

## **FAMILY OWNED BUSINESSES IN THE UNITED STATES: A REGIONAL COMPARISON**

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### **Abstract**

The purpose of this paper is to compare the profiles of managers and their family businesses in the western United States versus the rest of the nation. The business manager subsample used in this study are from the 1997 National Family Business Survey (NFBS), a stratified national sample of family business households. Population estimates and results from tests of differences between the western states and the rest are presented. Although businesses in the west differ significantly from those in the rest on several manager and business characteristics, in general there are more similarities than differences between the two groups.

Family businesses are an important sector in the U.S. economy. They account for about 90 percent of all firms in the nation (Bowman-Upton, 1991) and contribute millions of dollars annually to the gross national product and to total wages (Bowman-Upton, 1991). The recent expansion of the U.S. economy is

due in large part to the productivity and gains by small firms (U.S. Small Business Administration, 1999). About 1/3 of family owned businesses were listed on the Fortune 500 (Riordan, 1993).

The most recent work on family businesses comes from the 1997 National Family Business Survey (NFBS). The research based on this dataset have added new insights into methodology, business performance, and the impact of family and business on success in both spheres. Winter, Fitzgerald, Heck, Haynes, and Danes (1998) reported on the methodology used in the first national study NFBS, which employed a household rather than a business sample of family businesses. Heck and Stafford (1999) examined business and manager characteristics associated with business performance. Rowe, Haynes, and Stafford (1999) presented estimates of the economic contribution of home-based family business income to rural and urban communities. Masuo, Fong, Yanagida, and Cabal (in press) studied the factors associated with family and business success in family business households. A common theme of all of these studies is their focus on a national perspective of family businesses. Only one internal report to date presents findings on a regional basis (Jasper & Goebel, 1999).

The purpose of this paper is to compare the profiles of managers and their family businesses in the western United States versus the rest of the nation using the NFBS sample. This work is driven by the recognition that prospective and current business managers can relate more closely to regional rather than national comparisons of themselves and their businesses. The western region was selected as a comparison group because of the phenomenal growth that has occurred recently among small businesses in western states such as Colorado, Arizona, and Utah which ranked #2, 3, and 4 among all 50 states on nonfarm proprietors' income. In comparison, Pennsylvania, Indiana, and Missouri, states in the "Rest" group, ranked #50, 48, and 47. (U.S. Small Business Administration, 1999). State-by-state comparisons could not be made because of limitations due to small sample sizes at the state level.

## Literature Review

### Business Manager Characteristics

Business manager characteristics have changed drastically over the past decade. Today's business managers include more women and minorities. Between 1987 and 1997 the number of female business owners increased 89 percent; women-owned businesses generated \$3.1 trillion in gross revenues; and minority owned business increased 168%, generating \$495 billion in gross revenues (U.S. Small Business Administration, 1999). A number of factors have been found to influence business performance. Previous research has found that business performance is affected by the human capital of the business manager and by demographic characteristics such as sex and age (Kalleberg & Leicht, 1991; Roberson-Bennett, 1990; Rowe, Haynes, & Bentley, 1993). However, in a 1997 study of family businesses, Heck and Stafford (1999) found that business manager characteristics such as age, gender, and education did not significantly affect business success. Instead, the number of hours worked by the manager was the factor having the greatest influence on business performance. Gross revenue increased 1.7% or over \$10,663 (weighted data) for each additional hour per week that the manager worked.

Family businesses are closely related to the farm family enterprise because both tend to consider family goals when choosing among alternatives. Salamon (1985) identified two types of farm manager styles--yeoman versus entrepreneur. The yeoman farmer is concerned with passing on the farm to the next generation, while the entrepreneur farmer views his farm as a business, his land as an investment and his operations as a source of short-term profit. Brown and Salamon (1987) also observed that yeoman farm families differ from entrepreneurial farm families in terms of their management strategies and family characteristics. Yeoman farm families tend to run smaller-than-average operations, while entrepreneur families run larger- than-average operations. Parents, children and offspring in yeoman families work together, while the members of entrepreneur farm families tend to compete with one another. Heck and Stafford (1999) found that among family businesses, motivations for being in business can help to explain differences in business performance. Thus the yeoman versus entrepreneur pattern can provide a framework for understanding how long-term family goals influence business goals, business decisions, and ultimately business performance.

The groundwork for understanding the relationship between a manager's business philosophy and the goals of the business was established by Smith (1967) in his study of small manufacturing firms. He concluded that there are two types of entrepreneurs -- craftsman and opportunistic entrepreneurs, and that each was associated with a different type of firm. Entrepreneurs with a craftsman orientation have a more limited time orientation and tend to run more rigid firms. Opportunistic entrepreneurs are more future oriented and tend to have an adaptive firm that is expansion and growth oriented.

A related study on small businesses by Kotey and Meredith (1997) examined the relationship between entrepreneurial style and business goals. They found that business manager/owners who are entrepreneurial in nature tend to look more long-term and focus on growth and development of their firms. Managers who exhibit conservative, less entrepreneurial business styles require additional managerial training to succeed as entrepreneurs. Thus, variations in business performance may be related to the way in which entrepreneurial style influences goal setting in a business.

### Business Characteristics

Family businesses have one distinct advantage over other types of small businesses. They have access to labor. Hoy and Verser (1994) found that family businesses have a competitive edge over other small businesses when family members working in the business share values and ethics. Using the National Family Business Survey data, Heck and Stafford (1999) found that each family member who lives in the household and who works in the business adds at least \$190,000 or 19.9% annually to the gross revenues of the business. Similarly, extended family members (including relatives who live in the household and those who do not live in the household) contribute 18.4% to gross revenue (Heck & Stafford, 1999).

The geographic location of a business can influence its revenue potential. Heck and Stafford (1999) found that family businesses situated in rural areas earn less revenue those in urban locations. When the business is home-based, revenues are even lower.

Family businesses often begin as home-based enterprises. Over 60 percent of businesses owned by women during the period 1987 through 1997 started as home-based businesses (U.S. Small Business Administration, 1999). Heck and Stafford (1999) observed that among family businesses, home-based firms earned less than those that were not home-based.

Gross revenues for home-based businesses were 99.5% lower than earnings of non-homebased firms (Heck & Stafford, 1999). Despite their earnings disadvantage, home-based businesses make important contributions to local economies by filling market niches (Rowe, Haynes, & Stafford, 1999).

The benefits of computers to small businesses have been documented in a number of studies. Rowe et al. (1999) found that among home-based businesses, success was associated with the use of computers and the Internet in the business. Herbert and Bradley (1993) found that the use of proper computer systems and software and the manager's ability to effectively balance his time between computer and other managerial activities have positive effects on business performance.

With the completion of the 1997 National Family Business Survey, the family business literature has grown from studies based primarily on business samples to studies based on household samples. Studies based on household data can provide a more comprehensive view of the effects that families have on a business, and vice versa. The research reported in this paper extends the literature by examining how family businesses and their managers in the west compare with the rest of the nation.

## Methods

### Procedure

The findings in this paper are based on data collected from the Cooperative Regional Research Project, NE-167R, "Family Businesses: Interaction in Work and Family Spheres." The project was designed to examine the interaction between the family and business systems in family businesses. The sample for this study was drawn from listed telephone numbers for individuals from all 50 states and one Canadian province, with a focus on identifying households in which at least one person owned or managed a family business. Eligibility was based on the following owner-manager characteristics: worked in business for at least a year, worked at least 6 hours per week year-round or a minimum of 312 hours in the previous year, been involved in the daily management of the business, and lived in the same household with another family member.

Interviews were conducted with the household manager and the business manager, using separate instruments for each. When there was one individual in the household who held both roles, a separate combined manager interview schedule was

administered. A stratified random sampling technique was used in this study. The goal was to obtain equal numbers of completed interviews from each state except for Iowa and Manitoba, where a larger number was desired. Due to lower than anticipated response rates, the actual number of cases varied by state. Weights were computed to enable researchers to make population estimates of prevalence rates of households having family owned business and contributions of those businesses to the economy. See Winter et al. (1998) and Breidt and Wright (1998) for details on the sampling procedures used in the data collection.

### Subjects

A total of 1,116 family business households were found to be eligible for study, using the project's criteria. Of this number, 794 (71% completion rate) completed a household or a business interview. Of these 794 households, 708 were selected for study because they completed a business manager interview and there was complete data for all variables of interest in this study. There were 209 managers in the west and 499 managers in the rest. Of the 209 family businesses in the west, 12.5 percent were farm enterprises. In the rest, farms accounted for 10.4 percent of the family businesses.

For purposes of comparison, the U.S. was divided into two regions -- the west and the rest. The west consisted of 13 states -- eight from the U.S. Census Mountain Division (Arizona, Colorado, Idaho, Montana, Nevada, New Mexico, Utah, Wyoming) and five from the Pacific division (Alaska, California, Hawaii, Oregon, Washington). The 37 remaining states were called the Rest. The regions represented in the rest were: New England, Middle Atlantic, East North Central, West North Central, South Atlantic, East South Central, and West South Central.

### Analysis

When dealing with a national dataset like the 1997 NFBS, one critical question concerns whether the data be weighted or not weighted. The population used in the 1997 NFBS consisted of a simple random sample, stratified by state. Thus the data were weighted for population estimates. The data were not weighted for hypothesis testing, to avoid Type I errors and the problem of large variances (see Korn and Graubard, 1995 for recommendations based on large-scale health surveys).

The proposed analyses for this study consists of a chi-square test for two independent samples and a t-test of differences between two independent sample means. The SPSS crosstabs procedure and the SPSS independent-samples t-test procedure were used. The crosstabs procedure determines the significance of

differences between two independent groups, while the t-test procedure tests the null hypothesis that the population mean for a variable is the same for two groups of cases (Norusis, 1999).

### Variables

The variables used in this descriptive paper are divided into two groups: Business Manager Profile and Business Characteristics. There are five manager characteristic variables and 13 business characteristic variables.

The *Business Manager Profile* consists of five variables. Three of the variables are demographic in nature. They are: sex, education (measured at three levels - high school or less, some college, college degree or greater) and number of years in the business. The last two variables in the *Business Manager Profile* are the manager's philosophy for the business and the manager's satisfaction with community support of the firm. Manager's business philosophy is a continuum which ranges from keeping the business in the family (1 = yeoman) to the business is a way to earn money (5 = entrepreneur family). Community support is rated on a scale from very dissatisfied (1) to very satisfied (5). Standard deviations are only reported for the continuous variables.

*Business Characteristics* are measured by 13 variables. Eight of the variables relate to the type of business, the number and kinds of workers in the business, and the performance of the business. These variables include: Industry type (based on Standard Industrial Classification codes from the 1990 Census), whether the business is home based or not, legal ownership of the business, total number of unpaid workers, number of household members who work for no pay for the business, number of household members who work for pay for the business, 1996 business profit and gross business income. Total number of unpaid workers is the sum of unpaid household members and unpaid relatives living outside of the household. Profit and gross income are skewed, therefore the log of profit and gross income were computed and used in the t-test analyses. Two additional variables in the analyses related to the level of technology used in the business--the use of computers and the use of the Internet or World Wide Web in the business.

The last three variables are qualitative assessments by the business manager of the success of the firm (perceived business success and a composite business functioning score), and the manager's goals for the business. Perceived business success is based on the business manager's response to the question,

"Overall, how successful is your business to date?" Responses ranged from very unsuccessful (1) to very successful (5). Business functioning is measured by responses to a series of five questions related to satisfaction with the work situation. Each answer is rated with a score from 1 to 5. The sum of the scores is used to create a business functioning score for each business manager respondent.

The business functioning scale scores are distributed in three ranges, 25-19 points = good business functioning, 18-12 points = moderately dysfunctional business, and 11-5 points = highly dysfunctional business. This scale applies only to businesses employing workers other than family and household members. In 101 cases in which there are no other regular workers, this variable was missing.

The final qualitative measure was the business manager's to the question, "What is the most important long-range goal for their business?". The responses were: adequate financing (1), profit (2), positive reputation with customers (3), long-term viability (4), and growth (5).

### Findings

Table 1 in the Appendix presents profiles of the business managers and their businesses in two categories - the west and the rest. The data are weighted to more accurately represent the actual number of family businesses in each of the states in the two regions that were compared. In general, a typical *west* business manager was a male who had been in the business about 13 years. He had at least some college education, he valued his business as a way of life and a source of income (business philosophy) and was somewhat satisfied with the community's support of the business. The business was typically home-based, held as a sole proprietorship (77.8%), was in a service-oriented industry, and had over 6 paid workers, including household members and others not living in the household. While the business used computers, only 30 percent uses the Internet, mainly for company communications. Median profit for the business was approximately \$14,000, the profit margin was 20 percent, and gross business income was \$70,000. The business managers identified growth (32%), positive reputation with customers (30%) and adequate financing/profits (25%) as their top three goals. They rated their businesses as successful and appeared to be satisfied with the way that their businesses were functioning.

For the *rest*, the business manager was typically a male who had been in the business about 12.3 years. He had at least a bachelor's degree, he valued the business lifestyle and the money it provided (business philosophy), and was at least somewhat satisfied with community support for the business. The business was not generally home-based; a majority were sole proprietorships (49.0%); was in the service sector; and the firm employed an average of seven paid workers, including household members, and others not living in the household. Computers were used in the business, but only 29 percent used the Internet, primarily for business communications. Median annual profit was over \$16,000, the profit margin was 16 percent, and median gross income was \$100,000. Unlike their west counterparts, managers in the rest group identified positive reputation with customers (40%) as their top goal, followed by growth (22%) and adequate financing/profits (20%). Managers in the rest, like those in the west, rated their businesses as successful and they were satisfied with the way that their businesses were functioning.

The *business manager characteristic* (see Tables 3 and 4) that was statistically different between the west (N = 209) and the rest (N = 499) was education of the business manager ( $\chi^2 = 6.22$ , p .04). In the rest, over 40 percent of the managers completed a bachelor's degree, as compared to 30 percent in the west. Significant differences were found on four *business characteristics*: log of gross income (t = 1.15, p .25), whether the business was home based or not ( $\chi^2 = 4.96$ , df = 1, p .026), legal ownership of the business ( $\chi^2 = 9.52$ , df = 2, p .009), and use of computers ( $\chi^2 = 5.45$ , df = 1, p .02). Businesses in the rest earned \$30,000 more annually in gross business income (rest \$100,000; west \$70,000). However, profit in the west was 20 percent of gross income, while profit in the rest was 16 percent. There were more home-based businesses in the west (68.3%) than in the rest (46.4%). See Table 1 for the breakdowns, Table 2 for the t-test results and Table 3 for chi-square statistics.

## Discussion

A comparison of family businesses in the west and the rest of the United States shows more similarities than differences between the two groups. This finding dispels the notion that businesses in the west are very different from those in the rest of the nation. In general, men who have some college education are the managers of family businesses in both the west and the rest of the nation. Businesses in the both the west and the rest of the nation are predominantly in service sector industries, although there are slightly more businesses in the rest that are in

construction, transportation, and manufacturing industries.

About 7 out of 10 managers use a computer in the business. However, only a little more than 1 in 3 businesses report that they use the World Wide Web in their business, primarily for company communications (See Table 1 for a breakdown of the three main uses of the Internet in the businesses). Based on previous research by Rowe et al. (1999) on computer use and success, family businesses may benefit from greater use of computers in general, and use of the Internet for eCommerce in particular.

Despite the general similarities of the businesses and their managers in the two regions that were compared, there are a number of interesting differences between the two groups. There are more business managers in the rest who have college degrees than those in the west (rest, 42.2% vs. west, 29.5%). Managers in the west identify growth as their top business goal (32%) while managers in rest identify positive reputation (40%) as their most important goal. The growth-entrepreneur relationship observed in the west confirms Smith's (1967) work on types of managers and types of firms.

More of the businesses in the west are home-based. These businesses report lower gross revenues than those in the rest. Heck and Stafford (1999) observed that earnings were lower among home-based firms in their study of family businesses. Thus lower gross incomes may be explained by the higher percentage of home-based firms in the west. Although gross income was lower in the west than the rest (west, \$70,000; rest, \$100,000), profit was higher in the west (west, 20%; rest, 16%). The higher profit may be attributed to the greater number of hours worked by managers in the west (west, 44.52 hours per week; rest, 43.95 hours per week) and the substantially higher average gross income earned by businesses in the west in the transportation industry (west, \$1,149,815; rest, \$797,516). Studies based on U.S. Census data have also found a relationship between gross revenue and industry type (Rowe et al., 1999).

The findings from this study suggest that family businesses in the west are an interesting group that warrants further study. Western businesses earn less gross income yet their managers rate their firms as being more successful and as functioning better than their counterparts in the rest of the U.S. A major outcome of this research has been the development of a regional profile of family businesses. This profile can be expanded to look at whether there are more differences within the regions as compared to what was found between regions.

The next study should examine the role that gender and longevity in business play in explaining the higher profit margin observed among businesses in the West. Also motivation for being in business should be further examined using models developed by Salamon (1985) for farm families because of the similarities between the farm family business and other forms of family owned businesses. The yeoman versus entrepreneur pattern identified by Salamon (1985) can provide a framework for understanding the relationship between family goals and business goals, and how the give and take of resources between the family and business spheres impact business revenues and profits.

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