

Income Shocks, Capital Constraints, and Self-employment: Evidence from Germany.*

Frederik Thenée[§]

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Abstract:

Self-employment is an important driver of job creation and growth, but entry into self-employment carries financial fixed costs. With imperfect financial markets, capital constraints could bar entry. I study influences of exogenous shocks to personal wealth on the selection into self-employment and show that positive income shocks lead to an increase in the incidence of self-employment. This effect is driven by both an increase in the probability of selecting into self-employment and a longer survival of the new self-employed. Moreover, the effect is particularly pronounced in industries that are prone to self-employment and is stronger for more capital constrained individuals. The firms started in response to income shocks tend to be small at entry and new entrepreneurs are more likely to have been employed rather than non-employed beforehand. Overall the results are in line with capital constraints deterring long-living, profitable entrants.

Keywords: Self-employment, Income Shock, Capital Constraints, Start-up survival
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[§]University of Cologne (thenee@wiso.uni-koeln.de; <http://www.ieam.uni-koeln.de>).