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Social capital access and entrepreneurship☆

Stefan Bauernschuster[a,1], Oliver Falck[b,*], Stephan Heblich[c,2]

[a] Ifo Institute for Economic Research, Poschingerstr. 5, D-81679 Munich, Germany
[b] Ifo Institute for Economic Research and CESifo, Poschingerstr. 5, D-81679 Munich, Germany
[c] University of Stirling, Division of Economics, IZA and SERC, FK9 4LA Stirling, UK

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ABSTRACT

We investigate the effect of social capital access on entrepreneurship. Social capital helps entrepreneurs to overcome resource constraints. This is especially important in small communities where we often see a lack of market-oriented institutions such as venture capital firms. Entrepreneurs gain access to social capital via club memberships. Combining differences in the number of individual club memberships with differences in the importance of social capital across communities, we identify a causal small community mark-up effect of individual club memberships on entrepreneurship. Assuming that unobserved heterogeneity that might influence both the individual's selection into clubs and the occupational choice to be an entrepreneur is independent of community size, we find that the effect of club membership on the propensity to be an entrepreneur is 2.6 percentage points larger in small communities than in large communities. Robustness tests support the validity of our identifying assumption and results.

1. Introduction

The occupational choice to start and run an own business depends on individual abilities and skills but also on the access to social capital that facilitates the entrepreneur's access to information and resources (Granovetter, 1985).[3] Particularly, the access to social capital can facilitate information diffusion and technology adoption in the process of product creation (Bramoulle and Kranton, 2007), grant access to resources like labor or finance in the startup phase (Michelacci and Silva, 2007; Amit et al., 1990), and might even provide psychological aid in the business creation process (Sanders and Nee, 1996).

The importance of social capital access in the business creation process varies across communities depending on the institutions used to enforce contracts (Kranton, 1996; Kumar and Matsusaka, 2009). Take entrepreneurial finance as an example which is characterized by information asymmetries regarding the entrepreneur's future performance and prospects.

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* Corresponding author. Tel.: +49 89 9224 1370; fax: +49 89 9224 1460.
E-mail addresses: bauernschuster@ifo.de (S. Bauernschuster), falck@ifo.de (O. Falck), stephan.heblich@stir.ac.uk (S. Heblich).

[1] Tel.: +49 89 9224 1368; fax: +49 89 9224 1604.

[2] Tel.: +44 1786 46 7481; fax: +44 1786 46 7469.

[3] Individual entrepreneurial abilities include a person's risk aversion (Fairlie, 2002; Kihlstrom and Laffont, 1979; Cramer et al., 2002) and education (Falck et al., forthcoming; Lazear, 2005), but also practical experience (Fairlie and Robb, 2007) and genetic factors (Nicolaou et al., 2008) play a major role. Beyond these individual skills, social skills grant access to social capital (Glaeser et al., 2002). For a broader overview, see Parker (2009).

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In large communities, venture capital firms that specialize in condensing and evaluating the entrepreneur's performance and prospects provide entrepreneurial finance independent of personal contacts. By contrast, in small communities and in the absence of venture capital firms, social capital comes into play. Here, personal contacts from frequent interactions help to overcome information asymmetries and thus provide another, informal way to access entrepreneurial finance (Guiso et al., 2004; Sobel, 1985; Michelacci and Silva, 2007).[4]

Empirical research on social capital suffers from various identification problems (Durlauf, 2002a,b). As a consequence, evidence of any causal effects of social capital is scarce. As far as the role of social capital in entrepreneurship is concerned, any potential association between individuals' access to social capital and their occupational choices can hardly be interpreted as a causal effect of social capital access since unobserved individual heterogeneity might account for differences in social capital access and at the same time for differences in their occupational choice. A very similar logic applies to the community level. Clearly, one cannot ascribe differences in the levels of entrepreneurship across communities to differences in the importance of social capital as there might be many unobserved confounding community characteristics that are correlated with both entrepreneurship and social capital.

In this paper, we address these endogeneity concerns and attempt to establish plausibly causal effects of social capital access on entrepreneurship under relatively weak assumptions. To this end, we combine differences between individuals with differences across communities. On the individual level, we measure an individual's access to social capital by an individual's club memberships and then draw on individual differences in club memberships. On the community level, we exploit variation in the importance of social capital across communities of different size. We then take the cross-derivative of occupational choice with respect to club memberships and community size and find that the marginal effect of club membership on the propensity to be an entrepreneur is 2.6 percentage points larger in small communities than in large communities.

Our result can be interpreted as a causal small community mark-up effect of club memberships on a person's propensity to be an entrepreneur. In other words, knowing that the importance of social capital differs across community size, an increasing number of club memberships is more valuable in smaller communities where social capital substitutes for the lack of formal institutions (that facilitate, e.g., the access to finance) than in larger communities with supporting formal institutions. Our key identifying assumption is that unobserved heterogeneity that might influence both the individual's access to social capital, i.e., the selection into clubs, and the occupational choice to be an entrepreneur, is independent of community size. Robustness tests that challenge our identifying assumption in various ways support our finding.

The remainder of the paper is organized as follows: Section 2 introduces our method in detail; Section 3 our data. Then, in Section 4, we present our results and conduct several robustness checks that show them to be reliable. Section 5 concludes with some suggestions for further research.

2. The small community mark-up effect of individual club memberships on entrepreneurship

When estimating the effect of social capital access on an individual's occupational choice, omitted variable bias is a major concern. If social capital access is measured through memberships in clubs and associations, it might well be that there is unobserved heterogeneity between individuals that influences both the likelihood of being a club member and the propensity of being an entrepreneur. Thus, these omitted variables cause correlations between the error term and the club membership variable, which biases the estimates. To illustrate this point, imagine there are some people who are outgoing, energetic, active, and adventuresome. These people might more often join clubs than do others; however, they might also be more likely to be an entrepreneur due to the very same character traits. If we do not control for these traits in a multivariate analysis, we might mistakenly attribute the fact that someone is an entrepreneur to her membership in clubs, i.e., access to social capital, although, in reality, it is not club memberships that account for differences in occupational choice but unobserved individual characteristics. This means that the estimated effect of access to social capital on a person's propensity to be an entrepreneur might be upward biased. Due to this kind of endogeneity, the estimated association between club memberships and being an entrepreneur cannot be interpreted as a causal effect of access to social capital on the occupational choice to be an entrepreneur.

The problem of omitted variables could obviously be reduced by including a wide range of control variables for relevant personal characteristics in the model. However, due to data restrictions and since there is no clear theory on the determinants of social capital formation, the problem cannot be completely resolved in this way in practice (Durlauf, 2002a,b). To address these endogeneity concerns, we estimate community-specific correlations of social capital access and entrepreneurship by exploiting the variation in club memberships between individuals within communities and then draw on the differing impact of social capital on being an entrepreneur across communities of different size. This procedure allows us to identify a causal small community mark-up effect of club memberships on entrepreneurship under the identifying assumption that the self-selection process into clubs on unobservable individual characteristics that at the same time influence entrepreneurship is not different across community types.[5]

[4] Kumar and Matsusaka (2009) refer to these two types of social capital as "local capital" and "market capital". The former relies on social networks while the latter relies on impersonal market institutions.

[5] We are aware of the fact that large community size is often negatively correlated with (pro)social behavior (Putnam, 2000). However, this does not interfere with our identifying assumption.