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Family Businesses' Contribution to the U.S. Economy: A Closer Look

Joseph H. Astrachan, Melissa Carey Shanker

In 1995, we were commissioned to conduct research on the impact of family businesses on the U.S. economy. A search of all relevant research led to the conclusion that the majority of existing data relating to family businesses' economic contributions were not grounded in empirical research, and the definitions used to distinguish family businesses from other enterprises were ambiguous or non-existent. In 1996, we published a paper providing a framework for assessing the economic impact of family businesses across three ranges, defined by the degree of family involvement in the businesses. This paper revisits that research and updates and improves the original findings based on more recent data.

Introduction

How has the available research on family businesses' economic impact changed since 1995, amid greater attention by the White House on estate tax reform, seamless access to information on the Internet, and more university-based family business centers than ever? Unfortunately, there is not much new research.

There is still little doubt that family-owned and operated businesses are large contributors to the U.S. economy. However, just how to determine the exact extent of their impact continues to be difficult. A vast study of all of the family business literature and research since our original findings has convinced us that our definition-based formulas for estimating family businesses' overall economic impact is still the most accurate information available. With greater access to government information, we were able to refine our original data greatly and apply these new figures to our existing formulas, resulting in a new and improved framework with which to evaluate just how important family businesses are to the U.S. economy.

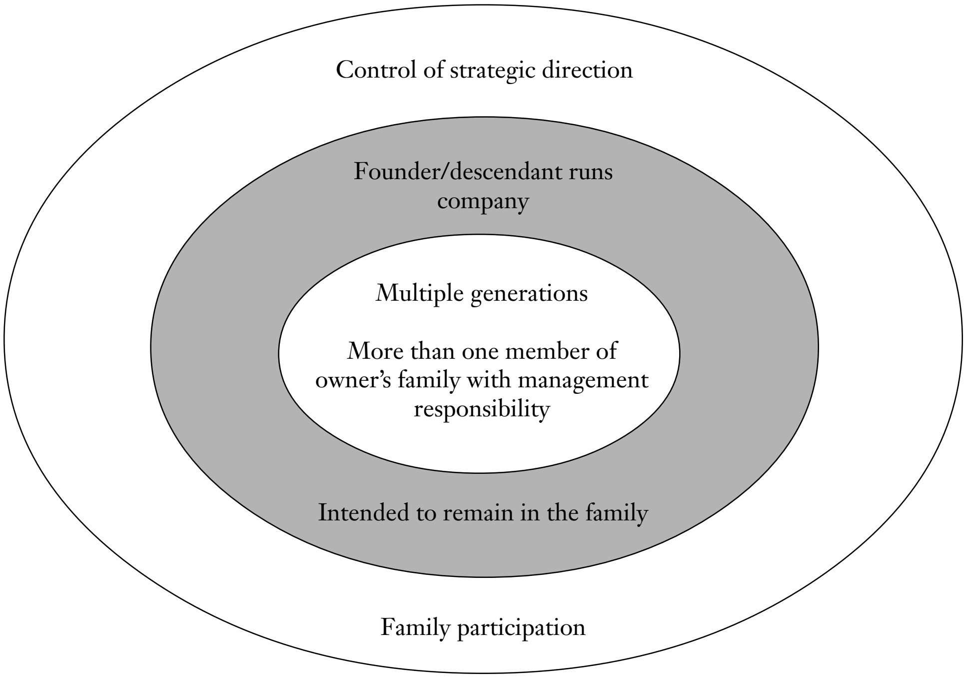
Defining a Family Business: The Ultimate Challenge

Given the private nature of most family businesses, accurate information about them is not readily available. The even greater challenge in quantifying family businesses' collective impact is that there is no concise, measurable, agreed-upon definition of a family business. Experts in the field use many different criteria to distinguish these businesses, such as percentage of ownership, strategic control, involvement of multiple generations, and the intention for the business to remain in the family.

All of these criteria can be important characteristics for describing a family business, depending on where the business is in its life cycle. In our research, we created a range of possible family business definitions from a broad, inclusive definition to a narrow and more exclusive one. The level of inclusiveness depends on the perceived degree of family involvement in the business.

Our broad definition, the outer circle of the "bull's-eye," is the most inclusive and requires only that there be some family participation in the business and that the family have control over

Figure 1. Family Business Universe



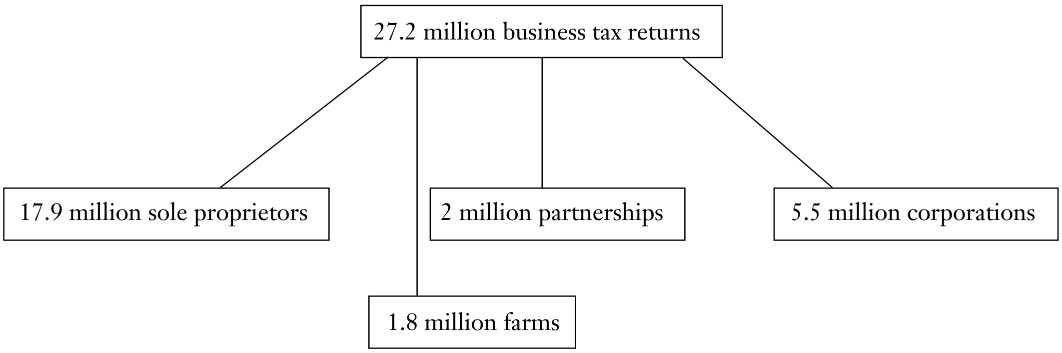
the business' strategic direction (see Figure 1). This definition covers the gamut of possibilities, from a large public company that has descendants from the original founding family as stockholders or on the board to an independent building contractor whose daughter manages his books and whose grandson performs occasional manual labor for him.

Our middle definition narrows the field by requiring that the business owner intends to pass the business on to another member of his or her family and that the founder or descendant of the founder plays a role in running the business (see Figure 1). The latter requirement separates out those businesses where the original family may have a stake in the business or a role on its board but very little interaction in day-to-day operations. The other requirement—intention—is a tricky concept to quantify, but, we believe, an important delineator. We believe that if an entrepreneur's long-term vision for his or her business is to build something for his or her children, then the planning and strategic decisions he or she makes will be different from those of a nonfamily business.

A family business in the center ring, our narrowest definition, may involve a grandparent/founder as chairman, two or three siblings in top management, one sibling with ownership but no day-to-day responsibilities, and younger cousins in entry-level positions (see Figure 1). In this scenario, multiple generations have a significant impact on the business. Although a common example of a family business at this stage of its life cycle, the founder no doubt had a similar profile to many of the "entrepreneurs" included in the other circles of the bull's-eye just a generation or two earlier.

Although we agree with the importance of the intangible aspects that make family businesses unique, they make quantifying family businesses' economic impact more elusive. Unlike the

Figure 2. Breakout of Total Business Tax Returns in 2000



Source: U.S. Department of Treasury, Internal Revenue Service (2000).

impartial measurements used to identify other business types, i.e., sales, number of employees, etc., the characteristics most often used to define family businesses are difficult, if not impossible, to collect. This is the primary reason why more research in this area has not been conducted.

Quantifying Family Businesses

Our research creates a framework for understanding the size of the family business universe based on possible criteria used to define one. A loose definition will ultimately include more businesses and result in larger economic contributions. A narrower definition results in a more homogeneous group of businesses, but less total economic impact. We have used existing information to extrapolate and make educated estimates on the size and impact of the family business universe in terms of its total size, contributions to the Gross Domestic Product, and employment of the U.S. workforce.

The Internal Revenue Service provides one of the very few accessible sources of information on privately held companies. Every legally operating business in the United States, large or small, public or private, family or nonfamily, files a tax return with the IRS. Looking at each component separately, we made logical judgments about each group's propensity to include family businesses.

Legal Form of Organization. According to the IRS, there are three legal forms of organization:

- *Individual proprietorship*. An unincorporated business owned by an individual. Also included in this category are self-employed persons. The business may be the only occupation of an individual or the secondary activity of an individual who works full time for someone else.
- *Partnership*. An unincorporated business owned by two or more persons having a shared financial interest in the business.
- *Corporation*. A legally incorporated business under state laws.

In 2000, 17.9 million sole proprietor businesses, 2 million partnerships, 5.5 million corporations, and 1.8 million farms filed for a total of approximately 27.2 million tax returns (see Figure 2).

Model for Broad Family Business Definition. It can be argued that a sole proprietorship (an unincorporated business owned by a single person, with no paid employees) is a type of family business; many scholars have incorporated this idea into their *family business* definitions. In support of this theory, it is likely that a high number of family members are helping out in such enterprises.

A study by Kirchoff and Kirchoff (1987) finds that smaller family businesses very often use both paid and nonpaid family labor, especially when starting out. (It is also likely that if family members are paid, they receive cash that is not reported.) A family farm is an example of a business in which family members work for the business but are unlikely to be listed as paid employees. In keeping with this theory, we have included all of the 17.9 million sole proprietorships and 1.8 million farms in our broadest family business universe, based on the belief that although only one family member is officially running the business, the family dynamics involved in businesses of this type qualify it as a family business in our broadest definition.

Partnerships and corporations may be somewhat less likely to exhibit this level of direct family involvement. Although the majority of partnerships and corporations are private, research done on public companies gives us a rare glimpse at empirically based data on the total number of family businesses present in public corporations. Burch (1972) finds that 47% of the 1965 *Fortune* 500 were family businesses, McConaughy (1994) finds that 21% of the *Business Week* 1000 list qualified, and Jetha (1993) finds that 37% of the 1992 *Fortune* 500 businesses qualified as family businesses under his definition. Although the definitions and methodologies used were different, this research seems to say that one-third to one-half of the very largest public companies are family businesses.

Unfortunately, this research on public companies represents only a small sliver of U.S. businesses. Even in terms of public companies, the majority are not traded on the big exchanges but rather via the over-the-counter market and "pink sheets," where smaller and closely held companies as well as high-tech start-ups go to gain access to capital. In many cases, these "public" companies remain in the owner's or family's strategic control and are, therefore, more likely to be family businesses that fit our broad definition, despite being considered "public" companies.

With what the research on public companies tells us, and based on what we know to be true about other large family businesses, we estimate that 60% of all public and private partnerships and corporations are family businesses under our broad definition. This is a conservative estimate based on years of experience working with these types of family entities.

Therefore, the model we use to determine the total number of family businesses and their impact on the economy for our broadest definition is 100% of sole proprietors and farms and 60% of partnerships and corporations.

Narrowing the Field

Although the IRS information is helpful, it is not necessarily an accurate picture of the total number of businesses, especially in terms of sole proprietors, because many people have full-time jobs elsewhere, operate multiple businesses, and/or file multiple tax returns. To get a better understanding of the type of sole proprietors that exist and their propensity to be family run, we referred to two sources of data from the U.S. Census Bureau (U.S. Department of Commerce, 1997) to help us meet the more specific criteria of our middle and narrow definitions.

Middle Definition: "Intention." The intention to pass on the business is an elusive but important distinction for a family business. The National Federation of Independent Business gives us one way to think about this. According to its research, which is based on special runs of the 1997 Census data, of the 21 million businesses listed in the 1997 Census, only 12 million represented the owner's "principal occupation" (U.S. Department of Commerce, 1997). Although intention is impossible to measure, we believe that if the business is not the primary focus of the family and the primary source of income, it is unlikely that the time and effort has been given to plan to keep it in the family for the future generation. With this in mind, the middle definition universe will consider only "principal occupation" sole proprietors. We have assumed that all partnerships and corporations represent

Table 1. Employers and Nonemployers in 2000

All firms	22,182,499
Nonemployers (firms with no payroll)	16,529,955
Employers	5,652,544

the owner's principal occupation and, thus, subtracted the total number of these tax returns from the 12 million "principal occupation businesses." This move left us with approximately 4.5 million "principal occupation" sole proprietors to consider.

Thus, when we apply our family business formula to the middle universe, we use the same framework as the broad model, but now limit the number of sole proprietors from 17.9 million to the 4.5 million that declare that their sole proprietorship is their "principal occupation."

Our Narrow Definition: Multiple Generations and Family Managers. According to the U.S. Census Bureau, nearly three-quarters of all U.S. business firms have no payroll, or are "nonemployers." Using Census data to help us narrow our IRS figures made sense because the primary source for the Census' nonemployer statistics is administrative records of the IRS. Nonemployer figures consist primarily of sole proprietorship businesses filing IRS Form 1040 Schedule C, although a very small percentage of the data is derived from filers of partnership and corporation tax returns that report no paid employees. These data undergo complex processing, editing, and analytical review at the Census Bureau to distinguish nonemployers from employers.

The Census states that the majority of these nonemployer businesses are very small, typically the second or third business in a household, and many are not the primary source of income for their owners. The Census also estimates that nonemployers account for only 3% of business receipts (U.S. Department of Commerce, 1997). We believe this number is quite understated due to the fact that many transactions take place in cash in these small businesses and are typically not reported. Either way, nonemployers, i.e., sole proprietors, represent the majority of businesses in the U.S. economy, but their makeup varies widely. The U.S. Census estimates that 16.5 million nonemployer firms existed in 2000 (see Table 1).

The remaining 5.6 million businesses are employers and are made up primarily of partnerships and corporations (see Table 1). Also included in this figure are about one million self-employed businesses owners that have paid employees.

At first glance, it may be confusing that the Census figures the total number of U.S. firms to be 22 million vs. the IRS's 27 million (see Table 1). The reason for this is that the IRS is counting all business tax returns, not individual business establishments. As mentioned earlier, many sole proprietors operate multiple businesses and file multiple tax returns. In addition, whenever two different sources of information are used, differing methodologies will result in different data.

So, how does the Census' nonemployer information pertain to our family business definitions? Our narrow definition requires, among other things, that "more than one member of the owner's family have significant management responsibility." This implies that the firm is an employer and that family members are on the payroll.

Therefore, in this definition, we will consider only the 5.6 million employer businesses in our formulas. Although not included in the Census' employer statistics, we add farms because they are traditionally family-run operations that "employ" many family members' efforts and meet the criteria of our narrowest definition.

In addition to requiring that family members be employed in the business, our narrow definition also states that multiple generations must be involved. Two earlier research studies help us here. John Ward's 1987 research on succession finds that approximately one-third of post-start-up family businesses survive and reach the second generation of ownership (Ward, 1987). In addition, a Mass Mutual family business study, which surveyed 1,002 family businesses, supports Ward's statistic by finding that 35% of the businesses it contacted had multiple generations working in the business (Andersen, 1995).

Therefore, the narrow definition requires that we eliminate a majority of the 27.2 million tax returns in 2000. We can consider only the 5.6 million employer businesses, and then, the existing research tells us that within the family business universe, only 35% of those family businesses employ multiple generations of the same family. Thus, the formula for our narrowest family business definition will include only 35% of the businesses included in our broad definition, or 35% of sole proprietors, and 21% (35% of the estimated 60% used in our broad definition) of partnerships and corporations.

These family business formulas for the broad, middle, and narrow definitions explained above are applied below to determine the total number of family businesses in the U.S. economy, their contribution to GDP, and the number of workers they employ.

Total Number of Family Business in the United States. The outer ring of our bull's-eye (broad) definition finds a total of 24.2 million family businesses in the United States, or 89% of all 2000 business tax returns.

According to our middle definition, 10.8 million family businesses operate in the United States, representing 39% of all 2000 tax returns but 89% of businesses that the owner claims are his or her "principal source of income."

Our high-family-involvement definition finds 3 million family firms in the United States, representing 11% of all 2000 tax returns but 54% of all "employer" businesses.

The results of each definition obviously show vast differences. The three rings of the bull's-eye in Figure 3 show how definitions can affect the size of the family business universe. We are not suggesting that the center ring is the real or best family business universe—only the most narrowly defined. This illustrates that the criteria used to define a family business play heavily on the overall perception of family businesses' contributions to our economy.

Family Businesses' Contribution to GDP

The U.S. Gross Domestic Product is the market value of the goods and services produced by labor and property located in the United States. The Bureau of Economic Analysis (U.S. Small Business Administration, 2000a) provides us with the breakdown of Real GDP by sector (see Table 2).

The Small Business Administration (SBA) then breaks down the business sector once more into small business (fewer than 500 employees)

Table 2. Real Gross Domestic Product by Sector (2000)

Total	$9,220 billion
Business (including farms)	$7,879
Small business	$4,097
Big business	$3,782
Households & institutions	$389
General government	$959
(Residual)	-$6.9

Source: U.S. Small Business Administration, Bureau of Economic Analysis (2000a).

and big business (more than 500 employees) (U.S. Small Business Administration, 2000b). In our research, the SBA's breakdown of the GDP into small and large businesses allows us to relate these figures back to our IRS-based formulas and make educated estimates about the number of small and large family businesses represented in this data.

Nonemployer firms are not included in the SBA's GDP calculations because of their relatively small (estimated 3% of sales and receipts) contribution to the total gross product and the difficulty in collecting information about these very small businesses. Of the approximately 5.6 million employer firms, only about 17,000—less than 1%—were deemed big businesses, i.e., those employing 500 or more in 2000. The remaining 5.5+ million small businesses most likely consist of all three types of IRS subgroups: sole proprietors, partnerships, or corporations. Because we are looking only at employer firms, the number of sole proprietors that contributed to the GDP will be limited, but we included farms in this calculation as well. (See the appendix for specifics.)

Broad, Middle, and Narrow Definitions. As illustrated in Figure 3, dividing the small and large businesses into IRS categories and applying the broad definition model established above (i.e., 100% of sole proprietors and farms and 60% of partnership and corporations) results in family businesses contributing 64% of the GDP, or $5,907 billion ($5.9 trillion). Applying the formula for the middle definition results in family businesses contributing 59% of the GDP, or $5,481 billion ($5.5 trillion). Applying our narrow definition to this data results in family businesses contributing 29% of the U.S. GDP, or $2,566 billion ($2.6 trillion).

Family Business Employment

The U.S. government employs 15% of all American workers. Other public and private enterprises employ the remaining 112 million workers. Approximately 56 million work for businesses employing fewer than 500 employees (72% in businesses with fewer than 20 employees), and about 55 million work for big businesses employing more than 500 workers. Table 3 below illustrates the division.

Using the narrow and broad family business models, we can estimate the number of small and larger businesses that are family run and then extrapolate the number of workers employed by each category from the workforce information provided above.

Using the broadest *family business* definition, family businesses employ 62% of the U.S. workforce, or approximately 82 million individuals. Our narrow definition would result in 27% of the workforce, or 36 million people.

Conclusion

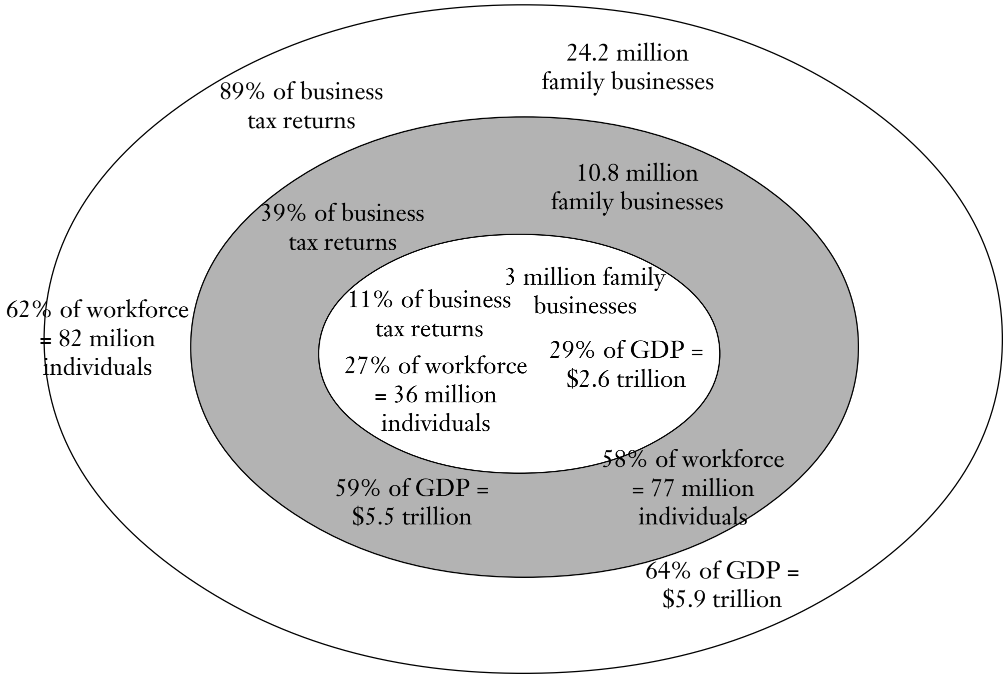
No matter what criteria are used, family businesses represent a substantial portion of the U.S. economy and have a massive impact on the

Table 3. Division of Total U.S. Workforce in 2000

U.S. Workforce in 2000	*No. of Employees (in thousands)*	%
Total workforce	133,101	100%
Government	20,680	15%
Small business	55,729	42%
Big business	54,976	41%
Farm	1,716	1%

Source: U.S. Department of Labor, Bureau of Labor Statistics, ERS-William Edmondson (farm) (2000).

Figure 3. Defining Family Business: The Family Business Bull's-Eye



economy as a whole. This research provides a range of estimates based on the degree of family involvement in a business. The difficulty in more accurately quantifying this impact stems from the lack of a universally agreed-upon definition for a family business and the fact that many of the criteria most important in defining a family business are difficult, if not impossible, to collect.

Clearly, more research is needed to study family businesses' importance to the U.S. economy, particularly as our leaders argue over the right tax policy to stimulate our lagging economy.

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Appendix

Definition	*Characteristics of Business*
Broad	• Family controls strategic direction • Family participates in business
Middle	• Founder/descendant runs business • Business is intended to remain in family
Narrow	• Multiple generations participate in business • More than one member of owner's family has management responsibility

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