

Student Loans and Entrepreneurship: An Overview

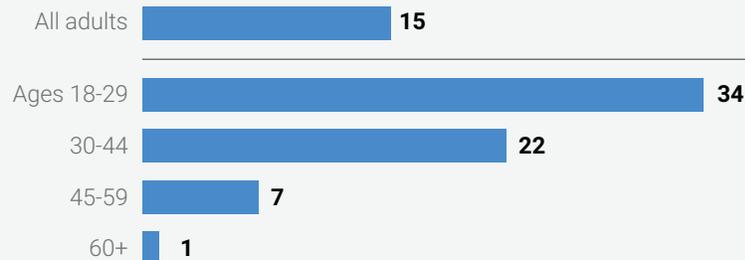
The relationship between student loan debt and entrepreneurship sits at the intersection of many questions related to labor markets, higher education, business dynamism, innovation, and capital markets. This brief considers these intersections.

Student loans: Some facts

Nearly 1 in 6 adults in the U.S. has outstanding student loan debt. Among those between the ages of 18 and 29, 1 in 3 reported having student loan debt.¹ Meanwhile, the share of new entrepreneurs aged 20-34 declined from 34% to 27% between 1996 and 2019.²

% of adults saying they currently have outstanding student loan debt for their own education

Source: Pew Research Center analysis of Federal Reserve Board's 2018 Survey of Household Economics and Decisionmaking.



Student loans: Some basics

Federal loans are disbursed by the U.S. Department of Education. These loans are based on a student's perceived financial need, and there are limits on the total amount that a student can borrow. Undergraduates are currently limited to \$57,500, and graduate or professional students are limited to a combined total of \$138,500 for both undergraduate and graduate loans. These loans offer flexible repayment options, and at least a portion are often subsidized for

undergraduate borrowers. The subsidy for graduate borrowers was eliminated in 2012.

In 2019, federal student loans accounted for roughly 92.2% of all outstanding student loans in the U.S.³

Private loans can be offered by state education departments, universities, banks, and other lenders. These loans often require an established credit record or a cosigner, and they can be larger than federal loans.

They can have either variable or fixed interest rates, and they are usually unsubsidized.⁴ Private student loans made up the remaining 7.8% of all outstanding student loans in the U.S. in 2019.³

Key trends in student loan debt in the U.S. include:

- Federal student debt tripled from just over \$516 billion in 2007 to \$1.5 trillion in 2020. Both the number of borrowers and the debt amount have increased in recent decades.⁵

Student loans: Some basics, cont.

- Two out of three college seniors (65%) who graduated from public or private nonprofit colleges in 2018 had student loan debt. The average student debt among graduating college seniors who took out student loans was \$29,200.⁶
 - *The share of students who took out loans was smaller among those pursuing graduate or professional degrees than among those obtaining undergraduate degrees. Total debt, however, was higher for the students pursuing higher levels of education.*
- In 2016, 54% of individuals graduating with master's degrees had federal student loans, with an average amount of \$63,700. Among those graduating with PhDs, 45% had federal student loans, with an average student debt amount of \$107,600.⁷

How can student loan debt matter for entrepreneurship?

Among individuals who start businesses, higher levels of student loan debt are negatively related to business income and employment. As a result, there is concern about the job creation potential of these new businesses.⁸

One way to consider the relevance of student loan debt is to think about the entrepreneurial process as a series of decisions. Surveys of borrowers suggest that student loan debt influences borrowers' perceptions of their options related to entrepreneurship. Borrowers report, for example, that student loan debt has affected their decision or ability to start a business, including the choice to delay starting a business.^{9,10}

A survey of 800 individuals between the ages of 18 and 34 found that among those with student debt who currently own or have plans to own a business, nearly half reported that their student loan payments affected their ability to start a business. It also found that approximately 4 in 10 young adults believe that

student loan debt had already impacted or would impact their ability to invest in an organization or hire new employees,¹¹ suggesting that they think beyond whether to start a business and consider the additional decisions they may face in the future if they start a business, such as hiring.

→ **Student loan debt can directly affect an individual's overall personal financial resources.**

Student loan payments reduce the amount of cash that is available for individuals to invest directly in entrepreneurial activities. Some aspiring entrepreneurs with student loan debt may not be able to accumulate enough of the upfront investment necessary to start a business. And those who are able to start a business may do so with less capital. As a result, they may need to delay or simply forego investments in some business activities, which may impact profitability and business growth.

For example, if an entrepreneur does not have the ability to pay the upfront costs associated with

hiring a worker to expand production capacity, business growth may be delayed.¹²

→ **Student loan debt can indirectly affect an individual's ability to start a business.**

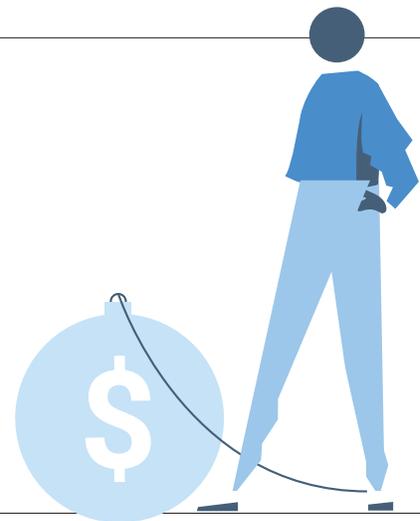
Student loan payments can also reduce an individual's ability to save or create a savings buffer that would free them up to engage in new business activity. Entrepreneurship may not provide a steady and predictable income immediately, and a business may need time to become viable enough to produce sufficient income. Entrepreneurs, therefore, may need to concentrate on their businesses for several months or more before seeing profits, but they still need to pay for rent, groceries, and other daily living expenses during this time. Monthly student loan payments can reduce the volume of savings available to meet these basic needs until the business becomes profitable. As a result, an entrepreneur could decide not to start the business or to divert attention to other income-generating activities while also working on the business.

How can student loan debt matter for entrepreneurship?, cont.

→ **Business failure can be more risky for entrepreneurs carrying student loan debt.**

Student loan payments require steady and predictable income. Entrepreneurship, however, is risky. Some entrepreneurs may find

that their businesses do not provide the steady or reliable incomes they sought, and some businesses may fail. Business failure can be riskier for entrepreneurs with student loan debt than those without this debt, as the cost of defaulting on student loans is high.⁸



Considerations

The relationship between student loan debt and entrepreneurship isn't necessarily linear or direct, and we need additional research on the specific levers that can affect this relationship. The considerations below can be useful for decision makers who seek to understand and respond to the challenges posed by this relationship.

→ **Acquiring education can be very important for an individual's opportunities, including entrepreneurship. At the same time, it can create a financial burden through student loan debt.**

Some occupations require a high level of training and education, regardless of whether or not individuals start their own businesses. Wages are higher, on average, among individuals with more education, and occupations that require advanced degrees are projected to grow over the next several years.^{13,14} Being able to start a business in particular fields often requires specialized education

because of specific occupational requirements or the nature of certain industries. More than two-thirds of self-employed civil engineers and biologists, for example, say that their occupations are closely related to their degrees.¹⁵ For many individuals, it is necessary to take out loans in order to acquire the education they need.

Some occupations that require higher education also require entrepreneurship skills. For example, almost 3 in 4 dentists in the U.S. are sole practitioners, and almost all dentists in the U.S. consider owning a dental practice at some point in their careers.¹⁶ Dental school, however, can be expensive. In 2019, average debt among dental school graduates in both private and public schools was \$292,169. Fewer than 1 in 5 dental school graduates reported no student loan debt, and almost 40% of graduates with debt borrowed more than \$300,000.¹⁷

→ **An institution's approach to financial aid can matter.**

College graduates of universities that eliminated student loans from their financial aid policies have been found to be more likely to start a firm and are more likely to receive venture funding within five years of graduation, compared to graduates of universities that did not remove student loans from their financial aid packages and consequently had more students with loans. Graduates from universities that eliminated student loans were also more likely to receive greater amounts of venture capital investment.¹⁸

→ **Education provides access to social networks and opportunities to build relationships that can be helpful for entrepreneurs.**

Connections made with faculty, staff, and other students while pursuing higher education can be important. These relationships can open up new opportunities and possibilities following graduation.

Considerations, cont.

Some students with higher levels of debt report that they were less likely to put off starting a new business if they had supportive relationships while in college.¹⁰ Access to resources, like mentors, can be important not only in the labor market but also in opening doors to business ownership in the future.^{15,19} Students can build new social connections, new ideas, and new skills that may create possibilities for entrepreneurship, regardless of loans incurred.

→ The relationship between student loan debt and entrepreneurship is not only about the individual.

Entrepreneurs' family financial situations also have an impact on decisions to start new businesses, particularly because many entrepreneurs face difficulty accessing capital and need to turn to personal sources in order to finance their businesses.²⁰ Students who do not take out loans because their families are able to finance their educations may also receive family support in financing a business.

In these cases, the lack of student loans is only one of several financial advantages the individuals hold in pursuing entrepreneurship.²¹

For those who do not have personal wealth, on the other hand, these capital needs serve as a substantial constraint, and student loans only exacerbate this barrier. Between 2012 and 2018, 1 in 4 families spent more than 11% of their take-home income on student loans. Among these families, younger and lower-income families had higher levels of student loan debt.²²

Sources: (1) Cilluffo. 2019. 5 Facts about Student Loans. Pew Research Center. (2) Ewing Marion Kauffman Foundation. 2020. Who is the Entrepreneur? Trends in Entrepreneurship, No. 9. (3) Amir et al. 2019. The MeasureOne Private Student Loan Report. MeasureOne. (4) Federal Student Aid. Federal Versus Private Loans. U.S. Department of Education. (5) Federal Student Aid. Federal Student Loan Portfolio. U.S. Department of Education. (6) The Institute for College Access & Success. 2019. Student Debt and the Class of 2018. (7) Smole. 2019. A Snapshot of Federal Student Loan Debt. Congressional Research Service. (8) Krishnan and Wang. 2019. The Cost of Financing Education: Can Student Debt Hinder Entrepreneurship? Management Science. (9) American Student Assistance (ASA). 2015. Life Delayed: The Impact of Student Debt on the Daily Lives of Young Americans. (10) Gallup and Purdue University. 2015. Great Jobs, Great Lives. The Relationship Between Student Debt, Experiences and Perceptions of College Worth. Gallup-Purdue Index 2015 Report. (11) Small Business Majority and Young Invincibles, 2016. Opinion Poll: Millennials Identify Student Debt, Retirement Savings as Barriers to Entrepreneurship. (12) Ewing Marion Kauffman Foundation. 2020. How Quickly Do New Employer Businesses Hire? Entrepreneurship Issue Brief, No. 3. (13) Torpey. 2018. Employment Outlook for Graduate-Level Occupations, Career Outlook, U.S. Bureau of Labor Statistics. (14) Torpey. 2019. High-wage Occupations by Typical Entry-level Education, 2017. Career Outlook, U.S. Bureau of Labor Statistics. (15) Blume-Kohout. 2014. Understanding the Gender Gap in STEM Fields Entrepreneurship. The Office of Advocacy of the United States Small Business Administration. (16) American Dental Association. 2013. Roadmap to Dental Practice. (17) American Dental Education Association. Educational Debt. (18) Krishnan and Wang. 2018. The Impact of Student Debt on High Value Entrepreneurship and Venture Success. SSRN Working Paper 3240607. (19) Ewing Marion Kauffman Foundation. 2020. Mentoring in Entrepreneurship Support: Some Basics. Entrepreneurship Issue Brief, No. 4. (20) Hwang et al. 2019. Access to Capital for Entrepreneurs: Removing Barriers. Ewing Marion Kauffman Foundation. (21) Baum. 2016. The Evidence About the Impact of Student Debt. In: Student Debt. Palgrave Pivot. (22) Farrell et al. 2019. Student Loan Payments: Evidence from 4 Million Families. JPMorgan Chase & Co.

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