

# Immigrant Entrepreneurs: The Entry of Immigrants into Firm Ownership

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# 1 Introduction

It is by now something of a truism to say that immigrants are widely perceived to be particularly entrepreneurial. Those perceptions are, at least partly, based in fact. Fairlie and Lofstrom(2015) in their review of the literature on immigrant entrepreneurs present patterns from US Census and other data showing that immigrants have a higher probability of reporting themselves as self-employed than the native born, and the same sort of patterns are evident in Canadian data. Similarly, Hunt(2011) finds that among people with university degrees in the US, immigrants are more likely to own a firm with at least 10 employees than the native born. Importantly, the perceptions appear to drive policy decisions as most major immigrant receiving countries have policies targeted at bringing in immigrant entrepreneurs. Those policies reflect a vision of entrepreneurs as innovators and job creators. But in the data used for most studies of immigrant entrepreneurs - including the data just quoted showing that immigrants are more entrepreneurial than the native born - entrepreneurship really means firm ownership, and it is well known that there is considerable heterogeneity among different types of firms. Some are, indeed, the platforms for implementing innovative ideas with associated job creation. But others are locations of last resort where the owners are barely employing themselves let alone any others. We are interested in whether immigrant firm owners fit more in the former or the latter category. Is expanding immigration in general and entry classes dedicated to entrepreneurs in particular a promising route for bringing in innovative, as opposed to last resort, firm owners? As we will see, immigrants to Canada who are specifically selected for their entrepreneurial interest and talent are more likely to open firms than immigrants in other entry classes but the vast majority of immigrant entrepreneurs did not enter through the entrepreneur class. Thus, it is important to ask whether expansion of immigration in general is likely to result in bringing in more innovative entrepreneurs.

In this paper, we look for answers to these questions in the firm start-up process. Haltiwanger et al(2015) argue that net job growth is accounted for almost entirely by new firm start-ups and, so, understanding the start-up process is of central importance. In our investigation, we consider three broad classes of characteristics of new immigrants: their skills related characteristics at time of arrival; their earnings and employment paths experiences in the receiving economy; and their location characteristics in terms of whether they live in an ethnic enclave and its impact on them. Using those characteristics, we ask whether the influence of those characteristics on the firm start-up process points toward firms being more or less ‘last resorts’. For example, to the extent that starting a new

firm is associated with low education and being unemployed in recent years, we believe it is less likely that the firm will be a source of job creation. We guide our investigation of the impact of the various factors on firm start-up with a theoretical search model with multiple sectors and ethnic enclaves. The model helps in deciding what to control for, sources of endogeneity, and potential solutions to any endogeneity.

At the heart of our investigation is a remarkable new Canadian dataset linking together the administrative records at time of arrival for all immigrants obtaining permanent residency between 2000 and 2009, the personal tax records for all those immigrants and for a comparison group consisting mainly of the native born, and firm tax records for all firms in Canada over the same years. From the arrival records, we obtain education, age, marital status, gender, and language skills at time of arrival as well as their entry class, i.e., whether they were assessed under Canada's point system, entered as a family member, entered as a refugee, or entered in a special entrepreneur class. The firm tax records - which pertain to incorporated firms - include a schedule for privately held firms that lists all owners with at least a 10% share in the equity of the firm. Using that, we can follow immigrants after arrival to see the first point at which they open an incorporated firm. We can also see all the workers at the firm in a year and link through their personal identifiers back to their own tax files and their own arrival records if they are immigrants. Thus, we can see, for example, whether immigrant firm owners hire other immigrants from their same source country. From the personal tax records we get both personal earnings and other income as well as a record of whether they own a non-incorporated firm. Thus, from this we can see the time until an immigrant starts a non-incorporated firm spell, which we will call a self-employment spell since we will see that this type of firm rarely employs anyone other than the owner. There is a considerable amount of information in this data and using it to examine the firm entry process is already a lengthy endeavour. We leave the examination of subsequent firm growth and exit to another paper.

The division that is possible in this data between incorporated firms and self-employment firms is crucial. Levine and Rubinstein(2013) examine the cognitive and non-cognitive traits that predict entrepreneurship, arguing strongly for the importance of separating incorporated from non-incorporated spells. They show that people who open incorporated firms tend to be rule breakers with high cognitive abilities while those who open non-incorporated firms have neither of these qualities. They hypothesize that risk takers incorporate exactly because they are taking a risk on a business idea and incorporation acts as a safe-guard for their own assets and for the firm. Non-incorporated firm owners

tend to look more like this is a choice of last resort rather than trying to pursue an innovative business idea. As we will see, the factors associated with opening of firm of each type fits with this assessment of the relative qualities of each type of firm owner. Importantly, it is self-employment that accounts for the greater tendency of immigrants to own firms. This is the first piece of evidence against immigration in general being an important source of the generation of innovative new firms. Firm ownership among immigrants seems less about implementing an innovation and more about implementing their own labour.

The impact of ethnic enclaves on immigrant entrepreneurship has been to focus of some attention in the existing literature, and for good reason. In our data, 80% of newly arrived immigrants live in communities with a greater proportion of residents being from their same source country than one would predict from random distribution across communities; almost half of them live in communities in which the ratio of the population from their source country to the population as a whole is at least three times what one would predict if immigrants were allocated across communities based just on community size, i.e., without regard to their ethnicity. Thus, enclaves are a key characteristic of immigrant life and we would like to know whether they have a positive or negative association with firm creation. The existing literature covers all the bases in terms of answers to this question. Early work by Borjas indicated that living in an enclave is associated with high rates of firm ownership. He and others (e.g., Aldrich and Waldinger(1990) argue that this is plausible and could arise if enclaves provide firms both with a captive labour force with limited outside options (especially in enclaves with lower levels of host country language ability) and a ready market for ethnically related goods. However, later papers find mixed results of enclaves effects on firm ownership with Aldrich and Waldinger(1990) and Yuengert(1995) finding no effect and Clark and Drinkwater finding a negative effect for the UK.

Our data allow us to provide a more complete investigation of the role of enclaves in firm creation. Working from our model, we construct variables related to four channels through which enclaves could affect firm opening: as a source of captive, low wage labour; as a market for ethnically specific goods; as location for the alternative of obtaining paid work rather than opening a firm; and as a source of business information and capital. We find that these factors affect the likelihood that a person will open an incorporated firm in the direction one would expect but that once one controls for these factors, the probability of opening a firm declines in the concentration of an enclave. We do not have an instrument for immigrant allocations across communities and so this result

could arise, as in Kerr and Mandorff(2015), because larger enclaves are less likely to create entrepreneurs (in their model this happens because individuals are more likely to bump into previously established entrepreneurs who can help them start a business in a smaller enclave) or, as in Damm(2009) because less able individuals are more likely to select into living in an enclave. Whatever the source of the association, we find offsetting effects that could be the source of the wide variation in results in the literature: enclaves have observable characteristics that imply that enclave firms are more profitable and those who open incorporated firms respond to those characteristics, but enclaves have an inherent negative association with firm opening. These effects cancel out, leaving only a small net association of enclaves with firm creation. Importantly, though, enclave characteristics that are associated with firm profitability are not consistent determinants of the probability an individual starts a self-employed firm, and enclave concentration is positively correlated with self-employment start-up. These patterns along with the fact that self-employment is much more likely to start if the individual was non-employed in the previous periods and that both education and language ability in English or French at arrival are negatively correlated with self-employment, point to self-employment being more a last resort than pursuing a profitable idea. The fact that self-employment is associated with living in an enclave and so many immigrants live in enclaves is, as a result, worrying.

Our paper fits within a broader literature on the determinants of entrepreneurship, i.e., opening firms, relating it to personal characteristics such as risk aversion, skills, and wealth. The question of whether credit constraints limit entrepreneurship has received particular attention (e.g., Hurst and Lusardi(2004) and Gentry and Hubbard(2004)). Our data does not include wealth measures and so we are unable to pursue that question directly, although we are able to examine impacts from rich earnings histories.

There is also a smaller, though still substantial literature on immigrant entrepreneurship (e.g., Lofstrom(2002) for the US, Schuetze and Antecol (2005) for Canada). Much of this literature uses Census data in Canada and the US and focuses on earnings as a measure of success. That literature finds that rates of self-employment rise with time at the host country at a declining rate, so that it has reached its maximum level by between ten and fifteen years after arrival.<sup>1</sup> By that point, the immigrant self-employment rate is above that for comparable native born individuals. However, immigrant self-employed earnings tend to be significantly below those of the native born, raising some speculation

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<sup>1</sup>Fairlie and Lofstrom(2013) provide a comprehensive review of these results and others related to immigrant entrepreneurship.

that at least some immigrants are pushed into self-employment (Frenette(2004), Hou and Wang(2011)). Georgarakos and Tatsiramos(2009) and Blume et al() use panel data, from the US and Denmark, respectively, to examine immigrant entrepreneurship. Both find patterns suggestive of owning a firm being a stepping stone in a process of full integration into the host economy but both focus mainly on firm death and growth rather than firm creation. Also, neither paper distinguishes between self-employment and incorporated firm ownership, a distinction that we find is important and that could explain patterns in their data such as Georgarakos and Tatsiramos(2009)'s finding that immigrant firm owners tend to be both more educated and more likely to be unemployed just before starting a firm.

Relative to the existing literature, our contributions come from a combination of our data and the use of our model to guide the empirical investigation. Unlike any previous data of which we are aware, we have immigrant landing records that allow us to see what the government sees at time of arrival. This allows us to make links to what is currently possible in terms of policy adjustments with respect to selection on the observable characteristics of applicants to try to increase the potential of the immigrant pool being innovative entrepreneurs. Our data also includes a form listing all owners of firms with at least a 10% share, which is an advantage over US administrative data where one must guess at which employees of firms might be the owners (Kerr and Kerr(2016)). The data also includes complete personal tax records that allow us to construct rich earnings and employment histories as part of investigating how experiences in the Canadian labour market affect the move into firm ownership. The combination of the personal and firm tax data also allow us to construct variables indicated by our theory that are related to the role of enclaves. For example, we construct a variable that corresponds to the wage pressures an immigrant from a particular source country by age by education by gender by location group would expect to face as an entrepreneur. Our search and bargaining model indicates that those pressures would be higher the better the outside employment options of the types of employees that prior arrival entrepreneurs from the same group tend to hire. We classify types of employees by *their* source country composition. Thus, our variable captures the possibility that hiring a disproportionate number of employees from a particular source country enclave (perhaps the entrepreneur's own) whose members tend to be employed in low wage industries implies low wage pressures for the potential entrepreneur herself. Finally, as mentioned earlier, our data allows for a clean delineation between incorporated firms and self-employed firms, and this distinction is crucial for understanding immigrant entrepreneurship. The sum total

of these advantages is a broad, consistent picture of immigrant entry into firm ownership.