

Entrepreneurs

The Most And Least Profitable Businesses To Start

Maureen Farrell, 01.18.08, 6:00 PM ET



In Pictures: The 10 Most Profitable Businesses To Start

Entrepreneurs start companies for all sorts of reasons. Maybe they have a passion, like being in control, want more flexibility--or even hate their current jobs.

But no matter the inspiration, one thing's for sure: They'd better make money. A rising revenue line might make for good cocktail conversation, but if you don't turn a profit--and keep turning one--you won't be an entrepreneur very long.

With the help of Sageworks, a Raleigh, N.C.-based private-company data provider, Forbes.com has assembled a list of the 10 most and least profitable businesses--on a pretax basis--that aspiring entrepreneurs might hope to launch. Average pretax profits ranged from a juicy 25% to a knee-wobbling negative 7%.

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Of the winners, little surprise that professional services--accounting, law, design and medical-related firms--accounted for eight of the top 10. Two big perks here: constant demand (no matter what the economy is doing, people will still get sick and still sue each other) and relatively low overhead. Bean counters trumped all, with a 25% average pretax margin. Next came the legal-service firms, at 21.6%, followed by dental offices (20.9%) and specialty design shops (17.6%).

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Specialization helps in health services, too. Chiropractors, optometrists, podiatrists, and physical, speech and mental health therapists--the fifth most profitable group as a whole, with a 17.5% margin--often have more pricing power (and require less expensive training) than general physicians. A big reason: Many of these niche providers are able to circumvent the large health insurers and health maintenance organizations skilled at taking their pounds of flesh.

Another nice thing about professional services is all the repeat customers. "If someone's been doing my taxes for 20 years, why would I switch?" says John Czepiel, professor of marketing at New York University's Stern School of Business. "There's a perceived cost of switching that keeps customers coming back."

As for those bleeding red ink, the reasons are myriad. Low barriers to entry, huge fixed and variable costs, lack of product differentiation, and little or no pricing power with buyers and suppliers are but a few.

Take community care facilities, the worst of the bunch with a -7.2% average pretax margin. This sector includes residential care facilities that also offer nursing assistance or other health services. Not only is the overhead overbearing, there's a shortage of nurses worldwide, pushing up wages. Pricing power is limited, too: In the United States, these facilities get paid by Medicare and Medicaid, a relatively stingy twosome.

A hodgepodge of support services is next on the loser list. These struggling outfits do everything from organizing trade shows and conferences to labeling and wrapping gifts--not exactly quantum physics. These functions have low barriers to entry and plenty of competition. Coordinator-types also have to pay out subcontractors, gobbling what little profit they hope to make. Average margin: -2.6%.

The next three groups also traffic in commodity products: beverage makers (-2.2%), real estate services (-2.1%), and bakeries and tortilla makers (-0.9%). Small food manufacturers really get squeezed in the value chain--trapped between suppliers, with whom they have little leverage relative to larger players, and massive retail chains with lots of buying power. "The only people making money in the food chain are big corporations, because scale is the only driver of profits in that industry," says James Nolen, finance professor at the McCombs School of Business at the University of Texas at Austin.

To be fair, these numbers are something of a snapshot, as the profitability of any industry ebbs and flows, at least somewhat, with the overall economy. "In [the early 1980s], the U.S. moved from a retail economy to a service-based economy," says Nolen. "In the late 1990s, [it] moved largely to a knowledge-based economy. You can sell [those skills] at a higher rate."

But there are other factors at play. Temporary jolts, such as high fuel costs, a weak U.S. dollar, collapsing real estate prices and a credit crunch, can turn winners into losers, and visa versa. Take small banks and credit unions, the tenth most profitable businesses on our list (margin: 13.6%). Small lenders have been more insulated from the credit crisis than the big guys, like **Citigroup** (nyse: [C - news - people](#)) and **Bank of America** (nyse: [BAC - news - people](#)), though who knows for how long.

On the other hand, U.S. liquor retailers haven't fared particularly well--not only because they don't have much pricing power with distributors, but because the weak dollar means they have to pay a lot more for imported alcohol these days.

Size matters too--even within the small-company universe. Tiny shops may not require a lot of overhead, but at some point--say, around \$3 million in revenues--the relative level of overhead spikes, crimping margins. Generally speaking, economies of scale don't kick in until a business hits the \$10 million in revenue range, says Nolen.

Business models and industry dynamics matter, but they aren't everything, says Sara Sarasvathy, associate professor of business administration at the Darden Business School at the University of Virginia. She conducted a study of 45 "expert entrepreneurs"--individuals who have built, and taken public, at least one company. Her hopeful conclusion: Entrepreneurs who profit in a given industry can see new opportunities where others can't, and are willing to bet on them.

"Philosophically, [expert] entrepreneurs don't think of the world as a given," says Sarasvathy. "They see everything as transformable."

Maybe--but then, data often speak louder than dreams.



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