

Saving for Retirement: A Look at Small Business Owners

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Many observers report that Americans do not save enough and that retirement savings are especially inadequate. This is said to be the case for households and workers, as well as business owners and the self-employed. Only half the work force is covered by an employer-sponsored pension plan and this share has not changed for almost three decades. Over 9 million self-employed individuals are without retirement plan coverage.

This paper identifies and fills several gaps in our understanding of the retirement savings behavior of business owners and the self-employed. While, most existing research has examined the retirement savings behavior of workers and families, this paper evaluates the importance of numerous business owner and business characteristics in determining how business owners and the self-employed save for retirement.

Background

The paper utilizes data from the U.S. Bureau of the Census's Survey of Income and Program Participation (SIPP). The reference period for the data is the four-month period from January to April 2006. Over 91 percent of the 4,922 business owners in the nationally-representative sample owned a business with less than 10 employees. The research divides business owners into two distinct ownership groups based on the number of employees that work at a business: micro-business owners who employ fewer than 10 workers and owners of larger businesses who employ 10 or more workers. Conventional wisdom holds that owners of larger businesses are more successful and more likely to have and contribute to retirement saving accounts than micro-business owners.

Overall Findings

The results of this study suggest some cause for concern about the retirement savings plan behavior of business owners. Retirement account ownership, contribution, and participation rates for all business owners are low. Several characteristics of business owners and their businesses have a significant impact on an owner's retirement savings decisions. In addition, asset accumulation significantly affects owners' retirement savings behavior. Business owners are more likely to own an Individual Retirement Account (IRA) and participate in a 401(k)/Thrift plan if they own a home and participate in other retirement savings accounts.

Key Results

The author's results offer substantial evidence for concern that business owners are not saving enough and that their retirement savings may be inadequate.

- Individual-based (outside work) retirement account ownership, contribution activity and employment-based participation (at work) among business owners are low. IRA ownership rate for business owners is only about 36 percent, and only one-third of business owners with an IRA contributed for the 2005 tax year. Less than 2 percent of business owners own a Keogh plan. Only about 18 percent of business owners participated in a 401(k)/Thrift plan.
- Homeownership or involvement in other retirement savings accounts are the most significant factors affecting IRA and 401(k)/Thrift plan participation.
- Business owners are more likely to own or contribute to retirement accounts if they are older, non-minority, educated, have more established

business(es) (e.g., larger, older, profitable), and own more than one business.

- Regression results show that business size is related to 401(k)/Thrift plan participation but not to IRA or Keogh ownership or IRA contributions. Having a micro-business with fewer than 10 employees reduces the probability of an owner having a 401(k)/Thrift plan from 17.4 percent to 10 percent, all else equal.

- Participation in one retirement account plan does not appear to preclude or substitute for owners' participating in other types of retirement account plans.

Additional Findings

Other regression results indicate the following:

- Being a male business owner reduces the probability of IRA ownership from 35.6 percent to 31.2 percent, all else equal. However, being male increases the probability of a business owner owning a Keogh account and participating in a 401(k)/Thrift plan (from 1.7 percent to 3.7 percent and 17.4 percent to 20.3 percent, respectively).

- Hispanic origin significantly reduces the probability of a business owner having an IRA, all else equal (from 35.6 to 17.6 percent); however, it is not a significant factor in determining 401(k)/Thrift plan participation. Being white increases the probability of owning an IRA but does not have a significant effect on 401(k)/Thrift plan participation.

- Sole proprietors and home-based businesses are less likely to own IRAs or participate in 401(k)/Thrift plans. Being a sole proprietor reduces IRA ownership from 35.6 percent to 32.0 percent and 401(k)/Thrift plan participation from 17.4 percent to 13.4 percent, all else equal. Having a home-based business reduces IRA ownership and 401(k)/Thrift plan participation from 17.4 percent to 13.4 percent.

Scope and Methodology

This research makes use of data from the Census's SIPP 2004 Panel, Wave 7. The reference period for the data is the four-month period January 2006 to April 2006. Data analyzed in this paper are from the core and two topical modules included in Wave 7: (1) Annual Income and Retirement Account and (2) Retirement Expectations and Pension Plan Coverage.

Two basic methods are used in the survey data analysis. First, a descriptive analysis of business owner characteristics by business size was performed. The characteristics include socio-demo-

graphic characteristics (i.e., age, sex, race, Hispanic origin, marital status, educational attainment, veteran and citizen status, homeownership and metropolitan location). Business characteristics analyzed included legal form, home-based status, industry sector, business age, number of businesses owned, and balance sheet indicators (i.e., total business expenses, monthly earned business income, and net profit or loss). These socio-demographic and business characteristics were also analyzed with respect to retirement plan options (i.e., IRA ownership, Keogh ownership, IRA or Keogh ownership, IRA contributions, and 401(k)/Thrift plan participation).

Multivariate logit models were used to isolate the effect of specific socio-economic or business characteristics on a business owner's retirement plan decisions. The purpose of each model is to assess how the initial probability of a retirement decision would change with a specific characteristic, holding all other characteristics constant. Separate models were used for individual-based retirement plans (IRAs and Keogh plans) and employer-based retirement plans (401(k)/Thrift plans). Business size is included as an independent dummy variable in the set of business characteristics. Odds ratios were converted into expected probabilities.

This report was peer reviewed consistent with the Office of 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.

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