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Wealth and Income: How Did Small Businesses Fare from 1989 to 1998?

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Purpose

The rapid expansion in the U.S. economy in the 1990s raises an important equity question: who earned the income and accumulated the wealth? Of special interest, how did families owning small businesses fare in relation to other families?

This study examines three issues using the Federal Reserve Board's Survey of Consumer Finances (SCF) data:

(1) Did families with small-business owners living in the household increase their incomes by more than families without small-business owners?

(2) Did small-business-owning families increase their wealth by more than other families?

(3) Among business owners, who were the winners and losers?

Scope and Methodology

SCF data from 1989, 1992, 1995, and 1998 are the main sources used in this study. The variables of interest include each household's business ownership status, income, and wealth (including assets and debt held by members of the household). Business owners are separated into four categories: self-employed business owner/managers with one or no employees; small business managers who are owner/managers with more than one employee; angel investors who are business owners with no active management responsibilities in any business; and other angel investors who are primarily owners with other investments where they provide some management support.

This study is primarily descriptive, using family income and wealth to compare business- and non-business-owning families. This descriptive analysis requires careful comparison of means using chi-square and t-tests to assess differences among business- and non-business-owning families across time (1989 through 1998). These simple comparisons are supported by more complex empirical models, which are designed to assess the determinants of high income (greater than $50,000 total family income) and high wealth (greater than $1 million total family wealth).

Logistic regression models are used to assess the types of families and business owners more likely to be classified as high income or high wealth. This study uses non-linear logistic regression models to predict the likelihood of high family income or wealth from binomial classifications of high income (yes/no) and high wealth (yes/no).

Highlights

The most important results and insights include:

(1) Families owning small businesses were significantly more likely to be classified as high income (57 percent chance) and high wealth (15 percent chance) than other families (30 and 3 percent chance, respectively) in 1998.

(2) Stock holdings proved to be an important determinant of high income and wealth. Among small-business-owning families, families with stock holdings had a 72 percent chance of being classified as high income and a 26 percent chance of being classified as high wealth in 1998, vs. 45 and 7 percent,

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respectively, for small-business-owning families without stock holdings.

(3) Mean income in 1998 dollars (real mean income) significantly increased between 1992 and 1998 for only one group of small-business owners, those with 25 employees or more.

(4) Real mean wealth trended upward for most groups of small-business owners; however, no statistically significant increase in real mean wealth was found for any group.

(5) Families owning small businesses realized a 17.4 percent increase in aggregate real income from 1992 to 1998; however, their share of aggregate income declined from 23 to 21.7 percent. This decline of 1.3 percent was captured by families not owning any business; their aggregate real income rose by 25.7 percent.

(6) Families owning small businesses realized a 37 percent increase in aggregate real wealth from 1992 to 1998; however, their share of aggregate wealth declined from 35.3 to 33.8 percent. Again, this decline of 1.5 percent was captured by families not owning any business; their aggregate real worth went up by 49.4 percent.

(7) Aggregate income and wealth change either because the number of families in a group have increased in number and/or because the families in the group have realized changes in income and wealth. While this economic expansion would appear to have been an excellent time for families to invest in small businesses, the number of families engaged in at least one actively managed small business appears to have remained remarkably stable at around 12 million families. (This estimate of the number of families should be used with caution because it could represent a sampling problem in the SCF. During an economic expansion, families that previously would not have been included in the sampling frame because they were relatively poor and could not be easily contacted by telephone were included in the more recent sampling frames. These families were less likely to be small-business owners; hence the population of families owning small businesses may be underestimated.)

(8) Among small-business-owning families, the most successful were those owning more than one business. They realized increases in mean income and wealth surpassing all other families.

(9) The economic expansion was relatively good news for business-owning families headed by women. These families realized higher rates than other business owners in growth of real mean net income (45 percent versus 28 percent) and wealth (108 percent versus 43 percent). In addition, these families did substantially better financially than non-business-owning families headed by women.

(10) Among families owning small businesses, the least successful were families owning smaller, younger, and less well-established small businesses. Relatively low unemployment rates, a strong stock market, and excellent employment opportunities working for others increased the financial challenges faced by small firms.

Conclusions

In general, families owning small businesses realized increasing net income and wealth over the 1990s. However, gains in aggregate income and wealth for families owning small businesses were surpassed by the gains experienced by non-business-owning families. The small business winners in this economic expansion were those with large asset holdings such as existing physical, financial, and human capital to take advantage of the favorable economic conditions and asset value appreciation. The lack of success of the younger, less well-established businesses in relation to older, better-established businesses (and non-business-owning families) in this very prosperous economic time suggests there may be an even more important role for agencies designed to assist fledgling small business start-ups.

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