Institute for Exceptional Growth Companies

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For immediate release
May 15, 2013

Healthy companies and healthy regions: Connecting the dots

In today's virtual world, it's easy to downplay the significance of place. Yet when it comes to regional prosperity, geography matters. Income and job growth is not random but rather spill over from one region to another, meaning that merely being next to a prosperous region will make your own economy more vibrant.

This may sound like a no-brainer, but until recently it's been hard to prove from a statistical perspective. Yet by using new models that factor in location and blending microeconomic ideas with macro ones, researchers at the Edward Lowe Foundation's Institute for Exceptional Growth Companies (IEGC), University of North Carolina at Charlotte and Northern Illinois University (NIU) have advanced the longstanding theory of regional income convergence — and revealed new insights about the geographic dynamics of the U.S. economy.

Convergence theory maintains that capital and wealth shift over long periods of time, spreading from richer areas to lagging ones, which allows these poorer areas to catch up to national averages. Although income convergence is a geographic process, most studies have ignored geographic relationships, says Harrison Campbell, an associate professor of geography and public policy at UNC Charlotte and the study's principal investigator. "Some have looked at industry composition, and a few have looked at how neighboring regions affect each other, but none have looked at how individual companies affect convergence."

Leveraging data from IEGC, Campbell and fellow researchers Ryan James and Gary Kunkle studied 177 regions over a 20-year period (1990-2010). The team used both a traditional model and one with spatially explicit tools, which yielded two sets of results to compare. Key findings include:

- Convergence is happening, but at a slower rate than previous studies have indicated — about one-third slower (or 1.3 percent per year as opposed to 2 percent per year).
- The economic health of one region has a definite spillover effect on neighboring regions.
- Particular kinds of establishments, known as sustained growth companies, accelerate the convergence process through their ability to create jobs.
- The presence of these sustained growth companies has a bigger impact in rural areas than non-rural areas.

Change agents of convergence

The concept of sustained growth companies builds upon previous research done by Kunkle, IEGC's research fellow. Although these companies represent different sizes, different industries and are located in different places, they share a common hallmark: the ability to generate repeated growth over long periods of time.

"Sustained growth companies are the hidden allocators of new jobs in the economy," says Kunkle. "This paper shows that they also play a significant role in allocating income growth as well — and help determine which regions experience faster income growth than others. Thus, income growth is not limited just to owners and employees of sustained growth companies, but extends throughout their neighboring communities."

The fact that sustained growth companies have a larger impact in rural areas was a surprise, Campbell says. "Previous literature suggests that these firms will perform better if they cluster in urban areas. Yet our results reveal the opposite — they had a negligible or slightly negative effect on income growth and convergence in metro areas."

The dramatic impact of sustained growth companies in rural areas might be explained by the fact that they are big fish in small ponds. "It doesn't matter how they land in that pond — it could be a brand new startup, an expansion of a nearby company or a business that has relocated to the area —but when they land, it's like a shot of adrenaline for the area," Campbell says. "What's also interesting is that concentration doesn't matter; the sheer presence of sustained growth companies makes an impact."

Innovative modeling and data

Critical to the study was developing an effective geographic model. To achieve this, the researchers leveraged new types of spatially explicit tools and introduced new geographic units: 177 economic areas defined by the U.S. Bureau of Economic Analysis. Smaller than a state and larger than an MSA, these multicounty areas approximate the extent of a labor market.

One of the benefits of the geographic model was that it produced far fewer outliers, which gave the researchers more confidence in their results. "The theory of income convergence is in itself geographical," says James, an economic geographer and assistant professor at NIU. "It suggests that capital is going to flow from capital rich areas to capital poor ones. Yet traditional models don't take into account the performance of neighboring regions, which is extremely important."

Another hallmark of the study: factoring in the role of individual business establishments. Past studies have looked at location attributes and regional conditions, such as population density, access to interstate highways, land quality and water supply, instead of looking at the individual actors responsible for economic growth.

The National Establishment Times Series (NETS) data set, which IEGC made available, was essential to studying the sustained growth company connection, Campbell observes: "This research couldn't have been done without it. NETS is an extraordinary data set that's potential is still unknown to most people. Past studies have relied on industries, which are like cruise ships; their averages turn very slowly because they consist of many different firms. In contrast, NETS enabled us to track individual U.S. establishments, the DNA of what really makes our economy run."

Moving forward

The researchers' findings provide statistical evidence that spatial relationships are extremely significant to regional prosperity. "So there's basis, at least for certain projects, for regions to start think beyond their own borders and work more cooperatively," says Campbell.

Connecting the dots between sustained growth companies and regional prosperity is equally important. "This study begs a whole new set of questions about how firms manage themselves," Campbell says. "If we can understand what makes the sustained growth companies tick, we may be able to reorient our approach to economic development and introduce policies that positively impact these important firms."

Other policy implications revolve around regional income convergence. "For example, many Southern states are right-to-work states — states that were poor and are now starting to catch up. A question arises about how policies such as right-to-work status might impact a state or region's ability to grow its economy," Campbell explains.

"Part of IEGC's mission is to get unique establishment time-series data into the hands of capable researchers so they can shed new light on the U.S. economy and the role of exceptional growth companies," says Gregg Cole, information technology research leader at the Edward Lowe Foundation, which launched IEGC in 2011. "This study is a wonderful example of how researchers are using the data not only to make new discoveries, but also reexamine traditional observations and improve on previous models."

To read the full paper, "Firm Growth and Regional Income Convergence: Is There a Connection?" visit http://youreconomy.org/pages/insights.lasso

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About the Institute for Exceptional Growth Companies (IEGC): The Institute for Exceptional Growth Companies was created by the Edward Lowe Foundation through a three-year grant from the NASDAQ Educational Foundation. IEGC is creating new datasets and using existing data in innovative ways to track and better understand exceptional growth companies, their impact on community and economic development, and their relationship with equity funding sources. For more information, visit http://youreconomy.org/pages/iegc.lasso

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