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Deploying industry advancement services to generate quality jobs

Actionable Ideas for Economic Recovery in American Cities Essay Series

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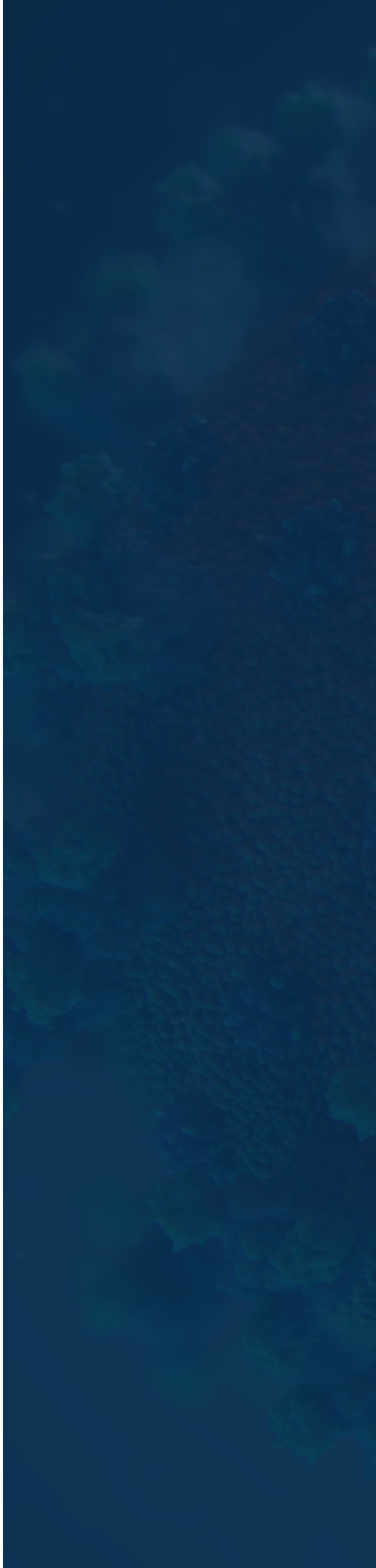

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ABOUT THE COVID-19 RECOVERY WATCH

The COVID-19 Metro Recovery Watch is aimed at informing local and state recovery strategies from COVID-19's historic economic impacts in ways that link near-term resilience to longer-term economic transformation, racial equity, and economic inclusion.

Check out the website.

Overview

To generate a more robust and resilient post-COVID-19 economic recovery, economic development organizations, universities, and other business service providers can support "missing middle" businesses (those with 10 to 99 employees) with sustainable growth potential through intensive, targeted outreach and a suite of services designed to enhance productivity and generate quality jobs.

This intervention is distinct from traditional "business retention and expansion" approaches in the intensity of relationship management involved, the level of industry expertise required of practitioners, and the focus on companies that may not currently be growing or directly requesting assistance. The "industry advancement services" delivered via this investment will be of higher quality, greater consistency, and greater depth than existing business development services. Given existing racial inequities in business ownership and incomes, implementing agencies should apply racial equity criteria in building the portfolio of companies that receive services.

Challenge

The American economy in the aftermath of the Great Recession was characterized by a proliferation of low-quality jobs, sluggish wage growth for most workers, and sustained disparities between racial groups.[1] The COVID-19 economic crisis is already exacerbating these trends[2] and forcing economic development leaders to consider a range of responses that 1) help local businesses maintain resilience and productivity, and 2) pursue economic and racial justice.

In pursuing both objectives, "missing middle" businesses (with approximately 10 to 99 employees) that are poised for steady but not dramatic growth should be a critical economic development focus in the wake of COVID-19.[3] Squarely positioned at the high end of the small business segments and on the low end of what is traditionally defined as "middle market" businesses, there are 1.1 million "missing middle" businesses nationwide, supporting 29 million jobs. [4] Those on the younger and smaller end of this group drive net job creation in local economies. Additionally, these businesses create better jobs and produce more innovations than small businesses overall.[5]

For all their importance, the U.S. economy has fewer of these larger small businesses due to a variety of factors that limit women and people of color as they consider starting and growing businesses.[6] These are structural impediments to entrepreneurship, and do not reflect the inherent entrepreneurial abilities or interests of different groups.[7] This results in women owning 33% fewer of these businesses than their adult share of the population would predict. People of color own 48% fewer "missing middle" businesses by the same metric, and Black Americans own 84% fewer.[8]

There are clear signs that these small businesses are at-risk. While small businesses with fewer than 10 employees have been more likely to shut down altogether because of COVID-19, employment losses among businesses with 10 to 99 employees have been about as large or larger.[9] And before COVID-19, these businesses were struggling more than was generally recognized. Over the past several decades, there has been a marked deterioration in the ability of even high-potential startups to scale successfully, so the pool of larger small businesses is not being replenished with innovative newcomers.[10] One explanation is that established smaller businesses were struggling to innovate and adapt to new technological and market conditions; the "diffusion machine" that used to spread know-how from big corporations to their smaller competitors appears to be broken.[11]

Now, to respond to COVID-19, these businesses suddenly must execute major strategic overhauls. McKinsey recommends that businesses create a "nerve center" to work simultaneously on supply chain stabilization, workforce protection, customer engagement, and financial stress testing.[12] Other management consulting firms recommend similarly comprehensive responses. But most businesses lack the capacity to do this even in the best of times. Very few will be able to in a massive and unpredictable recession.

Initiatives to upgrade the management capabilities of these businesses via free consulting and technical assistance—what we call "industry advancement services"—could not only help them weather the current crisis, but also address the challenges that were stunting their growth before the pandemic. Such investments can be justified on three grounds:

- **Management practices are a key driver of business success.** A growing body of research is quantifying the linkage between management capabilities and firm-level growth outcomes.[13] Researchers have tended to point to technological capabilities to explain growing productivity differences between firms, but one recent study found that differences in management practices have as much of an effect on productivity as do investments in R&D or information technology.[14]

- **Programs to teach these practices are effective.** The U.K.-based What Works Centre for Local Economic Growth studied a group of rigorously evaluated business advising programs and found that 14 of 23 had positive impacts consistent with other types of economic development interventions, such as innovation tax credits, workforce training, and small business capital provision.[15] In the U.S., estimated per-job cost of manufacturing extension partnerships (which provide consulting on manufacturing productivity) is about the same as customized job training and almost three times less than high-quality business incentives.[16]

- **These services are not widely available or adequately resourced.** Businesses of this size are not well-served by private sector consultants, especially those that are young and fast-growing (and thus unlikely to take time to seek strategic guidance) or those that are at risk of going out of business (and thus unlikely to have the resources to do so).[17] Nor are they well-served by the economic development system in most regions. Though these businesses are collectively responsible for a large share of net job creation, their growth tends to come in small, consistent increments. As a result, they are often overlooked in favor of support for startups or major business expansion and attraction projects that provide visible "wins." According to McKinsey, compared to immediate COVID-19 response programs, "fewer initiatives tackle the longer-term challenges that SMEs will face in adapting to the post-pandemic landscape if demand has yet to recover when the government stimulus runs out."[18]

Response

There are two components to an industry advancement services initiative. One is the creation of the infrastructure that enables effective delivery of services to businesses that are most likely to produce inclusive growth outcomes. The second component is the delivery of a suite of customized business services.

Business development infrastructure

Delivering industry advancement services will require most regions to bolster and extend their "business retention and expansion" systems. These are efforts by economic development entities to build relationships with existing companies, understand their needs, and connect them to relevant services. In many regions, however, these efforts only target businesses that have previously received incentives or have proactively requested assistance on a particular issue. Economic development practitioners often only ask a rote set of questions about basic short-term needs, rather than seeking to understand the business' underlying competitive challenges or growth opportunities. A business development infrastructure capable of supporting an equity-focused approach to industry advancement services would need to add two capabilities not present in many regions:

- A corps of industry experts whose job is to build relationships with businesses in key industries (and associated institutions, such as universities) to understand business needs, design appropriate services, and generate demand for those services among businesses.

- A clear, shared definition of the region's specific inclusion challenge and the ability to proactively target businesses whose growth would most directly address these challenges (see sidebar).

Criteria for prioritizing companies that will advance inclusion goals

Different regions will rate the following criteria differently depending on their industry profile and inclusive growth challenge. This provides a basic sense of how a region could identify the several hundred businesses that should be proactively targeted for industry advancement services, building on a cluster development and economic inclusion strategy led by Prosper Portland, Portland, Ore.'s local economic development agency.

Size and industry criteria: The first filter when assembling portfolios should be size and industry.

- Size: A minimum of 10 employees, maximum of 100. This is approximately the size at which businesses are large enough to need guidance on complex business management issues, but small enough that major consulting firms are not affordable.

- Industry: Advanced industries[19], or other traded sector industries. Traded sector businesses tend to provide better pay and benefits and larger positive spillover effects in the local economy, and their success will not come at the expense of other local businesses. It is likely worth prioritizing specific clusters within advanced or traded industries, so that services can be customized for the segments of the economy that have the highest growth potential.

Racial and economic inclusion criteria: The second filter is characteristics that make a company's survival or growth more likely to result in economically or racially inclusive outcomes, including:

- Ownership demographics: The owners are Black, Latino or Hispanic, other racial minorities, and/or women, acknowledging that there are significant disparities in business ownership across racial groups.[20]

- Workforce demographics: A disproportionate share of employees is Black, Latino or Hispanic, or other racial and ethnic minorities (relative to that population's share of overall employment in the region). It is important that these populations are represented in supervisory and management positions (not just frontline roles), acknowledging that people of color are underrepresented in industries offering high-quality jobs.[21]

- Job quality: The company has clear track record of providing quality jobs, as defined by high starting wages (relative to industry standard), widely available benefits, clear pathways for advancement, resources for skills development among employees, etc.

- Location: The company is located in a neighborhood that has experienced disinvestment and has a high share of disadvantaged residents, or is easily accessible to such neighborhoods without a car.

Services

A comprehensive set of industry advancement services would cover four areas: networking, talent management, process innovation, and product innovation.

Networking: Many regions tout their work building innovative startup "ecosystems" or anchor strategies focused on small, locally serving businesses. But scale-up and midsized firms are just as dependent on the ability to tap into networks of larger businesses for procurement, learning, and partnership opportunities.

- Minority Business Accelerator (Cincinnati): Part of the Cincinnati USA Regional Chamber, the MBA is designed to accelerate the development and growth of sizeable Black- and Latino- or Hispanic-owned businesses. It works on both the supply and demand sides. It supplies minority-owned businesses with strategy guidance, capital, and connections, and creates demand by working with "goal setter" companies, or major corporations that agree to adopt more inclusive procurement practices. MBA then connects the firms in its portfolio (there are currently 35 firms that collectively employ 3,500 workers, of whom 50% are minorities) to these "goal setter" corporations. As of 2019, the MBA had supported 67 companies over its 16 years in operation. Of the current portfolio of companies, 75% reported increased sales between 2018 and 2019 and 25% had annual sales in 2019 of over $50 million. MBA's goal calls for doubling the average firm size (from $25 million to $50 million), doubling total sales of its portfolio firms (from $1 billion to $2 billion), and doubling total jobs in its portfolio firms (from 3,500 to 7,000) between 2017 and 2022. This will require MBA to add 50 more companies to its portfolio over those five years. The organization is part of a local consortium of service providers—the Cincinnati Minority Business Collaborative—which allows it to identify these emerging startups.

Talent management: These are not interventions that provide training to workers directly—rather, they train business owners and managers on how to better hire, engage with, and upskill their workers, with an emphasis on eliminating racial and other biases in each of these areas.

- Genesis (Chicago): A pilot project run by the Illinois Manufacturing Excellence Center (IMEC), Genesis was designed to improve job quality by integrating "people" guidance (workforce engagement, productivity, employee stability) with "product" guidance (cost reduction, quality improvement, technology adoption) for small- to medium-sized manufacturers. The program was customized for each company, with services determined by surveys and focus groups with frontline employees. Genesis companies reported a 55% increase in sales over the course of the two-year program, compared to 37% among IMEC clients that did not participate in Genesis. As a result, 65% of Genesis companies reported retaining jobs, versus 42% of non-Genesis IMEC clients. Significant benefits accrued to workers as well: Annual earnings at Genesis companies increased by 12%, pushing those companies' wages from 78% to 84% of the industry average. The share of workers making less than $30,000 fell from 34% to 26%. Turnover among the most actively involved companies fell from 5.8% to 3.3%.[22]

Technology adoption and process innovation: This is a group of interventions that aims to boost the productivity of businesses through investments in process innovation, which can include technology adoption and implementation as well as guidance in areas such as market expansion.

- Aston University Business Engagement (Birmingham, England): One of the largest business schools in the U.K., Aston University runs several programs designed to connect small- and medium-sized businesses with expertise from the university as well as larger businesses. "Leading to Grow" is a partnership between two business schools and the regional economic development organization focused on digital technology adoption; businesses receive tailored support to identify relevant technologies and develop the management capabilities needed to implement them. "Think Beyond Data" is a European Union-funded program that pairs businesses with leading experts on artificial intelligence who can, for example, develop algorithms to automate business processes or implement new visual analytics platforms.

Product Innovation: Innovation is often measured in terms of patents and other formal mechanisms, but small- and medium-sized firms tend to innovate via informal, nonmarket mechanisms such as collaborations with research institutions and other firms in their industries.[23] Yet firms do less of this type of innovation than would be optimal, because it is difficult for them to identify and vet potential partners.[24]

- Knowledge Transfer Partnerships (U.K.): Managed by Innovate UK, this system for connecting firms to university resources has served 12,000 businesses over several decades. For a low fee, companies gain long-term access to expert resources within a university, with the project managed by a highly qualified "associate" (a recent graduate at the bachelor's, master's, or Ph.D. level). The associate works full time on the project, and an academic expert spends half a day per week on site with the company. Partnerships last one to three years and are jointly funded by Innovate UK and the participating firm, and the associate is typically hired full time at the company upon conclusion. They are typically focused on developing technologies and prototypes, but recently, a "management KTP" was launched to connect business schools to local businesses to drive growth through improved management capabilities.

Stakeholders and delivery model: In most regions, these services would be delivered by a distributed network of providers, with a single organization to act as the "hub" or "backbone." This is likely to be an existing economic development organization, possibly in coordination with a university (which may provide much of the technical assistance in several of the four areas above). The "hub" organization must be able to create the business development infrastructure (including defining the inclusion goal and prioritizing businesses/industries), convene service providers, orchestrate the delivery of services, and identify gaps in the system. Many regions currently try to coordinate and align these activities informally, but the twin challenges of confronting COVID-19 and making progress on racial equity demand a more intentional approach and dedicated resources for this convening function. Key stakeholders would include public and private economic development organizations, industry organizations, universities, and service providers such as Manufacturing Extension Partnerships.

Funding

The costs for this proposal are estimated for a metropolitan area of 1 million people. Costs for industry advancement services would roughly scale with a region's size. In a region with a population of 1 million, service providers in each of the four areas might work intensively with about 50 carefully selected businesses each year. Presuming that service delivery costs about $10,000 per company, this would create a total cost of $500,000 per service provider, or approximately $2 million across four organizations.

The staffing requirements for this strategy would include four business development managers in the "hub" organization, plus three to four staffers running one key initiative in each of the four areas outlined above (another 12 to 16 staffers, likely in four different organizations). If they are working within existing organizations and are able to take advantage of existing management and infrastructure, the 16 to 20 total staffers would cost approximately $2.5 to $3 million annually.

The total cost for a midsized region might be $4.5 to $5 million per year. However, some of the above services are provided on a fee-for-service basis (e.g., manufacturing extension programs), and some could come from improving, consolidating, and reorganizing services that are already being provided. A realistic range may therefore be between $3.5 million and $4 million of new investment annually, or about $20 million over five years.

Funds could be sourced from existing federal programs (e.g., Department of Commerce support for Manufacturing Extension Partnerships), Economic Development Administration grants, and local philanthropic and corporate resources.

Potential impact

Except for long-established and federally supported programs such as Manufacturing Extension Partnerships, few industry advancement services have been rigorously evaluated (as is the case for many economic development and workforce development interventions). As noted previously, evidence suggests that industry advancement services are at least as effective as other common economic development interventions. Independent studies of Manufacturing Extension Partnerships suggest that they produce one job-year (a job that lasts one year) for an investment of $3,000, or about $15,000 per job that lasts five years.[25]

If industry advancement services in other areas (e.g., talent management) deliver approximately the same return on investment—which seems like a reasonable assumption based on the self-reported outcomes of the programs profiled above—then in a region with a population of 1 million, the $2 million in spending on service delivery could yield nearly 700 job-years (which could be thought of as 130 jobs that last five years each). If the portfolio of companies is built with racial equity and job quality in mind, these new jobs are more likely to offer good wages to a wide diversity of workers and build wealth among entrepreneurs of color.

Endnotes

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2 According to the New York Times unemployment tracker, 16% of Black workers became newly unemployed between March 1 and June 15, compared to 12% of white workers. Ernie Tedeschi and Quoctrung Bui, "Unemployment Tracker: Job Losses for Black Workers Are Deepening," *The New York Times*, June 15, 2020.

3 In determining which businesses are "poised for growth," local leaders should consider industry dynamics—a manufacturing firm with quality jobs that could maintain its current employment via new product and process innovations should be considered as "poised for growth" relative to its industry.

4 This represents 22% of jobs at employer businesses.

5 It is well-established that larger firms pay higher wages; for a recent confirmation of this phenomena across both goods and services industries, see: Guiseppe Berlingieri, Sara Calligaris, and Chiara Criscuolo, "The Productivity-Wage Premium: Does size still matter in a service economy." *AEA Papers and Proceedings* 108 (2018): 328-333. For a review of firm size and innovation outcomes, see: Anne Marie Knott and Carl Vieregger, "Reconciling the Firm Size and Innovation Puzzle," Working Paper 16-20 (Washington: Center for Economic Studies, 2018).

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7 Andre M. Perry, Jonathan Rothwell, and David Harshbarger, "Five-star reviews, one-star profits: The devaluation of businesses in Black communities" (Washington: Brookings Institution, 2020).

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10 According to four MIT economists, the share of startups founded each year that would be *expected* to grow quickly increased by about 60% in the 25 years between 1989 and 2014, but the share that *actually* grew to 50 jobs in their first year fell by almost 40%. They conclude (emphasis ours): "to the extent that the current state of American entrepreneurship is facing a crisis, it is not in the rate of *creation* of high growth potential startups or even in the initial funding of those firms, but *instead in the potential of those firms to scale in a meaningful way over time*." Catherine Fazio and others, "A New View of the Skew: A Quantitative Assessment of the Quality of American Entrepreneurship" (Cambridge, MA: MIT Innovation Initiative Laboratory for Innovation Science and Policy, 2016).

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15 "Business Advice Evidence Review," What Works Centre for Local Economic Growth, accessed, June 18, 2020. https://whatworksgrowth.org/policy-reviews/business-advice/.

16 Timothy J. Bartik, "Helping Manufacturing-Intensive Communities: What Works?" (Washington: Center on Budget and Policy Priorities, 2018).

17 A Gallup study captures this gap in the marketplace: "Firms that finally reach the $2 million mark but are growing less than 20 percent per year fall out of favor with investors, are too small for professional services support, and lack the necessary attention to attract top talent."

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21 Joseph Parilla, "Opportunity for Growth" (Washington: The Brookings Institution, 2017).

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25 See summary here: Timothy J. Bartik, "What Works to Help Manufacturing-Intensive Local Economies?" (Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, 2018).

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