Where Should Regional Leaders Focus Their Job Creation Efforts?[1]

Pete Carlson | January 2014

Regional Growth Strategies

There's widespread recognition that we need to grow more jobs in the US, but there's very little consensus on how to actually do that. Which approaches make the biggest difference and why? The answer depends on a complex set of factors that are unique to each region, but there are some general patterns emerging from research and practice that can serve as a guide.

Local Economy

One place to start would be where the most jobs are already, in the local economy. In a typical region, two-thirds of all jobs are in businesses that serve the needs of local residents, such as schools, hospitals, grocery stores, restaurants, and dry cleaners. However, it's hard to grow the local economy directly, since the size of the local economy is largely a function of how much wealth there is in the community. When the level of wealth goes up, the local economy expands. When the level of wealth goes down, the local economy contracts.

In some communities, there are efforts under way to increase the level of wealth by ensuring that businesses are locally owned, making it possible to keep more of the revenue from those businesses circulating in the local economy. Research suggests that there may be some modest benefits to the community from recirculating more of its existing wealth, but the biggest opportunities for growing the local economy lie in generating new wealth.[2] That only happens when businesses sell their goods and services to others outside the community.

Traded Sector

When businesses sell their goods and services outside the community, they import wealth into the community, and that wealth is then circulated throughout the local economy. These businesses comprise the "traded sector."

Studies suggest that for every new traded-sector job that is created, five new jobs are also created in the local economy through a multiplier effect, making traded sector businesses the economic engines of the local economy.[3]

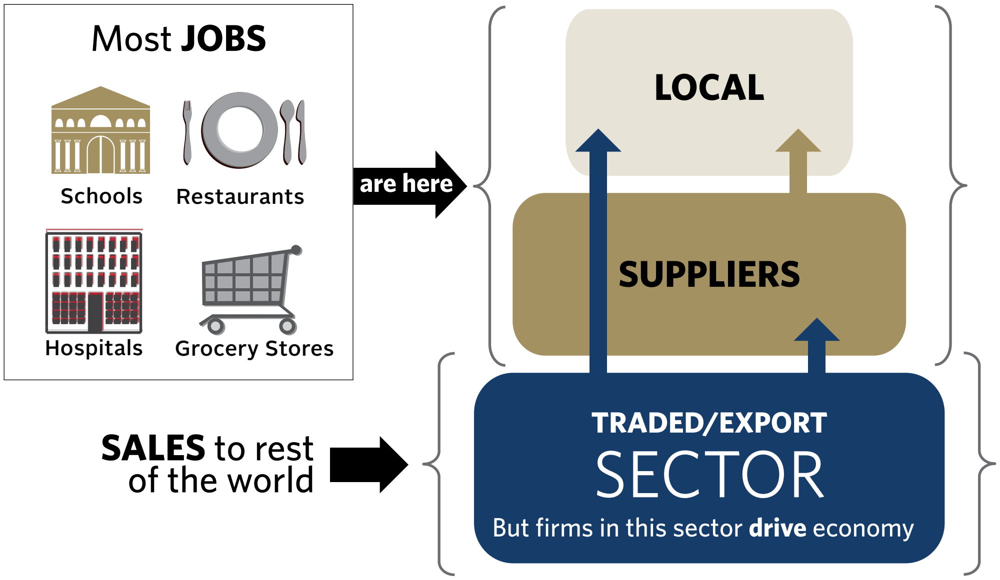
Within the traded sector, the biggest opportunities for growth right now are in businesses that export abroad, since markets are expanding faster overseas, particularly in Asia. Currently, 70 percent of the world's purchasing power is located outside the US, but less than 1 percent of US firms export abroad.[4] Research suggests that the biggest barriers businesses face in exporting abroad are lack of information about export opportunities, high initial costs,

[1] An earlier, working version of this paper was posted on the FutureWorks website.

[2] For a review of key studies, see **http://www.ilsr.org/key-studies-walmart-and-bigbox-retail/**.

[3] Enrico Moretti, The New Geography of Jobs (New York: Houghton Mifflin Harcourt, 2012)

[4] U.S. Commercial Service, "Exporting is Good For Your Bottom Line," International Trade Administration, 2008.



Source: OregonBusinessPlan.org

a fragmented and reactive export services delivery system in the US, and lack of capacity and resources among economic developers to provide needed guidance and assistance.[5]

There is also a caveat when it comes to the traded sector – the businesses that create the most wealth do not necessarily create the most jobs. Businesses can also boost their earnings by making productivity improvements, by moving work to lower-cost areas, and by taking advantage of tax incentives here and tax havens overseas. Over the past decade, businesses have been pursuing those strategies aggressively, particularly large, multi-national companies.[6]

Small Businesses

That suggests that it's important to pay attention to which businesses are creating the most jobs. For several decades, the conventional wisdom has been that most new jobs come from small businesses, based on an influential study by David Birch conducted in the late 1970s.[7] But that study only looked at the jobs that were being created, not at the jobs that were being destroyed. So the results were misleading.

A later study by Birch found that a small number of relatively small companies account for most net new job growth, with just 4 percent of all businesses responsible for all of the net new jobs in the economy.[8] However, these

[5] Amy Liu, Brad McDearman and Marek Gootman, "Strengthen Federalism: Establish a Regional Export Accelerator Challenge (REACH) Grant Program to Boost U.S. Exports and Trade Capacity," Brookings Metropolitan Policy Program, 2012.

[6] Derek Thompson, "Corporate Profits are Eating the Economy," The Atlantic, March 4, 2013.

[7] David G. W. Birch, "The Job Generation Process," MIT Program on Neighborhood and Regional Change, 1979.

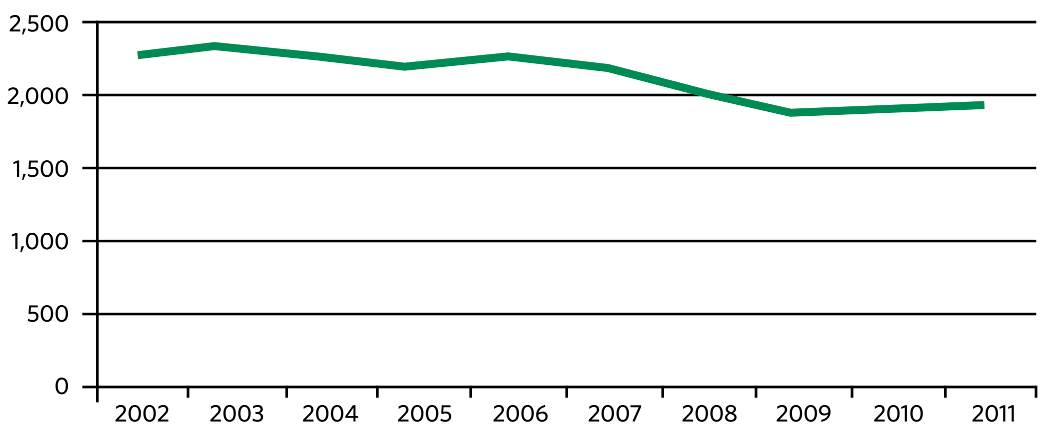
[8] David L. Birch, Anne Haggerty and William Parsons, "Who's Creating Jobs?" Cognetics, Inc., 1995.

"gazelles" represented only a small fraction of all small businesses, and some of them were not very small at all, suggesting that being small is not in itself the key to growth.

More recent research funded by the Kauffman Foundation came to the conclusion that start-ups are the key to growth.[9] In fact, their research suggested that ***all*** of the job growth in the US economy could be attributed to start-up businesses. Based on those findings, many people have concluded that the best way to stimulate job growth is to launch as many start-ups as possible.

As a result, start-ups have received a lot of attention from economic developers and policymakers, and have grown by 250 percent over the past decade. However, new start-up ventures have become smaller and less likely to survive, and those that do survive have created fewer jobs after their birth. In fact, most of the growth in small businesses has been among sole proprietors who have little interest in building a business.[10] As a result, the rate of job creation for start-ups has been declining in the US.[11]

New Jobs from Start-ups (in thousands)



Source: Kauffman Foundation

Existing Businesses

So, where does that leave us? New economic data from the National Establishment Time Series (NETS) database, which provides the most comprehensive picture of what's happening across all jobs in all kinds of businesses across all counties in the US, show that most of the job gains are

[9] Tim Kane, "The Importance of Startups in Job Creation and Job Destruction," Ewing Marion Kauffman Foundation, 2010.

[10] Karen Mills, "Who Are America's Job Creators?" The Washington Post blog series: On Small Business, April 6, 2013.

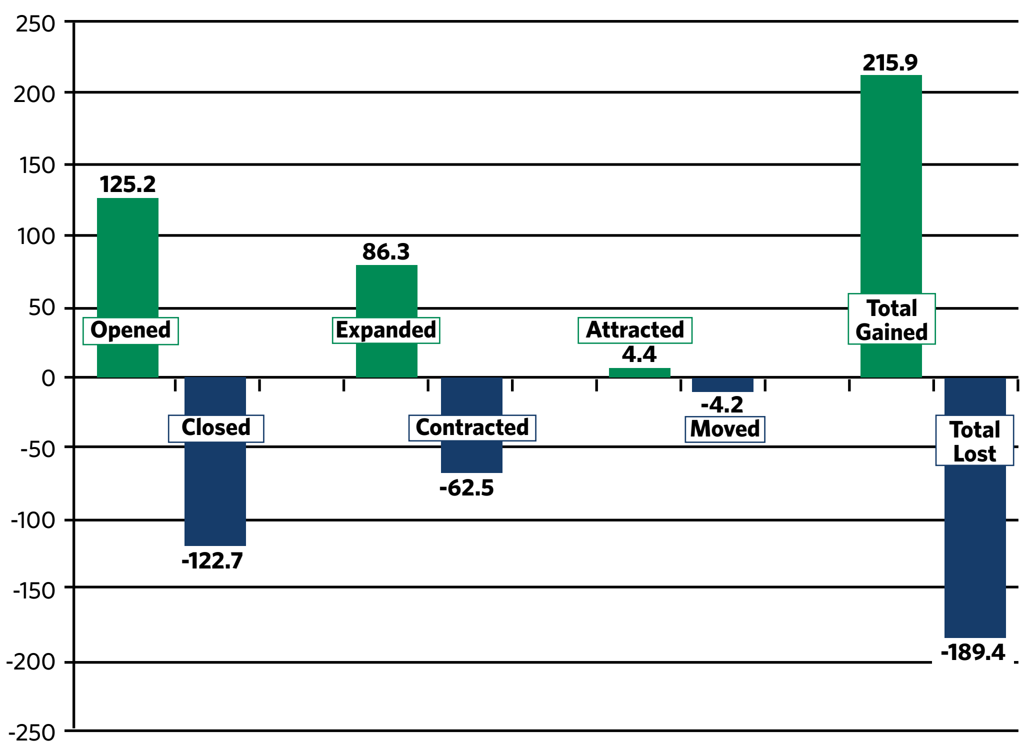
[11] E. J. Reedy and Robert E. Litan, "Starting Smaller; Staying Smaller: America's Slow Leak in Job Creation," Ewing Marion Kauffman Foundation, July 2011.

coming from the start-up of new businesses, followed by the expansion of existing businesses, with the attraction of businesses from elsewhere coming in a distant third.

However, it's also important to look at job losses to get a complete picture of what's happening in the economy. Those data show that job losses have been largely the result of business closures, followed by business contractions, and some firms moving out of the area.

When the two are combined, the picture that emerges suggests that the US is doing a good job of launching new businesses, but it is not doing as good a job of supporting the continued growth of those businesses. It also suggests that marketing and attraction efforts, while helpful, have not had a major impact on job growth. The biggest opportunities for job growth appear to be with existing businesses, which accounted for around 90 percent of all net new jobs between 1995 and 2010.[12]

Net New Jobs in the US (in millions)
1995-2010



Source: National Establishment Time Series

[12] YourEconomy.org, accessed May 24, 2013.

In addition, recent research has found that around 1 percent of businesses are responsible for nearly three-quarters of all new jobs created in the past five years.[13] However, contrary to conventional wisdom, these high-growth businesses are not necessarily high-tech businesses. They are spread across a wide range of industries, so a narrow focus on high-tech industry clusters could miss important opportunities for growth.[14] In fact, a study of high-growth firms in Pennsylvania found that 84 percent of high-growth businesses in that state were in service industries.[15]

It's important to note that "high" growth doesn't necessarily mean "fast" growth. The research suggests that the faster a business grows in one period, the less likely it is to continue growing in subsequent periods, and the more likely it is to die.[16] There's also evidence that regions with the fastest job growth have the hardest time sustaining their growth.[17] The biggest cumulative job gains appear to come from businesses that manage to sustain incremental growth over time.[18]

A close look at these sustained growth businesses shows that they are spread across rural areas, small towns, small cities and large urban areas alike, making it possible to spread the benefits of growth across an entire region. Moreover, these sustained growth businesses comprise a broader range of occupations than those in high-tech or knowledge-intensive industries, making them a more likely source for middle skill jobs.[19]

In short, job growth is highly concentrated among a small number of relatively small, sustained-growth businesses in a wide range of industries. The key is to find those businesses and to figure out how to support their continued growth.

Unfortunately, those relatively small, high-growth companies tend to be widely dispersed, not likely to seek assistance, and not likely to belong to established business organizations, making it difficult to identify and respond to their needs effectively. At the local level, that problem is compounded by the fact that most business organizations are mainly focused on responding to the needs of their larger and higher-contributing members, not on proactively reaching out to small, high-growth companies. Since deregulation, local banks have less capacity to maintain relationships with area businesses, while many local economic development organizations lack the capacity to provide the specialized assistance high-growth companies require.

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[13] Gary Kunkle, "Building Scale and Sustaining Growth: The Surprising Drivers of Job Creation," Institute for Exceptional Growth Companies, February 2013.

14 Yasuyuki Motoyama and Brian Danley, "The Ascent of America's High-Growth Companies: An Analysis of the Geography of Entrepreneurship," Ewing Marion Kauffman Foundation, September 2012.

15 Gary Kunkle, "High-Growth Firms Drive Pennsylvania's Economy," Team PA Foundation, 2011.

16 Gary Kunkle, "Building Scale and Sustaining Growth: The Surprising Drivers of Job Creation," Institute for Exceptional Growth Companies, February 2013.

17 Chris Benner and Manuel Pastor, "Buddy Can You Spare Some Time: Social Inclusion and Sustained Prosperity in America's Metropolitan Regions," MacArthur Foundation Network on Building Resilient Regions, May 31, 2013.

18 Gary Kunkle, "Building Scale and Sustaining Growth: The Surprising Drivers of Job Creation," Institute for Exceptional Growth Companies, February 2013.

19 Gary Kunkle, "Building Scale and Sustaining Growth: The Surprising Drivers of Job Creation," Institute for Exceptional Growth Companies, February 2013.

In addition, most programs to support entrepreneurial ventures tend to focus mainly on launching new enterprises, not on supporting their continued development once they get off the ground. And most of the assistance that is being given to existing businesses currently focuses on retention, not expansion, with economic developers mainly playing defense, not offense. As a result, there is little capacity in most regions to proactively identify which existing businesses have the most potential to grow, and to help those businesses identify new products, processes, markets, or technologies to support their growth.

Paradox

To build that capacity, regional leaders will need to abandon outmoded thinking and legacy systems that are out of step with new economic realities. For example, many regions still focus heavily on recruiting large firms, even though that strategy, which dates back to the 1970s and 1980s, has been yielding diminishing returns for some time now. Since 1995, business recruitment efforts have accounted for only around 2 percent of all new jobs created, and less than 1 percent of all net new jobs created.

Moreover, the combination of depressed deal supply and increasing demand for more jobs is fueling an arms race among states that are addicted to this approach, wasting scarce resources that could be put to other more productive uses. A recent study by the New York Times found that that states, counties, and cities have been spending more than $80 billion a year on economic development incentives, but have very little to show for it in terms of new jobs.[20]

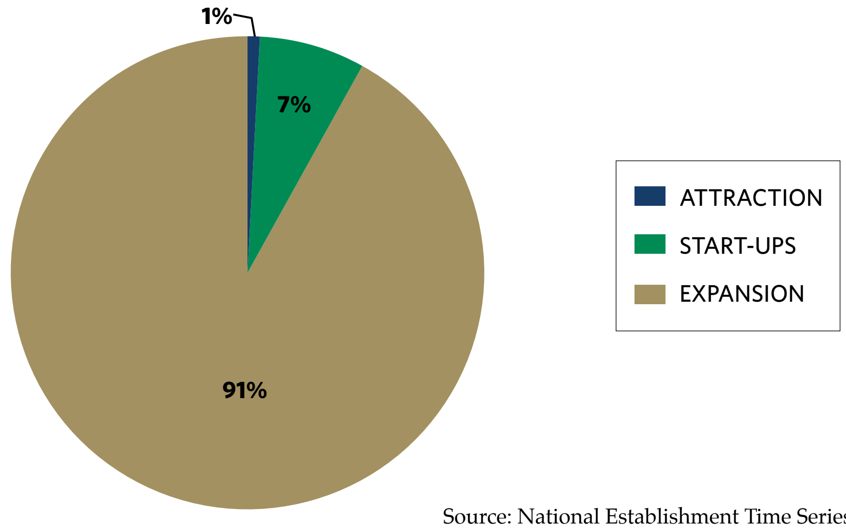
In response, some regions have shifted their focus to start-ups, and are putting infrastructure in place to launch more of them. However, start-ups have accounted for only 7 percent of all net new jobs created since 1995. And as noted earlier, start-ups have been yielding diminishing returns in terms of job growth over the past several years.

That leaves regions with the paradoxical situation where over 90 percent of all net new jobs are being created by existing businesses, but those businesses currently get the least attention and have the weakest infrastructure to support their growth. That weak link undermines regional job growth, since the information gleaned from on-the-ground interaction with existing businesses is a basic building block for sound business growth strategies across the board.

The information gleaned from an effective ground game plays a vital role in guiding regional decisions about which clusters to focus on, which interventions would make the biggest difference, and who to target for recruitment efforts. In addition, interviews with companies during retention visits often surface new opportunities for promoting buyer-supplier relationships within the region.

[20] Louise Story, "As Companies Seek Tax Deals, Governments Pay High Price," The New York Times, December 1, 2012.

Sources of Net New Jobs in the US 1995-2010



Source: National Establishment Time Series

That points to another paradox. The center of gravity of **regional** job growth efforts is actually at the **local** level, because in the absence of an effective ground game at the local level, regional efforts can become free floating and their impact can be hit or miss. They can also become driven by politics, rather than a systematic and rigorous analysis of what's actually needed on the ground.

If there is an effective ground game in place at the local level, regional efforts can focus on capturing and sharing lessons learned about what's working and what's getting in the way, collectively address issues of common concern across localities, provide technical assistance and shared services, make strategic investments, and generate outside funding and political support.

In response, a growing number of regions are focusing more attention on their ground game, gathering intelligence from existing businesses, analyzing that intelligence to identify where they should focus their job growth efforts, and building systems at the local and regional level capable of providing the right assistance to the right businesses at the right time.

Interplay

In the process, they are finding that it's the healthy interplay between activities at the local and regional levels that holds the key to how well the overall system of innovation in the region performs. Focusing on one level to the exclusion of the other can throw the whole system out of balance.

Similarly, regions are finding that a healthy interplay among their start-up, expansion and attraction efforts holds the key to leveraging the competitive assets within particular industry clusters. For example, start-ups often end up selling out to large firms to commercialize their new products or technologies and to provide an exit strategy for their early stage investors. Meanwhile, large firms are increasingly coming to rely on the strategic acquisition of small firms in their industry to support innovation, rather than conducting R&D in house.[21] Putting structures in place to support this symbiotic relationship can accelerate innovation within an industry cluster.

Moreover, recent research by Michael Porter suggests that a healthy interplay among strong industry clusters may hold the key to the growth of new industries.[22] That's because new industries often arise from the convergence of technologies across existing industries, and regions with strong industry clusters are likely to have the infrastructure in place to support the growth of those new industries.

However, it's proving difficult to engender that kind of interplay because job creation efforts remain highly fragmented into separate streams of work carried out by siloed organizations, often competing with each other for funding. To make matters worse, state funding for economic development activities has declined by 40 percent since 2009.[23] As a result, local economic development organizations are increasingly turning to the private sector for financial support,[24] exacerbating competition with regional economic development organizations, which are often already competing with each other for the same private sector funding to support their respective start-up, expansion, and attraction efforts.

In response, there are efforts under way in a number of regions to convene key private and public sector leaders to promote more effective interplay among the different elements of the region's innovation ecosystem, and to direct resources to where they can make the biggest difference. Those efforts hold great promise, and are currently getting a boost from the federal government through a variety of grant programs. But ultimately, their success depends on whether there is sufficient capacity on the ground to sustain and institutionalize them.

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[21] Gordon M. Phillips and Alexei Zhdanov, "R&D and the Incentives from Merger and Acquisition Activity," Review of Financial Studies, 2013.

[22] Mercedes Delgado, Michael E. Porter, and Scott Stern, "Clusters, Convergence, and Economic Performance," National Bureau of Economic Research Working Paper No. 18250, July 2012.

[23] SSTI, "Trends in Technology-Based Economic Development: Local, State, and Federal Action in 2012," 2013.

[24] IEDC, "New Realities for Funding Economic Development Organizations," International Economic Development Council, 2013.

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