



Initiative for a Competitive Inner City

Growing Successful Inner City Businesses: Findings From A Decade of ICIC Data

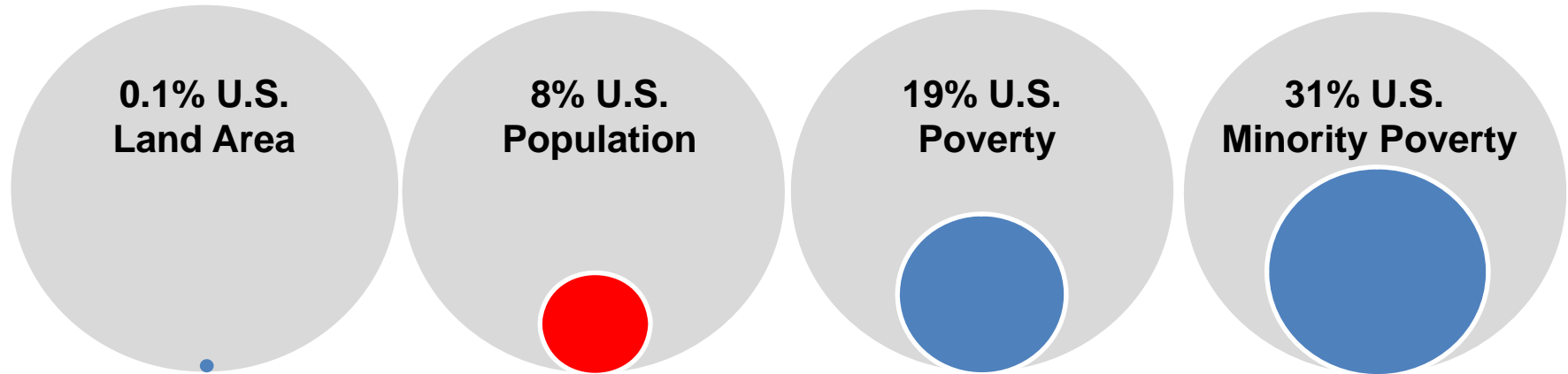
Dr. Michael Porter
Inner City Economic Forum Summit 2009
Washington DC
October 15, 2009



Agenda

- Inner City Economies: Recent Performance
- Impact: Why Are Growing Firms in the Inner City Important?
- Characteristics of Growing Inner City Firms
- Factors Influencing Growth
- Implications for Firms and for Policymakers

Poverty Concentration in the 100 Largest Inner Cities, 2000



- Targeting poverty in inner cities allows “**wholesale**” rather than “retail” approach to poverty reduction



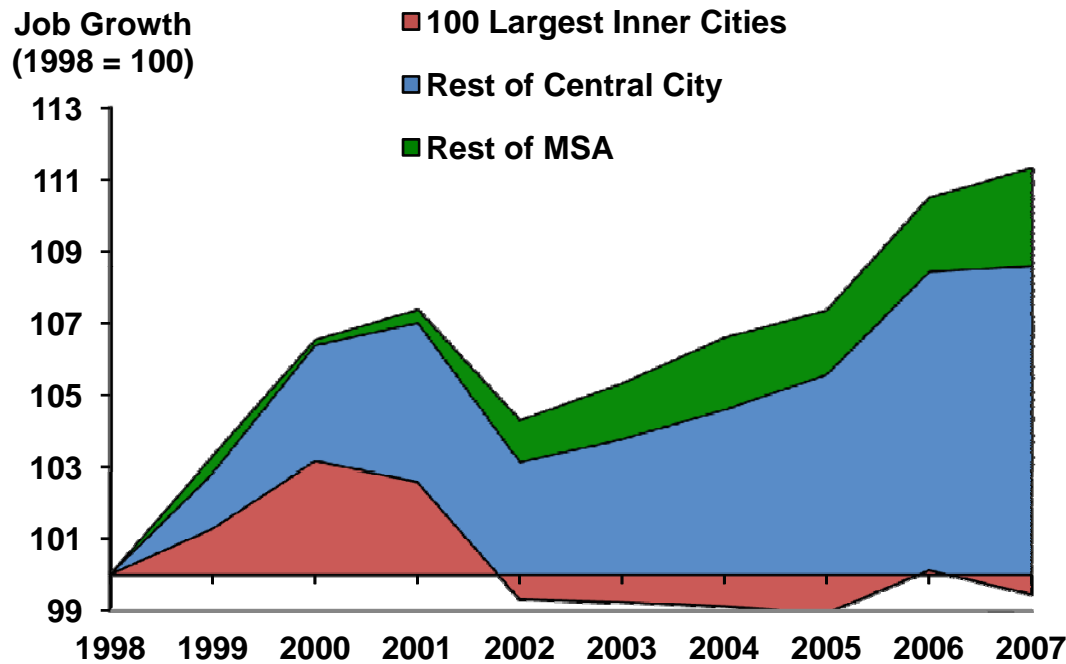
Methodology for Defining Inner Cities

- ICIC's analytical focus is with **inner city economies**, contiguous areas of distress of sufficient size representing **meaningful economic sub-regions**
- To identify inner city areas and their associated ZIP Codes, ICIC follows a rigorous methodology, starting with the **100 largest central cities** in the US
- Inner cities are defined as concentrations of **economic distress** in urban areas, measured by **poverty rates, income levels**, and **unemployment**
- Inner city poverty is quite **concentrated**. In 2000, the inner city areas delineated account for the great majority of households living in poverty, with **sixty-five percent** of the poor in the 100 largest central cities living in inner city areas



Inner City Economies Falling Behind

100 Largest Inner Cities vs. Rest of MSA, 1998 – 2007



	1998 – 2007	
	Job Growth CAGR	Net Job Change
Rest of MSA	1.2%	+6,732,200
Rest of Central City	0.9%	+1,419,200
Inner City	-0.1%	-49,300

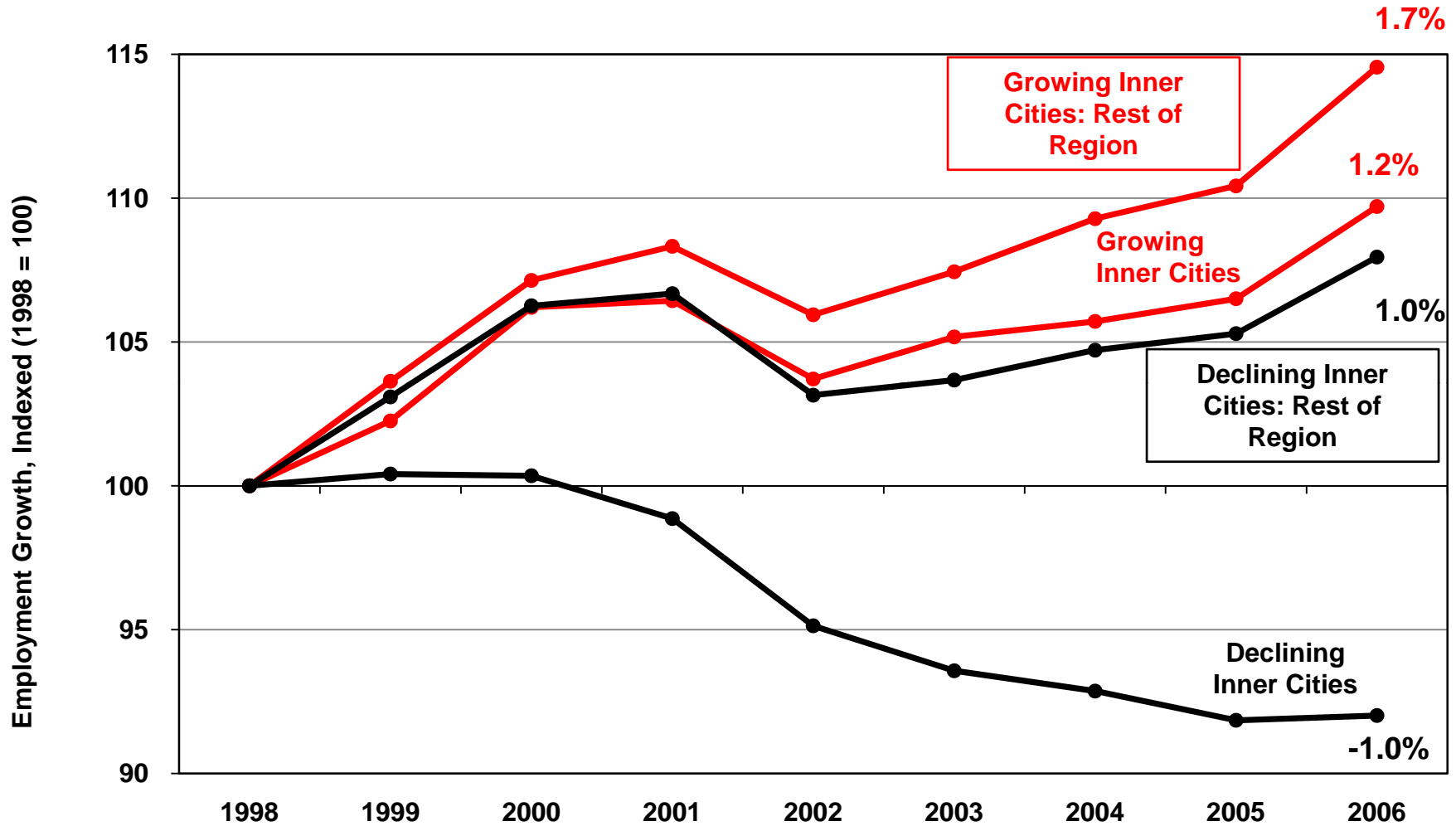


- Between 1998 and 2007, the 100 largest inner cities lost almost 50,000 jobs while their regions added over 6.7 million jobs



Inner City Job Growth vs. Rest of Region

Job Growth, 1998-2006



- Inner city decline occurs even amidst regional growth



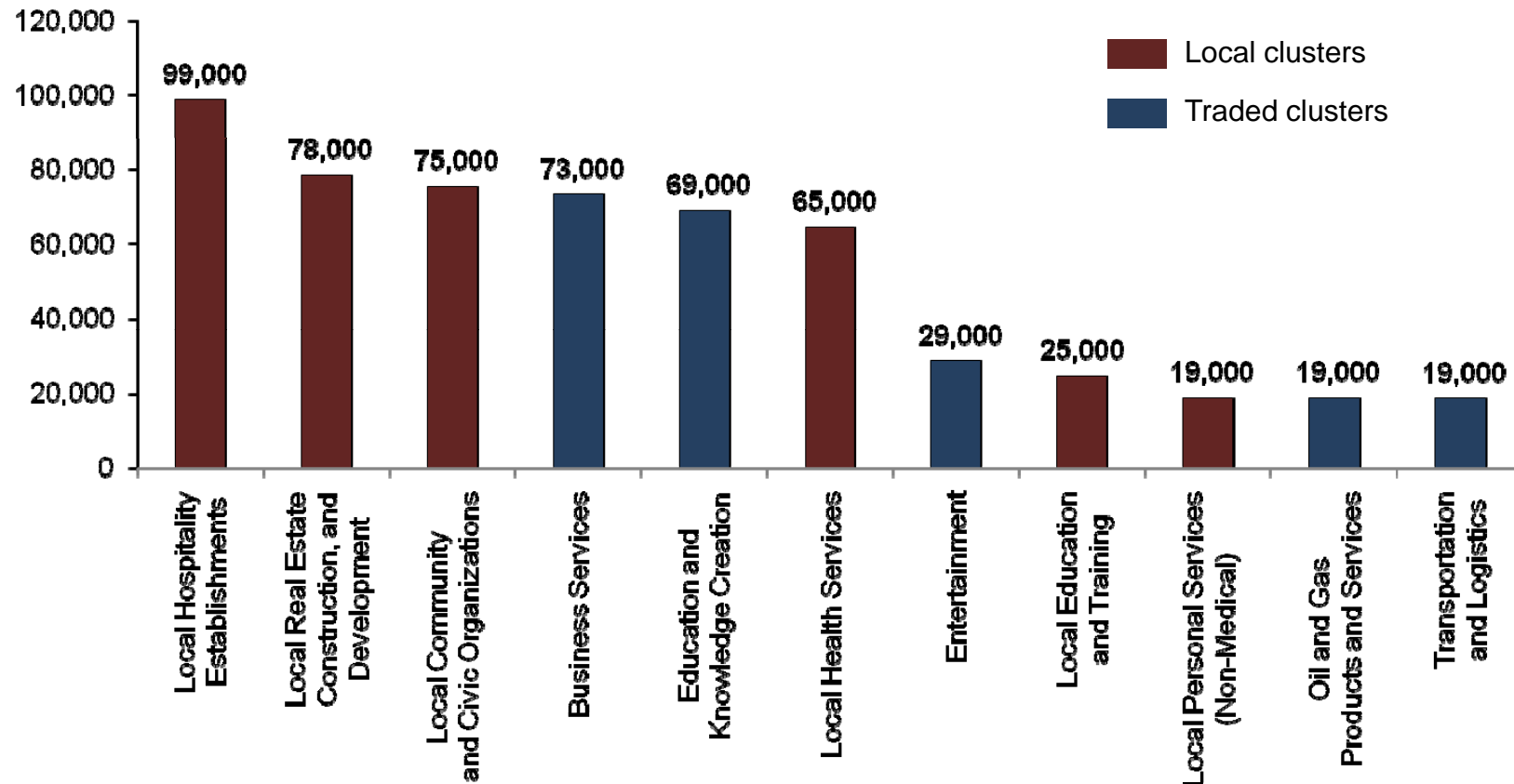
Non-Determinants of Inner City Economic Performance

Factor	Evidence
Regional economic performance	Regional economic performance accounts for less than 10% of inner city performance.
Globalization	Inner city economies are no more exposed to global competitive industries than anywhere else in the U.S.
Technological advancement	Inner cities perform reasonably well in emerging sectors including IT.

- Exogenous factors account for a small portion of inner city performance



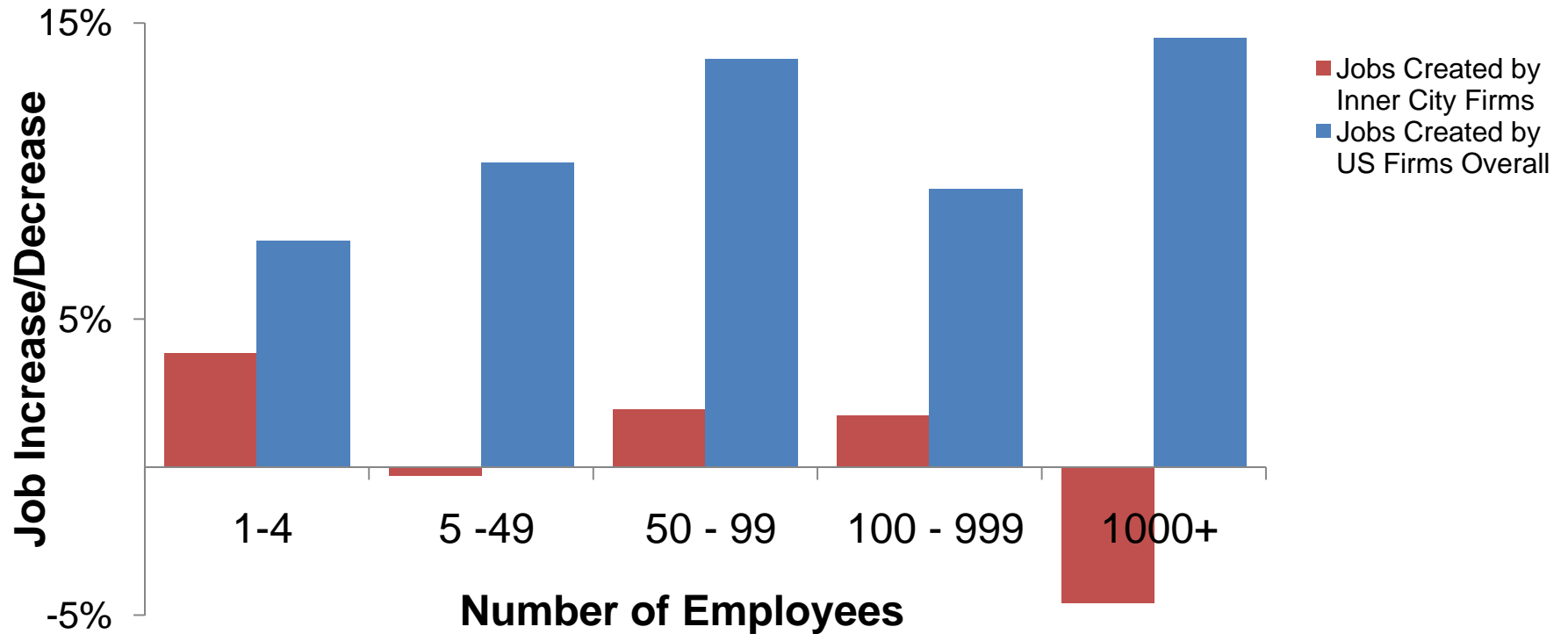
Inner City Job Growth in Growing Clusters, 1998 - 2007



- Inner cities have strengths in both local and traded clusters

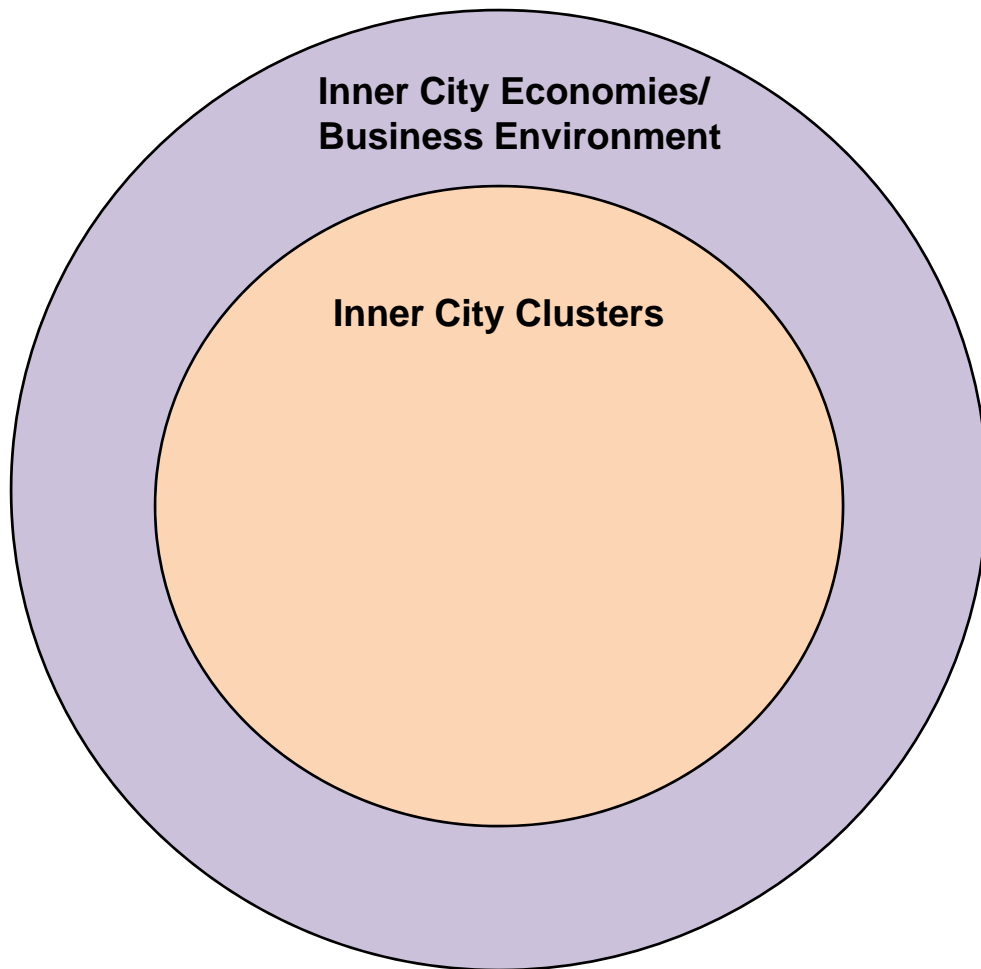
Where Has Job Growth Come From?

Job Creation Inner City vs. US Overall (1998 – 2006)



- Inner City firms have greater difficulty scaling up to 50 employees than US firms
- Large inner city firms have shown substantial job losses that more than offset gains by smaller firms

Evolution of ICIC Research & Analysis



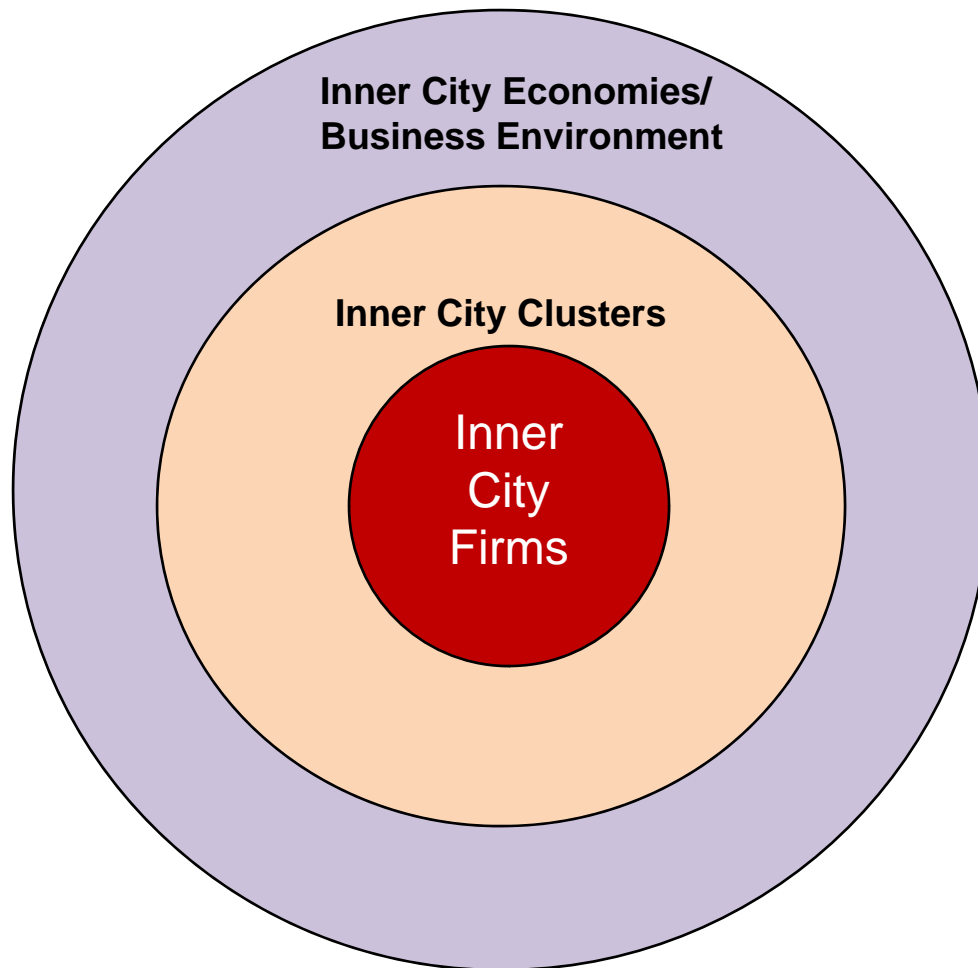
1995 to Present

- Competitive advantage of Inner Cities
- State of inner city economies database
- Federal policy work

1995 to Present

- Retail cluster study
- Universities
- Small manufacturers
- Construction, housing & real estate
- Local cluster work

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TODAY

- Analysis of growing firms in inner cities



ICIC Growing Inner City Firm Analysis Methodology

- ICIC has collected **firm-level data on almost 600 inner city firms** since 1999 via the **Inner City 100 program**
 - For-profit entities with a minimum 5-year operating history, at least \$1 million in revenue, at least 10 full-time employees and located in an inner city
 - Thriving companies that **leverage the competitive advantages** of doing business in inner cities
 - Unique and proprietary data that helps us understand the factors that **enable inner city firms to succeed** and the **obstacles** they face
 - For the first time, we **benchmarked** data on **successful inner city firms** to data on all **inner city firms** and all **U.S. firms**.
 - Benchmark data from ICIC's State of the Inner City Economy database, the Kauffman Foundation's Firm Survey database and other sources
 - Kauffman Firm Survey (KFS) database of 5,000 US Firms started in 2004 with 3 years of longitudinal data
-
- ICIC can determine **strategies** inner city firms can employ to maximize growth and **stakeholder actions** to help inner city firms succeed



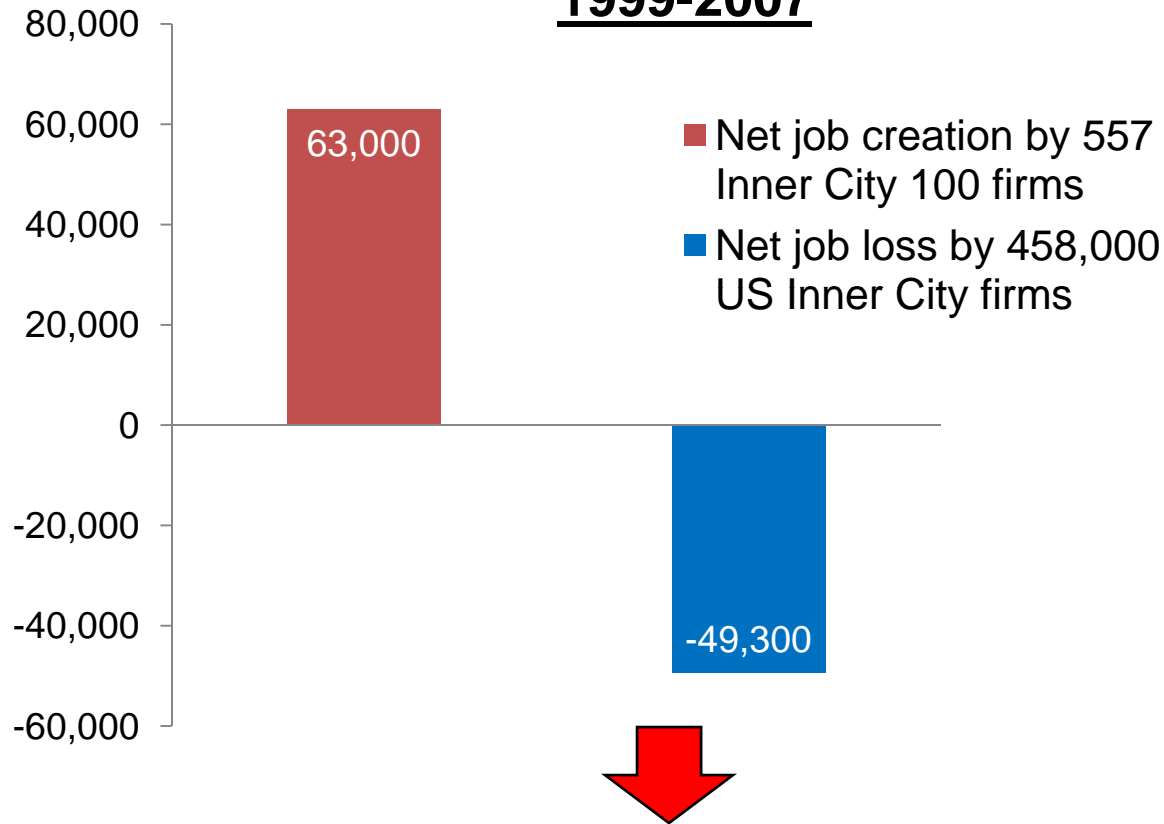
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Impact of Inner City 100 Firms on Inner City Economies

Inner City 100 Job Growth vs. Total Inner City Job Growth, 1999-2007

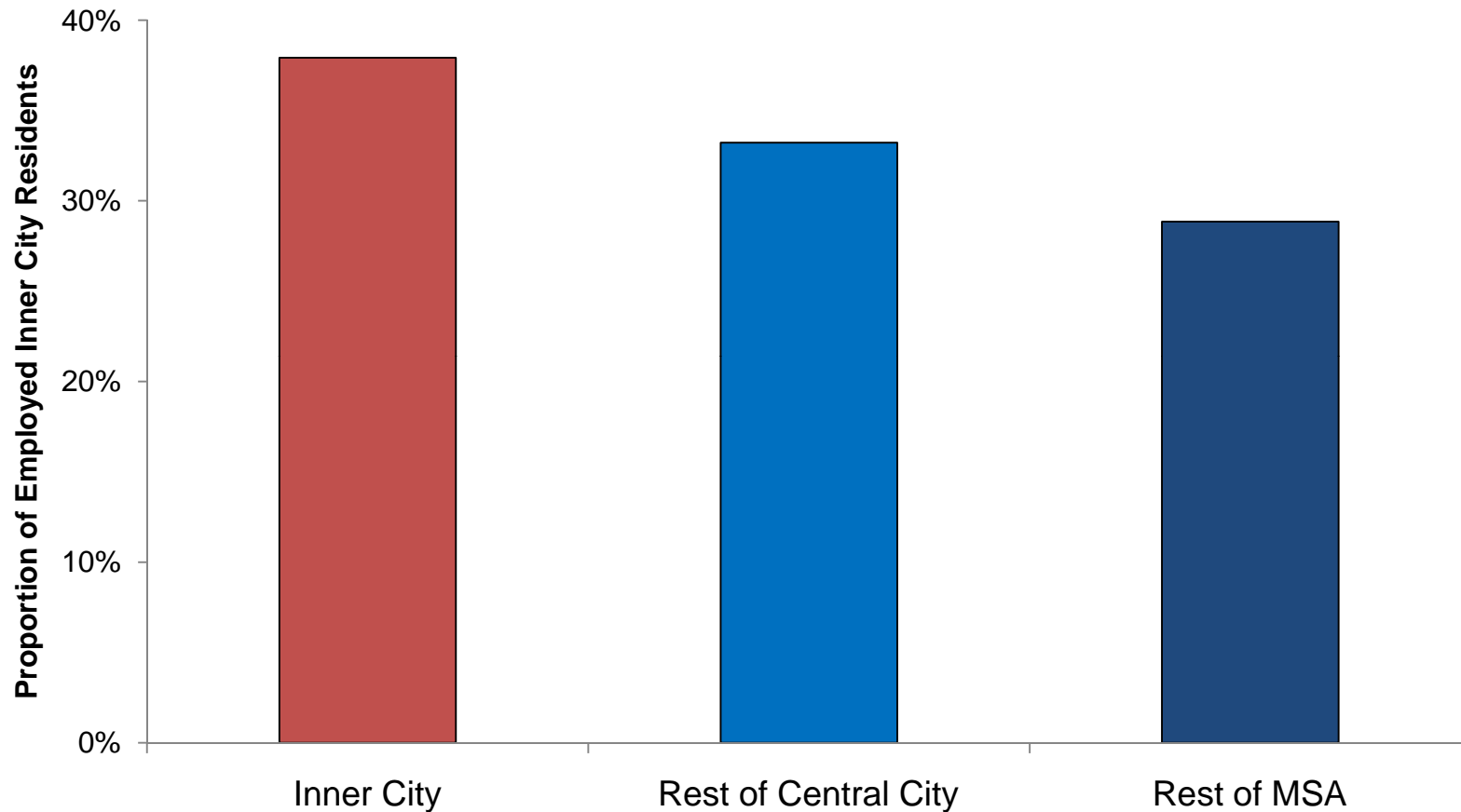


- A small number of rapidly growing firms can have a tremendous impact on inner city job creation and overall economic revitalization



Employment of Inner City Residents

Inner City Residents' Job Location Distribution, 2000



- Residents of the inner city more frequently work in the inner city



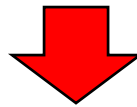
Impact of Job Creation for Inner City Residents

In a typical U.S. region inner city residents hold:

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

Creating 100 new jobs for inner city residents would require:

- 450 jobs in the inner city
- 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**



Selected Community Involvement Inner City 100 Firms

Volunteer Work

- Hope House
- Multiple Sclerosis Society
- Paraplegic Veterans Association
- Green for All
- Community Gate Path
- United Way
- Allie's House
- Special Olympics

Financial Investments

- Creating scholarships and intern programs at inner city schools
- Sponsoring needy families
- Donations to a local historical theater
- Financial incentives to employees using public transportation
- Donations to charter schools

“Charities are a large part of the corporate culture, and many employees value the opportunity to give back to the community through their jobs.”

- CEO of a Technology Company, 2009 ICIC Interview



Agenda

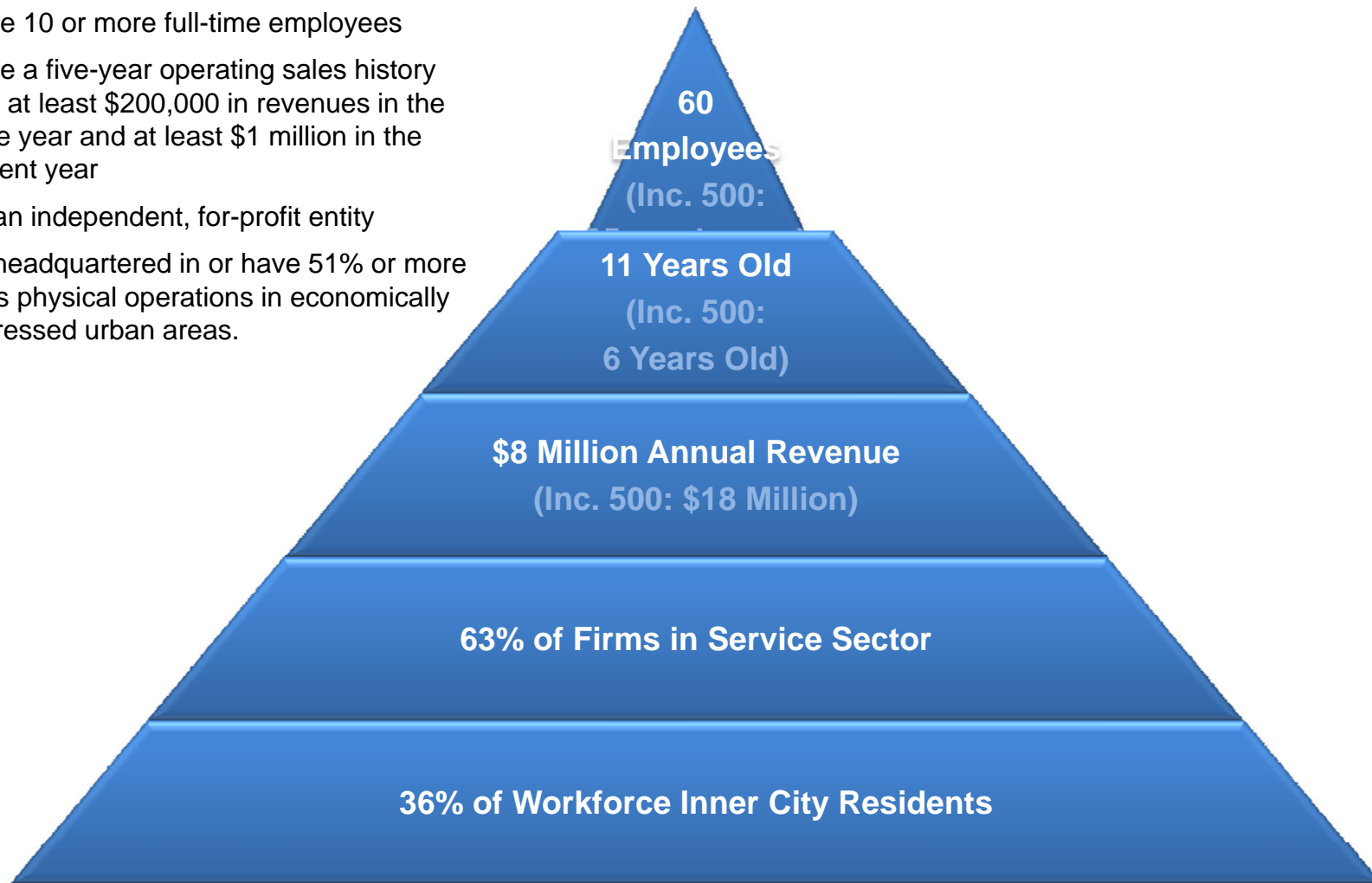
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Snapshot of a Typical Inner City 100 Firm

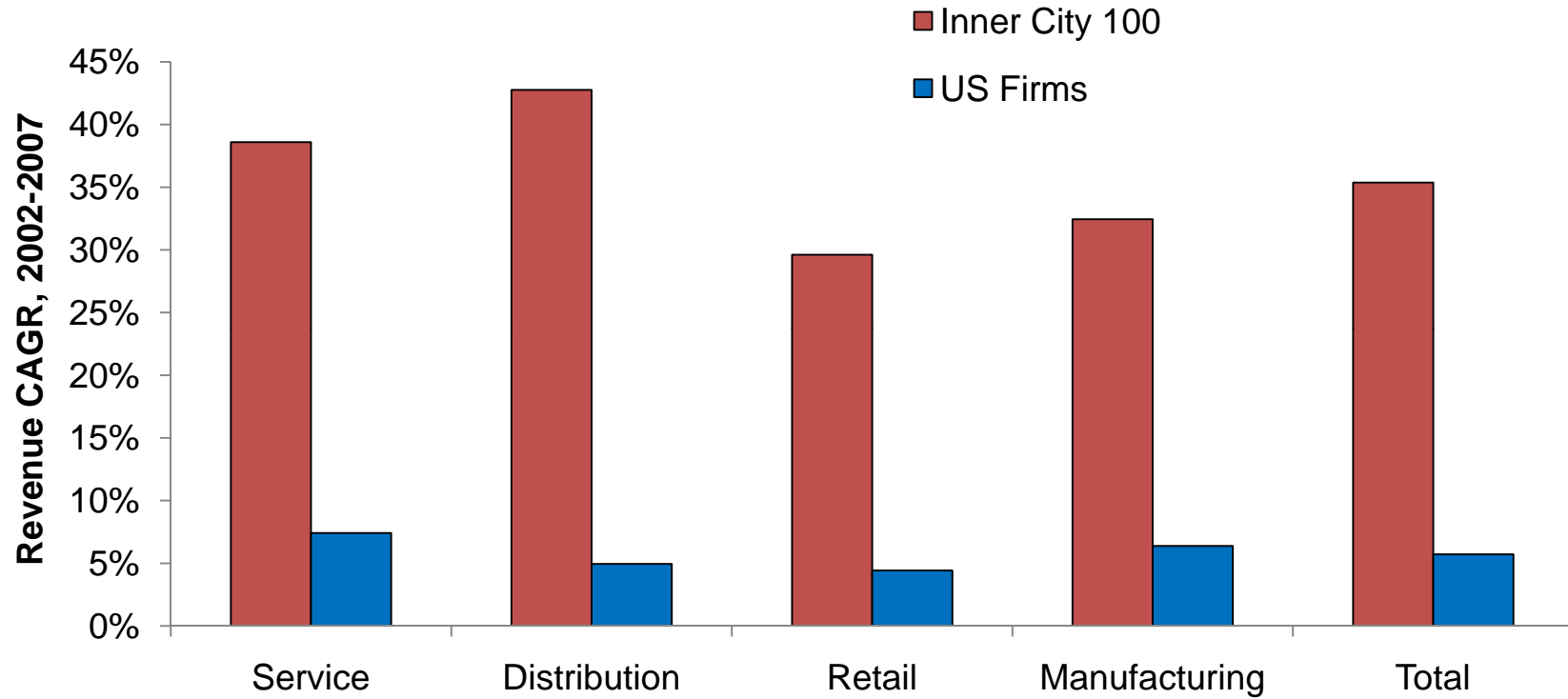
Inner City 100 Firms Must:

- 1) Have 10 or more full-time employees
- 2) Have a five-year operating sales history with at least \$200,000 in revenues in the base year and at least \$1 million in the current year
- 3) Be an independent, for-profit entity
- 4) Be headquartered in or have 51% or more of its physical operations in economically distressed urban areas.





Inner City 100 Firm Revenue Growth vs. Sector Averages

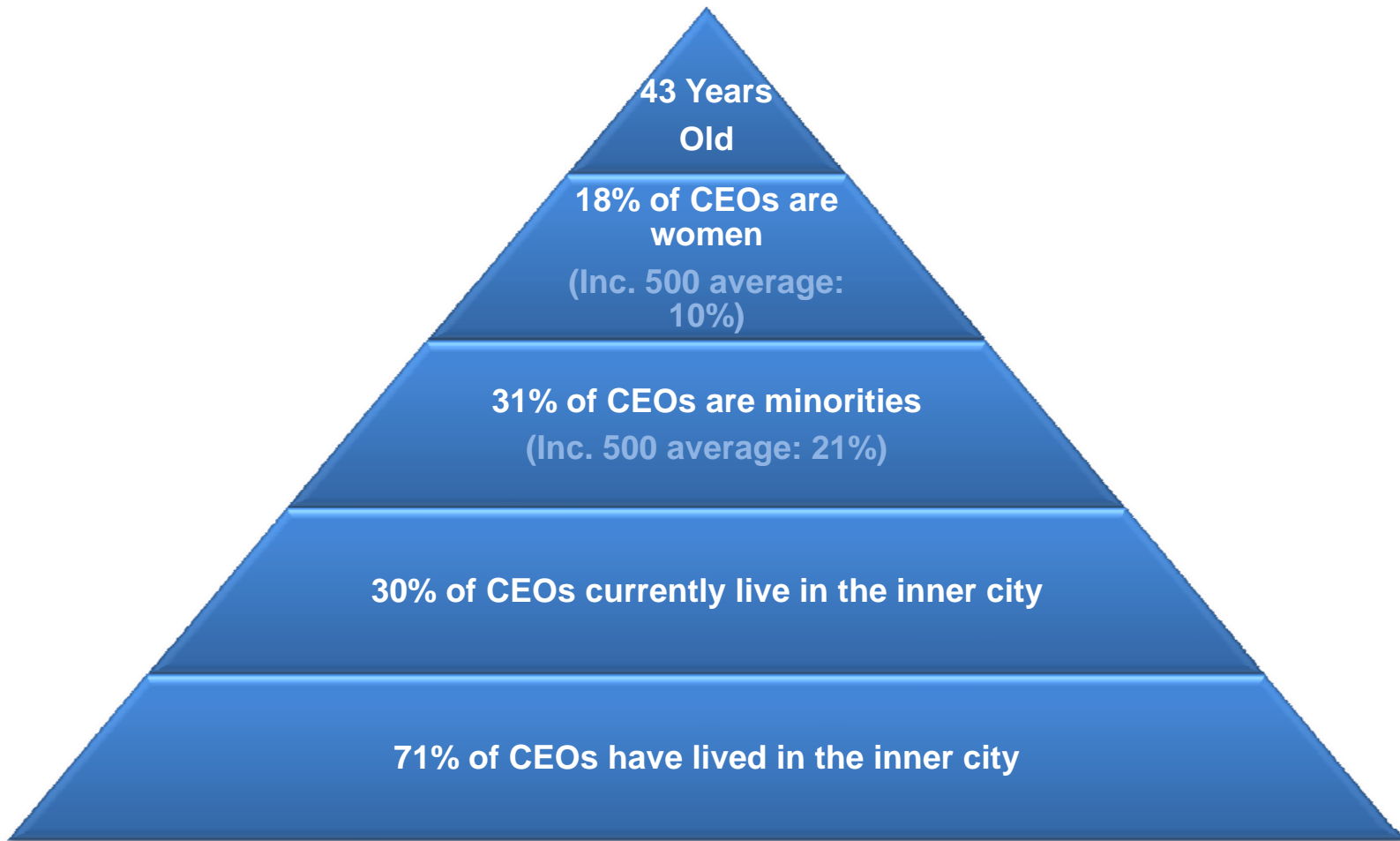


- Inner City 100 firms have much higher revenue growth across all sectors

Source and Notes: ICIC analysis of Inner City 100 Survey data, median values 2003-2007, n=100; US Economic Census 2007 & 2002 all values represent a weighted average, n=13,692,342 for 2002 and n=14,436,874 for 2007.



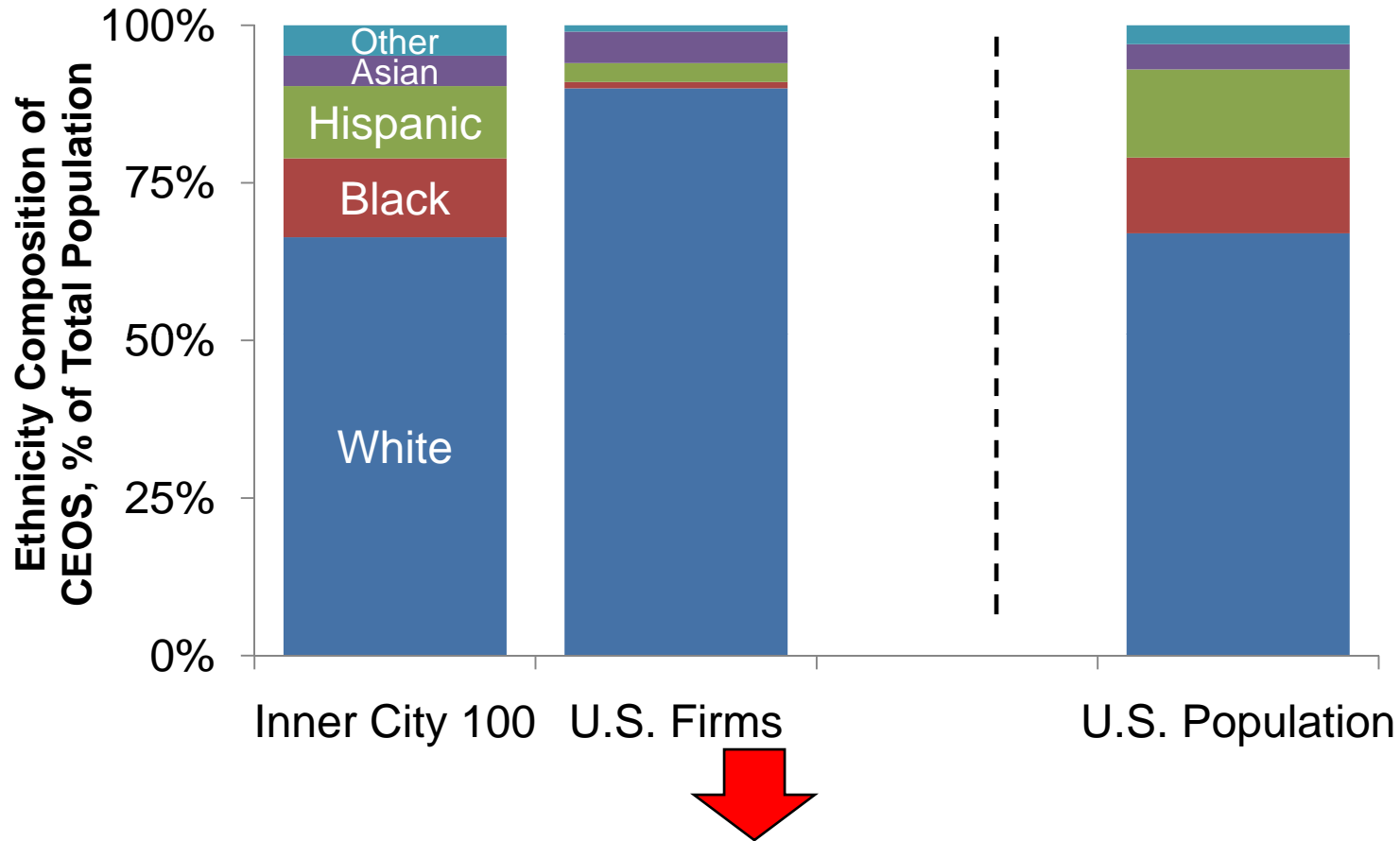
Snapshot of a Typical Inner City 100 CEO





Inner City 100 CEO Demographics

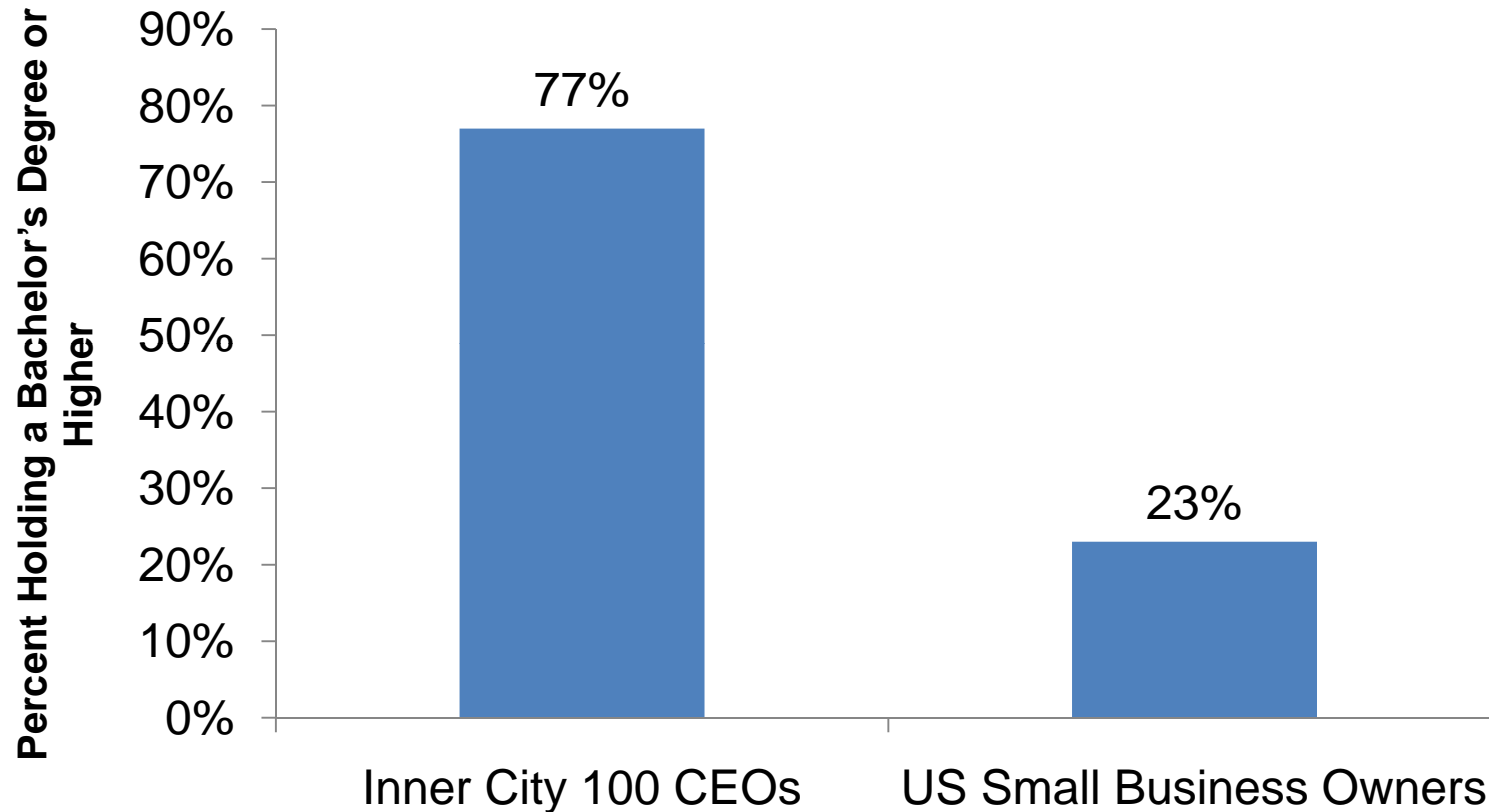
Ethnicity of Inner City 100 CEOs vs. US Firms and US Population



- Inner city 100 CEOs are more ethnically diverse than CEOs of US firms overall and closely mirror the demographics in the overall US population



Inner City 100: Proportion of CEOs and Business Owners with Advanced Degrees



- Inner City CEOs are **more educated** than US small business owners overall



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ICIC Factors Influencing the Growth of Inner City Firms

Financing

- Access to Capital
- Sources of Capital

Inner City Business Environment

- Advantages
- Disadvantages
- Use of Public Programs

Revenue Sources

- Customer Composition
- Government Contracts

Leadership and Human Capital

- CEO Background
- Inner City Workforce
- Employee Benefits and Training



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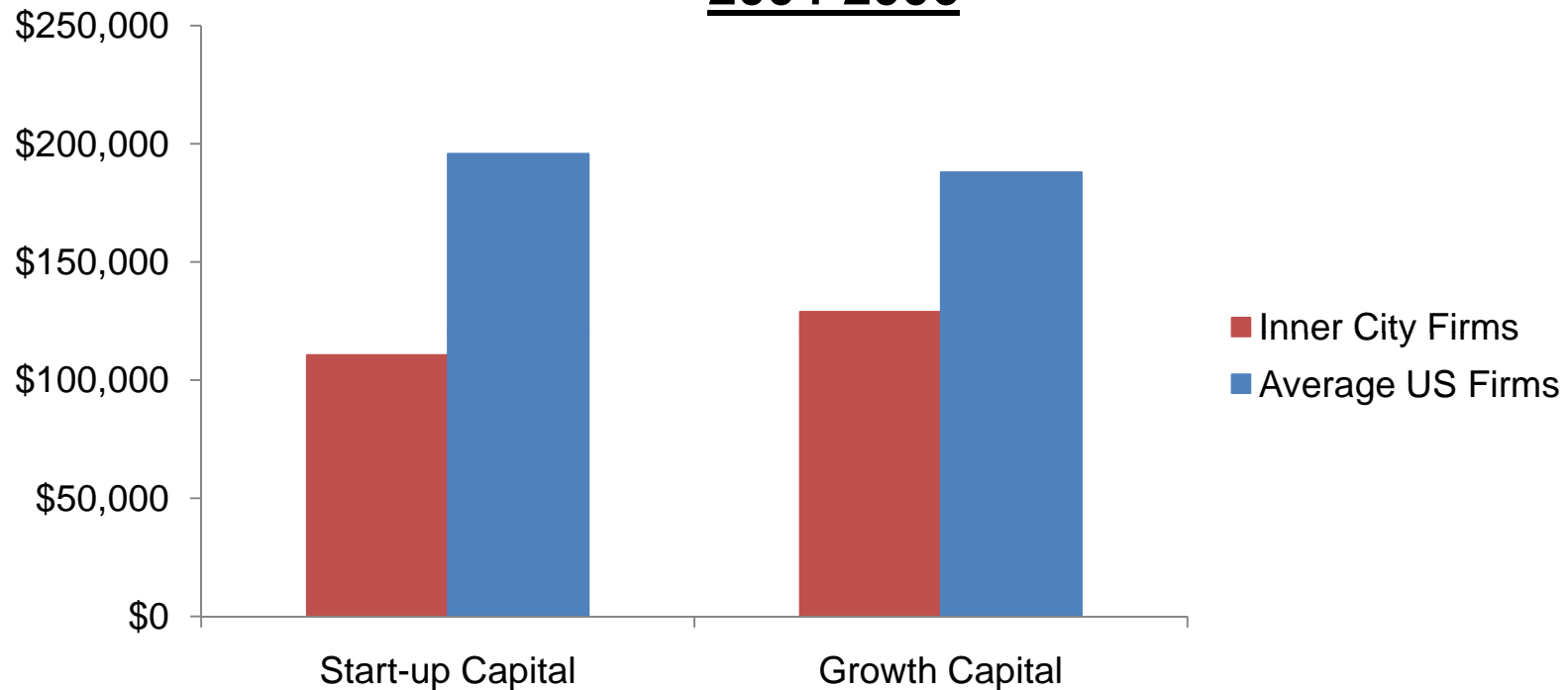
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ICIC

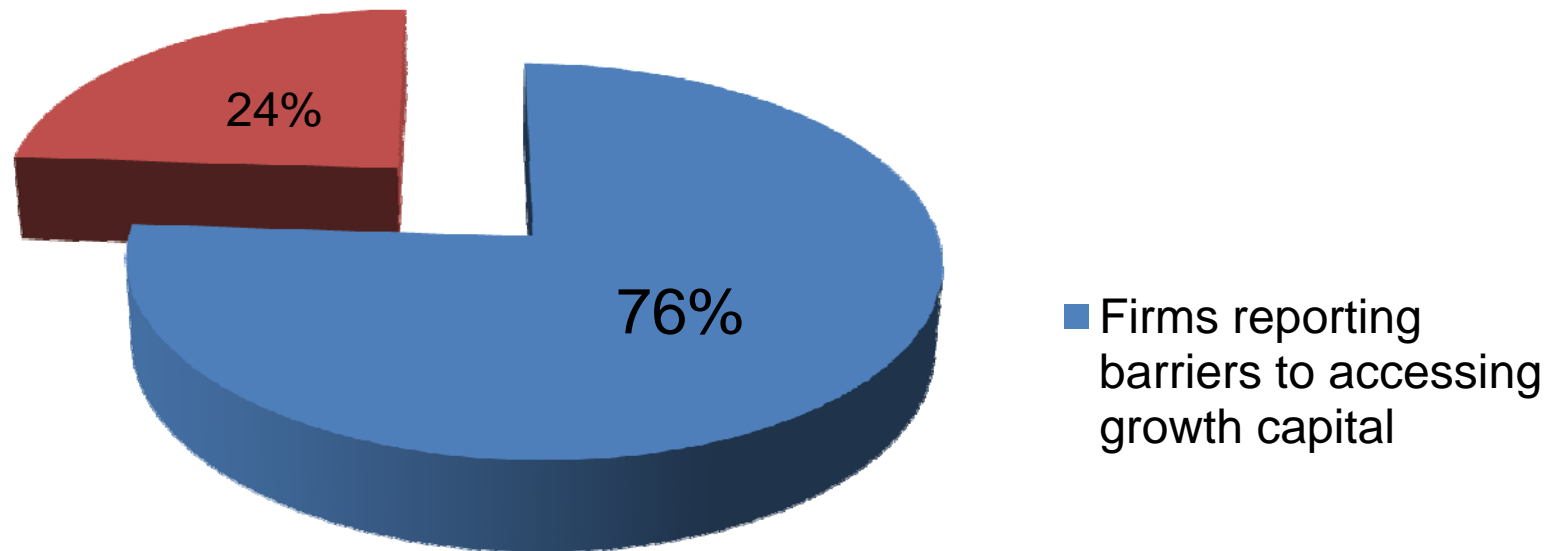
Financing: Limited Access to Capital

Start-up and Growth Capital for Inner City Firms vs. All US Firms, 2004-2006



- Inner City firms start with **44% less capital** than average US firms and receive **31% less growth capital**

Inner City Firms Reporting Barriers to Accessing Growth Capital, 2008-2009

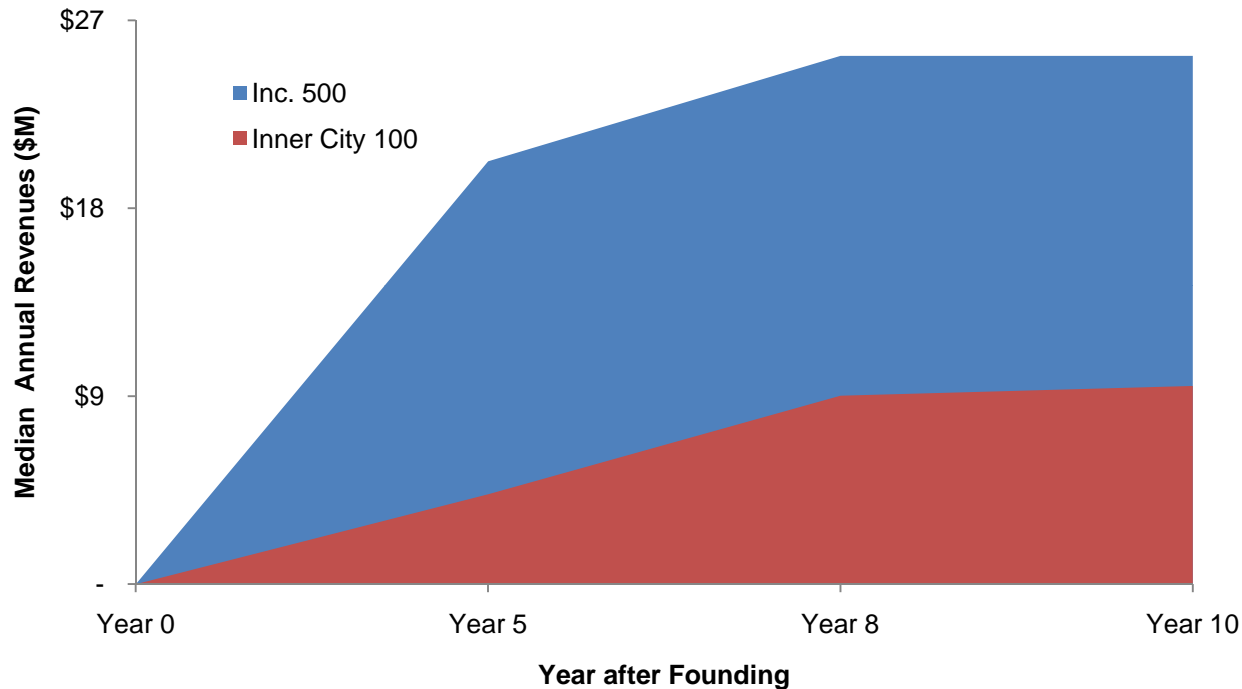


- 76% of growing inner city firms reported experiencing barriers to accessing growth capital



Financing: Business Growth Trajectory

Revenue Growth of Inner City 100 firms versus all other US Firms, Year 0 – Year 10 of Firm Lifecycle



- Limited capital influences growing inner city firms' **ability to accelerate growth** and achieve the same **scale** as growing non-inner city firms
- Inner city firm CEOs frequently run business for **cash flow rather than growth**

Source and Notes: ICIC analysis of Inner City 100 survey data, 199-2009, n = 850; Inc. 500 analysis of 1999-2008 Inc. 500 companies, n = 401. Lines are representative of the median values at each time period.



Financing: Impact on Inner City 100 Sector Distribution

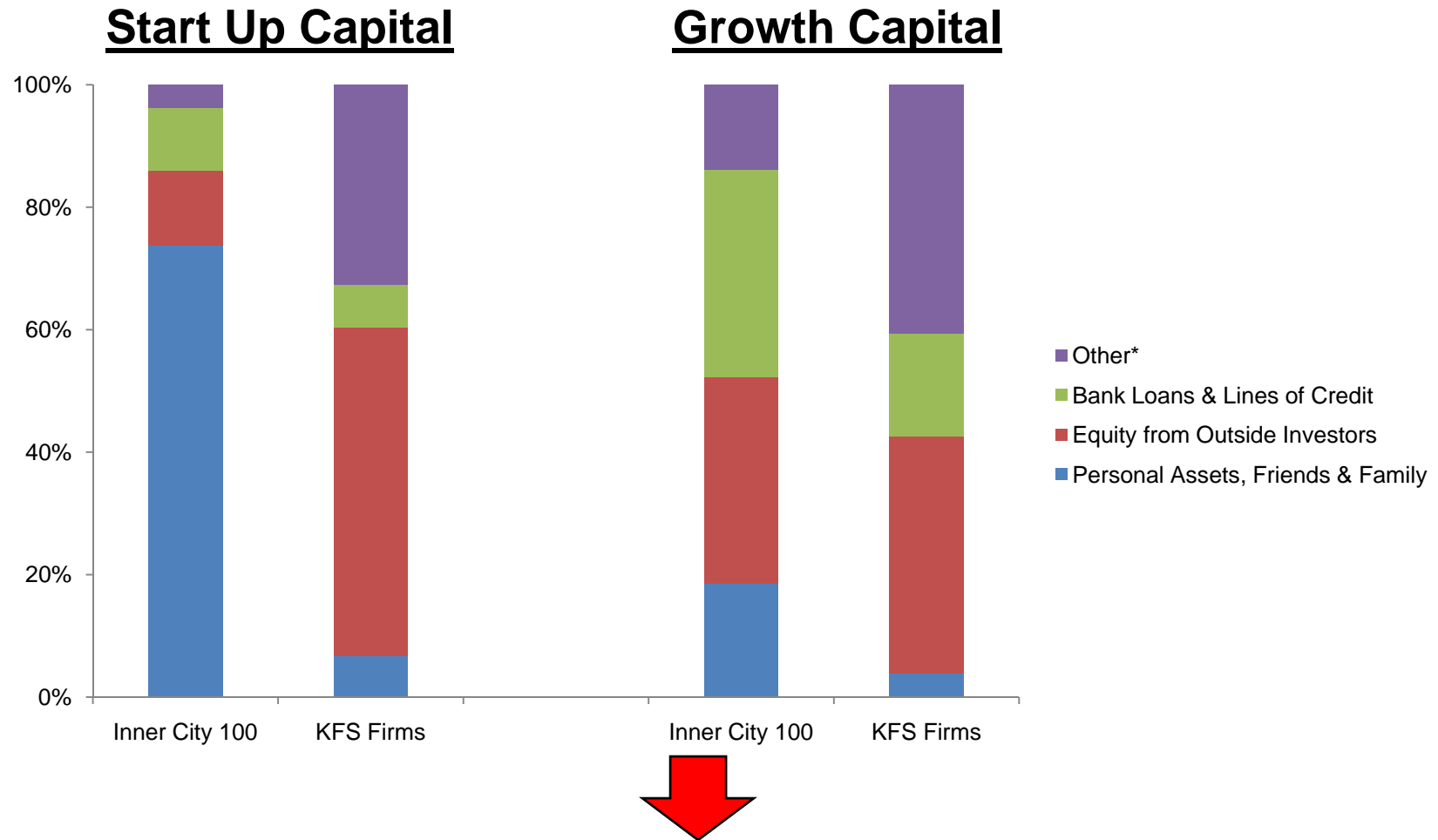
Number of Inner City 100 Firms versus all Inner City and US Firms, 2004-2006



- Lower amounts of start-up capital drive inner city firms into **less-capital intensive sectors**



Financing: Sources of Start-up & Growth Capital, 2004-2006



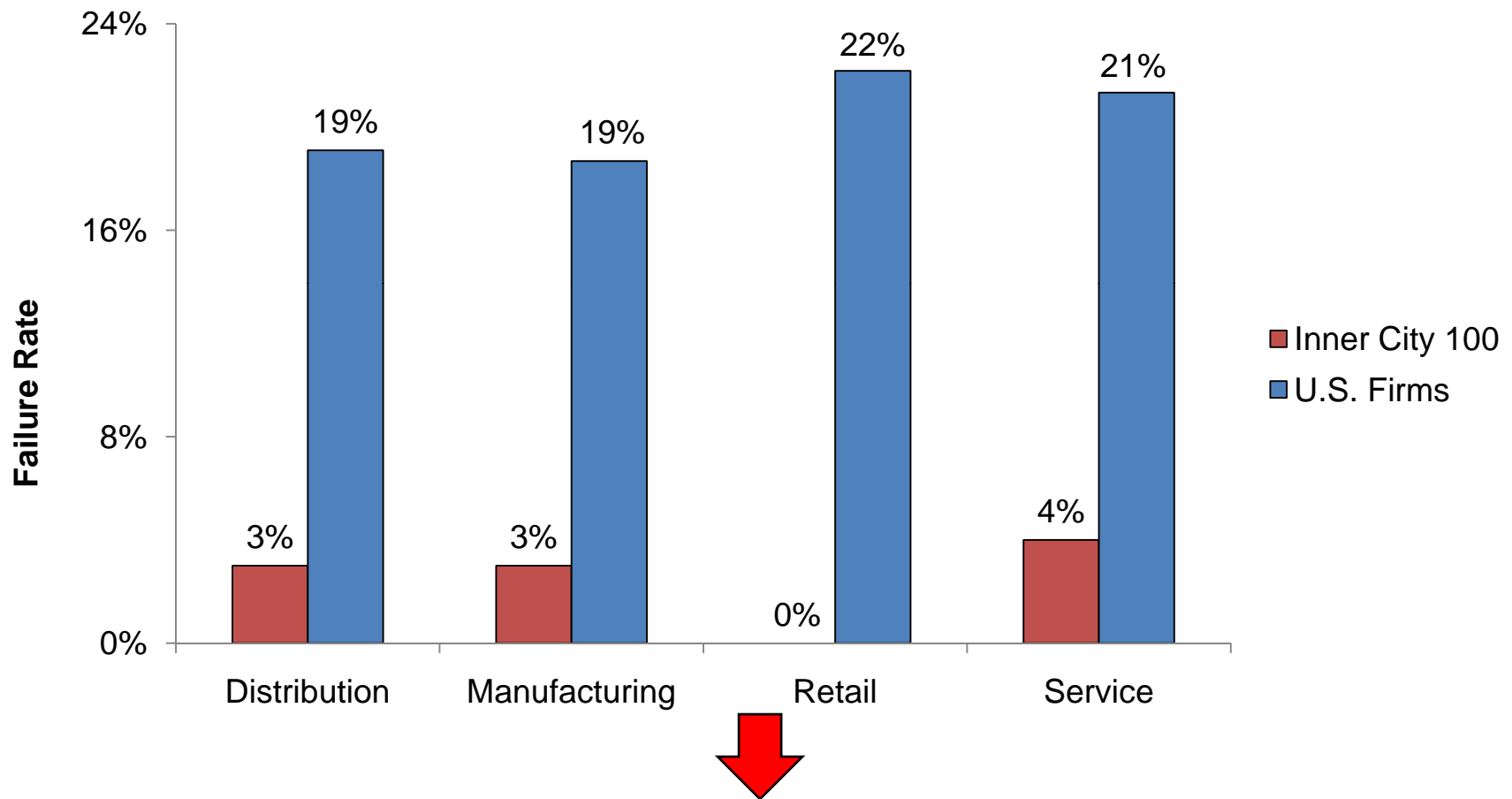
- Inner City 100 firms tend to be **more conservatively capitalized**, relying more heavily on personal assets to start up and on more bank loans to grow

Source: ICIC analysis of 2006 Inner City 100 survey data, n=64; Kauffman Firm Survey (KFS) data; * Other represents government sources for Inner City 100 firms and other companies for US firms



Sources of Capital: Low Failure Rates

Failure Rates by Sector, Inner City 100 vs. US Firms



- Over the past 11 years, only 16 Inner City 100 firms have gone out of business, none within the retail sector



Financing: Summary

“Capital access is a vicious cycle; without money, it is almost impossible to get money. We took out a \$50K line of credit with a bank, but we use this as more of a convenience, rarely relying on the debt and paying the balance off immediately so as not to accrue interest charges.”

- *Chief Strategy Officer, Advertising & Marketing Firm, 2009 ICIC Interview*

- Limited access to capital affects inner city firms' growth trajectories
- Heavier reliance on debt and internally generated funds means many inner city firms prioritize cash flow over growth
- Lower amounts of start-up capital drive inner city firms into less-capital intensive industries
- Because Inner City 100 firms are more conservatively capitalized, they tend to have lower failure rates than the national corporate average



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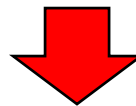
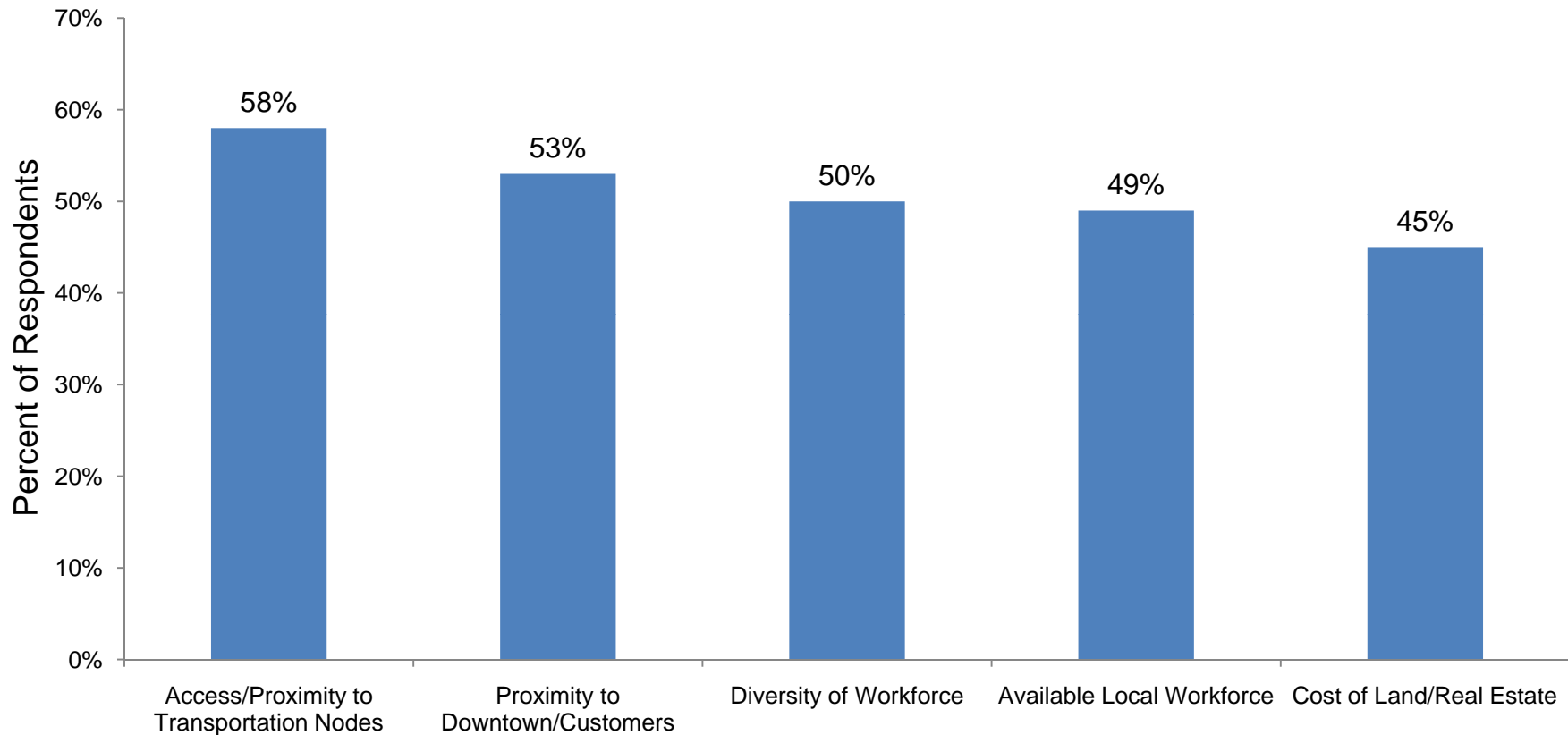
Leadership and Human Capital

- CEO Background
- Inner City Workforce
- Employee Benefits and Training



ICIC Business Environment: Advantages of Inner City

Most Cited/Highest Ranked Advantages, 2004-2009

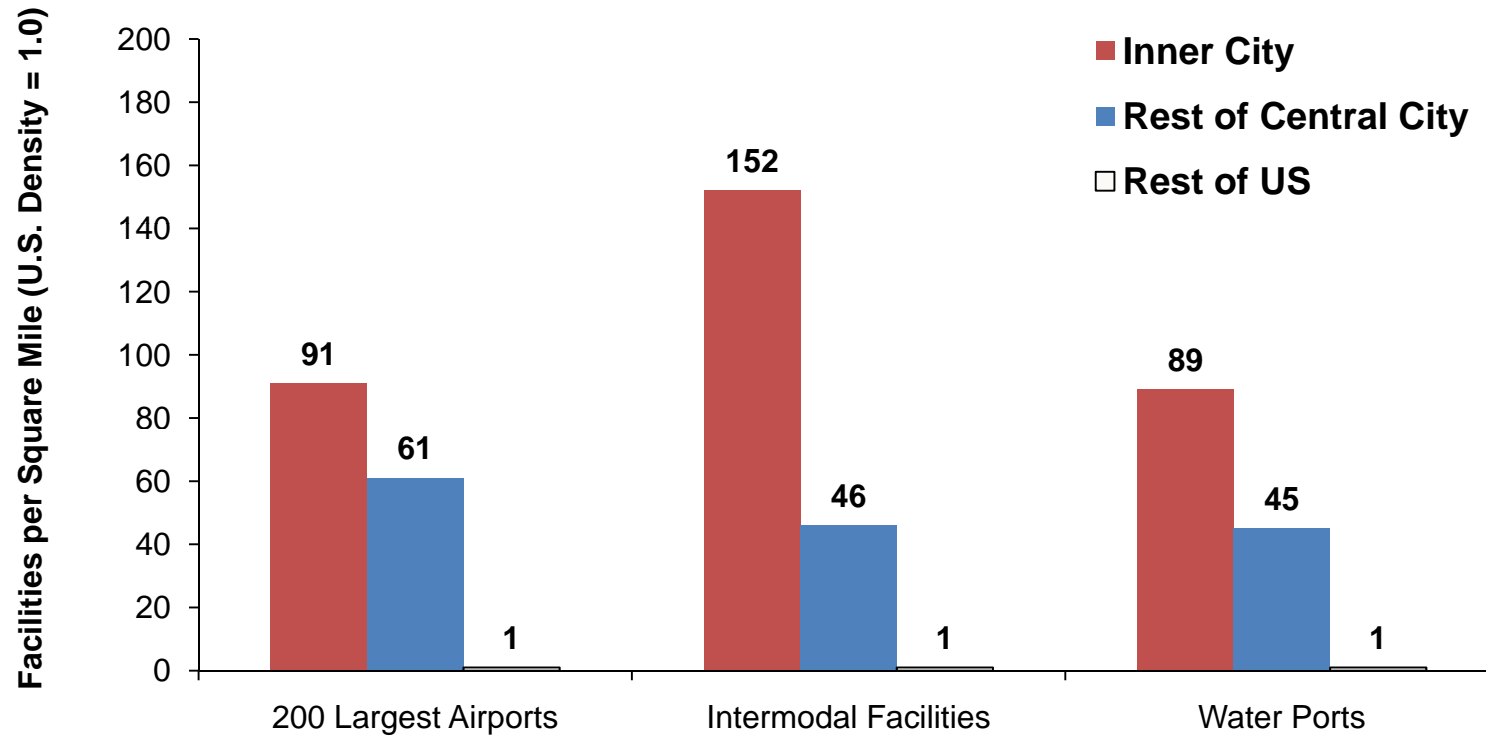


- Access and transportation are cited by Inner City 100 firms most frequently as advantages of their location

Source and Notes: ICIC analysis of Inner City 100 Survey data, 2004-2009, n=504. Respondents chose up to 3 factors out of a list of 10. (2004-2006) or ranked 1 or 2 on scale of 1 to 7 (2008-2009).

Business Environment: Location of Transportation Assets

Transportation Infrastructure Density, 2008

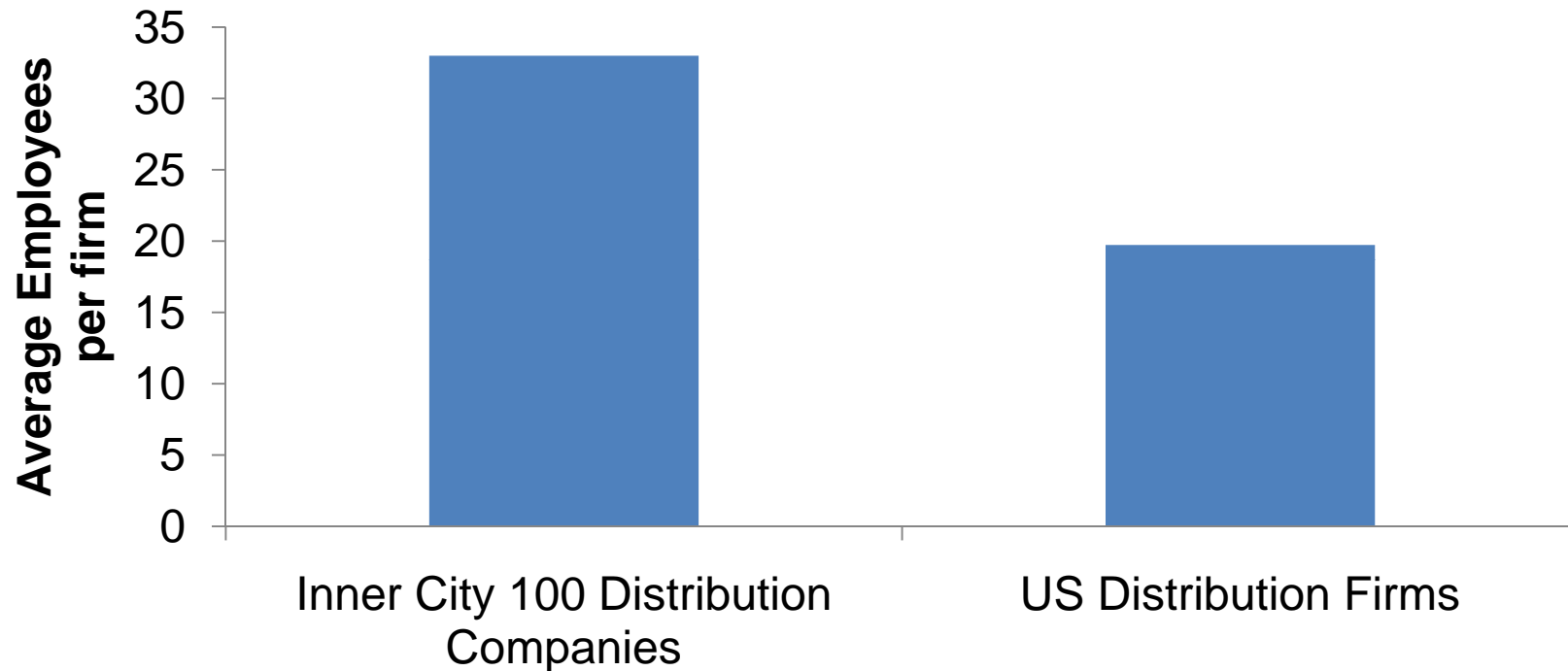


- Infrastructure density is an advantage of inner city location



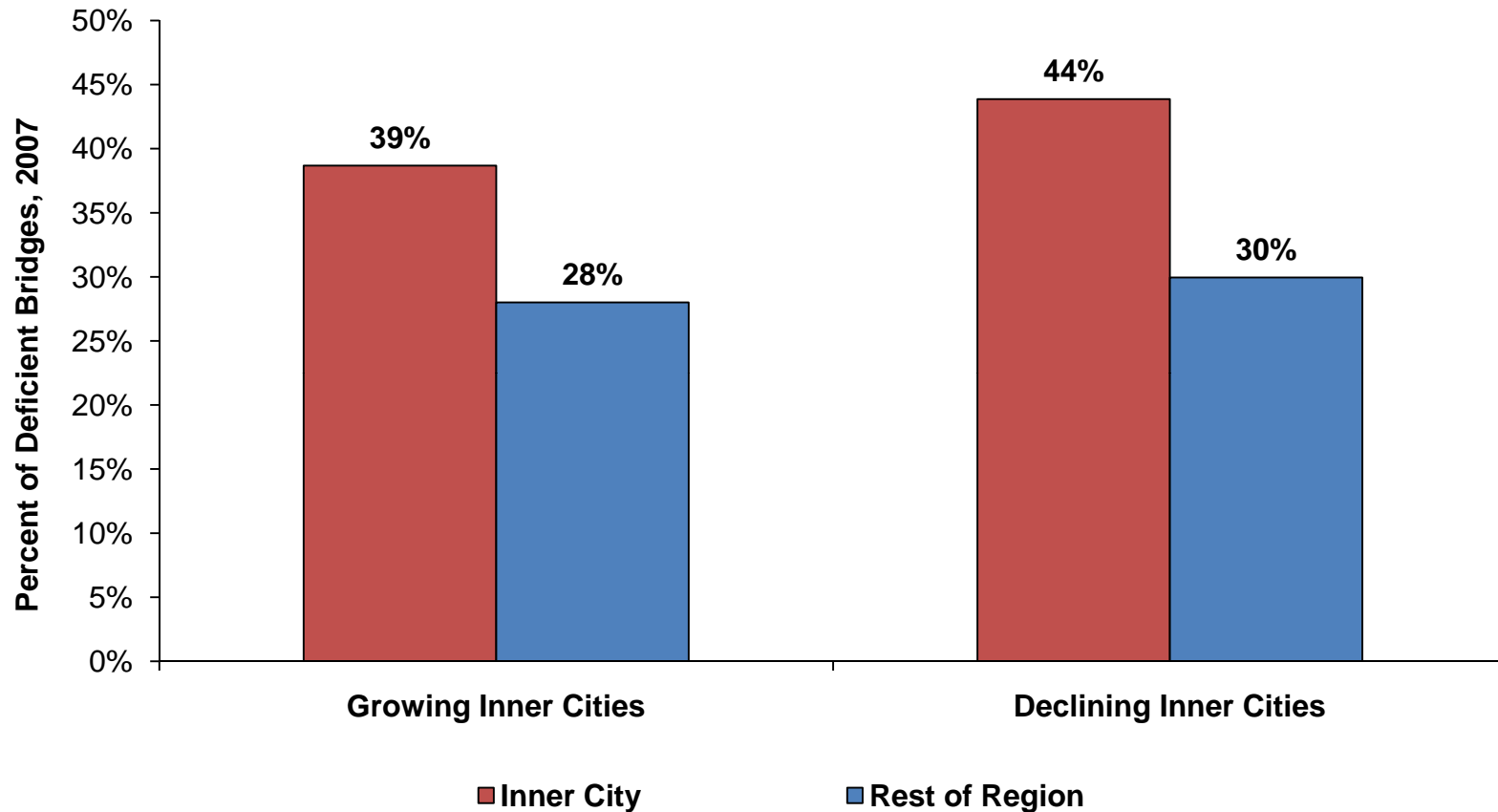
Business Environment: Inner City Distribution Sector Employment

Median Employees per Distribution Firm, Inner City 100 vs. US Firms



- Inner City 100 distribution firms achieve greater scale by taking advantage of infrastructure density

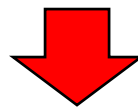
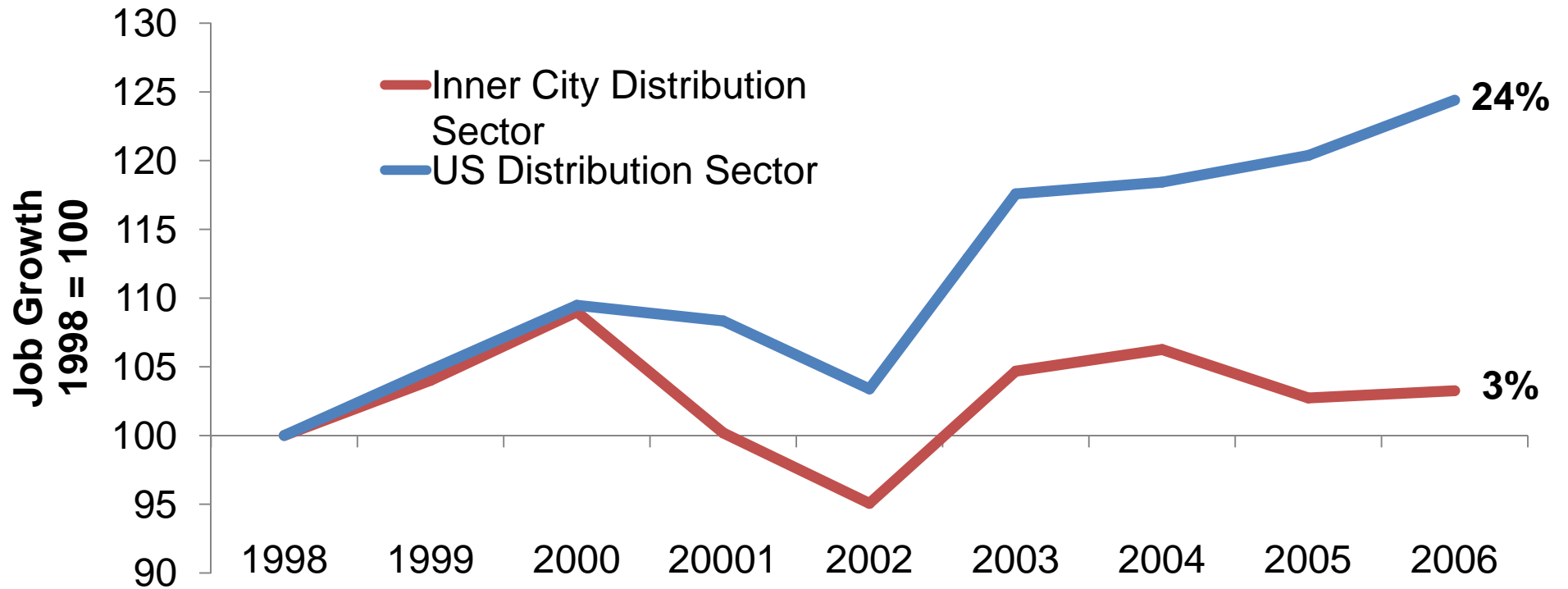
Business Environment: Bridge Quality



- When it comes to bridge quality, the only available proxy for infrastructure quality, inner cities are in noticeably worse shape than their central cities and regions



Business Environment: Inner City Distribution Sector Employment Growth, 1998-2006

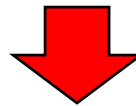
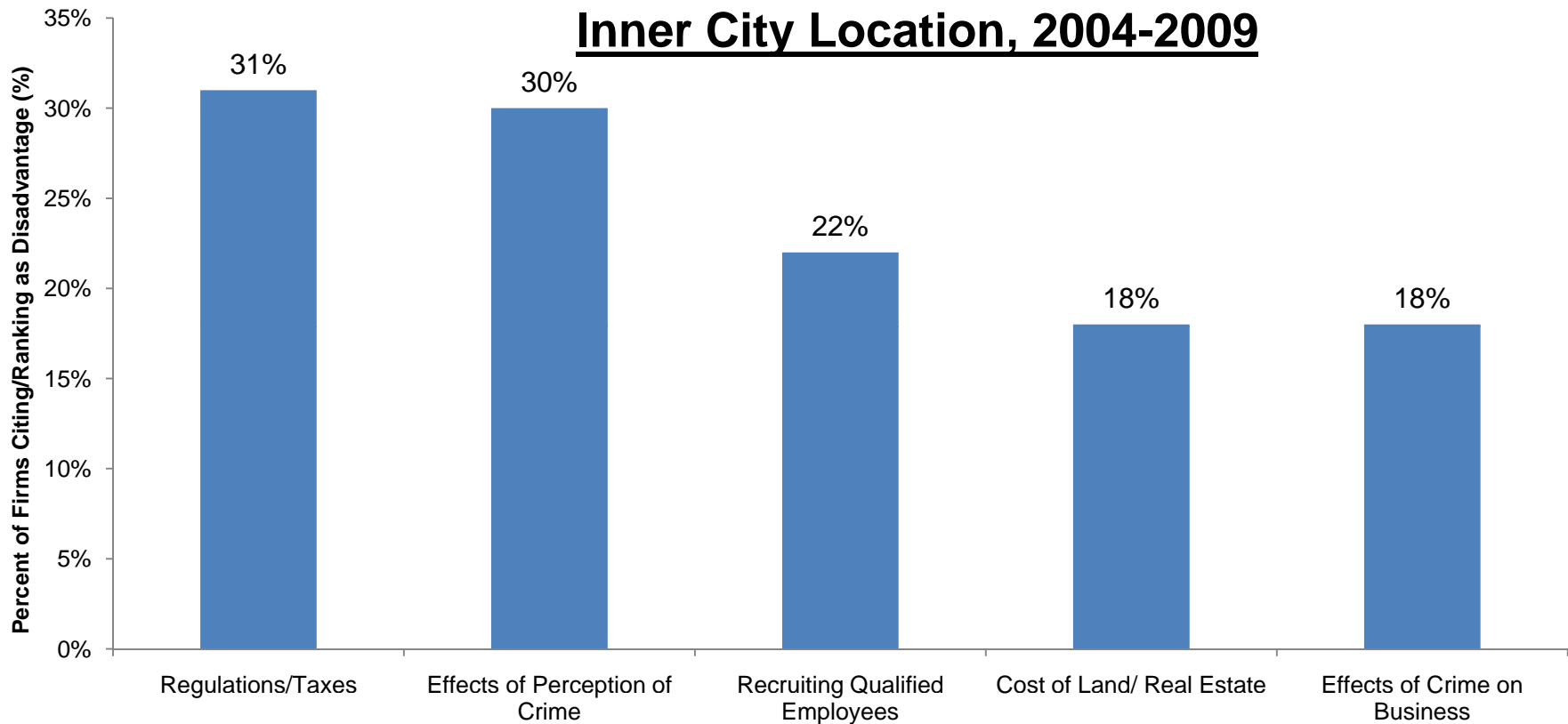


- Despite the benefits of infrastructure density within the inner city, **deteriorating infrastructure quality** is lessening this advantage over time



ICIC Business Environment: Disadvantages of Inner City

Most Cited/Highest Ranked Disadvantages to Inner City Location, 2004-2009



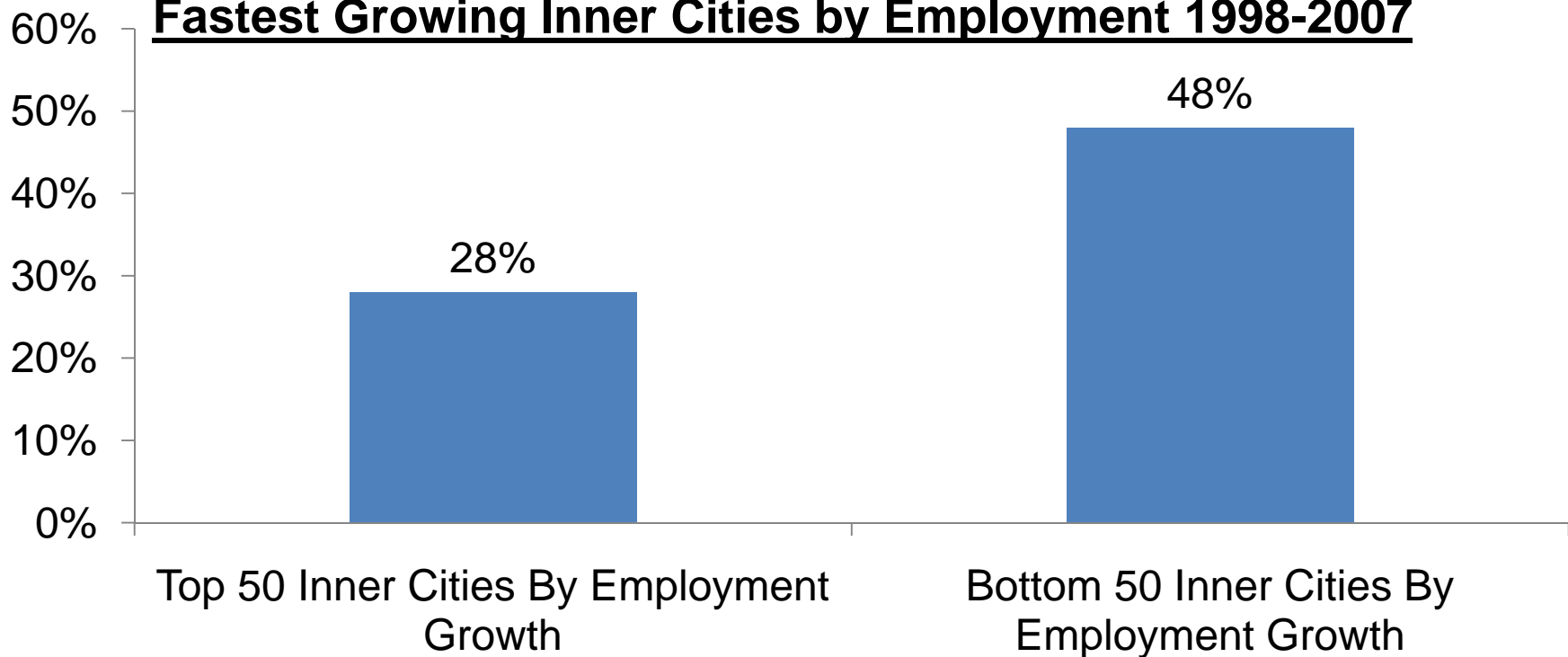
- **Regulations** and **crime** are the most cited disadvantages of doing business in the inner city

Source and Notes: ICIC analysis of Inner City 100 Survey data, 2004-2009, n=504. Respondents chose up to 3 factors out of a list of 10. (2004-2006) or ranked 1 or 2 on scale of 1 to 7 (2008-2009).



Business Environment: City Growth and Number of Inner City 100 Companies

Percent of Inner City 100 Firms Located in Top vs. Bottom 50 Fastest Growing Inner Cities by Employment 1998-2007

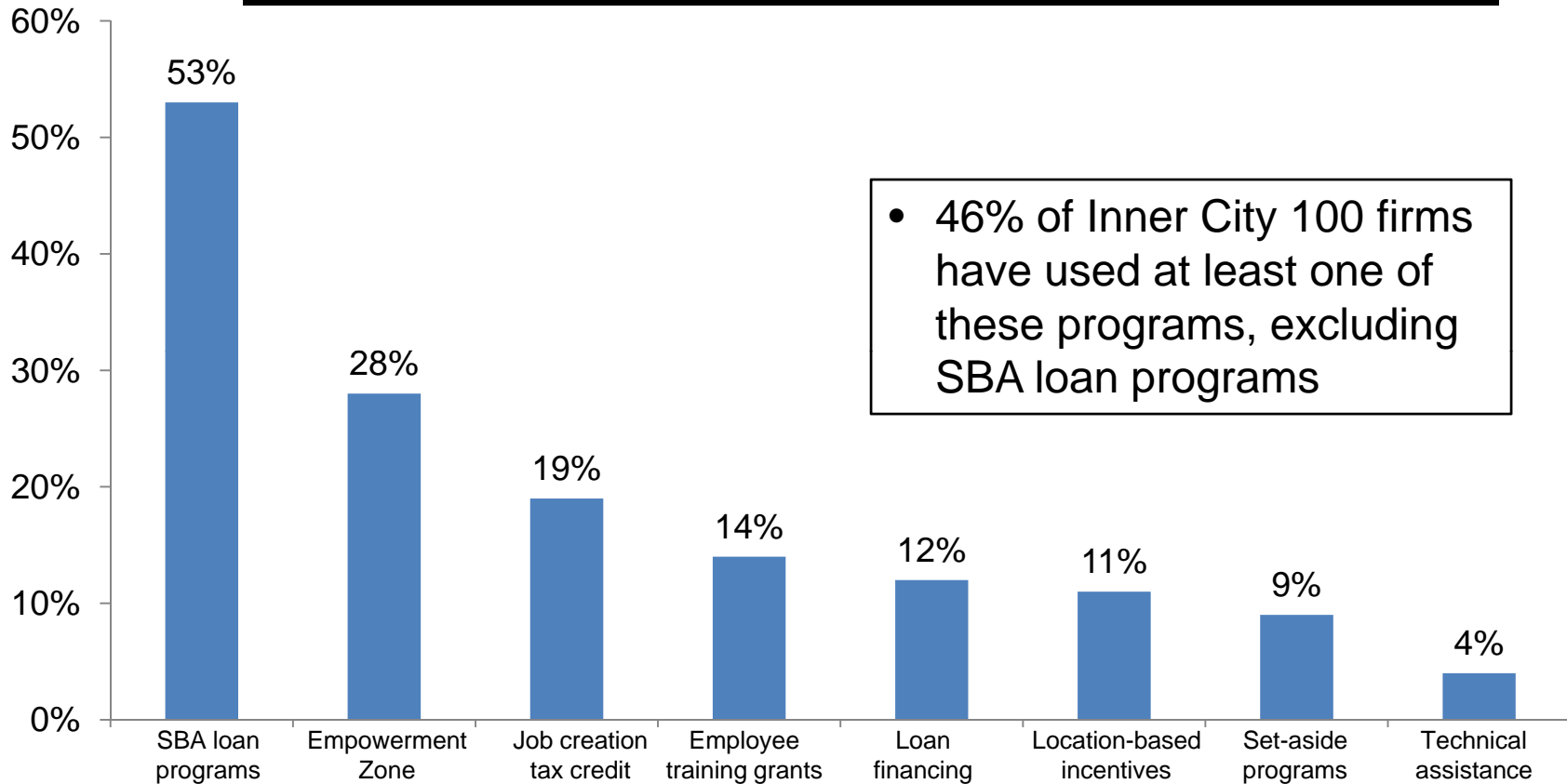


- Location matters but **does not determine success** as growing inner city companies succeed in both advantageous and disadvantageous environments



ICIC Business Environment: Use of Public Programs

Use of Public Programs by Inner City 100 Firms, 2006



• 46% of Inner City 100 firms have used at least one of these programs, excluding SBA loan programs

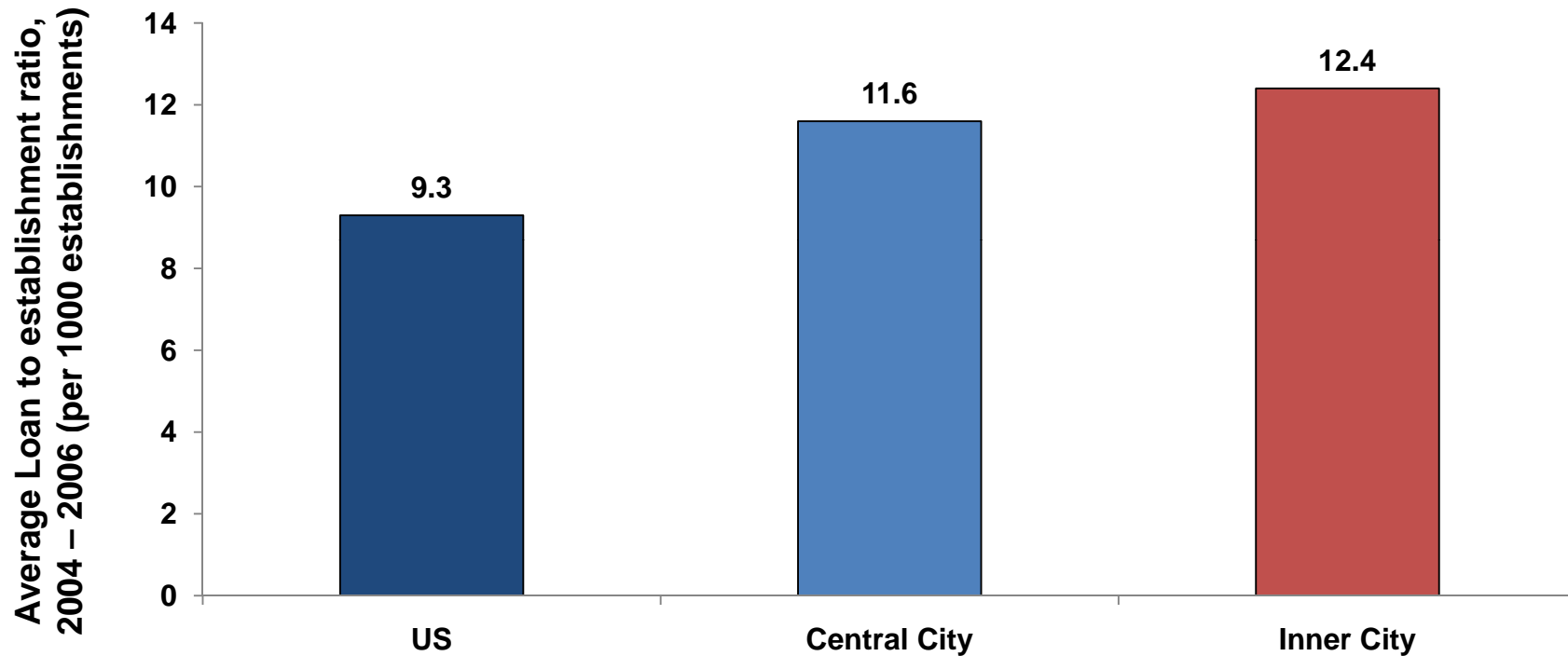


- **SBA loans, empowerment zone** and **job creation tax credits** are the most often used public programs by Inner City 100 firms



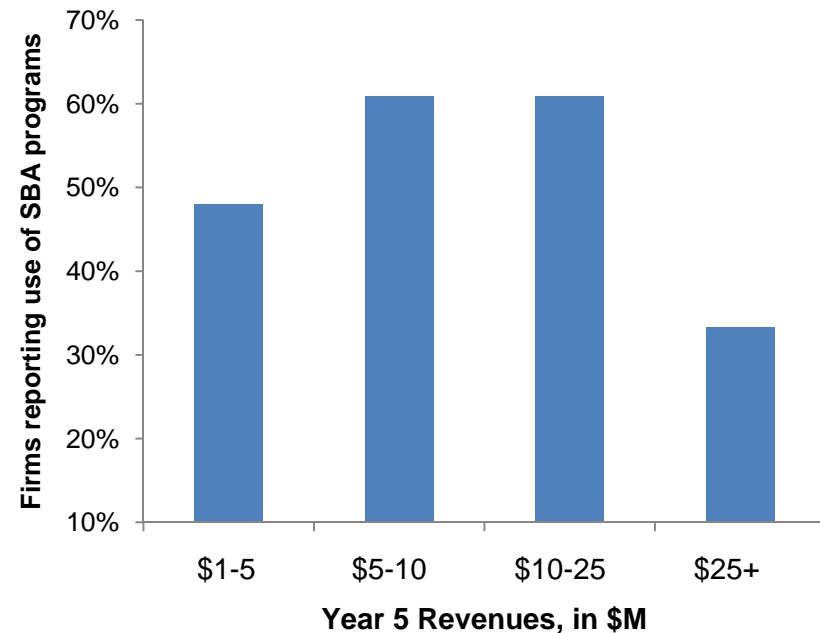
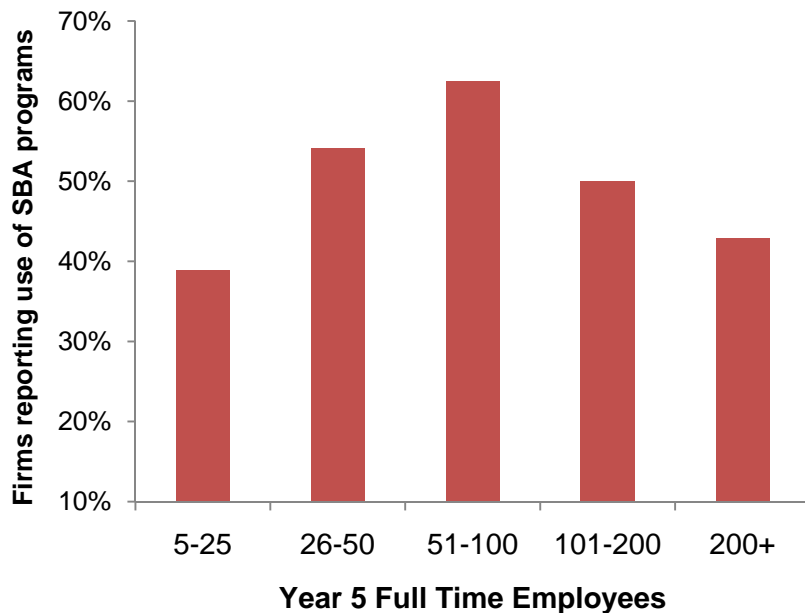
Public Programs: Use of SBA Loans

Higher SBA Loan Representation in the 100 Largest Inner Cities vs. Rest of Central City and the US, 2004 -2006



- Firms in inner cities have a higher concentration of SBA loans

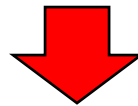
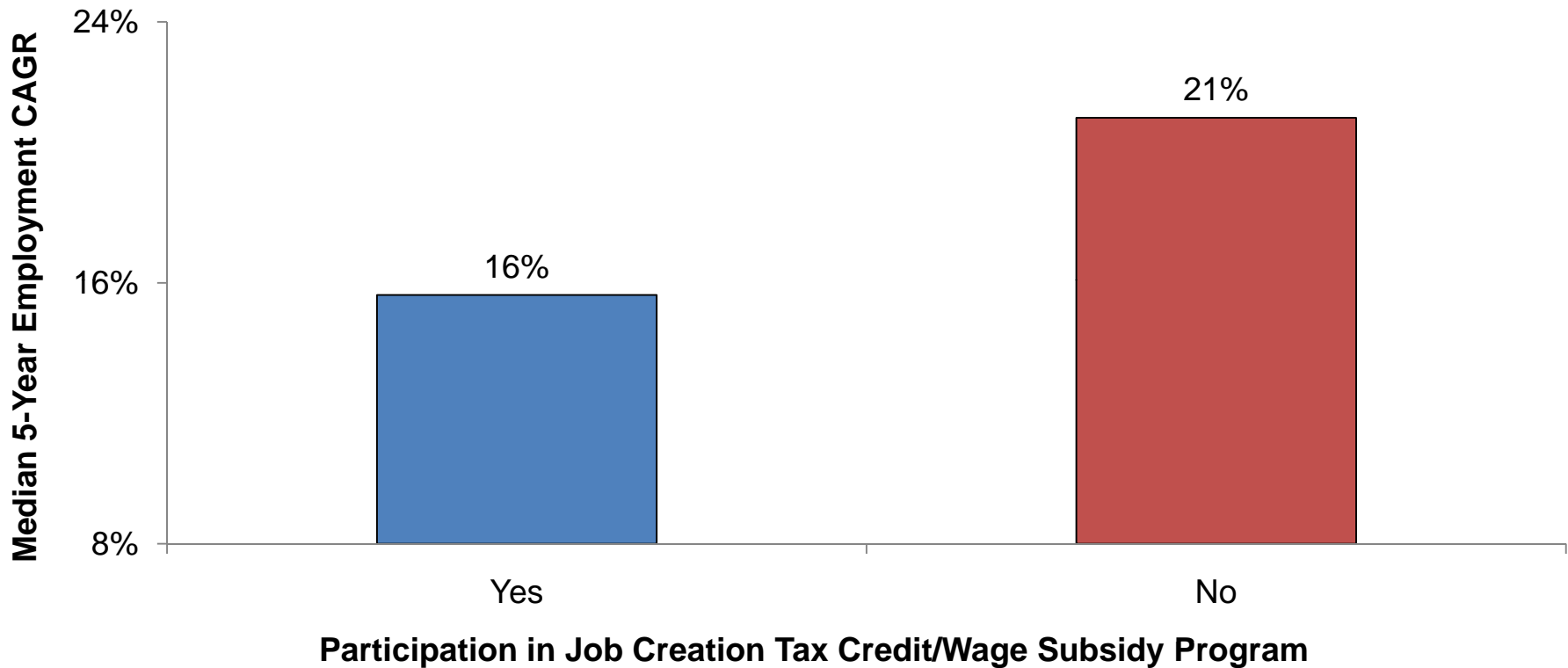
Use of SBA Programs by Inner City 100 Firms, 2007



- A higher percentage of firms that take advantage of SBA programs have already achieved some **critical mass**



Public Programs: Impact of Job Creation Tax Credits/Wage Subsidies on Employment Growth



- Inner City 100 firms who took advantage of job creation tax credits and wage subsidies **did not generate higher job growth**



Summary: Inner City Business Environment

“Frankly, we hope that our competitors never catch on to the value of the assets which exist in the inner city... the talented pool of people, the access to the infrastructure of transportation... create a set of resources that are unmatched any place else. But please, don't tell our competitors that.”

-CEO of a Technology Manufacturing Company

- Transportation-heavy industries are overly represented in the Inner City 100, however deteriorating infrastructure is weakening the inner city advantage
- City growth matters but does not determine individual firm success
- SBA programs are most heavily utilized by firms that have already achieved some growth
- Job creation tax credits and wage subsidies are not generating higher job growth among Inner City 100 firms who use them



ICIC Factors Influencing the Growth of Inner City Firms

Financing

- Access to Capital
- Sources of Capital

Inner City Business Environment

- Advantages
- Disadvantages
- Use of Public Programs

Revenue Sources

- Customer Mix
- Government Contracts

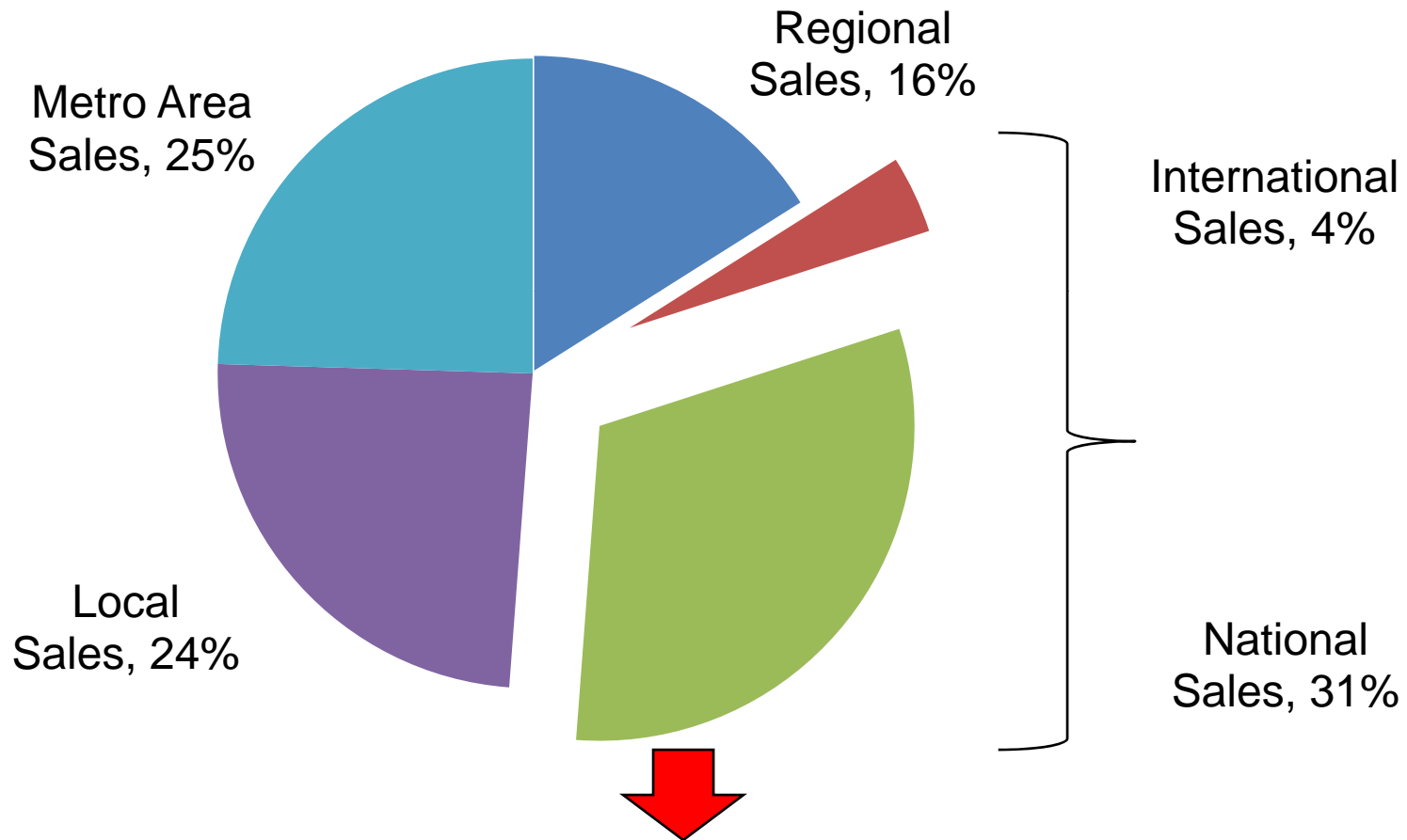
Leadership and Human Capital

- CEO Background
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ICIC Revenue Sources: Inner City 100 Customer Base

Inner City 100 Sales by Customer Location, 1999-2009

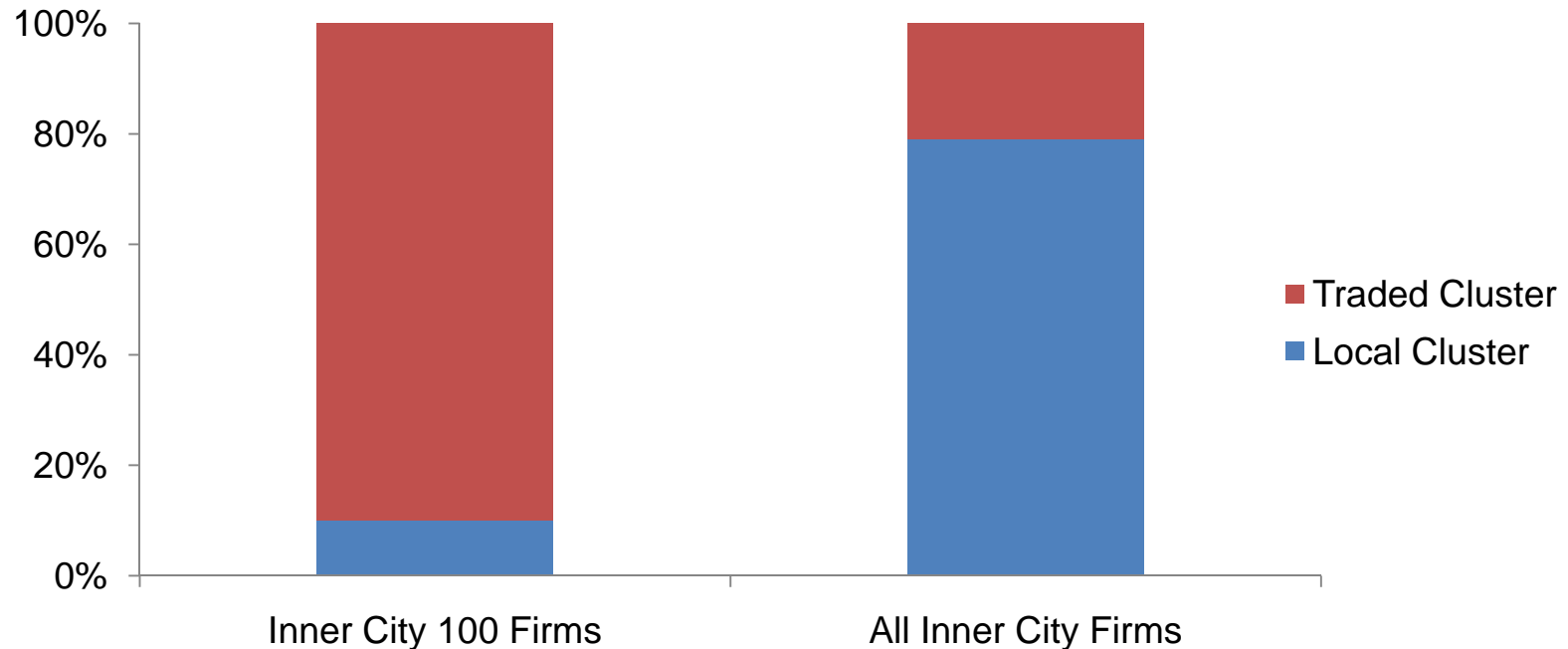


- **National and international sales** represent a significant portion of Inner City 100 firms' sales



ICIC Revenue Sources: Inner City Firms in Traded vs. Local Clusters

Percentage of Inner City Firms, 1999-2009

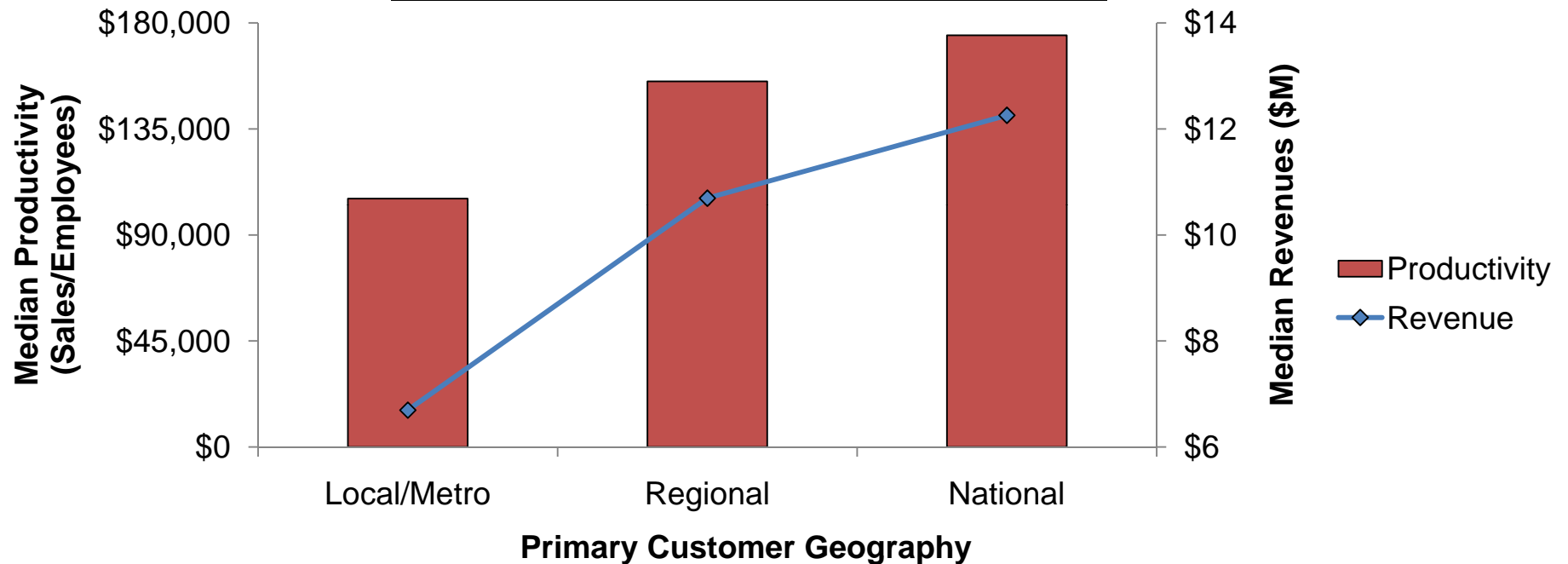


- While the overwhelming majority of inner city firms belong to local clusters, Inner City 100 firms are heavily skewed toward **traded clusters**



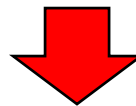
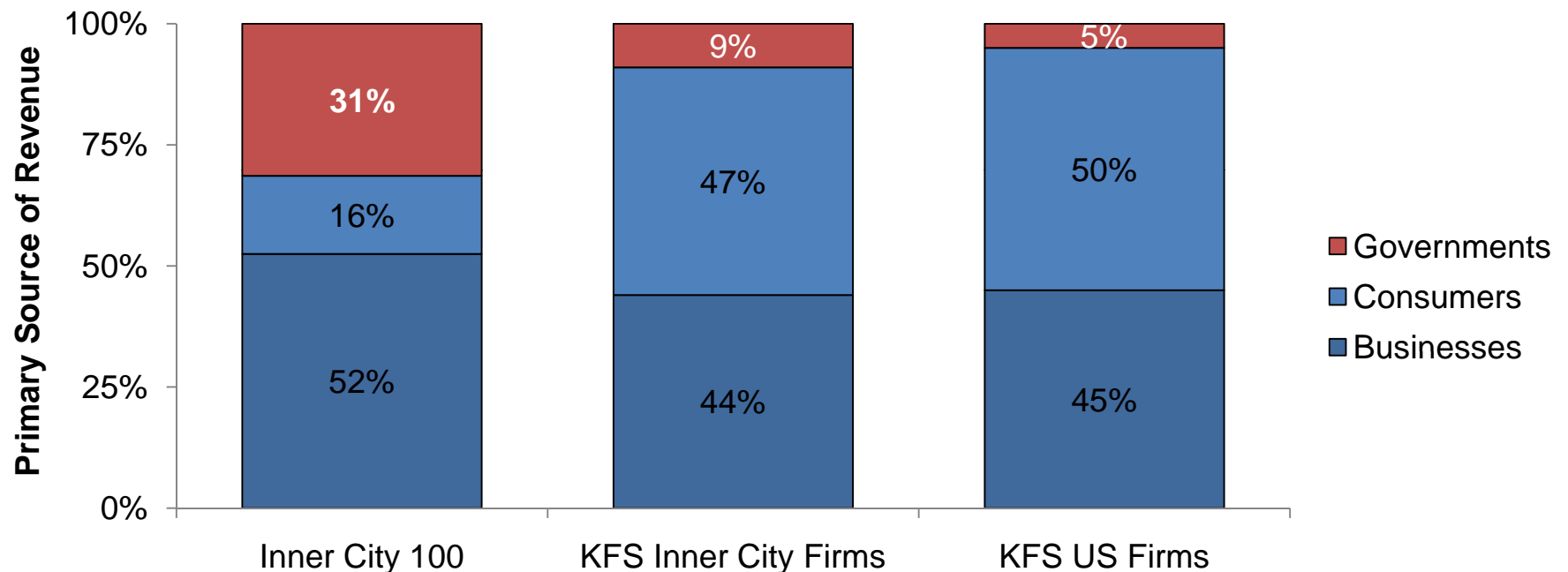
Revenue Sources: Impact on Business Productivity

Inner City 100 Productivity and Revenues by Primary Geographic Customer, 1999-2009



- Inner City firms with a broader customer scope typically have **higher revenues and median productivity per employee**

Customer Mix Comparison between Inner City 100, US Inner City Firms, and Total US, 2004-2006

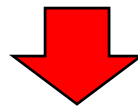
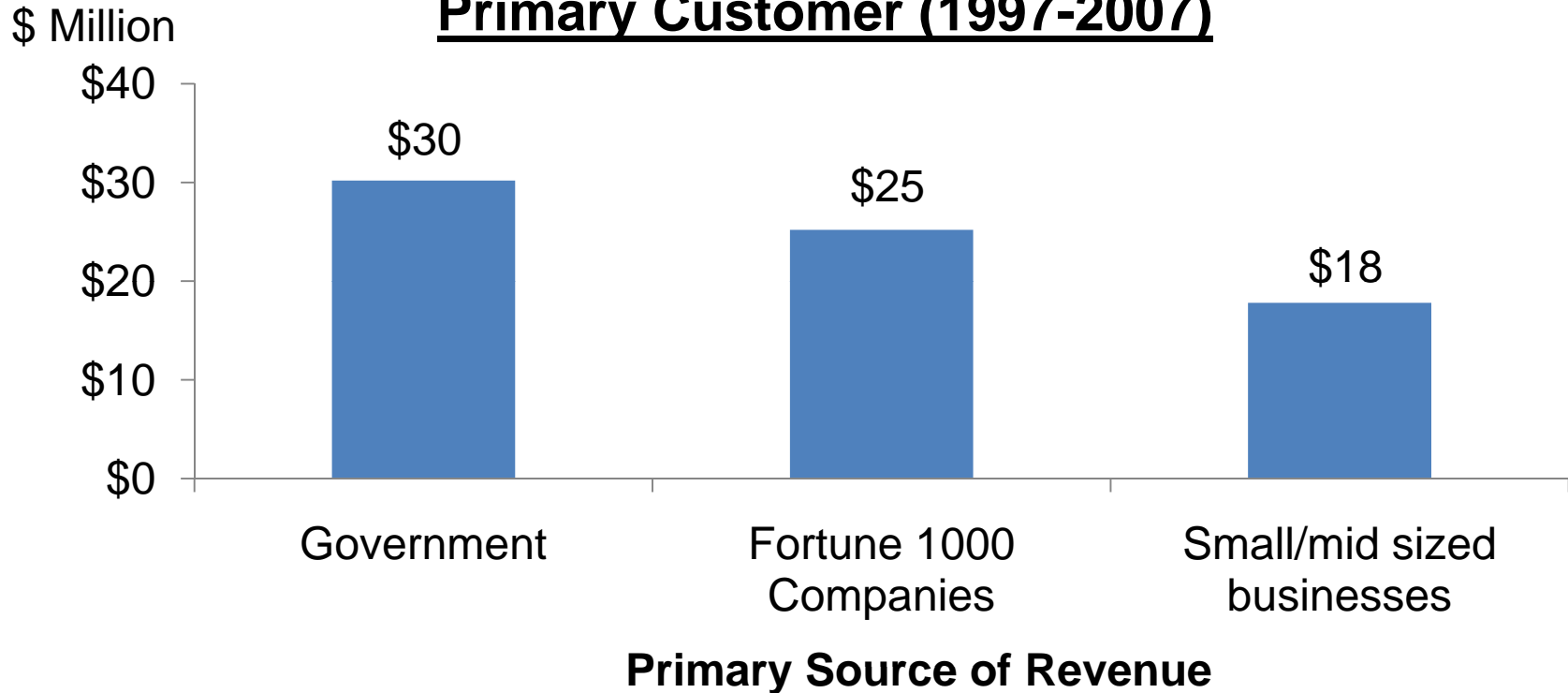


- The government is a major source of revenue for fast growing inner city businesses



Revenue Sources: Average Annual Inner City 100 Firm Revenues by Primary Customer

Average Annual Revenue for Inner City 100 by Primary Customer (1997-2007)



- Inner City 100 firms identifying the government as their primary source of revenue have higher average revenues



ICIC

Revenue Sources: Summary

“Our first government contract was landed in 1999. We rely on a mix in terms of government contract size, with some contracts being quite large and others small. These contracts are often a great source of stability. They can be quite large (up to several millions of dollars) and continue on for years, providing a reliable, steady source of revenue.”

-CEO of a Management Consulting Firm, 2009 ICIC Interview

- Inner City 100 firms have leveraged government contracts to achieve greater size and scale
- Inner City 100 firms with a more geographically diverse mix of sales typically have higher median revenues and productivity per employee



ICIC Factors Influencing the Growth of Inner City Firms

Financing

- Access to Capital
- Sources of Capital

Inner City Business Environment

- Advantages
- Disadvantages
- Use of Public Programs

Revenue Sources

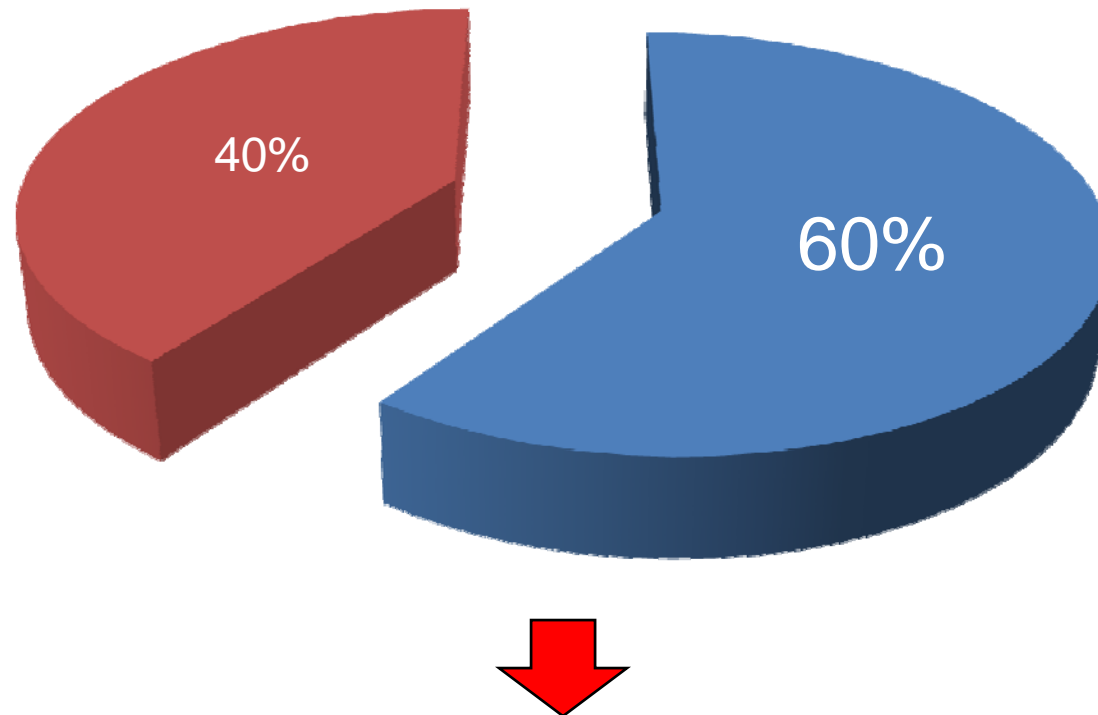
- Customer Composition
- Customer Location

Leadership and Human Capital

- CEO Background
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Leadership: Early Exposure to Entrepreneurship

Percentage of Inner City CEOs with a Family History of Business Ownership, 1999-2009

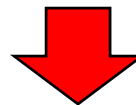
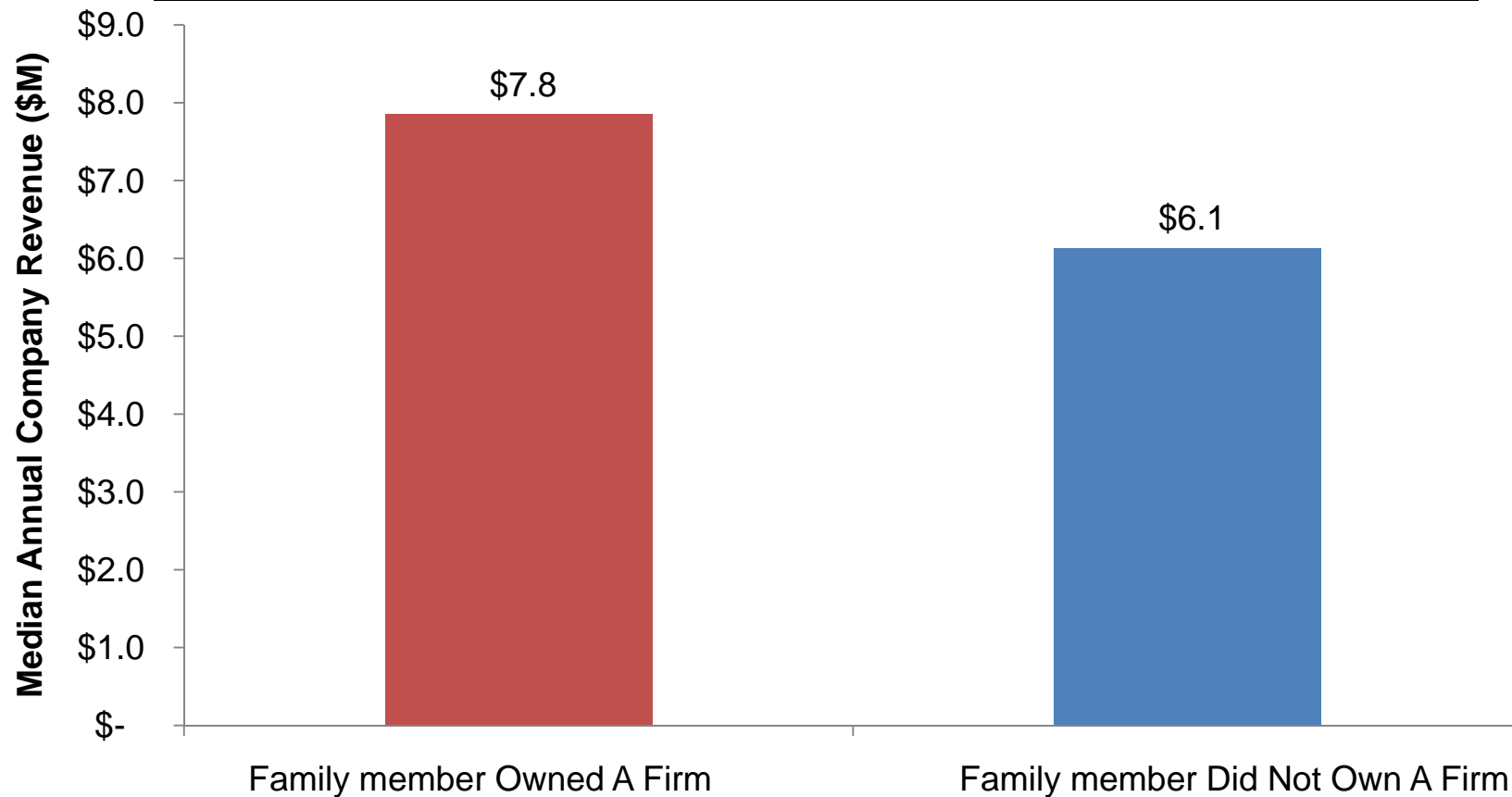


- 60% of Inner City CEOs had a close family member who owned a business while they were growing up



ICIC Leadership: Family Background in Entrepreneurship

CEO Family Background in Entrepreneurship, 1997-2007

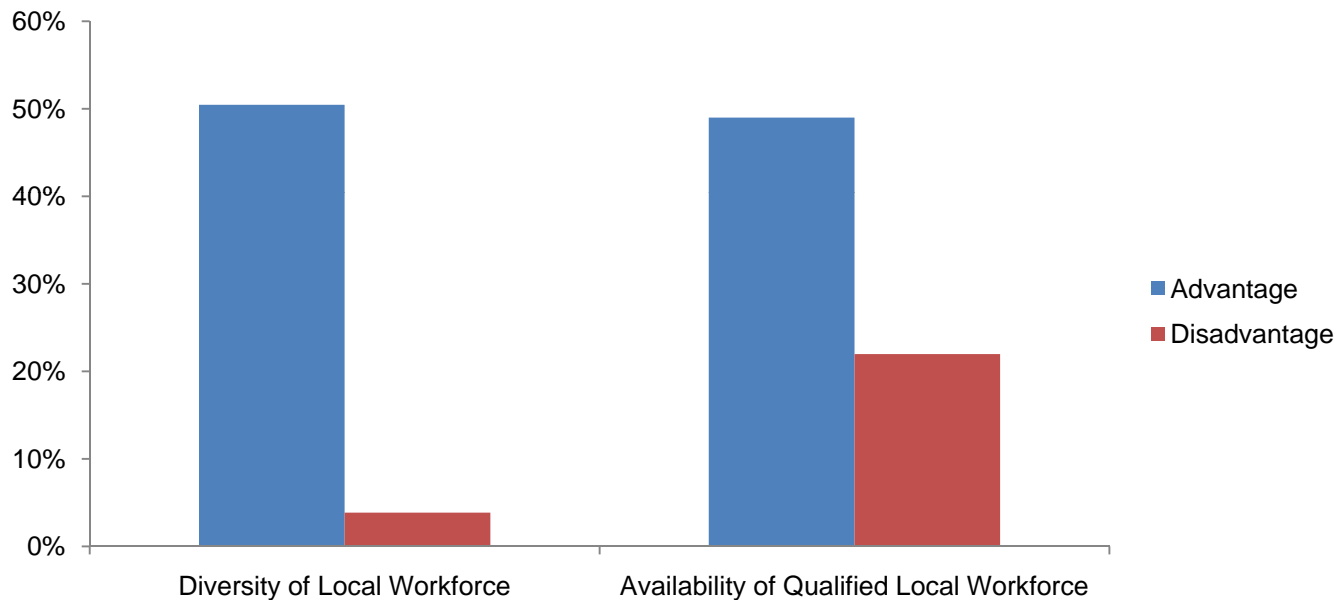


- Firms with CEO's with a family history of business ownership are **larger**



ICIC Workforce: Advantages and Disadvantages of the Inner City Workforce

Average Percent of Inner City 100 Firms Rating Workforce as Advantage or Disadvantage to Inner City Location, 2004-2009

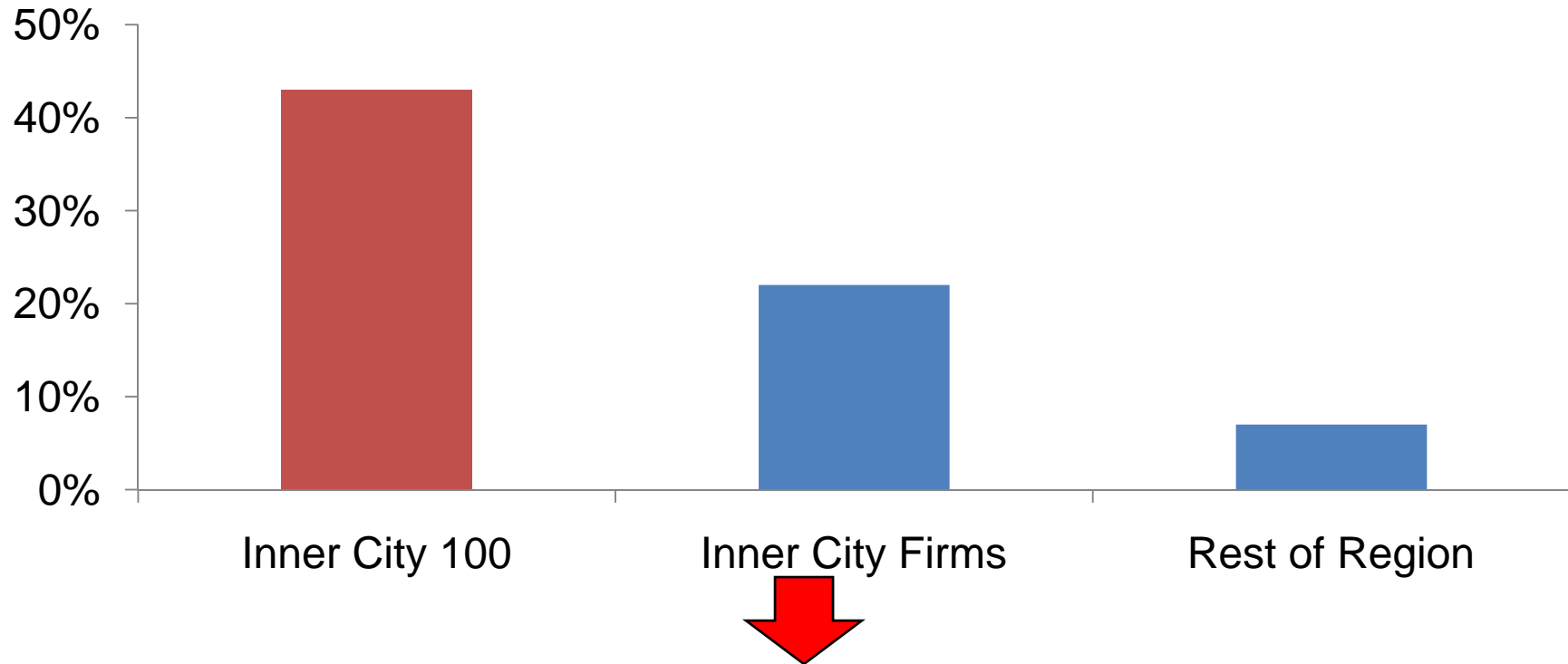


- Inner City 100 firms predominantly see the local workforce as an **advantage**



ICIC Workforce: Employment of Inner City Residents

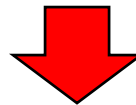
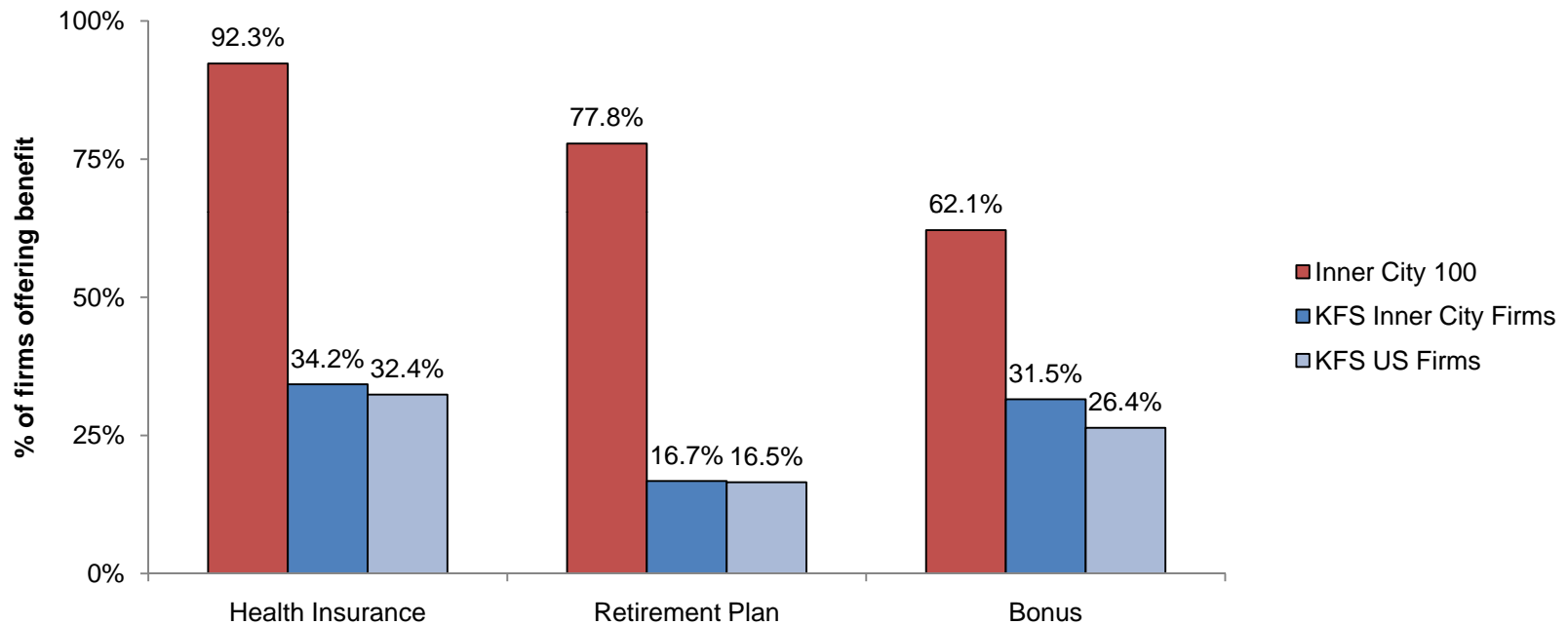
Percentage of Employees Residing in the Inner City



- Growing inner city firms are hiring **nearly twice as many local inner city residents** as a percent of their total employees

Benefits and Training: Benefits Offered

Employee Benefits Offered by Inner City 100 vs. Inner City and US Firms

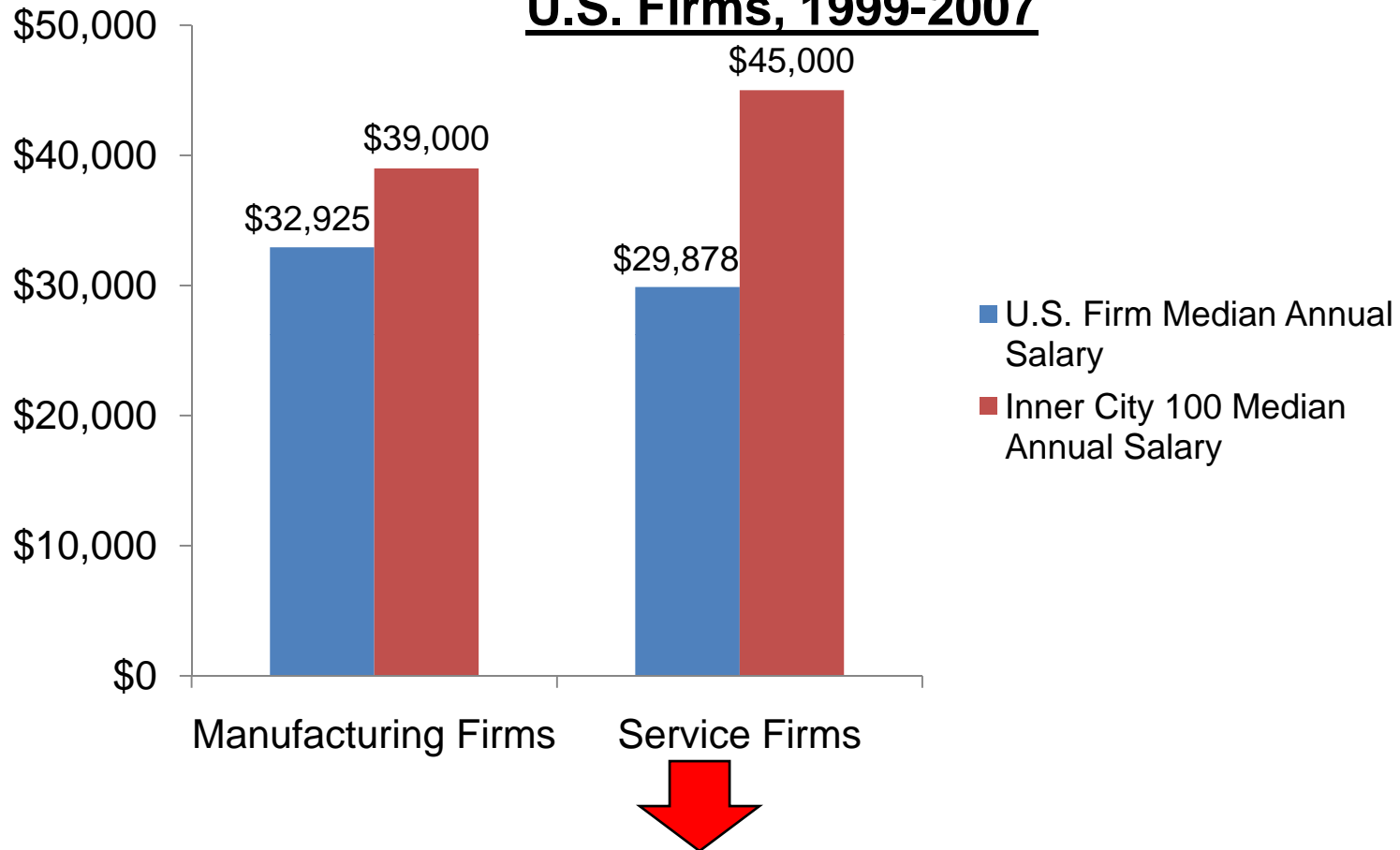


- A higher percentage of Inner City 100 firms **offer benefits** than their peer firms in inner cities and the US, independent of firm size



Benefits and Training: Annual Salaries

Median Annual Salary for Inner City 100 vs. U.S. Firms, 1999-2007

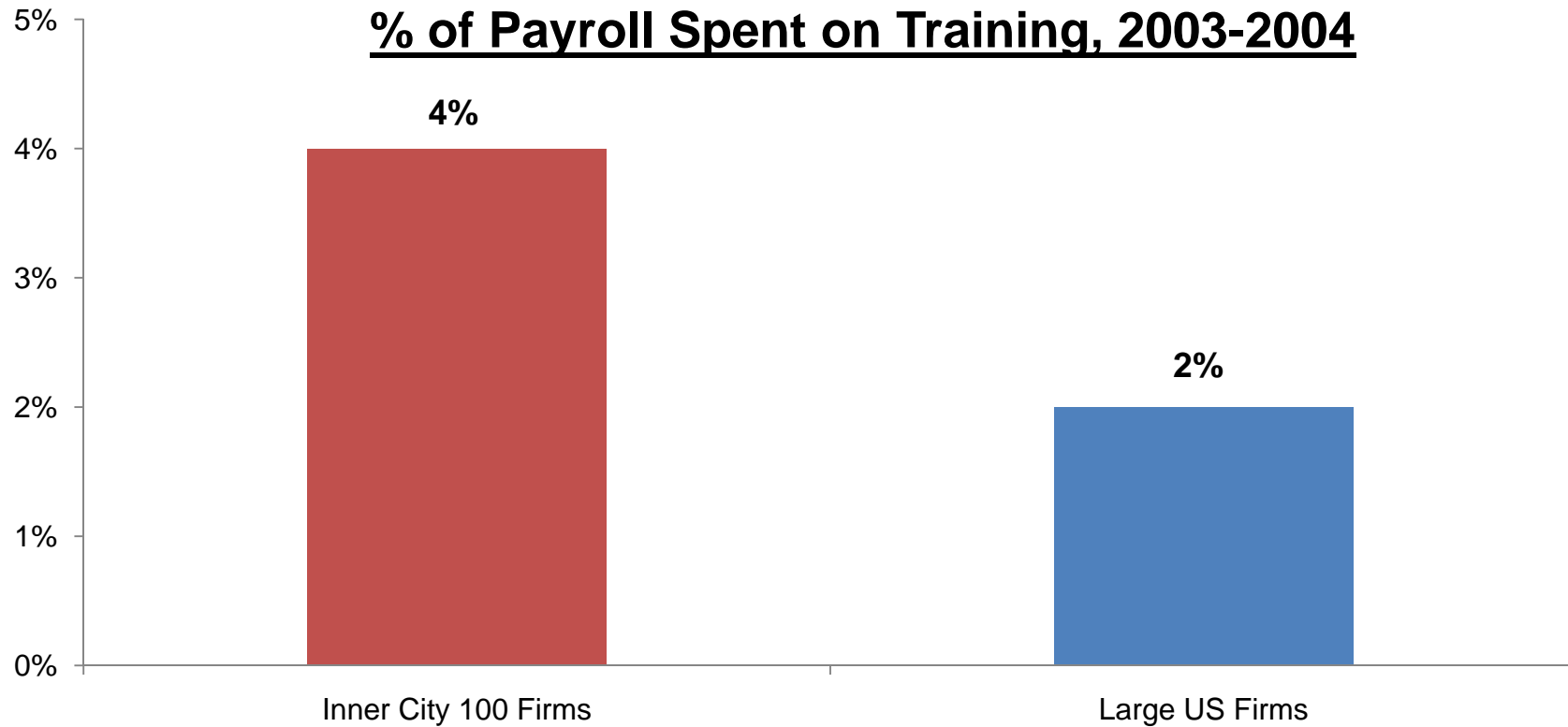


- Inner City 100 manufacturing and service firms pay employees higher salaries than US firms overall

Sources and Notes: ICIC analysis of Inner City 100 Survey data, 1999-2007, Bureau of Labor Statistics Establishment Data, Historical Data and Earnings 1999-2007.



Benefits and Training: Spending on Training



- Inner City 100 firms spend approximately **twice as much** of their total payroll annually on training as large corporations in the US

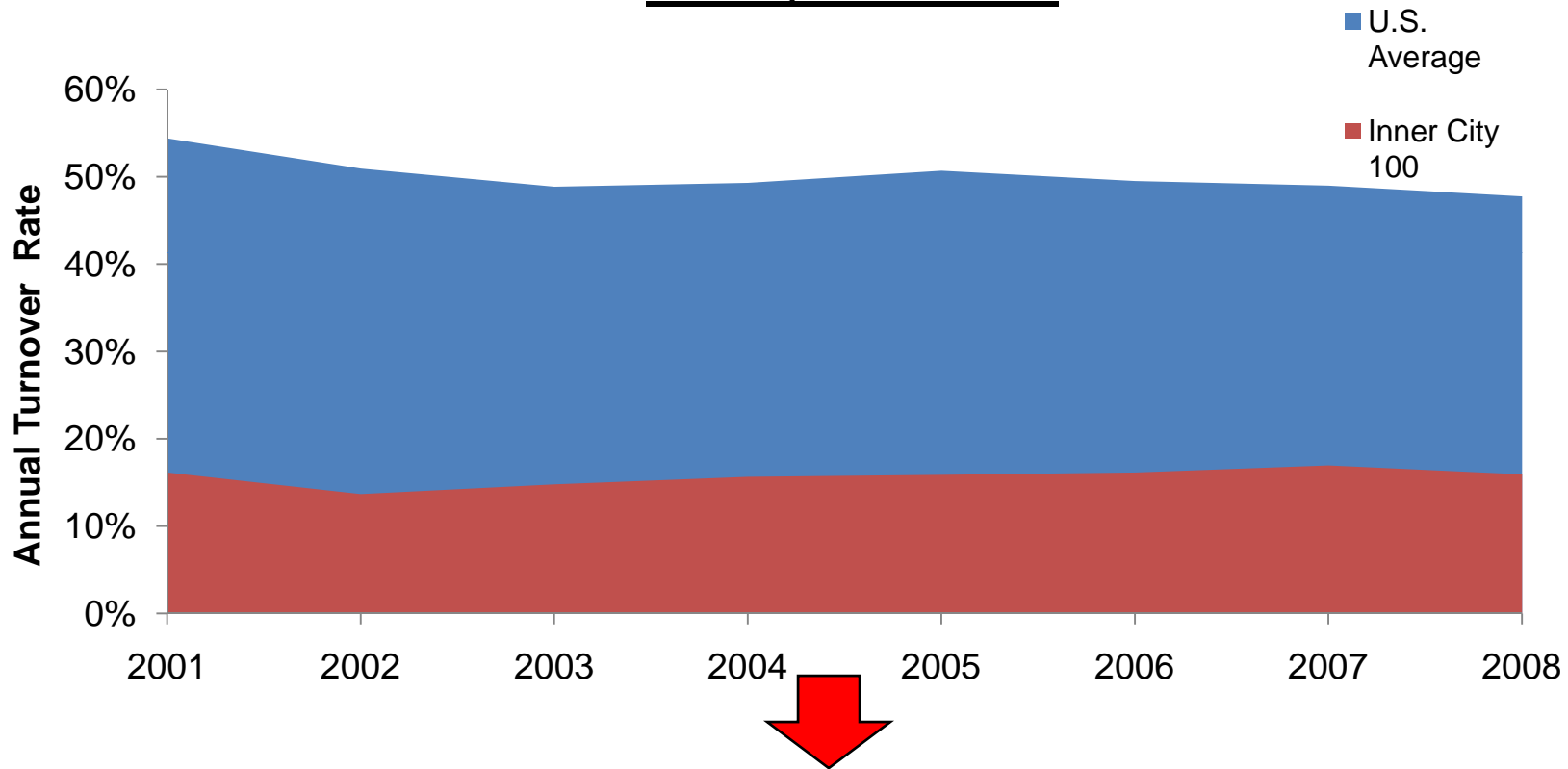
Source and Notes: ICIC analysis of Inner City 100 Survey data, 2003 and 2004; n=195

*According to the 2004 ASTD (American Society of Training and Development) survey of more than 375 major corporations, firms spend 1-3% of total annual payroll on training.



Benefits and Training: Impact on Employee Turnover

Average Employee Turnover Rate, Inner City 100 Firms vs. US Firms, 2001-2008

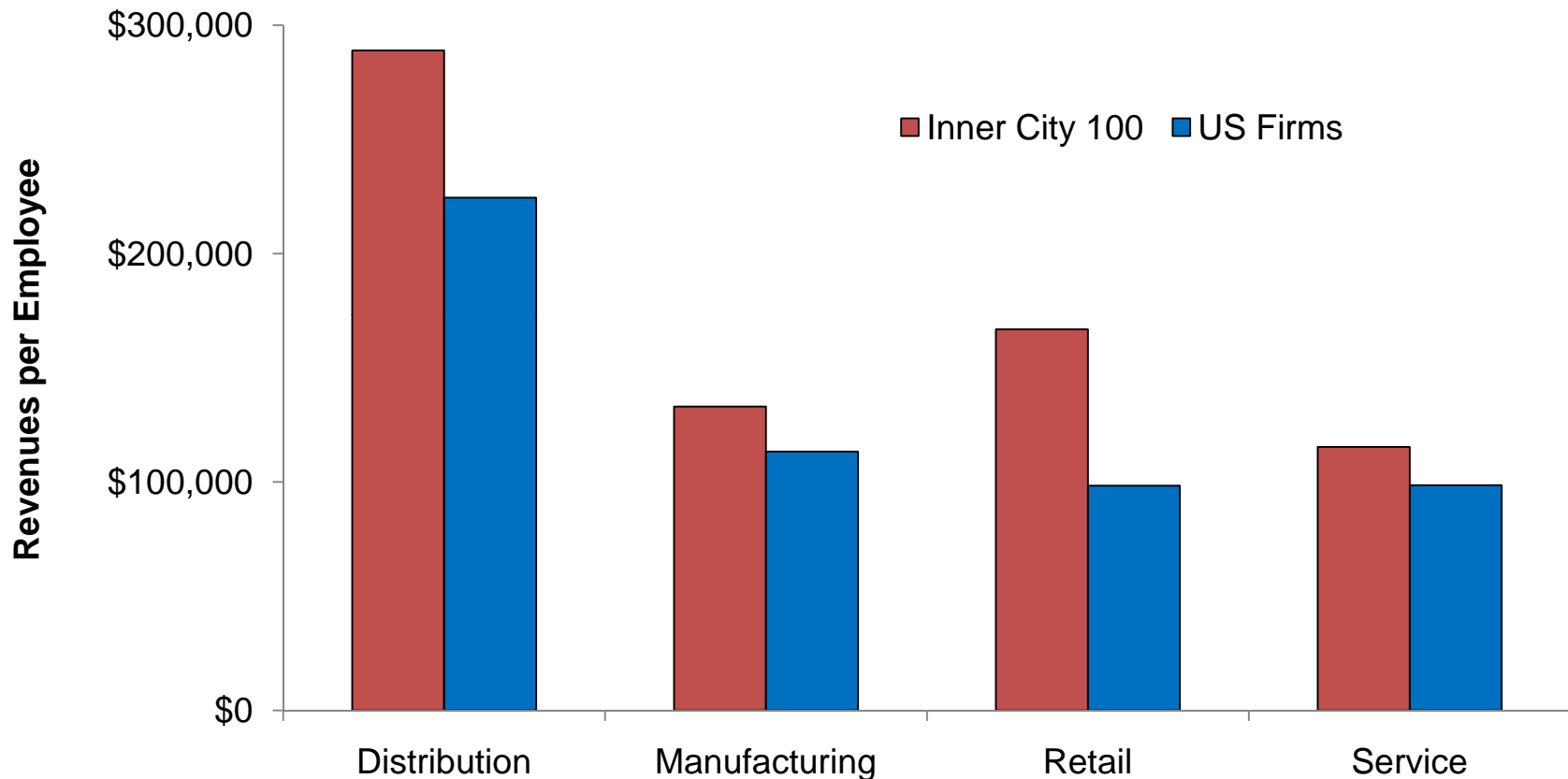


- Turnover rates in Inner City 100 firms are **significantly lower** than the national average



Benefits and Training: Impact on Firm Productivity

Revenue per Employee By Sector, Inner City 100 vs. US Firms



- Inner city 100 firms are **more productive** than their sector peers in the US overall



Summary: Leadership and Human Capital

“Everything in business is about the employees. Employees respond very well to benefits. The company simply cannot recruit without a strong benefits package. The most talented people have a number of competitors that they could go to.”
- CEO of a Technology Company

- A family history of business ownership has benefited Inner City 100 CEOs
- Inner City 100 firms are leveraging the advantages of the local workforce by hiring a higher percentage of inner city workers
- Inner City 100 firms spend more on training, pay higher wages and offer more benefits than other businesses, achieving lower turnover rates and higher productivity rates



Agenda

- Why Are Fast-Growing Firms in the Inner City Important?
- Project Methodology
- Characteristics of Fast-Growing Inner City Firms
- Factors Influencing Growth
- Implications for Firms and for Policymakers



Key Findings

- *Finding #1:* **Limited access to capital** and a heavier **reliance on debt** for growth have impeded Inner City 100 firms from **achieving the same size** as non-inner city growth firms
- *Finding #2:* **SBA loan products are heavily used** by successful inner city firms, especially firms with more than 25 employees
- *Finding #3:* Inner City 100 firms whose primary source of revenue is the **government** seem to have used these **contracts to scale** their businesses
- *Finding #4:* Inner City 100 firms **hire more local inner city residents** and spend more on **employee training**, generating **lower turnover** and **higher productivity**



Implications and Recommendations for Firms

- Implication: Mainstream sources of capital do not seem to be addressing the inner city business market well. SBA programs are filling some needs.

Recommendations:

- Be creative about leveraging payment terms with suppliers and factoring receivables to manage working capital needs without impacting growth
- Look for alternative sources of financing such as social venture capital or double-bottom-line funds, and take advantage of SBA loan programs
- There is a need for new private sector finance models that have new models for assessing inner city risk and offer new debt products with deferred repayment features to avoid the trade off between cash flow and growth

- Implication: Government contracts tend to provide a more stable base of revenue from which inner city firms can grow

Recommendation:

- Devote resources to generating sales from government sources

- Implication: To get the most out of the inner city workforce, training, benefits and competitive compensation is critical

Recommendations:

- Offer competitive salaries and benefits and invest in training to reduce turnover and increase productivity
- Provide employees with an opportunity to give back to their local communities



Implications and Recommendations for Policymakers

- SBA loan programs are important for inner city firms and are most utilized by companies that have already achieved some scale

Recommendations:

- Recapitalize existing 8a and SBIC programs that focus on businesses in distressed communities
- Fund new location-based programs
- Reduce red tape and transaction costs for SBA loans which hinder some smaller firms from taking advantage of the programs

- Implication: Training is important, especially for a more diverse employee base

Recommendations:

- Link training to clusters
- Orient training providers towards economic development and the needs of business
- Allow flexibility and experimentation at the local level
- Place training service centers near target populations
- Create better mechanisms for matching of residents to regional and inner city jobs
- Include “work readiness” programs
- Prepare lower-skilled workers in “middle-skilled” jobs

- Implication: Government contracts can be a significant part of getting inner city business to scale

Recommendation:

- Local, state and federal governments can include inner-city location targets in their procurement programs