FEATURE:
PERSPECTIVES

By **Torsten M. Pieper**, **Franz W. Kellermanns**, **Joseph H. Astrachan** & **Nina Anique Hadeler**

The Importance of Family Businesses' Contribution to the U.S. Economy

A survey provides some updated figures

Everyone involved with family businesses knows that those businesses are important contributors to the U.S. economy. They provide jobs, pay taxes, take care of their communities and are drivers of innovation not only in the United States but also worldwide. Neither the federal nor state governments track family business status in their economic data. The fact that the government doesn't collect any data on family businesses in a separate category is troubling for many reasons, not the least of which are the estate tax and pass-through income tax implications of current tax policy for business-owning families.

Joseph H. Astrachan and Melissa Carey Shanker laid the framework for establishing the ability to assess the impact of family businesses on the U.S. economy. The authors updated their framework in a 2003 article, which has since become one of the most cited articles regarding the impact of family businesses on the overall economy.[1]

However, it's been 18 years since the authors last updated their findings. Accordingly, and with the generous support of Family Enterprise USA, we revisited their framework to assess both the accuracy of the estimators for family and non-family businesses (the estimators) and to update the figures concerning their contributions to the U.S. economy.

Defining "Family Business"

Family businesses are notoriously difficult to define, as there are almost unlimited possibilities for the family to be directly or indirectly involved in the business. While there's continuing debate about the appropriateness of one family business definition over another, we don't presume to make a statement that more accurately reflects a true family business. We merely want to raise awareness that the obtained values vary based on the family business definition used, as we show below. In keeping with Astrachan and Shanker's model, we conceptualized family businesses along three definitions (broad, middle and narrow), which depend on the degree of family involvement in the business, and assessed their respective contribution to the U.S. economy.

The broad definition of "family control" implies either full strategic control of the company or partial strategic control of at least 5% ownership paired with participation of the family in the company through multiple generation owners, significant positions in management, board seats or firm leadership.

The middle definition of "family firm" is slightly less encompassing. It comprises firms that have multiple generations of family owners, which is a proxy for succession or succession intentions and one of three other variables: multiple family members in

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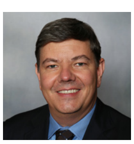
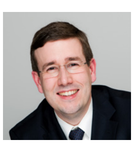
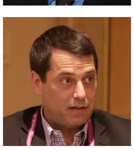





management positions, family member presence on the board or CEO belonging to the family.

Lastly, the narrowest definition of family firms requires at least two family members to be involved in management positions. Additionally, full strategic control (50+% ownership) over the company is required. Finally, either the CEO has to be a family member or several family members have to be present on the board of directors for a firm to be included in the narrow definition.

Below, we outline how we used these definitions in our empirical estimation of family firm impact.

Our Empirical Approach

Based on the above definition used, we created questionnaires that were sent to a representative sample of firms in the United States by employment sizes that are used for government purposes (less than 100 employees, 100-499 employees, 500-999 employees, etc.). In addition to the obtained survey data, we also coded non-respondent firms from the Internet or tried to contact them via phone. Further comparison of our responses to existing data showed a high level of consistency. We then estimated a curve for our data to obtain a smooth relationship between size of business and number of businesses in a category. We used those curves to develop our estimators of percentage of family businesses (given each of the three specific definitions) in each size category. These estimators enabled us to assess the overall impact of family businesses based on business tax returns, the percentage of the work force employed by family businesses and the overall impact of family businesses on the gross domestic product (GDP).

The Numbers

To calculate the number of family businesses and business tax returns, we drew information from two sources: (1) the Statistics of U.S. Businesses by Employment Size (U.S. Census Bureau, 2012), which allowed us to estimate the percentage of businesses in each employment class,[2] and (2) the Internal Revenue Service, which provided information on tax returns that we used to estimate the economic impact of family businesses in each size category.[3] There are two relevant types of tax returns that can be filed: individual tax and business tax. Within business tax returns, there are three legal forms of organization that we had to account for in our analysis: sole proprietorships; partnerships; and corporations. Note that small farms (agricultural firms) are generally classified in individual tax income returns. As these entities generally have strong family involvement, they're also part of our analysis. "Business Tax Returns," this page, provides an overview of legal forms that were used for our subsequent analysis.

Tax policy should ensure that intergenerational succession doesn't affect the viability of these firms and the associated employment base.

Using the percentage of businesses per employment class obtained through U.S. Census Bureau data, we distributed the number of sole proprietorships, partnerships, corporations and farms among the employment classes. We subsequently combined the results with the estimators calculated for each employment class to obtain the final impact for each family firm definition.

Specifically, the broad definition of family business was estimated to contain 32.4 million family businesses, representing 87% of all business tax returns in the United States. The middle definition was estimated to

Business Tax Returns

Numbers by legal form of organization

Type of tax return	Number of tax returns	%
Total	36,994,324	100
Sole proprietorships	25,226,245	68
Partnerships	3,715,187	10
Corporations	6,119,565	17
Farms	1,933,327	5

— U.S. Department of Treasury, Internal Revenue Service (2015)

be 9.1 million family businesses, accounting for 25% of business tax returns. Our narrowest ring encompasses 7.2 million family businesses, totaling 19% of business tax returns.[4]

Percentage of Workforce

We followed the same approach for estimating the percentage of the workforce attributable to family businesses. We obtained the ratio of paid employees per employment class from the U.S. Census Bureau. For the broad definition, family businesses are responsible for employing 59% of private sector workforce, accounting for 83.3 million jobs. Family businesses in the middle definition account for 23% of the U.S. workforce or 32.6 million jobs. In the last and narrowest, most conservative ring, family businesses employ 14% of the U.S. workforce, providing 20 million jobs.[5]

Estate taxes further place privately owned businesses at a disadvantage to their listed, non-family business counterparts.

Gross Domestic Product

Comparison by sector

Gross domestic product (GDP) by sector	GDP ($ billions)	%
Total	21,433	100
Private industries (non-farm)	14,158	66
Private industries (farm)	175	1
Government (federal, state and local)	7,100	33

— Total and Farm (Government receipts and expenditures, Bureau of Economic Analysis, 2019); U.S. Department of Commerce (Bureau of Economic Analysis, 2019)

Contribution to GDP

In a final step, we estimated the family firm impact on the real GDP. We drew information from the Bureau of Economic Analysis (U.S. Small Business Administration, 2019),[6] as well as from the U.S. Census Bureau by employment class. "Gross Domestic Product," this page, summarizes the data.

In our broadest definition, family businesses contribute 54% of private sector GDP, or $7.7 trillion USD. Family businesses in the middle definition contribute 23% of private sector GDP, or $3.2 trillion USD. Finally, family businesses within the narrow definition contribute 14% of private sector GDP, or $2 trillion USD.

Summary and Outlook

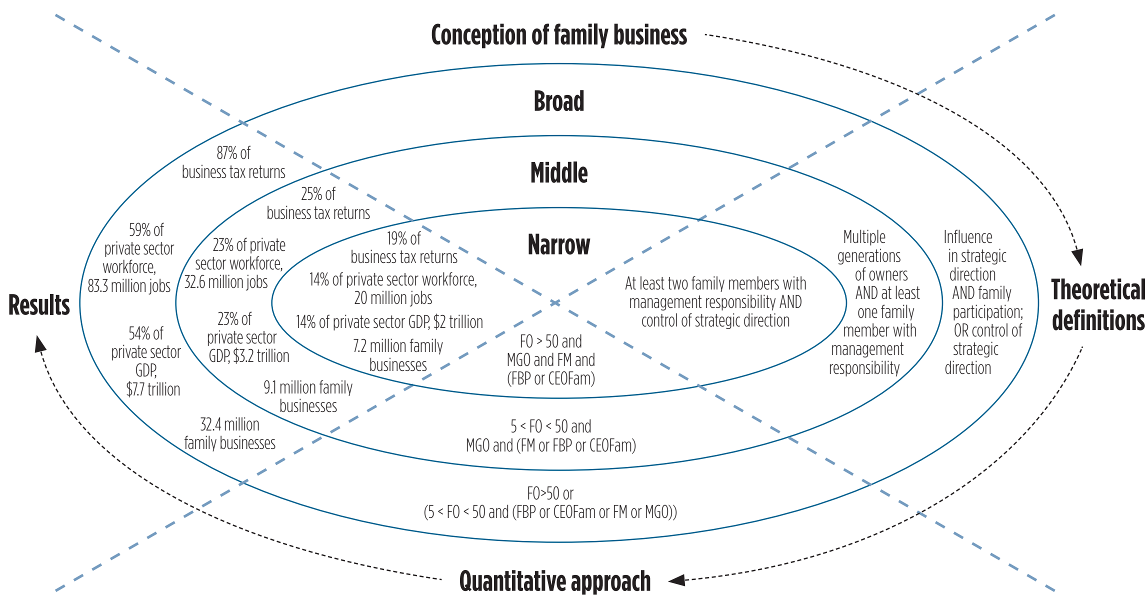
The resulting conceptualization is often portrayed as a bull's eye. The bull's eye consists of three concentric circles, moving from a broad conception of family business in the outer circle to a medium conception in the middle circle and finally to a more exclusive (narrow) conceptualization in the inner circle. The level of inclusiveness depends on the perceived degree of the family's past, current and future involvement in the business. In the outer ring (broad definition), some family participation is assumed, along with the family having control over the business's strategic direction. In the middle ring, the founder or descendant leads the company, and there's the intention to keep the company in the family. In the center of the bull's eye are those family businesses with multiple generations of owners and more than one generation of the owning family with management responsibility. "Bull's Eye," p. 67, summarizes the results and shows that family firms have a tremendous impact on the overall U.S. economy.

Lessons Learned

In light of the current COVID-19 pandemic, the relevance of this assessment becomes urgent. The entire world is in the midst of a health and economic crisis that has the potential to lead to extreme policy decisions. Accordingly, an up-to-date number on how family firms impact the economy may serve as a critical foundation for assessing the impact that policy decisions (for example, income taxes) might have on the economy. As key contributors of the U.S. economy, family businesses should become a key focus of support from the federal and state level in the effort of bringing the country back on track and dampening

Bull's Eye

Family business impact



Key:

- FO: % family ownership
- FBP: family board presence
- CEOFam: CEO is a family member
- FM: multiple family managers
- MGO: multiple generations of family owners
- GDP: gross domestic product

— Torsten M. Pieper, Franz W. Kellermanns and Joseph H. Astrachan

the economic consequences of COVID-19.

Also, considering the large number of family businesses and their role as employers, it raises the need to carefully assess the impact on pass-through and estate taxes on this group of firms. Tax policy should ensure that intergenerational succession doesn't affect the viability of these firms and the associated employment base. U.S. policymakers should consider innovative solutions, like reduced estate taxes for firms that maintain their employment base after ownership transfer to next generation family members, as Germany has adopted, in light of the impressive employment numbers by family businesses. For example, it's a mathematical fact that a business can only grow as fast as its return on equity (ROE), lest the business run out of cash and become technically bankrupt (it can grow faster as long as banks continue to increase the percentage of assets they're willing to lend against, but eventually that reaches its limit and stops). As taxes increase, ROE by definition decreases. When private businesses are taxed at a higher rate due to having selected a pass-through form than businesses with a "C" form, they're at a growth disadvantage. Similarly, the amount of returns kept in a business enables growth and any resources removed from the business reduces the growth rate. Thus, estate taxes further place privately owned businesses at a disadvantage to their listed, non-family business counterparts. The only way around this is to change tax policy, break the law or give up control by taking on owners who contribute capital but are unrelated to the original owning family. This of course forces the business to give up the many advantages of being a family business, such as stewardship,[7] long-term orientation,[8] financial performance,[9] innovation output[10] and social responsibility on various levels.[11]

— The authors would like to express their sincere gratitude to José Maria Salema Reis Travassos, a freelance data analytics consultant in Leipzig, Germany, who actively supported the data analysis and interpretation. The authors also owe deep gratitude to Daniel Garrett Van Der Vliet, Smith Family Business Initiative at Cornell University in Ithaca, N.Y., for his helpful suggestions and strong support.

Endnotes

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