

# SMALL BUSINESS RESEARCH SUMMARY

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## Homebased Business: the Hidden Economy

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### Purpose

Prior to this study, there had been very little in-depth information on the characteristics and economic contributions of firms operated from the home. For example, basic information on home-based businesses (HBBs) — such as the major types of business activities conducted in the home; the amount of funds typically needed for a business startup; the ability of home-based firms to survive, grow, and find capital; and the net profits of these firms — has been entirely lacking or based on small samples or anecdotal evidence.

Using detailed data collected by the Bureau of the Census in 1996 and 1997 concerning business activity in 1992, this report for the first time gives a detail-rich portrait of the home-based sector of the U.S. economy.

### Scope and Methodology

This report is based upon an analysis of previously unpublished data collected by the Census Bureau that breaks out information for both firms operated from home and firms operated from outside the home.

The original data were collected as part of the census of business that is conducted every five years (for business activity in years ending with a 2 or 7). The data cover business activity during 1992. A sampling of 125,000 businesses from the universe of businesses that filed business tax returns in that year

as sole proprietorships, partnerships, or subchapter S corporations was used by the Census Bureau to create the Characteristics of Business Owners (CBO) survey. This effort was underwritten in part by the U.S. Small Business Administration and the U.S. Department of Commerce's Minority Business Development Agency.

The CBO sample includes the smallest "active businesses" (defined as those with at least \$500 in receipts) and both employer and non-employer firms. Those firms surveyed included two gender and three racial and ethnic categories. In the sample, 33 percent of all firms are owned by women, 59 percent by non-minority males, 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 Alaska Native.)

### Highlights

Highlights of the report's findings include:

- Increasingly, people use their home to earn a primary income, not only a secondary or supplementary income. This varies by industry, demographic group, and location.
- Home-based businesses represent 52 percent of all firms and provide 10 percent of the total receipts of the economy, about \$314 billion in 1992.
- The share of receipts accounted for by home-based firms varied greatly by demographic group.

For example, it was 26 percent for all Black-owned firms, but only 8 percent for home-based firms owned by Asians.

- Over 55,000 HBBs had sales of more than \$1 million in 1992. These same firms employed over 3.5 million persons both at home and off-site.

- About 19 percent of home based firms had employees. This compares with 18 percent of non-home-based firms.

- The average receipts of all home-based firms was in the \$40,000 range, with some variance by demographic group. However, beginning at \$50,000, an increasingly greater percentage of firms are likely to be non-home-based.

- Of the three general business uses of the home — for clerical work, for production work, and for telecommuting — the most money by far is made by firms that use the home for clerical work. Firms owned by men were more likely to use the home for clerical tasks; firms owned by women were more likely to use the home to produce goods or services on the premises.

- Forty to 44 percent of all HBBs required less than \$5,000 for startup. Another 25 percent or so needed \$5,000 to \$25,000. By contrast, a quarter of non-home-based firms needed more than \$25,000 to start.

- One third of all home-based firms use personal assets to start, and 46 percent used personal savings. Because home-based firms tend to remain in the home — less than 5 percent eventually move out of the home — there is some evidence that capital constraints prevent more firms from expanding.

- Some industries — such as construction and transportation, communications, and utilities — show about the same profit whether operated in the home or outside of the home. In these cases, the home is generally used for clerical work.

- Disabled veterans operate 2 percent of home based firms, the same percentage as non-home-based firms.

- Owners of HBBs work on average 26 to 35 hours per week in their firms; by contrast, owners of non-HBBs work 35 to 43 hours per week, on average.

- Regardless of business location, 60 percent of very small firms sell primarily to individuals. Roughly 10 percent of customers are local, state, and federal government agencies. Slightly more Black-owned firms sell to the government than the other demographic groups surveyed. Firms owned by non-

minority males showed the highest business-to-business sales, at 43 percent.

- Among the ethnic and racial groups broken out in the study, Blacks had the highest proportion of female business owners; relatively few Hispanic women own businesses.

- Over half of all HBBs survive five years; firms which close do so primarily from lack of cash or access to a business loan. Between 1992 and 1996, about 85 percent of firms with paid employees survived, compared with 51 percent of those who had no paid employees.

- Home-based firms need help in removing business barriers to grow and succeed. Two areas in which they need assistance to enter the electronic world are (1) obtaining and paying for the credit card merchant status they need for electronic sales and (2) help in developing an Internet strategy. As Internet commerce becomes more sophisticated, HBBs may need capital to develop and maintain profitable Web sites.

- Laws drafted to restrict commerce in the home are outdated in this electronic era and need updating. In addition, restrictive tax rules which prohibit the deduction of legitimate expenses have a negative impact on home-based activity.

- The use of technology allows HBBs to work in teams without the need for daily face-to-face interaction. This allows a firm to expand beyond the physical confines of a residence, while expanding sales.

## Conclusions

In the past, a home-based business was viewed as a side business operated primarily as a hobby or as a source of secondary income. The data contained in this study show that assertion to be inaccurate.

The researcher's findings demonstrate how the home has become a hub of business activity, entrepreneurship, and business creation. Sole proprietorships, partnerships, and S corporations added \$2.9 trillion to the economy in 1992, with home-based firms contributing \$314 billion, or 11 percent. When regular C corporations are included, the home-based contribution to the U.S. economy is 5 percent of the estimated \$6.4 trillion total contribution of all small employer firms with less than 500 employees.

If anecdotal evidence is correct, the home-based business sector is growing in importance, driven by the revolution in information technology. It also offers opportunities for entrepreneurs and at-home

professionals in every demographic and ethnic group.

There continue to be problems faced by small, home-based businesses. These problems include: access to credit for those owners wishing to expand; difficulties on how to establish a presence on the Internet; the burdens of local zoning and use restrictions in residential neighborhoods; and the challenge of how to expand their customer base without leaving the home for a commercial location.

Running and owning a home-based firm offers new business owners a very inexpensive entry point into the world of business ownership. This report demonstrates that this activity is much more significant than previously thought. Clearly, the home became a hotbed of entrepreneurship during the 1990s, combining income, lifestyle choices, and significant profits and revenues.

## **Ordering Information**

The full text of this report, along with summaries of other studies performed under contract to the U.S. Small Business Administration's Office of Advocacy, is available on the Internet at [www.sba.gov/advo/research](http://www.sba.gov/advo/research).

Printed copies are available for purchase from:

National Technical Information Service  
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