Policy Recommendations

for the

Improvement of

Statewide Economic Development in Michigan

A White Paper delivered to:

Southwest Michigan First (Kalamazoo)
The Right Place (Grand Rapids)
Lakeshore Advantage (Zeeland)
Newaygo County Economic Development (Newaygo)
Cornerstone Alliance (Benton Harbor)
Battle Creek Unlimited (Battle Creek)

from

TAIMERICA
MANAGEMENT COMPANY
347 Girod Street
Mandeville, LA 70448
(985) 626-9868
FAX: (985) 626-9869
ebee@taimerica.com

Technology Assessment•Strategic Planning•Organization Design•Site Selection

June, 2010

INTRODUCTION

All fifty states have a statewide economic development agency (see Appendix). The Michigan Economic Development Corporation fulfills that role for the State of Michigan. The statewide EDO typically has a mission that includes business retention, assisting startups, and promoting the state to external investors. Other common elements of their missions include tourism promotion, diversifying the economy and improving the economic well-being and quality of life of the state.

The effectiveness of statewide economic development agencies has become a central policy debate in a number of states since the recession began in 2008. Arizona, for instance, recently decided to scrap its statewide Economic Development Organization (EDO) in favor of a new organization that is both closer to the business customers it serves and further distanced from the politics that drove staffing and budget decisions in the Arizona Department of Commerce. The same policy debates are now being voiced in Michigan.

This White Paper will recommend a new direction for the Michigan Economic Development Corporation that addresses the policy concerns currently expressed by the legislature, business community and regional economic development groups. Our recommendations are not based on an academic/ theoretical construct of the proper roles for statewide EDOs but on a review of what is working in statewide economic development in 2010. We identify five state programs that are working effectively as the framework for determining what the future MEDC should look like. The problem with the theoretical construct that guided the formation of MEDC and other statewide groups is that they were based on assumptions about job growth that have been invalidated. New data sources and forms of analysis are suggesting that many of the assumptions underpinning the programs and policies of statewide development groups are ineffective.

WHAT DOES RECENT RESEARCH SAY ABOUT VALID TACTICS IN ECONOMIC DEVELOPMENT?

MEDC was conceived in an era when economic development was being redefined by research on the role of small startup businesses in job creation. State agencies tailored their approach around the idea that 80 percent of jobs in the U.S. economy were being created by young, startup businesses. Research conducted since 2008 has overturned many of the premises behind these programs. A discussion of what we know today about the sources of job creation is important to understanding our later recommendations on MEDC programs.

ECONOMIC DEVELOPMENT MYTHS AND REALITIES

Myth #1. Big Business isn't Important in Economic Development

Our understanding of the factors that drive long-term economic growth at the state and regional level is changing as newer data become available. Many of the programs at state development agencies are based on the David Birch model from the early 1980s. Birch argued that most of the nation's job growth stemmed from small, startup businesses. Newer data sources and research methods have shown his conclusions and their corollaries to be inaccurate (see Table 1). The mix of jobs by company size has not changed in the U.S. in the last 25 years (see Chart 1). The policy reality is that economic development programs that focus exclusively on small, startup businesses are overlooking most of the opportunities to create new jobs. Critics might argue that Taimerica's published research on the subject skews our judgment on the issue and that mainstream researchers still embrace the Birch model. The reality is that a growing body of researchers are coming to the same policy conclusions. Consultants from McKinsey, an internationally recognized consulting practice, embraced the same conclusion in their op-ed piece in the *Washington Post* on February 7, 2010 entitled "Five myths about how to create jobs"[1]. (Myth #2. The key to boosting employment quickly is to help small businesses). McKinsey reports that from 1987 to 2005 a third of new jobs were created by businesses that employ more than 500 workers; that half of jobs in the country are in companies that employ more than 500 workers, even though they represent just one percent of all U.S. firms.

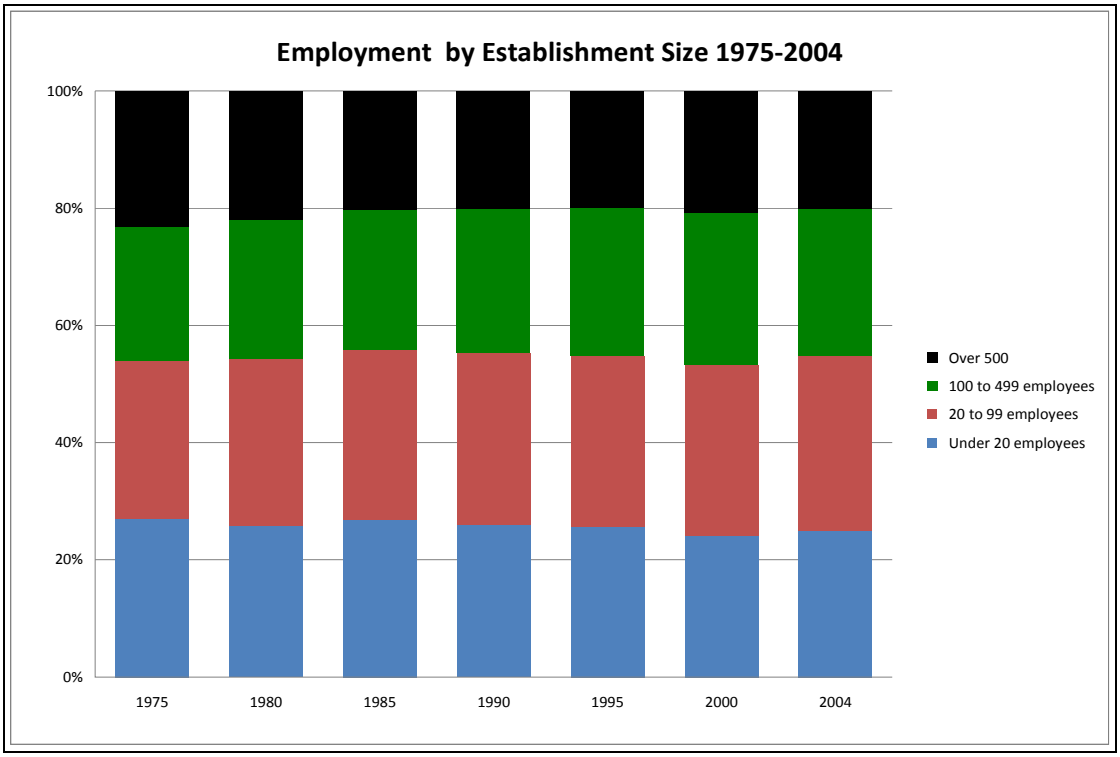
Because policy leaders are often not exposed to the most recent research on economic development, it is critical that Michigan leaders understand which of their opinions on economic growth have proven inaccurate. The data in Table 1, Myths and Realities about Job Creation in Economic Development, establishes a baseline of factual data that is critical to understanding the recommendations in this white paper.

[1] James Manyika and Byron Auguste, Five myths about how to create jobs, in *McKinsey Quarterly*, February 2010

Table 1. Common Myths and Realities about Job Creation

Myth	Facts	Source
Eighty percent of a community's new employment stems from business expansions	Forty-two percent of net job growth nationally since 2000 in traded clusters has come from business expansions	Calculations from database maintained by the SBA Office of Advocacy and the U.S. Census Bureau (see Chart 1)
Small business dominates employment growth in the U.S.	Small business employment growth since 1985 has been at the same rate as big business growth	Taimerica calculations from BEA employment size distributions for 1985 and 2005. See "Coming Full Circle: End of the Small Business Era?" at www.taimerica.com/News&Reports.html
Startup companies, especially small businesses, account for almost all employment growth in the U.S.	Business startups since 2000 account for 16% of net new jobs in the U.S; Most of the startup jobs are in population driven services Communities with the highest number of startup businesses also have the highest rates of business failures	Calculations using databases maintained by the SBA Office of Advocacy and the U.S. Census Bureau; See "Coming Full Circle: End of the Small Business Era?" at www.taimerica.com/News&Reports.html
Relocating companies are an insignificant source of new jobs in a community	Branch locations of existing companies generated 42% of net new jobs nationally since 2000	Calculations using databases maintained by the SBA Office of Advocacy and the U.S. Census Bureau (see Chart 1)
Gazelle firms—3% of the nation's small businesses—generate virtually all of the nation's net new jobs	High Impact firms- which on average are 24 years old- generated 84 percent of the nation's new jobs between 2002-06 High impact firms represent 6.5% of the nation's businesses Only 2.5% of High Impact firms have less than 20 employees	Acs, Parsons and Tracy, "High Impact Firms: Gazelles Revisited", contract for the Small Business Administration, June 2008
Big businesses don't add jobs	A third of jobs created by High Impact Firms are in big businesses (500+ employees)	Acs, Parsons and Tracy, "High Impact Firms: Gazelles Revisited", contract for the Small Business Administration, June 2008
Older businesses don't add jobs	The average High Impact firm is 24 years old-94.5% of the jobs generated by High Impact businesses are in companies that are over four years old	Acs, Parsons and Tracy, "High Impact Firms: Gazelles Revisited", contract for the Small Business Administration, June 2008
Business startups determine a community's employment growth rate	Communities with high startup rates also have high failure rates in startups Most startups are in population driven services, such as real estate and construction, so startup rates are a reflection of growth, not a predictor of it	Calculations from Bureau of Economic Analysis employment size distributions for 1985 and 2005. See "Coming Full Circle: End of the Small Business Era?" at www.taimerica.com/News&Reports.html

Chart 1.



Source: "Ed Bee, "Coming Full Circle" *Economic Development Journal*, Winter 2009, p. 7

Myth #2: Business Recruitment doesn't Matter

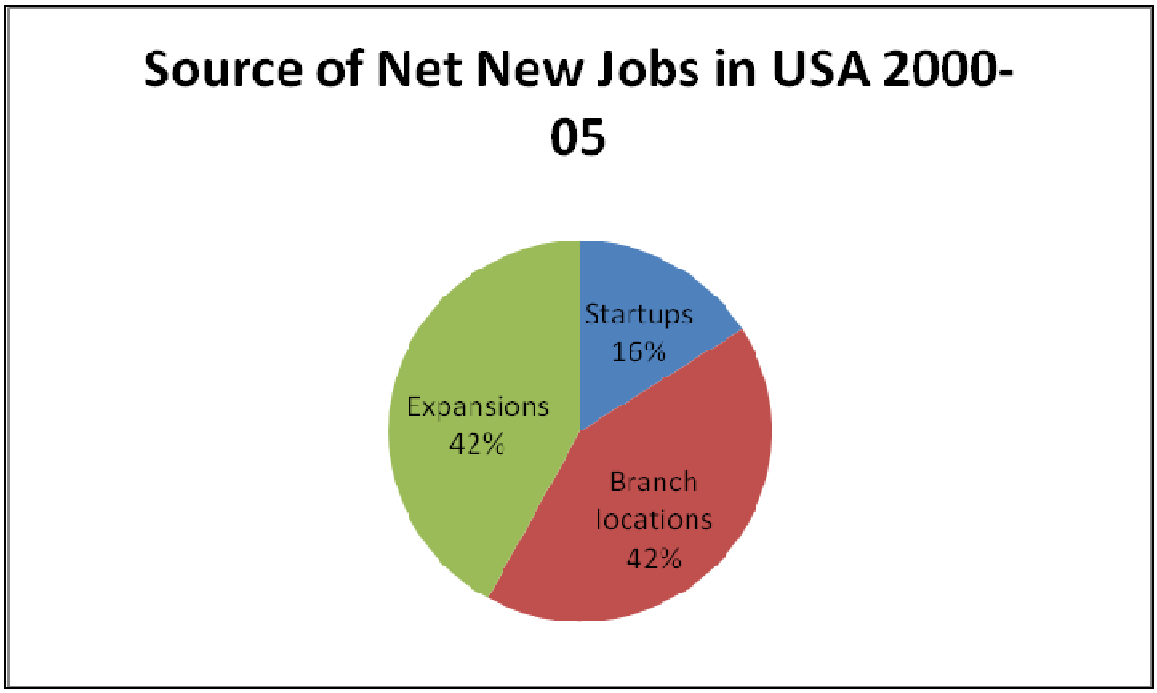
Data used in the economic development studies during the 1980s didn't distinguish between business startups and branch locations of big companies. When David Birch did his research, a new branch office for General Motors was counted as a startup business with the same number of employees because the data didn't allow this fine of a cross-tabulation. The analytical tools in these early entrepreneurship studies didn't separate traded clusters (industries that serve national and international markets) from non-traded clusters like construction, retailing, restaurants and personal services for similar reasons.

Current databases allow researchers to adjust for each of these conditions. When the adjustments are made, the data suggests that branch locations are an important source of jobs in traded clusters (see Chart 2), since most of the business starts in America are in the non-traded clusters. The collapse of the construction, real estate and retailing sectors since the meltdown in the subprime mortgage market demonstrate the fallacy of counting non-traded jobs in the economic development equation.

The second reality is that big businesses grow principally by branch locations with less than 500 employees, the threshold used by researchers to define a big business. The

conclusion is that branch locations matter more in economic development than imagined when MEDC and most statewide economic development groups were formed in the 1990s.

Chart 2.



Source: Taimerica from SBA and Census data

Myth #3: Eighty Percent of New Jobs Stem from Plant Expansions

The same databases used to quantify the role of business recruitment in economic development can be used to test the old adage that 80 percent of new jobs in a state stem from the expansion of current employers. The data suggest that the ratio is about 42 percent, equal in importance to branch locations.

Reality #1: Entrepreneurship is Important for Reasons Other than Job Creation

While Entrepreneurship doesn't have the job generation impacts attributed to it over the last 20 years, it is still a vital element in economic competitiveness. Entrepreneurial business starts enhance a region's competitiveness by raising productivity levels,

enhancing innovation rates and accelerating structural change. They are the "agents of creative destruction" identified by Joseph Schumpeter in the 1930s.[2]

A recent study sponsored by the SBA also concludes that the High Impact firms that accounted for 84 percent of the nation's job growth between 2002 and 2006 were characterized by their high levels of productivity. In other words, the number of High Impact firms and the level of entrepreneurial activity in a region are benchmarks of a state's competitiveness. Policies that stimulate entrepreneurship or enhance productivity are important to the health of a state's economy. By contrast, policies and programs that don't address the real needs of entrepreneurs or that don't have a measureable impact on business productivity will not improve the economic performance of states. It's important for states to assess their toolkit of state policy initiatives in this arena to see if they are delivering a tangible economic benefit.

Reality #2: Globalization is Redefining the Economic Development Marketplace

A growing share of the nation's jobs, especially in manufacturing, are created by companies with foreign ownership. The advent of global markets has shifted investments by U.S. companies to Asian and European markets while investments by European and Asian companies have shifted to the U.S. to serve their customer bases from domestic production sites. According to the Bureau of Economic Analysis, foreign direct investors acquired or established businesses worth $260 billion in 2008, the sixth consecutive annual increase in value. These investments represented 369,000 jobs.[3] Foreign owned companies now employ over five million U.S. workers.[4]

While foreign marketing is more important than ever in economic development, it is quite expensive and outside the reach of most regional and local EDOs. If the statewide EDO doesn't have an effective foreign trade and FDI program, it is unlikely that its communities will reap the benefits from globalization that its peer states are reaping. Foreign development is an important component of a statewide economic development program.

[2] Fritsch, Michael, "How does new business formation affect regional development?" *Small Business Economics* 30(2008): 3.
[3] Latest news release from the Bureau of Economic Analysis, found online at http://www.bea.gov/newsreleases/international/fdi/2009/fdi08.htm.
[4] NPR online at http://www.npr.org/templates/story/story.php?storyId=114215630.

Reality #3: Business Climate and Business Image Matter in State Economic Performance

It is challenging to manage economic development in a state with a poor business image. MEDC has to work more deals, hire more people, spend more on promotion and marketing and have more incentives in the toolbox to overcome a negative business image, because site selectors and expanding companies eliminate the state as a viable candidate in their preliminary screenings. So the MEDC will not generate the same level of activity as its counterparts in Georgia and Texas simply because the business climate surveys rate Michigan so poorly.

Reality #4: Industrial Structure Matters in State Economic Performance

Another important factor to consider in national rankings is the role that industrial structure plays in employment growth rates. States like Michigan with a high concentration of auto companies grow quickly when the auto industry is expanding but contract as quickly when the market softens. Likewise, energy production states like Texas and Wyoming have brisk employment growth rates when investments in the energy sector are booming but contract quickly when energy markets soften. The fallout is that statewide EDOs like MEDC can't find new deals fast enough to keep unemployment rates stable when their key industries decline.

Michigan has witnessed annual declines in employment since 2000, a decline that precedes the national recession that began in 2008 and a decline that is even more severe than those in neighboring states which also have big manufacturing economies (see Chart 3).

Paradoxically, *Site Selection Magazine*'s index of "New Plant Announcements per one million population" for 2009 ranks Michigan #4, far above other states with stronger business climate rankings (see Table 3). Much of this paradox between overall employment decline in Michigan and the number of announced new jobs in Michigan can be attributed to its industrial structure. MEDC can't work fast enough to fill the holes in its manufacturing and auto assembly industries.

WHAT'S THE NORM AMONG STATE ECONOMIC DEVELOPMENT GROUPS?

State economic development groups play an important role in attracting new investment. Site selection consultants and private companies choosing new locations often use statewide EDOs as a gateway for collecting community, site and building

information for investment projects. (As much as 60 percent of of major investment projects are handled by site selection consultants while the balance are managed internally by the company making the investment.)

What are the typical missions and functions in a statewide EDO? To give Michigan policy leaders a basis of comparison, Taimerica compiled a list of core functions in ten of the best statewide EDOs in the U.S. (see Table 2). The stated missions universally involve promoting the state to external investors. In the majority of states, the mission also involves business retention and assistance to startup businesses. Most states also reflect a social dimension in the EDO's mission, such as improving the economic well-being and quality of life for citizens or diversifying the economic structure of the state. Tourism promotion is a stated part of the mission in half of the groups.

We compiled a total of 18 core functions in the ten states. In terms of core functions, statewide EDOs universally are charged with business recruitment for their states while most also have a defined function in international trade and investment promotion. Business retention and small business development functions are common in the majority of statewide EDOs. Half of EDOs also handle the state's tourism and film promotion programs. A minority of the statewide EDOs perform additional functions, such as administration of the state's Community Development Block Grant (CDBG) Program, its federal workforce programs, and state tax incentive, grant and loan programs.

The role of statewide EDOs in the investment process has been enhanced by the prevalence of global investors in the U.S. economic landscape. The most recent figures from the Bureau of Economic Analysis suggest that foreign investors account for a significant share of new manufacturing investment in the U.S. and a growing share in U.S. services and mining. Recent estimates suggest that five million U.S. workers are employed by foreign owned companies. Foreign companies are even more prone to rely on statewide investment offices for collecting community information they need for evaluating investment locations.

Michigan has a broader mission and more complex functions than characteristic of other statewide EDOs. Michigan has a bigger budget, and among the biggest staffs of the benchmark states. When adjusted for the size of the state, however, Michigan is not the largest in either budget or staffing.

Governance of MEDC is also complex. MEDC has a board of 90 members, larger than most state Senates in the U.S. It has multiple boards and commissions as well that create a complexity not found in the other states we examined.

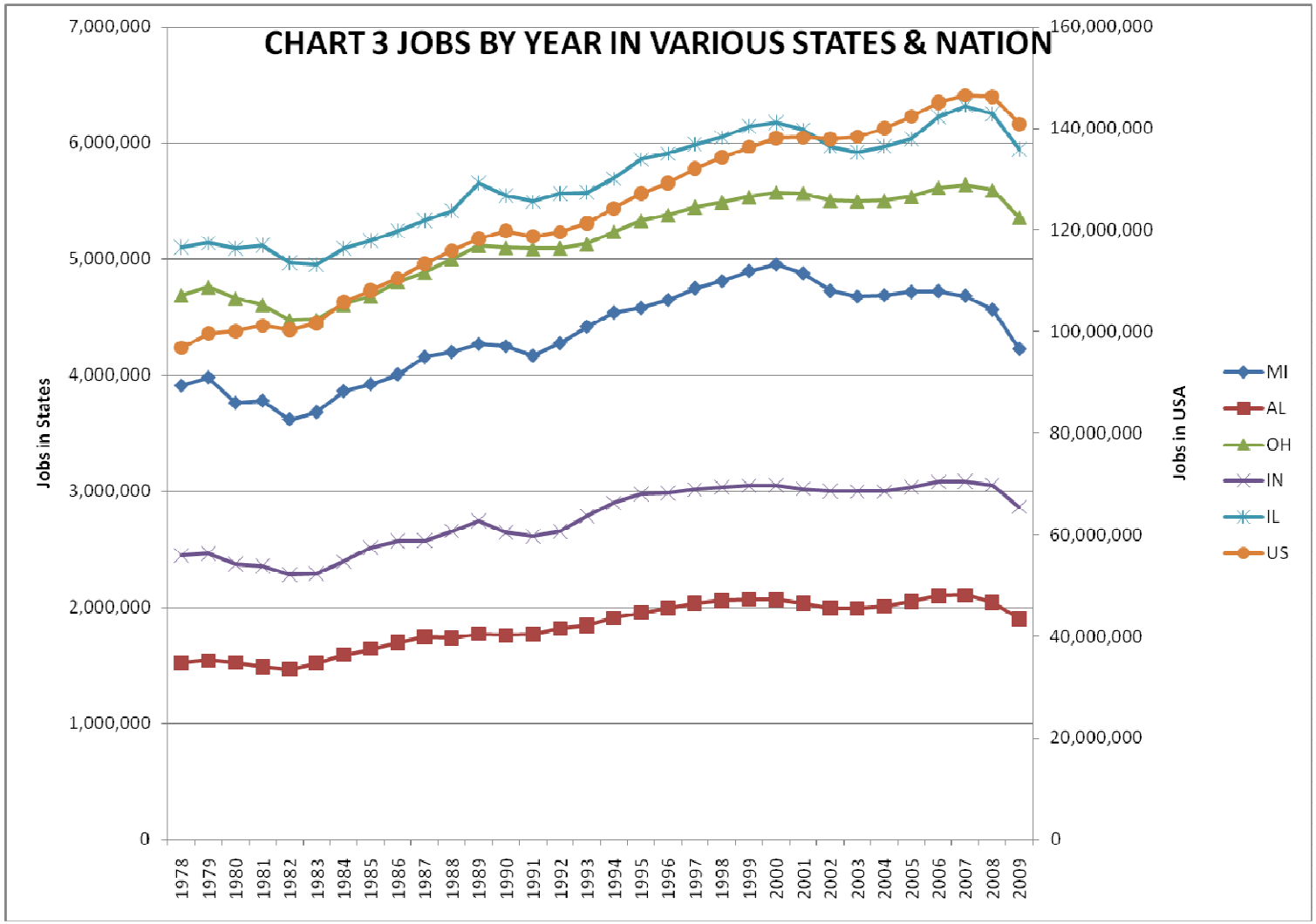


CHART 3 JOBS BY YEAR IN VARIOUS STATES & NATION
Jobs in States
Jobs in USA
7,000,000
6,000,000
5,000,000
4,000,000
3,000,000
2,000,000
1,000,000
0
160,000,000
140,000,000
120,000,000
100,000,000
80,000,000
60,000,000
40,000,000
20,000,000
0
1978 1979 1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004 2005 2006 2007 2008 2009
MI
AL
OH
IN
IL
US

Table 2: Missions and Functions in Michigan and Ten Other States

	Michigan	Texas	Florida	Georgia	Louisiana	Missouri	Nebraska	Nevada	North Carolina	Virginia	Wyoming
Mission Elements											
Support community development efforts							●	●	●	●	●
Assist with starting, retaining businesses	●			●	●		●	●	●	●	●
Promote state for business locations	●	●		●	●	●	●	●	●	●	●
Encourage increased travelers	●	●		●			●	●	●		●
Improve economic well-being and QOL			●	●	●	●		●	●	●	●
Create jobs		●	●	●	●	●			●		●
Diversify the economy			●		●	●			●		
Budget (millions without fed training/CDBG)	$ 113.0	44.7	$ 13.1	$ 39.6	$ 66.3		$ 9.3	$ 6.0	$ 54.9	$ 16.5	$ 55.1
Staff	152	50	80	208	143	10	88	25	455	76	52
Divisions#	10	5	4	4	23	1	4	5	15	4	6
Number of Boards & Commissions	4	0	1	1	1	1	1	1	3	1	1
Board Size	90	0	56	21	20	11	9	7	37	21	16
Org. Structure	PNP	C	PPP	C	G	PNP	C	C	G	C	G
Private investors (#)	0	0	29	0	0		0	0	0	0	0
Functions											
Business Recruitment	●	●	●	●	●	●	●	●	●	●	●
Business Retention	●		●	●	●		●	●	●		●
Small Business/Entrepreneurship	●		●	●	●		●	●	●		●
International Trade & Investment	●	●	●	●	●			●	●	●	●
Film, Music & Entertainment Promotion	●	●		●	●			●	●		●
Tourism	●	●		●			●	●	●		●
Science & Technology	●	●							●		●
Research/Business Intelligence	●	●	●		●					●	●
Strategy & Strategic Planning	●				●				●		●
Policy and legislation		●								●	
Workforce Development							●		●		
Community Development	●						●		●		●
Rural Development							●	●			●
CDBG	●						●	●	●		●
State Loan Programs		●			●		●		●		●
State Grant Programs	●	●			●		●		●		●
State Tax Incentives Administration	●				●						●
Procurement Outreach								●			●
Regional Outreach Offices		7	6	3	7	0	2			5	7
# International Offices	0	0	12	10		0				6	0

Table 3. Business Climate Rankings and Budget and Staffing Comparisons in Michigan and Ten Other States

	Michigan	Texas	Florida	Georgia	Louisiana	Missouri	Nebraska	Nevada	North Carolina	Virginia	Wyoming
CEO Magazine Rank in 2010	49	1	6	7	41	26	22	5	2	4	15
Site Selection Executive Survey Rank	23	1	9	3	24	26	NA	NA	2	6	NA
New Plant Rank per Million Pop. (Site Selection)	4	14	38	31	32	18	NA	NA	6	9	NA
Forbes Best States for Business Rank in 2009	49	8	18	6	44	29	9	31	5	1	22
Total employment in state (000)	4,111.7	11,093.0	8,092.6	4,217.1	1,895.6	2,695.1	936.9	1,196.6	4,016.4	3,846.7	269.9
State E.D. Budget per 1000 workers	$ 27,483	$ 4,030	$ 1,613	$ 9,390	$ 34,976	NA	$ 9,926	$ 5,014	$ 13,669	$ 4,289	$ 204,150
State E.D. staff per 1 million jobs in state	37	5	10	49	75	4	94	21	113	20	193

Chart 3. State E.D. Budget per 1000 Jobs in State

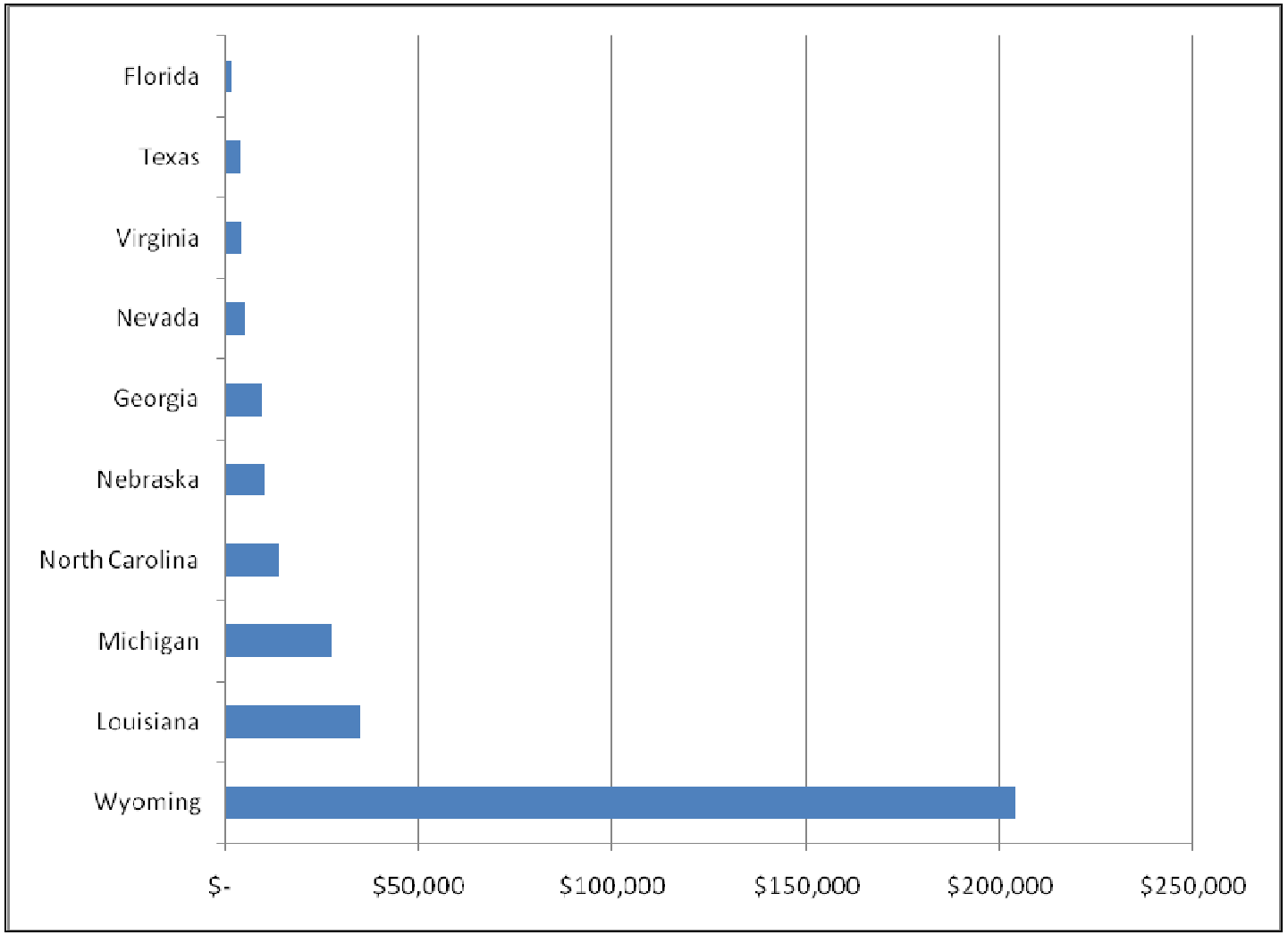
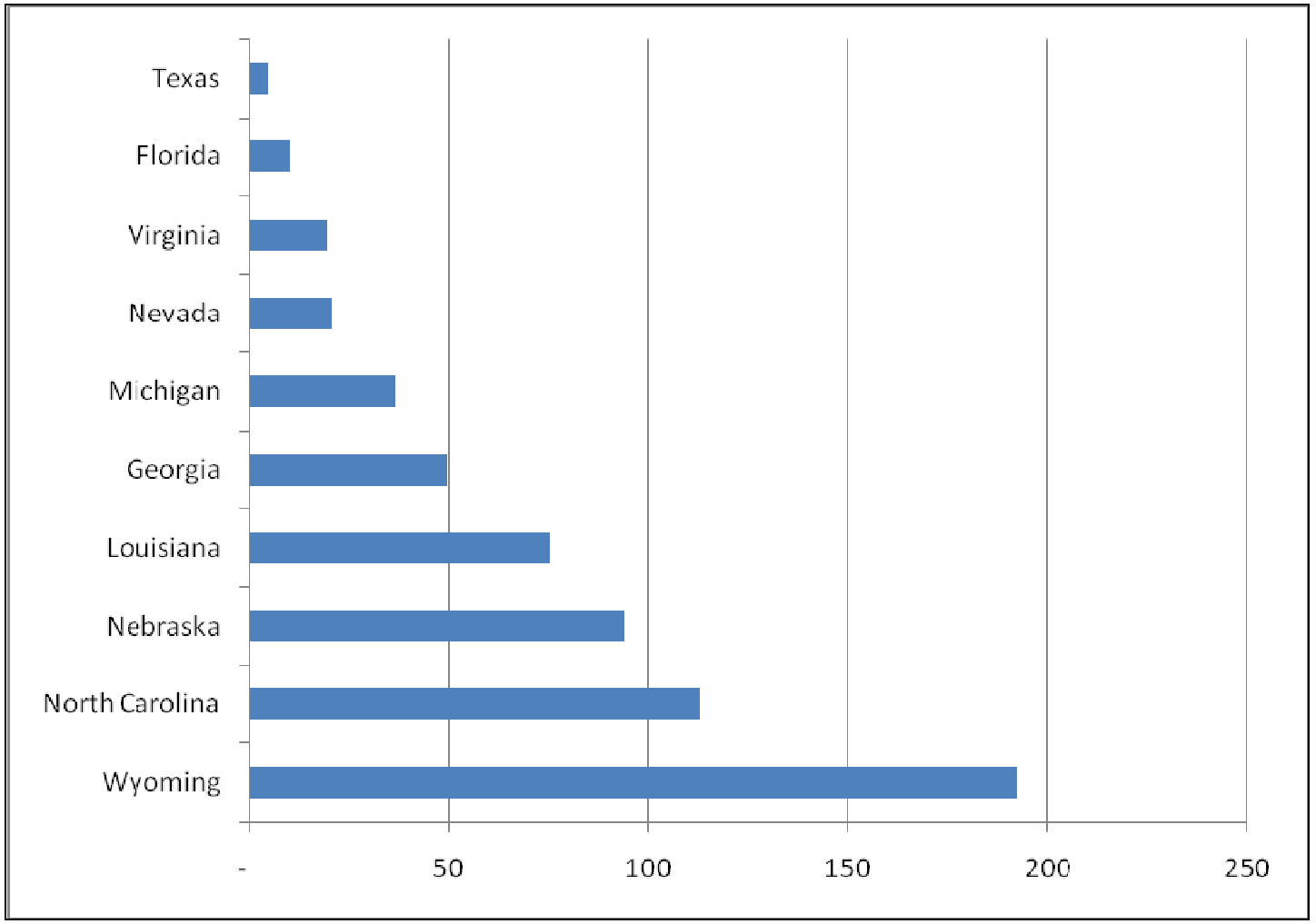


Chart 4. State E.D. Staff per 1 Million Jobs in State



IDENTIFYING THE TOP STATE ECONOMIC DEVELOPMENT GROUPS

The ten state development agencies selected for comparison with Michigan are consistently rated by site selectors and corporate real estate executives as effective. We used surveys by *Site Selection Magazine* to gauge this factor (see Table 3). The perceived business climate in a state is a factor that has to be considered in evaluating the effectiveness of state agencies as the business climate impacts how hard the group must work to achieve tangible results. We used recent surveys by *Chief Executive Magazine* and *Forbes* as our basis for rating state business climates. We then screened the list by for consistent employment, wage and salary and per capita income growth over fifteen years, to eliminate states where any one of the three parameters were below the national average. To be considered "Best Practice" or among the best-of-the-best groups, a state had to perform well on all three of these measures.

A word about rankings. They only tell part of the story of a group's effectiveness. Michigan is consistently rated among the top ten states in terms of plant announcements by *Site Selection Magazine* (see Table 3) yet executives in the "C" suite rate the business climate poorly.

Table 4. Economic Performance of the Benchmark States (X indicates growth rates in excess of national average for 5, 10 and 15 years thru 2008)

State	Population Growth	Per Capita Income Growth	Wage and Salary Growth
Michigan			
Florida	X	X	X
Missouri		X	
Nevada		X	X
North Carolina	X		X
Virginia	X	X	X
Wyoming	X	X	X
Georgia	X		X
Texas	X	X	X

The "Best-of-the-Best" based on all three screens are Florida, Virginia, Wyoming and Texas (see Table 4). Each of these state EDOs are described in the following section of the report.

THE BEST OF THE BEST

FLORIDA

Rankings
Chief Executive Magazine "Best and Worst States" #6
Site Selection "Executive Survey Rank" #9
Forbes "Best States for Business" #18
Site Selection New Plants per Million Population Ranking #38

Observations
The statewide economic development function in Florida is handled by Enterprise Florida, a public/private corporation with a blend of public and private funding. Private funding represents about 10 percent of the organization's $13 million operating budget and comes from 29 investors, principally state utilities and law firms.

Enterprise Florida was launched in 1996 with the goal of shifting more of the role and financial resources for statewide development to the private sector. The goal of raising the majority of funds from the private sector has not materialized, however.

Enterprise Florida is governed by a board of 63 members, appointed by different entities but subject to Senate confirmation. The Governor serves as Chair with a private sector member nominee serving as Vice-Chair.

Key economic functions of Enterprise Florida consist of business recruitment, business retention, small business development, international trade and investment. State and federal community development programs, state incentive administration and federal workforce programs are handled by the Governor's Office of Tourism, Trade and Economic Development. Enterprise Florida is able to focus on its core functions of trade and investment promotion. Enterprise Florida spends a significant share of its resources on international trade development, maintaining 12 offices around the world.

Florida historically budgeted about $400 million per year in performance incentives, deal closing funds, innovation and technology development and various community development incentive programs. That budget was trimmed to about $100 million in the current fiscal year.

VIRGINIA

Rankings
Chief Executive Magazine "Best and Worst States" #4
Site Selection "Executive Survey Rank" #6
Forbes "Best States for Business" #1
Site Selection New Plants per Million Population Ranking #9

Observations
The Virginia Economic Development Partnership is a quasi-public state authority created in 1995 with responsibility for statewide economic development. Governance of the partnership is via a 15 member board of directors of private sector members. Staff are agency employees who report to the Executive Director, which is hired on contract by the Board but who reports to the Secretary of Commerce. The governance and organizational structure was designed to minimize political influence in the state's ED program. Board members serve staggered terms so that only three members per year are subject to appointment. A new governor cannot change the majority of board members until the third year of their four year term.

The core functions of the VEDP are business recruitment, international trade development, business intelligence. The VEDP does not administer the state's community development, workforce or incentive programs. VEDP makes recommendations to the Governor's office on the awarding of discretionary incentives but does not have the authority to award incentives. The concept is that VEDP should act as the company's advocate after calculating that the return on investment to state residents is adequate. The Governor's Opportunity Fund is a major statewide incentive for landing major new investments. The fund is awarded by the Governor's office on a selective basis to local communities on a matching basis for use in project awards.

VEDP has a limited role in initiatives that impact the state's business climate. Their general counsel works extensively with the legislature on modifications to incentive programs but the State Chamber and the Virginia E.D. Association is the vehicle for lobbying the legislature for needed changes.

Governor's in Virginia are mandated to create a statewide economic development in their first year of office. These strategic plans guide the programs at VEDP but the targeted clusters and promotion efforts have been consistent for the last 8 years during the terms of several governors.

WYOMING

Rankings
Chief Executive Magazine "Best and Worst States" #15
Site Selection "Executive Survey Rank" #NA
Forbes "Best States for Business" #22
Site Selection New Plants per Million Population Ranking #NA

Observations
The Wyoming Business Council (WBC) is an agency of state government. The Governor appoints its 16 member board of directors, which hires the Executive Director and staff. The Council was formed in 1998 with a board mission of community development, business development and human development. The WBC was formed with three legislated goals:

- Business Goal-business promotion that complements Wyoming's assets
- People Goal- improvements to the quality of life and opportunities for people of WY
- Place Goal- Develop Wyoming with places where people want to live, work, visit and play

The agency presents a detailed report to the legislature every two years that includes some unique performance measures:

- Percentage of businesses receiving services relative to the number of total businesses,
- Percentage of towns and cities receiving services as a percentage of these entities,
- Percentage of respondents to a client satisfaction survey that were satisfied with the assistance received from the WBC,
- Jobs created by companies assisted by WBC compared to total employment growth in Wyoming,
- Existing jobs supported through the WBC compared to total employment, and
- Comparison of financial investments made by WBC grants and loan programs compared to local and private sector capital investments.

The WBC reports have level of detail and sophistication of metrics that we have not seen in any other statewide program.

Core functions of the Business Council include 16 of the 20 listed functions performed by the other ten states we evaluated, the longest list of core functions for any statewide EDO. Wyoming does not offer tax incentives for companies but does make investments through its Community Assistance Grants and Loan programs for infrastructure or facilities required by business prospects. Loan assistance is provided to small businesses through its Partnership Challenge Loan Program. These loan and grant programs

constitute about 60 per cent of its total budget. The Business Council does not have a dedicated international development office or any foreign offices.

Wyoming's economic performance is atypical of most states in that it has witnessed simultaneous growth in wages, per capita income, and jobs. Its performance is tied to success in these three areas by the legislature which suggests that the adage "what gets measured gets done" has some validity in economic development.

TEXAS

Rankings
Chief Executive Magazine "Best and Worst States" #1
Site Selection "Executive Survey Rank" #1
Forbes "Best States for Business" #8
Site Selection New Plants per Million Population Ranking #14

Observations
Governor Rick Perry created the Governor's Office of Economic Development and Tourism in 2003 by transferring functions from the Texas Department of Economic Development, which was sunset by the legislature when the new organizational structure was adopted. The Governor's staff of 50 replaces the 167 employees at the former TDED.

The office is part of the executive function in Texas and its staff serve at the pleasure of the governor. The economic development program in Texas is built on the concept that economic development is local. With a few exceptions, the incentives and funding sources for economic development in Texas are under local control. The governor's philosophy is that he best serves the interests of the state by supporting local economic development efforts. This philosophy extends to business retention and expansion, which is a local function and to science and technology development, which is handled by seven Regional Centers of Innovation and Commercialization whose boards include the directors of local economic development programs.

The core functions of the Governor's Office of Economic Development consist of business recruitment, international trade and foreign direct investment, tourism promotion, business intelligence, science and technology development and formulation of economic development policy. State workforce and CDBG programs are handled by other state agencies which is a departure from Texas's former E.D. Department. Small business efforts are directed to the Small Business Development Centers at regional universities and the few staff at the Governor's office involved in small business serve as traffic cops to direct inquiries to the local programs.

The governor uses an advisory council of private sector leaders to advise him on changes needed in Texas statutes. The Governor's office handles state incentives through the Economic Development Bank, although the incentive effort is meager at the state level and most of the incentives are statutory and don't require state level approval.

Texas has two state incentive programs: The Texas Enterprise Fund and the Texas Emerging Technology Fund. Combined funding for the two programs is about $380 million per biennium which is not part of the Governor's office of ED budget of $45 million per year.

The Governor's office accomplishes it mission of state promotion through the TexasOne program. TexasOne is funded through three year memberships and has about 135 members, who pay annual dues between $1,000 and $50,000. The marketing and promotion by TexasOne is controlled by its members. Most of the regional and many of the local economic development groups in the state are members. Total support for TexasOne in 2009 was $2.2 million, which is not part of the budget of the Governor's office.

Strategic direction for Texas Economic Development is set by the Governor's Competitiveness Council which consists of 29 members appointed by the governor from the private sector.

International development is handled by an Austin staff assigned to various global regions. The state has no foreign offices but does promote its advantages through a series of trade missions and investment seminars throughout the world.

LESSONS FROM THE TOP ECONOMIC DEVELOPMENT GROUPS

With the exception of Wyoming, which has the smallest state population in the U.S., the statewide EDOs in the top performing states have much more focus on business recruitment and much less focus on administering economic development and incentive programs. Here is a recap of the lessons learned from this analysis:

Lesson #1: Focus and Culture Matter. The large staffs required to administer incentive, workforce and CDBG programs within a statewide EDO diverts management attention from business development. All of the large population states with strong recruitment and retention programs have few other core functions. The lesson from Virginia, Texas and Florida is that a statewide EDO has to choose between one of two corporate cultures: it either focuses on business development customers or it focuses on processing paperwork correctly to insure that public dollars aren't misspent.

Lesson #2: Continuity Matters. Effective statewide EDOs have policies, budgets and staffs that are consistent over time. They have little turnover, dedicated sources of funding and policies that transcend changes in governors. They have strategies and targets that are consistent for long-periods. Virginia, for instance, has had the same target industries for eight years during the terms of three different governors. Texas likewise has had a consistent set of targets and only two CEOs at its statewide EDO over the last six years.

Lesson #3: Political Insulation Matters. Virginia has the longest track record as an effective statewide EDO of any of the best performing states. VEDP has been in existence since 1995. Its governance is designed to remove political influence from its strategy and staffing. The board, rather than the governor, chooses the CEO who works on a contract basis rather than at the pleasure of the board or governor. Although the governor makes all of the appointments to the board, terms are staggered in such a way that a new governor will not have the ability to change the majority of board appointments until the third year of their term. The Virginia model has been the most effective we've seen at providing the political insulation and continuity needed to deliver economic development results.

Lesson #4: Simplicity Matters. The most effective EDOs are located in states with highly rated business climates. Simple, predictable and consistent tax policy and regulation are the most effective tools for delivering sustainable economic development. Incentive programs must also be simple, predictable and consistently applied. Complex incentive programs are not salable at company headquarters nor to boards of directors. Ironically, complex incentives, which are designed to deliver higher returns to taxpayers via their selective use, actually deliver a lower return on tax dollars than incentives with simple

and clear rules. Statutory incentives in Michigan, rather than discretionary incentives, are a policy shift that could improve the state's business climate.

Lesson #5: Speed Matters. States like Michigan, with discretionary incentives, are competing against states with statutory incentives, where investors know immediately whether or not their projects will qualify for incentives. Unless Michigan can quickly make decisions on awards, they will lose projects. The speed of location decisions has accelerated dramatically in the internet era. Project locations that previously took six months to decide now are routinely made in a matter of 60 days. Ironically the speed at which MEDC makes incentive decisions has apparently slowed over time.

Lesson #6: Recognizing the Customer Matters. All of the effective state EDOs identify the business investor, not the legislature, governor or community, as their customer. The best groups, like Virginia Economic Development Partnership and the Governor's Office in Texas, see themselves as an advocate for the companies they work with. If business investment matters to a state's economy, statewide EDOs need to see investors as their customers and legislatures, governors, and communities as their stakeholders, not vice-versa.

Lesson #7: Metrics Matter. The old adage "What gets measured, gets done" certainly applies in economic development. The example from Wyoming demonstrates a clear relationship between performance measures and performance. If the principal goal in an economic development strategy is to raise per capita incomes, then the organization's success has to be measured by how effectively it is raising per capita income. No matter whether an EDO is structured as a state agency, private non-profit or public/private organization, metrics matter. Most EDOs deliver mediocre performance because they don't spend adequate time on defining their performance measures. The same thing is true in the for-profit world. That's why so many of the world's top corporations have shifted to a Balanced Scorecard approach to defining their performance. (For more about the application of the balanced scorecard in economic development, refer to "The Balanced Scorecard: A New Framework for Managing the Economic Development Framework" on Taimerica's website: http://www.taimerica.com/documents/BalancedScorecardWhitePaper12-15-09.pdf)

Lesson #8: Board Involvement Only Matters when it Drives Policy, Strategy and Staffing. MEDC has a large board of directors, with 90 members. Virginia's board has 15 voting members; Wyoming's has 16; the average Fortune 500 board has between eight and twelve members. Among the best performers, Florida's board is the largest at 65 members, which includes a number of major private sector investors who serve automatically on the board because of their financial investment. Large boards tend to function more like legislatures than corporate boards. (The MEDC board is, in fact, nearly triple the size of the Michigan Senate.) A smaller board, with involvement by private sector leaders, could make a big difference in the effectiveness of MEDC, if the

board has more control on setting policy, strategy and staffing. This is the lesson from Virginia and Wyoming.

WHAT LOCAL DEVELOPERS HAVE TO SAY ABOUT MEDC

Taimerica interviewed six development groups in Southwest Michigan as part of this White Paper. The six groups represent a combined experience of over 100 years, including nearly 100 years in Michigan. The group had experience working with and for MEDC, as well as with statewide EDOs in other states.

Economic development is a team effort. While companies evaluate states first, they invariably locate within communities. Both the community and state must perform and work together for successful outcomes. Our experience demonstrates that local developers have an excellent grasp of the organizational, strategic and staffing issues that hinder the effectiveness of their statewide peers.

Our interviews were not conducted for attribution. They were conducted as open-ended rather than as highly structured interviews. The appropriate way to present our findings is therefore as the consensus view of the group, rather than as individual responses. Our findings are divided into the nine subjects which respondents addressed.

Marketing and Promotion

- MEDC generates leads through its site selection contacts but most leads in bigger communities come from their own marketing and promotion. MEDC is the only source of leads in smaller communities. The bigger communities have their own recruitment initiatives in Asia and Europe to supplement MEDC.
- ED marketing and image campaigns by MEDC were rated as ineffective to dismal by those interviewed.

Incentives

- Incentive programs in MI are too complicated and rules too inconsistent across programs. The hodgepodge of programs in Michigan is impossible for companies to sell to their CEOs and boards. Incentive complexity is an image problem for the state which mirrors image problem from the state's complex tax code.
- Processing time is too long on incentives, most of which have to be approved by MEDC. It often takes 6 weeks for local EDOs to get a yes/no answer from MEDC on whether a company will qualify for an incentive.
- The payback period for analysis of value is 12 months in MI versus 36 months in OH. OH wins many projects because of this.

Tourism

- The Pure Michigan campaign was rated as an unqualified success by all EDOs interviewed.

MEDC Strategy

- MEDC lacks continuity in terms of their targets. Their focus shifts every two years: example: from life sciences to bio-energy to batteries. Communities invest in programs and find that MEDC is dropping their matching initiatives after investments have been made at local level.
- The battery strategy at MEDC is considered a success by some developers but a risky move by others because it shifted all of MEDC's resources into unproven technologies that might not pay off for Michigan.
- Strategy development and execution have become much more political recently and this hurts MI.

MEDC Organizational Structure

- Too many silos at MEDC which hurts its effectiveness.
- Metrics no longer matter as much as politics at MEDC
- MEDC is involved in retention and much of their local office time is spent on it. Mixed views among EDOs in terms of how important a role MEDC plays in business retention except as a conduit for leveraging state incentives on projects.

MEDC Personnel

- MEDC is understaffed in business promotion and incentive processing for the level of activity in the state. Some EDOs expressed views that resources assigned to local offices could be better deployed evaluating and processing incentives
- CEO selection is too influenced by Governor's office. Selection should be driven by board.
- Too much politics, especially recently, in staff hiring
- State personnel policy of job bidding based on seniority has moved MEDC career staff into technical jobs for which they lack the training, experience and skills. Especially severe with the reductions in force that MEDC has witnessed in the last five years. The organization now lacks the capacity to do effective evaluation of project incentives.
- High staff turnover in last 5 years has hampered MEDC's ability to get the job done.
- Staffing at MEDC is two-thirds civil service and one-third hired from outside government. Half of MEDC staff think their job is to follow the rules and half focus on getting deals done. The rule following culture affects MEDC's ability to win deals.

Corporate Culture

- MEDC does not value its local EDOs are partners. Some of EDOs expressed culture as "arrogant" toward local EDOs

- Field reps at MEDC have to function as advocates for local projects with MEDC headquarters staff. Some reps are effective at selling their projects while others aren't, so this affects which communities get deals.
- Corporate culture at headquarters is that companies should court MEDC for incentives. Mindset is absent that MEDC should court companies because the competition is so keen for investment.
- Union influence in MI affects how MEDC does its job. MEDC staff are not able to deal with the reality that union influence varies among regions of the state. SW Michigan suffers because MEDC won't recognize that union influence affects perceptions of business climate.

International

- MEDC has closed its overseas office in the last decade.
- MEDC contract offices in Japan and Europe have been effective. Bigger EDOs still see need to have their own programs however (Battle Creek in Japan and Grand Rapids in Europe, for example). Bigger communities generate most of their foreign leads from their own efforts. Sense is that MEDC's global effort is under-developed.

Developers in SW Michigan had many relevant observations on issues that need to be addressed in MEDC's marketing and promotion strategy, incentive administration, strategic direction, organizational structure, personnel and staffing policies, corporate culture and international emphasis.

Notice that developers don't think everything at MEDC is broken. The Pure Michigan tourism promotion program has delivered measureable results for Michigan communities. MEDC's battery target strategy has attracted investments but the developers we interviewed are mixed on whether it will deliver long-term jobs creation to the state. On the marketing front, MEDC delivers investment leads to its communities and its lead generation is the source of prospects for smaller communities. If MEDC were eliminated and not replaced, the evidence suggests that Michigan would see less business investment.

OUR RECOMMENDATIONS

This White Paper is not an exhaustive study of MEDC and its programs. The limited scope of this assignment didn't allow us to undertake the kind of detailed organizational study that would be needed to retool Michigan's statewide EDO completely. Our findings and recommendations are based on seventy-years of professional practice in economic development in six states, experience with site selection consulting, the limited analysis we performed on statewide economic development in other states, and

the observations of a representative group of E.D. professionals in Southwest Michigan. Based on our findings, we make the following recommendations:

Maintain a Statewide Business Development Function in Michigan. Michigan's citizens and communities will suffer if the state eliminates its statewide economic development organization. Site selectors and foreign investors in particular choose to work with a statewide organization when looking for investment locations. Site selectors, whether consultants or on company staffs, prefer to begin their searches by screening communities via a statewide gateway.

Site selection is really a process of site elimination. You start with a long-list of communities and sites and eliminate those that don't meet your requirements. Michigan will get on far fewer of these site screening lists if it forces consultants to contact individual communities in Michigan rather than work through a single internet gateway for Michigan.

Replace MEDC with a More Focused Business Development Organization. An effective organization has to have a way of setting priorities. Too many functions and programs diminish its ability to stay focused on its core mission. We recommend that policy makers replace MEDC with an organization focused on business development. Transfer incentive evaluation, CDBG administration and community development to another agency such as Florida did when it created the Governor's Office of Tourism, Trade and Economic Development. This results in a logical split between product development and business development, which is an advantage in terms of creating the appropriate organizational culture for business development.

The successor to MEDC will be able to recommend the awarding of discretionary incentives while maintaining a role as an advocate for the companies it works with. This will help the organization maintain a better balance between its customers and its stakeholders. MEDC's core functions should consist of business recruitment, international trade and investment promotion, research & business intelligence and possibly tourism promotion and business retention.

Insulate Michigan's new EDO from Political Influence over its Strategy and Personnel Practices. Virginia's track record over the last 15 years is conclusive: Minimize political influence over the strategic direction, operations and staffing at a statewide EDO and you will see more continuity and better long-term results. The legislature and executive branch should demand that the new EDO have effective performance measures and budget controls but should let the organization hire its CEO and staff without interference and set pay and hiring, firing and promotion practices that diverge from those in state agencies. The new EDO should have personnel policies designed to insure that staff have the technical skills and experience needed to function in their jobs, not to insure that the most senior people in the organization survive until retirement.

Provide a Governance Structure that Permits the new EDO to Maintain Continuity in its Strategic Direction. Boards that are structured like legislatures make policies like legislatures. Big boards are also a hindrance to maintaining a narrow focus and mission for an EDO. A smaller board than MEDC, with staggered terms of office, will insure that the new EDO has more continuity in strategy and therefore delivers better long-term performance.

Create a Mechanism for the Redesign of Michigan's Tax and Incentive System. A redesign of the state's economic development organization will have limited effect as long as the business climate in Michigan is perceived so poorly among investors. The incoming Governor of Michigan should create a commission jointly with legislative leaders that looks carefully at streamlining and simplifying both Michigan taxes and Michigan incentives.

Create a Mechanism for Improvement of the Business Climate and Competitiveness of Michigan. US states are no longer at the vanguard of the economic development business. The most successful economic development programs over the last twenty years have been in nation-states like Singapore and Ireland. One of the lessons learned from these countries is that government leaders must be aware of how their policies and programs affect the state's competitiveness for business. Ireland has created an organization called Forfás which is the best example to follow (see www.forfas.ie for a more information about the concept). If states don't measure their economic competitiveness, it's likely that it will erode over time.

Create a better process for tying the performance of Michigan's statewide EDO to the state's economic development strategy. Taimerica's research on best practice EDOs in 2009 demonstrated clearly that the old adage, "what get's measured gets done" is true in economic development. Organizations that achieve exceptional results have a process for imbedding their long-term strategy into day-to-day operations. These EDOs have accountability and performance systems that implement the Balanced Scorecard concept that has become common among the nation's largest private sector corporations. The best EDOs don't rely strictly on financial measures alone but also measure performance by feedback from stakeholders and customers, by having internal business processes and knowledge/learning systems that reward staff for improving skills and achieving strategic objectives. Michigan can deliver better results for its citizens by tying the performance of its statewide EDO with the achievement of Michigan's strategic plan.

CONCLUSION

Michigan has experienced a severe economic depression over the last decade. While it is easy to identify MEDC as the lone culprit in the story, the facts are that many other factors have contributed to Michigan's decline in competitiveness. Michigan needs a statewide business development organization. The evidence is clearer than it's been in the last 30 years that business recruitment is a vital component of economic development. Without a viable statewide EDO to act as Michigan's business developer, communities and citizens in Michigan will continue to see a decline in their economic fortunes. This White Paper offers some policy recommendations for the improvement of statewide economic development in Michigan, albeit they are largely conceptual and not fully developed, as Taimerica had limited time and budget to complete this investigation.

We would recommend that economic developers in Southwest Michigan embrace these findings and band together to build a political consensus among government leaders to pursue needed reforms for MEDC, as well as for the state's incentive and tax programs. If Michigan focuses its massive assets on improving its competitiveness for business, few states, or nation-states for that matter, will be able to match it. In the global race for economic development, Michigan can become a much stronger player. These recommendations provide a platform for doing so.

TAIMERICA
MANAGEMENT COMPANY

APPENDIX

List of Appendices

In Order of Reference

State Economic Development Organizations in the US
"Five myths about how to create jobs" by McKinsey
Coming Full Circle: The End of Small Business?" by Ed Bee
"High Impact Firms: Gazelles Revisited" by Acs et al (Executive Summary)
"How does new business formation affect regional development?" by Michael Fritsch
"Foreign Direct Investors' Outlays to Acquire or Establish U.S. Businesses Increased in 2008" by the Bureau of Economic Analysis
"Foreign Companies Remake The American Dream" by National Public Radio
Chief Executive Magazine "Best and Worst States"
Site Selection "Executive Survey"
Forbes "Best States for Business"
Site Selection New Plants per Million Population
"The Balanced Scorecard: A New Framework for Managing the Economic Development Framework" by Ed Bee

State Economic Development Organizations in the US

Name	ED Agency
Alabama	Alabama Development Office
Alaska	Department of Commerce, Community, and Economic Development
Arizona	Arizona Department of Commerce
Arkansas	Arkansas Economic Development Commission
California	California Employment Development Department
Colorado	Colorado Office of Economic Development and International Trade
Connecticut	Department of Economic & Community Development (DECD)
Delaware	Delaware Economic Development Office (DEDO)
District of Columbia	Office of the Deputy Mayor for Planning & Economic Development (DMPED)
Florida	Enterprise Florida Inc.
Georgia	Georgia Department of Economic Development
Hawaii	Department of Business, Economic Development & Tourism
Idaho	Idaho Department of Commerce
Illinois	Department of Commerce and Economic Opportunity (DCEO)
Indiana	Indiana Economic Development Corporation (IEDC)
Iowa	Iowa Department of Economic Development
Kansas	Kansas, Inc.
Kentucky	The Kentucky Cabinet for Economic Development
Louisiana	Louisiana Economic Development
Maine	Department of Economic and Community Development (DECD)
Maryland	Maryland Department of Business and Economic Development
Massachusetts	CEDAC: Community Economic Development Assistance Corporation
Michigan	Michigan Economic Development Corporation (MEDC)
Minnesota	Minnesota Department of Employment & Economic Development
Mississippi	Mississipi Development Authority
Missouri	Missouri Department of Economic Development
Montana	Montana Department of Commerce
Nebraska	Nebraska Department of Economic Development
Nevada	Nevada Commission on Economic Development
New Hampshire	NH Department of Resources & Economic Development
New Jersey	New Jersey Economic Development Authority
New Mexico	New Mexico Economic Development Department
New York	New York State Department of Economic Development (Empire State Development)
North Carolina	North Carolina Department of Commerce
North Dakota	Economic Development & Finance Division
Ohio	Ohio Department of Development
Oklahoma	Oklahoma Department of Commerce
Oregon	Oregon Economic & Community Development Department (ECDD)
Pennsylvania	Pennsylvania Department of Community & Economic Development
Rhode Island	Rhode Island Economic Development Corporation
South Carolina	SC Jobs-Economic Development Authority (JEDA)
South Dakota	South Dakota Economic Development
Tennessee	Tennessee Department of Economic & Community Development
Texas	Texas Economic Development Council
Utah	Governor's Office of Economic Development
Vermont	Vermont Department of Economic Development
Virginia	Virginia Economic Development Partnership
Washington	Washington State Department of Community, Trade & Economic Development (CTED)
West Virginia	West Virginia Economic Development Authority (WVEDA)
Wisconsin	Wisconsin Economic Development Association
Wyoming	Wyoming Business Council

McKinsey&Company

FEBRUARY 2010

McKinsey Quarterly

MCKINSEY GLOBAL INSTITUTE

Five myths about how to create jobs

With unemployment hovering just below 10 percent, job creation is now priority number one in Washington. But America's jobs challenge is a marathon, not a sprint.

James Manyika and Byron Auguste

With the unemployment rate in the United States lingering just below 10 percent and the midterm elections just nine months away, job creation has become the top priority in Washington. President Obama has called for transferring $30 billion in repaid bank bailout money to a small-business lending fund, saying, “Jobs will be our number one focus in 2010, and we’re going to start where most new jobs do: with small business.” The fund is among several measures—such as tax incentives, infrastructure projects, and efforts to increase exports—that the White House has proposed to help boost employment. As Americans consider the various approaches, we must have realistic expectations. We need to debunk some myths about what it takes to stimulate job growth.

1. Surely there’s a quick fix.

Oh, were that only the case. The scale of the challenge is enormous. Quick action is important, but remember that the US economy has lost more than 7 million jobs in the past two years. The country would need to create more than 200,000 net new jobs each month for the next seven years to get unemployment back to what was once considered a normal 5 percent. Quick fixes focused on 2010 alone won’t be enough.

Of course, the right mix of government policies can help. But even if Obama’s proposals were enacted right away and they accomplished all that he hopes, they would at best represent a good start. America’s jobs challenge is a multiyear marathon, not a sprint.

2. The key to boosting employment quickly is to help small businesses.

New jobs come from both small and big businesses. From 1987 through 2005, nearly a third of net new jobs were created by businesses that each employed more than 500 workers. By 2005, these big companies accounted for about half of the country’s total employment, although they made up less than 1 percent of all US firms.

But a look at the past two economic booms shows that the pace of job creation depends on more than the size of the businesses. During the economic expansion of the 1990s, large US multinational corporations—which employ an average of about 1,000 workers each in the United States—created jobs more rapidly than other companies. This was because they dominated computer and electronics manufacturing, the sector that drove much of that boom. During the more recent expansion of 2002–07, most of the net new jobs came from local service sectors, such as health care, construction, and real estate—which comprise both large and small businesses.

3. High-tech jobs will solve the problem.

There is a lot of talk these days about green businesses, biotechnology, and other emerging industries that will create the jobs of the future. While they are obviously part of the solution, these industries are too small to create the millions of jobs that are needed right away. The semiconductor and biotech industries, for instance, each employ less than one-half of 1 percent of US workers; clean-technology workers, such as those who design and make wind turbines and solar panels, account for 0.6 percent of the workforce.

Related thinking

"The power of productivity"

We'll be able to generate significant numbers of new jobs only by spurring broad-based job growth across the economy, particularly in big sectors such as retail, wholesale, business services, and health care. High-tech innovations will help employment grow over the long term, as new technology spreads throughout the economy and transforms other, larger sectors. For example, while the semiconductor industry alone doesn't account for much US employment, the computer revolution has fueled the growth of other industries such as retail and finance; similarly, the clean-technology business by itself doesn't employ many people, but its developments could transform a big sector such as energy, creating new business models and new jobs.

4. Higher productivity (when an economy produces more goods and services per worker) kills jobs.

Not so. While productivity growth means that individual companies may need fewer employees in the short term, it spurs long-term gains in the economy as a whole. Since the industrial revolution, increasing worker productivity has brought rising incomes, higher profits, and lower prices. These forces stimulate demand for consumer goods and services and for new plants and equipment—fostering, in turn, industry expansion and job creation.

Take cell phones. Even 15 years ago, they were big, unwieldy, expensive, and worked only in limited coverage areas. But as new technologies enabled workers to produce phones and provide service more cheaply, the industry took off. Cell phones are now ubiquitous, and this has created jobs not just among phone makers but also among retailers, service providers, and a new industry of developing and selling applications for smart phones.

5. Increasing exports will revive manufacturing employment.

Maybe for some companies in some industries, but not for the economy overall. While it's painful to accept, reducing unemployment is not mainly about regaining the jobs that have been lost. Sure, rising exports will cause some factories to scale up again, and many laid-off workers will be called back. But most new job growth will come from other sectors.

History shows that recessions—particularly those that follow a financial crisis—accelerate the growth or decline already underway in industries. In this recession, for example, the auto, financial-services, and residential-real-estate industries have contracted significantly and won't regain their peak employment anytime soon.

An increase in exports may stem—but will not reverse—the multidecade decline in manufacturing employment. In today's developed economies, net growth in new jobs doesn't come from manufacturing; it comes from service industries. Fortunately, boosting exports creates jobs in supporting service industries, such as design, trucking, shipping, and logistics.

James Manyika is the San Francisco–based director of the McKinsey Global Institute. **Byron Auguste** is a director in McKinsey's Washington, DC, office. This article originally appeared in the *Washington Post*, on February 7, 2010.

coming full circle

By Ed Bee, CEcD

Nothing is more central in economic development and, ironically, more controversial than job creation. For the first 50 years of professional economic development, the answer of what created jobs was unambiguous: manufacturing plant recruitment produced economic growth and new jobs. But a new paradigm emerged in the early 1980s driven by research conducted by David Birch at MIT. Birch reported that small business startups accounted for the vast majority of the nation's net new jobs.

Still nice, but not the job creator we thought.

Needless to say, Birch's findings turned economic development on its head. Boards, investors, and the federal development community began to question the effectiveness of traditional approaches, such as recruitment and promotion. Infrastructure geared toward promotion, such as business and industrial parks, was given lower priority for grant funding and assistance. Development groups turned their focus inward toward assistance for small businesses, startups, and existing companies. Academic researchers increasingly derided marketing, promotion, and recruitment strategies as a waste of development resources. A significant number of communities abandoned strategies built on community competitiveness and the recruitment of external investment. Why worry about such things when it's the local startups that matter?

What we know about the accuracy of the Birch paradigm has grown exponentially in the last decade and has great importance to the practice of economic development at the local, regional, state, and national level. A significant body of research is now emerging which provides an unparalleled clarity on which economic development strategies and tactics create jobs. These findings are once again turning economic development on its head.

Ed Bee, CEcD, is president of Taimerica Management Company, Mandeville, LA (ebee@taimerica.com)

What we know about the accuracy of the Birch paradigm has grown exponentially in the last decade and has great importance to the practice of economic development at the local, regional, state, and national level. A significant body of research is now emerging which provides an unparalleled clarity on which economic development strategies and tactics create jobs. These findings are once again turning economic development on its head. This article examines the implications of that research on regional and community economic development strategy.

We should pause at this point to explain what David Birch said about small businesses and job growth, because an elaborate urban mythology has evolved about what Birch supposedly said on the subject.

Birch's first published article, in *The Public Interest*, expounds on his findings, which were later refined with a discussion of mice, elephants,

THE END OF THE SMALL BUSINESS ERA?

David Birch's research on small business turned the economic development profession on its head in the 1980s. Traditional economic development approaches like recruitment and promotion were ridiculed. In this article, we find that the share of US jobs in small business hasn't changed since 1980, invalidating Birch's findings about the dominance of small business in job growth. New data suggest that recruitment is a much better strategy for job creation in the primary sector than startups and small business development. Developers need a more rigorous investigation of new techniques like Birch's before testing them in their communities. It's time to move beyond "one-size-fits-all" models of economic development strategy.

and gazelles[i]. Birch explains with some eloquence that he is not advocating interventionist policies to stimulate small business growth but is simply demonstrating that policies such as industrial targeting practiced by the Japanese and advocated actively by organized labor at the time, will not work in America because it's small businesses that create almost all of the nation's net new jobs.

The point of Birch's research was to demonstrate that the extreme churn in US labor markets makes interventionist policies less practical than improvements in the business climate. To be fair to Birch, he did not advocate policies to stimulate business starts nor small business development attributed to him but worried that politicians would be tempted to intervene because, without them, "there would be a relatively small role for these elected and appointed officials to play in the management of our economy."[ii]

TABLE 1. Percentage of Jobs Created by Size of Firm and Region

Number of employees in firm	PERCENT OF JOBS CREATED				
	Northeast	*North Central*	*South*	*West*	*U.S. Average*
0-20	177.1%	67.2%	53.5%	59.5%	66.0%
21-50	6.5%	12.0%	11.2%	11.6%	11.2%
51-100	-17.4%	5.2%	5.5%	6.3%	4.3%
101-500	-33.3%	3.1%	9.4%	9.3%	5.2%
500+	-32.9%	12.4%	20.4%	13.3%	13.3%
TOTAL	100.0%	100.0%	100.0%	100.0%	100.0%

Source: David Birch, "Who Creates Jobs?" *The Public Interest* 65 (1981): 8.

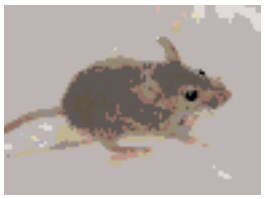
WHAT BIRCH SAID ABOUT SMALL BUSINESS AND ENTREPRENEURSHIP

What, in fact, did Birch say about small business? His primary finding was that ***"Of all the net new jobs created in our sample of 5.6 million businesses between 1969 and 1976, two-thirds were created by firms with twenty or fewer employees, and about 80 percent were created by firms with 100 or fewer employees"*** (see Table 1). [iii]

His second primary finding was that ***"About 80 percent of the replacement jobs are created by establishments four years old or younger"*** (see Table 2).[iv]

By combining the two statements, policy pundits and the "Second Wave" developers that emerged in economic development during the era concluded that only small startup businesses mattered in job generation.[v] A host of interventionist policy prescriptions, such as incubators and small business development centers, resulted from Birch's findings, or more accurately, from what policy analysts attributed to him. The idea of competition for investment and recruitment of large companies was branded as fools' errands by the emerging group of "Second Wave" developers.

After a decade of academic debate, Birch revised his findings. On further analysis, Birch concluded that the situation with small business was more complicated than first imagined. The net job creators consisted of a subset (four percent) of the young startup firms he called "gazelles" (in contrast to the remaining 96 percent that he classified as elephants and mice). Ninety-six percent of the small businesses (the mice) started small and stayed small throughout their lifetimes. The elephants were the large firms in the economy. It was this elite group of small businesses that governed employment growth within the nation's regions.



96% of small businesses stay small.

WHAT THE NEW DATA SAY ABOUT SMALL BUSINESS

If Birch was accurate, the US should have seen a metamorphosis in its economic structure over the last 30 years. The proportion of jobs in the smallest firms should have mushroomed from 26 percent to over 44 percent of total jobs based on the 66 percent of total growth that he estimated they contributed to the national job totals. Likewise, the percentage of jobs in firms with fewer than 100 employees should have grown to 65 percent of the total using the 80 percent of total growth that Birch estimated for 1974-76 (see Table 3). These percentages were calculated by assuming that the per-

TABLE 2. Percentage of Replacement Jobs Created Between 1974 and 1976 by Age of Establishment and Region

Age of Business (years)	PERCENT OF REPLACEMENT JOBS CREATED			
	Northeast	*North Central*	*South*	*West*
0-4	75.5%	80.8%	80.4%	80.9%
5-8	10.4%	8.4%	9.9%	8.8%
9-12	7.5%	6.0%	5.1%	5.5%
13+	6.6%	4.8%	4.6%	4.8%
TOTAL	100.0%	100.0%	100.0%	100.0%

Source: David Birch, "Who Creates Jobs?" *The Public Interest* 65 (1981): 8.

TABLE 3. Prediction Based on David Birch's Findings, 1975-2004

	JOBS (000)						
Size of Firm	**1975**	**1980**	**1985**	**1990**	**1995**	**2000**	**2004**
Firms with <20 Employees	16,323	24,622	28,758	36,919	41,446	50,508	51,174
Firms with 20 to 99 Employees	16,272	18,032	18,910	20,641	21,601	23,523	23,665
Balance of Firms	29,675	32,190	33,443	35,916	37,288	40,034	40,236
TOTAL JOBS	**62,270**	**74,844**	**81,111**	**93,476**	**100,335**	**114,065**	**115,075**
Jobs in Firms with <20 Employees	26.2%	32.9%	35.5%	39.5%	41.3%	44.3%	44.5%
Jobs in Firms with 20-99 Employees	26.1%	24.1%	23.3%	22.1%	21.5%	20.6%	20.6%
Jobs in Firms with <100 Employees	**52.3%**	**57.0%**	**58.8%**	**61.6%**	**62.8%**	**64.9%**	**65.1%**

Source: Calculated by Taimerica from The Statistical Abstract of the U.S., various years.

centages of growth that Birch reported for the under 20 and under 100 employee firms classifications continued through 2004.

The numbers don't tell Birch's story, however. The proportion of jobs in the smallest companies has been stable since 1985 while the proportion in the largest companies has not changed either (see Figure 1). Something is amiss: clearly, Birch's findings don't tell the whole story.

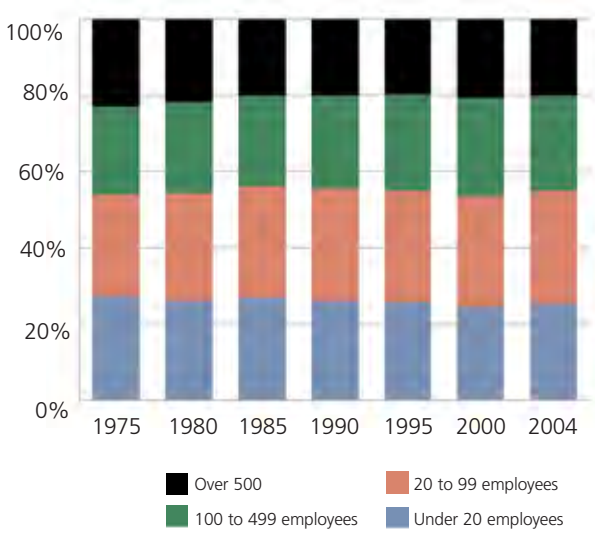
Researchers have concluded that Birch's findings are just a single piece in a complex puzzle. Some postulate that his sample was taken at a time of dramatic restructuring which was atypical of the US economy. Others have concluded that startup companies unleash a process of "creative destruction" (first described by Joseph Schumpeter), which eventually leads to a shakeout of other businesses in the market. Since these shakeout effects take a decade to work through the economy, studies like Birch's that look at a four-year period overestimate the effects from startup businesses.

In some cases, such as in lagging regions, the net employment effects of small business startups are even negative over time.[vi] In short, the role of small business startups in economic development is a complex problem that defies the simplistic solutions posited by policy analysts. Developers can't rely solely on small business to sustain economic growth.

In short, the role of small business startups in economic development is a complex problem that defies the simplistic solutions posited by policy analysts. Developers can't rely solely on small business to sustain economic growth.

FIGURE 1.

Employment by Establishment Size 1975-2004



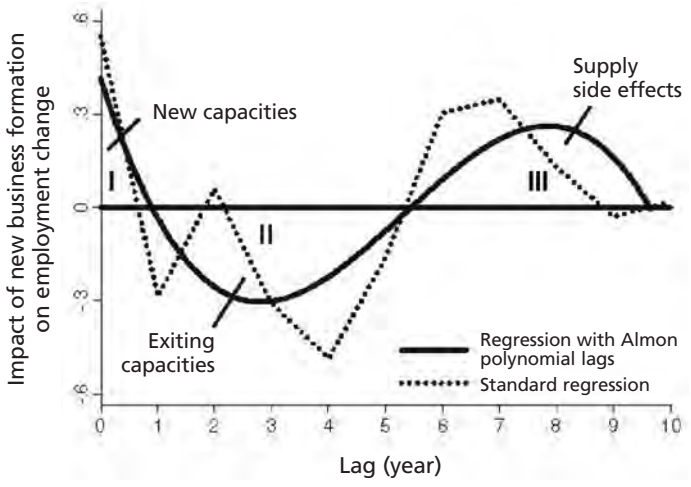
Source: Calculated by Taimerica from The Statistical Abstract of the U.S., various years

WHAT THE NEW DATA SAY ABOUT ENTREPRENEURSHIP

The second tenant of Birch's evaluation was that the vast majority of net new jobs were created by companies started within the prior four years, specifically: ***"About 80 percent of the replacement jobs are created by establishments four years old or younger."*** This conclusion did not change with his later findings about gazelle firms. Birch's findings are the linchpin in the argument that only small business startups matter in economic development.

Recent research has concluded that this finding also is inaccurate. Michael Fritsch found recently that entrepreneurs have a complex impact on employment, which can be divided into three phases. In phase I, small businesses generate new jobs in a region, termed New

FIGURE 2: Employment Effects of New Businesses Over Time

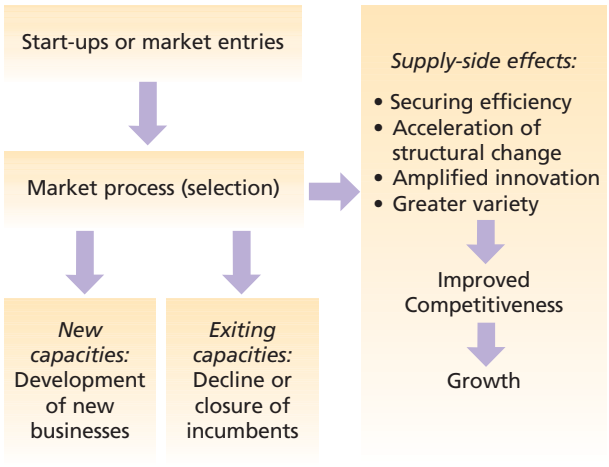


Source: Fritsch, Michael. "How does new business formation affect regional development?" *Small Business Economics* 30 (2008): 8.

Capacities in Figure 2. Growth is followed by a decrease in employment in Phase II as competitor firms exit the market, termed Exiting Capacities in Figure 2. This is followed by a period of growth and decline as "supply side" effects improve regional productivity, termed Supply-side Effects in Figure 2 (A further explanation of Supply-side Effects is shown in Figure 3).[vii] Fritsch's model explains how young small businesses could create net new jobs over four years, as Birch suggested, yet not have any long-term effects on the distribution of jobs among small and large companies.

Fritsch argues that entrepreneurs are essential in a region's economic competitiveness, not because of their job creation impacts, but because of what they bring to the region in terms of enhanced productivity and competitiveness. He asserts that startups eventually raise productivity levels in a region, enhance innovation rates, and accelerate structural change. They are the agents of "Creative Destruction" identified by Joseph Schumpeter in the 1930s.[viii]

FIGURE 3. New Business Formation

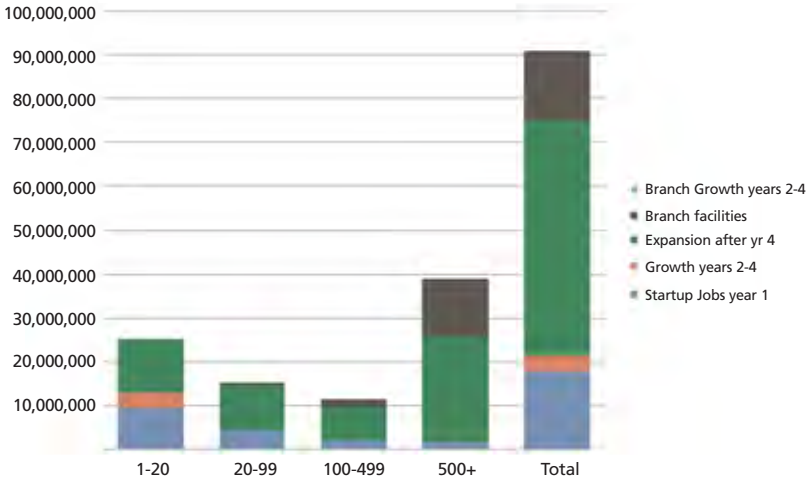


Source: Fritsch, Michael. "How does new business formation affect regional development?" *Small Business Economics* 30 (2008): 3

Zoltan Acs, in a recently released study conducted for the SBA's Office of Advocacy, has determined that Birch's statement about young startups does not apply today to the US economy. His research with a new longitudinal database shows that few of the jobs are created by young startup companies. Most of his High Impact firms (a refinement of Birch's Gazelles) are 24 years old, a finding to be discussed later.

FIGURE 4.

US Emp. Growth by Est. Size and Source 2001-2005



Source: Compiled by Taimerica from SBA Office of Advocacy databases

WHAT THE NEW DATA SAY ABOUT JOB CREATION

Figure 4, constructed from data collected by the SBA Office of Advocacy, shows the sources of job growth at the national level during the most recent five-year period. Business expansions contribute about two-thirds of the growth in new jobs. Startups and branch locations each contribute about a fifth of the total. The data underestimate the role of startups and branches and overestimate the role of expansions however because the SBA data measure the jobs generated at startups and branches during their first 12 months of operation while expansions are all growth after the first 12 months of operation. If jobs at startups and branches were calculated for the first 48 months of operations, for instance, these businesses would account for a higher share of the total growth and expansions would be a smaller share of the total. The length of time that the SBA assumes a business is in start-up phase affects the calculations (the same is true from branch facilities which are a subset of startups).

Birch's earlier conclusion that entrepreneurial startups contribute 80 percent of the nation's job growth is not

confirmed by these new data. What Birch said about the extreme job churn in the US economy is certainly still true and Figure 4 validates that conclusion. The US economy generated nearly 90 million gross jobs in five years, yet the net job increase was merely 5 million jobs (this churn could be high because of the sizeable restructuring in the US economy during the period due to globalization).

Economic developers have been faulted frequently by policy pundits for counting gross, rather than net, jobs in their measures of success. While this argument has validity, developers need a sense of gross job generation because it is the level of gross job creation that determines the demand for training. Moreover, the uncertainty of how "Creative Destruction" affects net job generation over time also affects the reliability of net job figures.

What might surprise developers is the impact that the largest companies have on total job generation. Companies with 500+ employees generate more gross jobs than small businesses and account for about half of total job creation. Startups generate a lot of gross jobs but, because the failure rate among startups is also high, the net jobs picture is much lower.

States with high levels of startups also have a high level of business failures among small companies (see and compare Tables 4 and 5). Startup rates are strongly related to population growth rates. The statistical correlations are strong and statistically significant (R-square of .40 for metros and .48 for states, both statistically significant at the .0001 level).

A careful examination of these numbers suggests that population growth stimulates the formation and growth of startup businesses -- and not vice-versa. Most of the entrepreneurial development programs created in the third wave of economic development assumed just the opposite, that increasing the rate of business startups stimulates economic growth. The lesson here for developers, academic observers, and policy pundits is that, as a source of new jobs, expansions and branch locations matter more than startups; and that startups flow from economic growth rather than stimulate it. As is apparent in Table 5, the states with the highest failure rates also have high population growth rates; and are the same states that have the highest startup rates. Of the five states with the highest startup rates between 2000 and 2005, four are also on the list of the states with the highest new business failure rates.

TABLE 4.
States with Highest and Lowest Startup Rates

		2000-05	
Rank	State	Jobs in Startups (%)	Population Growth (%)
Highest			
1	Nevada	34%	19%
2	Florida	33%	11%
3	Arizona	31%	15%
4	Idaho	31%	10%
5	Texas	29%	9%
Lowest			
46	Maine	18%	3%
47	Vermont	18%	2%
48	Wisconsin	18%	3%
49	South Dakota	18%	3%
50	Iowa	17%	1%

Source: Compiled by Taimerica from SBA Office of Advocacy databases

TABLE 5. States with Highest and Lowest New Business Failure Rates

		2000-05	
Rank	State	Job Losses from Failures (%)	Population Growth (%)
Highest			
1	Florida	-30%	11%
2	Arizona	-25%	15%
3	Nevada	-25%	19%
4	Texas	-25%	9%
5	Utah	-25%	12%
Lowest			
46	Hawaii	-17%	5%
47	North Dakota	-17%	-1%
48	Vermont	-17%	2%
49	Iowa	-16%	1%
50	Wisconsin	-16%	3%

Source: Compiled by Taimerica from SBA Office of Advocacy databases

WHAT THE NEW DATA SAY ABOUT GAZELLES

The focus on entrepreneurship in economic development over the last two decades is based on Birch's finding that the majority of the nation's net new jobs come from small business startups.

A landmark study of the SBA's longitudinal data has just been published by Zoltan Acs that gives new insights because of the database's enhanced capabilities and refinements. Acs tested Birch's findings about young small business and "gazelle" firms using the SBA's longitudinal data. What he found was that the companies that grow in both sales and jobs (which he calls "High Impact") are a different breed than Birch's gazelles (which were defined by sales growth alone). High Impact firms, like Gazelles, are an elite group, representing just 6.5 percent of the nation's companies. But High Impact firms differ from Gazelles in two important ways:

1) most are not small businesses, and

2) just 2.5 percent are startups (established in the last four years).

Table 6 is a cross-tabulation of High Impact firms by size and age. High Impact firms generate 84 percent of the nation's net new jobs. Notice that just a fraction of the jobs among High Impact firms are attributed to the smallest businesses (1-19 employees). And fewer than five percent of the jobs in this size class are in firms under four years old. The strategic implications are clear: Ignoring large businesses omits most High Impact firms; Focusing on startups excludes 97.5 percent of High Impact firms. Focusing on small startup businesses ignores 98 percent of the traffic.

TABLE 6. High-Impact Job Generation, 2002-06

Firm Size (No. Employees)	High Impact Jobs	Share (%)	High-Impact Firm < 4 yrs old	High-Impact Firm > 4 yrs old
1-19	2,883,475	38%	5.5%	94.5%
20-499	2,130,682	28%	0.9%	99.1%
500+	2,514,538	33%	0.4%	99.6%
TOTAL HIGH-IMPACT	**7,528,695**	**100%**	**2.5%**	**97.5%**
All Firms	9,009,760	NA	NA	NA
High-Impact Share (%)	84%	NA	NA	NA

Source: Acs, Parsons, and Tracy, "High-Impact Firms: Gazelles Revisited", contract for the Small Business Administration, June 2008.

THE IMPORTANCE OF THE ROLE OF STARTUPS IN ECONOMIC DEVELOPMENT

Economic development involves the stimulation of overall growth in the local or regional economy. To sustain their organizations, economic developers must demonstrate that their programs deliver growth that would not happen otherwise. Startups serving local markets are typically examples of businesses that would happen without the support of economic developers. It's obvious from the SBA's data that most of the jobs generated by startup businesses are in sectors serving local markets (see Table 7). A disproportionate share of startup jobs occur in sectors that serve local markets, such as food service, construction or retail trade.

Economic development involves the stimulation of overall growth in the local or regional economy. To sustain their organizations, economic developers must demonstrate that their programs deliver growth that would not happen otherwise. Startups serving local markets are typically examples of businesses that would happen without the support of economic developers.

TABLE 7. Startup Jobs by Sector, 2000-05

		2000-05	
Sector	**Initial Jobs**	**In Startups**	**Percent**
Accommodation & foodservices	9,635,349	3,390,736	35%
Admin. & support, waste mgt., rem. svcs.	8,365,519	2,210,505	26%
Construction	6,201,120	2,127,477	34%
Retail Trade	14,475,239	2,080,830	14%
Health care & social assistance	13,864,441	1,987,526	14%
Professional, scientific, & technical services	6,431,473	1,940,169	30%
Manufacturing	16,658,144	1,304,926	8%
Other services (except public admin.)	5,152,985	1,165,117	23%
Wholesale trade	5,971,197	844,287	14%
Finance & insurance	5,965,455	741,819	12%
Real estate & rental & leasing	1,873,780	645,964	34%
Transportation & warehousing	3,627,533	609,084	17%
Information	3,234,298	482,452	15%
Arts, entertainment & recreation	1,639,859	467,552	29%
Educational services	2,431,909	286,072	12%
Management of companies & enterprises	2,788,270	153,542	6%
Mining	456,638	67,901	15%
Utilities	667,135	24,686	4%
Auxiliaries, exc. Corp., subsid., reg. mgt. ofcs	959,260	1,177	0%
TOTAL	**110,399,604**	**20,531,822**	**19%**

Source: Compiled by Taimerica from SBA Office of Advocacy databases

To get an accurate picture of the role of startups in economic development, we should look at startups in primary production and services, which excludes sectors driven by local market growth. Those data demonstrate a different pattern than for the overall economy. With the exception of professional, technical and scientific services, these data suggest that growth in primary sectors is driven much more by branch locations and expansions than by startups (see Table 8). Mining is an example. Branch facilities in mining generated 93,000 gross jobs between 2000-05 while expansions generated 337,000 jobs. Startups by contrast generated just 68,000 gross jobs, which is just 5 percent of the gross job development in mining during the period.

When Manufacturing (which has seen such a dramatic decline that it obscures the overall growth pattern) and Professional, Scientific and Technical services are excluded, the primary sector totals demonstrate that startups account for just 15 percent of the gross new jobs and had a negative net impact on jobs (births minus deaths). Startups in the primary sector actually resulted in a net decrease in jobs over the 2000-2005 period. Branch locations have a much larger impact than startups in terms of gross jobs and are nearly equal to expansions as a source of net new jobs.

The conclusions we have to accept are that branch locations and expansions, excluding sectors oriented toward local markets, are far more important in economic development than startups and are nearly equal in importance from a net jobs standpoint. In terms of logistics (warehousing and distribution), information services, and company management, branches are a more significant source of net new jobs than either startups or expansions.

The conclusions we have to accept are that branch locations and expansions, excluding sectors oriented toward local markets, are far more important in economic development than startups and are nearly equal in importance from a net jobs standpoint. In terms of logistics (warehousing and distribution), information services, and company management, branches are a more significant source of net new jobs than either startups or expansions.

TABLE 8. US Primary Sector Dynamics, 2000-05 (Jobs)

		Births			*Deaths*			
Sector	**Initial**	**Startups**	**Branches**	**Expansions**	**Startups**	**Branches**	**Contractions**	**Net Change**
Total, all economic sectors	110,671,753	20,868,221	19,095,795	70,112,316	19,950,793	16,753,894	67,759,842	**5,611,803**
Primary Sectors								
Mining	456,638	67,901	93,245	336,614	66,775	89,048	306,160	**35,777**
Manufacturing	16,658,144	1,304,926	1,022,227	6,310,029	1,712,216	1,780,630	8,207,304	**(3,062,968)**
Wholesale trade	5,971,197	844,287	929,701	3,680,658	1,085,916	947,515	3,431,792	**(10,577)**
Transportation & warehousing	3,627,533	609,084	875,725	2,247,602	644,089	616,670	2,454,772	**16,880**
Information	3,234,298	482,452	1,332,664	2,148,908	520,533	1,101,655	2,444,618	**(102,782)**
Professional, scientific, & technical services	6,431,473	1,940,169	1,265,521	5,421,300	1,775,231	1,072,178	4,683,765	**1,095,816**
Management of companies & enterprises	2,788,270	153,542	978,967	2,143,754	113,059	906,186	2,160,615	**96,403**
Administrative & support & waste mgt. & remed. serv	8,365,519	2,210,505	2,113,938	8,589,921	2,315,341	2,195,776	7,840,963	**562,284**
Total Primary Sectors	**47,533,072**	**7,612,866**	**8,611,988**	**30,878,786**	**8,233,160**	**8,709,658**	**31,529,989**	**(1,369,167)**
Total Primary Sector less PST services	41,101,599	5,672,697	7,346,467	25,457,486	6,457,929	7,637,480	26,846,224	**(2,464,983)**
Total Primary sectors less PST services and manufacturing	24,443,455	4,367,771	6,324,240	19,147,457	4,745,713	5,856,850	18,638,920	**597,985**

Source: Compiled by Taimerica from SBA Office of Advocacy databases.
Note: PST= Professional. Scientific and Technical Enterprises

IMPLICATIONS FOR ECONOMIC DEVELOPMENT STRATEGY

Here is a recap of what these new data say about the performance of different job generation strategies:

- A small business focus fails to generate significant net jobs.
- Startups typically do not drive economic growth; rather, economic growth typically drives startups. Most startups are organized to exploit emerging market opportunities from local population growth, such as in retailing, personal services, and construction.
- Most startups are focused on local markets and therefore don't stimulate local or regional job creation. We know from economic development theory that businesses must generate new wealth from outside of the local market to raise the standard of living and overall level of regional employment. Businesses that exist on local markets recirculate wealth rather than create it.
- High Impact companies are the fountain for economic growth although we do not have cost effective methods of identifying them in advance.
- Branch locations are an important economic development strategy.
- Existing industry expansions are nearly equal in terms of net job generation to branch locations in the primary sector.
- Entrepreneurship matters in job generation but the connections and path to success are not known so interventionist techniques are questionable policy tools.

These conclusions have significant implications for overall economic development strategy. This research suggests that Second Wave strategies that surfaced following David Birch's research have not offered any better job performance than the recruitment strategies which they replaced. As a matter of fact, the new data suggest that branch recruitment in the primary sector is a more productive strategy than startups and even rivals business expansions in the generation of net new jobs.

The bigger picture implications from this research are: 1) There isn't a single economic development strategy that works universally well throughout the US, and 2) new ideas in economic development can generate unintended consequences. Communities that shifted their focus inward by following Second Wave strategies probably became less competitive over time because their inward focus ignored the need to remain globally competitive. Anecdotal evidence suggests that recruitment strategies, as practiced in the most dynamic communities, such as Dallas or Atlanta, probably provide a better platform for adapting to competitive challenges than existing industry or startup strategies.

As a profession, we have to do a better job of investigating the "new- new-thing" in economic development. Why did it take us 25 years to discover that the assumptions and theories behind Second Wave development were clearly flawed? We need a more rigorous review of new ideas before testing them in our communities.

Recent research in Germany in cognitive psychology demonstrates that single emphasis strategies, such as entrepreneurship or small business development, are not the answer in complex fields like economic development.[ix] This research, using simulation models with panels of civic leaders, demonstrated that teams that focus all of their resources on solving a single development problem actually retard growth. There are too many interactions and feedbacks in a complex system like economic development to make this kind of simple approach workable in practice.

Most startups are focused on local markets and therefore don't stimulate local or regional job creation. We know from economic development theory that businesses must generate new wealth from outside of the local market to raise the standard of living and overall level of regional employment. Businesses that exist on local markets recirculate wealth rather than create it.

Developers have to recognize that they need complex methods to solve complex problems. Just as physicists needed calculus to solve problems of planetary motion, developers need more sophisticated tools than these policy generalizations for doing community development.

Most of the theories about effective economic development have focused on a "one-size-fits-all" model of economic development.

Most of the theories about effective economic development have focused on a "one-size-fits-all" model of economic development. Proponents of Second Wave techniques, for instance, were typically adamant that communities had to shed their business recruitment ways. More recent approaches, such as cluster development, are built on the assumption that previous techniques are invalid. What these data suggest is that such generalizations are unfounded.

Proponents of Second Wave techniques, for instance, were typically adamant that communities had to shed their business recruitment ways. More recent approaches, such as cluster development, are built on the assumption that previous techniques are invalid. What these data suggest is that such generalizations are unfounded.

The best tools and techniques in economic development defy generalization. They depend on a community's assets and liabilities and what investors are buying in the marketplace in a given era. Providing a location that is globally competitive for investors, whether recruited from elsewhere or home grown, is a better model for long-term performance than the interventionist techniques advocated by policy pundits during the last 25 years.

We might well find that a handful of techniques are generally useful in most communities or we might find, in contrast, that there are different classes of communities that respond better to one set of economic development tools and techniques than to others. But we won't find these solutions until we resist the temptation of looking for a single silver bullet or a single approach that works universally in all circumstances.

ENDNOTES

[i] Birch, David. "Who Creates Jobs?" *The Public Interest* 65 (1981): 3-14.

[ii] Birch, p. 12.

[iii] Birch, p. 7.

[iv] Birch, p. 8.

[v] A term coined by Robert Atkinson with the former Congressional Office of Technology Assessment. See Ed Bee, "Small Business Vitality and Economic Development", *Economic Development Journal*, Summer 2004.

[vi] Fritsch, Michael. "How does new business formation affect regional development?" *Small Business Economics* 30 (2008): 1-14.

[vii] Fritsch, p. 8.

[viii] Joseph Schumpeter, *The Theory of Economic Development,* Cambridge, MA 1934: Cambridge University Press.

[ix] See for instance, Dietrich Doerner, *The Logic of Failure*.

High-Impact Firms: Gazelles Revisited

by

Zoltan J. Acs, William Parsons and Spencer Tracy
Corporate Research Board, LLC
Washington, DC 20037

for

under contract number SBAHQ-06-Q-0014

Release Date: June 2008

The statements, findings, conclusions, and recommendations found in this study are those of the authors and do not necessarily reflect the views of the Office of Advocacy, the United States Small Business Administration, or the United States government.

SBA Office of Advocacy
www.sba.gov/advo

Small Business Research Summary

Advocacy: the voice of small business in government

June 2008 No. 328

High-Impact Firms: Gazelles Revisited

Zoltan Acs, William Parsons and Spencer Tracy;
Corporate Research Board, LLC, Washington, DC 20037
2008. [91] pages. Under contract SBAHQ-06-Q-0014

This study revisits and expands upon some of the conclusions on rapidly growing firms made by the small business research pioneer, David Birch, in the 1980s. Birch found that rapidly growing firms, which he termed "gazelles," are responsible for most employment growth. While Birch's definition of gazelles was based on their revenue growth, this study examines firms with significant revenue growth and expanding employment. These are termed "high-impact firms" to distinguish them from gazelles. The research offers summary statistics helping to define the scope and characteristics of high-impact firms. The report sheds light on several previously unanswered questions, including: What are high-impact firms before they become high-impact firms? What happens after their high-impact phase?

Overall Findings

High-impact firms are relatively old, rare and contribute to the majority of overall economic growth. On average, they are 25 years old, they represent between 2 and 3 percent of all firms, and they account for almost all of the private sector employment and revenue growth in the economy.

Highlights

• From 2002 to 2006 there were 376,605 high-impact firms in the United States. This number increased from 299,973 between 1998–2002 and was greater than the 352,114 firms in the 1994–1998 period of analysis.

• During the 1994–2006 period, firms with fewer than 20 employees represented 93.8 percent of the high-impact firms and 33.5 percent of job growth among high-impact firms, while firms with 20 to 499 employees represented 5.9 percent and 24.1 percent, respectively.

• For the three firm-size categories analyzed, the average size of high-impact firms in the 1-19 size category was 3 employees at the beginning of the period of analysis, increasing almost out of the size category to 16; for the 20-499 firm-size class it was 65 increasing to 209; and for the over-500 size class, it was 3,648 increasing to 8,041.

• The average high-impact firm is around 25 years old, but they are younger than low-impact firms.

• High-impact firms exist in all industries. While some industries have a higher percentage of these firms, they are not limited to high-technology industries.

• High-impact firms exist in almost all regions, states, metropolitan statistical areas (MSAs) and counties.

• Low-impact firms do not grow on average.

• Nearly all job loss in the economy in each of the three time periods analyzed is attributable to low-impact firms with more than 500 employees.

• Less than 3 percent of high-impact firms were born in the previous four-year period, however as firm size increases that number doubles to over 6 percent.

• In the four years after a high-impact firm undergoes its high-growth phase, only about 3 percent die. Most remain in business and exhibit at least some growth.

• The data suggest that local economic development officials would benefit from recognizing the value of cultivating high-growth firms versus trying to increase entrepreneurship overall or trying to attract relocating companies when utilizing their resources.

Scope and Methodology

A new data set, the American Corporate Statistical Library (ACSL), has been developed by the Corporate Research Board and was used for this project. The ACSL stitches together data from public and private sector sources over a 12-year period, allowing users to analyze discrete business patterns. Its principal data sources are Dun & Bradstreet's DMI file, the Bureau of Labor Statistics' Industry Occupation Mix, and the Census Bureau's PUMS file. The report uses cross-sectional files of the full DUNS DMI file for each year over the last 10 years. (This dataset is updated every six months.) The ACSL links Dun & Bradstreet's cross-sections into a longitudinal file that tracks every establishment from its birth through any physical moves it makes, capturing changes in ownership along the way, and recording the establishment's death if it occurs.

For the purposes of this study, a high-impact firm is an enterprise with sales that doubled over the most recent four-year period and an employment growth quantifier of two or more over the same period. (The employment growth quantifier equals the product of a firm's absolute change and percent change in employment.) Firms over three four-year periods from 1994 to 2006 are analyzed, and three firm-size categories are defined to determine exactly where these firms make their greatest impact on the economy.

While the data offer excellent coverage of firms that are at least five years old, tables in the report show that the coverage of firms under five years old is limited. This does not affect the report's analysis of high-impact firms, which are found to be on average 25 years old. However, it does limit the report's ability to evaluate the economic impact of small firms (many of which are under five years old) and compare small and large firm sectors for low-impact firms.

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.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at ***www.sba.gov/advo/research***. Copies are available for purchase from:

National Technical Information Service
5285 Port Royal Road
Springfield, VA 22161
(800) 553-6847 or (703) 605-6000
TDD: (703) 487-4639
www.ntis.gov
PB2008-109311
Paper A06 ($48.00)
CD-ROM A00 ($40.00)
Download A00 ($25.00)

For email delivery of Advocacy's newsletter, press, regulatory news, and research, visit ***http://web.sba.gov/list***. For RSS feeds, visit ***www.sba.gov/advo/rss-library.html.***

TABLE OF CONTENTS

Executive Summary 1

1. Introduction 4
2. The Relationship between New Business Formation and Employment Growth 8
   - 2.1 Theory 8
   - 2.2 The Impact of Startups over Time 12
   - 2.3 Comparison of BITS Startups with D&B Startups 15
3. Methodology 16
   - 3.1 Methodology 16
   - 3.2 Period of Analysis 17
   - 3.3 Research Questions 18
4. Results 20
   - 4.1 How Do High-Impact Firms Compare with All Other Firms? 22
     - 4.1.1 Age 22
     - 4.1.2 Employment Size of Firm 24
     - 4.1.3 Efficiency 29
   - 4.2 Where Are High-Impact Firms Found? 30
     - 4.2.1 High-Impact Firms by Industry 30
     - 4.2.2 High-Impact Firms by Geography 33
     - 4.2.3 High-Impact Firms' Proximity to the Central Business District 35
   - 4.3 What Are High-Impact Firms Like In Their Pre-Growth Phase? 37
   - 4.4 What Happens To High-Impact Firms after Their Growth Period? 40
5. Do "Decliners" Cancel Out the Contribution of High-Impact Firms? 43
6. Conclusion 43
7. References 45
8. Appendixes 49
   - Appendix A. Dun and Bradstreet Birth Rates by MSA, 1998-2001 49
   - Appendix B. High-Impact Firm Distribution by Large MSAs 56
   - Appendix C. High-Impact Firm Distribution by Medium-Size MSAs 58
   - Appendix D. High-Impact Firm Distribution by Small MSAs 59
   - Appendix E. High-Impact Firm Distribution by Large Counties 63
   - Appendix F. High-Impact Firm Distribution by Medium-Size Counties 65
   - Appendix G. High-Impact Firm Distribution by Small Counties 67
   - Appendix H: Data Overview 82

FIGURES AND TABLES

Figure 1: Distribution of Employment Effects—All Startups 12
Figure 2: Distribution of Employment Effects—Startups With Fewer Than 20 Employees 13
Figure 3: Distribution of Employment Effects—Startups With 20-499 Employees 14
Figure 4: Distribution of Employment Effects—Startups With At Least 500 Employees 15

Table 1. Gazelles and High-Impact Firms, by Select Variables 21
Table 2. Ratio of High-Impact Firms to Low-Impact Firms, 1994-2006 22
Table 3a. Distribution of High-Impact Firms by Age Range and Firm Size 23
Table 3b. Distribution of Low-Impact Firms by Age Range and Firm Size 23
Table 4a. Percent of High-Impact Firms by Employment Size of Firm, 1994-1998..... 25
Table 4b. Percent of High-Impact Firms by Employment Size of Firm, 1998-2002 25
Table 4c. Percent of High-Impact Firms by Employment Size of Firm, 2002-2006..... 26
Table 4d. Percent of Low-Impact firms by Employment Size of Firm, 1994-1998..... 26
Table 4e. Percent of Low-impact firms by Employment Size of Firm, 1998-2002 27
Table 4f. Percent of Low-Impact Firms by Employment Size of Firm, 2002-2006..... 27
Table 5a. High-Impact Firm Efficiency, by Industry and Employment Size 29
Table 5b. Low-Impact Firm Efficiency, by Industry and Employment Size..... 30
Table 6. Share of High-Impact Firms by Industry 31
Table 7. High-Impact Firm Distribution by Region, 2002-2006 33
Table 8. Distribution of High-Impact Firms by State 34
Table 9a. High-Impact Firm Distribution by Proximity to the Central Business District 36
Table 9b. Low-Impact Firm Distribution by Proximity to the Central Business District 36
Table 10a. High-Impact Firm Status and Volatility In the Preceding Four Years (1994-1998)..... 39
Table 10b. Low-Impact Firm Status and Volatility in the Preceding Four Years (1994-1998)..... 39
Table 11a. High-Impact Firm Status and Volatility after the Study Period (2002-2006). 42
Table 11b. Low-Impact Firm Status and Volatility after the Study Period (2002-2006) . 42
Table 12. Dramatically Declining Firms 43

EXECUTIVE SUMMARY

The purpose of this study is to revisit some of the conclusions of the early work on rapidly growing firms. Some of the most controversial findings of David Birch's original studies were that both small firms and very young firms were responsible for the vast majority of job replacements. In fact, we find support for Birch's gazelle findings with respect to firm size but not firm age.

We examine both the employment and sales effects to classify enterprises as high-impact firms. For the purposes of this study we define high-impact firms as enterprises whose sales have at least doubled over a four-year period and which have an employment growth quantifier of two or more over the period.[1] We analyze these firms over three four-year periods from 1994 to 2006, and we compare three firm-size categories to determine exactly where these firms make their greatest impact on the economy. The primary study period is 1998-2002. In addition, by examining the four years before and after this period, we are able to investigate the birth of high-impact firms (how they are characterized before entering their growth period) and their follow-on period (what happens to them after their high-growth stage).

Here are some of the basic conclusions about high-impact firms.

Essential characteristics:

- From 2002 to 2006 there were 376,605 high-impact firms in the United States. This number increased from a level of 299,973 between 1998 and 2002 and was greater than the 352,114 firms found during the 1994-1998 period of analysis.

- The average high-impact firm is *not* a new startup.

- The average age of a high-impact firm is around 25 years old. These firms exist for a long time before they make a significant impact on the economy.

[1] The employment growth quantifier equals the product of a firm's absolute change and percent change in employment.

- High-impact firms come in all sizes. Over the 1998-2002 time period, the average size of high-impact firms in the 1-19 employee firm-size class was 3 employees increasing to 16, for the 20-499 firm-size class it was 65 increasing to 209, and for the 500-or-more class it was 3,648 increasing to 8,041.

Impact on jobs and revenues:

- High-impact firms account for almost *all* employment and revenue growth in the economy.

- Job creation by high-impact firms over the 12-year period was 58 percent in small firms. Small firms (fewer than 500 employees) created about half the jobs and large firms (500-plus employees) created the other half during the first two periods (1994-1998 and 1998-2002) but not in the third one (2002-2006).

- Low-impact firms do *not* grow on average.

- Nearly all the job losses in the economy over any of the three four-year periods studied are attributable to low-impact firms with more than 500 employees.

Where high-impact firms are found.

- High-impact firms exist in *all* industries. While some industries are characterized by a higher percentage of such firms, high-impact firms are by no means all in high-technology industries.

- High-impact firms exist in almost *all* regions, states, MSAs, and counties. The share of high-impact firms in most jurisdictions varies from 2 percent to 3 percent of all firms.

Early characteristics of high-impact firms:

- Fewer than 3 percent of the smallest high-impact firms came into being in the previous four-year period. As firm size increases, however, that rate doubles to over 6 percent.

- As many as 25 percent of the high-impact firms in the 500-plus firm-size class were also high-impact in the previous four-year period. In other words, some enterprises double their sales and revenue more than once and expand employment over eight years or more. This trend accelerates in the 500-plus firm-size class. These so-called "super-high-impact" companies account for a small percentage of firms, but they are still in the thousands.

Later-stage characteristics of high-impact firms:

- In the four years after a high-impact firm is classified as such, only about 3 percent die; most continue and exhibit at least some growth.

- Super high-impact firms are more numerous among large firms (500-plus employees). The percentage of large high-impact firms that remain in the high-growth category for more than one period is almost double the rate for smaller firms.

While our measures are not strictly comparable, the findings offer support for Birch's observation that gazelles (high-impact firms) account for almost all the job creation in the economy. On average, high-impact firms are smaller and younger than other firms. However, they are not new firms and they are found in all firm-size classes, not just the 1-19 employee firm-size class. Moreover, the trend accelerates as firms become larger, lending support to Davis and Haltiwanger's (1996a and 1996b) contention that large firms grow faster than small firms. What is unclear is whether better data or a different macroeconomic environment drives these results. While the original period Birch studied (1969-1976) was dominated by large firms, we view the 1994-2006 timespan as more entrepreneurial (as manufacturing employment has declined in the intervening years).

How Does New Business Formation Affect Regional Development? Introduction to the Special Issue[1]

Michael Fritsch

Friedrich Schiller University Jena, German Institute for Economic Research (DIW) Berlin and Max Planck Institute of Economics, Jena, Germany

April 2007

This paper gives an overview of the empirical research on the effects of new business formation on regional development and introduces the contributions to this special issue. The effects of new businesses on regional development emerge over a longer time-period of up to ten years. A main focus of the contributions to this special issue is on the distribution of these effects over time and on the magnitude of the overall effect. While the basic pattern found for the different countries and regions is quite similar, the magnitude of the overall effect can be quite different and may even be negative. There are strong indications, that the type of entrants plays an important role in this respect.

JEL-classification: M13, O1, O18, R11

Keywords: Entrepreneurship, new business formation, regional development, international comparison

Address for correspondence:

Prof. Dr. Michael Fritsch
Friedrich-Schiller-University Jena
Faculty of Economics and
Business Administration
Chair of Business Dynamics, Innovation and Economic Change
Carl-Zeiss-Str. 3, D-07743 Jena, Germany
Phone: ++49 / 3641 / 94 32 20
Fax: ++49 / 3641 / 94 32 32
m.fritsch@uni-jena.de

[1] I am indebted to Florian Noseleit, Alexandra Schroeter and Roy Thurik for their helpful comments and suggestions on earlier versions of this contribution.

1. Aims and scope

It seems rather plausible to expect that new business formation stimulates growth. As a consequence, many politicians as well as scholars believe that stimulating new business formation is a promising way for achieving economic growth. This belief is also a main motivation of most of the research in this field. The empirical evidence concerning the effects of new business formation on economic development is, however, far from being entirely clear. Until recently, only very few empirical studies could provide persuasive evidence of a positive statistical relationship between new business formation and growth while many other studies could not find such an effect (see the overview by Carree and Thurik, 2003). We still do not have sufficient knowledge about the ways in which new business formation shapes economic development and what time period it takes until the effects become visible in empirical data.

The contributions to this special issue all provide evidence on the effect of new business formation on economic development in the short, medium and long run. They are based on a workshop that took place at the Max Planck Institute of Economics in Jena, Germany in July 2005. This introductory chapter discusses the state of research on the effects of new business formation on development. What are the relevant hypotheses? What empirical evidence do we have? What are the main research questions? Section 2 will first provide a conceptual framework for investigating the effects of new business formation on growth. Section 3 gives an overview of the different approaches to assess the impact of new businesses on development and reviews the available empirical evidence. An overview of the main results of the contributions collected in this special issue follows in section 4. Section 5 provides conclusions for policy as well as for further research.

2. Possible effects of new firm formation on economic development

2.1 Review of the effects

The main starting point of the discussion and empirical research on the effects of new business formation on economic development was a study conducted by David Birch (1979) titled "The Job Generation Process," which circulated as a mimeographed research report (see also Birch, 1981, 1987). Birch asserted that small and, particularly, new businesses are the main job generator in the US-economy. This study found a tremendous echo in the political as well as in the academic sphere. Responses ranged from enthusiastic praise for a new solution to employment problems to pronounced skepticism (see for example Storey, 1994, for a review on initial reactions to the Birch study). Most importantly, however, it stimulated numerous follow-up analyses for the USA and for many other countries. One main innovation of the Birch study was that it analyzed longitudinal micro-level data that covered nearly the entire US economy. Unfortunately, reliable information on new business formation and longitudinal micro-level data, which would have allowed the employment of firms and establishments[2] to be tracked over the years, was hardly available at the time when this discussion began.[3] Therefore, considerable efforts had to be directed in order to make the existing data sources accessible for research and for the creation of new ones. Also in this respect, the Birch study had an enormous impact.

For understanding and judging the results of the diverse analyses that have been carried out since the beginning of the debate, a systematic review of the different types of effects of new business formation on economic development is helpful. New firms represent an

[2] A start-up can be a new firm or a new establishment of a multi-plant enterprise. The term "new business" is used here as an overall category that encompasses the set up of a new headquarters as well as the creation of a new subsidiary establishment.

[3] Birch (1979) used micro-data from the Dun & Breadstreet credit rating agency for the USA in the 1969 - 1976 period.

entry of new capacities into the market and are, therefore, an essential element of the market process. The evolution of the newcomers, e.g., given by the number of their employees or by their market share, may be labeled as the *direct effect* of new capacities. This is, however, only a part of the contribution that the new businesses make to economic development. Due to competition and market selection, only a fraction of the start-ups will survive for a longer period of time (Boeri and Cramer, 1992; Fritsch and Weyh, 2006), and those which do succeed in establishing themselves in the market may displace incumbents. Therefore, two types of *exiting capacities* may result from the entry of new businesses. Firstly, a considerable part of the new businesses fail to be sufficiently competitive and, thus, have to leave the market after some time. And secondly, the crowding-out of incumbents by their new competitors leads to declining market shares or market exit. These effects are rather indirect in nature. Given that market selection works according to a survival of the fittest scenario, firms with relatively high productivity will remain in the market while those with a low productivity have to reduce their output or exit.[4] At a constant output level, this market selection process should lead to a decline in employment, not to new jobs, because fewer resources are needed in order to produce the given amount of goods and services at a higher productivity level. Hence, although starting a new business means creating additional capacities that require personnel to operate them, the effect of new business formation on the number of jobs in the economy does not necessarily need to be positive but could just as well be negative.

[4] Crowding-out effects may occur in the output market because the entrants gain market share as well as in the input market due to the additional demand of the new businesses for resources can that lead to scarcity of inputs and increasing factor prices.

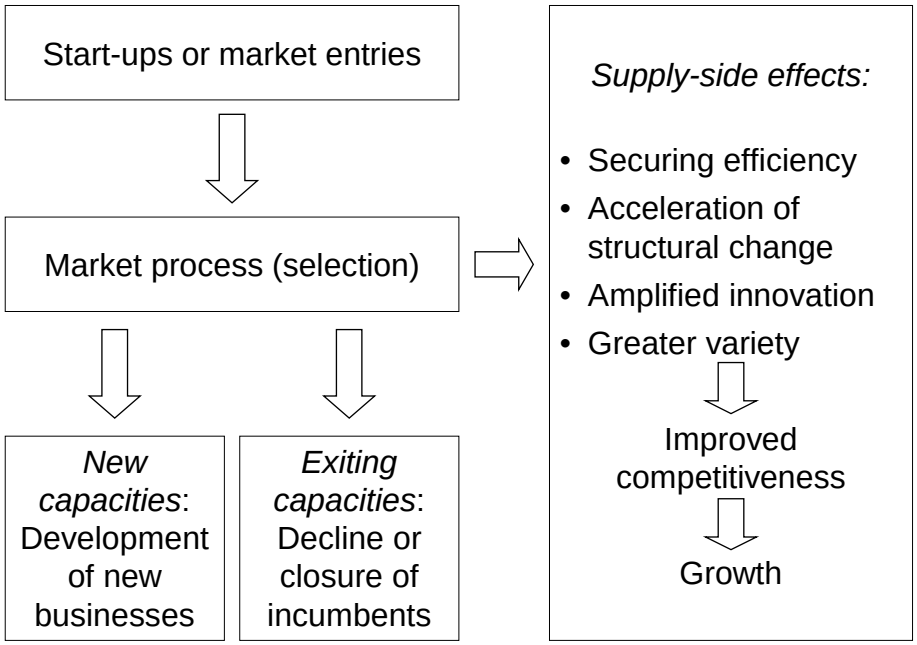


Figure 1: New business formation and the market process

However, a well-functioning market process is in no way a zero-sum game in which the gains of one actor are necessarily completely at the expense of the other actors. There are several ways in which competition by entry of new businesses can stimulate employment growth on the supply-side of the market. The main supply-side effects of entry could be (cf. figure 1):

- *Securing efficiency and stimulating productivity increase* by contesting established market positions. Not only the actual entry but also the very possibility of an entry forces the incumbents to perform more efficiently (Baumol, Panzar and Willig, 1988).

- *Acceleration of structural change*: It can frequently be observed that structural change is mainly accomplished by a turnover of the respective economic units, i.e., by entries of new firms joined by exits of old-established incumbents. In this case, the incumbents do not undergo necessary internal changes, but rather are substituted

by newcomers.[5] This type of process has been emphasized by J.A. Schumpeter's (1911/1934; 1942) concept of „creative destruction" and by Alfred Marshall's (1920) analogy of a forest in which the old trees must fall in order to make way to the new ones.

- *Amplified innovation*, particularly the creation of new markets. There are many examples of radical innovations that have been introduced by new firms (Acs and Audretsch, 1990; Audretsch, 1995; Baumol, 2004). One major reason for this pronounced role of new firms in introducing radical innovation could be that incumbent suppliers are more interested in exploiting the profit possibilities of their given product program versus searching for new opportunities, particularly if the new products may contest their established ones (Geroski, 1995, 431; Klepper and Sleeper, 2005). Due to such reluctance that this sort of incumbent firms have towards new ideas, to set up one's own business may appear to be the only or the most promising possibility for inventors to commercialize their knowledge (Audretsch, 1995; Klepper and Sleeper, 2005).

- *Greater variety* of products and problem solutions. If the product program of a newcomer differs from those of the incumbents, or if an entrant introduces significant process innovation, this leads to a greater availability of goods and problem solving methods. Such an increased variety implies a higher probability of finding a supply with a better match for customer preferences. Increased variety due to new supplies may stimulate an intensified division of labor as well as follow-up innovation and can, therefore, generate significant impulses for economic development.

[5] Such a process could, for example, be observed in the transformation of former socialist economies of Central and Eastern Europe, where new firms – the bottom-up component – had a considerably stronger impact on structural change, cf. Brezinski and Fritsch (1996) and the contributions in Pfirrmann and Walter (2002).

These effects are rather indirect in character and lead to improvements on the supply-side of the market. They are not necessarily limited to the industry to which the start-up belongs, but rather may also occur in completely different industries that use the improved supply as an input. They also do not have to be limited to the region in which the entry occurs but can also emerge in other regions (see section 2.2). The *indirect supply-side effects* are the drivers of competitiveness of the respective industries that may induce employment growth and increasing welfare. They are the reason why one should expect positive employment effects of new business formation.

It is important to note that the emergence of the supply-side effects of new business formation does not necessarily require the newcomers to be successful and to survive. As long as entry induces improvements on the side of the incumbents, it will generate positive supply-side effects, even if most of the new businesses fail and have to exit the market soon after entry. Therefore, even the failed start-ups may make a significant contribution to the improvement of supply and competitiveness.[6] Failure of new businesses may, however, not be completely irrelevant because a high probability of failure could discourage potential market entry.

This review of the different impacts of new business formation on market processes makes very clear that the evolution of the new businesses represents only a portion of their total effect on development. The most important influence that the start-ups have on growth and employment occurs rather indirectly on the supply-side. As far as the market process is working according to a survival of the fittest scenario, the direct employment effects, i.e., the growth of new businesses, as well as the displacement of incumbents, should sum up

[6] Thus, even in a “revolving door” regime in which the vast majority of the entries soon have to exit the market (Audretsch, 1995), the start-ups may have an important effect to the extent that they are a challenge for the incumbents.

to a decline in employment. Under a properly functioning market regime, growth from new business formation can only be expected from improvements on the supply-side. If, however, the process of market selection does not work as it should and allows the survival of relatively unproductive competitors, this would then weaken the competitiveness of the economy and, thus, cause the supply-side effects to become negative.

It is plausible to assume that the challenge that a new business poses upon its competitors on the output market critically depends on its quality. Quality can mean multiple issues here such as the entrepreneurial skills of the founder(s), the knowledge base and other resources of the new business as well as its innovativeness. Therefore, the innovative entry of businesses that are led by well-prepared entrepreneurs, who have the necessary knowledge and other resources available, can be expected to have a stronger effect and, particularly, lead to larger supply-side improvements than non-innovative new businesses, which are run by persons without appropriate skills and are not successful at sufficiently accessing the relevant factors of production. It could also be expected that the supply-side effects will be relatively large in markets which are characterized by a high intensity of competition because of greater pressure for improvements. Moreover, supply-side effects may be larger in global product markets as compared to local services due to greater numbers of direct competitors that are affected by the challenges of an entrant.

2.2 Regional effects

Thus far, the effects of new business formation have been discussed with the implicit assumption that the geographical unit of observation encompasses the entire input and output market, which is relevant for the start-ups. If the effects in a certain region are analyzed and if this region covers only a part of the relevant markets, considerable differences can be found in the effects between the regions for a number of reasons:

- First, start-ups in different regions can be of dissimilar quality and, therefore, more or less successful with regard to survival and employment growth; thus, the direct employment effects can vary considerably.
- Second, the crowding-out effect of a successful entry may not occur in the same region in which a start-up takes place but in other regions.
- Third, the supply-side effects can also occur in other regions, resulting from the competitors located in these regions which introduce improvements in their supply.

This suggests a number of hypotheses concerning regional differences, such as the following:

- Regions with a large share of high quality start-ups may experience stronger direct employment effects than regions in which only very few of the new businesses are of such a high quality.
- Success of start-ups and direct employment effects should also be higher in regions where relevant resources are abundant and competition for these resources is not very intense. Because the incumbents also benefit from such a favorable environment, displacement effects should be relatively low and supply-side effects may be relatively pronounced.
- Regions in which most of the businesses are characterized by a relatively low productivity level can be expected to experience a much more pronounced decline in employment due to displacement effects, in comparison to regions where a high share of the suppliers is in the high productivity range. Also, the supply-side effects in low productivity regions should be smaller if those challenged incumbents, which are located in other regions, operate in the high-productivity range.
- The magnitude of the supply-side effects in a region may depend on the innovativeness of the regional suppliers as well as on the quality

of the regional innovation system in which they are embedded. Among the factors that can be expected to shape the efficiency of the regional innovation system are the qualification of the regional workforce, the presence of academic research institutions, the innovativeness of other firms in the region as well as the availability of innovation related business services (Fritsch and Slavtchev, 2007).

- The magnitude of the effects may, particularly, depend on the size of the respective industry in the region. If, for example, a successful start-up is the only supplier of the industry located in the region, output-induced crowding-out effects will not occur and supply-side effects may be relatively small.

Obviously, the effects of new business formation cannot be expected to be identical in all regions, but rather there should be considerable differences. The employment effects of new business formation will probably be rather positive in high productivity regions with high-quality entries, abundant resources and a well-functioning innovation system. They will be much smaller or may even be negative in low productivity regions with low-quality entries, scarcity of relevant resources and an inefficient innovation system.

3. Review of the empirical evidence

3.1 Different approaches to analyze the effect of new business formation on economic development empirically

The discussion about the effects of new business formation on economic development has focused on employment creation for a long time. One reason for this concentration on employment is probably the particular concern of policy for job generation and for the prevention of unemployment. Another reason may be the greater availability of information on employment as compared to other performance

indicators, especially at the micro-level of firms[7] as well as for regions and industries. Many of these studies followed the approach taken by Birch (1979) and analyzed employment development of cohorts of businesses, particularly of newly founded businesses. Although this type of analysis may be well suited to detect the direct employment effects of start-ups, it is not possible to examine any indirect effects with such an approach. Because new businesses by definition create new jobs, this direct employment effect cannot be negative. In order to also account for the indirect effects of new business formation on development, the relationship between new business formation activity and some aggregate performance measure such as the change of employment, the change of gross domestic product or the change of productivity in the respective country, region or industry, has to be analyzed.

For a meaningful comparison of regions or industries of different size or different economic potential, the number of start-ups has to be related to a measure of this economic potential, i.e., a start-up rate should be used. Most commonly, the number of employees is chosen as the denominator of the start-up rates what Audretsch and Fritsch (1994) labeled the 'labor market' approach. This kind of start-up rate is based on the notion that each member of the workforce is faced with the decision to work as a dependent employee in someone else's business or to start his or her own firm. The entry rate according to the labor market approach may be regarded as the propensity of a member of the regional workforce to start an own business.[8]

---

[7] Another output measure for which information is frequently available at the micro-level of firms is turnover. Compared to employment, turnover as an output-indicator has at least two disadvantages. First, if firms have different shares of value added, the development of turnovers may not adequately reflect the development of their level of economic activity. Second, information on turnovers is hardly available on an establishment level for those economic units that belong to a multi-establishment firm. In these cases, turnovers cannot be correctly assigned to regions of the establishments.

[8] Because start-ups are usually located close to the residence of the founder(s) (Gudgin, 1978; Mueller and Morgan, 1962; Cooper and Dunkelberg, 1987), the

To analyze the relationship between start-up rates and the development of employment or turnover at the level of industries leads to serious difficulties in the interpretation of the results. If industries follow a life-cycle, then the number of entries and the start-up rate will be relatively high in the early stages of the life-cycle when the industry is growing, and it will be relatively low in latter stages in which the industry declines (Klepper, 1996). Can the resulting positive correlation between the start-up rate and development of the industry in subsequent periods be regarded as an *effect* of entry on growth? Probably not – and, indeed, entirely different results are found if, for example, the relationship between the level of start-ups and subsequent employment change is analyzed on the level of regions and on the level of industries (see Fritsch, 1996). This clearly demonstrates that geographical units of observation are much better suited for such an analysis than industries.

Nearly all of the available empirical studies that have analyzed the impact of new business formation on the development of regions or countries use correlations or regressions for assessing the relationship between an indicator of the level of new business formation activity (e.g., a start-up rate) and a measure of economic development that is based on employment or on GDP (e.g., Reynolds, 1994, 1999; Audretsch and Fritsch, 1996, 2002; Fritsch, 1996, 1997; Acs and Armington, 2003; van Stel and Storey, 2004; Fritsch and Mueller, 2004).[9] Some studies have included an indicator for entrepreneurship into a production function that contains information on the contribution of other inputs to growth (Audretsch and Keilbach, 2004; Audretsch, Keilbach and Lehmann, 2006; Wong, Ho and Autio, 2005). In this type of approach, entrepreneurship is regarded as a production factor that

---

regional workforce can be regarded as an appropriate measure of the number of potential entrepreneurs.

[9] Bosma, Stam and Schutjens (2006) analyzed the effect of a turbulence rate (number of entries plus number of exits divided by the number of existing businesses) on the change of total factor productivity of regions.

introduces resources such as initiative, opportunity recognition as well as the willingness and the ability to take risk into the model.

The advantage of analyzing the contribution of entrepreneurship within the framework of a production function is that this approach is more comprehensive than the regression of start-up rates on development because it systematically accounts for other determinants of growth, and it has a foundation in production theory. However, entrepreneurs do not accomplish success and growth by spirit and initiative alone, but rather they must hire labor and make capital investments. Hence, in a production function framework that includes the inputs of labor and capital parts of this impact of entrepreneurship on development may be attributed to labor and capital and not to the entrepreneur who made the respective decisions. Therefore, the effect of entrepreneurship may well be underestimated in this sort of analysis. However, those empirical studies, which more or less solely relate the start-up rate to growth, are in danger of overestimating the effect of entrepreneurship due to the neglect of other factors. A severe bottleneck of applying the production function approach is that it is rather demanding with regard to necessary data. Particularly, data on the capital stock must generally be regarded as figures of questionable reliability and are, in many countries, hardly available on a regional basis.

3.2 Empirical evidence on the effects of new business formation on economic development

The first systematic analysis of the relationship between the level of new business formation and regional employment change has been conducted by Reynolds (1994, 1999) for the USA. Reynolds found a pronounced positive effect. However, conducting the analysis for different time periods revealed considerable variation. A positive relationship between the regional level of start-ups and subsequent growth was confirmed by Ashcroft and Love (1996) for the UK, by Acs and Armington (2003) for the USA, by Brixy (1999) for East Germany as well as by Braunerjhelm and Borgman (2004) for Sweden. But a

number of other studies could not identify such a positive relationship between the level of start-ups and regional employment growth (Audretsch and Fritsch, 1996; Fritsch, 1996, 1997; EIM, 1994). In an international cross-section analysis for 36 countries participating in the GEM project, van Stel, Carree and Thurik (2005) found some confirmation for a positive effect of "total entrepreneurial activity" (TEA)[10] on GDP growth in highly developed countries but not for the poorer countries of the sample. Audretsch and Keilbach (2004) included the start-up rate into a Cobb-Douglas production function and identified a positive effect on the level of GDP as well as on labor productivity in West German regions. In a study based on GEM data for 37 countries Wong, Ho and Autio (2005) divided the indicator of total entrepreneurial activity into several groups. A significantly positive impact on GDP growth was only found for "high growth potential" TEA[11] but not for overall TEA, necessity TEA and opportunity TEA.[12]

One reason for the partly mixed results of the studies analyzing the impact of new business formation on employment change could be that the entry and turnover of establishments (firms) may lead to a productivity increase (see Baldwin, 1995; Disney, Haskel and Heden, 2003; Foster, Haltiwanger and Krizan, 2001; OECD, 2003), which compensates for the employment effect. Another reason may be that not all of the effects of new business formation on employment emerge immediately at the time when the newcomers enter the market. Due to data restrictions, the analyses mentioned above did not include any or

[10] Total entrepreneurial activity is the percentage of the adult population between 18-64 years old that is either actively involved in starting a new venture or is the owner/manger of a business that is less than 42 months old (Reynolds et al., 2005).

[11] A venture was classified as having a "high growth potential" if it fulfilled our criteria: "(1) the venture plans to employ at least 20 employees in 5 years; (2) the venture indicates at least some market creation impact; (3) at least 15% of the customers of the venture normally live abroad; and (4) the technologies employed by the venture had not been widely available more than a year ago" (Wong, Ho and Autio, 2005, 345).

[12] Necessity entrepreneurship is understood as a start-up that occurs because of missing alternatives (e.g., out of unemployment). A new business that is set up to pursue an opportunity is classified as an "opportunity" entrepreneurship. See Reynolds et al., (2005) for details.

only rather short time-lags between the occurrence of the start-ups and the respective effect on output and may, therefore, have assessed the effects on regional development only rather incompletely. In an analysis for West German regions, Audretsch and Fritsch (2002) did, indeed, find evidence for positive long-term effects of new business formation. In this study, new business formation activity in the early 1980s could not explain regional employment change in the rest of the decade but provided an explanation of employment change in the 1990s.

Van Stel and Storey (2004) analyzed the relevance of such time-lags more systematically and estimated a time-lag structure of the effects of new business formation on regional employment growth with data for Great Britain. They confirmed that there are considerable time-lags between new business formation and its effect on regional development, which they found to be positive. According to their results, the magnitude of the effects over time takes the form of an inverse 'u' with a peak for the start-up activity that occurred five years earlier. The impact then becomes weaker and no effect of new business formation on regional employment could be identified for start-ups rates with a time-lag of more than ten years. A severe problem in such an analysis of the lag-structure emerges from a high correlation between yearly start-up rates. Due to such high correlation the original estimates may not reflect the 'true' lag structure. In dealing with this problem, van Stel and Storey (2004) applied the Almon polynomial lag procedure. This procedure attempts to approximate the lag structure by a polynomial function (see Greene, 2003, for a detailed description of this method). In this type of analysis, an assumption has to be made about the order of the polynomial to be used for estimating the lag structure.

3.4 The 'wave' pattern

Fritsch and Mueller (2004) applied the Almon polynomial lag procedure in an analysis of the effect of new business formation on regional development in West Germany. They also found that a statistically significant effect of new business formation on employment is restricted

to a period of about ten years. While van Stel and Storey (2004) had assumed a second-order polynomial for estimating the lag structure of new business formation rates, Fritsch and Mueller (2004) also applied higher order polynomials. With a third and higher order polynomial, they found a 'wave' pattern of the effects as shown in figure 2. This figure depicts the original regression coefficients that have been found without application of the Almon lag procedure as well as the coefficients that result from this procedure by assuming a third-order polynomial. The resulting smoothened lag structure suggests that new business formation during the current year has a positive impact on employment change. For years t-1 to t-5, the effect is negative with a minimum in t-3. For the entries in years t-6 to t-9, a positive relationship is found with a maximum between years t-7 and t-8. The magnitude of the effect then decreases and becomes slightly negative in the last year of the sample (t-10). The overall effect of new business formation on employment change can be measured by the sum of the regression coefficients for the start-up rates of the different years (Gujarati, 2003, 658), which are depicted by the three areas in figure 2.

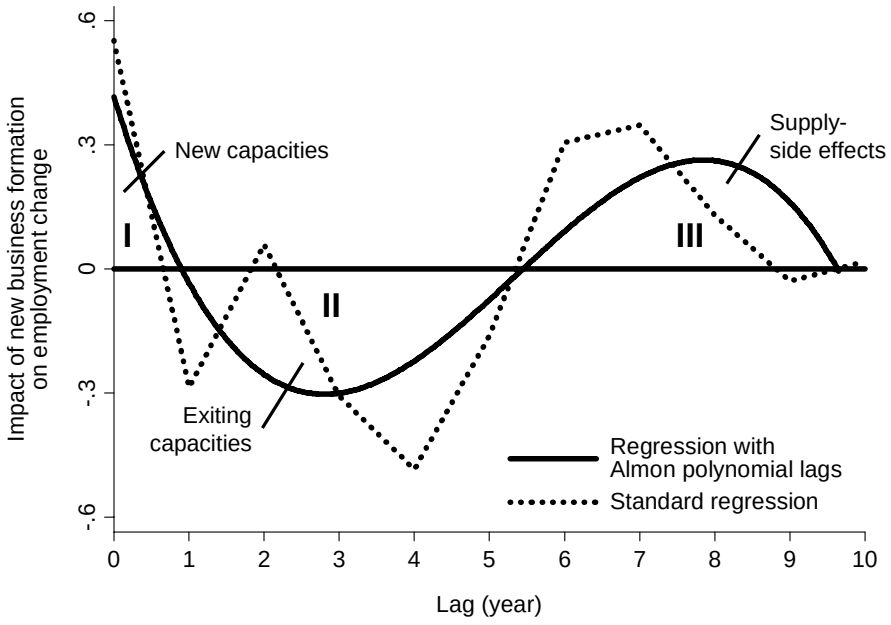


Figure 2: The effects of new business formation on employment change over time in West Germany – regression coefficients

for start-up rates and the results of the Almon lag procedure assuming a third-order polynomial

Fritsch and Mueller (2004) suggest the following interpretation of this wave-pattern that builds on the systematization of effects, which has been presented in section 2. According to this interpretation, the positive employment impact for start-ups in the current year can be understood as the additional jobs that are created in the newly founded businesses at the time of inception. This direct employment effect is indicated in area I in figure 2. It is well known from a number of analyses that employment in entry cohorts tends to be stagnant or decline from the second or the third year onward (Boeri and Cramer, 1992; Brixy and Grotz, 2004; Fritsch and Weyh, 2006). Therefore, new firm formation activity in year t-3 and more distant time periods should not lead to any significant direct employment effect. As soon as a new business is set up, it is subject to market selection and will, perhaps, gain market shares from incumbent suppliers. Thus, the negative impact of the start-ups in years t-1 to t-5 (area II in figure 2) are probably a result of exiting capacities, i.e., new businesses that fail to be competitive and from the displacement of incumbents. The positive impact of new business formation for years t-6 to t-10 on employment (area III in figure 2) is probably due to a dominance of indirect supply-side effects, i.e., increased competitiveness of the regional suppliers resulting from market selection. After about nine or ten years, the impact of new business formation on regional employment has then faded away.

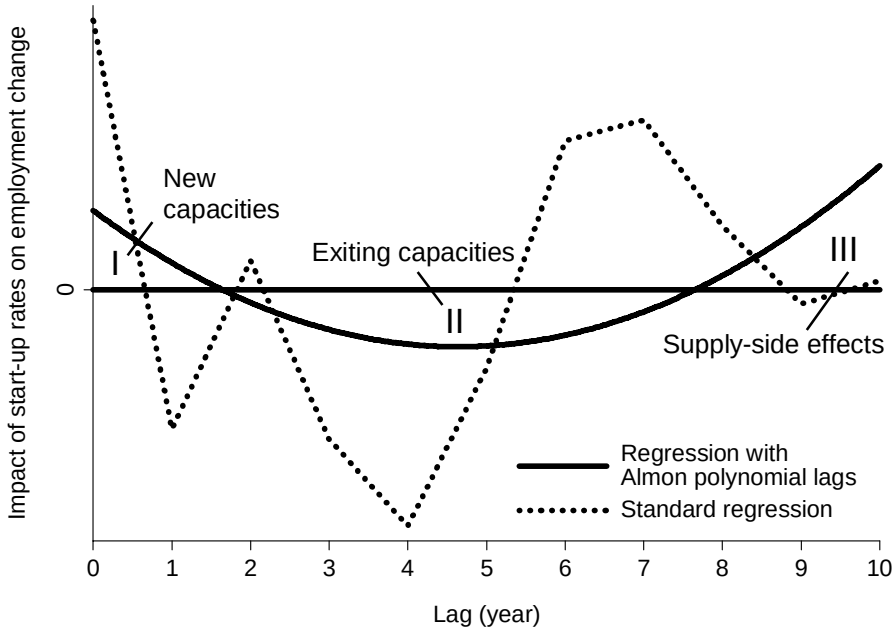


Figure 3: The effects of new firm formation on employment change over time in West Germany – regression coefficients for start-up rates and the results of the Almon lag procedure assuming a second-order polynomial

When assuming a second-order polynomial for the Almon lag procedure, the resulting lag structure found by Fritsch and Mueller (2004) is 'u'-shaped (figure 3), not inversely 'u'-shaped as was found in the analysis by van Stel and Storey (2004) for Great Britain. The interpretation of the 'u'-shaped lag structure is quite similar to that for the wave pattern, which resulted from assuming a higher order polynomial. According to Frisch and Mueller (2004), the initial increase of employment can be regarded as the direct employment effect of new business formation (area I in figure 3). It is followed by a period in which the crowding-out effects prevail (area II), before the employment increasing supply-side effects finally start to dominate (area III). What is different between the two patterns is that these supply-side effects then become stronger and stronger without decreasing again in the more distant years. Such an increase is, however, highly implausible given the statistical insignificance of start-up rates during these periods. The increase in the curve for the latter periods is probably caused by the

very nature of a second-order polynomial, which by definition possesses only one inflection point.

If the interpretation of the lag structure proposed by Fritsch and Mueller (2004) is correct, both patterns imply that the indirect employment effects as indicated in area I and II are more important than the direct effect, i.e., the initial employment created in the newly founded businesses (area I). This becomes particularly clear if the supply-side effects (area III) are compared to the net effect of new and exiting capacities, which is indicated in area I minus area II in figure 2 and 3. Moreover, since the analysis covers the direct effects completely but does not account for crowding-out effects as well as supply-side effects that occur in other regions, the relative importance of the indirect effects can be assumed to be even considerably higher.

4. Overview of contributions in this issue

The contributions to this special issue are all based on the workshop "The Effects of New Businesses on Economic Development in the Short, Medium and Long Run" that took place on July 11th and12th, 2005 at the Max Planck Institute of Economics in Jena, Germany. The aim of this workshop was to compare the empirical findings for different countries, particularly with regard to the wave-pattern that has been described in section 3.4. Analyses have been conducted for Germany, Great Britain, the Netherlands, Portugal, Spain and the USA as well as for a sample of 21 OECD countries. Table 1 provides an overview of the data used and the main results of these studies.[13]

[13] Most of the studies use a sector-adjusted start-up rate in order to control for the effect that the composition of industries has on the number of start-ups. This would result in a bias of overestimating the level of entrepreneurship in regions with a high composition of industries where start-ups play an important role, and underestimating the role of new firm formation in regions with a high composition of industries where new-firm start-ups are relatively unimportant. To correct for the confounding effect of the regional composition of industries on the number of start-ups, a shift-share procedure is employed to obtain a sector-adjusted measure of start-up activity (see the Appendix of Audretsch and Fritsch, 2002, for details).

Summarizing the main findings, one can say that there is rather strong supporting evidence for the wave pattern as identified by Fritsch and Mueller (2004) on the basis of data for West Germany. There are, however, some exceptions. The main exception in this respect is the study for Portugal (Baptista, Escária and Madrugo), which finds a 'u'-shaped pattern of the lag structure. Van Stel and Suddle in their analysis for the Netherlands identify an inverse 'u'-shaped pattern if the employment effects of the first two years are excluded. However, including these first two years resulted in the familiar s-shaped curve. Acs and Mueller in their study for US Metropolitan Statistical Areas (MSAs) identify a number of different lag structures when restricting the analysis to particular types of entry. However, when all entries are placed together, the curve is 's'-shaped.

Carree and Thurik in their contribution analyzed the effect of changes of the number of business owners, which indicates net-entry on growth in 21 OECD countries. They found a s-shaped pattern for employment change as well as for GDP change and for change of labor productivity as a dependent variable. However, the effects on GDP and labor productivity change are only statistically significant in the initial phase when the businesses are set up. The significantly positive effect of net-entry on labor productivity is rather remarkable given the results of many empirical analyses, which showed that new businesses tend to enter with a below average productivity level, and it often takes a period of about 8-10 years until they attain that average level (Baldwin, 1995; Bartelsman and Doms, 2000; Carree and Thurik, 1999; Farinas and Ruano, 2005; Verhoeven, 2004). If an excess of the number of entries over the number of exits does not result in a productivity decline of the economy, this indicates that – given the below-average productivity of the start-ups in the first years – entry stimulates improvements in the incumbent firms!

Obviously, there are important differences according to the type of entry and the characteristics of the region. The study for US-MSAs by

Acs and Mueller identified a s-shaped lag structure according to the wave-hypothesis if all start-ups were included in the analysis. For start-ups of large firms with 500 or more employments (‘elephants’), most of them probably branch plants, the curve for the lag structure was ‘u’-shaped. For start-ups of small firms with less than 20 employees (‘mice’), presumably most of them single-establishment companies, the impact is always positive but with monotonously decreasing strength. Van Stel and Suddle investigated the effect of start-ups of different industrial sectors on overall employment change. They found that the effect of new businesses affiliated to the manufacturing sector is more than three times higher than that of start-ups in construction, transport & communication and in service industries. The lowest impact was found for new businesses in the trade sector.

Some of the studies also identified regional differences that are rather striking. According to Fritsch and Mueller, the effects of start-ups on employment are much more pronounced in the West German agglomerations and in the moderately congested areas than in rural regions. The differences found between West German regions with a relatively high level of labor productivity and low productivity regions are even larger. While the overall effects of start-ups on employment in high-productivity regions are rather positive with the usual s-shaped lag structure, they are negative with a ‘u’-shaped lag structure in the low-productivity areas. This clearly suggests that new business formation may, in certain regions, lead to a decrease and not an increase of employment. Negative overall effects of new business formation on employment are also found by Mueller, van Stel and Storey for Scotland and Wales as well as for those regions of Great Britain, which are characterized by a rather low start-up rate. An overall negative impact was also identified by van Stel and Suddle for the rural regions of the Netherlands. Acs and Mueller compared the effects for MSAs with a

Table 1: The effects of new businesses on economic development in the short, medium and long run – Overview of data and main results of studies

Author(s)	Country	Time period	Definition of start-ups	Sector(s) of start-ups	Sector-adjustment of start-up rate	Dependent Variable(s)	Length of time-lag (years)	Pattern of time-lags found
Acs & Mueller	USA	1989-2003	New establishments[a]	All private sectors[c]	No	Employment change in all private sectors[c]	6	's'-shaped, 'u'-shaped or monotonously declining depending on type of entry and type of region
Arauzo-Carod, Liviano-Solis & Marin-Bofarull	Spain	1978-1996	New establishments	Manufacturing	Yes	Employment change in manufacturing	7	's'-shaped
Baptista, Escária & Madrugo	Portugal	1982-2002	New establishments[a]	All private sectors[c]	Yes	Employment change in all private sectors	10	'u'-shaped
Carree & Thurik	21 OECD countries	1972-2002	Change of number of business owners[b]	All private sectors[c]	No	Change of employment, GDP, labor productivity	14	's'-shaped
Fritsch & Mueller	West Germany	1983-2002	New establishments[a]	All private sectors	Yes	Employment change in all private sectors	10	's'-shaped
Mueller, van Stel & Storey	Great Britain	1980-2003	New establishments[d]	All private sectors[c]	Yes	Employment change in all private sectors[c]	8 / 10	's'-shaped
Van Stel & Suddle	Nether-lands	1988-2002	New firms (headquarters)	Most private sectors[e]	Yes	Employment change[e]	8	's'-shaped or inversely 'u'-shaped

a: excluding start-ups without employees (pure self-employment); b: including pure self-employment; c: excluding NACE groups A (agriculture, hunting and forestry) and B (fishing); d: largely excluding establishments below a certain turnover threshold; e: excluding NACE groups A (agriculture, hunting and forestry), B (fishing), C (mining and quarrying), E (electricity, gas and water supply) and M (education).

relatively high share of rapidly growing companies (‘gazelles’) with the rest of the regions of their sample and found that start-ups in those gazelle regions produced larger employment effects. This can be regarded as an indication that innovative entry has a relatively strong effect on competition and the emergence of supply-side improvements.

6. Issues for further research and policy implications

The empirical analyses reported in this special issue suggest a completely new view on the effects of new business formation on regional development. According to this new view, the most important impact of entry is that it spurs competition and market selection. If this competition works according to a survival of the fittest scenario, an increase of productivity will occur. At a given level of output, this increase in productivity should lead to a decline in employment, not to additional jobs. Employment growth may occur due to improved competitiveness of the regional economy that are induced by supply-side effects such as increased efficiency, more rapid structural change, amplified innovation and increased variety. For the emergence of these supply-side effects, it is unimportant if the improvements occur on the side of the newcomers or in the incumbent businesses. It is also not very important that the newcomers survive and grow. New business formation should be regarded as part of the competitive process in which market selection plays a central role. It is no doubt that new businesses introduce a dynamic element into the economy and can make an important contribution to development – but this contribution occurs rather indirectly and the success and growth of the entries themselves makes only a small part of this overall effect.

This new view on the effects of entry on economic development has important implications for policy as well as for further research. One implication for future research is that analyses of the post-entry performance, which were in the center of the empirical research on the effect of new business formation on economic development, are of

rather limited relevance. Obviously, focusing on the evolution of the new businesses while neglecting the consequences for the incumbents, for innovation activity as well as for the development of output (quality and quantity) is not an appropriate approach for investigating the issue. For a better understanding of the effects of start-ups on development, the new businesses should be regarded as in integral part of the market process. As markets can have rather different characteristics**,** the effects of entry may vary considerably according to these market specificities such as minimum efficient size, the stage of the product life cycle, the technological regime etc. While much research has been conducted on the chances of new businesses' survival and growth in different market environments (e.g., Audretsch, 1995), little is known about the role of market characteristics for the impact of new businesses on the development of the market in terms of productivity, efficiency, adjustment to environmental conditions, innovation and product variety. Because the studies collected in this special issue provide strong indications that it takes up to ten years before the main effects of new business formation on industry performance occur, such an analysis should account for sufficiently long time-lags.

The evidence of pronounced regional differences in the magnitude of the employment effects of new business formation clearly indicates that geography is important and that regional conditions can play a rather significant role. Regions differ not only in regard to their level of new business formation activity but also in regard to their ability to transform the impulses of entry into growth. There are also differences between countries and regions with regard to the length of relevant time-lags and to the shape of the lag structure. Obviously, the regional conditions are rather significant and one may well distinguish different types of regional growth regimes in this respect (Audretsch and Fritsch, 2002; Fritsch, 2004; Fritsch and Mueller, 2006).

There are several factors that may be responsible for differences of the impact of entry on regional development and that deserve further investigation. First, there may be substantial variation in the quality of

the start-ups between regions. It is plausible to assume that innovative entry constitutes a greater challenge for the incumbents and may have a larger impact in the market and the local economy than non-innovative entry.[14] Second, the quality and the impact of the entry may be shaped by the availability of resources such as venture capital, qualified labor, knowledge spillovers as well as a supportive infrastructure in the region. Third, the regional share of the industry in which the entry occurs may be significant. If new businesses induce improvements on the supply-side, a start-up in an industry with a large share of regional employment may have a stronger impact on regional development than a start-up in an industry that has only a small share.[15] Fourth, differences may exist with regard to the importance of local competition and the spatial diffusion of supply-side improvements. If an industry operates on a global scale, supply-side improvements and an increase of competitiveness are more likely to occur in other regions than in a market that is more or less limited to the region (e.g. personal services). Particularly, the negative effects of entry on regional employment that has been found for certain types of regions casts doubts on policy measures which aim to further regional growth by promoting the emergence of new businesses. We need to know much more about the differences between national and regional growth regimes and their influence on the employment effects of new businesses!

The analyses of effects of new business formation on regional development have an important policy implication in regard to the market mechanism as a selection procedure. If the market does not work according to a survival of the fittest scenario, the competitiveness

[14] Falck (2007) found in an empirical analysis on the level of industries in West Germany that short-lived entries, which exit after less than two years, have no significant effect on industry development. A positive effect can, however, be identified for new businesses that remain in the market for a longer period of time. This strongly indicates that the quality of the entries is important for their impact on growth.

[15] However, in the event of pronounced cross-industry spillovers, the size of the share of the respective industry in the region may not be relevant.

enhancing supply-side effects will not occur. If the market selection process does not function sufficiently well, entry will be more or less ineffective or even result in a decrease of welfare. Therefore, the highest priority of any policy towards entry is to secure a smooth and reliable selection of the fittest scenario. Particularly, policy should avoid anything that may distort this selection process. In this context, support of entries is a rather critical issue. If incumbent suppliers lose market shares to entries or even have to exit the market because the newcomers gain subsidies, then the selection process does not work properly, and it will not lead to desirable results (c.f. van Stel and Storey, 2004). Therefore, any policy that supports new firms after they have been set up may be considered as being questionable. Policy directed at stimulating entry may try to fuel the entrepreneurial spirit, provide advice for nascent entrepreneurs, lower administrative hurdles for start-ups etc. – however, it should abstain from any interference with fair competition.[16]

All in all, the contributions to this special issue provide new insights in an important field. Thus, they also provide important directions for further research that will hopefully lead to further progress.

[16] A critical issue, in this respect, is new high-technology firms. In a number of countries, high-tech start-ups obtain massive public support in terms of soft loans, guarantees for private equity or direct subsidies. One may, however, argue that the support of high-technology start-ups is primarily a means for stimulating the conversion of knowledge into innovative products that would not occur otherwise. But such a policy should not neglect the possible distortion of the market selection process.

References

Acs, Zoltan J. and David B. Audretsch, 1990, *Innovation and Small Firms*, Cambridge: Cambridge University Press.

Acs, Zoltan J. and Catherine Armington, 2002, 'The determinants of regional variation in new firm formation', *Regional Studies* **36**, 33-45.

Acs, Zoltan J. and Catherine Armington, 2006, *Entrepreneurship, geography and American economic growth*, Cambridge: Cambridge University Press.

Acs, Zoltan J. and Pamela Mueller, 2007, 'Employment Effects of Business Dynamics: Mice, Gazelles and Elephants', *Small Business Economics* (this issue).

Arauzo-Carod, Josep-Maria, Daniel Liviano-Solis and Mònica Martin-Bofarull, 2007, 'New business formation and employment growth: some evidence for the Spanish manufacturing industry', *Small Business Economics* (this issue).

Ashcroft, Brian and James H. Love, 1996, 'Firm Births and Employment Change in the British Counties: 1981-1989', *Papers in Regional. Science* **25**, 483-500.

Audretsch, David B. and Michael Fritsch, 1994, 'On the Measurement of Entry Rates', *Empirica* **21**, 105-113.

Audretsch, David B. and Michael Fritsch, 1994, 'Creative Destruction: Tubulence and Economic Growth', in Ernst Helmstädter and Mark Perlman (eds.), *Behavioral Norms, Technological Progress, and Economic Dynamics: Studies in Schumpeterian Economics*, Ann Arbor: University of Michigan Press, pp. 137-150.

Audretsch, David B., 1995, *Innovation and Industry Evolution*. Cambridge: MIT Press.

Audretsch, David B. and Michael Fritsch, 2002, 'Growth Regimes over Time and Space', *Regional Studies* **36**, 113-124.

Audretsch, David B. and Max Keilbach, 2004, 'Entrepreneurship capital and economic performance', *Regional Studies* **38**, 949-959.

Audretsch, David B., Max Keilbach and Erik Lehmann, 2006, *Entrepreneurship and economic growth*, Oxford: Oxford University Press.

Baldwin, John R., 1995, *The Dynamics of Industrial Competition: A North American Perspective*, Cambridge: Cambridge University Press.

Baptista, Rui, Victor Escária and Paulo Madrugo, 2007, 'Entrepreneurship, Regional Development and Job Creation: the Case of Portugal', Small Business Econoics (this issue).

Bartelsman, Eric J. and Mark Doms, 2000, ' Understanding Productivity: Lessons from Longitudinal Microdata, *Journal of Economic Literature* **38**, 569-594.

Baumol, William J., John C. Panzar and Robert .D. Willig, 1988, *Contestable Markets and the Theory of Industry Structure*, revised edition, San Diego: Harcourt Brace Jovanovich.

Baumol, William J., 2004, 'Entrepreneurial Enterprises, Large Established Firms and Other Components of the Free-Market Growth-Machine', *Small Business Economics* **23**, 9-21.

Birch, David L., 1979, The Job Generation Process, Cambridge (Mass.): MIT Program on Neighborhood and Regional Change (mimeo).

Birch, David L., 1981, 'Who creates jobs?' *The Public Interest*, 3-14.

Birch, David L., 1987, *Job Creation in America: How our smallest companies put the most people to work,* New York: The Free Press.

Boeri, Tito and Ulrich Cramer, 1992, 'Employment growth, incumbents and entrants – Evidence from Germany', *International Journal of Industrial Organization* **10**, 545-565.

Bosma, Niels, Erik Stam and Veronique Schutjens, 2006, Creative Destruction and Regional Competitiveness, EIM Scales Paper H200624, Zoetermeer, Netherlands: EIM Small Business Research and Consultancy.

Braunerhjelm, Pontus and Benny Borgman, 2004, 'Geographical Concentration, Entrepreneurship, and Regional Growth – Evidence from regional data in Sweden 1975-1999, *Regional Studies* **38**, 929-947.

Brezinski, Horst and Michael Fritsch (eds.), 1996, *The Economic Impact of New Firms in Post-Socialist Countries - Bottom Up Transformation in Eastern Europe*, Cheltenham: Edward Elgar Publishers.

Brixy, Udo, 1999, *Die Rolle von Betriebsgründungen für die Arbeitsplatzdynamik*, Nuremberg: Bundesanstalt für Arbeit.

Brixy, Udo and Reinhold Grotz, 2004, 'Entry-Rates, the Share of Surviving Businesses and Employment Growth: Differences between Western and Eastern Germany since Unification', in Michael Dowling, Juergen Schmude and Dodo zu Knyphausen-Aufsess (eds.), *Advances in Interdisciplinary European Entrepreneurship Research*, pp. 143-152.

Carree, Martin A. and A. Roy Thurik, 1999, 'Carrying capacity and entry and exit flows in retailing', *International Journal of Industrial Organization* **17**, 985-1007.

Carree, Martin A. and A. Roy Thurik, 2003, 'The Impact of Entrepreneurship on Economic Growth', in Zoltan J. Acs and

David B. Audretsch (eds.), *Handbook of Entrepreneurship Research*, Boston: Kluwer, pp. 437-471.

Carree, Martin A. and A. Roy Thurik, 2003, 'The Lag Structure of the Impact of Business Ownership on Economic Performance in OECD Countries', *Small Business Economics* (this issue).

Cooper, Arnold and William C. Dunkelberg, 1987, 'Entrepreneurial Research: Old Questions, New Answers and Methodological Issues', *American Journal of Small Business* **11**, 11-23.

EIM 1994, *Kleinschalig ondernemen 1994, deel II: Regionaleconomische dynamiek en werkgelegenheidscreatie*, Zoetermeer: EIM Small Business Research and Consultancy.

Disney, Richard, Jonathan Haskel and Ylva Heden, 2003, 'Entry, Exit and Establishment Survival in UK Manufacturing', *Journal of Industrial Economics* **51**, 91-112.

Falck, Oliver, 2007, 'Mayflies and Long-Distance Runners: The Effects of New Business Formation on Industry Growth', *Applied Economic Letters* **14** (forthcoming).

Farinas, Jose C. and Sonia Ruano, 2005, 'Firm productivity, heterogeneity, sunk costs and market selection', *International Journal of Industrial Organization* **23**, 505-534.

Foster, Lucia, John Haltiwanger and Cornell J. Krizan, 2001, 'Aggregate productivity growth : lessons from microeconomic evidence', in: Charles R. Hulton, Edward R. Dean and Michael J. Harper (eds.), *New Developments in Productivity Analysis*, Chicago: University of Chicago Press: 303-363.

Fritsch, Michael, 1996, 'Turbulence and Growth in West-Germany: A Comparison of Evidence by Regions and Industries', *Review of Industrial Organization* **11**, 231-251.

Fritsch, Michael, 1997, 'New Firms and Regional Employment Change', *Small Business Economics* **9**, 437-448.

Fritsch, Michael, 2004, 'Entrepreneurship, Entry and Performance of New Businesses Compared in two Growth Regimes: East and West Germany', *Journal of Evolutionary Economics* **14**, 525-542.

Fritsch, Michael and Pamela Mueller, 2004, 'The Effects of New Business Formation on Regional Development over Time', *Regional Studies* **38**, 961-975.

Fritsch, Michael and Pamela Mueller, 2006, 'The Evolution of Regional Entrepreneurship and Growth Regimes', in: Michael Fritsch and Juergen Schmude (eds.), *Entrepreneurship in the Region*, New York: Springer, pp. 225-244.

Fritsch, Michael and Antje Weyh, 2006, 'How Large are the Direct Employment Effects of New Businesses? – An Empirical Investigation', *Small Business Economics* **27**, 245-260.

Fritsch, Michael and Pamela Mueller, 2007, 'The Effect of New Business Formation on Regional Development over Time: The Case of Germany', *Small Business Economics* (this issue).

Fritsch, Michael and Viktor Slavtchev, 2007, What Determines the Efficiency of Regional Innovation Systems? Friedrich-Schiller-University Jena, Germany: Jena Economic Research Papers 006-2007.

Geroski, Paul, 1995, 'What Do We Know About Entry?' *International Journal of Industrial Organization* **13**, 421-440.

Greene, William, 2003, *Econometric Analysis*, 5th ed., Upper Saddle River, NJ: Prentice Hall.

Gudgin, Graham, 1978, *Industrial Location Processes and Regional Employment Growth*, Westmead: Saxon House.

Gujarati, Damodar N., 2003, *Basic Econometrics*, 4th edition, Boston: MacGraw-Hill.

Klepper, Steven, 1996, 'Entry, exit, growth, and innovation over the product life cycle', *American Economic Review* **86**, 562-583.

Klepper, Steven and Sally D. Sleeper, 2005, 'Entry by Spinoffs', *Management Science* **51**, 1291-1306.

Marshall, Alfred, 1920, *Principles of Economics*, 8th ed., London: Macmillan.

Mueller, Eva and James N. Morgan, 1962, 'Location Decisions of Ma*nufacturers', A*merican Economic Review **52***, 204-217.*

Mueller, Pamela, 2005, Entrepreneurship in the Region: Breeding Ground for Nascent Entrepreneurs? Working Paper 05/2005, Faculty of Economics and Business Administration, Technical University Freiberg.

Mueller, Pamela, André van Stel and David J. Storey, 2007, The Effect of New firm Formation on Regional Development Over Time: The Case of Great Britain, *Small Business Economics* (this issue).

OECD, 2003, *The Sources of Economic Growth in OECD Countries*, Paris, OECD.

Pfirrmann, Olver and Günter H. Walter (eds), (2002): *Small Firms and Entrepreneurship in Central and Eastern Europe – A Socio-Economic Perspective*, Heidelberg: Physica.

Reynolds, Paul D., 1994, 'Autonomous Firm Dynamics and Economic Growth in the United States, 1986-90', *Regional Studies* **27**, 429-442.

Reynolds, Paul D., 1999, 'Creative Destruction: Source or Symptom of Economic Growth?' in Zoltan J. Acs, Bo Carlsson and Charlie Karlsson (eds), *Entrepreneurship, small and medium-sized enterprises and the macroeconomy*, Cambridge: Cambridge University Press, pp. 97-136.

Reynolds, Paul D. et al., 2005, 'Global Entrepreneurship Monitor: Data Collection Design and Implementation 1998-2003', *Small Business Economics* **24**, 205-231.

Schumpeter, Joseph A., 1911/1934, *Die Theorie wirtschaftlicher Entwicklung*, Berlin 1911: Duncker & Humblot; english edition: *The Theory of Economic Development*, Cambridge, MA 1934: Cambridge University Press.

Schumpeter, Joseph A., 1942, *Capitalism, Socialism and Democracy*, New York: Harper and Row.

Storey, David J., 1994, *Understanding the Small Business Sector*, London: Routledge.

Van Stel, André and David Storey, 2004, 'The Link Between Firm Births and Job Creation: Is there a Upas Tree Effect?' *Regional Studies* **38**, 893-909.

Van Stel, André, Martin Carree and Roy Thurik, 2005, 'The Effect of Entrepreneurial Activity on National Economic Growth', *Small Business Economics* **24**, 311-321.

Van Stel, André and Kashifa Suddle, 2007, 'The Impact of New Firm Formation on Regional Development in the Netherlands', *Small Business Economics* (this issue).

Verhoeven, Wim H.J., 2004, Firm dynamics and labor productivity, in Gearge Gelauff, Luuk Klomp, Stephan Raes and Theo Roelandt eds., *Fostering productivity – patterns, determinants and policy implications*, Amsterdam: Elsevier.

Wong, Poh Kam, Yuen Ping Ho and Erkko Autio, 2005, 'Entrepreneurship, Innovation and Economic Growth: Evidence from GEM Data', *Small Business Economics* **24**, 335-350.

BEA BUREAU OF ECONOMIC ANALYSIS U.S. DEPARTMENT OF COMMERCE

NEWS RELEASE

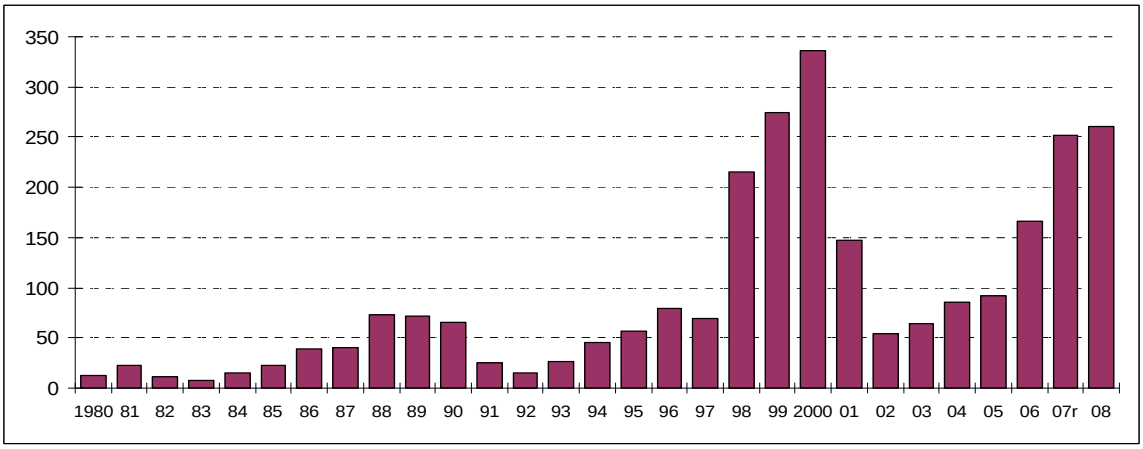
EMBARGOED UNTIL RELEASE AT 8:30AM EDT, THURSDAY, JUNE 4, 2009

Thomas Anderson: (202) 606-9879 BEA 09-23

Foreign Direct Investors' Outlays to Acquire or Establish U.S. Businesses Increased in 2008

Outlays by foreign direct investors to acquire or establish U.S. businesses increased 3 percent in 2008, to $260.4 billion. Outlays in 2008 were the third-largest on record and the sixth consecutive increase since a falloff in outlays in 2001-2002.

Outlays for New Investment in the United States by Foreign Direct Investors, 1980-2008



Billion $
r Revised
U.S. Bureau of Economic Analysis

NOTE.—Outlays consist of expenditures by foreign investors to acquire or establish U.S. business enterprises (U.S. affiliates) in which they own at least 10 percent of the voting securities, or the equivalent. Outlays differ from financial flows for foreign direct investment in the United States as recorded in the international transactions accounts (balance of payments). Unlike financial flows, outlays can reflect domestic as well as foreign sources of funding and are limited to transactions involving new U.S. affiliates. Financial flows, in contrast, include financing of both existing and new U.S. affiliates and reflect sell-offs and other subtractions from investment as well as additions.

This news release is available on BEA's website at www.bea.gov/newsreleases/rels.htm.

-more-

Among major industries, there was a substantial increase in outlays in manufacturing, which accounted for the majority of the spending by investors in 2008. Outlays were also large in information and in finance. Outlays in real estate fell sharply.

Outlays increased from investors in Europe, Latin America and Other Western Hemisphere and in the Asia and Pacific region. As in previous years, the largest share of outlays was from European investors. Outlays by investors from Canada and the Middle East fell.

Outlays in 2008

In 2008, as in previous years, most outlays by foreign direct investors were to acquire existing businesses. These outlays were $242.8 billion, compared with $17.6 billion to establish new U.S. businesses. Outlays made by, or through, existing U.S. businesses were $213.3 billion, much greater than the outlays of $47.1 billion made directly by foreign investors.

Outlays in manufacturing rose to $141.1 billion from $118.4 billion and accounted for more than half of total outlays in 2008. Within manufacturing, the increase was more than accounted for by beverages and tobacco products, where outlays were boosted by a large transaction. Among other manufacturing industries, spending was also substantial in chemicals, especially in pharmaceuticals. Outside manufacturing, outlays continued to be high in financial industries such as securities and commodities brokers, insurance, and depository institutions (banking).

By country of ultimate beneficial owner, outlays by European investors rose to $157.9 billion and represented 61 percent of total outlays in 2008. Much of the increase in European investment was accounted for by Belgium and Finland. Outlays by investors from the United Kingdom, which in previous years has often been the largest investing country, fell sharply. Outlays from Asia and Pacific rose, with Japanese investors more than accounting for the total increase and for over 60 percent of the region's outlays. Outlays by Japanese investors were boosted by acquisitions in pharmaceuticals manufacturing, in wholesale trade and in finance. Spending by investors from Latin America and Other Western Hemisphere also rose in 2008.

The ultimate beneficial owner is the investor, proceeding up a U.S. affiliate's ownership chain, beginning with the foreign parent that is not owned more than 50 percent by another investor. The data on new investment outlays are classified by country based on the location of the UBO; thus, they are shown against the country of the investor that ultimately owns or controls the affiliate, even though the investor may have channeled the funds for the investment though another country, such as a financial center.

The estimates of outlays for 2007 have been revised down 9 percent from the preliminary estimates published last year.

Employment and assets of newly acquired or established businesses

In 2008, U.S. businesses that were newly acquired or established by foreign direct investors had 368,500 employees, compared with 496,600 employees in 2007. Employment at newly acquired or established firms was largest in manufacturing (146,600) followed by finance (except depository institutions) and insurance (95,700). The total assets of newly acquired or established businesses were $895.7 billion, up from $411.8 billion in 2007. Newly acquired businesses in finance (except depository institutions) and insurance accounted for the largest share of assets in 2008. Because assets can be financed not only by funds from foreign direct investors but also by funds from other owners and lenders, assets of the newly established or acquired U.S. affiliates generally will exceed the related investment outlays.

* * *

Estimates in this report are based upon a Bureau of Economic Analysis survey that covered (1) existing U.S. business enterprises in which foreign investors acquired, either directly or through their U.S. affiliates, at least a 10 percent ownership interest and (2) new U.S. business enterprises established by foreign investors or their U.S. affiliates, also using the 10 percent ownership interest threshold.

Additional details on the new investments by foreign investors in 2008 will appear in the June issue of the *Survey of Current Business*, the monthly journal of the Bureau of Economic Analysis.

Replacement of New Investment Series

BEA has eliminated the survey of new foreign direct investment in the United States but is designing a new survey of new investments by foreign direct investors to better capture greenfield investments. The new survey will collect data on the construction of new plants and other new business facilities in the United States by existing U.S. affiliates of foreign direct investors as well as the data previously collected on foreign investors' acquisitions of existing U.S. companies and establishment of new U.S. affiliates. The new survey is currently being developed and comments or suggestions are welcome; send them to <be13@bea.gov>.

* * *

BEA's national, international, regional, and industry estimates; the *Survey of Current Business;* and BEA news releases are available without charge on BEA's website at www.bea.gov. By visiting the site, you can also subscribe to receive free e-mail summaries of BEA releases and announcements.

Table 1. Investment Outlays by Type of Investment and Investor, 1994–2008

[Millions of dollars]

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 r	2008
Total outlays	**45,626**	**57,195**	**79,929**	**69,708**	**215,256**	**274,956**	**335,629**	**147,109**	**54,519**	**63,591**	**86,219**	**91,390**	**165, 603**	**251,917**	**260,362**
By type of investment:															
U.S. businesses acquired	38,753	47,179	68,733	60,733	182,357	265,127	322,703	138,091	43,442	50,212	72,738	73,997	148,604	223,616	242,799
U.S. businesses established	6,873	10,016	11,196	8,974	32,899	9,829	12,926	9,017	11,077	13,379	13,481	17,393	16,999	28,301	17,564
By type of investor:															
Foreign direct investors	13,628	11,927	32,230	13,899	120,828	120,878	105,151	23,134	13,650	27,866	34,184	40,304	44,129	88,337	47,078
U.S. affiliates	31,999	45,268	47,699	55,809	94,428	154,078	230,478	123,975	40,869	35,725	52,035	51,086	121,474	163,580	213,284

r Revised
Source: U.S. Bureau of Economic Analysis

Table 2. Distribution of Investment Outlays by Size, 1994–2008

[Percent]

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 r	2008
Total outlays	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**	**100**
$5 billion or more	0	(D)	0	0	55	55	48	30	(D)	(D)	(D)	0	18	24	46
$2 billion — $4.999 billion	27	18	29	12	11	16	20	22	18	(D)	13	28	30	34	16
$100 million — $1.999 billion	51	48	55	67	27	24	27	40	45	43	47	59	45	37	28
Less than $100 million	22	(D)	16	21	7	5	5	9	(D)	12	(D)	13	7	5	10

r Revised
D Suppressed to avoid disclosure of data of individual companies.
Source: U.S. Bureau of Economic Analysis

Table 3. Investment Outlays by Industry of U.S. Business Enterprise, 2005–2008

[Millions of dollars]

	2005	2006	2007 r	2008
All industries	**91,390**	**165,603**	**251,917**	**260,362**
Manufacturing	**34,036**	**56,330**	**118,370**	**141,079**
Food	1,646	1,857	576	(D)
Beverages and tobacco products	(D)	4,668	(D)	52,628
Textiles, apparel, and leather products	(D)	(D)	176	422
Paper	(D)	(D)	(D)	(D)
Printing and related support activities	(D)	(D)	(D)	62
Petroleum and coal products	225	0	(D)	(D)
Chemicals	9,598	12,335	47,642	37,452
Plastics and rubber products	1,636	86	3,506	1,304
Nonmetallic mineral products	388	1,439	1,309	918
Primary metals	4,877	4,598	12,812	6,714
Fabricated metal products	111	884	3,690	256
Machinery	382	1,827	(D)	12,315
Computers and electronic products	3,596	(D)	7,287	7,286
Electrical equipment, appliances, and components	747	1,660	(D)	3,215
Transportation equipment	5,942	1,267	13,415	833
Other	4,663	6,562	11,627	15,068
Wholesale trade	**3,489**	**8,273**	**5,631**	**3,977**
Retail trade	**1,262**	**1,295**	**6,867**	**2,775**
Information	**8,487**	**10,341**	**8,585**	**22,214**
Publishing industries	2,555	5,068	(D)	13,286
Motion picture and sound recording industries	(D)	(D)	(D)	381
Telecommunications	(D)	4,308	(D)	3,618
Other	2,085	(D)	2,468	4,930
Depository institutions	**7,973**	**7,547**	**12,307**	**15,996**
Finance (except depository institutions) and insurance	**5,529**	**33,776**	**27,497**	**29,584**
Real estate and rental and leasing	**8,756**	**12,441**	**17,852**	**3,796**
Professional, scientific, and technical services	**6,407**	**8,923**	**9,018**	**15,167**
Other industries	**15,453**	**26,677**	**45,790**	**25,775**

r Revised
D Suppressed to avoid disclosure of data of individual companies.
Source: U.S. Bureau of Economic Analysis

Table 4. Investment Outlays by Country of Ultimate Beneficial Owner, 2005–2008

[Millions of dollars]

	2005	2006	2007 r	2008
All countries	**91,390**	**165,603**	**251,917**	**260,362**
Canada	**13,640**	**12,121**	**38,502**	**25,181**
Europe	**56,416**	**106,732**	**132,454**	**157,853**
France	5,608	18,140	14,307	16,565
Germany	7,239	20,514	15,831	12,823
Netherlands	2,609	4,769	8,357	12,545
Switzerland	2,332	12,401	6,501	9,041
United Kingdom	30,420	26,261	56,051	19,657
Other Europe	8,206	24,648	31,408	87,222
Latin America and Other Western Hemisphere	**5,042**	**(D)**	**(D)**	**18,259**
South and Central America	980	2,273	(D)	3,551
Other Western Hemisphere	4,062	(D)	1,933	14,708
Africa	**(D)**	**(D)**	**(D)**	**129**
Middle East	**5,068**	**11,755**	**21,882**	**12,263**
Asia and Pacific	**10,924**	**15,759**	**34,408**	**44,863**
Australia	4,713	5,650	12,983	10,522
Japan	4,245	8,350	7,928	28,041
Other Asia and Pacific	1,966	1,758	13,497	6,301
United States [1]	**(D)**	**(D)**	**18,071**	**1,813**

r Revised

D Suppressed to avoid disclosure of data of individual companies.

1. The United States is the country of ultimate beneficial owner for businesses newly acquired or established by foreign investors that are ultimately owned by persons located in the United States.

NOTE. For investments in which more than one investor participated, each investor and each investor's outlays are classified by the country of each individual ultimate beneficial owner.

Source: U.S. Bureau of Economic Analysis

Table 5. Selected Operating Data of U.S. Business Enterprises Acquired or Established, by Industry of U.S. Business Enterprise, 2007–2008

	2007 r					2008				
	Millions of dollars			Thousands of employees	Hectares of land [1]	Millions of dollars			Thousands of employees	Hectares of land [1]
	Total assets	Sales	Net income			Total assets	Sales	Net income		
All industries	**411,777**	**162,678**	**7,334**	**496.6**	**357,750**	**895,733**	**182,941**	**7,270**	**368.5**	**81,137**
Manufacturing	147,085	78,642	4,487	141.7	(D)	146,356	60,091	2,364	146.6	36,411
Wholesale trade	8,084	11,939	300	20.0	193	4,704	6,124	126	27.8	138
Retail trade	13,462	24,509	51	117.9	606	5,697	4,702	82	5.6	841
Information	9,045	2,881	–48	9.6	97	21,368	5,633	–476	15.1	1,467
Depository institutions	54,811	2,577	588	11.7	241	90,684	4,390	217	20.8	351
Finance (except depository institutions) and insurance	79,378	9,323	979	16.8	117	538,084	75,686	3,541	95.7	522
Real estate and rental and leasing	26,479	2,257	276	1.6	13,028	9,227	896	62	2.5	6,094
Professional, scientific, and technical services	9,994	4,423	–51	27.2	26	14,627	4,211	207	22.0	8
Other industries	63,438	26,128	753	150.1	(D)	64,986	21,208	1,147	32.4	35,305

r Revised
D Suppressed to avoid disclosure of data of individual companies.
1. One hectare equals 2.471 acres. Thus, for all industries, acres of land owned in 2008 was 200,490.
NOTE. For newly acquired businesses, the data cover the most recent financial reporting year preceding acquisition. For newly established businesses, the data are projections for the first full year of operations.
Source: U.S. Bureau of Economic Analysis

Foreign Companies Remake The American Dream

October 27, 2009

More than 5 million Americans work for companies that aren't American. *New York Times* senior business correspondent Micheline Maynard, author of *The selling of the American Economy: How Foreign Companies Are Remaking the American Dream*, says the foreign share of the American economy is almost double the share of the U.S. auto industry.

ROBERT SIEGEL, host:

When the economic stimulus plan was working its way through Congress, it included a Buy American provision. You want stimulus money to build something, use American steel or American textiles. Organized labor was all for it. And in no time, the provision was dropped.

Economic nationalism sputtered in the face of a reality about the U.S. economy. Our country is home to so much foreign investment that working for a foreign-owned company is no longer exotic. And according to Micheline Maynard, it is increasingly attractive.

Maynard is a senior business correspondent for The New York Times, and she's the author of a new book, "The Selling of the American Economy: How Foreign Companies Are Remaking the American Dream."

Welcome back to the program.

Ms. MICHELINE MAYNARD (Author, "The selling of the American Economy: How Foreign Companies Are Remaking the American Dream"): Thank you for having me.

SIEGEL: How big a share nowadays of the U.S. job market is a - the total of jobs at foreign-owned companies?

Ms. MAYNARD: There are about five million, few more than five million jobs at foreign-owned companies in the United States. And if you think back to the discussion about saving the automobile industry, there were studies at the time that said there were about three million American auto jobs. So the foreign share of the American economy is almost double what the American automobile industry is.

SIEGEL: You've actually written about four foreign-owned companies and how they operate in this country, and their experiences are actually quite different.

Ms. MAYNARD: That's right. I write about Toyota, which is probably the one foreign company that if you ask someone: Who's from another country doing business in the United States? They would say Toyota.

I write about EADS, which is the owner of Airbus, the aircraft manufacturer and also a big military defense contractor. I write about Tata of India. And, you know, people don't really know what this company is. But if you drink Eight O'Clock Coffee for breakfast, they own Eight O'Clock Coffee.

And the last company is Haier of China, which actually has a refrigerator factory in the Carolinas and builds all those refrigerators that kids have in their college dorms and also those wine refrigerators that people bought a lot over the last few years.

SIEGEL: Now, getting a company like one of these to set up a factory is something that is incredibly attractive to governors. And you described two governors incredibly different in terms of their political orientation, remarkably similar in terms of their interest to attract foreign investment.

Ms. MAYNARD: Yes, I talk about Jennifer Granholm, who's the governor of Michigan, a Democrat supported by the United Automobile Workers. And yet, she has made it her job to do a number of foreign trade missions over the years, going to places like Japan and the Middle East and Korea to find companies that will invest in Michigan.

I also talk about Haley Barbour, the Republican governor of Mississippi, who really has left no stone unturned going out to look for foreign investment. I tell a story about Hurricane Katrina, which people know hit Mississippi very hard. But at the end of that week, he was already making calls to places in Japan, China and Korea and saying, we will be open again for business. That was how determined he was to land foreign investment.

SIEGEL: We can understand how attractive it is to say to the governor of a state to have more jobs here, jobs at a foreign-based company. Why is it so important to those companies to be here?

Ms. MAYNARD: A couple of reasons. First of all, we're still the biggest consumer market in the world. Until China grows and becomes more prosperous, this is a place where everybody wants to compete. Second, despite what you might hear about American workers elsewhere, American workers have a great reputation to foreign companies. They see that you are probably cheaper to employ than especially for a European company, which pays higher wages and has higher labor costs. So American workers are attractive.

Imagine if you're from Europe and you're used to a country that's filled in, and you come to a place like Alabama and Mississippi, and they show you acres and acres of empty land. They offer to clear it. They offer to help you with road building. I mean, for some of these companies that are used to all these restrictions and red tape, it's a dream come true.

SIEGEL: Well, thinking ahead, I mean, do you think that the distinction between the U.S.-owned company and the foreign-owned company is obsolescent? Twenty-five years, 30 years from now, do you think that people won't even understand what we were talking about in this conversation?

Ms. MAYNARD: Some people will still have resistance to it because some people will always have resistance to immigration, to foreign investment in anything. You know, there are people who won't buy German cars because of what happened during World War II.

But 25 to 30 years from now, if we haven't become a little bit more blind to this or at least neutral about it - and I am not saying that foreign companies are the solution to America's economic problems, I just think they're part of the solution. And that if we are going to have an economy that's open to the world, you know, let's be a little more welcoming. Let's not be as resistant to foreign companies because they might be able teach us something and we might be able to teach them something.

SIEGEL: Well, Micki Maynard, thank you very much for talking with us once again.

Ms. MAYNARD: Thank you, Robert.

SIEGEL: Micheline Maynard is a senior business correspondent for The New York Times and her new book is called "The Selling of the American Economy: How Foreign Companies Are Remaking the American Dream."

comments

Discussions for this story are now closed. Please see the **Community FAQ** for more information.

Recent First

Mike Smith (msmith3904) wrote:
Jerry-

Interesting thoughts, however, I do believe you are oversimplifying things a bit.

That Dodge Ram may have been built in Mexico. But where did its parts come from? Where was it designed and engineered? Did Chrysler export a vehicle to offset that import? These are all important considerations.

See, if you buy a Toyota built in the US, it likely has just as many parts from the US as an average Ford, GM, or Chrysler. However, almost without exception, it was developed overseas. Those are good paying white collar jobs that are not being supported. Toyota also relies heavily on imports in the US still, accounting for over half of their sales. Chrysler is dependent on imports, but not to as great a degree. Then you have Ford, which imports almost the exact same number of vehicles from Canada as they export to Canada (no harm there), and imports almost the same number of vehicles from Mexico as they export to Latin America (no real harm there).

If Toyota hits that same balance, and supports the same level of white collar jobs, they are, in

my mind, every bit as domestic as Ford, GM, or Chrysler. But they aren't there yet, and they aren't getting there with any speed.
Tuesday, October 27, 2009 11:46:56 PM
Recommend (0) Report abuse

jerry Schneider (burleycreek) wrote:
I found the story on foreign companies interesting and it reminded me of a recent conversation with a friend. I own a Dodge Ram diesel truck, so it can be considered an American truck, made by Chrysler. However, the plate on the door notes that it was assembled in Mexico. So I wondered to my friend, am I doing more to buy American if I buy a Dodge Ram truck assembled in Mexico or a Toyota assembled in Ohio? I maintain that by buying a Toyota, even though it's owned by a foreign company, I am buying "more American" because at least American workers were paid to do the work to assemble it. These days, supporting American workers and preserving jobs seems more American than the profits Chrysler, an American company, might make, while the real work on the vehicle was done by Mexicans.
Tuesday, October 27, 2009 11:12:49 PM
Recommend (0) Report abuse

CHIEF EXECUTIVE
PRINT · EVENTS · ONLINE

Issue Date: May/June 2010, Posted On: 4/29/2010

Best and Worst States for Business 2010

Click here to visit the Best/Worst States 2010 Resource Center More than 600 CEOs rated states on a wide range of criteria from taxation and regulation to workforce quality and living environment, in our sixth annual special report.

In *Chief Executive's* annual survey of best and worst states for business, conducted in late January of this year, 651 CEOs across the U.S. again gave Texas top honors, closely followed by North Carolina, Tennessee and Virginia. They gave the booby prize for worst state to California, with New York, Michigan, New Jersey and Massachusetts filling out the bottom five-a line-up virtually unchanged from last year. Florida and Georgia each dropped three places in the ranking, but remain in the top 10. Utah jumped six positions this year to sneak into the top 10 at No. 9.

The business leaders were asked to draw upon their direct experience to rate each state in three general categories: taxation and regulation, quality of workforce and living environment. Within each category respondents graded states in five subcategories, as well as ranking each in terms of its importance to the respondent and how individual states measure up (Click here to see How CEOs Grade the States chart).

For example, Texas fares competitively with Nevada and Delaware in terms of taxation and regulatory environment, but scored best overall, in no small measure because of the perception that its government's attitude to business is ideal. Runner-up North Carolina edged Texas slightly in its living environment, but scored somewhat below the Lone Star state in terms of government attitude to business and work ethic, which is a sine qua non for the business leaders. (Click here to see the chart) After employee work ethic, CEOs most highly prize lower tax rates and perceived attitudes toward business, followed by living environment considerations, such as real estate costs and education.

"Texas is pro-business with reasonable regulations," one CEO respondent remarked, "while California is anti-business with anti-business regulations." Another commented, "California is terrible. Even when we've paid their high taxes in full, they still treat every conversation as adversarial. It's the most difficult state in the nation. We have actually walked away from business rather than deal with the government in Sacramento."

	2010 RANK	STATE	2009 RANK	CHANGE
TOP 10	1	TX	1	0
	2	NC	2	0
	3	TN	5	2
	4	VA	7	3
	5	NV	6	1
	6	FL	3	-3
	7	GA	4	-3
	8	CO	10	2
	9	UT	15	6
	10	SC	9	-1
BOTTOM 5	47	MA	47	0
	48	NJ	48	0
	49	MI	49	0
	50	NY	50	0
	51	CA	51	0

Click here to view the full chart

Best and Worst States for Business 2010

“The leadership of California has done everything in its power to kill manufacturing jobs in this state,” observed another CEO. “As I stated at our annual meeting, if we could grow our crops in Reno, we’d move our plants tomorrow.”

How is it that the nation’s most populous state at 37 million, one that is the world’s eighth-largest economy and the country’s richest and most diverse agricultural producer, a state that had the fastest growth rate in the 1950s and 1960s during the tenures of Democratic Governor Pat Brown and Republican Governors Earl Warren and Ronald Reagan, should become the Venezuela of North America?

Californians pay among the highest income and sales taxes in the nation, the former exceeding 10 percent in the top brackets. Unemployment statewide is over 12.2 percent, higher than the national average. State politics seems consumed with how to divide a shrinking pie rather than how to expand it. Against national trend, union density is climbing from 16.1 percent of workers in 1998 to 17.8 percent in 2002. Organized labor has more political influence in California than in most other states. In addition, unfunded pension and health care liabilities for state workers top $500 billion and the annual pension contribution has climbed from $320 million to $7.3 billion in less than a decade. When state employees reach critical mass, they tend to become a permanent lobby for continual growth in government.

Bill Dormandy, CEO of San Francisco medical device maker ITC, summed it up: “California has a good living environment but is unfavorable to business and the state taxes are not survivable. Nevada and Virginia are encouraging business to move to their states with lower tax rates and less regulatory demands.”

BIGGEST GAINS

2010 RANK	STATE	2009 RANK	CHANGE
30	WA	40	10
27	AR	35	8
9	UT	15	6
22	NE	28	6
15	WY	20	5

BIGGEST LOSSES

2010 RANK	STATE	2009 RANK	CHANGE
38	OR	24	-14
24	ND	17	-7
45	CT	38	-7
20	AL	14	-6
35	MS	30	-5

5-YEAR BIGGEST GAINS

2010 RANK	STATE	2005 RANK	5 YEAR CHANGE
21	AK	46	25
15	WY	35	20
13	ID	33	20
24	ND	41	17
28	MT	44	16

5-YEAR BIGGEST LOSSES

2010 RANK	STATE	2005 RANK	5 YEAR CHANGE
46	IL	17	-29
44	OH	20	-24
31	MN	12	-19
42	WI	26	-16
48	NJ	37	-11

Lone Star Leader

By contrast, Texas, the second-most populous state and the world's 12th largest economy, is where 70 percent of all new U.S. jobs have been created since 2008. Unsurprisingly, it scores high in all the areas CEOs value most. "You feel like state government understands the value of business and industry to create jobs and growth," observed one CEO. Its tax credits and incentives to business choosing to locate or expand are among the most aggressive. The Texas Enterprise Fund is by far the largest deal-closing fund of any state, with grants totaling $377 million disbursed in 2008.

Little wonder then that while Texas gained over 848,000 net new residents in the last 10 years, according to the Census Bureau, California lost 1.5 million. New York State's net loss exceeded 1.6 million - the highest of any state. High-tax, big- government New Jersey ranked fourth, with a net loss of almost 460,000, enough to drop it from 10th to 11th place in population.

"The New York state legislature is the most dysfunctional in the land and one of the reasons why New York is the worst," one exasperated New York City business leader volunteered. The political elites in the states that dismiss out-migration trends overlook the radical demographic adjustment underway. As higher-income earners leave, they are more often replaced by those with lower incomes and lower skills, many needing public assistance. Gone too are the entrepreneurs and risk-takers, off seeking regions where their job creating abilities are rewarded.

Another more daunting reality is in store. The so-called de-leveraging of America hasn't reached government. U.S. cities and states have issued over $2 trillion in new debt since 2008, with another $1 trillion scheduled this year. The problem is that state revenues in real terms may not reach 2008 levels until late in 2012, according to John Thomasian of the National Governors Association Center for Best Practices. As he emphasizes in his paper, "The Big Reset: State Government after the Great Recession," states will have to rethink and redesign government in terms of what is essential and what can be made more efficient if their citizens are to have much of a future.

The results of this survey may point the way.

Click here for more information on the *Chief Executive's* Best and Worst States for Business survey and other economic indicatiors.

Contact:
Mark Arend
Conway Data, Inc.
770 325-3438 tel
Mark.Arend@conway.com

Suite 200
6625 The Corners Parkway
Norcross, GA 30092 USA
www.sitenet.com

Press Release
November 2, 2009

Site Selection Names Top State Business Climates

Atlanta, November 2, 2009: Site Selection magazine has named North Carolina the state with the Top Business Climate for 2009. As revealed in the November 2009 issue of the magazine, research based in part on a survey of corporate real estate executives has identified the Tar Heel State's overall climate for capital investment to be tops in the United States for the fifth year in a row, and for the eighth time in the last nine years. Texas placed second this year, with Virginia rising from eighth last year to third this year. Ohio takes fourth this year, and Tennessee rounds out the top five.

Among North Carolina's strengths cited by executives were the state's tax climate, work force, incentives and economic development strategy, non-union environment, utility infrastructure, and legal and regulatory environment. Helping build and retain the talent base and corporate community all at once is a high-caliber infrastructure of higher learning, a topic explored at length in the magazine's November cover story.

"The concentration of brainpower and R&D activity in North Carolina cuts across many disciplines, territories and institutions," says Adam Bruns, managing editor of Site Selection. "Research parks, schools, companies and communities in the state have developed a real knack for working across boundaries, and it continues to pay off."

The annual business climate rankings are determined 50 percent by performance of the state in Conway Data's New Plant Database, which tracks new and expanded business facility activity, and 50 percent by a survey of corporate site seekers across the country. The survey asked, "Based upon your experience, what are the top 10 state business climates, taking into consideration such factors as lack of red tape, financial assistance and government officials' cooperation?" By this measure alone, North Carolina ranked second behind Texas. Georgia, South Carolina and Tennessee placed third, fourth and fifth, respectively.

Site selectors also were asked to rank the factors most important to them when determining a location for a new facility. The top three factors are transportation infrastructure, existing work force skills, and state and local tax schemes.

The entire Business Climate story, as well as the publication's annual legislative and incentives analysis, appears in the November 2009 edition of Site Selection and at www.siteselection.com.

Site Selection magazine, published by Conway Data Inc., delivers expansion planning information to 44,000 executives of fast-growing firms. The senior publication in the development field, Site Selection is also available via Site Selection Online (www.siteselection.com). The SiteNet Dispatch, a weekly e-mail newsletter, goes to more than 29,000 industry professionals.

Conway Data is an international publishing and association management company headquartered in Atlanta. The firm manages the Industrial Asset Management Council, the Development Hall of Fame and the World Development Federation (WDF), offers consulting services and awards the annual Conway Safe Skies Award.

TOP TEN STATE BUSINESS CLIMATES 2009

1. North Carolina
2. Texas

3. Virginia
4. Ohio
5. Tennessee
6. South Carolina
7. Alabama
8. Georgia
9. Indiana
10. Kentucky

EXECUTIVE SURVEY BUSINESS CLIMATE RANKINGS 2009

1. Texas
2. North Carolina
3. Georgia
4. South Carolina
5. Tennessee
6. Virginia
7. Alabama
8. Ohio
9. Florida
10. Colorado

| Top of Page | CDI Press Releases | SiteNet | Search SiteNet |

Forbes.com

Special Report

The Best States For Business

Kurt Badenhausen, 09.23.09, 6:00 PM ET

The carnage of the economic downturn is everywhere with bankruptcies, foreclosures and unemployment soaring nationwide. None of the 50 states are immune. Only two, Alaska and North Dakota, are expected to see employment gains this year. Maryland, North Dakota and Virginia (by a hair) are the only states where the economy is projected to expand in 2009. Housing? Every state saw a decline in median home prices last year.

The recession has shaken up our fourth-annual ranking of the Best States for Business with some big movers up (North Dakota, Oregon and Iowa) and some former high-fliers on the way down (Florida, Nevada and Arizona).

In Pictures: Where All The States Rank

Amid this mess, Virginia nabbed the top spot with the best business climate in the country for the fourth straight year. Virginia's economy has deteriorated, with the number of unemployed soaring 60%, while gross state product is flat and household incomes are expected to fall 4%, according to West Chester, Pa.-based research firm Moody's Economy.com.

Relative to the rest of the country though, Virginia is booming. Its 6.5% unemployment rate is fifth lowest in the country with the four states ahead of it all having dramatically smaller economies and employment bases. Virginia is the only state ranked in the top 20 in each of the six broad categories we examined. The state finished in the top three in half of those categories (labor supply, regulatory environment and quality of life). Virginia's $325 billion economy is expected to be the 10th largest in the U.S. in 2009.

The state benefits from a highly educated workforce that is expected to expand over the next five years. Energy costs are 30% below the national average. The state's tort environment ranks fifth best in the country, according to California think tank Pacific Research Institute. The state government's finances are in good shape--it's held on to a top AAA rating from Moody's since 1971. Eleven public companies with more than $10 billion in revenues call it home, including Altria, General Dynamics and Capital One Financial.

Smart incentives help, too. Each year Park Ridge, Ill.-based Pollina Corporate Real Estate does a study that compares states' economic development departments and programs. This year Virginia topped the Pollina study after finishing second last year.

"Virginia's economic development department truly understands what global competition is all about," says Brent Pollina, who authored the study. The Virginia Jobs Investment Program, for example, is open to both new and existing companies and offers flexible and customized employee recruiting and job training for businesses. The program has helped more than 2,400 companies over the past five years recruit and train 75,000 Virginians.

"We believe we offer a unique proposition because companies know the business climate is going to remain friendly," says Jeff Anderson, head of the Virginia Economic Development Partnership. In February, Hilton announced it would move its corporate headquarters from Beverly Hills to Fairfax County. Last year Canon revealed plans to expand its Virginia operations with a $600 million investment that will create 1,000 new jobs. Overall companies announced plans to spend $5.1 billion to relocate or expand in Virginia in 2008, which is expected to create more than 20,000 new jobs.

Our Best States ranking measures six vital categories for businesses: costs, labor supply, regulatory environment, current economic climate, growth prospects and quality of life. We factor in 33 different points of data to determine the ranks in the six main areas. Business costs, which include labor, energy and taxes are weighted the most heavily. We relied on nine different data providers. Moody's Economy.com is the most-utilized resource.

A common theme with our top-ranked states is an expanding, educated workforce. The three states that followed Virginia in the

rankings (Washington, Utah and Colorado) also ranked in the top four along with Virginia in our labor supply category, which looks at high school and college attainment, as well as net migration and projected population growth. "When we talk to prospective clients, their No. 1 issue every time is workforce," says Virginia's Anderson.

Three of the biggest drops in our ranking were states where the housing boom and population surges once fueled rapid economic growth. In our 2007 ranking, Arizona, Florida and Nevada were the top three states in several areas including: five-year net migration, projected population growth, gross state product growth and five-year projected job growth. With the collapse of the housing market, the outlook is far less rosy. People are expected to continue to flock to these three states, but the employment and economic forecast has worsened considerably in all three locales. Each of these states fell at least 10 spots in the current ranking.

New Jersey also had a big fall. Over three years, the state's ranking plunged from 19th to 34th to 45th this year. High business costs have been a long-time problem (12% higher than the national average) with taxes being a major gripe. The Tax Foundation dubs New Jersey the worst state when it comes to its business tax climate. Fed up, residents are fleeing. Net migration out of New Jersey was the seventh worst among all states over the past five years. The Garden State also ranks poorly for job growth, income growth and economic growth over the past five years.

While New Jersey slides, our bottom three states from last year (Alaska, Louisiana and West Virginia) all climbed at least four spots. On the strength of an improved economic and employment outlook relative to the rest of the country, West Virginia moved up to 46th place after two straight years at the bottom of our list. Alaska is projected to have the strongest job growth of any state over the next five years and ranked 42nd, up six spots from last year.

Louisiana is making a comeback from the damage inflicted during Hurricanes Katrina and Rita in 2005. The state moved up five spots to 44th place. Louisiana launched a workforce development reform plan last year that borrows heavily from labor programs in Texas and Georgia, both among our top 10. "Louisiana FastStart has changed the perception of Louisiana's workforce from a concern to a top selling point," says Stephen Moret, head of Louisiana Economic Development. Moret cites the program as central to attracting business expansions by a new green car company, V-Vehicle, and manufacturer Gardner-Denver.

In Pictures: Where All The States Rank

Special Report

Table: The Best States For Business

Kurt Badenhausen, 09.23.09, 06:00 PM EDT

How the states match up.

Our Best States ranking measures six vital categories for businesses: costs, labor supply, regulatory environment, current economic climate, growth prospects and quality of life. We factor in 33 different points of data to determine th ranks in the six main areas. Business costs that include labor, energy and taxes are weighted the most heavily. We relied on nine different data providers. Moody's Economy.com is the most utilized resource.

OVERALL RANK	2006 RANK	STATE	BUSINESS COSTS RANK[1]	LABOR RANK[2]	REGULATORY ENVIRONMENT RANK[3]	ECONOMIC CLIMATE RANK[4]	GROWTH PROSPECTS RANK[5]	QUALITY OF LIFE RANK[6]	POPULATION	GROSS STATE PRODUCT ($BIL)	FIVE-YEAR CHANGE (%)	GOVERN
1	1	Virginia	20	3	2	18	12	1	7,804,600	325	2.9	Tim Kaine
2	3	Washington	27	2	5	3	1	24	6,593,900	265	3.3	Chris Gregoire
3	2	Utah	14	4	11	11	22	17	2,756,900	88	4.6	Gary Herbert
4	6	Colorado	33	1	17	5	2	15	4,975,800	203	2.8	Bill Ritter
5	4	North Carolina	3	15	4	16	33	34	9,305,500	329	2.8	Beverly Perdue
6	5	Georgia	28	7	1	23	15	33	9,765,700	329	1.9	Sonny Perdue
7	13	North Dakota	6	37	26	8	4	21	643,200	24	4.1	John Hoeven
8	9	Texas	29	23	10	1	3	39	24,553,400	926	3.7	Rick Perry
9	10	Nebraska	11	24	23	23	23	10	1,788,800	67	2.1	David Heineman
10	16	Oregon	17	6	41	13	17	25	3,820,400	147	4.5	Ted Kulongoski
11	7	Idaho	12	17	35	10	36	18	1,534,900	46	4.5	C.L. Otter
12	14	Maryland	42	8	29	18	7	14	5,642,600	221	2.2	Martin O'Malley
13	24	Montana	23	8	38	6	16	35	972,500	27	3.2	Brian Schweitzer
14	22	Iowa	9	39	16	22	46	8	3,009,100	110	3.0	Chet Culver
15	21	Kansas	25	21	12	30	26	27	2,814,600	98	2.5	Mark Parkinson
16	23	South Dakota	1	33	41	21	21	23	807,100	30	3.4	Mike Rounds
17	11	Minnesota	32	10	30	35	20	6	5,242,700	217	2.0	Tim Pawlenty
18	8	Florida	36	11	25	14	9	40	18,388,700	603	3.0	Charlie Crist
19	20	New Hampshire	41	5	46	26	5	4	1,320,400	51	2.0	John Lynch
20	26	Oklahoma	13	41	9	4	47	38	3,647,900	107	2.5	Brad Henry
21	12	Delaware	5	12	26	40	39	36	878,500	49	1.9	Jack Markell
22	31	Wyoming	2	29	48	15	26	32	536,000	22	2.9	Dave Freudenthal
23	17	Tennessee	10	39	3	38	34	42	6,244,600	210	2.2	Phil Bredesen
24	35	Illinois	34	27	13	32	28	20	12,942,500	516	1.5	Pat Quinn
25	29	South Carolina	19	31	6	36	30	43	4,507,200	127	1.2	Mark Sanford
26	32	Arkansas	8	44	34	17	14	41	2,866,700	79	2.3	Mike Beebe
27	15	New Mexico	26	32	31	11	6	48	1,992,100	61	2.7	Bill Richardson
28	28	Alabama	22	42	19	25	13	45	4,679,700	137	2.4	Robert Riley
29	30	Missouri	15	38	21	42	25	29	5,924,000	194	1.1	Jay Nixon
30	25	Indiana	7	43	14	47	49	16	6,399,200	210	0.6	Mitchell Daniels
31	19	Nevada	24	26	28	2	40	49	2,615,100	103	4.8	Jim Gibbons
32	38	New York	46	30	17	18	35	13	19,506,400	965	3.6	David Paterson
33	41	Pennsylvania	38	34	15	37	32	7	12,466,600	444	1.5	Edward Rendell
34	36	Massachusetts	48	16	22	33	40	2	6,506,600	312	2.2	Deval Patrick
35	33	Connecticut	45	18	33	31	37	3	3,504,700	178	2.2	M. Jodi Rell
36	18	Arizona	31	14	45	7	38	47	6,562,700	210	3.8	Jan Brewer
37	39	Ohio	30	47	8	43	48	12	11,491,200	386	0.4	Ted Strickland
38	40	California	50	22	39	27	10	26	36,962,400	1,546	2.9	Arnold Schwarzenegger
39	27	Hawaii	47	19	43	9	31	28	1,292,700	50	3.2	Linda Lingle
40	42	Mississippi	18	49	20	46	19	46	2,946,000	72	1.5	Haley Barbour
41	46	Maine	44	25	32	39	28	19	1,315,600	40	1.6	John Baldacci
42	48	Alaska	37	28	40	29	11	44	690,000	30	1.8	Sean Parnell
43	44	Kentucky	16	45	24	45	44	31	4,290,400	127	1.6	Steven Beshear
44	49	Louisiana	20	50	36	34	8	50	4,418,500	145	1.9	Bobby Jindal
45	34	New Jersey	49	20	47	44	24	5	8,699,200	390	1.3	Jon Corzine
46	50	West Virginia	4	48	49	28	43	37	1,815,700	46	1.7	Joe Manchin III
47	36	Vermont	43	13	44	49	42	9	621,300	22	2.1	Jim Douglas
48	43	Wisconsin	35	36	37	41	45	11	5,638,700	198	1.5	Jim Doyle

49	47	Michigan	39	46	6	50	50	30	9,978,900	326	-0.9	Jennifer Granholm
50	45	Rhode Island	40	35	50	48	18	21	1,050,600	38	0.9	Don Carcieri

1 Index based on cost of labor, energy and taxes.
2 Measures educational attainment, net migration and projected population growth.
3 Measures regulatory and tort climate, incentives, transportation and bond ratings.
4 Reflects job, income and gross state product growth as well as unemployment and presence of big companies.
5 Reflects projected job, income and gross state product growth as well as business openings/closings and venture capital investments.
6 Index of schools, health, crime, cost of living and poverty rates.

Sources: Moody's Economy.com; Pollina Corporate Real Estate; Pacific Research Institute; Tax Foundation; Sperling's Best Places; Census Bureau; SBA; FBI; Dept. of Education; Forbes.

In Pictures: Where All The States Rank
Table: The Best States For Business

See Also
Finding the Right City
What's North Dakota's Secret?
The Best Cities For Business And Careers
The Best Countries For Business

The Road To 1,200 Is Open

Golf's Most Beautiful Swing

The Recession Isn't Over, Ben

TARP: Return On Investment

Reader Comments

interesting list. i would almost say you could reverse it and use that as a list of more friendly to consumers. and its missing a lot of things that would also be really important to business too. li **[Read More]**

Posted by willid3 | 09/25/09 03:23 PM EDT Report Abuse

Post a Comment

Intelligent Investing | Data | Knowledge | Insight | Wisdom

Today On Forbes.com

The Average Investor Is His Own Worst Enemy
David K. Randall
Terry Odean's research on behavioral flows how people sabotage themselves.
- Retail Stocks Back In Style
- Junk Bonds: Are Worse Days Ahead?
- Investment Guide 2010

SITE Selection ONLINE

Expanded Web Edition

COVER STORY

From Site Selection magazine, November 2009

Click to view sidebars ...

Texas Again Tops Corporate Survey

Powerful Package

SAS Campus Leads in More Ways Than One

Watch and Learn

Commerce and curriculum are a natural match in North Carolina, which tops the business climate rankings yet again.

by ADAM BRUNS

adam.bruns@conway.com

How has North Carolina managed to rank No. 1 in Site Selection's annual business climate rankings eight times in the past nine years? It may have something to do with its infrastructure of higher learning.

"When I worked for the state department of commerce in the late nineties, I could count on one hand the number of projects in a five-year period that had serious conversations with our university system," says Leslie Boney, now associate vice president for economic development research, policy and planning for the University of North Carolina's 16-campus system. "Now it's hard to find a project that does not involve a conversation with our university system."

A view across Hechenbleikner Lake on the campus of UNC-Charlotte. Home to the Charlotte Research Institute (part of the newly formed North Carolina Research Parks Network), UNC-Charlotte just launched a new program built around the forthcoming 200,000-sq.-ft. (18,580-sq.-m.) Energy Production Infrastructure Center (EPIC).
photo courtesy of UNC-Charlotte

Conversations with several corporate project decision-makers make it easy to corroborate Boney's thesis.

Take **Siemens Energy's** Oct. 8 groundbreaking for a 60,000-sq.-ft. (5,574-sq.-m.) expansion adjacent to its existing steam turbine generator manufacturing plant in Charlotte. Over the next five years, the company plans to invest a total of nearly US$50 million and create 226 new engineering and manufacturing jobs at this location. The expanded facility, designed to achieve LEED Gold certification, will house engineering operations that will support the company's design, manufacture and service of power generation components.

"We've had a large presence in the Charlotte area and in other areas in North Carolina for 40 years now, and it was our first-hand knowledge of the excellent business environment here that convinced us to expand our investment further," said Randy Zwirn, president and CEO of Siemens Energy, Inc. Siemens Energy employs 780 at its existing 550,000-sq.-ft. (51,095-sq.-m.) Charlotte facility. Zwirn alluded to the area's emergence as an energy center of excellence. Mark Pringle, plant manager in Charlotte, seconds that assertion.

"Charlotte has become a hub for energy companies that are starting to locate here, predominantly driven by nuclear energy, but now others," he says. They include Westinghouse, AREVA, Shaw, Duke, Fluor Group and the recently located Toshiba America Nuclear Energy. The city also has long been home to one of five principal offices and R&D labs for the Electric Power Research Institute (EPRI). The Siemens facility performs work on all sizes of generators and steam turbines, regardless of the prime mover generation source.

"It's been an excellent climate to work in," says Pringle of the Charlotte area. "You can tell the local government pays attention to it, and wants to help support and nurture according to our needs. We get attention when we ask about things."

That includes attention from the university system, as UNC-Charlotte is in the midst of launching a new program around

the new, $76-million Energy Production Infrastructure Center.

"They have a college focused on developing new engineers for the power production business," says Pringle, who serves on that new college's board of advisors. "It's just now starting to take off." Pringle says the company has also mined machining and welding talent from area trade schools, as well as working with local institutions in recruiting and co-op assignments. That relates directly to the new project

Mark Pringle, Charlotte plant manager, Siemens Energy

"We have a large building, the largest plant Siemens has in the United States," says Pringle. "We've launched an initiative to put more engineers at the site so they're designing the product right next to where it's being built. It's the way Siemens does business in Germany and other countries."

Siemens originally bought the power business from Westinghouse in 1998. Its headquarters is in Orlando.

"The obvious decision was to expand in Orlando or make the move and put them next to the factory," says Pringle, who's worked for Siemens for 28 years. "I'm glad we are able to convince them. Being close to the product was a big lever."

According to the Charlotte Regional Partnership, more than 1,400 undergraduate engineering degrees and 1,000-plus graduate and doctoral degrees are awarded annually at major universities within 250 miles (402 km.) of Charlotte.

Site Selection's 2009 Top State Business Climate Rankings

Overall Ranking		Executive Survey Rank	2008 New Plant Rank	2006-2008 New Plant Rank	New Plant Rank per Million Pop.	2009 New Plant Rank (Jan. – Aug.)	Final Total Points
1	North Carolina	2	5	4	6	3	382
2	Texas	1	2	1	14	6	381
3	Virginia	6	8	7	9	1	359
4	Ohio	8	1	2	1	14	358
5	Tennessee	5	11	6	11	15	344
6	South Carolina	4	16	18	13	12	333
7	Alabama	7	13	13	7	15	331
8	Georgia	3	19	11	31	11	324
9	Indiana	11	10	14	12	7	320.5
10	Kentucky	14	9	12	2	19	309.5
11	Pennsylvania	20	4	9	10	2	303
12	Michigan	23	3	5	4	4	300
13	Florida	9	12	10	38	13	299
14	Illinois	19	7	3	20	5	297
15	Iowa	16	15	16	3	23	287
16	New York	21	6	8	25	10	275
17	Mississippi	13	22	21	15	26	270.5
18	Oklahoma	17	25	25	22	26	239
19	Missouri	26	18	17	18	15	235
20	Colorado	10	30	35	37	30	234
21	Utah	12	31	32	29	41	226.5
T22	California	24	14	26	45	9	216
T22	Minnesota	27	17	15	17	35	216
24	Arizona	15	35	33	43	24	213
25	Louisiana	24	28	19	32	19	211.5

Source: Conway Data New Plant Database

High-Tech Capital

There's no shortage of major educational institutions in Raleigh-Durham- Cary. The biggest of them — North Carolina State University — gave birth some time ago to Durham-based **Cree**, a developer and manufacturer of energy-efficient LED lighting and semiconductor applications. In early October, the company announced it would add 275 jobs at its Durham facility, and hopes to create an additional 300 jobs by the end of 2012. Approximately half the company's payroll of 1,500 works at the Durham site. The company in August launched production of LED products in partnership with Flextronics at a site in Mecklenburg County.

Greg Merritt, Cree vice president of corporate marketing, says the company is adding the manufacturing capacity within its existing facility footprint. He says the company considered several options, but chose Durham due to its existing LED chip manufacturing capability. Reasonably priced and reliable power also was important. Asked about the continuing relevance of the university connection, Merritt says, "We were founded in this area due to a strong scientific and technology culture, central location and a high standard of living. We also benefit from a highly skilled local work force. Cree draws talent from the public universities and community colleges in North Carolina, as well as from other states and around the world as we grow."

The company's most recent expansion was in 2004, when a $300-million, 300-job R&D investment was aided by an 11-year Job Development Investment Grant (JDIG) that could total $5.1 million in benefits.

In yet another instance of JDIG assisting in the creation of high-value jobs, **Deutsche Bank** in August announced it would invest $6.7 million in a new technology development center in Cary, where the newly formed DB Global Technology Inc. will create 319 jobs over the next five years. The JDIG agreement would award the company up to $9.4 million over 11 years. The new jobs at DB Global Technology will pay an overall average wage of $88,213.

In July, Milken Institute named Raleigh-Cary as the second best performing city in the nation when it comes to economic growth, behind only Provo-Orem, Utah.

"We are extremely excited at the prospect of opening a professional IT development center in the

'I SAW A SHIMMERING LIGHT': The fanciful "Cree Shimmer Wall" that adorns the new Raleigh Convention Center took on new meaning in October. That's when Cree, the homegrown company that helped

Research Triangle, which is home to some of the most highly skilled technology talent," said Anthony P. McCarthy, global CIO, Capital Markets Technology at Deutsche Bank.

sponsor the work and manufactured the 56 LEDs that light its 79,464 square aluminum pixels, announced a plan to add 575 employees to its nearby Durham campus by 2012.
photo courtesy of Cree

"Deutsche Bank is the perfect example of the role that higher education can play in terms of skills and in terms of doing sponsored research," says UNC's Leslie Boney.

"We hosted the delegation before we knew who they were," says Tom White, economic development director at North Carolina State University in Raleigh, who co-hosted delegates from "Project Athena" with Dennis Kekas, associate vice chancellor for N.C. State's Centennial Campus research park (celebrating its 25th anniversary), in March. Presentations from various departments at N.C. State were on the agenda for that meeting, conducted at the College of Engineering. The DB team included representatives from London and Frankfurt, as well as project leaders from the New York office, and consultants from Deloitte and Jones Lang La- Salle. The state's effort was led by Steve Brantley with the North Carolina Dept. of Commerce. Two other buildings in downtown Raleigh and in RTP were considered before the final location was chosen in Cary.

White says DB is part of a cluster in the high-tech financial sector that began emerging about five years ago with projects from Credit Suisse and Fidelity.

"Their willingness to endorse this market as a comfortable home to establish an operation and expand helped us compete successfully for the Deutsche Bank investment," says White.

Among the products made at Siemens' expanding facility in Charlotte (left) is the world's largest generator, here shown in position at the Olkiluoto nuclear power plant in Finland.
photos courtesy of Siemens Energy

Hard-Wired Collaboration

Also helping the area compete is Research Triangle Park (RTP), which now can more credibly be called "the granddaddy of all research parks" as it concludes its golden anniversary celebration. Prominent private schools such as Duke University also lend depth to the landscape.

Source: Site Selection survey of corporate real estate executives, October 2009

"A creation like RTP supplies a community of active intellect and inquiry that no one school could create on its own," said Duke President Richard H. Brodhead at the annual global conference of the International Association of Science Parks held in Raleigh in June 2009. "We all know how much emerges from obscure laboratories. But one thing we don't sufficiently remember is that the knowledge economy does not and cannot thrive everywhere. The first feature you need in that ecosystem is the phenomenon of critical mass — a community of people similar enough, but different enough to provoke each other and strike sparks. The Research Triangle's main function is it supplies that critical mass, with a very large population of very smart, highly trained people in a small area. I was told there are more PhDs per capita in this area than any other — which I promise you was not true in 1957."

That sense of concentrated brainpower is reflected in the National Science Foundation's just-released ranking of 2008 total R&D expenditures at U.S. universities and colleges. Schools in the Tarheel State ranked 7th (Duke University), 26th (UNC-Chapel Hill), 47th (North Carolina State University) and 87th (Wake Forest), out of 679 institutions in the country. The only states with more institutions in the top 100 in that ranking were, in order, California, New York and Texas – states with populations that range from double to quadruple the 9.2 million residents in North Carolina.

The campuses themselves may attract that funding. But the growing network of research parks in the state only help spread its effects further.

"Like most research universities, Duke does some of the technology transfer work in-house," said Brodhead, "but it is an essential advantage to have access right down the street to an R&D apparatus [RTP] that is adjacent, complementary but not identical to the university."

UNC's Boney says the latest effort to address tech transfer is a new report, developed with IBM, that makes recommendations on how to improve tech transfer across all 16 campuses, in order to "make it easier for companies to work with us," he says. "We want a more innovative culture on campus that creates more intellectual property, and looks at options for how we partner with companies to make sure we offer a full range of relationships."

Boney says working with the community college system is also important, especially when it comes to 2+2 articulation programs that allow for credit transfers: "That ends up making a difference for the number of aerospace companies in the state," he says. "That kind of cooperation is an important thing for the companies to see. It also pays off in determining the

Transport, Talent and Taxation Top Factor List

Site Selection's October survey of corporate real estate executives reveals which factors on average are most important to them when they are involved in location decision making.

1. Transportation infrastructure
2. Existing work force skills
3. State and local tax scheme
4. Utility infrastructure
5. Land/building prices and supply
6. Ease of permitting and regulatory procedures
7. Flexibility of incentives programs
8. Access to higher education resources
9. Availability of incentives
10. State economic development strategy

range of skills a company will need when they get here. Making sure credits transfer is mind-numbingly boring on one level, but for a company it's very important."

Rick Weddle, president and CEO of Research Triangle Park, says RTP still gets attention because of the big players in the neighborhood, but "nobody paid attention to the fact that there were 1,500 spinoffs out of RTP. SAS, Quintiles ... we have some of the largest companies in the world that were guys just starting stuff. More jobs have come out of those 1,500 firms in the Triangle than out of the big companies."

Weddle also echoed a point Brodhead made: Schools work with business, but they also make the extra effort to do the unthinkable – work with each other.

"Universities are notorious for not working well even among themselves," said Weddle. "In the Triangle, at these three universities [Duke, UNC-Chapel Hill and N.C. State], it is hard-wired into their culture to work well across lines."

Texas Again Tops Corporate Survey

Fifty percent of our annual business climate ranking comes from a survey we conduct each September asking corporate decision-makers to rank their top 10 states for ease of doing business. For the third consecutive year, Texas has topped that poll of more than 100 respondents. The only thing keeping the state from topping North Carolina is, paradoxically, its large and growing population, which can hurt a territory when per capita calculations are done.

The relatively robust picture in Texas is represented, however, by those very population trends: The state boasts three of the nation's 10 largest cities: Houston, ranked fourth, saw a 13.6-percent growth between 2000 and 2008, according to the Census Bureau. San Antonio ranks seventh (1,351,305 residents, up 16.5 percent). Dallas ranks eighth, with 1,279,910 residents. Meantime, the state capital of Austin ranks 15th, and saw 15-percent growth over that period.

John Talhelm, senior vice president, Jones Lang LaSalle, Houston

The people numbers are reflected in property numbers: In the third quarter 2009 report from CB Richard Ellis, only 11 of 57 markets recorded unchanged or lower vacancy rates, and "the Texas markets of Fort Worth, Austin and Houston stood out as relatively good performers. The state's natural resources, hightech firms, and banks' conservative lending practices have helped that local economy to outperform the rest of the country so far in this recession." CoStar Group's third quarter report showed Houston having most under-construction inventory in the nation at 3,273,959 sq. ft. (304,151 sq. m.).

John Talhelm, senior vice president of Jones Lang LaSalle in Houston, has 23 years of experience to draw on in assessing the Texas business climate, especially for the industrial sector, since moving there himself from New York in 1977. He says the low cost of entry coming into Texas as a new or start-up company has always struck him as one of the state's big selling points.

"You can get a greenfield site if you so choose, and be out of the ground in 10 to 12 months, with the shortest period of time less than six months," he says. "We're one of still a few states with no state income tax. And the other thing you find here is a tremendous work force across the board, whether you're looking for a highly skilled machinist or advanced degree people."

Talhelm cites Houston's 95 consulates, port, NASA and the Texas Medical Center in noting the global cast of the metro area: "We have a huge international community here, and we all seem to get along pretty good," he says. It includes The Woodland, which has one of the highest per-capita ratios of people with advanced degrees in the nation. Paired with that diversity is a certain can-do spirit that has guided the area through rough patches such as the loss of 250,000 petrochemical jobs in the 1980s.

"You didn't hear anybody crying about it," he says. "Not that many people moved out. A lot stayed here, built new companies, picked themselves up and brushed themselves off. The same thing happened with Enron. A year after their collapse, the 4,800 people who lost their jobs were all back in new careers, having started new companies or been hired by other companies. That's the spirit that pervades Texas. That's one of the things that draws people."

The University of Texas M. D. Anderson Cancer Center in Houston is one of several Texas institutions leading the state to the

The biggest adjustment people have to make is ...you guessed it... the sheer physical size of the state.

"It's a 12-hour drive from Houston to Amarillo, and 1.5 more hours to go before you get outside the state," he says. Even navigating just the 11,000 square miles (28,490 sq. km.) of the Houston metro can be daunting. Talhelm says the transportation challenges of the area come from its successful clusters of employment, as opposed to the single central business district that most big cities tout.

Over and above those office clusters, there is the 35 miles (56 km.) of petrochemical facilities along the area's energy corridor, with manufacturing tied to that industry.

nation's upper echelon in R&D funding.
photo courtesy of M.D. Anderson Cancer Center

"The petrochemical and oil and gas industry is and always will be a major part of the economy of Houston," says Talhelm of the environment in which he conducts most of his work. "It represents over 50 percent of the total refining capacity for the U.S. for petrochemical products. They do an amazing job out there keeping their plants running at peak levels, and are doing an amazing job with the environment. A normal day out on the ship channel is blue skies and sunshine."

That may sound a bit rosy to some. But it's clearly the perception of Texas as a whole for corporate executives.

– Adam Bruns

Powerful Package

The North Carolina economy and Massachusetts-based EMC Corp. both got their start selling furniture. Today, they're both technology leaders, based in part on their ability to rearrange infrastructure for the better.

In late September, the two parties found an arrangement to their liking, as EMC announced a $280-million, 397-job expansion at multiple locations in the Research Triangle area. The Fortune 200 company plans to establish a new research facility and data center in Durham County and increase its presence in Research Triangle Park and Apex. In October, Durham County approved $1.2 million in incentives for the deal, and City of Durham officials were mulling their own $1 million in sweeteners. And in the final week of the month, EMC purchased for $113 million a 450,000-sq.-ft. (41,805-sq.-m.) distribution center in Durham.

EMC's facility in Apex, N.C.
photo courtesy of EMC

The state will offer a $7.4-million Job Development Investment Grant (JDIG) to EMC to facilitate the expansion, contingent on job creation and maintenance over a nine-year period.

The 397 new jobs will pay an overall average salary of $73,325 per year, not including benefits, significantly higher than the Durham annual average of $57,772 and the Wake average of $43,160. In addition, because of language in the JDIG statute, the awarding of the grant to projects in such prosperous counties means as much as $2.48 million could be added to the state's Industrial Development Fund for infrastructure improvements in economically distressed counties.

"We're very pleased to receive this generous grant from North Carolina," said Bob Hawkins, vice president of North Carolina operations at EMC. "EMC already has an extensive footprint in the state, so the grant enables us to continue investing in and leveraging North Carolina's world-class talent pool to drive EMC's innovation and long-term growth."

In an e-mail interview, Hawkins calls the company's North Carolina operations "a strategic element of our business. EMC's R&D facility in RTP develops software for our midrange product lines, while our factory in Apex manufactures and delivers those products to the U.S. and Canada. We also have a significant sales and service presence in Raleigh, Greensboro, and Charlotte. Other factors that make North Carolina an attractive location include a well-educated, talented work force; close proximity to engineering graduates; an abundance of relatively low-cost power; and statutory incentives that are favorable to business, including R&D tax credits and some sales tax exemptions."

The company looked at candidate sites across North America for this project, including New York, Washington, Virginia and Canada. Hawkins says the site investigation was launched earlier in 2009 and included a meeting with North Carolina Secretary of Commerce J. Keith Crisco, former chairman and CEO of Asheboro Elastics Corp., in June. Other meetings quickly followed with Wake and Durham County officials as well as City of Durham leaders.

"Key factors for EMC were the cost of power, the ability to meet a critical and short timeline, and the support of the state and local agencies," says Hawkins. "To the latter point, the support and cooperation we received from the Department of Commerce and Wake and Durham Counties was incredible. It was very clear to us from the outset that they were going to do everything possible to make sure that North Carolina was our first choice."

Other partners in the attraction included North Carolina Community Colleges and Duke Energy. Hawkins says power costs were a key consideration, as powering and cooling data centers or R&D labs are some of the highest operating costs for technology companies like EMC. Working with a utility such as Duke that has a culture of economic development made a major impact, he says: "Not only is the cost of energy a factor, but continuous supply and the ability to support our growth requirements are key considerations as well."

EMC itself services the data center needs of major corporations with its products, though Hawkins says it's not currently doing business with any of the new "data farms" from the likes of Google and Apple that recently have popped up in North Carolina. Among EMC's other growth sites are R&D operations in its home state of Massachusetts and in India, and a new center of excellence established in Egypt in September 2009.

Of the company's 914 employees in the state, 750 work in the Triangle.

– Adam Bruns

SAS Campus Leads in More Ways Than One

Jim Goodnight, CEO of Cary-based business analytics software firm **SAS**, got his start in business at North Carolina State University. Today, he is one of the most outspoken corporate executives on the links between business and education. He also puts his money where his mouth is, from endowed professorships to philanthropic efforts to the founding of the independent college prep school Cary Prep to the development of SAS inSchool software.

In 2009, SAS has continued to put its money where its campus is: In March, it announced the development of a $70-million, 38,000-sq.-ft. (3,530-sq.- m.) cloud computing facility (top right). The beginning of that construction process overlapped the completion of its new executive briefing center on the Cary campus (rendering, right). In May, the SAS Solar Farm (bottom right) was the site chosen by Gov. Bev Perdue for the announcement of her energy reform package, which among other measures establishes the Department of Commerce as the home for state energy policy, including a weatherization program. The package aims federal recovery money toward new programs that include a revolving loan fund for energy-saving projects, a green business grant fund, "green-collar" training at community colleges and several programs funding energy efficiency and renewable energy efforts.

photos courtesy of SAS

– Adam Bruns

www.siteselection.com

TOP OF PAGE

Top of Page | Letter to Editor | Site Selection Online | SiteNet

THE BALANCED SCORECARD:

A NEW FRAMEWORK FOR

MANAGING THE

ECONOMIC DEVELOPMENT ORGANIZATION

By
Ed Bee, CEcD, President
Dave Kolzow, PhD, Principal

TAIMERICA
MANAGEMENT COMPANY
347 Girod Street
Mandeville, LA 70448
(985) 626-9868
FAX: (985) 626-9869
ebee@taimerica.com

Technology Assessment•Strategic Planning•Organization Design•Site Selection

December, 2009

TABLE OF CONTENTS

THE BALANCED SCORECARD: A NEW FRAMEWORK FOR MANAGING THE ECONOMIC DEVELOPMENT ORGANIZATION 3

BACKGROUND AND RATIONALE FOR THE USE OF THE BALANCED SCORECARD IN ECONOMIC DEVELOPMENT 4

THE BALANCED SCORECARD AND EDOs 12

FIVE PERSPECTIVES IN THE BALANCED SCORECARD FOR ECONOMIC DEVELOPMENT 14

IMPLEMENTING A BALANCED SCORECARD 22

CONCLUSIONS ABOUT THE BALANCED SCORECARD APPROACH 30

APPENDIX 32

THE BALANCED SCORECARD: A NEW FRAMEWORK FOR MANAGING THE ECONOMIC DEVELOPMENT ORGANIZATION

If you don't measure results, you can't tell success from failure.
If you can't see success, you can't reward it.
If you can't reward success, you're probably rewarding failure.
If you can't see success, you can't learn from it.
If you can't recognize failure, you can't correct it.
If you can demonstrate results, you can win public support.
Tom Peters

The news about the flow of revenues for state and local government and for non-profit organizations continues to be discouraging. Hiring is on hold, staff is being let go and not replaced, budgets are getting tighter, membership levels are dropping, and agencies and organizations are being asked to do "more" with "less." Financial pressures are leading city councils, county commissioners, and contributors to want more information on the results being achieved by the programs they fund. They want to see evidence that these programs are well managed. They want to know which services have been successful in achieving results. The increasing scarcity of funding resources is forcing the question: "what kind of bang are we getting for our buck?" In other words, organization stakeholders want accountability. This is the new environment in which the economic development organization increasingly finds itself. And the need for accountability will not abate when the economy recovers. It's an enhanced mandate for economic development groups that has become the norm.

The purpose of this white paper is to improve the performance of economic development organizations through the application of a new tool. The Balanced Scorecard in Economic Development™ is a management tool that integrates strategic thinking into the work practices and procedures of economic development organizations (EDOs). This document consists of three sections. It begins with a discussion of the background and rationale for the Balanced Scorecard; a discussion of the balanced scorecard follows, followed by a discussion of the steps involved in implementing the balanced scorecard in an economic development organization.

BACKGROUND AND RATIONALE FOR THE USE OF THE BALANCED SCORECARD IN ECONOMIC DEVELOPMENT

The Link Between Performance and Accountability

Certainly, the typical economic development organization has some awareness of what it is doing and what it is accomplishing, but it typically focuses more on day-to-day activities rather than on long-term strategies. Even the results of this day-to-day activity are frequently not communicated effectively to the stakeholders and Board of the organization. Organizational plans, written for guiding the actions of the organization's staff, don't do much to educate local stakeholders. It is no surprise, then, that local leaders often have little trust or confidence in how development organizations are spending their time and money.

Economic Development Organizations (EDOs) clearly need to improve accountability if they intend to succeed over the long term and they need to communicate their accountability measures to stakeholders and customers. An effective accountability system is not meant to negatively criticize an organization, placing blame and/or punishing employees. Instead, the accountability system should be designed to motivate the organization toward higher levels of performance. To properly serve their stakeholders and customers, development organizations need to make the necessary information available that can facilitate an understanding of what is happening and why. Unfortunately, measurement of performance is one of the weakest areas in management today, and much of the measurement that exists is focused on finances.[1]

Strategic Planning Doesn't Guarantee Good Performance

A recent survey suggests that 74 percent of economic development groups have a strategic plan.[2] Strategic planning has become the norm in economic development because the most meaningful changes take many years to implement. Executing economic development strategy is a formidable challenge. Many good plans never get implemented. Research by Harvard professors Robert Kaplan and David Norton suggests that only ten percent of business organizations execute their strategy.[3] We believe,

[1] Niven, Paul R. Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results. New York: John Wiley & Sons, Inc., 2002.
[2] Gordon, Gerald. Strategic Thought and the Economic Development Professional, Washington, DC: IEDC, 2006.
[3] Niven, Paul R. Balanced Scorecard for Government and Nonprofit Agencies. New York: John Wiley & Sons, Inc., 2006.

based on our professional experience, that the percentage for economic development organizations is probably as low. Kaplan and Norton identified four barriers than hamper the execution of strategy (see Figure 1):

- Vision Barrier - Only five percent of the workforce understands the strategy.
- People Barrier - Only a fourth of managers in private business have incentives linked to the attainment of strategy (rather than to profits).
- Management Barrier - 85 percent of executives spend less than one hour per month discussing strategy. This barrier is also an issue for economic development leaders. Gerald Gordon's survey of economic development professionals suggested that about half spend less than 20 percent of their time on strategy. (The majority of developers in the survey felt they lack adequate time for implementing strategy).
- Resource Barrier - 60 percent of organizations don't link their budgets with strategies.

While we lack comparable statistics for economic development groups, we have to believe that their situation is no better than corporations in the for-profit world. In other words, economic development groups typically receive little tangible value from their investments in strategic planning because they fail to execute their strategies.

Is strategic planning therefore a failure? The answer is, of course: NO. Strategies are a necessary but insufficient condition for transforming a regional or local economy. Examples abound of communities that have transformed themselves when they execute sound strategy.

Figure 1. Barriers to Execution of Strategy

The Balanced Scorecard Improves Performance in EDOs

Effective performance measures are key in executing strategy, but effective performance measures, are not the financial metrics like cash flow or return on investment or their economic development counterparts: amount of new capital investment and announced jobs. These measures look backward to measure how well the organization controlled costs or closed deals but they don't provide the forward looking measures needed to execute strategy. In most cases, visionary strategies are hampered by looking at annual financial results or, in economic development, by looking at announced projects and jobs.

Kaplan and Norton, creators of the Balanced Scorecard, recognized several years ago that the most successful adopters of the scorecard technique excelled because they had harnessed it to guide the company's long-term strategy.[4] The Balanced Scorecard and Strategy go hand in hand, and Kaplan and Norton sum up this subject very well: "*The formulation of strategy is an art. The description of strategy, however, should not be an art. If we can describe strategy in a more disciplined way, we increase the likelihood of successful implementation. With a Balanced Scorecard that tells the story of the strategy, we now have a reliable foundation*."[5]

Seven Characteristics of Effective EDOs

1. A clear vision that is broadly held throughout the organization;
2. A mission statement that captures the purpose of the organization and its core values;
3. A written strategic plan that guides the long-term performance of the organization;
4. Excellence in managing the organization's operations, with performance measures that demonstrate that excellence;
5. A customer as well as stakeholder perspective in operations, budgeting, reporting, and planning;
6. An internal communications system that breaks down silos and encourages interaction; and,
7. An excellent system for learning, sharing knowledge within the organization, and adapting to change.

The success of this approach demonstrates that high-performing organizations all have seven attributes (see text box).

[4] Kaplan, Robert Kaplan and David Norton. "Using the Balanced Scorecard as a Strategic Management System." Harvard Business Review. July-August 2007: 2-13.

[5] Kaplan, Robert and David Norton. The Balanced Scorecard – Translating Strategy Into Action. Cambridge: Harvard Business School Press, 1997.

The most effective use of the Balanced Scorecard involves a collaborative effort within the organization. This means spending time initially to develop effective and interactive communications, a challenging vision, and a clear mission for the organization. The first question that needs to be asked is the vision question: "***What are we trying to accomplish?***" The second question is the strategy question: "***Are we doing the right things?"*** The answer to these questions may require a change in the culture of the organization, which has to support the building and implementing of a Balanced Scorecard if the organization is to succeed in improving to a high performance level.

Prerequisites to the Balanced Scorecard

The Balanced Scorecard is useless in the absence of an exciting vision, a clear written strategy for achieving it, and a well defined mission for the organization. We will briefly discuss each of these prerequisites prior to discussing the five perspectives in the Balanced Scorecard for Economic Development.

Vision and Strategy

A vision statement for the organization is a word picture of what it would like to eventually become. It involves looking into to future and determining what changes key stakeholders or Board members would like to see happen. It is easy to develop rather vague and lofty statements about the future of the organization, such as "being the best economic development organization" or "one of the best." However, these kinds of statements don't translate very well in terms of what the organization does on a daily basis to accomplish that vision. A vision has to be achievable to be inspirational. As organizational learning expert Peter Senge has observed, "*Vision translates mission into truly meaningful intended results – and guides the allocation of time, energy, and resources. In my experience, it is only through a compelling vision that a deep sense of purpose comes alive."*[6]

However, it is impossible to recognize achievement and success regarding the vision if there is no way to measure it. That is the function of the strategic plan that follows and the performance measures used to determine progress and results which will be discussed further after we explain the five perspectives in the Balanced Scorecard model.

Mission

A mission statement defines the primary purpose of the organization. It clarifies why it exists and who it serves. Unlike goals and strategic actions, which are formulated to be achieved over time, the organization never completely fulfills its mission. Instead, it serves as a blueprint for the ongoing work of the organization. It should neither be too

[6] Senge, Peter. "The Practice of Innovation," Leader to Leader. 9 (1998), 16-22.

short (a slogan) or too long (an essay), but should capture the essence of what the organization is about. It should also be easy to understand, but should at the same time inspire the staff and stakeholders to perform at quality levels. The mission of economic development organizations vary depending on the size and scale of the organization.

A well-stated mission enables all employees to see how their day-to-day actions are consistent with the values of the organization, and helps them understand how those values are crucial to the success of the organization. Everything that an organization does and measures should directly support its overall mission.[7]

The Balanced Scorecard Overview

If you're not keeping score, you're just practicing.

The Balanced Scorecard is a management approach for improving organization accountability and performance. It is a tool used by numerous private companies and a growing number of non-profits to measure and align performance with the company's or organization's vision and strategies for success, and to assist in implementing those strategies. The Scorecard puts strategy, which is the key driver of results for organizations, at the center of the management process.

It has been estimated that about half of major companies in the U.S., Europe, and Asia are using Balanced Scorecard approaches in one form or another.[8] In 1997, *Harvard Business Review* called the Balanced Scorecard one of the most significant business developments of the previous 75 years.

Why did the Balanced Scorecard emerge? Managers in the 1980s began to understand that financial metrics, such as return on investment or profit margins, did not help improve operations since financial measures are "lagging" indicators of performance. The Balanced Scorecard was developed by professors Kaplan and Norton at Harvard in the 1990s to overcome the weaknesses of financial measures as a tool for managing operations.[9]

In 1996, Charlotte became the first municipality in the United States to adopt the balanced scorecard. City officials realized that they had to modify the management tool in order to make it fit the public sector.[10] Subsequently, a number of municipal

[7] Osama, Athar. "Using a Balanced Scorecard to Measure Your Economic Development Strategy," Economic Development America, Fall 2008.
[8] Advanced Performance Institute.
[9] Kaplan, Robert and David Norton "The Balanced Scorecard: Measures that Drive Performance" Harvard Business Review. Jan.-Feb. 1992: 71-80.
[10] Niven, Paul R. Balanced Scoreboard: Step-by-Step for Government and Nonprofit Agencies. Hoboken NJ: John Wiley & Sons, 2003.

governments and non-profits have adopted the Balanced Scorecard as a management improvement tool.

The Scorecard recognizes that excellent performance involves much more than financial performance. This is particularly true in the knowledge-based organization where value is less on tangible products and more on the ideas and experience of people scattered throughout the organization. The Scorecard system is designed to help everyone in the organization create value by understanding and working towards a shared vision and set of strategies. This can transform day-to-day operations, with employees demonstrating desired behaviors that lead to achieving the organization's strategies.

Performance measures can be developed based on these strategies, which can then be used to improve decision-making and to show progress toward desired results. After all, an organization can't improve what it can't measure. Successful organizations must "Do the right things" to obtain desired outcomes, but also must "Do things right." For many organizations, the ultimate outcome is to meet customer needs and requirements.

This system is called a "Balanced" Scorecard because it provides a means for achieving balance within the organization. For example, if an organization pays too much attention to their budget and internal processes, but ignores their employees' needs for learning and growth or don't try to find out how to better serve their customers, the organization is clearly "unbalanced." This can lead to poor strategies and ineffective decisions. Too much time can be spent on trying to figure out what went wrong, and it is often likely that mistakes will repeat themselves.

Achieving this balance requires that attention is paid to linking the EDO's strategies across the following five perspectives (as opposed to the four perspectives in the for-profit model). Those organizations that are able to demonstrate "excellence" excel in each of five perspectives (see Figures 2 and 3):

- **Financial Perspective:** This covers the financial goals of an organization and enables management to track financial success. It should revolve around determining the financial steps that are necessary for ensuring the execution of the organization's strategy. The emphasis for nonprofits is demonstrating a satisfactory return on investment for funders and members. Financial measures, however, focus on past performance and past activities in the organization, and have little predictive power. Furthermore, they are more about short-term gains rather than long-term success. Financial measures are not the "drivers" of the future performance of the organization, financial or otherwise.

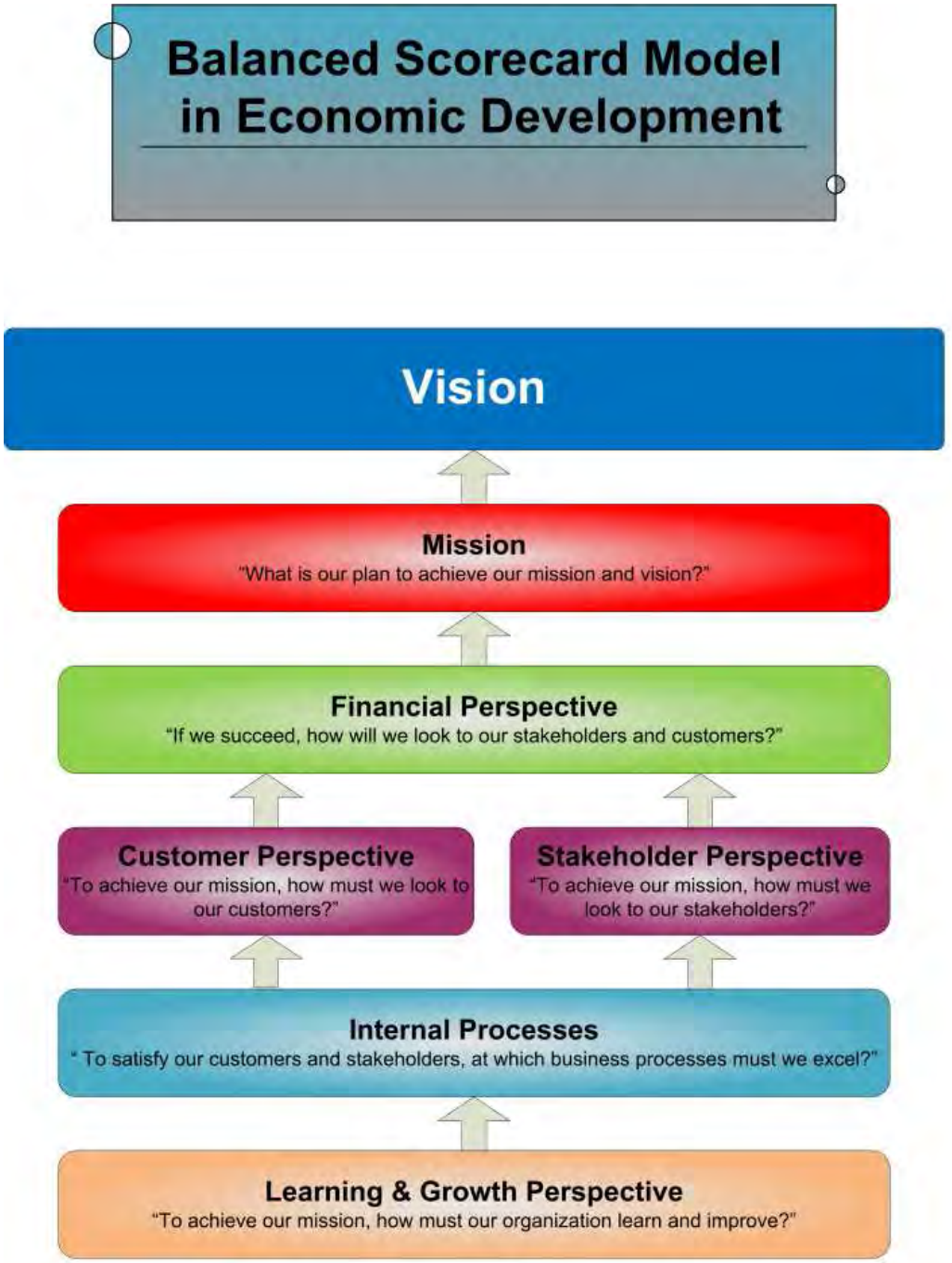
- **Customer Perspective:** The focus is on establishing excellent relationships with customers and clients. Performance measures of importance to customers might include timeliness, quality of services, levels of performance, and possible costs.

- **Stakeholder Perspective:** Those local constituents of the organization who fund it and who receive value from it generally have outcome expectations. This is an important perspective for economic development organizations, but isn't included in the original Balanced Scorecard mode that is portrayed in Figure 1.

- **Internal Process Perspective:** The organization determines how to excel at its core operations with the intent of meeting customer needs, satisfying stakeholders, and demonstrating good financial performance.

- **Learning and Growth Perspective:** The learning organization incorporates training, knowledge management, building staff capacity, developing leadership, using technology effectively and changing the corporate culture as necessary to excel at sustaining change and improvement. The question that the organization must focus on is what capabilities, skills, and tools do its employees need to help them successfully execute the organization's strategies. This measures the organization's ability to adapt and innovate for the future.

Figure 2.



Source: Adapted by Taimerica from A Knol by Dylan – Balanced Scorecard for Nonprofit Organizations

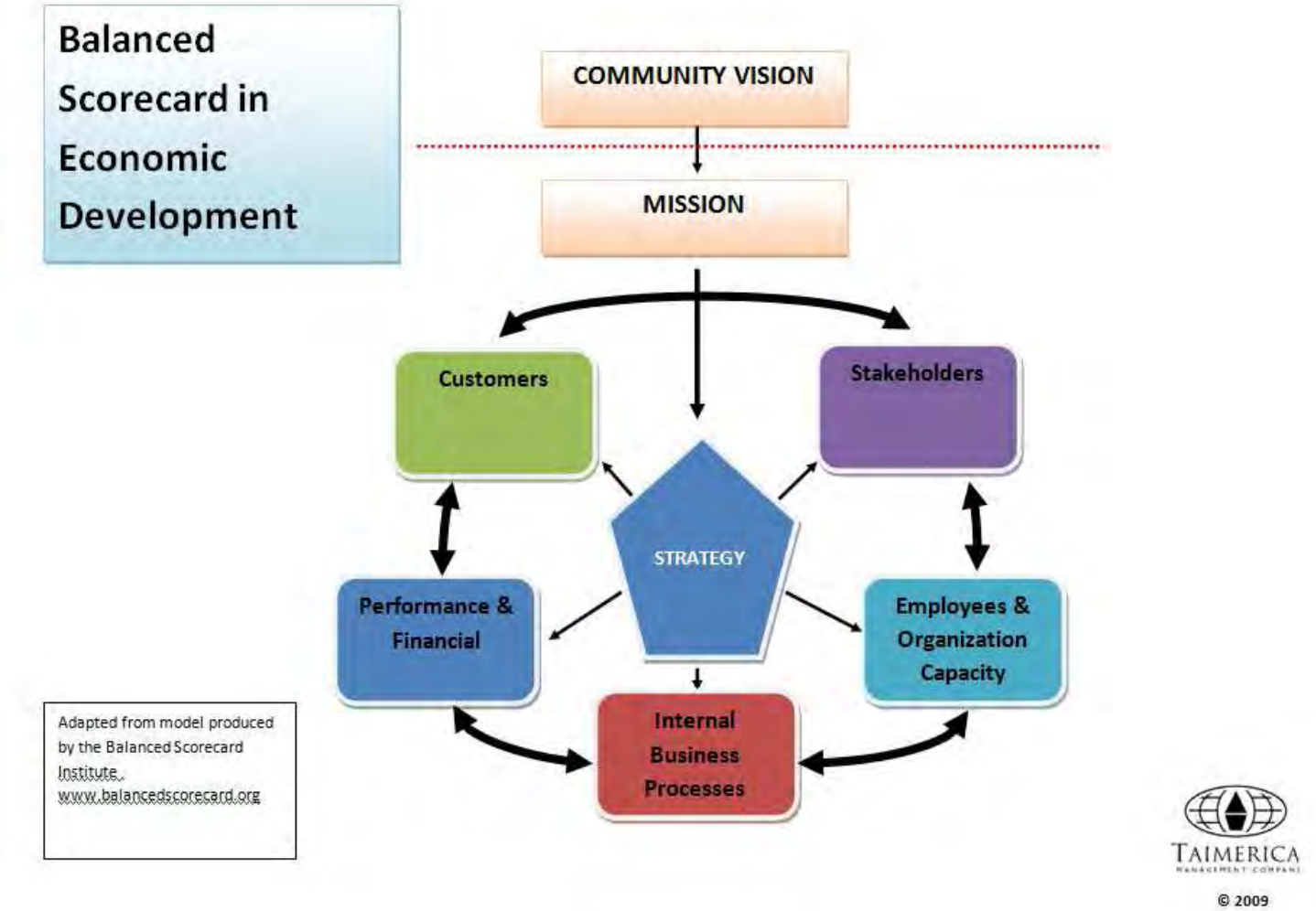
THE BALANCED SCORECARD AND EDOs

Taimerica conducted a nationwide study of best practices in economic development in the summer of 2009. When we analyzed the characteristics of best practices EDOs, we discovered that they typically embody the five perspectives of the Balanced Scorecard.

Taimerica modified the Balanced Scorecard used in Corporate America to guide our analysis of effective management in Economic Development. Our model reflects the differences between for-profit companies and nonprofit economic development organizations (see Figure 3). Unlike private companies, the vision of economic development organizations is determined externally by community leaders and stakeholders rather than from within the business (shown by the dashed red line).

As in Corporate America, however, vision and strategy ("Doing the right things") are central to success. Economic development groups have to consider five perspectives, rather than the four in the corporate model, in their balanced scorecard. The perspective of stakeholders has been added to our model to reflect their importance in economic development. Each of the perspectives will be discussed at length in the next section of this report.

Figure 3.


Balanced Scorecard in Economic Development
COMMUNITY VISION
MISSION
Customers
Stakeholders
STRATEGY
Performance & Financial
Employees & Organization Capacity
Internal Business Processes
Adapted from model produced by the Balanced Scorecard Institute
www.balancedscorecard.org
TAIMERICA
© 2009

FIVE PERSPECTIVES IN THE BALANCED SCORECARD FOR ECONOMIC DEVELOPMENT

The five perspectives shown on the Balanced Scorecard model need further explanation. Who, for instance, are our customers and how do we distinguish customers from stakeholders? In the for-profit world, it's pretty clear that customers are the people who buy your product or service while stockholders are people that own the business. But the for-profit model is a poor analogue for economic development organizations. Customers don't pay for the group's services and stakeholders don't receive a monetary return.

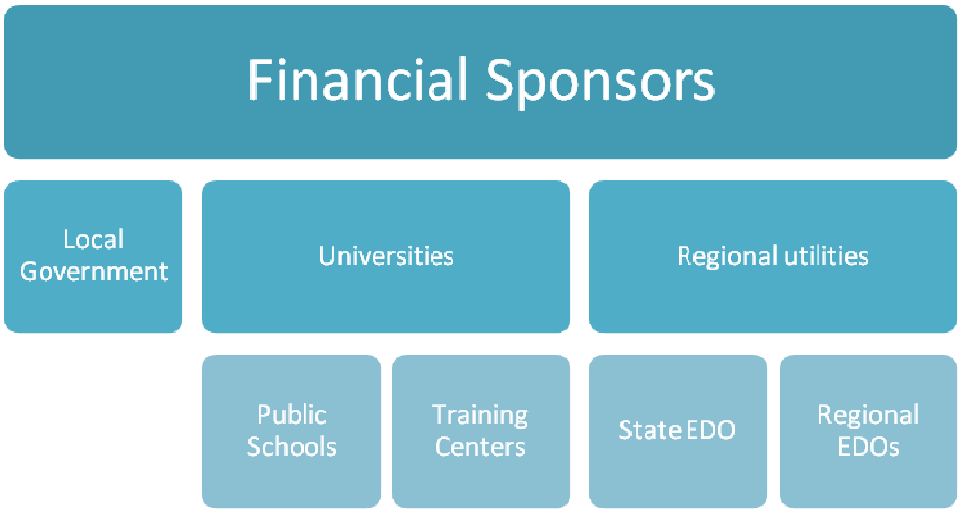
Distinguishing Between Customers and Stakeholders

Peter Drucker defines customers as those who must be satisfied in order for the organization to achieve results. Who are the customers of an economic development organization? As in the for-profit world, they are the businesses that consume your services, even though their purchases don't involve a monetary transaction. Typical customers include existing businesses in the community that are looking to expand their operations or external businesses that are contemplating an investment in the community. They could include local entrepreneurs or consultants hired by external investors. Different customers will have different requirements. For example, site consultants have a different set of needs than local small business start-ups.

Who are the key stakeholders for an economic development organization? This is a complex topic because the stakeholders are more diverse than found in the corporate world, where key stakeholders might include key suppliers, banks, the investment community and environmental and government regulators.

Stakeholders in economic development include financial sponsors, development groups at the state or regional level, universities, K-12 schools and other training institutions, utilities, as well as local governments that might provide financial support or grant incentives (see Figure 4). The complexity of economic development stakeholders is the primary reason that we have assigned them a separate perspective in our Balanced Scorecard in Economic Development.

Figure 4. Typical Stakeholders for an EDO



Customer Perspective

A review of recent research on best management practices clearly demonstrates that all organizations, private, public, or non-profit, need to pay more attention to their customers and clients. Customer service is a core value, an attitude, and a set of supporting management structures which make providing what the customer wants and values at the center of the organization. If customers are not satisfied, they will lose confidence in the organization and go elsewhere to get their needs met. The economic development organization needs to answer the question: "Does everyone involved in this organization know what our customers want and how their work affects those customers?"

Taimerica's research on Best Practices suggests that EDOs (both regional and local) that excel have a customer-dominated culture. Economic development organizations that display best practices generally have value systems and internal business processes that stress providing customer value. The essence of good customer service is forming a relationship with customers – a relationship that transcends a specific transaction, such as one business retention visit. How can an economic development organization truly serve others if it doesn't value their needs and desires, if it doesn't understand them, and if it doesn't strive to meet their needs and provide them with excellent value?

While nonprofit organizations have perhaps always intuitively recognized the importance of satisfying customers, they haven't always taken the time to integrate the core concept of customer service into the way they manage their organizations. Employees aren't necessarily rewarded for offering excellent customer service; management systems are not designed to track feedback from customers as a means of improving performance; evaluations may include customer outcomes but they don't always include measures of

customer satisfaction; and perhaps most disturbing, nonprofit programs are not always judged against the hard standard of providing customer value.

Leading regional economic development organizations, such as in Indianapolis and Charlotte, have a formal process for obtaining customer feedback on an annual basis, plus they use the results to improve internal processes. This is something that also occurs in the businesses that have been successful in their use of the Balanced Scorecard.

Stakeholder Perspective

Funders and other supporters are more aware than ever of the reputation of the nonprofits they support. Dissatisfied stakeholders are a sure way to lose financial support. On the other hand, positive feedback from stakeholders can form an essential element of an evaluation system. It can provide information to provide information that funders and other supporters are increasingly demanding to validate their financial support.

Taimerica's research suggests that Best Practice EDOs have more of their stakeholder base concentrated in the private sector than in traditional EDOs. This frees up senior management time from fundraising (private commitments often run for five years versus annual commitments by government) which provides stability in operations and more time for executives to spend with strategic issues.

The one area where Best Practices organizations differ from traditional EDOs is in their use of systematic electronic surveys of stakeholders to gauge their satisfaction with reported results and with the frequency and depth of communications they receive.

Financial Perspectives

The Balanced Scorecard does not ignore traditional financial matters, even though it moves away from a dependence on them for evaluating the performance of the organization. As was stated earlier, financial measures tell the story of past events, rather than provide a path to future actions. Financial measures don't tell the organization how well they are serving customer needs, or the level of support of the Board, or the capabilities of the staff.

However, timely and accurate financial data will always be important to the organization. After all, the level of funding and expenditures provide important parameters on the level of activity of the organization. This information also can be used to demonstrate to stakeholders and investors a return on their investment in the organization. Use of the Balanced Scorecard also demonstrates to the funders of the organization a willingness to

provide meaningful information that can be used in future decisions about the need for and use of resources.

The fundamental purpose of an organization's budget is to allocate resources among the possible alternatives that the organization is planning for. However, most organizations don't link their budgets to their strategic planning, and, instead, plan their strategies based on the size of their budgets.[11] Instead, the human and financial resources necessary to achieve Scorecard targets should form the basis for the development of the annual budgeting process.[12]

The excellent economic development organizations tend to have stable and predictable sources of funding with more revenues to work with than the typical EDO. Stability in funding stems from the dominant role that private investors play in those organizations demonstrating best practices, which insulates them from political pressures. In terms of budget performance, the benchmarked organizations generate budget surpluses and amass assets over time. These financial reserves give managers a lot of flexibility in adapting to unusual opportunities.

Internal Business Processes

Internal business processes run a wide gamut. They include all of the organization's practices and activities that define its work. If these internal business processes are to be excellent, the organization must have the right people, knowledge, and work systems. In the economic development arena, core operations focus on a combination of business recruitment, working with existing business, entrepreneurial development, creating a positive business climate, site development, etc.

The performance measures that are developed to define this work enable management to know how well the organization is performing, and whether its products and services are meeting the needs of its customers, clients, and stakeholders. These performance measures have to be carefully designed by those who know these work processes most intimately. If the organization is to improve the performance of its internal business processes, it first has to know what those processes are and how well they are performing. Otherwise, it is difficult to determine where possible problems lie and what must be dealt with more immediately. This includes measuring the time it takes to get things done and how quality levels compare to what the customer or client demands.

[11] Niven, Paul R. Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results. New York: John Wiley & Sons, Inc., 2002.
[12] Niven, Paul R. Balanced Scoreboard: Step-by-Step for Government and Nonprofit Agencies. Hoboken NJ: John Wiley & Sons, 2003.

As EDOs do not produce a tangible product or service (except for those in the real estate development business), their internal operations are simpler than their counterparts in private business. They don't have to worry about distribution and delivery, R&D, or environmental regulations. Their Internal Business Processes are less likely to lead to competitive advantages than the other factors in the balanced scorecard. Exceptions might include: 1) Ability to provide detailed site selection information to prospect companies on a quick turnaround; or 2) ability to rapidly resolve complex expansion issues of companies within their jurisdiction.

Businesses that use the Balanced Scorecard approach survey customers to rate the effectiveness of their internal business processes. This becomes the basis for change and improvement initiatives within the organization. Some of the best practices EDOs that Taimerica evaluated are using similar tools. Indianapolis has used double blind surveys of site consultants to refine their marketing and proposal development process. Charlotte has used surveys to improve communication with stakeholders and to refine its marketing and promotion programs. The use of customer surveys is just emerging in economic development as a tool for the redesign of internal business processes.

Employees and Organizational Capacity

This perspective is sometimes referred to as the "innovation and learning perspective". It is concerned with the organization's intangible assets that build value. It involves employee training and changing the organization's culture to support continuous staff and organizational improvement. The focus is on building employee's skills, increasing their satisfaction on the job, and improving the flow of communication within the organization. The key ingredients for building organizational capacity and successful performance are motivated employees with the right mix of skills and tools operating in an organizational environment designed for sustaining operational improvements.[13] It is in this innovation and learning perspective arena where an organization determines its destiny.

Unfortunately, many organizations pay too little attention to the need to build their capacity as a "learning organization." This is despite the reality that the measures developed in this "perspective" are really the enablers and sustainers of all other measures on the Scorecard.[14]

Remembering that good customer service is a vital perspective of the organization, it is important to recognize the power and importance of employees to provide that service. Employees that are in direct contact with the customer are ultimately the conveyors of

[13] Ibid.

[14] Niven, Paul R. Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results. New York: John Wiley & Sons, Inc., 2002.

good or poor service and consequently they need the training, support, and authority to provide that service. If the organization takes time to train and support its employees, they are more likely to take care of the customers.

In the Knowledge Economy, economic development organizations are becoming increasingly aware that the management and staff must increase their capacity as knowledge workers. People in the organization are the only repository of knowledge for the organization, and are therefore its primary and essential resource. Therefore, the "implicit knowledge" held within the minds of the staff and members of the organization need to be made "explicit" and become part of the discussion and learning process. Because of the increasing complexity of economic development and changing technologies, employees and management need to move into a continuous learning mode.

It is the set of strategies for the organization that should determine where the training is needed and how the results should be measured. It is especially important to train staff in the skills and knowledge that is necessary for them to be able to develop Balanced Scorecard performance measures that will help the organization execute its strategic plan. However, learning is more than training. It also includes the use of mentors and tutors so that the level of motivation for this learning can be increased and past experience can readily be incorporated. Knowledge management systems can help support the learning environment and ensure that knowledge is captured and not lost.

The Learning and Growth Perspective encompasses three dimensions: human, information, and organizational capacities.

Human Capital

The skill and knowledge of the workforce are at the core of the competencies of the organization. When measuring human capital, skills are the easiest to identify, measure, monitor, and improve.[15] It is more difficult to measure "talent." Talent is a function of motivation, personality, experience, and skills wrapped into an individual. It is difficult to develop talent via training. It is important that the economic development organization try to match its talented people with the appropriate jobs.

A common thread among the Best Practice organizations that Taimerica surveyed in 2009 was their recognition of the value of talent as a competitive asset. The best practices organizations pay much higher salaries than their traditional counterparts. In other words, they are willing to pay top dollar to recruit the talent they need. The caliber of executive talent in EDOs is the asset that appears to best explain excellent

[15] Niven, Paul R. Balanced Scoreboard: Step-by-Step for Government and Nonprofit Agencies. Hoboken NJ: John Wiley & Sons, 2003.

performance. It matters more than software, internal business processes, performance measurement systems, or any of the other assets that the organization controls.

This issue of human capital is particularly important for EDOs, since they have fewer avenues for building competitive advantage than their counterparts in private business. A major corporation can build advantages through its asset deployment (location of production facilities, for example, or the level of capital it invests in R&D, software, or production plants). In economic development, competitive advantage stems largely from the talent within the organization, which is not to say that talent isn't important as well to a private enterprise.

Information Capital

Information capital is frequently divided into three types of applications: transaction processing (which is an insignificant activity in most economic development organizations); analytic applications; and transformation applications (software and systems for managing change). Good research (analytic applications) is one area of Information Capital where EDOs can gain competitive advantage.

The economic development market is too small to offer the range of customized software or expert knowledge management systems found in the for-profit sector. Those that exist, such as GIS, customer relationship software, or BR&E software, are widely adopted and therefore don't distinguish Best Practice groups from others.

Organization Capital

Organization Capital is often the most important contributor to corporate performance and growth. This resource, however, is rarely measured internally or reported to stakeholders, thereby seriously hampering both management's efforts to effectively allocate resources and the policy-making decisions of Board members and other stakeholders.[16]

Organization Capital consists of the unique systems and processes that are used by the organization in its work activity and in managing its human resources. It is the persistent creator of excellence and growth for any organization. Organization Capital typically can be categorized as having three components: the culture of the organization, its work practices, and the effectiveness of its leadership.

[16] Lev, Baruch and Suresh Radhakrishnan, "The Value of Organizational Capital," from http://pages.stern.nyu.edu/~blev/docs/TheValuationOfOrganizationCapital.pdf

A number of work practices are key to building organizational capital. One key area is access to organizational information and open communication. This is occurring increasingly through the deployment of such information technology as groupware and business-intelligence tools. The desired outcome is to empower workers to make more decisions with less supervision. Organizations also need to invest in promoting a corporate culture and offer workers strong performance-linked incentives and rewards. Best Practice EDOs have a customer-focused culture. The culture of quality organizations should promote a focus serving the customer, provide an effective means of communicating their strategic and financial goals on a regular basis, expect top-quality employees, and support an investment in "human capital" through training.

By and large, these actions are complementary. In fact, when organizations take only some of these steps, such as providing workers with more information but not empowering them to act on it, the quality of the output of the organization can suffer.

The "Balance" in the Balanced Scorecard

The interconnection, or link, between the previous aspects of the Balanced Scorecard is the strategic plan. The organization's strategies answer the question: "Are we doing the right things?" If the strategies don't support the vision and mission of the organization, they are just isolated activities that may not build the organization's capacity to excel.

The "execution of a strategy is more important, and more valuable, than the formulation of a strategy."[17] The Balanced Scorecard focuses the organization on improving those work processes most critical to the organization's strategic success. The idea is that if the organization wants to deliver the right performance in one perspective (e.g., financial success), it has to deliver the right outcomes in the other perspectives (e.g., delivering what the customer wants). If done correctly, the Scorecard integrates customer service with stakeholder service with financial performance.

For example, if one desired outcome of the economic development organization is to improve the ability to work with prospects and close deals, then the plan must outline how staff will be trained in how to respond to prospects, how they will be rewarded for good performance, how this will be demonstrated to stakeholder to increase their support, where the money will come from for additional training, etc. All of these are separate items in a strategic plan, but if they aren't integrated into an overriding strategy, their importance will be lost and the likelihood of implementing them will be reduced.

[17] Niven, Paul R. Balanced Scoreboard: Step-by-Step for Government and Nonprofit Agencies. Hoboken: John Wiley & Sons, 2003.

This integration might be better understood by thinking about the use of "if-then" statements. If we increase training, then staff will be more capable of responding to prospects. If prospects are more satisfied, then more positive leads and projects will be generated. If the level of prospect activity increases, then the stakeholders will be more enthused. If the stakeholders are more enthusiastic, then they will be interested in increasing funding for the organization. If the organization has more funding, then it can be more aggressive in developing leads.

The strategic plan is also the beginning point for performance measurement. Performance measures need to be developed so that managers and staff pursue long-term outcomes rather than rely on short-term results. The best plans focus their organizations on "making a difference" rather than on just "keeping busy."

IMPLEMENTING A BALANCED SCORECARD

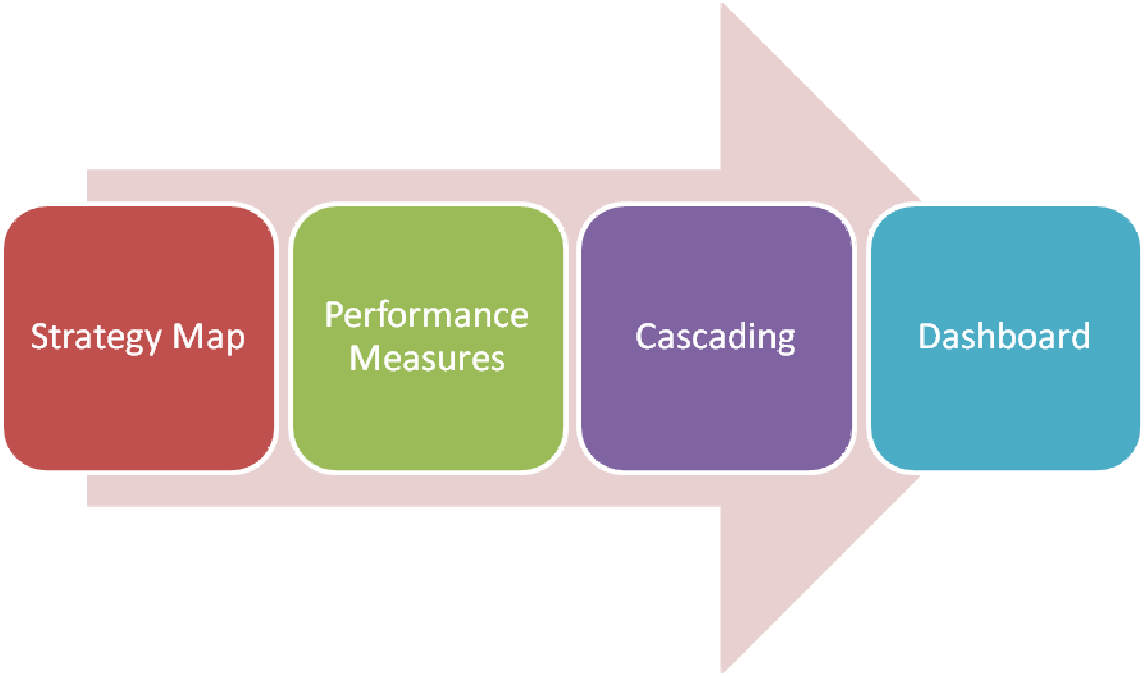
The Balanced Scorecard can be the source of a true management system for the organization, but it must be fully developed, continually used, and managed carefully. Furthermore, this is an integrated process; the output from each step must link to the input of the next step. The strategic actions must be congruent so that they are tied together in a useful way. This is "a continuous journey, not a project."[18] It has no beginning and no end. *"A scoreboard journey is a quest for high performance, a focus on results, an increase in group and individual accountability, and an embracing of organizational change."*[19]

The Scorecard gives management a way of ensuring that all levels of the organization understand its vision, mission, and strategies, and that all the activities of the organization are aligned with the plan. When the measures on the Scorecard link together properly, the strategy becomes much clearer. Furthermore, once the Scorecard has been developed, all of the strategic actions within the organization's strategic plan should be reviewed with the intent of determining which are truly critical to the fulfillment of the desired outcomes and which are only consuming valuable resources. Furthermore, this framework helps the organization's management and staff identify what should be done and measured.

Implementing a balanced scorecard involves four sequential steps as shown in Figure 5 and discussed below.

[18] Rohm, Howard and Larry Halbach, "A Balancing Act: Sustaining New Directions," Perform, 2 (3), 2.
[19] Rohm, Howard. "Improving Government Performance: Using the Balance Scorecard to Plan and Manage Strategically," Balanced Scorecard Institute.

Figure 5. Steps to Implement the Balanced Scorecard



Step #1: Developing a Strategy Map and Performance Objectives

A "strategy map" shows a logical, step-by-step connection between the strategic actions in the form of a cause-and-effect chain. To develop a strategy map, the organization selects a few strategic objectives within each of the perspectives, and then defines the relationship among these objectives by drawing links between them. Generally speaking, improving performance in one Perspective (such as learning and growth) enables the organization to improve performance in another Perspective (such as internal processes), which in turn enables the organization to create desirable results in the Financial Perspective. Reading the map means starting at the bottom of it and asking the question, "Why?" In other words, "what is the logic behind the strategies?"

Good strategy maps can tell the story of your organization's strategy. For example, "if we provide employees with the necessary training, technology, and culture, then they will be able to implement the necessary internal processes that will provide customers a satisfaction of their needs that in turn will result in achieving our financial objectives, thereby allowing us to execute our mission and achieve our vision." Figure 6 demonstrates an example of the cause and effect relationship in strategy maps while Figure 7 demonstrates an example of a strategy map in economic development.

Figure 6. Example of Cause-and-Effect Linkages on a Strategy Map

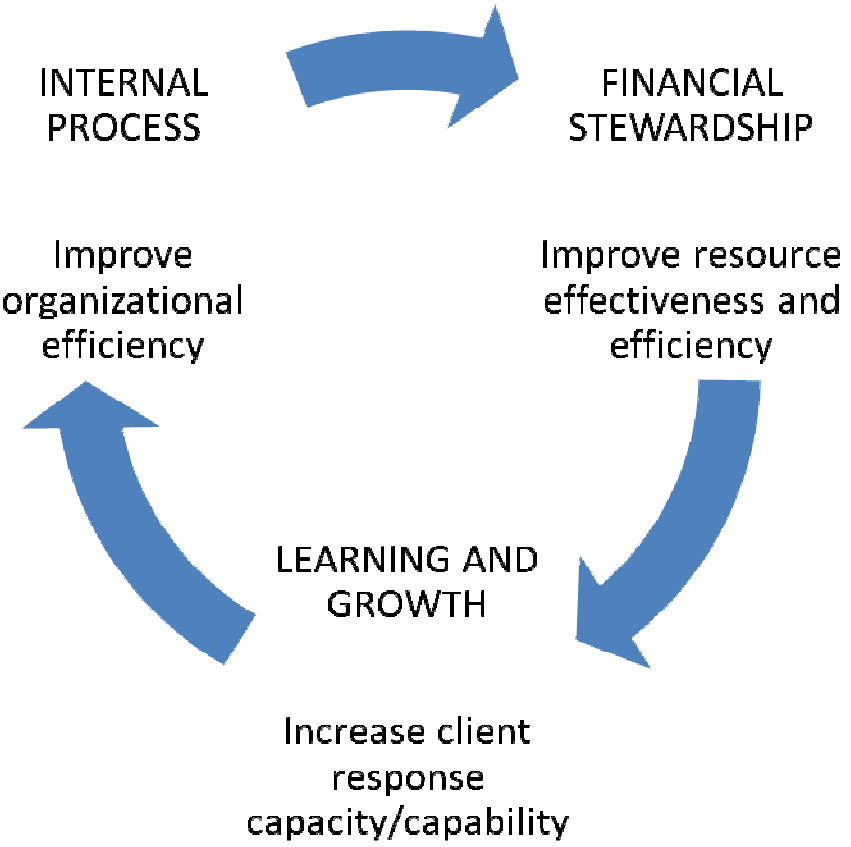
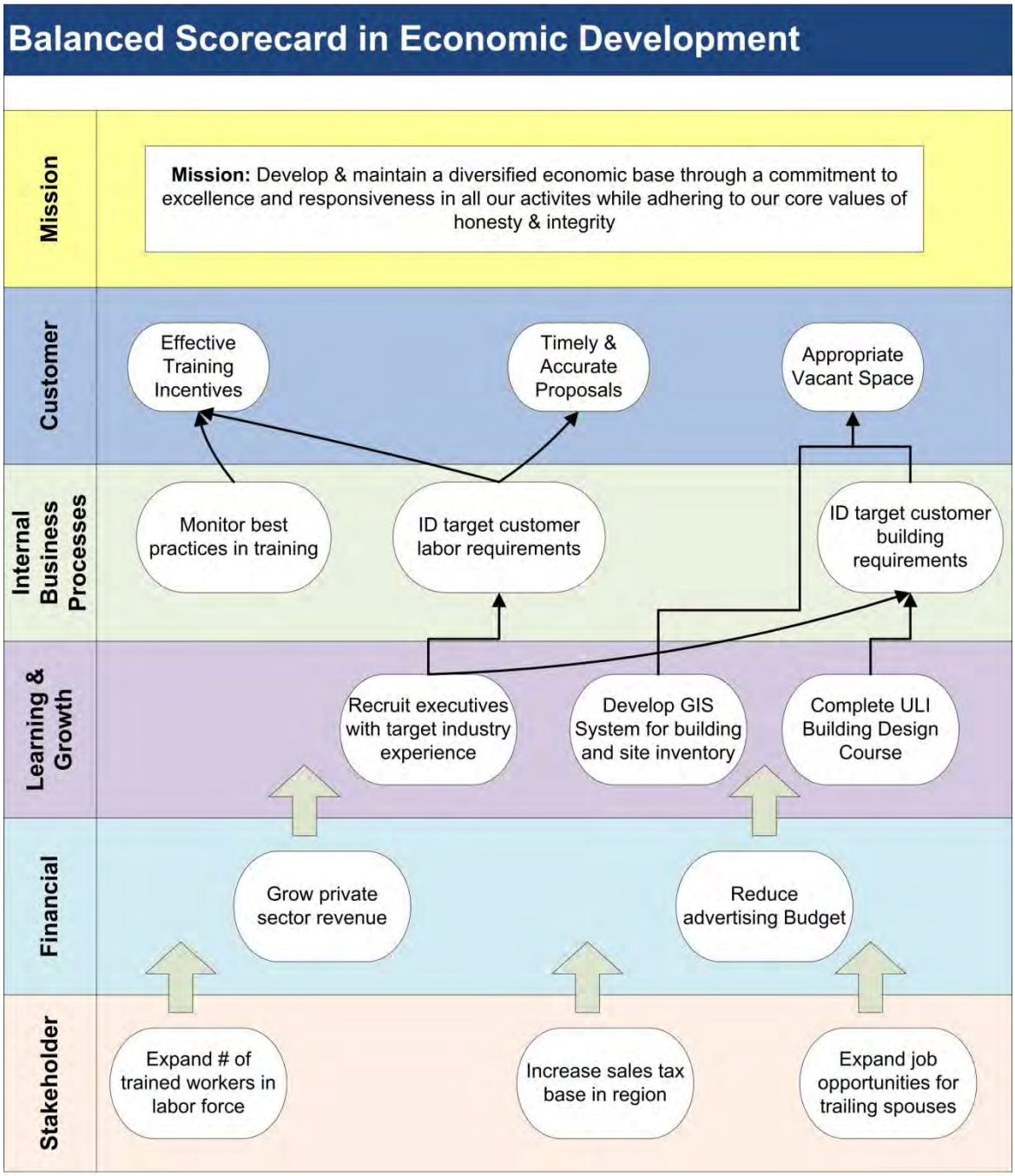


Figure 7. Strategy Map Example



The graphic portrayal of the strategy map helps the organization see if there is balance within the five perspectives. It also helps in identifying any possible gaps or missing elements. The review of the strategy map also provides an excellent opportunity to

communicate the strategies of the organization to its Board, its other stakeholders, its members, its funders, and its employees. This review process needs to take place frequently, especially when the Balanced Scorecard system is first initiated.

Step #2: Developing Performance Measures (also called Key Performance Indicators)

Once the set of strategies, or strategic actions, have been laid out in the strategic plan, the organization needs to develop performance measures for each of them. Performance measures are basically the standards used to evaluate and communicate performance against expected results.[20] "You can't improve what you can't measure."[21] For example, how will the training of staff to improve their response to prospects be measured, or how will management be able to determine improvements and the effectiveness of what is being done?

Performance measures are the means by which the organization determines whether it is moving satisfactorily toward achieving its desired outcomes and successfully implementing its strategic plan. Performance measures are "the tools we use to drive desired action, provide all employees with direction in how they can help contribute to the organization's overall goals, and supply management with a tool in determining overall progress toward strategic goals."[22] Clear and objective performance measures serve to describe in useful terms the strategic actions of the organization's plan and how the more imprecise vision will be achieved. A well-functioning performance measurement system that could provide credible, meaningful and actionable insights into the success of our economic development strategies (or lack thereof) would be a welcome addition to the economic development professional's toolkit.[23]

Performance measures help the organization track its results against its targets, and enable it to celebrate its successes as well as to identify potential problems earlier. Lagging performance indicators are those that show how successful the organization was in achieving outcomes. Leading indicators are those that are a precursor of future success; a performance driver. This feedback from the organization's internal business processes and results can then be used to continuously improve the performance and outcomes of the organization, making this a continuous improvement process.

[20] Niven, Paul R. Balanced Scoreboard: Step-by-Step for Government and Nonprofit Agencies. Hoboken NJ: John Wiley & Sons, 2003.
[21] Balanced Scorecard Institute.
[22] Niven, Paul R. Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results. New York: John Wiley & Sons, Inc., 2002.
[23] Osama, Athar. "Using a Balanced Scorecard to Measure Your Economic Development Strategy," Economic Development America. Fall 2008.

The performance measures, or metrics, also need to reflect the priorities of the strategic plan, since this plan is what should be driving the performance of the organization. Ideally, these metrics should be SMART:

- Specific
- Measurable
- Achievable
- Realistic
- Timely

Traditional performance measures among economic development organizations have consisted of metrics such as jobs or projects announced. However, this approach suffers from the "attribution" problem (measuring outcomes over which the organization has no direct control).

In a 2004 survey of economic development organizations (EDOs) conducted by Brigham Young University, 93 percent of respondents indicated that they were likely to increase their use of performance measures in decision-making, yet only 20 percent thought that performance measures were effective in increasing awareness of program results, setting strategies, and improving programs. Clearly, the art of developing effective and appropriate performance measures is in need of improvement.

Organizations with experience in performance measurement tend to be better candidates for the Balanced Scorecard, because they are more experienced at responding to the complexity of tracking performance within the Scorecard Perspectives. In other words, understanding what the different types of measures are, what service aspects they capture, and how they can be used to make decisions helps management place the measures in the appropriate Perspective.[24]

Once the performance measures have been developed, it will be necessary to determine whether the data to support them is currently available or will need to be collected. For example, it may be necessary to survey past clients and prospects to find out how well their needs were met by the staff of the organization.

Step #3: Cascading the Balanced Scorecard

The process of developing Balanced Scorecards at every level of the organization has been called "cascading." The concept consists of ensuring that all employees at all levels are aligned with the organization-wide Balanced Scorecard. This means that the performance measures and desired outcomes at all levels are in line with the

[24] Rivenbark, William C. and Eric J. Peterson, "A Balanced Approach to Implementing the Balanced Scorecard," Popular Government. Fall 2008: 32.

organization's overall goals and outcomes, and it is clear how all levels of activity will contribute to the success of the organization.

Peter Drucker, the management guru, has stated that *the nonprofit must be information-based. It must be structured around information that flows up from the individuals doing the work to the people at the top – the ones who are, in the end, accountable – and around information flowing down. This flow of information is essential because a nonprofit organization has to be a learning organization.*[25]

As the Balanced Scorecard is cascaded down through the organization, strategic actions become more operational and tactical, as do the performance measures. Research has demonstrated that most employees in non-profit organizations do not understand the organization's strategy.[26] Another attractive feature of the Balanced Scorecard is that it can be changed without rewriting the entire plan. As one outcome is met, it can be replaced. If an outcome is not met, action can be taken to clarify, change, or more carefully delineate that outcome in terms that will make achieving it possible.

If done correctly, this approach can transform an organization's strategic plan "from an attractive but passive document into the 'marching orders' for the organization on a daily basis."[27] The Balanced Scorecard can greatly assist management in executing the actions in their strategic plan. The strategies will reflect the priorities of the organization that need to be addressed in order to meet desired outcomes

Step #4: Developing the Dashboard

The final step in the completed scorecard is the evaluation of it. This answers such questions as:

- Are our strategies working?
- Are we measuring the right things?
- Has our environment changed?
- Are we budgeting our money strategically?

The Key Results Dashboard is like the dashboard of a car. It focuses attention on a manageable group of indicators, that when looked at together, provide a snapshot of the overall performance of the organization. The dashboard has one simple function: to present the information you choose in some form that makes it available for you to see in a format that is easily read and understood.[28] Incorporated into this dashboard should

[25] Drucker, Peter F. Managing the Non-Profit Organization, New York: HarperBusiness, 1990.
[26] Niven, Paul R. Balanced Scorecard Step-by-Step: Maximizing Performance and Maintaining Results. New York: John Wiley & Sons, Inc., 2002.
[27] Balanced Scorecard Institute.
[28] Hannabarger, Chuck, Rick Buchman, and Peter Economy, Balanced Scorecard Strategy for Dummies. Indianapolis: Wiley Publishing, Inc., 2007.

be the milestones by which you'll evaluate your plan and that will facilitate your reporting progress to your stakeholders. An example of a dashboard is shown in Table 1.

Table 1. Balanced Scorecard Dashboard Example

Area	Responsibility	Objectives	Measurement	Target
Financial Perspective				
Increase efficiency in managing budget	John	Reduce wasted expend.	Reduction of overtime hours	10% reduction in waste
Achieve financial stability	John	Meet budgeted growth targets	Revenue growth vs. budget targets	Budget targets for growth
Learning and Growth Perspective				
Recruit & retain talented employees	Tim	Retain best qualified staff	Turnover rate	Will not exceed 10% ann. rate
Ensure organizational learning based on data, outcome, and experience	Tim	Increase org. learning	Track all external training and conferences attended	Baseline
Internal Process Perspective				
Improve business practices and efficiencies	Jennifer	Pursue best practices in marketing	Average time to respond to a request for information	Improve-ment from previous year
Set up knowledge management system	Tim	Increase sharing of info and knowledge within org.	Increased use of KM system on Intranet	Baseline
Customer Perspective				
Deliver services consistent in quality	John	Increase mgmt. proficiency	Improved feedback from customers/clients	10% increase in customer satisfaction

CONCLUSIONS ABOUT THE BALANCED SCORECARD APPROACH

What distinguishes Best Practice EDOs from their traditional counterparts? The Balanced Scorecard provides a framework for answering this question. The conclusions are that Best Practices EDOs excel because they:

1. Operate with a clear vision for the future of their community that is widely held by leaders and stakeholders throughout the community and integrated into the organization's vision.
2. Have a focused mission that is understood by their key stakeholders.
3. Have written strategic plans that guide their overall activities. These strategies keep leaders focused on actions that lead to long-term improvements.
4. Have a preponderance of private sector funding that gives leaders the flexibility of focusing on long-term goals.
5. Have a revenue generating system that limits the level of fundraising activities of senior leaders.
6. Measure performance based on stakeholder and customer feedback rather than on announcements, jobs created, or other measures that can't be directly controlled by EDO organizations.
7. For regional EDOs, have effective lead dissemination systems that are transparent, fair, and developed with input of local EDOs. Effectiveness comes from the recognition by EDOs that they have to customize the process for their members rather than copy one used successfully in other regions.
8. Rely less on advertising and direct mail than their traditional counterparts
9. Use the same software and internal business processes as their traditional counterparts.
10. Have a corporate culture that is focused on external conditions (customers and markets trends) rather than internal processes.
11. Exhibit no differences in their use of training or innovation tools.
12. Have much different community attitudes about the need to acquire and maintain talent than traditional EDOs.

Advantages of the BSC Approach

In conclusion, the Balanced Scorecard provides a number of benefits to EDOs that adopt it:

- **Alignment** - The Balanced Scorecard provides a mechanism for aligning the various activities, processes, and people throughout the organization with the EDO's strategic goals and outcomes.

- **Communication** - The Balanced Scorecard and the decisions and actions that it drives become a mutually reinforcing, highly visible way to communicate the strategies throughout the organization.
- **Accountability** - The Balanced Scorecard links individual performance to organizational strategies and provides a constructive mechanism for holding people accountable for results.
- **Individual contributions** - As managers and individuals throughout the organization come to understand the strategy and how their performance contributes to success, they are able to take advantage of opportunities and make independent decisions that contribute to the strategy in ways not necessarily anticipated by the drafters of the strategic plan.
- **Transformation** - As people work together to achieve common objectives, the balanced scorecard provides leverage and becomes a means for increasing the productivity of the organization. As performance is reported throughout the organization, the feedback process becomes a mechanism to transfer knowledge and to refine and modify the strategies based on facts and insights of people throughout the organization. Strategy development becomes an ongoing, dynamic process that can evolve readily in response to changing circumstances, new ideas etc.[29]

The intensity of competition in economic development is unlikely to change in the future. EDOs that want to survive into the future will have to both improve their performance and communicate that performance to their stakeholders, in other words provide both performance and accountability. The Balanced Scorecard in Economic Development provides a time tested management framework for insuring that EDOs achieve both aims.

[29] Popa, Simona A. "The Balanced Scorecard: Translating Strategy into Results," paper presented at The Ninth International Conference "Investments and Economic Recovery", May 22-23, 2009.

APPENDIX

SELF-ASSESSMENT

This assessment helps the organization to determine the need for a Balanced Scorecard effort. To complete this exercise, read each statement in Table 2 and consider how much you agree with what is stated. The more you agree, the higher the score you assign. For example, if you fully agree, assign a score of five points.

Table 2. Assessing the Need for a Balanced Scorecard

Characteristic	1	2	3	4	5
Our organization has a commitment to quality, but we haven't seen a significant improvement in our operation.					
If we didn't produce Performance Reports for our Board for a month, nobody would notice.					
We tend to ignore our intangible assets such as employee knowledge and innovation, customer relationships, and a strong culture.					
We have a strategic plan but have a difficult time successfully implementing it.					
We rarely review out performance measures and make suggestions for new and innovative indicators.					
Our executive director and Board president spends the majority of their time together discussing how to deal with planning contingencies and other policy issues.					
Budgeting at our organization is based largely on what we have spent in the past.					
Our employees and Board members do not have a solid understanding of our mission, vision, and strategies.					
Our employees do not know how their day-to-day actions contribute to the organization's success.					
Nobody takes responsibility for the performance measurement process at our organization.					
We have numerous initiatives taking place in our organization, and it's possible that not all are truly strategic in nature.					
There is little accountability in our organization for the things we agree as a group to do.					
People tend to stay within their "silos," and as a result we have little collaboration within the organization.					
Our employees have difficulty accessing the critical information they need for serving their customers/clients.					
Priorities for our organization are often dictated by current necessity or for "putting out fires."					
The environment in which we operate is changing, and in order to succeed our organization must also change.					
We face increased pressure from stakeholders to demonstrate results.					
We don't have clearly defined performance targets for both financial and nonfinancial indicators.					
We can't clearly articulate our strategies in a one-page document.					
We sometimes make decisions that are beneficial in the short term, but may harm long-term quality.					

Scoring Key

26-30 If your score fell in this range you most likely have a strong performance measurement in place. The program has been cascaded throughout your organization, to ensure all employees are contributing to your success, and is linked to key management processes.

31-60 You may have a performance measurement system in place but are not experiencing the benefits you anticipated or need to succeed. Using the Balanced Scorecard as a Strategic Management System would be of benefit to you.

61-100 Scores in this range suggest difficulty in successfully executing your strategies and meeting the needs of your customers and other stakeholders. A Balanced Scorecard system is strongly recommended to help you focus on the implementing of strategies and align your organization with overall goals.