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Some Factors in the Profitability of Small Family Businesses

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Operating a family business can be a profitable and rewarding experience. But there may be costs to members of the family. Family members often work for no pay, and the business may utilize resources that would otherwise have been available for family use. In a family business, because the boundaries between work and family activities are less distinct, the use of resources in one sphere can impact positively or negatively on outcomes in the other sphere. For example, we found a positive and direct relationship between family success and business success in family business households (Masuo et al. 2001). While higher levels of family success are associated with higher levels of perceived business success, the reverse is not true, we found. Factors such as firm size, type of business, level of profit, and net worth may help to explain this one-way relationship.

We examined information from a national survey of family businesses in an effort to inform prospective entrepreneurs about what successful family businesses are like. The data are from 708 business-manager households from rural and urban areas in all 50 states that were surveyed in the 1997 National Family Business Survey of small, family-owned businesses with less than 99 workers. The owner-managers worked at least 6 hours per week year-round (or a minimum of 312 hours in the previous year), and they lived in the same household with at least one other adult family member.

We compared the characteristics shared by most of the profitable businesses surveyed with those of the least profitable businesses. The sample was divided into quartiles according to business profit, with the most profitable group representing the top quartile and the least profitable group representing the bottom quartile. The top quartile businesses

- earned between $48,000 and $7 million annual profit
- averaged 0 unpaid workers and 18 paid workers
- were not home-based
- were largely in the service, retail trade, and construction industries.

In contrast, the least profitable group of businesses

- ranged in annual profit from –$250,000 to +$2,500
- averaged 2 unpaid workers (including relatives living outside the household and household members) and 3 paid workers
- were home-based
- were largely in the service, retail trade, and agriculture/mining industries.

Business managers in the most profitable group averaged 46.6 years old, were 91.3% males, had 14.7 years of business experience, and worked 49.4 hours per week in the business.

Managers in the least profitable group were about the same age but more were female (54% males), they had less business experience (10.6 years) and did not work as many hours in the business (38.3 vs. 49.4).

Another comparison between the two groups revealed that more than twice as many businesses in the top quartile operated a virtual store in 1997 (2.9% vs. 1.3% for the least profitable businesses).

Thus business profit is correlated in the national survey to certain business-manager characteristics including sex, years of business experience, and hours worked in the business. Success of a business is also related to business characteristics such as access to labor, whether the business is home-based or not, location and type of the business, and use of computers and the Internet in the business. Family businesses have a competitive edge over other types of businesses because of their access to unpaid help from household members. Home-based businesses located in rural areas tend to earn lower levels of income. The lower levels of income

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are explained by the tendency for home-based businesses to establish themselves in lower-paying industries. Also, businesses operating in rural areas tend to have limited access to the business support services and customers that are more readily available in urban areas (Heck and Stafford 1999). When computers and the Internet are used in home-based businesses, however, gross income increases (Rowe et al. 1993).

E-commerce retailing has leveled the playing field for small firms by reducing store and direct-mail costs and by providing global access to customers. According a *Business Week* article (Weintraub 2001), ActivMedia Research found that more small companies (<10 employees) reported making a profit on the Web than did large companies (100 or more employees). The article cautioned that in some instances Web sales have simply replaced on-premises sales, resulting in no increase in total sales.

While most entrepreneurs are interested primarily in the characteristics of profitable businesses, banks may be interested in the characteristics of the least profitable family businesses, in order to differentiate high- from low-risk customers.

Our analysis of the 1997 survey data has implications for people interested in starting a family business. Profitable status is associated with businesses that have more workers, are not home-based, operate a virtual store, and are in the service, retail trade, or construction industries. Compared to the less profitable businesses, the more profitable businesses tend to be run by male managers who work more hours and have more years of business experience.

For a manager willing to work hard, operating a family business can be a profitable and rewarding experience. Because there are human and material costs to family members who live in a family business household, the needs and wants of family members must also be addressed in order for the business to succeed, because family success directly influences business success.

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