

Myths and Realities: Family Businesses' Contribution to the US Economy— A Framework for Assessing Family Business Statistics

Melissa Carey Shanker, Joseph H. Astrachan

This article presents a framework for assessing commonly accepted family business statistics, based on the criteria used to define a family business. Using existing research from multiple fields and sources, a range is extrapolated for the total number of family businesses in the US, their contribution to Gross Domestic Product (GDP) and employment.

Introduction

Family businesses are important contributors to the US economy, but the extent of their impact has been a matter of debate. The most commonly cited figures claim that family businesses represent 90-98% of all US businesses (Beckhard & Dyer, 1983; Hershon, 1975; Stern, 1986), that they employ over half the work force, create over half of all new jobs and generate 40-60% of the GDP (Becker & Tillman, 1978; de Visscher & Bruel, 1994). Closer analysis of these statistics reveals that a large portion of these family business “facts” have been cited so often that original sources cannot be located.

In an effort to gain a more accurate empirically-based understanding of US family businesses' collective economic impact, we reviewed the family business literature to identify quoted economic statistics. We then traced statistics to their origin. The majority of statistics identified were not rooted in formal research. In addition, the definitions used to qualify a business as a “family business” were ambiguous, or omitted altogether. Our investigation revealed four categories of family business statistics. The first category is “Street Lore” statistics and is comprised of those statistics which lack evident research origins or coinciding family business definitions. The majority of quoted family business statistics fits the “Street Lore” definition. The second largest portion of family business data consists of “Educated Estimates” based on expert knowl-

edge and experience in the field. The third statistical category—a smaller portion of family business statistics—is comprised of extrapolations based on known data or small samples of family businesses that have been projected out to the entire universe. The last and smallest set, based on actual empirical research which uses a precise definition of a family business, can be termed “family business facts.”

Our initial analysis raised several questions: Are the majority of economic statistics we read in family business literature reliable? Can such statistics be meaningful in the absence of precise family business definitions? Are the “Street Lore” statistics representative of reality or are they simply an example of the old adage that “if you say anything *enough* times, people will believe it”?

Reasons for Lack of Quantitative Research

Although much qualitative research exists on family-owned businesses, few quantitative studies have been sought to determine their precise cumulative size and economic impact. The lack of substantial data is not surprising. Until recently few academics, governmental agencies, or data gathering enterprises, regarded families in business as characteristically distinct entities (Lansberg, Perrow & Rogolsky, 1988). Most research on family business is less than 10 years old.

Another reason that more extensive quantitative research has not been accomplished is the difficulty in defining and identifying family businesses (Handler, 1989). Given the private nature of most family businesses, accurate information about them is not readily available. But even if all pertinent information were available, a common definition of what constitutes a family business does not exist. Unlike impartial measurements that separate small businesses from Fortune 500s, such as number of employees or sales revenues, there is no standard of measurement for specifying a family business. Without a precise definition or formula for distinguishing family run businesses from their non-family counterparts, research regarding their prevalence and economic contributions is difficult.

Family Business Definitions

Economic measurement of US family businesses is obviously linked to their definition. While anyone can intuitively recognize a “family business,” even the field’s experts find the task of defining precisely such businesses difficult. Family business scholars lack consensus on which criteria are most important in identifying a family business (Handler, 1989). The criteria used to define family business include: percentage of ownership, voting control, power over strategic direction, involvement of multiple generations, active management by family members, and others.

Figure 1. Family Business Definitions by Degree of Family Involvement




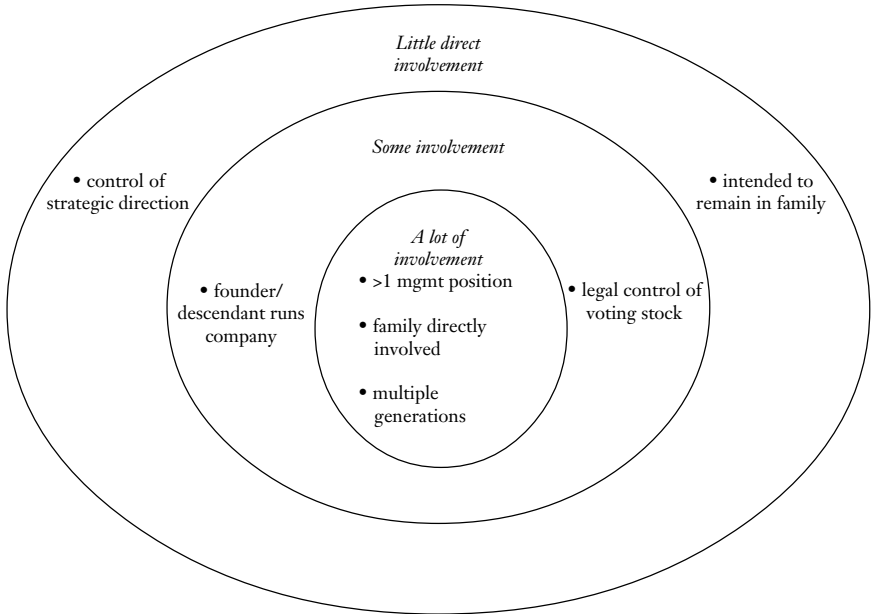
<i>Broad</i>	<i>Middle</i>	<i>Narrow</i>
<ul style="list-style-type: none"> • effective control of strategic direction • intended to remain in family 	<ul style="list-style-type: none"> • founder/descendant runs company • legal control of voting stock 	<ul style="list-style-type: none"> • multiple generations • family directly involved in running and owning • more than one member of owners family having significant management responsibility
		
Little direct family involvement	Some family involvement	A lot of family involvement

Figure 1 divides the criteria used to define family businesses into three groups: broad, middle and narrow definitions. The broadest and most inclusive definition requires that the family have some degree of effective control over strategic direction, and that the business is at least intended to remain in the family. This definition includes businesses where a family member is not in direct daily contact with the business but influences decision-making, perhaps through board membership or significant stock ownership. The middle

Figure 2. The Family Universe Bull's Eye



division would include all the criteria of the broadest group and would require that the founder or descendant runs the company. Again, this definition would include those businesses where only one member of the family is directly involved in the day-to-day operations. The narrowest family business definition would require that the business have multiple generations involved, direct family involvement in daily operations, and more than one family member having significant management responsibility.

The three rings of the “Bull’s Eye” in figure 2 above show how definitions can affect the size of the family business universe. Note that we do not suggest that the center ring is the real or best family universe—only the narrowest and most tightly defined. A looser definition will ultimately include more businesses and result in larger economic contributions. While the outer ring of businesses appears to be legitimate “family businesses,” many people working in the field of family business prefer more restricted family business definitions. One should distinguish the “type” of family business to which one refers before blindly accepting general statistics about family businesses’ size and impact.

Framework for Assessing Family Businesses’ Contribution to the Economy

Our objectives are to review the state of current family business statistics and to establish a framework for understanding the size of the family business universe based on various criteria. This framework will help to put frequently quoted family business statistics into perspective. We have used existing information to extrapolate and make educated estimates on the size and impact of the family business universe, e.g., total number of family businesses, and contributions to GDP, employment and job creation. A range of statistics based on the broad, middle and narrow family business definitions established earlier are provided, and permit us to offer general statistical boundaries of the family business universe.

Size of the Family Business Universe

Family business “Street Lore” statistics state that 90-98% of all US businesses are family run (Rosenblatt, de Mik, Anderson & Johnson, 1985; Beckhard & Dyer, 1983; Barnes & Hershon, 1976). In order to determine the reliability of these statistics, US businesses were broken down into various subgroups (public and private corporations, partnerships, and sole proprietorships) and existing research was used to assess the propensity of each subgroup to include family businesses.

Public Companies

Only three research studies have been conducted that examine the number

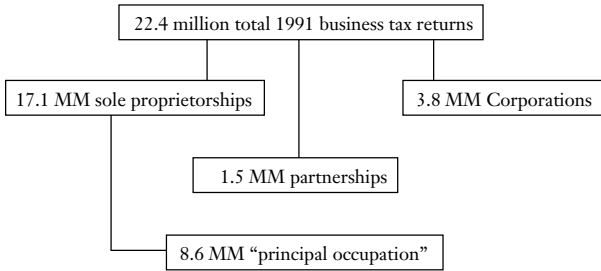
of family businesses in well-known groups of public companies. These studies have been given the rare distinction of being labeled “Family Business Facts” because each statistic is based on empirical research, and each uses a precise family business definition. The earliest study located was Philip Burch’s 1972 “Managerial Revolution Reassessed.” Burch’s study, based on the 1965 *Fortune 500*, examines the top 300 manufacturing firms and the top 50 merchandising, transportation and commercial banking companies. His definition used the following criteria: (1) 4-5% or more of voting stock held by a family or group of families or one affluent individual; and (2) inside or outside representation on the part of the family on the board of directors, generally over a period of time. Burch found that not only were close to half (47%) of these publicly held firms family controlled, but that the family had been wielding its power for many generations. Dan McConaughy from the University of Cincinnati (1994) researched the *Business Week 1000* list and found that 21% of those publicly held businesses had top managers that were direct descendants of the founding family and used the following definition: a family business is one in which the CEO, President, or Chairperson is a descendant of the founding family. Hasnehn Jetha from Loyola University based his 1993 unpublished research on the 1992 *Fortune 500* list and discovered that 37% of that list qualify as family businesses according to his definition, which is one that involves a member from at least the second generation who was a descendant of the founding family and who is a key officer, director, or owner. This research seems to point in the direction of approximately one-third of the largest publicly held companies being family-run operations.

Yet this is not the entire picture. According to the National Association of Security Dealers, there are approximately 54,000 public companies. The three studies we referred to deal with only the largest publicly-traded companies. There are only 3,000 stocks traded on the New York and American Stock Exchanges, leaving another 51,000 to be traded in the over-the-counter market (OTC). The OTC market typically caters to smaller, closely-held companies as well as high tech and bio tech start-ups. Most of these smaller publicly-traded stocks remain in family control, and are only traded to give the family businesses access to equity capital. Taking this into consideration, an estimate that 60% of all public companies are family operated businesses would be conservative. However, public companies represent less than 2% of all US companies. A valid picture of family businesses requires focus on private companies.

Privately-held Companies

The IRS provides one of the very few accessible sources of information on privately held companies (US Department of Treasury, IRS, 1993). Every legally operating business in the US, large or small, public or private, family or

Figure 3. Breakout of Total Business Tax Returns in 1991



non-family, files a tax return with the IRS. Looking at each component separately, logical judgments were made about each group's propensity to include family businesses.

There are approximately 17 million sole-proprietorships in the US. It can be argued that a sole-proprietorship (an unincorporated business owned by a single person) is a type of family business; and many scholars have incorporated this idea into their definitions (Alcorn, 1982; Barnes & Hershon, 1976). In support of this theory, it is likely that there is a high occurrence of family members helping out in such enterprises. A study by Kirchoff & Kirchoff (1987) found that smaller family businesses very often use both paid and non-paid family labor, especially when first starting out. Depending on the strictness of the family business definition used, it is probable that sole proprietorships as a whole has the potential to include a large number of family-run businesses. An important distinction to note regarding sole proprietorships is that the 17 million total includes 1.9 million schedule F tax returns, or farmers. Non-farm sole proprietors total 15.2 million. For our purposes we have included farmers, because farms are traditionally family-run operations.

Of course, not all of the sole proprietorships represent the main occupation of the tax filer. In fact only 8.6 million called their sole proprietorship their "principal occupation" (Dennis, 1993). This distinction is addressed in the formulation of the statistical range for a narrower definition of a family business which includes "multiple family members in management" as one of its criteria.

Partnerships made up 1.5 million of total business tax returns in 1991. Partnerships possess many of the same business dynamics as sole-proprietorships in that they are often small and have the potential to include high levels of family involvement.

The last category is the private corporation, of which 3.8 million filed tax returns in 1991. It is more difficult to make assumptions about the degree of family-involvement inherent in a corporation. Based on these three categories of US businesses and the research available, the authors extrapo-

lated estimations of the size and impact of family businesses in the US that coincide with the high and low family involvement definitions established earlier (see Figure 1).

Model for Low Family Involvement (Broad) Definition

The broadest and most inclusive definition of a family business consists of all sole proprietorships 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. As discussed earlier, many small businesses involve the contributions of non-paid family members. Partnerships and private corporations may be somewhat less likely to involve this level of direct family involvement. In keeping with the public corporation estimate formulated earlier, the authors estimate that 60% of all partnerships and private corporations can be deemed family businesses. This is a conservative estimate based on years of experience working with these types of family entities. Adding these figures to the 60% of all public companies estimated earlier as family businesses results in 20.3 million total family businesses in the US, or 92% of all US businesses (see Appendix 1 for calculations). This estimate is based on the broadest definition of a family business, with the outer ring of the bull's eye as its parameters. This estimation is quite close to the "Street Lore" estimation that claims 90-98% of all businesses are family businesses.

Model for High Family Involvement (Narrow) Definition

In comparison, the stricter criteria of the narrow definition disqualifies a majority of the 20.3 million family businesses in the broad group. As mentioned before, only 8.6 million of the total 17.1 million sole proprietors that filed tax returns claimed that the business was their "principal occupation" (Dennis, 1993). In the model's narrow definition more than one family member must have significant managerial responsibility. Only the group of 8.6 million "principal occupation" sole proprietors are included in the narrow definition. If the business is not the principal source of income for the family unit, it is unlikely that more than one family member has taken an active role in its management. In addition, the narrow definition requires that multiple generations be involved in the business. According to John Ward's research on succession (Ward, 1987), approximately one-third of post-start-up family businesses survive and reach the second generation of ownership. *The MassMutual 1994 Family Business Study* (Rosenblatt, 1985), which surveyed 1002 family businesses via telephone, supported Ward's statistic by finding that 35% of the businesses contacted had multiple generations working in the business. Weeding out the 35% of probable multiple generation family businesses results in 3.01 million "principal occupation" sole proprietors that can reasonably be considered potential family businesses under the narrow definition. Applying this same model to

partnerships, corporations and public companies, results in 1.1 million potential family-run partnerships and private corporations and 11,340 publicly owned, but family operated businesses. Tallying the sole proprietors, partnerships, corporations and public, we find 4.1 million family businesses which meet the criteria of the stricter definition, i.e., multiple generations and more than one family member with significant managerial responsibility (see Appendix 1 for calculations).

Depending upon the criteria used, there may be a vast difference (16.2 million) in the total number of family businesses. Even though these estimates may be inexact, they illustrate that when “Street Lore” claims that over 90% of all US businesses are family-run, many businesses with little direct family involvement are included. Therefore, a lenient definition of a family business must be accepted if “Street Lore” statistics on the number of family businesses are to be considered.

The same logic has been employed to scrutinize the other commonly quoted statistics regarding family businesses’ contribution to Gross Domestic Product (GDP), employment and job creation. The established ratio of 100% sole proprietors to 60% partnerships and corporations to 60% public companies will be the model for the broad definition, and 35% / 21% / 21% respectively for the narrow family business definition. (see Appendix 1 for calculations)

Family Businesses’ Contribution to the GDP

Family business “Street Lore” claims that between 40-60% of the US GDP is generated by family businesses (Hershon, 1975; Becker & Tillman, 1978; de Visscher & Bruel, 1994). First, it must be noted that there is really no way to calculate the exact amount of GDP that family businesses—or for that matter, any business—directly contributes to GDP. There are many extraneous factors that go into determining the Gross Domestic Product (personal consumption + private domestic investment + government purchases + net exports). Yet estimations can be made based on the total output of goods and services that various business types generate. For example, the Department of Commerce (US Small Business Administration, 1993) reports that government spending is estimated to account for 36% of Gross Domestic Product. The Small Business Administration estimates that 38% of the GDP is generated by small (less than 500 employees) businesses. Thus we may assume that big businesses (500+ employees) account for the remaining 26% of GDP.

According to the US Department of Commerce (US Small Business Administration, 1993), there are 22 million small businesses (less than 500 employees) in the US and approximately 14,000 big businesses (500+ employees). Small businesses can consist of all three types of IRS subgroups: sole proprietorships, partnerships and corporations. It is, however, assumed that the 14,000 large businesses are primarily public or private corporations.

Dividing the small and large businesses into IRS categories and applying

the broad definition model established earlier in this paper results in the following: under the broad definition, an estimated 50% of the GDP—or \$3,339.6 billion in 1993 dollars of goods and services—were generated by family businesses. The higher family involvement criteria of the narrow definition for qualifying a family business established in this paper results in the following: an estimated 12% of total goods and services, or approximately \$830.9 billion in 1993 dollars (see Appendix 2 for calculations). Again, “Street Lore” is slightly on the high side of probable reality, with its claims that family businesses generate 40-60% of US GDP. Based on this analysis, a truer family business range falls closer to 20-40% of total GDP. Because of the very complex make-up of GDP, these are only estimations, but help provide a more meaningful understanding of existing family business statistics and GDP statistics in general.

Family Business Employment

Family business literature suggests that family businesses employ over half of the US work force (Becker & Tillman, 1978; de Visscher & Bruel, 1994). Workforce statistics for 1994 state that there are approximately 130 million people employed in the US (US Department of Labor, Bureau of Labor Statistics, 1994). The US government employs close to 15% of all American workers. Of the remaining 111 million workers employed by other public and private enterprises, 54 million work for businesses employing 500 employees or less and 48 million work for larger businesses employing 500 or more.

Using the narrow and broad family business models defined earlier, we can estimate the number of small and large businesses that are family run and then extrapolate the number of workers employed by each category from the work force information provided by the Department of Labor (US Department of Labor, Bureau of Labor Statistics, 1994). Using the broadest definition model, family businesses employ 59% of the total US work force, or approximately 77 million people. The narrower definition would result in 15% of the work force or approximately 20 million people employed by family firms (see Appendix 3 for calculations). In our literature review, “Street Lore” suggested that family businesses employ over half of the US work force. Once again, the broader family business definition must be used for “Street Lore” statistics to be valid.

Family Business Net Job Creation

Job creation statistics regarding family businesses are not as prevalent in family business literature as other economic statistics because of controversy related to job growth calculations. Various sources have attempted to quantify job creation and attribute growth to a particular sector. It is a complicated procedure and there are several conflicting views in terms of the reliability of databases used and the differences between service and manufacturing indus-

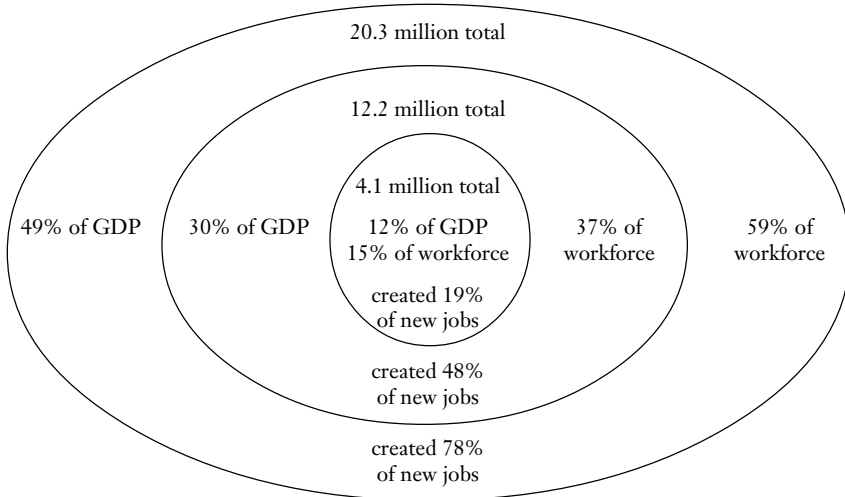
tries. Nevertheless, there is some consensus among economists that small businesses have been responsible for the majority of new jobs during the past two decades. This bodes well for family businesses' role in job creation.

In 1979, David Birch published the first empirical evidence that small firms (fewer than 100 employees) created the most new jobs (Birch, 1979). His 1994 research (Birch, Haggerty & Parsons, 1994) proposes that the very small businesses, employing less than 20 employees, accounted for virtually all new net job growth from 1989-1993. The Small Business Administration (US Small Business Administration, 1993) reports that small businesses (fewer than 500) created 2/3 of all new net jobs from 1976-1990. Dun & Bradstreet's Dun's 5000 survey (Dun & Bradstreet Corporation, 1994) projects that this trend will continue, and that 73% of new (net) jobs will come from businesses with less than 100 employees.

The US Small Business Administration calculates share of jobs created by firm size for the years 1976-1990 (US Small Business Administration, 1993). Based on these numbers we were able to apply our broad definition and narrow definition models to extrapolate the share of jobs created by family businesses.

Based on the broad definition, family businesses generated 78% of all new net jobs from 1976-1990, whereas only 19% of new jobs were created by family businesses that fit the narrower definition (see Appendix 4 for calculations). Such an example illustrates yet again how economic statistics vary depending upon the criteria used to define the family business universe.

Figure 4. Family Business Bull's Eye



Conclusion

The difficulty in identifying and defining a family business has led to a lack of

general economic profile information regarding the size and impact of this important segment of the US economy. The criteria used to define a family business will directly affect the size of the universe and therefore family business' overall apparent impact on the economy. The research of this paper is summarized in Figure 4.

We found that most family business statistics quoted in literature are a form of "Street Lore" or commonly accepted estimates—estimates that in fact are not derived from primary research. Despite the lack of research foundations, "Street Lore" statistics tend to be reasonable when viewed through the prism of a broad and inclusive definition of a family business. If a more rigorous definition is used, however, "Street Lore" statistics can be considered inflated and invalid estimates.

This paper provides a framework to assess available statistics based on the criteria chosen to include in a family business definition. In addition, using existing data, a more realistic range of economic contributions made by family businesses was extrapolated.

Implications of Findings on US Economy

Whatever the definition, family businesses represent a substantial portion of the US economy and have a massive impact on the economy as a whole. According to the MassMutual Survey, 13% of family businesses have members 65 years or older who direct the business. According to the Department of Health, life expectancy for a 65 year old white male is 13 additional years. Applying these facts to the total number of family businesses based on our broad definition model suggests that in the next 10-20 years approximately 3 million US businesses may be forced to transfer ownership (or 533,000 businesses using the narrow definition). How much capital will be taken out of the business sector to pay estate taxes in the next two decades? Will the economy be adversely affected by a "estate tax bubble?" What will be the domino effect on the entire economy? Are only large family businesses hurt by estate taxes? How does estate taxes' capital drain affect the development and perpetuation of small family businesses in the US? If family businesses represent 90% of all US businesses, how much in total taxes do they pay? To what extent are family businesses funding the US government?

Answers to these important questions are not currently available. Clearly, there is a need for more research and study regarding family business' importance in the US economy, particularly for policy reasons. Developing accurate information is an expensive proposition. Yet the evidence in this paper strongly supports the value of further study of this crucial sector of the US economy.

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Melissa Carey Shanker is a Graduate Research Fellow and MBA student at Loyola University, Chicago. Joseph H. Astrachan is an Associate Professor of Management and Entrepreneurship at Kennesaw State College, Marietta, GA.

Appendix 1. Total Number of Family Businesses in the US

Model for total number of family businesses based on broad and narrow definitions of a family business

Broad Definition Model	total (000)
100% of Sole Proprietorships	17,100.0
60% of partnerships & private corporations	3,200.0
60% of publicly owned co.s	32.4
Total # of F.B.s	20,332.4
Narrow Definition Model	
"35% of "principal occupation"	
Sole Prop. (8.6 million)	3,010.0
21% of partnerships* & private corporations	1,113.0
21% of publicly owned co.s*	11.3
Total # of F.B.s	4,134.3

* 35% (multi-generational businesses) of the 60% of total partnerships and corporations that were determined to be family businesses under the broad definition.

SOURCES: "1991 IRS income statistics, 1994 Mass Mutual Family Business Survey"
National Association of Securities Dealers

Appendix 3. Family Business Employment

Total Workforce as of 8/94 = 129,866,000		
Small Business = 53,769,000	Farm Workforce = 9,402,000	
Big Business = 47,682,000	Government = 19,013,000	

Broad Def'n Model: formula: IRS category share of employment x broad model index	100% of Sole Proprietors/60% partnerships & corp./ 60% public corp. total (000)	
Sole Prop.(total)	76% of employment by small businesses x 100% =	40,864
Part. & Corp. (<500)	24% of employment by small businesses x 60% =	7,743
Public/Private Corp.(500+)	100% of employment by big businesses x 60% =	28,609
Family Business Workforce		77,216
% of total US workforce		59%

Narrow Def'n Model: formula: IRS category share of employment narrow model index	35% of "principal occupation" Sole Prop./21% Part. & Corp./21% Public co.s ³	
Sole Prop. ("principal occupation")	38% of employment by small businesses x 35% =	7,151
Part. & Corp. (<500)	24% of employment by small businesses x 21% =	2,710
Public/Private Corp. (500+)	100% of employment by big businesses x 21% =	10,013
Family Business Workforce		19,874
% of total US workforce		15%

SOURCE: Department of Labor Statistics, August 1994

Appendix 4. Family Business Contribution to Job Creation

<i>IRS Categories</i>	<i>Total</i>		<i>Share of Job Growth</i>	
	<i>Businesses (000)</i>		<i>Broad Def'n</i>	<i>Narrow Def'n</i>
Small business (less than 500 employees)	= 22,386		100%	100%
-Sole Prop.(principal occupation)	= 8,600		38%	38%
-Sole Prop.(not principal occupation)	= 8,500		38%	n/a
-Partnerships & Corporations (<500)	= 5,300		24%	24%
Big Business (500+ employees)	14		100%	100%
-Corporation(500+)	14		100%	100%
 Broad Def'n Model: 100% of Sole Proprietors/60% Part. & Corp./60% Public co.s				
Formula: IRS category share of job growth x broad model index				
Sole Prop.			76% of jobs created by small business x 100%	
Part. & Corp. (<500)			24% of jobs created by small business x 60%	
Corp. (500+)			100% of jobs created by big business x 60%	
 Narrow Def'n Model: 35% of "Principal Occupation" Sole Proprietors/21% of Part. & Corp./21% of Public Co.s"				
Formula: IRS category share of job growth x narrow model index				
"Principal occupation"				
Sole Prop. (8.6 million)			38% of jobs created by small business x 35%	
Part. & Corp. (<500)			24% of jobs created by small business x 21%	
Corp. (500+)			100% of jobs created by big business x 21%	

Family Business Job Creation 1976-1990

	<i>US SBA DATA</i>		<i>EXTRAPOLATIONS</i>	
	<i>Small Business</i>	<i>Big Business</i>	<i>Family Broad</i>	<i>Family Narrow</i>
1976-78				
jobs created	4407	1655	4977	1172
share	73%	27%	82%	19%
1978-1980				
jobs created	2605	3172	4285	1153
share	45%	27%	74%	20%
1980-1982				
jobs created	1473	69	1373	290
share	95%	4%	89%	19%
1982-1984				
jobs created	3312	1006	3597	830
share	77%	23%	83%	19%
1984-1986				
jobs created	2411	2199	3499	913
share	52%	48%	76%	20%
1986-1988				
jobs created	2770	3399	4543	1231
share	45%	55%	74%	20%
1988-1990				
jobs created	2664	-501	2408	498
share	119%	-19%	90%	18%
Total Job Growth	19642	11500	24656	6086
	63%	37%	78%	19%

SOURCE: US SBA, Office of Advocacy, Small Business Data Base.