Institute for Exceptional Growth Companies

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Sustained growth: a new view of job creation

CASSOPOLIS, Mich. — Traditionally researchers have looked at either absolute growth or relative growth to evaluate how much or how fast businesses are expanding. Yet there is a third metric, sustained growth — the number of times a company expands over a period of years — that provides new insights into economic development, says Gary Kunkle, economist and research fellow at the Edward Lowe Foundation's Institute for Exceptional Growth Companies (IEGC), which is releasing a paper on Kunkle's findings.

Kunkle, who has a Ph.D. in public policy and regional economy, determined that a very small group of companies (about 1 percent) was responsible for 72 percent of job growth from 2005 to 2010. Yet their success, he shows, was not triggered by large, singular growth events but instead was due to repeated, incremental expansions. In a nutshell, the more frequently these companies grew, the more jobs they accumulated over time.

What's more, Kunkle goes on to show that sustained growth (both at the establishment and firm levels) is linked with regional growth in a cumulative process — something that has never been demonstrated before. As firms grow more frequently, they acquire more scale; and as regions increase their number of sustained growth firms, they achieve higher employment growth. "Bottom line, what goes on inside of companies determines whether or not a region will grow," Kunkle explains. For example, he points to Florida, which grew faster than New York during the 2005-2010 period. "Although Florida had fewer people, it had more sustained growth companies."

The stickiness of sustained growth

Sustained growth is a powerful metric because it not only analyzes past performance but also helps predict future success. In his paper, Kunkle shows that companies with sustained growth (those that expanded employment at least twice during the 2005-2010 period) increased their survival rate by 50 percent — and increased their chances of growing again in the next five years by 67 percent.

In contrast, relative growth, which measures the speed or percent of employment change over a period, correlates negatively to future growth. Kunkle found the faster a company grew in the past, the less likely it was to survive and grow in the future. "It's the story of the tortoise and the hare," he says. "Those that run the fastest tend to burn out."

Similarly, absolute growth, the total amount of employment change, had no influence on the odds of future survival or growth for the next five years and reduced the odds of a company being in the top 1 percent of sustained growth companies.

"Our evidence strongly suggests that growth is a learning curve," Kunkle says. "It doesn't matter if your company offers industrial cleaning services, makes medical devices or breeds cattle. All companies face the same set of challenges and decisions each time they expand. And the more frequently they grow, the better they get at making these decisions."

Don't fence them in

What's especially interesting about sustained growth companies is their diversity. Rather than being concentrated in specific industries or geographic areas, these powerful job creators can be found in all industry sectors and in every populated county across the United States.

This challenges traditional thinking about economic development, such as industry cluster theory, which believes that business growth is largely driven by external factors, such as a firm's industry, geographic location and reaction to government policy.

Yet if that were true, then sustained growth companies would be overwhelmingly concentrated in a few knowledge-intensive industries, located in urban areas and be the ones that billions of dollars of cluster policies have favored, Kunkle says. "Our data shows that is not the case. The superheroes of job growth can be found in all locations and industries — and they're not necessarily the ones favored by public policy."

Other preliminary findings of Kunkle's research include:

- **Corporate scale is shrinking**. Large companies in the United States are becoming fewer in number with less capacity. During the last decade, the percentage of companies with 100 or more employees decreased by more than 40 percent. What's more, the average size of business establishments fell from an average of 11.9 employees in 2000 to 7.4 employees in 2010, a scale loss of 37 percent.

- **Startups are not able to save the day.** During the same 2000-2010 period, the number of companies with less than 20 employees skyrocketed; however, their job-creating muscle has likewise atrophied. By 2010, the average startup was born with less than half the number of jobs compared to the prior decade. Sole proprietorships, which form the majority of startups, were 20 percent less likely to survive for five years than those born in the early 1990s — and survivors created 36 percent fewer new jobs than before. "In a nutshell, startups are no longer the job creators that we tend to think they are," says Kunkle.

- **Minority- and women-owned companies represent a disproportionately larger share of sustained growers.** Minorities own about 2.5 percent of sustained growth establishments, compared with 1.5 percent of other establishments (those without sustained growth). Similarly, women own 9.8 percent of establishments with sustained growth, compared to 9.1 percent of other establishments. "These differences are highly significant because they are derived from a measure of every company in the economy, not merely a sample," Kunkle writes.

In addition to his own studies, Kunkle is coordinating other research teams with leading scholars from around the world to track the performance of U.S. companies for IEGC. Research topics include: the impact of capital markets, supply chains, relocations, policy and legislation.

Instead of relying on government data that is aggregated and confidential at the firm level, IEGC leverages the National Establishment Time-Series (NETS), a unique longitudinal data set that tracks more than 44 million U.S. establishments from 1990 to 2010. This data, which IEGC combines with other data sets, enables researchers to decompose the economy down to its most basic components — establishments, which are individual workplaces. "This has given us insights into mechanics that underlie growth in the economy — processes that were previously hidden from view," Kunkle says.

Recognizing sustained growth as a key metric is just the tip of the iceberg, says Kunkle, who will be collecting additional data through surveys and the development of more data tools. "If we can capture the insights behind these expansion challenges, then we can help educate management teams on how to solve these problems and reduce the risk every time they expand."

"Gary's research debunks some commonly held beliefs about how jobs are generated in this country, and presents a thesis that is hugely important for the academic and policy community to engage with," says Doug Tatum, chairman of IEGC's advisory committee and an associate professor at Middle Tennessee State University who holds the Wright Travel Chair in Entrepreneurship. "His theories and conclusions are consistent with the experiences and observations of business people in the marketplace — it's truly a landmark piece of work."

One of IEGC's goals is to expand the knowledge base of entrepreneurship, especially with regard to the middle market, points out Gregg Cole, information technology research and development leader at the Edward Lowe Foundation. "Gary's work sheds new light on how regions can support their growth companies and what kind of regulatory practices and taxing policies are needed," Cole says. "In addition, by finding more high potential growth companies and helping them achieve repeated growth, we will be able to increase the percentage of exceptional growth companies."

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About the IEGC and the Edward Lowe Foundation: The IEGC was created by the Edward Lowe Foundation in 2011 through a three-year grant from the NASDAQ Educational Foundation. IEGC is creating new data sets 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. One of its key data resources is the National Establishment Time-Series (NETS), a unique longitudinal data set compiled by Oakland, Calif.-based Walls & Associates. More information about IEGC can be found at: http://youreconomy.org/pages/iegc.lasso

Established in 1985, the Edward Lowe Foundation is a national, nonprofit organization that supports entrepreneurship through research, recognition and educational programs, which are delivered through entrepreneur support organizations. The foundation focuses on second-stage companies — those that have moved beyond the startup phase and seek significant, steady growth. For more information, visit www.edwardlowe.org

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