Small Business Creation and Economic Well-being of Nonmetropolitan Counties: The Case of Georgia

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The Case of Georgia

Does small business development benefit rural economies more than recruitment of outside investment? In the ongoing debate about the relative merits of these two approaches to economic development, critics make the following case against the recruitment strategy: Since many communities are competing for the few major facilities that are located each year, communities have become embroiled in a bidding war against each other. Winners are few and victory comes at high cost.[1] Moreover, evidence indicates that success in attracting branch establishments does not guarantee sustainable growth of local economies. Branch plants typically employ workers with limited skills in routine mass production.[2] Employment is vulnerable to closures and mass layoffs because parent firms have more freedom than independent firms to spatially shift production.[3] In addition, externally owned firms tend to purchase inputs from distant suppliers and channel profits to other regions, thus generating smaller local multiplier effects than homegrown businesses.[4] Such arguments often go on to propose small business development as a more productive strategy. David Birch's evidence that small firms contributed 80 percent of new jobs to the economy between 1969 and 1976 is cited,[5] suggesting that the probability of success in job generation is high with the small business strategy. In addition, agglomerations of small, innovative firms have been acclaimed for contributing to the resilience of local economies and for enhancing the skill levels of an area work force.[6]

By the late 1980s, this perspective had become orthodoxy in the field of economic development. However, evidence began to emerge which called into question the conventional wisdom that small firms are the key to economic growth. Research demonstrated that the share of jobs in small firms was not increasing, but remaining quite stable.[7] Though job growth rates are higher on average in small firms than in large ones, most small firms don't grow at all, and large start-ups account for the lion's share of new firm employment increases.[8] Recent studies have challenged not only the job-generating power of small businesses, but also the benefits of small-firm job creation. Case study research of industrial districts suggests that small, locally owned firms in many areas depend on contracts from large corporations and provide low-wage, unstable employment.[9] Evidence from microdata clearly indicates that small firms pay lower wages and offer fewer fringe benefits than large businesses to workers with similar qualifications.[10]

Vulnerability of the local economy due to dependency on large or externally owned businesses is a particularly salient issue for rural communities. Nonmetropolitan areas have a disproportionate share of manufacturing industries with routine operations and few managerial and professional jobs.[11] These rural industries are more vulnerable than others to cyclical variations in employment, and within industries rural branches are the first to be cut in recession.[12] During the 1980s, branches of large externally owned retail firms began restructuring the residentiary services sector in rural communities, as well.[13]

Encouraging entrepreneurship and small business development has been a major theme in professional discourse of rural development practitioners and academics. Community factors related to business creation have been examined and policies and programs for assisting small, locally owned businesses proposed and initiated.[14] Arguments for targeting small business development are based on perceived

disadvantages of industrial recruitment and the branch plant economy and evidence that small firms create most new jobs in the rural economy.[15] Yet rural communities continue to pursue external investment, and recent research suggests that this approach may compare favorably with the entrepreneurial strategy. Mirroring national trends, the size distribution of rural firms has not shifted toward smaller firms, but remained quite stable overall.[16] The flexible specialization model of networks of technologically advanced small firms holds little promise for rural areas,[17] though small and mid-sized rural businesses may compete successfully in niche markets of mature, generally low-technology industries.[18] Moreover, attracting a significant new manufacturing plant may not be an impossible dream, but a relatively common event, for some rural communities.[19]

In comparing strategies for economic development, policy makers must go beyond the focus on job creation by large and small businesses to assess the long-term impacts of recruitment and entrepreneurial strategies on the economic and social well-being of the community as a whole. Little empirical work is available that explicitly addresses broader community impacts of large and small business job creation in rural areas. Among the few relevant studies are surveys of rural household and firms in Georgia[20] compared aspects of job quality. The conclusions were similar to those reached by Brown, Hamilton and Medoff from their analysis of national data: Workers in small firms receive lower wages and fewer fringe benefits than their counterparts in large enterprises. However, indirect effects of manufacturing growth are small in rural areas where few opportunities for forward and backward linkages exist and where residents travel freely to other communities to work and shop. Thus higher employees wages of large businesses may not translate into higher income and employment overall for counties where large firms predominate. Another study analyzed the association of "entrepreneurial content" with measures of employment and income growth. Results indicated that small businesses contribute to the economic health of nonmetropolitan counties, but the study was not designed to compare the impact of large and small business creation.[21]

The purpose of this study is to examine the association of small and large business development with county-level measures of economic performance. While most research has focused on the probability of success in creating or attracting businesses and jobs, and geographic characteristics that determine such success, this analysis addresses the consequences of small and large business development for county economies. Based on data for nonmetropolitan counties in Georgia between 1985 and 1994, this study concludes that the vitality of small business development has a stronger positive impact on rural county employment, tax base, and sales than success in attracting establishments owned by large enterprises. However, the size characteristics of county businesses have little influence on local average wage levels and employment stability.

Data and Methodology

A series of elementary linear regression equations are estimated to analyze the contribution of large and small business development to economic performance in Georgia's 117 nonmetropolitan counties.

$$E = \beta_0 + \beta_1 B + \beta_2 D + \beta_3 M + \beta_4 R + \beta_5 A + \epsilon$$

The dependent variable, E, is economic performance, and the policy variable of major interest is D, an indicator of development activity or character. The model controls for the size of the county's business population, (B= number of firms in operation, 1989), the industrial base of the county, (M = 1 if manufacturing predominates), and the degree of rurality (R = 1 all towns have populations smaller than 10,000 and A = 1 if the county is adjacent to a metropolitan area). To avoid problems of multicollinearity, the effects of small and large business development are

analyzed in separate equations. Standardized and unstandardized estimates of β_2 are the main focus of the analysis. Comparisons of standardized coefficients indicate which type of development contributes most to economic performance. The unstandardized coefficients are useful for expressing the effects in meaningful incremental terms.

This analysis tests the effect of three development strategy variables on five economic performance measures. With the exception of the employment stability index, the performance variables are expressed as absolute changes between 1989 and the latest year for which data are available (1994 or 1995, except for taxable sales for which 1993 is the most recent year). The new business variables in D are measured for two time periods: businesses opening between 1989 and 1994 and surviving in 1994, and those opening 1985-1989 and surviving in 1989. Measures for the later period are approximately coincident with the performance measures and can be interpreted as immediate effects of development. Measures from the earlier period provide information about longer-term outcomes and offer a stronger basis for inferring the direction of causality, since they precede measurement of performance.

The strategy variables, D, are constructed from administrative data on private employers registered with the Georgia Department of Labor's (GADOL) Unemployment Insurance Program. Thus, the data include only businesses with employees, and start-up dates refer to the time that a business first registered an employee with the system. The number of small start-ups and the total number of small businesses in operation measure the small business or entrepreneurial vitality in each county. The number of large businesses locating in each county indicates the level of recruitment success.[22] A small business is defined as an establishment of an enterprise employing fewer than 100 workers. The numbers of new and operating businesses refer to business *establishments*, or distinct business locations. However, the *size* of the business is determined by the number employed at all locations

throughout Georgia by the company or enterprise that owns the business. An establishment of a large firm that is new to a county may employ few or many workers locally, and it may be of any industrial sector.

A brief profile of development activity in Georgia's 117 nonmetropolitan counties may clarify the definitions used in this analysis. On average, the business population totaled 309 per county in 1989. Between 1989 and 1994, 97 small businesses, employing an average of 4.9 workers each, began operations in the typical nonmetro Georgia county and were still in operation in 1994. During the same period, an average of 17.8 establishments owned by large enterprises opened, creating an average of 22.1 jobs each. Of the 2,084 large businesses (establishments of large enterprises) opening in all rural counties during the five-year period, 138 employed 100 or more workers locally.

Five indicators of county economic performance are analyzed. Growth in total employment is a key outcome measure, since job creation is the fundamental goal of most economic development efforts. Change in total employment between 1989 and 1994 is calculated from county of work data taken from the Regional Economic Information System of the U.S. Bureau of Economic Analysis. New businesses, large or small, are generally expected to have a positive impact on employment growth. The total effect on local employment will be greater than the direct effect of the jobs created in the new firms to the extent that inputs are purchased from other local businesses and new profits and wages are spent locally. Total effects could be less than the direct effect if new firms displace old firms. Such displacement may occur when retail or service businesses serve a local market to small to support both new and old businesses. Competition from new businesses may cause old ones to contract or close. Competition for workers could also lead to displacement of existing jobs. New firms may even have a negative effect on total employment if they displace older firms that have been using more labor-intensive technologies. Earlier research

indicates that small businesses are more closely linked to the local economy than subsidiaries of large enterprises. Thus, small business starts are expected to affect total employment more than new large firms. Evidence also suggests that the rate of job growth is higher in small firms. Thus, when total firm population is held constant, the number of small firms is expected to be positively related to total employment growth.

The trend in the value of a county's tax base, hence its ability to finance education and other public services and facilities, is another indicator of economic performance. Data on change in the property tax digest were obtained from the Georgia Department of Revenue as a measure of county ability to generate revenue. The tax digest is a reasonable, but imperfect, measure of the value of real and personal property. However, county-to-county variation may reflect non-uniform assessment practices and variations in residential property as well as investment in commercial and industrial properties. Business creation and expansion is expected to be positively correlated with investment in plant and equipment. Expansion in the tax base due to business development, like employment growth, is subject to multiplier and displacement effects.

Change in taxable sales is a measure of ability to generate revenue as well as an indicator of consumer spending. In Georgia, the local option sales tax, which generates 22 percent of total local government revenue, is the second largest revenue source after the property tax, which accounts for 36 percent.[23] The Georgia Department of Revenue provided county sales tax data. New businesses are expected to have a positive influence on sales, though displacement of existing sales and the proportion of firms not involved in taxable sales activity will reduce the effect.

Development encompasses not only expanding employment opportunities, but also wage levels. Therefore, change in average weekly wages and an index of employment stability were derived from data available from the Georgia Department of Labor. Both large and small business start-ups are expected to contribute to wage growth as the labor market tightens due to increased demand for labor. Since previous research indicates that wage levels tend to be higher in larger firms, new large firms are expected to affect wage growth more strongly than small businesses.

The stability of local employment is another important aspect of labor market performance. To examine employment stability, an index was adapted from a measure suggested by Malizia and Ke.[24] The index was constructed by dividing the residuals estimated from a linear regression of average annual employment 1989-1995 on time in years by the predicted employment to get a relative difference, averaging the sum of the squared relative differences, and taking the negative square root. Small business development is expected to increase employment stability, since economic dislocation stimulates entrepreneurship. Large businesses, on the other hand, are expected to decrease stability as openings and closings generate swings in demand for labor.

Results:

The findings from the regressions of change in total employment on three small business variables indicate that small business development has a strongly positive impact on total county employment growth. The addition of one new small firm results in an overall gain of 21 jobs in total employment. Considering that the average direct employment effect of a new small firm is fewer than five workers, the regression coefficient suggests that small businesses have large multiplier effects. The longer-term effects from small firms created in the previous five-year period, are slightly lower, but still substantial. Another indicator of small business development, the number of small businesses, old and new, is also strongly associated with total job growth. Standing in contrast to the effect of small business development on employment, the impact of new large businesses was not statistically significant.

Table 1

E = Change in total wage and salary employment 1989-1994

    mean E = 691

D = Policy Variable	Mean	R^2	β_2	t	β_2*
New small firms, 1989-1994	97	.7232	20.72	5.46***	1.75
New small firms, 1985-1989	109	.6736	18.14	3.02***	1.72
Number small firms, avg 1989-1994	281	.6808	19.72	3.34***	4.58
New large firms, 1989-1994	18	.6490	3.72	0.305	.063
New large firms 1985-1989	10	.6468	16.60	0.596	.118

* standardized β *** $\alpha < .01$

Results displayed in Table 2 show that concurrent (1989-1994) small firm creation and average number of small firms contribute considerably to tax base growth. The formation of a new small firm adds $2.5 million to the tax digest, while the presence of additional small firms among a county's business population adds $4.2 million. The longer-term effect from those small businesses created during 1985-1989 on growth on the tax digest receipts over the subsequent six years was not significant. The attenuation of the effect may indicate that after heavy investment at start up, young firms make little additional investment in plant and equipment in their second five years of operation. Consistent with the results for employment growth, these regression results suggest that new large businesses do not have a positive effect on tax-base growth. In fact, the effect may even be negative.

Table 2

E = Change in property tax digest 1989-1995

    mean E = $46,630 x 1000

D = Policy Variable	Mean	R^2	β_2	t	β_2*
New small firms, 1989-1994	97	.2803	2530	2.69***	1.39
New small firms, 1985-1989	109	.2394	1357	0.96	.83
Number small firms, avg 1989-1994	281	.2946	4192	3.10***	6.33
New large firms, 1989-1994	18	.2338	-612	-0.23	-.07
New large firms 1985-1989	10	.2406	-6589	-1.04	1.73

* standardized β *** $\alpha < .01$

Retail businesses, large and small, are primarily responsible for direct impact on sales growth. Since most businesses do not effect sales directly, the low explanatory power of the models (as measured by R^2) is not surprising. However, results show that both large and small start-ups affect sales growth. A comparison of the standardized coefficients indicates that the impact of new small firms is stronger than the effect of large firms. The longer-term effect of large firms (new 1985-1989) is stronger than the immediate effects, suggesting that sales growth of affiliated establishments accelerates in the second five years.

Table 3

E = Change in taxable sales 1989-1993

mean E = -$8,733 x 1000

D = Policy Variable	Mean	R^2	β_2	t	β_2*
New small firms, 1989-1994	97	.1048	443	2.59***	1.50
New small firms, 1985-1989	109	.0610	-	-	-
Number small firms, avg 1989-1994	281	.0508	-	-	-
New large firms, 1989-1994	18	.1053	1273	2.61***	.86
New large firms 1985-1989	10	.1139	3078	2.77***	.87
* standardized β					*** α < .01

Results of the analysis indicate that none of the business development models explained significant variation in either wage change or employment stability. (see Table 4) A possible explanation for this outcome is that labor markets in Georgia's small rural counties adjust to changes in demand by changing commuting patterns, while maintaining wages and numbers of employed residents. The effects of business creation are not confined to the county where the new establishment is located, but spread to surrounding counties.

Table 4

D = Policy Variable	E = Change in average weekly wages	E = Index of employment stability
	R^2	R^2
New small firms, 1989-1994	.0152	.1029
New small firms, 1985-1989	.0229	.0903
Number small firms, avg 1989-1994	.0137	.0878
New large firms, 1989-1994	.0157	.0945
New large firms 1985-1989	.0151	.0930

Summary and Implications

In summary, evidence from rural Georgia counties leads to three conclusions. First, small business development is strongly correlated with growth in employment and property tax base, but success in recruiting establishments affiliated with large enterprises is not significantly associated with these important economic development goals. The strong effects of small business development are consistent with the idea that small, independent firms tend to purchase inputs and retain profits locally, therefore generating impacts that go well beyond their direct job creation and investments. On the other hand, the lack of significant total effects of start-ups of large businesses suggests that new large firms are displacing existing local firms.

Second, the number of both large and small start-ups was related positively to sales growth during a period of decreasing sales overall in rural counties. Their influence on sales growth is the only significant positive consequence of large businesses found in this study, and that effect is smaller that the corresponding effect of

new small businesses. That new establishments owned by large enterprises contribute to county sales without adding significantly to total employment or property values, suggests that these businesses are more efficient and perhaps better able to serve local consumer needs than the firms they replace.

Finally, county wage levels and employment stability are not sensitive to variations in any of the business development variables tested. These performance dimensions appear to be determined by other factors not included in this analysis, such as the demographic characteristics of the county's population and employment opportunities available in neighboring counties.

What do these conclusions mean for economic developers? Bearing in mind the limitations discussed below, these results provide some rare quantitative evidence on the actual impact of development strategies. The evidence provides support for rural economic development polices which encourage entrepreneurship and small business development. A number of techniques are available for nurturing "homegrown" business. Management assistance aids individuals who may be highly knowledgeable in their specific fields, but who lack general management skills in such areas as accounting, strategic planning, personnel management and marketing. Venture capital programs match investors with entrepreneurs, and revolving loan funds help small funds leverage the debt financing they need. Business incubators provide affordable space and shared support services for fledgling firms. Trade associations and community-based business organizations offer entrepreneurs opportunities for networking, mentoring, and lobbying for favorable public policies. Customized training can raise employee productivity. Cooperative market research and promotional activities help small retail and service businesses multiply the effectiveness of their advertising budgets. This research suggests that rural counties can expand their employment and tax base by enhancing the local entrepreneurial climate.[25]

Conversely, these results suggest that local politicians and developers should be extremely cautious about offering development incentives to affiliates of large enterprises. The high-profile investments by large manufacturing plants or major retail outlets, announced with such fanfare, may be offset by hidden losses of jobs and depreciation of property values elsewhere in the local economy. Externally controlled businesses may generate benefits for the local economy, (for example, increased retail sales), but careful consideration should be given to how they will relate to existing businesses before encouraging their development.

Finally, this research provided discouraging evidence about the effectiveness of business creation, large or small, in improving the quality of job opportunities. Though the results suggest that business creation within a county has no significant effect on wage growth or employment stability of county residents, findings do not rule out the possibility that labor demand factors affect job quality on a broader, regional scale. Economic developers may find that cooperation between counties on economic development efforts helps improve job opportunities for a larger labor market area. However, this evidence could also indicate that labor supply factors are dominant. This explanation implies that policy makers should focus on education and training initiatives to achieve higher wages and steadier employment levels.

The conclusions of this study must be considered tentative or exploratory because of several limitations inherent in the data and approach used. First, since the data include a single state during a limited time period, it is difficult to generalize the conclusions. Similar results might be expected in other southeastern states, but development impacts might differ in large, sparsely populated rural counties of the West or slow-growth areas of the Midwest or Northeast. Also, due to the small number of nonmetropolitan counties, the statistical power of the analysis is weak. Perhaps the effects of new large firms would have been significant if the sample were larger. Finally, the separate single-equation models do not permit detailed

analysis of the relationships between the variables of interest.

Thus, the findings reported here point to several areas where additional research is needed. First, the analysis should be conducted in other states and time periods to determine whether the results are widely valid or specific to conditions in Georgia. Expansion of the analysis to include more counties would also permit stronger tests of the relationship of large-business development to job and tax-base growth and the effects of the development variables on wage growth and employment stability. Another issue worthy of additional research is the possible displacement of existing firms when new large businesses are attracted to a community. What kind of businesses are closing or contracting? Are they closing because of competition with new firms, or are their difficulties due to unrelated factors? How do the impacts of manufacturing and non-manufacturing affiliates differ? Finally, why are wages and employment stability unresponsive to the type and extent of business development occurring in a county? Will a multi-equation model or an analysis of multi-county labor markets indicate more favorable labor market outcomes? The present study has raised more questions than it has answered. However, it is a useful beginning in an area where research is badly needed. Good decisions on economic development strategy require information not only on the number of businesses and jobs created directly, but also the total impact of business development on local economies.

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22. An implicit assumption is made that start-ups of this scale are new, locally owned businesses. New large businesses are assumed to be externally controlled.

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