

Homebased Business: the Hidden Economy

A report from 125,000 women, men, black, Hispanic and other minority entrepreneurs

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EXECUTIVE SUMMARY

People become self-employed because they want to be their own boss as well as earn income. Those wanting primary income are more likely to choose a non-residential location, work long hours throughout the year and hire employees. In comparison, more homebased business owners want a second income, fewer have employees and they tend to work fewer hours and weeks of the year. As of 1992, the total contribution of small businesses to the economy is 2.9 trillion dollars with homebased firms contributing 314 billion, or 11 percent.

The Characteristics of Business Owners (CBO) Survey

The CBO sample represents the 125,000 self-employed owners of the 17.3 million businesses that filed Schedule C, partnership or S corporation tax returns in 1992. In 1992, nine million, over one-half of the firms, were homebased. A homebased business (HBB) is defined as a business that is conducted in or out of the home with no other headquarters location. There is no way to know precisely the number of HBBs in 1999 because government statistics always lag. But estimated on the basis of the 24.8 million 1998 nonfarm business tax forms, the number of HBBs has grown from 9 million to 10-12 million, an increase of between 11 and 33 percent, from 1992 to 1999.

Surveyed in 1996-7, business owners, including two gender and three racial and ethnic categories, were asked to recall information about their firms. In the sample, 33 percent of all firms are owned by women, 59 percent by nonminority men, 3 percent by blacks, 4 percent by Hispanics and 4 percent by "other minorities". The other minority category is about 93 percent Asian and Pacific Islander and 3 percent American Indian and Alaskan Native ancestry. This study is based on special tabulations of the CBO provided by the Census Bureau. When reviewing the findings, it is important to recognize that the CBO omits all C corporations, some of which are homebased.

Contribution of Small Business

Table ES-1, Business Profiles by Receipts, compares the contributions of homebased and non-homebased businesses (non-HBBs) with breakouts for each of the demographic groups. Overall, homebased firms average about one-tenth that of non-homebased firms in both total and average receipts.

Table ES-1 Business Profiles by Receipts

1992

	Receipts (\$1000)	Average Receipt (\$1)	HBB as % of Non-HBB Total Receipts	HBB as % of Non- HBB Average Receipts
All Businesses*	\$2,941,476,351	\$183,973		
Homebased	313,628,757	36,677	12 %	10 %
Non-homebased	2,627,847,594	353,326		
Women-Owned Businesses	594,895,993	111,489		
Homebased	73,004,785	23,499	14	10
Non-homebased	521,891,207	234,115		
Nonminority Male-Owned Businesses	2,158,330,969	226,984		
Homebased	219,294,310	44,420	11	10
Non-homebased	1,939,036,658	424,121		
Black-Owned Businesses	24,139,704	49,965		
Homebased	5,158,637	19,214	26	22
Non-homebased	18,981,067	88,425		
Hispanic-Owned Businesses	98,730,343	142,221		
Homebased	13,028,330	38,158	15	16
Non-homebased	85,702,014	242,937		
Other Minority-Owned Businesses	132,932,677	231,835		
(Asian, Pacific Island, American Indian & Alaskan Native)				

Homebased	10,376,568	50,122	8	15
Non-homebased	122,556,108	334,516		

*According to the SBA/Advocacy data base by firm size, employer businesses with <500 employees in 1992 contributed \$6.4 trillion in receipts. The CBO is a sample of the newest and smallest businesses.

Owner Characteristics

Entrepreneurs want to earn money while being their own boss. More homebased operators want to earn a secondary income while non-homebased owners are in business to earn their primary income. Other than that different emphasis, no single demographic characteristic uniquely defines homebased owners. Compared with non-homebased owners, slightly more homebased business operators are women, married, born in the U. S. and have a college degree but not a doctorate or professional degree and, on average, they are a year younger than those operating a non-homebased firm.

There is no significant difference between homebased and non-homebased owners in their military veteran status, high school education and business employment, management and prior ownership experience. Entrepreneurs do not differ in having had—or not had—a business in the family, prior experience in a family business or previous management experience. Instead, the variations apply to individual groups—women, non-minority men, blacks, Hispanics and other minorities—and specific industries. An important demographic distinction is that the majority of other minority business owners, who are primarily Asian, and about one half of Hispanic owners was not born in the U. S.

Business Characteristics

Although business owner profiles are quite similar, their business characteristics differ markedly according to whether they are operated from home or from more traditional locations, as shown in Tables ES-2 and ES-3. Thus, more homebased firms are sole proprietorships founded by their owners; more non-HBBs require capital, borrow in larger amounts and hire paid employees. Non-HBB owners work longer hours. Homebased and non-homebased businesses are similar in that very few are franchises, owners depend on their personal savings to capitalize their businesses and they sell their products and services to both local and export markets. Although five percent of all firms grossing \$1 million or more are HBBs—demonstrating that they have the capability to be as profitable as non-HBBs—the great majority earn less. The cross-over point is at about \$50,000 in gross receipts: with rising earnings above that figure the firms are increasingly non-homebased; with each drop below \$50,000, relatively more are homebased. Higher business earnings are associated with homebased clerical work, not the production of goods and services. Homebased firms earn profits equivalent to non-HBBs only in the construction and transportation, communications and utilities industries.

Capital Required to Start/Acquire Firm

Non-homebased and other minority firms need the most capital to begin operations. Women-owned firms require less startup capital than nonminority male-owned firms do. More non-homebased firms borrow startup capital and in greater amounts than homebased businesses. Regardless of location, small businesses rely heavily on personal savings and assets to start or acquire their firms.

Employees

Only nine percent of homebased businesses have paid employees compared with 32 percent of non-homebased firms. Overall, 80 percent of all small businesses operate without employees. Most employees are used for clerical work rather than production of goods and services.

Time Worked in Business

The owners of non-homebased firms consistently work longer hours than do homebased business owners. Furthermore, fewer homebased than non-homebased businesses are operated year-round. Time spent ranges from 26 to 35 hours, on average, for all homebased firms, but non-HBB owners spend about 10 hours per week more on their businesses, that is, 35 to 43 hours. Non-homebased other minority business owners work more hours than do owners from other demographic groups. Business owners who hire employees work longer hours, not less.

Customer Definition and Language of Commerce

Homebased and non-homebased firms have similar markets in terms of percentages of customers that are white and non-Hispanic. The majority of customers served by homebased and non-homebased women- and nonminority male-owned firms are white and non-Hispanic. In contrast, black-owned firms tend to have black customers and roughly 20 percent of Hispanic and other minority firms have a customer base that is less than 10 percent white.

Source of Sales and Market Area

Regardless of location, 60 percent or more of small businesses sell primarily to individuals. Roughly 10 percent of customers are local, state or federal government agencies. Slightly more black-owned firms than the average, that is 11 percent homebased and 15 percent non-homebased firms, sell to the government. About 10 percent of women- and nonminority male-owned firms sell to the government. Nonminority male-owned firms, homebased or not, show the highest business to businesses sales (43 percent), compared to women-owned businesses (WOBs) (31-34 percent).

Contrary to common perceptions, homebased businesses sell in the same marketplace as non-homebased firms. About one-third of both homebased and non-homebased businesses sell in the neighborhood and half market within the city or county. Although some sell nationally, very few export. Electronic commerce offers potential, particularly for niche HBBs.

Business Success

Homebased businesses tend to remain in the home. Location has no bearing on survival rates. Over half of all homebased and non-homebased firms survive five years or more; both close primarily from lack of cash or not having access to a business loan. More firms with paid employees survive than those without, 85 to 51 percent.

In response to cash flow problems or low sales, more homebased firms use other income. More non-homebased businesses respond by adding capital, or seeking family help. Surprisingly, 37 percent of both HBBs and non-HBBs are rated as successful by their owners at the time the firms cease operations.

Business Opportunities and Contributions

The majority of both women and non-minority men prefer homebased firms to businesses located in more

traditional commercial locations. Women-owned businesses resemble non-minority male-owned firms if they are homebased in requiring little or no capital and relying on personal loans or savings to cover start-up costs. But three times more nonminority male-owned firms hire employees and nearly four times as many earn profits exceeding \$10,000. Another difference is that women produce goods and services while men do clerical tasks at home. Also, twice as many industries afford a homebased male-owned firm economically viable opportunities. Unlike women, when men operate their firms outside the home, one-quarter hire paid staff, more firms need startup funds and they acquire their capital in larger amounts and they acquire it from bank loans. In fact, men can choose to work either at home or not and achieve gross receipts within a range of \$50,000-100,000. Women must operate their firms from commercial quarters if they want a better than average chance of grossing over \$50,000.

Table ES-2 Business Profiles by Gender

Characteristic (Percent of firms in category)	Homebased Businesses	Non-homebased Firms
Women-Owned Businesses	55.2%	44.8%
Main reason for being in business	2.7/1 second income/primary	1.3/1 second income/primary
Main work at home	Production	NA
Percent with employees	3%	15%
Hours worked, maximum average	32 hours/week	38 hours/week
Capital need	< \$5,000	<\$5,000
Capital source	Personal loan/savings	Bank loan/savings
Dominant industry	All but Finance, insurance & real estate (FIRE)	FIRE
Best business opportunity	Construction, Wholesale trade	FIRE
Profits > \$10,000	6%	24%
Percent for whom firm contributes 100% of personal income	19%	26%
Range in which receipts are independent of HBB/non-HBB location	\$25,000-50,000	
Nonminority Male-Owned Businesses	51.7%	48.3%
Main reason for being in business	1.7/1 second income/primary	1.5/1 primary income /second
Main work at home	Clerical	NA
Percent with employees	9%	25%
Hours worked, maximum average	36 hours/week	44 hours/week
Capital need	< \$5,000	\$5,000 - \$25,000

Capital source	Personal loan/savings	Bank loan/savings
Dominant industry	Agric. services, Construction, Transportation, communications & utilities (TCU), Services	Manufacturing, Retail trade, Wholesale trade, FIRE
Best business opportunity	TCU, Wholesale trade, Construction, FIRE	Wholesale trade, TCU, Construction
Profits > \$10,000	22%	38%
Percent for whom firm contributes 100 % of personal income	28%	36%
Range in which receipts are independent of HBB/non-HBB location	\$50,000-100,000	

The majority of blacks, Hispanics and other minorities do not operate their business from home. Blacks have the highest proportions of female business owners and they are the group most interested in supplementary, rather than primary income. Irrespective of business location, few black-owned firms obtain capital. Instead they draw on personal resources.

Relatively few Hispanic women own businesses. Although twice as many non-homebased Hispanic owners want primary, not secondary income, their capital needs remain minimal and they tend to fund their enterprises from personal resources. Unlike blacks and other minorities who must move to a commercial location to gross over \$25,000, on average, Hispanics regardless of location can gross up to \$50,000.

Table ES-3 Business Profiles by Ethnicity

Characteristic (Percent of firms in category)	Homebased Businesses	Non-homebased Firms
Black-Owned Businesses	48.3%	51.7%
Percent women owners	48%	42%
Main reason for being in business	2.5/1 second income/primary	1.3/1 second income/primary
Main work at home	Production	NA
Percent with employees	7%	13%
Hours worked, maximum average	34 hours/week	38 hours/week
Capital need	< \$5,000	<\$5,000
Capital source	Personal loan/savings	Personal loan/savings
Dominant industry	All but TCU, FIRE	FIRE, TCU
Best business opportunity	Construction, TCU	Wholesale trade
Profits > \$10,000	7%	17%

Percent for whom firm contributes 100 % of personal income	19%	26%
Range in which receipts are independent of HBB/non-HBB location	\$10,000 - 25,000	
Hispanic-Owned Businesses	46.2%	53.8%
Percent women owners	30%	28%
Born in USA.	53%	47%
Main reason for being in business	1.3/1 second income/primary	2.1/1primary income/second
Main work at home	Clerical	NA
Percent with employees	8%	21%
Hours worked, maximum average	34 hours/week	42 hours/week
Capital need	< \$5,000	< \$5,000
Capital source	Personal loan/savings	Personal loan/savings
Dominant industry	Agric. services, Construction, Services	Manufacturing, TCU, Retail trade, Wholesale trade, FIRE
Best business opportunity	Construction, Wholesale trade	Wholesale trade
Profits > \$10,000	16%	31%
Percent for whom firm contributes 100% of personal income	31%	39%
Range in which receipts are independent of HBB/non-HBB location	\$25,000 - 50,000	
Other Minority-Owned Businesses (Asian, Pacific Island, American Indian & Alaskan Native)	34.3%	65.7%
Percent women owners	37%	30%
Born in USA.	37%	18%
Main reason for being in business	1.8/1 second income/primary	1.7/1 primary income /second
Main work at home	Production	NA
Percent with employees	5%	22%
Hours worked, maximum average	32 hours/week	48 hours/week
Capital need	< \$5,000	\$25,000+
Capital source	Personal loan/savings	Personal loan/savings

Dominant industry	Agric. services, Construction, Services	Manufacturing, TCU, Retail trade, Wholesale trade, FIRE
Best business opportunity	Construction, Wholesale trade	Wholesale trade, Retail trade, Manufacturing, Services
Profits > \$10,000	16%	39%
Percent for whom firm contributes 100% of personal income	17%	30%
Range in which receipts are independent of HBB/non-HBB location	\$10,000 - 25,000	

Other minorities, who are primarily Asian, have the lowest percent of homebased firms and low representation of women owners. Four times as many non-HBBs as homebased firms have employees. Strikingly, over one-fourth of those that do, list family responsibilities as their main reason for starting a business. A high percentage of other minorities are foreign-born. Compared with the other groups, other minority businesses (OMBs) require the most capital, but most depend almost entirely on personal loans or savings for funds. Thirty-nine percent of non-homebased OMBs make \$10,000 or more in profits which puts them on a par with non-minority male-owned businesses (MOBs).

Homebased Firms Need Help in Removing Business Barriers

To meet their potential in today's Information Age economy, HBBs need help. Actions that would lend credence to homebased firms and help them attain their goals include the following:

? ***Increase Access to Developing Markets and Electronic Commerce***

The Internet is rapidly changing commerce for all firms by offering the smallest company, as well as giant corporations, new pathways to global markets. HBBs as well as non-HBBs are finding the Internet to be an effective low-cost way to reach new markets. Two areas in which HBBs need help are 1) obtaining and paying for the credit card merchant status they need for electronic sales and 2) developing their Internet strategies. For example, electing to enter electronic commerce with a niche business may be a more successful approach than trying to compete with mass product mass merchandisers like the Amazon.coms.

? ***Remove Legal Barriers and Restrictive Tax Policies***

Local zoning codes and legal ordinances prohibiting work in homes are outdated when the commercial activity takes place on computers. Laws drafted to restrict commerce in the home need updating.

Tax codes also need updating to recognize the contribution of homebased firms to the economy. Restrictive rules for deducting home office expense and the threat of increased audit risk have a negative impact on homebased firms.

? ***Provide Access to Capital***

Capital may be less critical than success in identifying, reaching, and selling competitively in the global marketplace. However, there may be contracts that small businesses do not obtain because capital is lacking for such startup costs as obtaining required insurance, hiring staff and overhead costs. As Internet commerce

becomes more sophisticated, homebased businesses may need capital to develop and maintain profitable web sites.

? **Set Up Virtual Companies to Overcome Residential Space Limitations**

Hiring paid employees increases gross income and profits. But there are limitations as to the number of workers a residence can accommodate. The use of technology to work in teams without daily face-to-face interaction allows the homebased firm to expand beyond the limitations of residential space.

Homebased Business or Not? A Basis for Choice

Small business affords opportunities for entrepreneurs and at-home professionals. This analysis of the CBO has documented clear disparities between gender and ethnic groups. However, within any one of these groups, where to locate one’s business is an economic and lifestyle choice. Depending on the particular industry and business, the odds heavily favor businesses located in the traditional commercial location. However, independent of whether they are located in the home or not, firms *can* gross over a million dollars, so the opportunity is there.

Table ES-4 strikingly documents that HBB owners who are motivated, who hire employees and spend equivalent time on their business, narrow the gap between HBB and non-HBB profits. Although the maximum average profit of HBBs remains lower than that of non-HBBs (\$25K vs. \$43K), HBBs operated for primary income, full time and throughout the year with paid employees, narrow the gap between HBBs and non-HBBs. In fact, as the table shows for the primary income CBO segment, 87 percent of HBBs versus 84 percent of non-HBBs generate net profits greater than \$10,000 and for 67 percent of HBBs versus 51 percent of non-HBBs grossing over \$25,000, the business supplies 100 percent of personal income.

In choosing to be self-employed, business location may be less important than the owner’s motivation, time commitment and decision to hire employees or work alone. So in part, the choice of a homebased or non-homebased business comes down to balancing economic needs with lifestyle choices.

Table ES-4 Firms Operated for Primary Income

100% contribution to personal income, income < \$25K				
No paid employees	48%	47%	27%	32%
Paid employees	64%	46%	50%	41%
100% contribution to personal income, income > \$25K				

No paid employees	36%	39%	17%	26%
Paid employees	67%	51%	49%	46%
Maximum average profit	\$25K	\$43K	\$17K	\$35K
Net profit > \$10K, income < \$25K				
No paid employees	19%	30%	27%	32%
Paid employees	50%	60%	50%	41%
Net profit > \$10K, income > \$25K				
No paid employees	50%	59%	17%	26%
Paid employees	87%	84%	49%	46%
Work full-time week (40+ hours)				
No paid employees	48%	56%	28%	41%
Paid employees	79%	76%	66%	71%
Work full year (48+ weeks)				
No paid employees	65%	67%	51%	59%
Paid employees	88%	92%	86%	87%

Organization of This Report

The report is organized for readers seeking various levels of detail about small business. The *List of Key Findings*, *Summary Table* and *Chapters 1 and 2* cover the major highlights of the research. The following chapters are organized for those with more than a casual interest in the subject. Chapters 3 through 5 each begins by summarizing chapter highlights followed by detailed findings about *Owner Characteristics*, *Business Characteristics* and *Business Success*. The final chapter, *Business Opportunities and Contributions*, recaps profiles of demographic groups—women, nonminority men, black, Hispanic and "other minority" owners, and of

each industry sector. The report concludes by speculating on the future of small business—whether or not homebased—in the Information Age.

Order a bound copy of the complete report from joannepratt@post.harvard.edu or view the [full report](#) on the SBA web site.
