ARE ENTREPRENEURS SENSITIVE TO EVERYDAY VARIATION IN FINANCING COSTS?

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The problem: Why estimate (again) the impact of financing on entrepreneurship?

While there is much evidence on how regime shifts in the cost of financing (e.g., deregulation, mortgage crisis), there exists little information on ‘everyday’ changes in interest rates. Yet, the impact of small and large economic shocks is often quite different (e.g., hysteresis in labor supply).

How to measure short-term entrepreneurial responses?

- Most administrative records measure entrepreneurship based on tax returns, but tax filings occur (at most) four times a year.
- However the impact of ‘everyday’ changes is likely to be shorter term, requiring a high frequency index of entrepreneurship (e.g., daily). And, heterogeneity in startups can be substantial.

Using data from the Startup Cartography Project (Guzman & Stern, 2019)—a project documenting the legal registration of new firms in the US and estimates of their founding potential (quality)—we develop a novel daily index of firm registrations, allowing us to shed light on the short-term impacts of policy changes on entrepreneurship. (Visit at startupcartography.com)

The identification approach

Entrepreneurship is investment, so co-determined with interest rates. Solution: identification through heteroskedasticity

Main Findings:

1. An increase of one percentage point in the interest rate is correlated with a drop of 3.5% in quality-adjusted flow of entrepreneurship.
2. The drop in quantity alone is large—the lower quality firms are affected more.
3. The drop last for about six weeks.
4. There is not compensating overshooting—the loss is permanent.

Impact of interest rates on firm formation. 500 bootstrap samples.

Quality-adjusted quantity of startups

Quantity of startups

Time-period coefficients

T-bill rate coefficients with time lags by weeks

Takeaways

- In contrast to prior work, liquidity is important for U.S. entrepreneurship.
- Even in the case of small interest rate shocks.
- Also suggesting a nuanced picture of how monetary policy impacts investment.

Note: There is a clear common pattern between the two: the correlation between RECPI and 3-month T-Bill rates increases when the variance of the daily T-Bill rate increases.