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Where there's a will, is there a way? Barriers to becoming self-employed

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It is important for the German economy to have thriving levels of business start-up activity because entrepreneurs help to maintain the country's ability to compete. However, for several years now high levels of employment have acted as a significant brake on efforts to reverse a decline in the number of business start-ups. A great many potential entrepreneurs are absorbed by strong demand in the employment market. On the whole, there is also much less desire to set up business on one's own these days and this has stifled entrepreneurship both in Germany and in other industrialised countries.

Nonetheless, one in four people still say they are open to the idea of becoming self-employed. The KfW Start-up Monitor confirms this. There is no lack of start-up potential, so what is preventing potential entrepreneurs from taking that final step? It is not just the advantages they see in being salaried employees, what frightens people most is the financial risk of being self-employed. Changes to insolvency laws have thus far failed to calm their fears. Another factor is the fear of failure. However, this is very much an appendant consideration rather than something that actually holds potential entrepreneurs back.

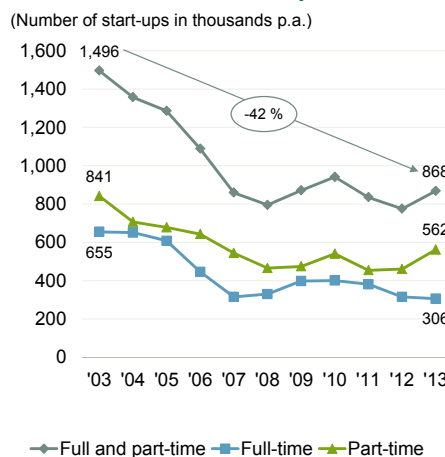
What can be done to provide a boost to business start-ups? More could be done to encourage people to become self-employed who would normally shy away from starting up their own business, i.e. women and older people. It should be noted, however, this would have the effect of reducing supply in the employment market. Both the employment market and the business start-up sector could benefit

from an influx of skilled workers from abroad, as migrants often display an above-average tendency towards entrepreneurship. Many previously self-employed people would also be prepared to give it another go. However, there would need to be a change of culture in two respects.

People often have difficulty deciding to become self-employed because of the uncertainties associated with it. This is precisely the reason why it is important to ensure that we have the right framework in place. Key to this is ensuring that we retain the good conditions and improve the bad ones.

Business start-ups strengthen the economy because they exert renewal and efficiency pressure on existing businesses, thus helping to make the economy fit for the future. Some 868,000 people became self-employed in Germany in 2013. This equates to 1.67% of the total population aged

Figure 1: Slump in number of full-time business start-ups



Note: Business start-ups include those by full-time and part-time freelancers and self-employed persons in the commercial sector.

Source: KfW Start-up Monitor.

between 18 and 64 years. However, ten years earlier the KfW Start-up Monitor revealed that just under 1.5 million people had started a business that year (Figure 1) – equivalent to 2.84% of the total population in the same age bracket. So there has been a sharp fall in the number of business start-ups in recent years.

On a positive note, the reduction in the number of business start-ups has meant an improvement in their quality. Significantly fewer people who are looking for work find themselves forced into self-employment because of a lack of salaried employment alternatives. Unlike business starters who go out on their own in order to capitalise on a specific business idea, people who are forced into self-employment tend to copy others, are less persistent and are much less likely to employ other people. However, people forced into self-employment tend to start off by competing on price – which has the effect of putting pressure on established companies to be efficient.¹

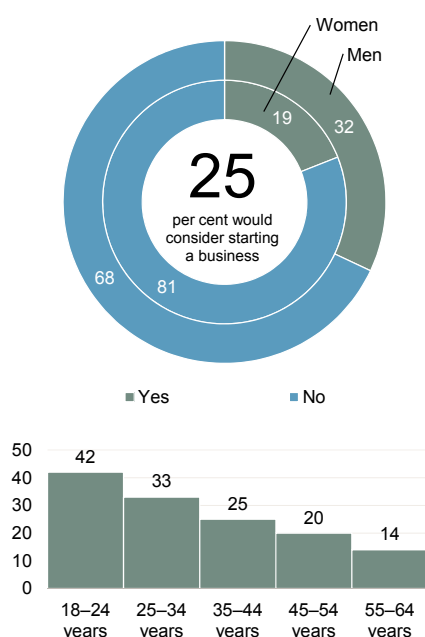
Given the positive effect they have, it would be beneficial to once again have a greater number of entrepreneurs in Germany. It seems especially important to encourage high-tech business start-up activity, given that the statistical probability of a single individual creating another Google or Facebook is very low. The more technologically innovative entrepreneurs are, the more likely it is that one of them will be able to make this happen.

Start-up potential is there

There is already strong potential in Germany for start-up activity to increase. One in four people in the 18 to 64 age-bracket who are not currently self-employed (that is: salaried employees, the unemployed and people who are not economically active) are open to the idea of starting up their own business (Figure 2). Greater numbers of men (32%) than women (19%) are open to the idea of becoming self-employed. Self-

Figure 2: Self-employment is an option for one in four people

(In per cent)



Note: The question was: "Setting current circumstances aside, could you imagine yourself becoming self-employed?" All figures refer to people aged between 18 and 64 years who are not currently self-employed (that is: salaried employees, the unemployed and people who are not economically active).

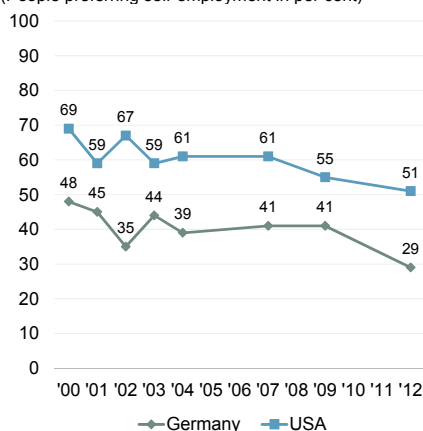
Source: KfW Start-up Monitor 2014.

employment is also more likely to appeal to younger people than to older people. 18 to 24 year-olds are three times more likely to consider self-employment than 55 to 64 year-olds.

In 2013, the numbers of women and older people who were open to the idea of starting up their own business bore very close comparison to the numbers of people who actually went ahead and did so (women: 4 in 10; older people: 1 in 10). However, these numbers are lower than the actual percentage of women and older people in the population as a whole. If we are to breathe new life into business start-up activity, one of the key issues will be how to encourage these groups of the population to embark on such a step. Business start-up activity can also benefit from immigration, as migrants often display an above-average inclination towards entrepreneurship.² Previously self-employed people represent another major source of business start-up potential. Almost half of those who had previously started up a business (44%) would be prepared to venture anew.

Figure 3: Self-employment becomes less attractive

(People preferring self-employment in per cent)



Note: The question in 2012 was: "If you were able to choose from a range of occupations, would you prefer to be employed or self-employed?" Between 2000 and 2009 the question was: "Assume you were able to choose from a range of occupations; which would you prefer to be: employed or self-employed?"

Source: Flash Eurobarometer 354.⁵

What are the reasons for the sharp decline in the number of business start-ups over the last ten years and what is preventing potential entrepreneurs from taking that first step?

Self-employment has become less attractive

Have Germans abandoned their business start-up ambitions? It is difficult to generalise. The fact is that the alternatives to self-employment have become more attractive because the so-called "opportunity costs" of being self-employed have increased significantly. Opportunity costs are the benefits people forego if they choose an alternative course of action. For self-employed people foregone benefits are those associated with salaried employment, namely security of employment, predictable income levels, regulations governing the working hours or the holidays they are entitled to and so on. The better someone's career opportunities are, the more influential these benefits become. 2006 heralded the start of the upturn in the employment market (although recently this is phasing out), since when it has absorbed a large proportion of the total labour force. The reverse side of what is otherwise an entirely positive development is a corresponding reduction in the number of business start-ups.

Entrepreneurship in Germany is also strongly influenced by employment policy measures.³ At the end of 2004 there was an initial cut in the level of support provided by the Employment Agency for unemployed people to start up their own business; a further cut followed at the end of 2012. This made it less attractive for unemployed people to become self-employed – well before the upturn in the employment market had really got going.⁴

Waning levels of business start-ups are also linked to fundamental changes in the way the general population perceives self-employment. Given a choice in the matter, more and more people would prefer to be employees. This phenomenon is also evident in other industrialised countries, including the United States (Figure 3). While there is still a much greater preference for self-employment in the United States than there is in Germany, the trend is distinctly downwards.

Barriers to self-employment have a major effect

The 2014 KfW Start-up Monitor (Figure 4) clearly revealed the extent to which a range of factors was responsible for dissuading potential entrepreneurs from actually starting up their own businesses. The fundamental considerations were:

1. the financial risk of being self-employed,
2. the advantages associated with being an employee,
3. a lack of entrepreneurial spirit or business idea,
4. fear of failure,
5. too great a burden of responsibility, combined with too poor an image of self-employment.

1. Financial risk - the number one scare

Financial risk is the most commonly quoted reason for not becoming self-employed (77%). That said, most entrepreneurs find that they can manage the initial financial commitment required. As a rule, only one third of entrepreneurs

Figure 4: Safety first – a brake on start-up activity

(Reasons for not becoming self-employed in per cent)



Note: People who were prepared to consider the possibility of becoming self-employed were asked: "What has prevented you from becoming self-employed up to now?" People who rejected the idea of becoming self-employed were asked: "Why can you not imagine yourself being self-employed?"

* "Not the entrepreneurial type" was an answer given only by people who rejected the idea of becoming self-employed.

** "Haven't had a business idea" was an answer given only by people who were prepared to consider the possibility of becoming self-employed.

Source: KfW Start-up Monitor 2014.

commit any capital at all, with a further third injecting capital provided by private investors. The total committed by half of these entrepreneurs – whether their own funds or funds obtained from private investors – is less than EUR 5,000.⁶ However, entrepreneurs generally have to plan on injecting additional capital into their business during the first few years of its existence.⁷

Entrepreneurs also face operational risks. These can exceed the level of initial financial commitment many times over. Business starters can restrict the extent of these operational risks by selecting a legal form that limits their liability. A new legal form has even been introduced which allows to set up a limited company with an initial deposit of only EUR 1 (Unternehmergesellschaft). However, most entrepreneurs continue to operate as sole traders, thus with unlimited liability.

The real financial risk of unemployment becomes clearer when analysing the statistics. Every year, business failure is the main cause of over-indebtedness for eight per cent of people in financial difficulty.⁸ This percentage correlates quite closely to the proportion of the general population that is self-employed – a surprisingly low figure in view of the greater financial risks that self-employed people take on compared to the average consumer.

2. Being employed has (too many) advantages

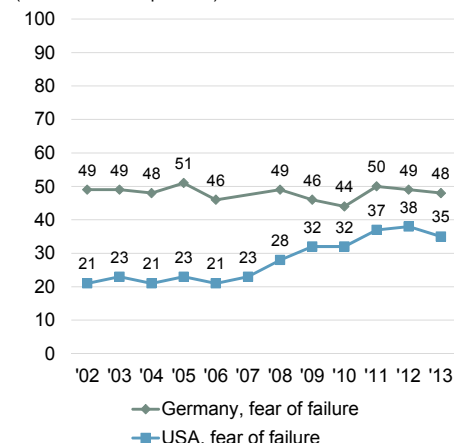
After financial risk, the most common reason for not starting up a business is the advantages associated with salaried employment, principally the security that it can offer. The driving force behind the reduction in the number of business start-ups in the last ten years has been the increasing attractiveness of salaried employment. Three of the four most commonly cited reasons for not becoming self-employed (income insecurity: 68%; lack of welfare provision: 63%; and job insecurity: 60%) are also often quoted as factors in favour of salaried employment.⁵ Whether the person is open to the idea of becoming self-employed or not has no influence on the relative importance of each of these reasons. However, those who lean towards self-employment tend to be more optimistic and perceive these barriers less frequently.

3. Lack of business idea or entrepreneurial spirit

Absence of a business idea is the next commonest barrier, affecting 36% of those prepared to consider self-employment, after financial risk and the advantages of salaried employment. 62% of people who cannot imagine themselves being self-employed say that this is simply because they do not see themselves as "the entrepreneurial type"

Figure 5: Fear of failure in Germany stable, becoming more acute in the US

(Fear of failure in per cent)



Note: The question was: "Would fear of failure prevent you from starting a business?"

Source: Global Entrepreneurship Monitor.⁹

(Figure 4). While little can be done to change people's personal perceptions to any great extent, it is possible to help people who are considering self-employment but who lack a business idea. Potential business partners can be brought together via so-called "idea exchanges", such as those organised by chambers of industry and commerce. Idea exchanges provide a place where business ideas - often already protected by patents and utility models – can be bought and sold, or can be offered to licensees or producers.

4. Fear of failure: Germany in the lead, but the United States are catching up

The next most significant barrier – at 42% across the board – is fear of failure. However, it was cited in almost one third fewer cases than job insecurity and cannot therefore be regarded as one of the principal barriers. Self-doubt is likely to be reflected in a fear of failure. A popular interpretation also suggests that fear of failure is a reflection of the fear of stigmatisation as a consequence of failure.

Compared to other countries, fear of failure in Germany is relatively high and has remained stable over time (Figure 5). A corresponding conclusion is often drawn that stigmatisation as a consequence of failure is a particular problem in Germany. However, if we disregard anecdotal examples, there is no empirical evidence to suggest that self-employed Germans

whose businesses fail are subject to any distinct form of stigmatisation within their social environment.¹⁰

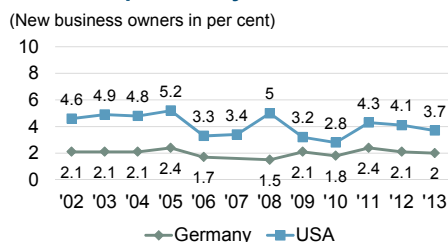
In the United States – frequently quoted as a classic example – fear of failure virtually doubled within a period of six years (2006–2012) (Figure 5). However, this was not reflected in American business start-up activity to anywhere near the same extent (Figure 6). It is, therefore, possible to see fear of failure much more as an appendant consideration rather than something that actually prevents potential entrepreneurs from taking that first step. The American experience also contradicts the argument that fear of failure is a reflection of the fear of stigmatisation. It is inexplicable why this sort of stigmatisation should have been so greatly exacerbated in the United States within the space of just a few years.

5. Responsibility, pressure and image play a subordinate role

One in three people are disinclined to start their own business because they perceive that it comes with too great a burden of responsibility (i.e. to their staff or their own family) and too much pressure (Figure 4). Although these barriers weigh less heavily than others, they should not be underestimated.

It goes without saying that self-employment entails a greater level of (personal) responsibility. It affects health insurance, for example, as self-employed people have to take out private cover (possibly for all of their family dependants). The need to earn enough every month to afford this essential outlay can put people under a great deal of pressure. This type of psychological stress is generally accompanied by greater time pressure. Although self-employment fundamentally affords people a great deal more flexibility when it comes to structuring their working day and their leisure time, it does nonetheless tend to result in longer working hours. The number of full-time hours worked by a self-employed person is significantly higher than the number of hours worked by an employee in a typical full-time job.¹² It would appear that people are generally aware of the actual pressures associated with being self-employed but that this knowledge does not have a negative effect on how

Figure 6: New business owners not spooked by new fears



Note: New business owners are defined as people who, at the time in question, were active owners and managers of a new business from which they had been drawing a salary, wages or other emoluments for no less than 3 months and no more than 42 months (3½ years). The indicator thus reflects a blend of new and established business start-ups, still in their fragile initial years.⁹

Source: Global Entrepreneurship Monitor.⁹

self-employment is perceived. "Low prestige" is the least cited (15%) barrier to setting up a business.

More business starters desired - but where will we get them from?

In view of the fact that salaried employment also holds certain attractions for people who are prepared to consider self-employment, the very strong employment market does nothing to encourage business start-ups to get going again. Action targeted at increasing the number of business start-ups conflicts with the goal of satisfying employment market demand because established medium-sized companies – the backbone of the German economy – need an adequate supply of qualified staff. Measures designed to increase people's willingness to start up a new business would make it more difficult to satisfy the demand for specialist personnel – especially as the more widespread demographic changes that are expected in the future will leave qualified staff in short supply.

Start-up activities are also not immune to the effects of demographic change. Many business starters take the plunge into self-employment when aged between 30 and 45 years. Demographic changes mean that this age group is likely to dwindle – with inevitable consequences for business start-up activity.

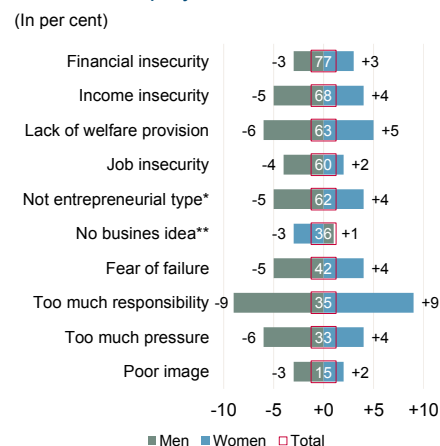
In order to slow down only those elements of decline that are due to demographic factors, it would be advisable in the future to introduce measures targeted at mobilising population groups who have not previously shown any great in-

clination to set up their own business. This includes women.¹³

Mobilising female potential, using immigration

Compared to men, women are more risk-averse and less optimistic.¹⁴ This partly explains why they are less interested in starting up a business than men are (19% of women vs 32% of men). However, these personality differences also appear to influence their perception of the barriers. Although men and women agree on the order in which they would place the various barriers, women are much more likely than men to agree that the barriers cited do actually constitute an impediment – with the exception that women are much less likely to cite the lack of a business idea as a reason not to become self-employed (Figure 7). As they are more likely to have a business idea up their sleeve, measures designed to break down business start-up barriers could well prove quite effective in the case of women.

Figure 7: Women are more likely than men to be concerned about their responsibilities while self-employed



* "Not the entrepreneurial type" was an option only for people who rejected the idea of becoming self-employed.

** "Haven't had a business idea" was an option only for people who were prepared to consider the possibility of becoming self-employed.

Source: KfW Start-up Monitor 2014.

The "too great a burden of responsibility" argument is where we see the greatest contrast between the sexes in their perception of business start-up barriers. This is a factor for 44% of women but only 26% of men. Even though self-employment may provide greater scope

to combine family and career, the various risks associated with being self-employed can represent a major burden on families. Women are more likely than men to consider this. In 2013, the "burden on the family" argument was cited by 42% of women who had been planning but did not ultimately proceed with a business start-up project as their reason for pulling out; the corresponding figure for men was just 37%. If it is the case that women are more concerned than men about the responsibilities they would have to assume if they were self-employed, it might explain this disparity. Measures aimed at enhancing women's willingness to start up their own business need to take their specific requirements into account.

The disadvantage of measures aimed at enhancing people's willingness to start up their own business is that they reduce supply in the employment market and increase competition for qualified staff. One way round this might be to accept higher levels of skilled immigration, which would help to satisfy demand within the employment market and also to improve business start-up activity without the need for additional self-employment incentives. There is strong demand in the employment market for well-trained specialist personnel from abroad, many of whom display an above-average tendency towards entrepreneurship.²

Re-starters offer potential – providing we can manage a couple of cultural changes!

Almost half of those who had previously started up a business (44%) would be prepared to venture anew. Tapping this potential is a declared policy objective.¹⁵ The current shortening of probationary periods in the insolvency code (see box) should not, therefore, be seen purely as a measure aimed at reducing the financial risk associated with being self-employed. It is also designed to make it easier for people who had previously been self-employed but whose businesses did not succeed, to start again ("Restart"), thus helping to establish a "second chance culture". People have been calling for this sort of cultural change for years.¹⁶ And it is a call that is worthy of support – everyone deserves a second chance. Typically, the call is justified by saying that people who have failed in business tend to be more successful if they are allowed to start again, as they learn from their business mistakes. Numerous theory-based studies have proceeded on that assertion.

However, no credible studies – on either a national or an international level – have so far succeeded in providing empirical evidence of this. At best, there is no difference between the success rates of re-starters and first-time starters.¹⁷ Venture capitalists are keen to promote the myth

of the failed entrepreneur rising like the phoenix from the ashes. There are some notable instances of re-starters who have succeeded – Lars Hinrichs, for example - and these help to keep the myth alive. However, the myth does not apply to the typical entrepreneur. If anything, re-starters are at an even greater risk of failing once again – and that makes their credit default risk higher.¹⁸

This relates to the fact that many people whose businesses had previously failed block out – whether consciously or subconsciously – any sort of learning process. They refute any suggestion that they might have made business mistakes and, instead, blame external factors such as the economy for their failure. The main reason for business failures is often individual sales problems which can be traced back to the availability and quality of the product or service being sold, the client base, regional market limitation factors or insufficient market knowledge and poor marketing.²⁰ In other words, problems that fall into the entrepreneur's area of responsibility. Acknowledging one's own mistakes – both to oneself and to others – is an essential learning process. The government can provide incentives in order to develop a new "culture of learning", not least by motivating people whose businesses had previously failed to accept external assistance in addressing their business mistakes.

If we are serious about making a lasting change towards a second-chance culture, it is essential that we develop a culture of learning.

Relaxation of insolvency law so far ineffective

The fact that the financial risks associated with unemployment act as a barrier to business start-ups has long been a topic for political debate. The 1999 insolvency law reform also witnessed an attempt to alleviate the consequences of that risk (see box). It was this reform that introduced the possibility of obtaining discharge of residual debt. Defaulters are required to "be of good conduct" for a certain length of time (the probationary period) before they can become debt-free.

Box: Insolvency Code

The old Bankruptcy and Conciliation Code was superseded in 1999 by the Insolvency Code. Insolvency law reform introduced the first ordinary insolvency proceedings for natural persons that Germany had ever had ("consumer insolvency"). Closely associated with this was a new possibility of obtaining discharge of residual debt. Under residual-debt exemption proceedings, natural persons may be discharged from the obligation to pay their residual debts after completing a probationary period. Opening up the possibility of obtaining discharge of residual debt represented a watershed in the German legal system. Prior to this, debts continued to hang over natural persons until such times as they were repaid or forgiven by creditors – a whole lifetime, in most cases.

When it was first introduced, the probationary period lasted for seven years, beginning from the point at which (in the case of a discharge of residual debt application) insolvency proceedings were completed. The *Insolvenzrechtsänderungsgesetz (Insolvency Law Amending Act)* (2001) reduced the probationary period to a nominal six years. In practice, however, the time taken to obtain discharge was shortened by more than six years, as the probationary period would now begin once the insolvency proceedings begin. This can still take several years.¹⁹ The Shortening of Residual Debt Discharge Proceedings and Improvement of Creditors' Rights Act (*Gesetz zur Verkürzung des Restschuldbefreiungsverfahrens und zur Stärkung der Gläubigerrechte*, GIRSTG), that came into force on 1st July 2014, brought about a further reduction in the probationary period to five years. The probationary period can now end as soon as three years after it began, providing by that stage that the cost of the proceedings has been covered and at least 35 per cent of the total owed to insolvency creditors has been repaid.

The prospect of obtaining relatively quick debt relief after business insolvency would – so the thinking has it – take away the fear of financial risk that might otherwise act as a barrier to starting up a new business. A number of studies show a connection between making insolvency law "more friendly" to defaulters and an increase in business start-up activity.²¹

In Germany, however, expectations have been dampened by reality, as there has been no sign of any boost to start-up activity.

Fear of asset loss outweighs debt relief incentive

Why should that be? It may result from the two principal elements of financial risk: indebtedness and impoverishment.

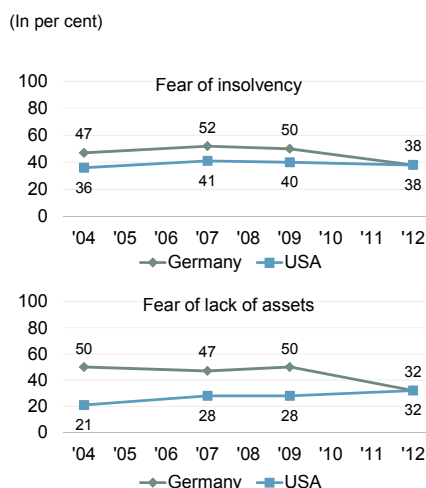
It might be possible to reduce indebtedness through debt forgiveness. It can be assumed, however, that the financial risk of impoverishment weighs rather more heavily on entrepreneurs, whose entire assets are generally at risk. Ultimately, legal reforms aimed at limiting liability do not cover any of the entrepreneur's personal assets pledged as collateral or any personal liability he has accepted under guarantees. When it comes to risking the loss of personal assets as a result of business failure, insolvency law reform has not brought about any changes that make self-employment more attractive. This could explain why the reform has had no demonstrable effect on business start-up activity. Should this assumption be correct, the current shortening of the probationary period will once again cause expectations¹⁵ to be dashed, and fail to demonstrate any measurable causal effect.

The level of a potential entrepreneur's income constitutes a third element of financial risk. However, this is a manageable risk, as most entrepreneurs (84%) manage to achieve at least the same level of household income in their first year as they did before becoming self-employed.²²

Risk tolerance levels rising – are business start-ups following suit?

The relaxation in insolvency law brought about by the 1999 reforms ought to have the most noticeable effect on start-up ac-

Figure 8: Fear that self-employment could lead to insolvency or to loss of assets falls to US levels



Note: The question was: "If you were to become self-employed today, which two risks would you fear most?". There were six answers to choose from: insolvency, loss of assets, uncertain level of income, job insecurity, fear of personal failure, and stress.

Source: Flash Eurobarometer.²³

tivity attributable to people no longer typical of the risk profiles that had applied up to that point, to people (as yet) without savings or to people who have had insufficient time following an earlier financial disaster to build up new savings – attributes, in fact, that apply to the majority of young people. There is no more than weak evidence to suggest that these people's perception of financial risk acts as a barrier to starting up a new business. Younger people (aged 18 to 24 years) who are prepared to consider self-employment cite this risk rather less frequently (58%) than, for example, those aged between 45 and 54 years (68%).

In recent years people in Germany appear to have become generally more tolerant with regard to the financial risk associated with self-employment. Fear that self-employment could lead to insolvency or to loss of assets has fallen (Figure 8) – and is now as low as it is in the United States, generally regarded to be one of the industrialised nations with the greatest propensity to risk and with very "debtor-friendly" insolvency laws. However, Germans' new-found risk-tolerance levels have so far failed to find any long-term resonance in business start-up activity.

Developing business start-up potential

The way in which we approach basic framework conditions is still correct. If entrepreneurs' efforts to embark upon self-employment are thwarted, many abandon their plans. The route to self-employment should, therefore, be free of unnecessary stumbling blocks. It is, therefore, essential to maintain good framework conditions and to deal with any negatives that may arise, if we are to exploit business start-up potential as effectively and efficiently as possible.

Germany has an excellent support infrastructure.²⁴ This is important because funding difficulties are a systematic obstacle for entrepreneurs who are seeking to invest. We therefore have to maintain the full range of support programmes that make it easier for them to gain access to funding. Funding difficulties hit technologically innovative business starters harder than anyone else. The breadth and depth of support programmes targeted at these entrepreneurs therefore warrants expansion. There also needs to be some strengthening of Germany's innovation system, since technologically innovative business starters benefit from the external effects of diffusing knowledge and technology.

Potential can also be found in spin-off companies set up by major corporations. Such corporations are able to provide incentives to their staff to market their research findings and innovations in the form of spin-off ventures. Not only can corporations benefit in a technological sense, they can also benefit financially by making the necessary venture capital available from their own resources.

If we are to lay the foundations for improvement there is also much to be said in favour of putting greater effort into teaching entrepreneurial skills, such as personal initiative and decisiveness as well as openness and willingness to accept risk, at an earlier stage (ideally in schools). When it comes to providing business start-up material in schools, Germany has a great deal of catching up to do.²⁴ The efforts of the Federal Ministry of Economics and Energy [to bring the spirit of entrepreneurship into schools](#) is therefore the right approach.²⁵ ■

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