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Small Business Research Summary

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Do Business Definition Decisions Distort Small Business Research Results?

An Office of Advocacy Working Paper
Brian Headd and Radwan Saade. 2008. 33 pages.

One of the most basic assumptions underpinning research on small business status and performance (as well as the impact of other factors on small business) is the definition of a small business, or the choice of a business unit. This paper shows that mixing data on different kinds of businesses can distort research results. It accomplishes this by showing that differences exist among business types and emphasizing that the choice of business type at the outset of research is significant.

Overall Findings

The typical nonemployer firm and employer firm differ. The most immediately obvious difference is their size and number. Employers are larger operations, but nonemployers outnumber employer firms by a three-to-one ratio. Pooling data on both groups creates hazards in results and interpretation. And using one group to deduce results for the other group or the group as a whole also poses logical problems. With nonemployers representing three out of four businesses, researchers should be aware that results of business studies that include nonemployers will tend to reflect trends among nonemployers because of their overwhelming number. On the other hand, the results of research focusing just on employers will most likely not apply to nonemployers.

Highlights

Using a unique U.S. Census Bureau data set on the characteristics of businesses, the report presents a plethora of data cross tabulating business and owner characteristics such as year acquired, owner demographics, home-based status, and franchise status.

• Nonemployers experienced high growth rates from 1992 to 2005, while employers and the self-employed grew at much lower rates.

• In 2002, nonemployers averaged $47,400 in annual sales, while employers averaged $4.2 million.

• From 1997 to 2002, nonemployers and employers combined experienced a decrease in average receipts per firm. Yet for the same time period, when taken as separate groups, they both had average receipt increases. The reason for this apparent contradiction is that the number of nonemployers grew faster than the number of employers. By 2002, nonemployers were a higher share of the combined total number of employer and nonemployer firms.

• With the net share of nonemployers growing faster than employers, 15 percent of nonemployers were new businesses while only 5 percent of employers were new in 2002. This was mainly due to the fact that nonemployers face lower barriers to entry than employers do.

• As one would have believed *a priori*, employers were more likely to be franchises and less likely to be home-based than nonemployers (3.8 percent vs. 1.4 percent and 22.8 percent vs. 61.0 percent, respectively).

• Employers tended to have owner teams while nonemployers tended to be solo operations. Employers were single owners 38.5 percent of the time, while 59.5 percent of nonemployers were solo owners.

• Nonemployers had a larger share of younger owners (under 35), 16.3 percent vs. 8.3 percent, and women owners, 38.7 percent vs. 27 percent, than employers. Similarities between owner characteristics do exist; for both business types, 15 percent were veterans, and 11 percent were older (65 or over).

• Hispanic, black/African American, and American Indian/Alaska Native business owners had higher shares of nonemployer firms than the United States as a whole. Asians had a larger share of employer firm owners than the overall distribution.

• Some of the differences among employers and nonemployers, such as home-based and franchising status, can be attributed to the mix of industries typical of each group. Employers have a higher share of manufacturing firms and of the accommodation and food services industry. Nonemployers are more heavily represented in real estate and services in general.

• The ratio of employer and nonemployer firms was similar across states.

• Financing results were consistent with expectations. Employers were more likely than nonemployers to use start-up and expansion financing; employers were also more likely to take out bank loans. Nonemployers tended to rely more on credit cards. Both groups were similar in that their main financing routes were internal. Personal and/or family savings were used by 66.7 percent of employers at start-up and by 53.6 percent of nonemployers.

Scope and Methodology

The study relies upon special tabulations from the U.S. Census Bureau's 2002 Survey of Business Owner (SBO) program. The special tabulations are cross-tabulations for both nonemployer and employer firms on such business and owner characteristic such as owner age, type of financing, industry, and home-based status. They are listed in 13 tables in the report's appendix.

The report discusses the differences among nonemployer and employer firms with regard to business characteristics, owner characteristics, and financing. From these results, the authors present the case that nonemployer and employer firms are unique.

With a few exceptions, the SBO defines a nonemployer business if it has at least $1,000 in annual receipts and an employer business if it had any payroll during the year at any of its business locations.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research at ***advocacy@sba.gov*** or (202) 205-6533.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at ***www.sba.gov/advo/research***. Copies are available for purchase from:

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