A Cluster-based Approach to Inner City Economic Development

Inner City Economic Summit
October 4th, 2011

Professor Michael E. Porter
Initiative for a Competitive Inner City
Current economic development has shifted from national to regional strategies; with these are growing federal efforts around building regional clusters.

This development is a great step forward.

However, the country’s most distressed urban cores also require specific economic development strategies.

Over almost two decades, ICIC has learned a great deal about what works and does not work in inner cities.

We need to better integrate what we know about inner city economies to enhance inner city growth within the regional framework.
Agenda

I. Why Focus on the Inner City?

II. Why a Cluster-based Approach for Economic Growth?

III. A Cluster Strategy for Inner Cities
   A. Overview
   B. Examples
Poverty, especially *minority poverty* is concentrated in *Inner cities*

Targeting poverty in inner cities allows *wholesale* rather than retail approach to *poverty reduction*
What is an Inner City?

Definition of Inner City
Contiguous census tracts in central cities that are economically distressed, as defined by having:

- **Poverty rate** 20% or higher
- **Two of three other criteria:**
  - Poverty rate 1.5 times or more than the MSA
  - Median household income 50% or less than the MSA
  - Unemployment rate 1.5 times or more than the MSA

ICIC has tracked the performance of inner cities in 100 of the largest U.S. Cities

100 Largest U.S. Cities

Example: Cleveland, OH

Source: State of the Inner City Economy Database (SICE) Database 2000, ICIC analysis
Inner Cities: Key Facts

- Inner cities have a **younger** and **more diverse** population than the rest of the U.S., and they are also important sites for **minority-owned businesses**.

### Inner Cities vs. U.S.

<table>
<thead>
<tr>
<th>Category</th>
<th>Inner Cities</th>
<th>U.S.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poverty Rate</td>
<td>31%</td>
<td>9%</td>
</tr>
<tr>
<td>Minority Population</td>
<td>81%</td>
<td>60%</td>
</tr>
<tr>
<td>Foreign-born</td>
<td>23%</td>
<td>11%</td>
</tr>
<tr>
<td>Population Under 25</td>
<td>42%</td>
<td>33%</td>
</tr>
<tr>
<td>College Attainment</td>
<td>12%</td>
<td>24%</td>
</tr>
<tr>
<td>High School Degree</td>
<td>60%</td>
<td>80%</td>
</tr>
<tr>
<td>Firms with &lt;5 Employees</td>
<td>51%</td>
<td>54%</td>
</tr>
<tr>
<td>Minority Business Ownership</td>
<td>40-45%</td>
<td>18%</td>
</tr>
<tr>
<td>Average Firm Size</td>
<td>19 Employees</td>
<td>16 Employees</td>
</tr>
</tbody>
</table>

Source: State of the Inner City Economy Database (SICE) Database 2000, ICIC analysis

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Progress on Poverty Rates in Inner Cities, 2000-2009

Note: In some inner cities, changes in poverty levels may be largely attributed to population migrations

Source: State of the Inner City Economies (SICE) Database, American Community Survey 2005-2009; ICIC analysis

Reduction in Poverty Rate, 2000-2009

- Riverside
- Los Angeles
- Brooklyn/Queens
- Newark
- Washington, DC
- Increased in poverty
- Boston
- Chicago
- Rest of U.S. Average = 1.2%
- Inner City Average = 1.4%
Inner Cities: Employment Growth

- Inner cities have experienced a **net job loss** over the past decade.


<table>
<thead>
<tr>
<th></th>
<th>Number</th>
<th>Percentage</th>
<th>CAGR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rest of U.S.</td>
<td>+5,900,000</td>
<td>7.2%</td>
<td>0.6%</td>
</tr>
<tr>
<td>Rest of Central City</td>
<td>+700,000</td>
<td>4.2%</td>
<td>0.4%</td>
</tr>
<tr>
<td>Inner City</td>
<td>-300,000</td>
<td>-3.3%</td>
<td>-0.3%</td>
</tr>
</tbody>
</table>

Source: State of the Inner City Economy Database (SICE) Database 2000, ICIC analysis
Why Inner City Jobs Matter

Inner City Residents Hold:

- 22% of jobs in the inner city
- 11% of jobs in rest of the central city
- 7% of jobs in the rest of the region

Creating 100 New Jobs for Inner City Residents Would Require:

- 450 inner city jobs
- 850 jobs in the rest of the central city
- 1,450 jobs in the rest of the region

“Jobs anywhere” are not enough. Often inner city residents cannot access jobs in the rest of the region.

Inner city-based firms hire disproportionally more inner city residents.

Source: U.S. Census Special Tabulation; ICIC analysis

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Employment Growth in Inner Cities: Growing Regional Employment is Not Enough

The correlation between regional and inner city growth is only 20%

Only 18 out of 100 inner cities outperformed the rest of their regions
Summary: Improving Inner City Economic Performance

- Inner cities have suffered a **net loss of jobs** over the past decade
- 82% of inner cities have performed worse than their regions
- The conventional growing regional jobs is helpful but not sufficient

- Inner cities require **specific strategies** for economic growth and job creation
- Inner city jobs strategies must match the skills of inner city residents
II. The Need for Cluster-based Approaches to Economic and Job Growth
Three Drivers of Competitiveness and Economic Performance

**Business Environment**
- Conditions for inputs, competitive dynamics, demand, and supporting industries that encourage growth
- Typical policies include investments in logistics, infrastructure, higher education systems, or corporate tax policy

**Clusters: Groups of Related Firms**
- Develop and upgrade geographically concentrated groups of interconnected companies and associated institutions in a particular field, e.g., biotech in MA or energy in Houston
- Typical policies include targeted workforce development, export promotion, and specialized infrastructure and research initiatives
- **New focus for economic development policy**

**Individual Firms**
- Assist individual firms in improving their competitiveness
- Typical policies include SBA loans, technical assistance through SBDCs, HUBZones, location incentives, and subsidies
What is a Cluster?: Example of the Food Cluster

Federal Nutrition Regulation and Subsidy
(WIC, School Lunches, Farm-to-School Policies, SNAP, Community Food Projects)

Food Safety Regulation
(FDA, Food Safety Modernization Act; USDA, Food Safety and Inspection Service)

Non-Agricultural Ingredients
Packaging
Machinery
Agricultural Production
Fish and Fish Products
Inspections and Certifications
Processing
Wholesale Aggregators and Distribution

Distribution Centers
National Independent Wholesalers
Local/Regional Independent Wholesalers
Terminal and Other Markets
Jobbers
Retail
Food Services and Catering
Restaurants

Local Land Conditions:
Zoning, building availability, use restrictions (agriculture, processing)

Local Procurement Standards
(e.g., schools, hospitals, government)

Foundations
(e.g., support for food-related initiatives)

Source: ICIC/Karp/Next Street Food Cluster Project
Why Clusters Matter

- Clusters increase productivity
  - Efficient access to specialized inputs, services, employees, information, institutions, training programs, and other “public goods”

- Clusters encourage new business formation
  - Easier commercialization of new products and greater opportunities for starting new companies due to available skills, suppliers, etc.

- Cluster policy leverages policy investments over numerous companies
  - Investments in training, information, export promotion, etc. will benefit many companies across a range of industries

- Cluster policies are less distortive than those aimed at individual firms or industries

- Cluster policy does not pick firm or cluster winners
Strong Clusters Drive Regional Economic Performance

- Specialization in strong clusters
- Breadth of industries within each cluster
- Strength in related clusters
- Presence of a region’s clusters in neighboring regions

- Faster job growth
- Higher wages
- Higher patenting rates
- Greater new business formation, growth and survival

- Build on **existing and emerging** clusters rather than chase hot fields
- Economic diversification usually occurs **within clusters** and **across related clusters**

Clusters provide a framework for organizing the implementation of many public policies and public investments to achieve greater effectiveness.
III. The Role of Cluster Strategies in Inner Cities
### Types of Clusters

<table>
<thead>
<tr>
<th>Definition</th>
<th>Traded Clusters</th>
<th>Local Clusters</th>
</tr>
</thead>
</table>
| Compete to serve national and international markets| – Life sciences  
– Transportation and logistics| – Local health services  
– Local retail |
| – High wage jobs  
– Higher productivity and innovation potential |                                                                                  | – Maximum job creation  
– Jobs that match resident skills |

<table>
<thead>
<tr>
<th><strong>Representative Clusters</strong></th>
<th><strong>Traded Clusters</strong></th>
<th><strong>Local Clusters</strong></th>
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<td>– Life sciences</td>
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<td>– High wage jobs</td>
<td>– Local health services</td>
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| | | – Jobs that match resident skills |

<table>
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<th><strong>Relative Productivity</strong></th>
<th><strong>Traded Clusters</strong></th>
<th><strong>Local Clusters</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Relative Productivity</td>
<td>144.1</td>
<td>79.3</td>
</tr>
<tr>
<td>National Annual Wage (2009)</td>
<td>$56,900</td>
<td>$37,280</td>
</tr>
<tr>
<td>National Wage Growth (1998 – 2009)</td>
<td>9.8%</td>
<td>6.2%</td>
</tr>
<tr>
<td>National Wage Growth (1998 – 2009)</td>
<td>9.8%</td>
<td>6.2%</td>
</tr>
<tr>
<td>Patents (per 10,000 employees)</td>
<td>23.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Share of National Employment (2009)</td>
<td>27%</td>
<td>72%</td>
</tr>
<tr>
<td>Share of Inner City Employment (2009)</td>
<td>26%</td>
<td>74%</td>
</tr>
<tr>
<td>National Employment Growth (1998-2009)</td>
<td>-3.5%</td>
<td>+11.4%</td>
</tr>
<tr>
<td>Inner City Employment Growth (1998-2009)</td>
<td>-9.6%</td>
<td>+0.4%</td>
</tr>
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Clusters in Inner Cities: Traded Clusters

- Traded clusters are key for economic well-being, and we will continue to study them.
The Importance of Local Clusters in Inner City Employment Growth

Local Clusters

Actual: 4%
Matching Regional Growth: 14%
620,000 jobs

Traded Clusters

Actual: -2%
Matching Regional Growth: 5%
190,000 jobs

Source: State of the Inner City Economies (SICE) Database, ICIC Analysis.

*Benchmark employment is calculated by applying industry growth rates of the region to the inner city.
Clusters in Inner Cities: Local Clusters

- Local clusters represent a wide range of activities serving businesses and communities

Source: State of the Inner City Economies (SICE) Database, ICIC analysis.
Local Cluster Job Accessibility

Local Cluster Average Wages

<table>
<thead>
<tr>
<th>Cluster Type</th>
<th>Average Annual Wage, 2009 ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Utilities</td>
<td>67</td>
</tr>
<tr>
<td>Local Financial Services</td>
<td>56</td>
</tr>
<tr>
<td>Local Commercial Services</td>
<td>50</td>
</tr>
<tr>
<td>Local Industrial Products and…</td>
<td>50</td>
</tr>
<tr>
<td>Local Real Estate</td>
<td>46</td>
</tr>
<tr>
<td>Local Health Services</td>
<td>46</td>
</tr>
<tr>
<td>National Average</td>
<td>43</td>
</tr>
<tr>
<td>Average Local Cluster Wage</td>
<td>37</td>
</tr>
<tr>
<td>Local Logistical Services</td>
<td>36</td>
</tr>
<tr>
<td>Local Household Goods and Services</td>
<td>31</td>
</tr>
<tr>
<td>Local Motor Vehicle Products and…</td>
<td>31</td>
</tr>
<tr>
<td>Local Entertainment and Media</td>
<td>30</td>
</tr>
<tr>
<td>Local Food and Beverage</td>
<td>27</td>
</tr>
<tr>
<td>Local Education and Training</td>
<td>27</td>
</tr>
<tr>
<td>Local Community and Civic Orgs</td>
<td>24</td>
</tr>
<tr>
<td>Local Personal Services</td>
<td>20</td>
</tr>
<tr>
<td>Local Retail Clothing</td>
<td>19</td>
</tr>
<tr>
<td>Local Hospitality</td>
<td>14</td>
</tr>
</tbody>
</table>

Educational Requirements by Cluster Type

- College or Higher: 29% in Traded Clusters, 23% in Local Clusters
- Some College: 30% in Traded Clusters, 32% in Local Clusters
- High School or Less: 41% in Traded Clusters, 45% in Local Clusters

Source: SICE; BLS; ICIC Analysis.

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Type of Local Clusters

<table>
<thead>
<tr>
<th>Definition</th>
<th>Business-to-Consumer (B2C)</th>
<th>Business-to-Business (B2B) and Hybrid (B2B/B2C)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Serves local consumers</td>
<td>- Serves both local consumers and local businesses</td>
<td></td>
</tr>
<tr>
<td>- Local health services</td>
<td>- Local commercial services</td>
<td></td>
</tr>
<tr>
<td>- Local hospitality establishments</td>
<td>- Local logistical services</td>
<td></td>
</tr>
<tr>
<td>- Offers important entry-level jobs</td>
<td>- Local utilities</td>
<td></td>
</tr>
<tr>
<td>- Promotes availability of goods and services</td>
<td>- Local real estate</td>
<td></td>
</tr>
<tr>
<td>- Offers middle-wage jobs</td>
<td>- Strengthens business environment</td>
<td></td>
</tr>
</tbody>
</table>

| Share of National Employment (2009) | 40% | 33% |
| Share of Inner City Employment (2009) | 38% | 35% |
| National Employment Growth (1998-2009) | +15.4% | +6.8% |
| Inner City Employment Growth (1998-2009) | +6.6% | -5.7% |
| National Average Annual Wage (2009) | $33,000 | $43,000 |

- When analyzing local clusters, it is important to distinguish between those that serve primarily **businesses** and those that serve primarily **consumers**

Source: State of the Inner City Economies (SICE) Database, ICIC analysis.

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Local B2B Cluster Gap Analysis

- Each inner city has different cluster strengths and weaknesses
- ICIC is mapping B2B strengths and weaknesses for 100 inner cities nationwide

Source: State of the Inner City Economies (SICE) Database, ICIC analysis.
Evolution of Inner City Cluster Strategy

Local B2C Clusters

- Grow B2C clusters such as **local retail** that serve local populations and improve quality of life
- These jobs provide the most accessible entry-level jobs
- ICIC and others spent a decade addressing the inner city retail gap, lending to good progress

Local B2B Clusters

- Greater focus on **B2B clusters** such as local commercial services
- These clusters provide higher-wage jobs and improve the operating environment for businesses

Traded Clusters

- Focus on **traded clusters** that are advantaged by inner city locations, such as logistics and hospitality
Every City Requires a Specific Urban Economic Development Strategy

Define the Value Proposition

- What is the distinctive competitive position of the geography given its location, legacy, existing strengths, and potential strengths?
  - What unique value as a business location?
  - For what types of activities and clusters?

Develop Unique Strengths

- What elements of the business environment can be unique strengths relative to peers/neighbors?
- What existing and emerging clusters represent local strengths?

Achieve and Maintain Parity with Peers

- What weaknesses must be addressed to remove key constraints and achieve parity with peer locations?

- Economic strategy requires setting priorities and moving beyond long lists of separate recommendations

Building an Economic Strategy: Evolving Thinking

**Tactical**
(Zero Sum Competition)

- Focus on attracting **new** investments
- Compete for **every** plant/investment
- Offer **generalized** tax breaks
- Provide **subsidies** to lower / offset business costs
- Every city and sub-region **for itself**
- **Government** drives investment attraction

**Strategic**
(Positive Sum Competition)

- Also support greater local investment by **existing** companies
- Reinforce areas of **specialization** and emerging cluster strength
- Provide state support for training, infrastructure, and institutions with **enduring benefits**
- Improve the **efficiency of doing business**
- Harness efficiencies and coordination **across jurisdictions**, especially with neighbors
- Government and the private sector **collaborate** to build cluster strength

Harnessing the New Process of Economic Development

- Competitiveness is the result of both **top-down** and **bottom-up processes** in which many companies and institutions take responsibility.

**Old Model**
- **Government** drives economic development through policy decisions and incentives.

**New Model**
- Economic development is a **collaborative process** involving government at multiple levels, companies, teaching and research institutions, and private sector organizations.

## Strengthening Inner Cities within Regional Frameworks

<table>
<thead>
<tr>
<th>Business Environment</th>
<th>Clusters: Groups of Related Firms</th>
<th>Individual Firms</th>
</tr>
</thead>
</table>
| ▪ Work to improve business environment | ▪ Focus on inner city and regional cluster strengths  
▪ Include local clusters  
▪ Strengthen relationships between inner city firms and leading cluster actors | ▪ Create linkages with capital access and business development services |

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