a profit. Twenty-nine percent of nonemployer firms indicated growing revenues and 25 percent said they were profitable, compared to 48 and 45 percent of employer firms. The fact that nonemployers are relatively young helps explain much, but not all, of the weakness. Young firms are much less likely to be profitable in general, but young nonemployer firms are even more likely to be operating at a loss.

Figure 6: Change in Revenue in Past 12 months (Percent of Firms)



Source: Joint Small Business Credit Survey, 2014. N=1,996

Despite weak performance, nonemployer firms are optimistic about future returns. While less than a third of nonemployer firms reported an increase in revenues over the past 12 months, nearly twice as many said they expect revenues to tick up over the next 12 months.

While many nonemployers anticipate revenue growth, most do not expect to hire. Eighteen percent of nonemployer firms said they plan to hire full-time employees over the coming 12 months, compared to 38 percent of employer firms. Even among firms that experienced increasing revenues, only a quarter of nonemployers expect to hire full-time employees, about half the rate reported by employer firms.

Table 1. Hiring Expectations for Growing Firms

In the next 12 months,	Firms with increasing revenues	
	Nonemployer firms	Employer firms
Expect a decrease in full-time employees	2%	4%
Expect no change in full-time employees	73%	47%
Expect an increase in full-time employees	25%	49%
Total	*100%*	*100%*

For the self-employed, hiring employees is not necessarily the goal. A recent survey of Etsy sellers[4] explains that "the vast majority of Etsy sellers—91 percent—want to increase their sales in the future. But when asked about the size of their shops in five years, very few aspire to be "as big as possible." The majority of sellers—61 percent—want their future shops to be "a size I can manage myself."

While most nonemployer firms never expand, those that do hire and transition into employer firm status make up a nontrivial share of new employer firms. Davis et al. (2009) estimate that between

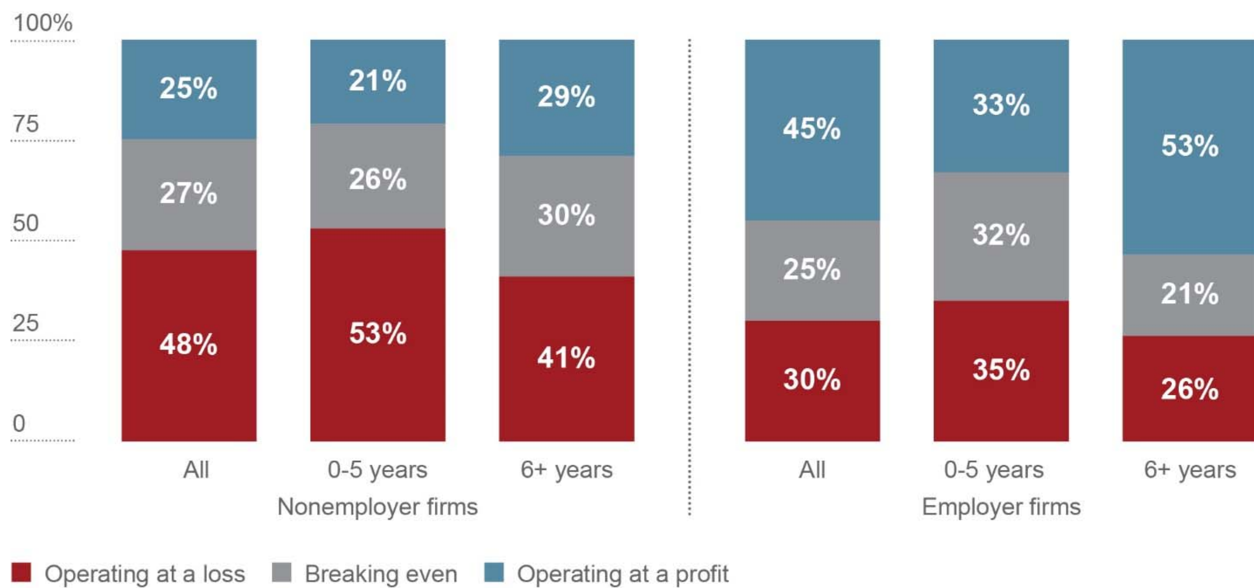
[4] Etsy is an online marketplace where entrepreneurs sell goods through virtual shops. The Etsy Sellers Survey estimated that 83 percent of Etsy sellers operated without employees.

1997 and 2000, 3 percent of nonemployers, or about 220,000 firms, “migrate” to employer firm status. They estimate that a quarter of all new employer firms start out as nonemployer firms.

Prior ownership experience.

About a third of nonemployer firms indicated they had owned another business prior to this one, somewhat less than for employer firms. However, prior ownership experience does not necessarily translate to better business performance for nonemployers. About half of nonemployer firms, regardless of prior ownership experience, report operating at a loss. Older nonemployer firms with prior ownership experience performed somewhat better. One fifth of young nonemployer firms whose owner had previous experience owning a business were operating at a profit, compared to about a third of older nonemployer firms.

Figure 7: Profitability for Nonemployer Firms by Age (Percent of Firms)



Source: Joint Small Business Credit Survey, 2014. N=1,996

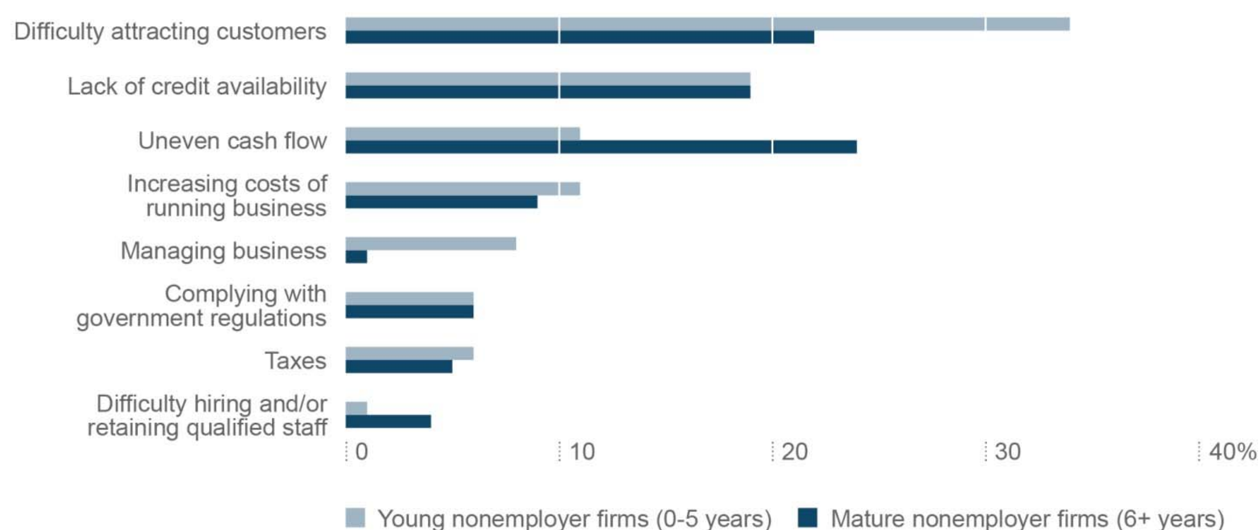
Nonemployer and employer firms face similar challenges.

As did employer firms, nonemployers cited difficulty attracting customers, lack of credit availability, and uneven cash flow as their top challenges. Of the nonemployer firms that selected “lack of credit availability” as their top challenge, over half did not apply for credit in the first half of 2014, mainly because they did not think they would be approved. Old and young nonemployers alike reported being concerned about credit availability, but older firms were twice as likely to have cited uneven cash flow as a top concern. Younger nonemployers are more challenged by finding customers.

Table 2. Top Business Challenge

Top Challenge	Nonemployer Firms	Employer Firms
Difficulty attracting customers	29%	18%
Lack of credit availability	19%	15%
Uneven cash flow	17%	20%
Increasing costs of running a business	10%	20%
Complying with government regulations	6%	6%
Taxes	5%	6%
Managing business	5%	4%

Figure 8: Top Business Challenge for Young and Mature Nonemployer Firms (Percent of Firms)



Source: Joint Small Business Credit Survey, 2014. N=1,923

Credit Access for Nonemployer Firms

In this next section, we use the SBCS to shed light on nonemployer use of financing, funding sources, and demand for and access to credit.

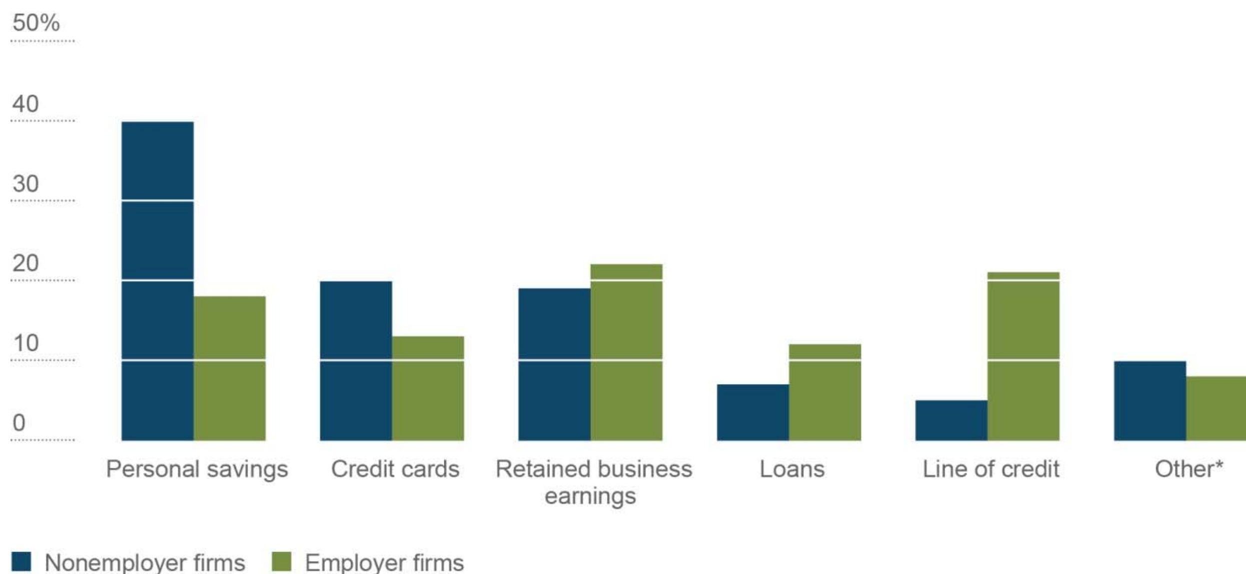
Personal sources are the top used source of funding according to the firms in the 2014 SBCS.

Other surveys have also revealed the importance of owner funding. In the 2007 survey of business owners, 30 percent of respondents said they used personal/family savings or assets as a source of expansion capital. Personal assets are even more important for the start-up phase. In the Kauffman Firm Survey, 63 percent of participating firms that began operations in 2004 used owner equity. Unfortunately, with the Great Recession came declining home values, a collapse in equity markets, and cuts in credit card lines. These circumstances combined to reduce the ability of business owners to tap personal sources.

Using data from the SBCS, we find that nonemployer firms in particular rely heavily on such personal sources to fund their business. When asked how their business was funded during 2013, 40

percent of the nonemployers said they relied on personal savings as their primary funding source compared to less than 20 percent of employer firms. Nonemployers were also much less likely to use loans and lines of credit from banks and much more likely to use credit cards.

Figure 9: Primary Funding Source (Percent of Firms)



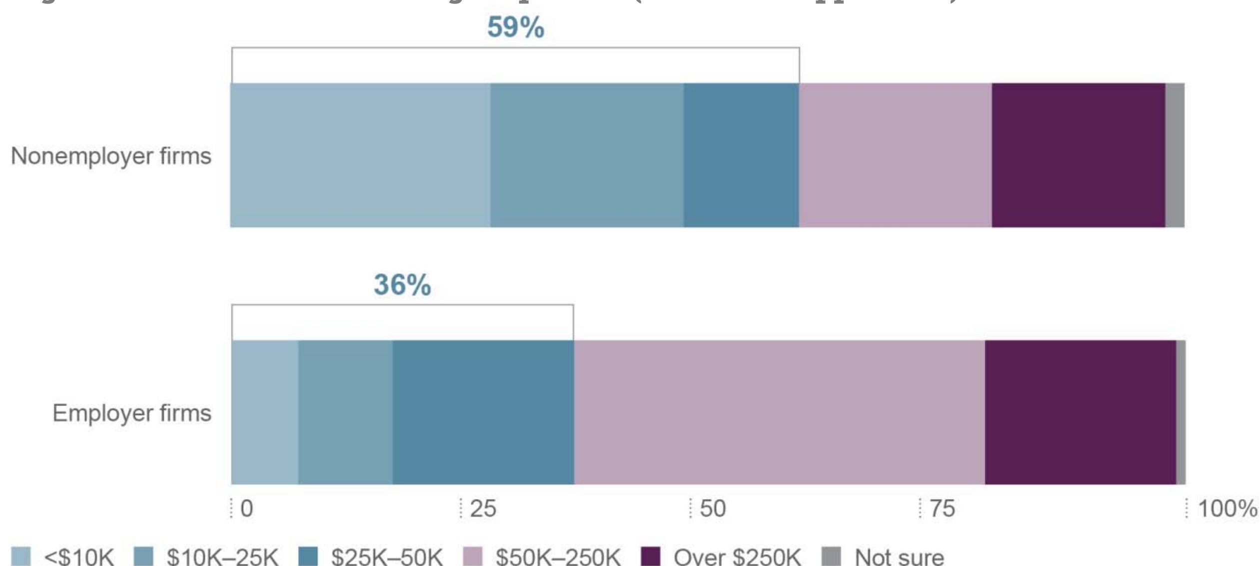
*Other includes equity investments, trade credit, commercial mortgages, leasing, and other.

Source: Joint Small Business Credit Survey, 2014. N=1,933

Credit demand is low for nonemployer firms.

The relatively high reliance on personal savings suggests that some nonemployers have a lower demand for credit than do employer firms while others have difficulty obtaining outside funding. When asked if they applied for financing in the first half of 2014, 19 percent of nonemployers applied for financing compared to 35 percent of employer firms. Nonemployers also mostly needed microloans. Figure 11 below shows the distribution of the amount of financing sought for those that applied. About half of nonemployer applicants sought less than $25,000 and a further 12 percent sought between $25,000 and $50,000. About one-quarter sought more than $100,000, compared to 42 percent of employer firms.

Figure 10: Amount of Financing Requested (Percent of Applicants)

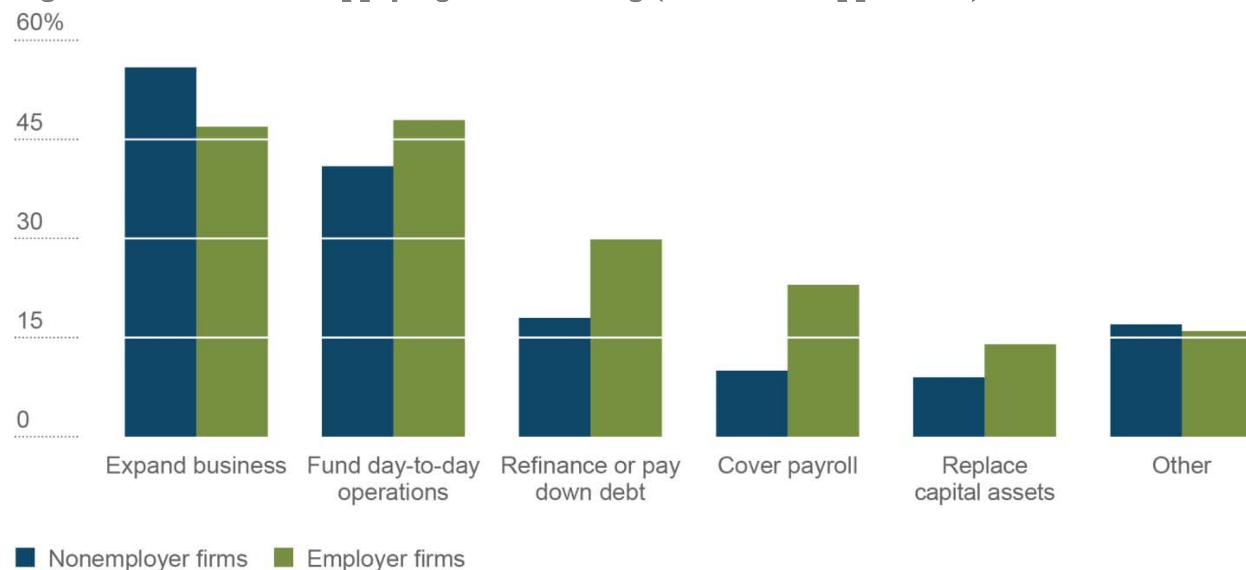


Source: Joint Small Business Credit Survey, 2014. N=587

This finding is not surprising given that requests for financing generally rise with revenues, and nonemployers have lower revenues than do employer firms. However, nonemployers have a lower demand for credit even when we compare firms within the same revenue size category. For example, of firms with between $50,000 and $250,000 in annual revenues, one-fifth of nonemployer firms applied compared to one-third of employer firms. Nonemployers also sought less. Roughly two-thirds of nonemployer applicants requested less than $50,000, compared to half of applying nonemployers.

Figure 11 below shows the reasons why firms were seeking credit. Like employer firms, nonemployers looking for financing reported doing so mostly to expand their business or fund their day-to-day operations.

Figure 11: Reason for applying for financing (Percent of Applicants)



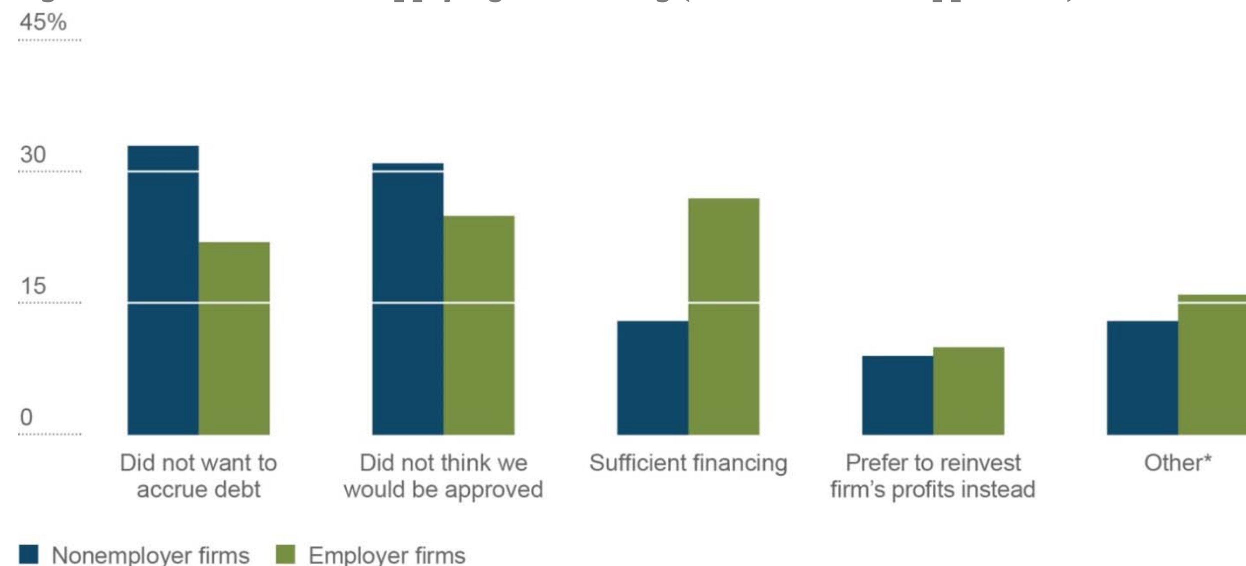
Source: Joint Small Business Credit Survey, 2014. N=588

Like their low rate of credit applications suggest, the self-employed are also less likely to hold business debt. Only about one-third of nonemployer firms held any debt as of the end of 2013. Of those with debt, one-third held less than $10,000 and 27 percent held between $10,000 and $25,000. It's important to note that the SBCS does not ask specifically about outside debt. Therefore, respondents could have included as business debt a loan from an owner or family member, or debt secured by their home or other assets.

Few nonemployers give "sufficient financing" as the reason for not applying.

Nonemployers gave a variety of reasons for not applying, but it usually was not because they didn't need credit. When asked why they did not apply, only 13 percent said they had sufficient financing, compared to 27 percent of employer firms. The most cited reason for not borrowing was "did not want to accrue debt," suggesting that at least some of the lower application rate could reflect a preference on the part of the owner. It's clear that lack of credit options also plays a role in the decision to borrow. Twenty-five percent of employer firms and 31 percent of nonemployer firms did not apply for financing in the first half of 2013 because they believed they would not be approved.

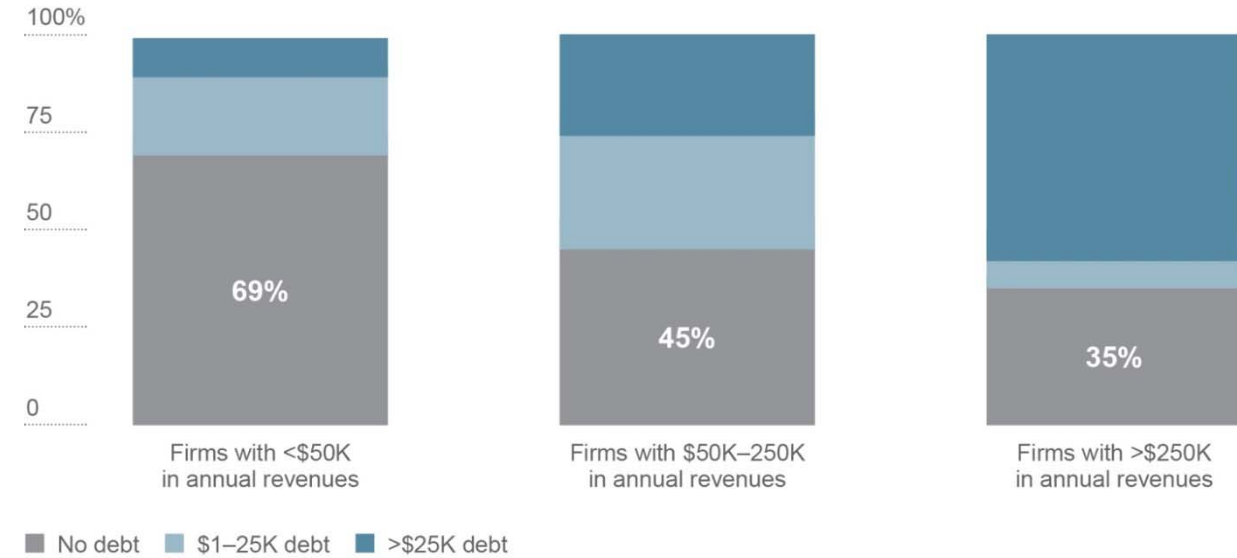
Figure 12: Reason for not applying for funding (Percent of Non-Applicants)



Source: Joint Small Business Credit Survey, 2014. N=1,285

The lack of debt among nonemployers appears related to the facts that most nonemployers have relatively small businesses and smaller firms tend to have less debt. Seventy percent of firms with less than $50,000 in revenue had no debt compared with a third of firms that have more than $250,000 in revenues. About half of nonemployers fall into the less than $50,000 category. But the fact that nonemployers are smaller does not fully explain their lower debt holdings. Even within the same revenue category, nonemployers are less likely to hold debt. For example, 36 percent of employer firms in the $50,000 to $250,000 revenue category held no debt, compared to 55 percent of nonemployer firms in the same revenue category.

Figure 13: Outstanding Business Debt by Firm Revenue Size (Percent of Firms)



Source: Joint Small Business Credit Survey, 2014. N=1,821

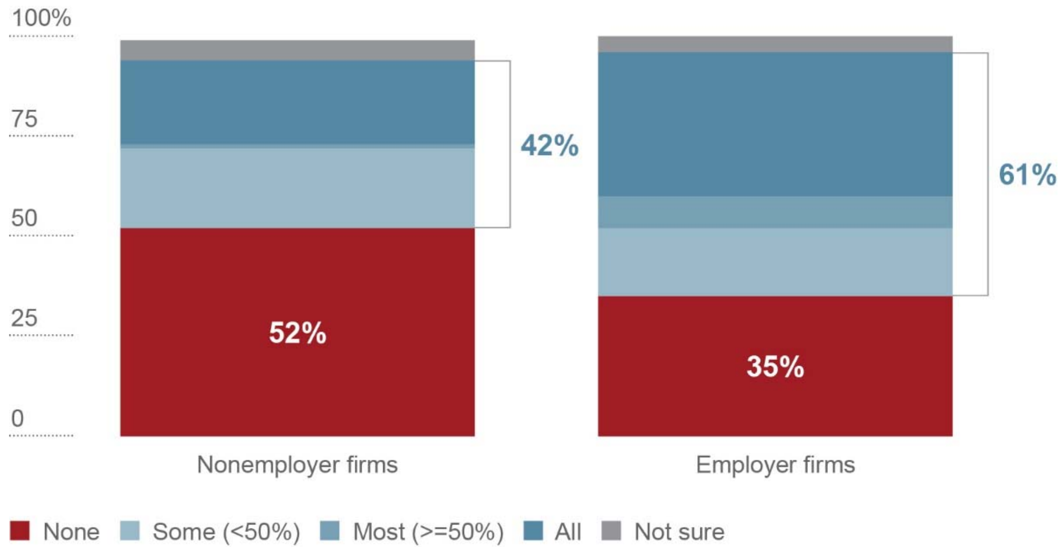
Figure 14: Firms with No Outstanding Business Debt by Employer Status (Percent of Firms with No Debt)

Source: Joint Small Business Credit Survey, 2014. N=794

Nonemployers have difficulty obtaining financing.

When nonemployers do seek outside financing, they face a tough market. The credit needs of the self-employed are difficult to fulfill for several reasons. Half of nonemployer firms have been around fewer than five years, giving them little sales history. Without a solid revenue stream, it is difficult for creditors to assess risk. Ultimately, less than half of self-employed applicants are approved for any financing compared to 61 percent of employer applicants in the first half of 2014.

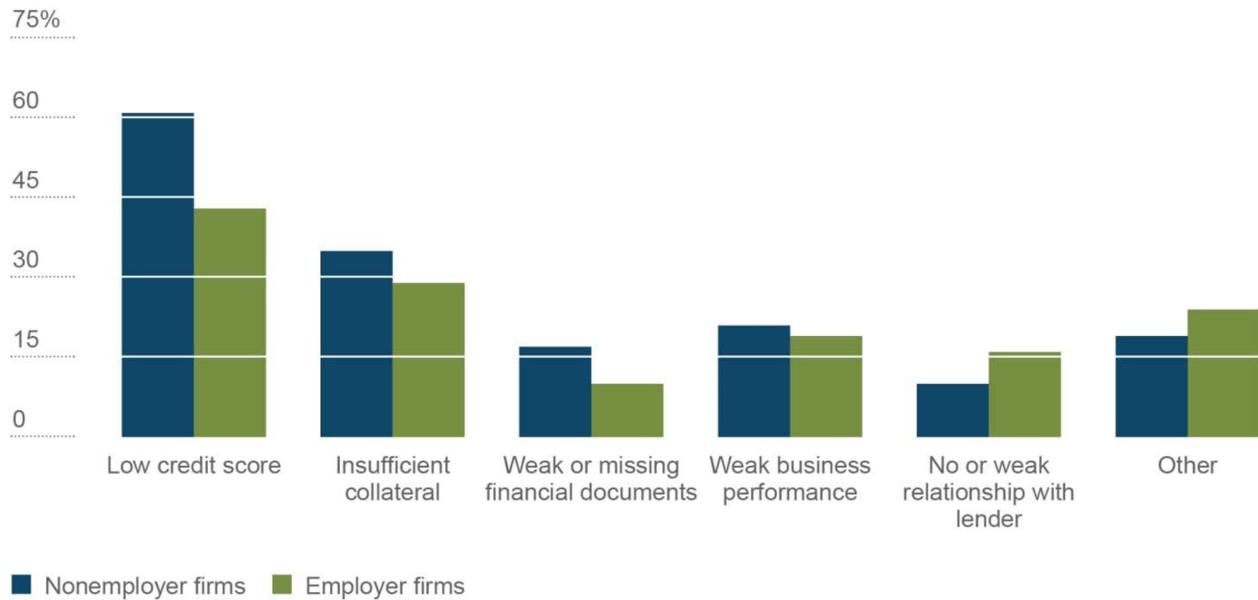
Figure 15: Amount of Financing Received (Percent of Applicants)



Source: Joint Small Business Credit Survey, 2014. N=586

The top-cited reason for not receiving the credit requested was "poor credit score." Nonemployers also were less likely to have been turning a profit—25 percent of nonemployers compared to 45 percent of employer firms were profitable in the first half of 2014. Given these factors, it is not surprising that a greater portion of nonemployer applicants were denied credit compared to firms with employees.

Figure 16: Reasons for Getting Less Credit Than Requested (Percent of Applicants Receiving Less Than Full Amount)



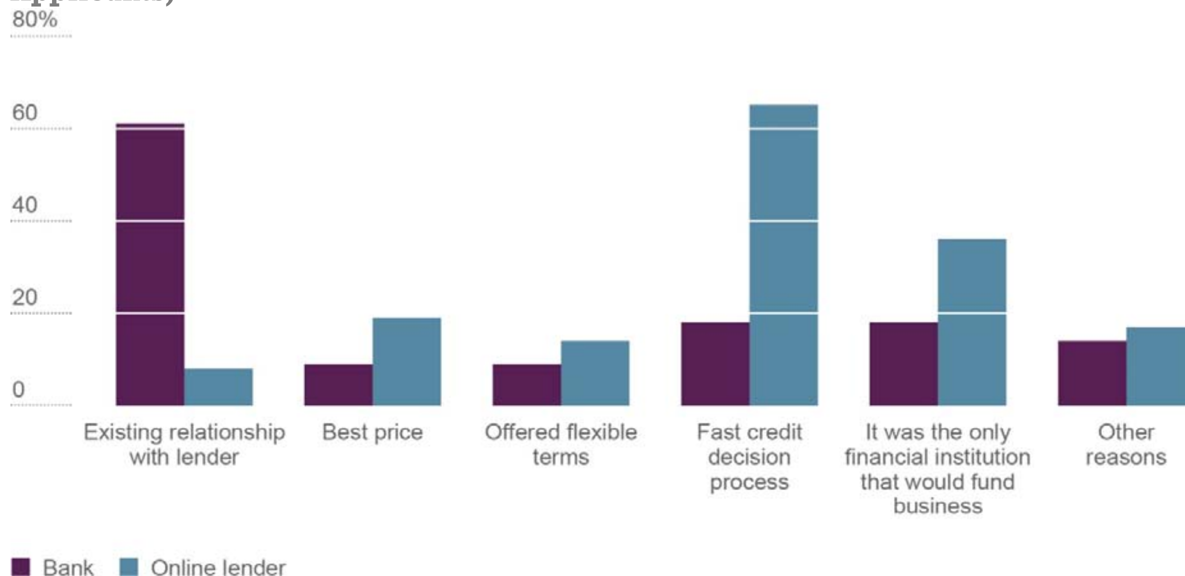
Source: Joint Small Business Credit Survey, 2014. N=322

Online lending is a prominent financing source for nonemployer firms.

When traditional options for funding pulled back and personal finances withered during the recession, the market stepped forward to provide alternatives. New online financing products have sprung up in recent years to fill these gaps in the credit market (Mills and McCarthy 2014). Many online lenders streamline the credit application process by allowing firms to directly submit accounting records to the website and then match lenders to borrowers, allowing for a faster way to broadly search for a variety of credit products.[5] Borrowers must be wary, though, as some online alternative lenders can have hidden or confusing terms and very high interest rates. Alternative lenders are understandably attractive. They offer a large diversity of products, some of which require less information than a bank would require in a traditional underwriting process. This results in more credit approvals and a quicker turnaround time. They can also provide a more flexible way of repaying, allowing seasonal firms or those with unpredictable revenue streams to make payments as they receive revenue instead of fixed monthly payments.[6] Nontraditional financing also opens the door for greater participation. There are many websites that allow individuals to provide financing directly to businesses. The direct lending market ranges from food carts in developing countries, to bakeries down the street, to pools of hand-picked "growth" businesses.[7] Despite the growth in online lending, it remains a relatively small portion of total lending (Mills and McCarthy 2014).

The tradeoffs of online lending are reflected in the SBCS. When asked why they applied at their chosen lender, firms who had gone to a bank mostly indicated that an existing relationship was the primary motivating factor. Those applying online, however, were more likely to report needing a fast credit decision or because it was the only lender that would fund them. Interestingly, 19 percent of firms applying online said they were doing so to get the best price, compared to 9 percent of firms applying at a bank. It's unclear if borrowers are actually getting a better price online. It is conceivable that applicants think it's a good price due to misleading credit terms.

Figure 17: Reasons for Applying to Banks versus Online Lenders (Percent of Applicants)

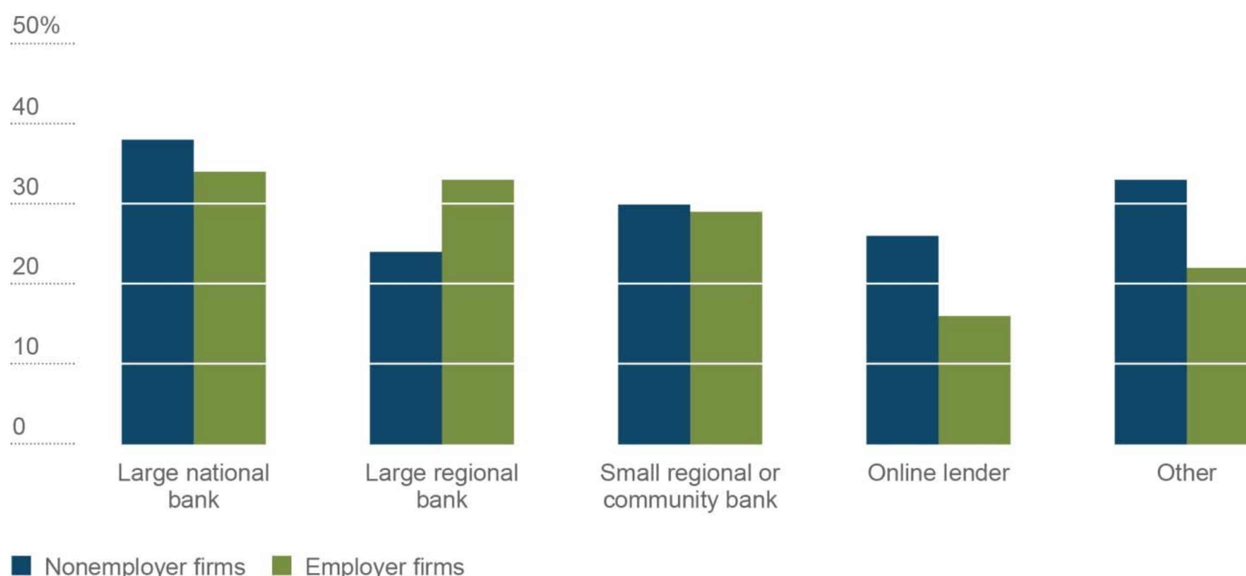


Source: Joint Small Business Credit Survey, 2014. N=526

[5] For example: Biz2Credit, Lending Tree, CanCapital, Kabbage.
[6] For example: Merchant Cash Advances and PayPal Working Capital.
[7] For example: Kiva, SmallKnot, Angellist, Kickstarter, Indiegogo.

The ability to tap alternative sources of funding is especially important for the self-employed, who have a more difficult time finding financing. Access to online sources present them with more options. Nonemployer applicants were nearly twice as likely to apply online for loans and lines of credit as employer firms in the first half of 2014. While this could be a positive sign that alternatives are developing to meet the needs of nonemployers, there is a potential downside. Early evidence from focus groups[8] suggests that online lending terms may not be well understood by borrowers, putting them at risk for unknowingly taking on expensive credit (Lipman and Wiersch forthcoming). Many nonemployers also applied more often to "other" sources, which include credit unions and community development financial institutions.

Figure 18: Application Rate by Source (Percent of Applicants*)

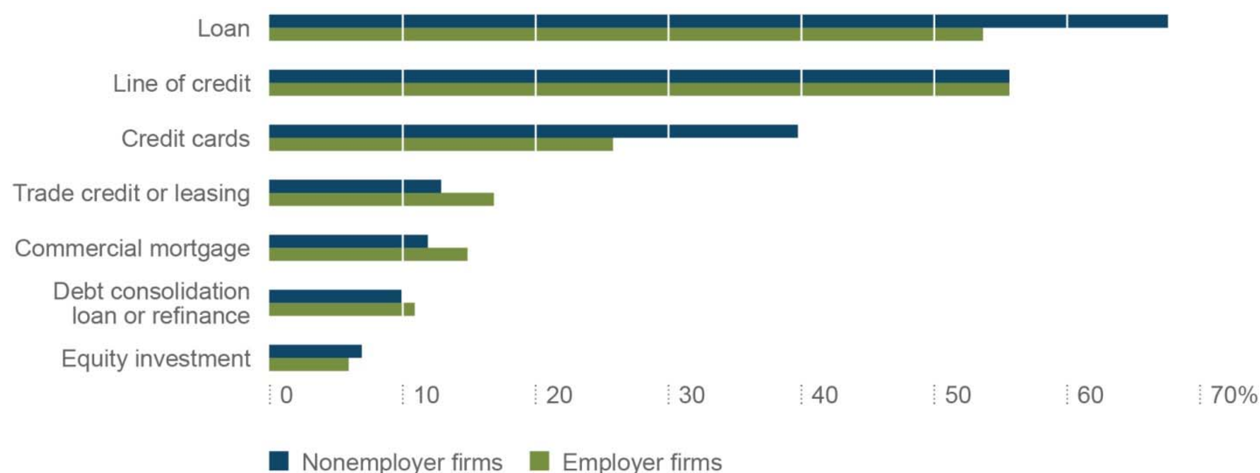


*For loans, lines of credit, debt consolidation loans or refinancing, and commercial mortgages only.
Source: Joint Small Business Credit Survey, 2014. N=528

Loans and lines of credit are the most sought-after product type for nonemployers and employer firms alike. For employer firms, these are by far the most commonly applied for products. However, nonemployers tend to cast a broader net. In particular, they apply for credit cards more frequently, which is likely related to their need for relatively small amounts of credit. In the first half of 2014, 40 percent of nonemployer firms applied for credit cards compared to 26 percent of employer firms. Nonemployers were also more likely to cite applying to "other" types of products, which include home equity lines of credit, private grants, factoring, and construction loans.

[8] According to focus group research done by the Federal Reserve Board of Governors and Federal Reserve Bank of Cleveland, small business owners generally perceive online loans as being more expensive than traditional bank loans. However, potential borrowers in the focus group could identify the advertised interest rate of an online loan but had considerable difficulty understanding how product terms and fees can affect the effective interest rate. They were unsure about whether there is any advantage to paying back the loan early or what the cost would be if they could not pay the loan back on time.

Figure 19: Product Application Rates (Percent of Applicants)



Source: Joint Small Business Credit Survey, 2014. N=584

Methodology

Overview

The Small Business Credit Survey (SBCS) is a convenience survey of establishments conducted by the Federal Reserve Banks of Atlanta, Cleveland, New York, and Philadelphia. The SBCS captures the perspectives of businesses with fewer than 500 employees in Alabama, Connecticut, Florida, Georgia, Louisiana, New Jersey, New York, Ohio, Pennsylvania, and Tennessee. The SBCS reports information about business performance, financing needs and choices, and borrowing experiences.

The survey ran from September 9, 2014, to November 7, 2014. In total, there were 2,016 responses, though the number of responses to each individual question varied. The time frame of the questions also varied, depending on the question asked. Most questions referred to either 2013 or the first half of 2014. The full questionnaire is available here.

Survey Design

The SBCS questionnaire is an online survey distributed by more than 80 partner organizations throughout the 10 states of coverage.[9] Partner organizations include civic and nonprofit partners, primarily chambers of commerce, industry associations, technical assistance centers, and development corporations and authorities. In addition to outside organizations that disseminate the survey on our behalf, the survey is also sent to willing business contacts that are members of the regional economic information network (REIN) of the Federal Reserve Bank of Atlanta.

The sampling frame consists of businesses on the distribution lists of the partner organizations and members of REIN. Partners contact businesses on their distribution lists, asking them to participate in an online survey. Each partner is assigned a unique hyperlink to track response rates. Partner

[9] We target partners in respective districts of the Federal Reserve Banks of Atlanta, Cleveland, New York, and Philadelphia. The resulting responses are from Alabama, Connecticut, Florida, Georgia, Louisiana, New Jersey, New York, Ohio, Pennsylvania, and Tennessee.

distribution lists are either administrative or membership-based.[10] In most cases, partners make their distribution list or number of businesses on the distribution list available to us.

Survey Weighting

The SBCS is not a random sample. In this paper, results are weighted to reflect the full population of employer firms and nonemployer firms, respectively, in our coverage area. We weight employer firms and nonemployer firms separately because the attributes of the populations differ greatly. We develop differing weighting schemes due to data availability. Employer firms are weighted to reflect the industry, employee size, and age composition of the population of employer firms in our coverage area.[11] Less data are available for nonemployer firms and so we weight for industry composition only.

Nonemployer Firms in the SBCS

We ask respondents if their businesses have any paid employees other than the owners. Respondents who indicate they have no paid employees are considered self-employed, and their responses are recorded as nonemployer firms. We do not ask respondents about the legal status of their businesses or if they currently own additional businesses.

Conclusion

Using data from the 2014 Small Business Credit Survey, we explored differences between nonemployer and employer firms. To our knowledge, no other single data set is as recent or contains this level of detail on credit applications, debt, and firm characteristics.

In summary, we find that:

Nonemployer firms in the SBCS are optimistic about their future, but in practice most are operating at a loss and have declining revenues.

- 48 percent of nonemployer firms operated at a loss during the first half of 2014 (30 percent of employer firms).
- 29 percent of nonemployer firms experienced increased revenues over the past 12 months (48 percent of employer firms).
- 62 percent of nonemployer firms expected revenues to increase over the next 12 months (65 percent of employer firms).

Even among revenue-growing nonemployer firms, most do not plan to add employees in the next year.

- 18 percent of all nonemployer firms plan to hire full-time employees over the next 12 months (38 percent of employer firms).
- 25 percent of nonemployer firms that experienced growing revenues over the past 12 months plan to hire full-time employees (49 percent of employer firms).

[10] For example, all businesses in New York City are required to register with the city's Department of Consumer Affairs, whereas Chamber of Commerce membership is voluntary. We also use publically available lists of firms to distribute the survey, such as New York State's Minority- and Women-Owned Businesses Directory.
[11] Age data are from the U.S. Census Bureau Business Dynamics Statistics, 2012. All other data are from the U.S. Census Bureau Survey of Business Owners, 2007.

Personal sources of funding and credit cards are the main source of financing for nonemployer firms. Compared to employer firms, nonemployer firms are much less likely to hold debt.

- 40 percent of nonemployer firms used personal savings as their primary funding source, followed by credit cards (20 percent).
- 34 percent of nonemployer firms had outstanding debt (62 percent of employer firms).
- 47 percent of nonemployer firms with revenues >$50,000 had no debt (66 percent of employer firms).

There is less demand for financing among nonemployers. Not thinking they would be approved and not wanting to take on debt were the top reasons for not applying.

- 19 percent of nonemployer firms applied for credit (35 percent of employer firms).
- 37 percent of nonemployer firms were discouraged (did not think they would be approved) and another 33 percent indicated they did not want to accrue debt.

Nonemployer credit applicants had a more difficult time getting approved. This difficulty stems at least in part from being less creditworthy (young, less profitable, and having poor credit scores).

- 42 percent of nonemployer applicants got at least some of the credit they applied for (61 percent of employer firms).
- 61 percent of nonemployer applicants cited having a low credit score as the reason for not being approved for all of the credit they applied for (43 percent of employer applicants).

Many nonemployer credit applicants turn to online lenders. Loans and lines of credit are popular credit products, and nonemployers were more likely to apply for credit cards than were employer firms.

- 26 percent of nonemployer applicants applied to an online lender (16 percent of employer applicants).
- 40 percent of nonemployer applicants applied for credit cards (26 percent of employer applicants).

The most important caveat to our analysis is that the SBCS was designed with employer firms in mind. For instance, we do not ask if the owners of nonemployer firms had other income streams or wage employment. We also do not ask for their legal status (incorporated versus unincorporated) or how their personal finances are related to their business finances. In future editions of the SBCS, we hope to incorporate questions specific to nonemployer firms. Because nonemployer and employer firms are such different populations and have very different credit needs, it is important to unpack their respective performance and credit experiences.

We have only touched the surface of the financing and credit experiences of nonemployer firms. There are many areas for future research, including getting a better understanding of personal credit histories and motivation for being self-employed. In future iterations of the SBCS, we will continue to unpack the diversity of small businesses.

The main purpose of the SBCS is to give policymakers, business industry associations, chambers of commerce, local governments, and other community stakeholders timely and relevant information

about the small businesses they serve. By better understanding the needs and challenges of small businesses, we can better support programming for nonemployer and employer firms alike.

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