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Survival and Growth of Independent Firms and Corporate Affiliates in Metro and Nonmetro America

James P. Miller

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Survival and Growth of Independent Firms and Corporate Affiliates in Metro and Nonmetro America. By James P. Miller. Agriculture and Rural Economy Division, Economic Research Service, U.S. Department of Agriculture. Rural Development Research Report No. 74.

Abstract

Analysis of new firm survival and growth during 1980-86 reveals that local, independent firms survived better and grew faster than corporate affiliates in nonmetro areas. Independent firms quickly reached their optimum size after beginning operation. The rate of employment expansion for nonmetro independent firms was about half that of metro independent firms. Corporate affiliates in traditional nonmetro industries dependent on natural resources and low-wage labor continued to locate mostly in nonmetro areas. In developing future strategies for industrial development, the strengths and weaknesses of corporate ownership and control should be balanced against those of local ownership.

Keywords: Business survival, growth, location, ownership, independent firms, affiliates.

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Summary

Longitudinal study of approximately 924,000 independent firms and affiliates that started between 1978 and 1980 reveals that the nonmetro business survival rate was 49 percent during 1980-86, some 5 percentage points above the rate in metro areas. However, businesses that survived in nonmetro areas expanded employment 9.3 percent between 1980 and 1986, less than half the employment growth rate in metro areas.

New independent firms in nonmetro areas survived better and grew faster than corporate affiliates over the 1980-86 period. Of the independent firms that started between 1978 and 1980, 53 percent survived through the 6-year period, and their employment expansion rate was about 19 percent. Only 39 percent of the corporate affiliates survived, and their rate of employment expansion was only about 3 percent.

Changes in business and industry ownership structure have called into question the feasibility of rural areas attracting new independent businesses in fast-growing, high-tech manufacturing and advanced services industries. In developing future strategies for industrial development, the strengths and weaknesses of corporate ownership and control should be balanced against those of local ownership (Doeringer, Terkla, and Topakian). Their differences imply differentiated policy approaches, including one for improving the longer term prospects of local businesses, and another seeking commitments from the management of large corporations to keep their branch plants open and to retrain and relocate workers when they restructure or scale down their companies. State and local developers must differentiate between dependable companies that will remain committed to an area and those that are footloose and unreliable.

Independent firms in metro areas grew faster. Their rate of employment expansion about doubled those in nonmetro areas. New independent firms that survived at least 6 years in high-growth industries were concentrated more in metro areas also. Surviving firms in high-tech manufacturing and advanced producer services, the high-growth industries, were the most metro-oriented during the 1980-86 period. Surviving firms in natural-resource-based industries, low-wage manufacturing, and residential services, however, were the most nonmetro-oriented group.

Nonmetro areas have attracted more affiliates of out-of-State firms in goods-producing industries, especially the less sophisticated operations in high-tech manufacturing. Affiliates in industries dependent on natural resources and low-wage labor have also been the most nonmetro-oriented, continuing the previous long-term trend.

Survival and Growth of Independent Firms and Corporate Affiliates in Metro and Nonmetro America

James P. Miller

Introduction

Structural changes in business and industry in the early 1980's have caused many rural communities to reassess their economic development strategies. Rural unemployment has remained above the urban rate since 1978, and rural job expansion has not kept pace with that in urban areas. Part of the problem is that new businesses in growth industries, such as advanced producer services and high-technology manufacturing, have contributed to job growth less in rural than in urban areas (Miller and Bluestone; McGranahan). Urban areas have attracted the new fast-growth, "glamour" industries, while rural areas have had to depend more on businesses in traditional industries--agriculture, mining, and labor-intensive manufacturing--that did not expand employment much in the 1980's. Nonmetro employment grew by only 4.2 percent between 1980 and 1986, about a third of the metro growth rate.

Recent findings that small, independent businesses have created a disproportionate share of new jobs in the 1970's and 1980's have piqued the interest of rural policymakers seeking new ways to reduce unemployment (Birch; Armington and Odle; U.S. Small Business Administration). Many State and local development organizations believe that small businesses create jobs and promote economic prosperity, and have started programs to help nurture small fledgling businesses--incubator facilities, venture/equity capital programs, enterprise zones.¹ But little is known about the growth and locational stability of new independent businesses in rural areas.²

¹ Throughout this report, the term "business" is used generically to refer to either an establishment or a firm. The term "firm" refers to the unit of ownership. It can be a multiunit firm or an independent (single-unit) firm. The term "establishment" is used to denote a single workplace, which can be a headquarters, an independent firm, or an affiliate (i.e., a branch or subsidiary of a multiunit firm). The terms "establishment" and "business" are thus synonymous.

² The phrase "locationally stable" is borrowed from Barkley. It denotes the tendency of firms to remain in business and to retain employees in any given area, regardless of whether the period is one of expansion or recession.

Some studies have found that small independent firms are more likely to fail and have more variable growth than the affiliates of large firms (Barkley; Brock and Evans; Jackson). Some researchers have argued that small firms are more likely to face "liquidity constraints," and thus close or lay off workers more quickly than do large firms, particularly during a recession. But, little evidence exists to document this in rural areas.

This report presents some preliminary results of a longitudinal analysis of new business survival and growth during the 1980-86 period, which started with two recessions and ended with prolonged recovery. The analysis tracks the survival and employment growth, through 1986, of nonmetro and metro businesses that started between 1978 and 1980, by their ownership status.

Review of the Literature

Over the past 10 years, literature on regional and local development policy for rural areas has emphasized the advantages of local ownership over external control (Coffey and Polese; Jacobs). The argument for local ownership, first, is that independent firms are more likely to be integrated into the local economy than externally controlled affiliates (Watts). Independent firms tend to purchase more from the local area and sell less outside the local area, keeping most of their revenue in the area. Studies by Klimasewski and by Cocheba, Gilmer, and Mack, for example, have demonstrated that rural manufacturing affiliates were weakly linked to regional economies in the South.

Stable employment is the second major advantage of local ownership. Jobs in independent firms are believed to be more locationally and cyclically stable than jobs in affiliates. Several studies have shown that independent firms in a recession tend to have lower closure rates than do branch plants. Watts observed that corporate affiliates, particularly in nonmetro areas, are the first to experience cutbacks of employment and closings during downturns of economic activity. Independent firms tend to have lower closure rates primarily because they are forced to adjust onsite or to face the prohibitive cost of moving, whereas parent firms abandon affiliates in hard times and possibly expand at other sites to compensate for the affiliates they have closed. Parent firms are more likely to serve wider, more diversified markets than are independent firms, which gives parent firms more freedom to spatially shift production over the business cycle.

U.S. studies, thus far, have presented only a partial picture of business growth and survival in nonmetro areas. Most research has focused on national trends and has failed to consider differences between locally owned and absentee-owned businesses. Birch, using 1969-76 Dun and Bradstreet (D&B) data, found that regardless of its age, the odds of an establishment closing in this 7-year period were quite high. Only about 45 percent of all businesses survived. The probability that a firm will fail over a given time period decreases with firm size for firms of the

same age, and decreases with firm age for firms of the same size. Birch did not focus on independent firm survival, but showed that they generated about 52 percent of net employment growth.³

Mills, and Gray and Phillips present evidence, based on D&B data, bolstering the argument that independent firms provide more stable employment over the business cycle than do affiliates. Small and mostly independent firms with fewer than 500 employees acted as shock absorbers to cyclical fluctuations by retaining employees and remaining in business during recessions, thus moderating wide fluctuations of larger firms during economic downturns. Closure rates for small firms were lower than for large firms during the 1980-81 recession, and were higher during the recovery. A recent study by Phillips and Kirchoff found that on average, 40 percent of businesses (most of them independent firms) started between 1978 and 1980 survived at least 6 years.

Studies by Erickson and by Erickson and Leinbach found that manufacturing branch plants in nonmetro areas are more adversely affected during periods of slumping demand than are metro plants in the same organization. As product demand falls and inventories accumulate, production is curtailed at the nonmetro sites. Parent organizations centralize their activities in fewer plants. Erickson believes that "where there is limited capital investment in labor-intensive nonmetro branch plants, there is considerable incentive to discontinue operation there before doing so in main plants." Nonmetro areas are thus the first to suffer and the slowest to recover from cyclical downturns.

Barkley found that in rural Iowa, independent firms exhibited a higher tendency for failure than did branch plants. But in terms of relocation rates, branch plants were more locationally unstable, or more likely to move than were independent firms. The corporate objective during a cyclical downturn or period of long-term retrenchment is to consolidate branch operations to reduce overhead costs, whereas independent firms are more likely to remain in the area.

Large corporations have a wider range of strategy options than do independent firms. They may see the abandonment of affiliates in mature product lines as the best strategy. Returning to the core function of the company may help build competitiveness and may add stability to the remaining jobs provided.

Hansen and Carlsson believe that mature economies may be entering a new phase of "vertical disintegration," or contracting out functions once performed in the company. As employment is reduced in older, mass-production facilities, more jobs are created in flexible, small-scale operations able to efficiently produce an increasing variety of goods and services in small

³ Miller, however, who used a different, edited version of the D&B data, documented that independent firms were responsible for only 32 percent of net employment growth in nonmetro areas between 1976 and 1980, compared with 40 percent in metro areas.

batch runs. The result has been an increase in the number of plants and a decline in average plant size.

Little is known about the effect of corporate vertical disintegration on ownership structure and employment in nonmetro areas. Hansen maintains that a return to flexibility and small-scale operations has favored metro areas and has revitalized industrial agglomerations. This result may help explain the resurgence of metro employment growth in the 1980's and the slower growth of nonmetro areas. Schoenberger agrees with Hansen that vertical disintegration has increased concentration of metro economic activity. Branch plants of mature companies, as well as small innovative firms, are drawn to urban markets.

On the other hand, Bergman and Goldstein believe that much of the Nation's future economic activity will continue to be vertically integrated in large corporations and to be geographically decentralized. They attribute much of the rural industrialization over the past two decades to an increase in corporate control of the economy. The pull of urban agglomeration weakens, rather than strengthens, as firm size and concentration of ownership increase.

Data and Methods

The analysis in this report covers four issues that have not been accurately and thoroughly addressed in previous studies: (1) The survival rates of new firms in nonmetro areas, and how these rates compare with metro rates; (2) How rapidly surviving businesses expand employment; (3) Whether or not ownership status is a factor in the rate of survival and growth; and (4) The relationship between ownership status and the location of surviving jobs.

Data for the analysis were derived from the U.S. Establishment and Enterprise Microdata (USEEM) files of the U.S. Small Business Administration.⁴ The USEEM database is extremely useful for examining how firms operate after they are formed. We can identify new businesses in a given period and then track their survival and growth in later periods.⁵ Data on new formations that survive and grow are more likely to reflect changes in

⁴ The USEEM files cover approximately 93 percent of full-time business activity in the United States, generally firms with at least one paid employee or with a Dun and Bradstreet credit rating. For a full discussion of the USEEM file, see U.S. Small Business Administration (1988).

⁵ A new firm is established by its first appearance in D&B files. Disappearances from the D&B files determine the level of survival. However, many disappearances (an unknown number) result from changes of ownership. Thus, a survival rate could be biased downward by a large number of businesses changing ownership and company titles, i.e., divestitures and mergers.

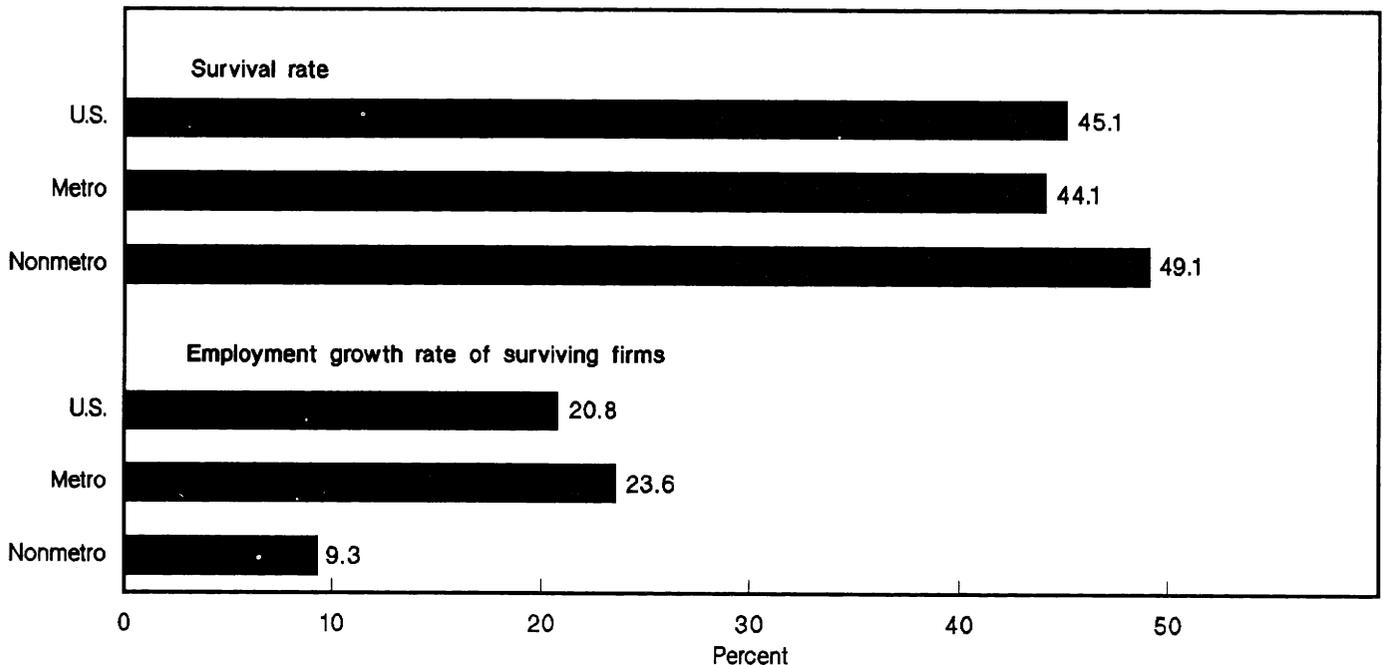
recent location than do data for all establishments. As Malecki has pointed out, firm births (the flow of new entrants) more accurately measure the recent competitive advantage of regions than the stock of firms, which is the only type of data available from national databases. USEEM data are also useful for identifying whether the kinds of new firms that survive in nonmetro areas are headquartered locally or out of State. Finally, with the USEEM files, we can get a better focus on the sources of job growth and stability by examining categories of new firm survivors classified by their firm size, ownership status, and industry group.

New Business Survival and Growth

The USEEM survival-rate data may enhance the bleak portrait of new businesses in the United States. Business failure data are imprecise, but the standard estimates are that as few as 33 percent of new businesses survive 5 years, and by the 10th year, only about 1 in 5 is still operating (Solomon). Our preliminary results show that about 45 percent of the 924,000 new firms that started between 1978 and 1980 survived at least 6 years, which is consistent with the findings of Phillips and Kirchoff (fig. 1).

Even more striking, the nonmetro survival rate was 49 percent, 5 percentage points above the rate in metro areas. However, the firms that survived in nonmetro areas expanded employment only

Figure 1
Survival and employment growth of new establishments, 1980-86¹



^{1/} Establishments starting 1978-80.

9.3 percent between 1980 and 1986, less than half the rate of employment growth in metro areas.

Ownership Status and Size Differences

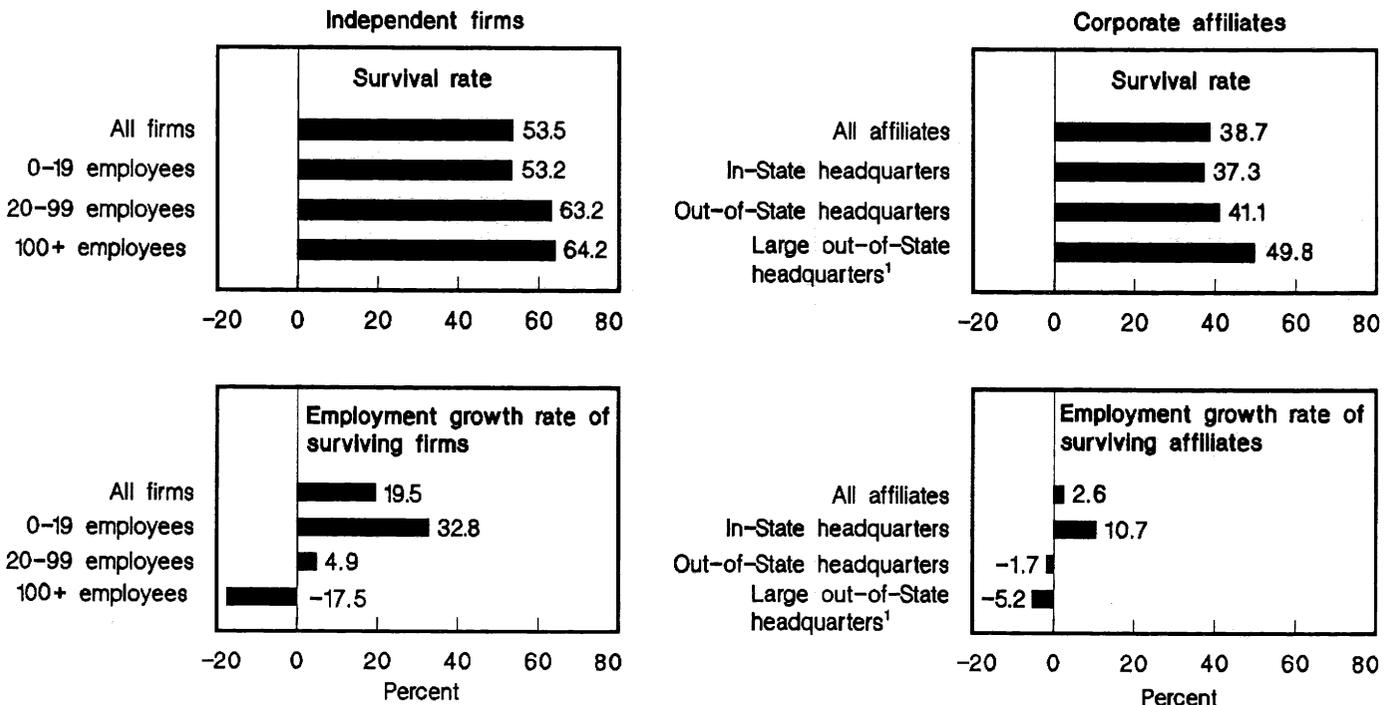
New independent firms in nonmetro areas appeared to be more locationally stable and quicker to expand employment than did new affiliates over the 1980-86 period. The independent firm survival rate of 53.5 percent was substantially higher than the 38.7-percent rate of survival for affiliates (fig. 2). And the 19.5-percent rate of job growth of independent firms was well above the 2.6-percent job growth for affiliates.

Chances for survival appeared to improve with the size of firm regardless of ownership status, corroborating earlier findings by Birch. The largest independent firms and affiliates of the largest parent companies had the highest survival rates.

On the other hand, larger independent firms and affiliates were slow to expand employment in nonmetro areas. Most large establishments may have been close to their optimum employment size soon after they began operating. Employment even declined in affiliates of the largest firms. New affiliate employment of large (1,000 or more employees) companies headquartered out of State declined 5.2 percent between 1980 and 1986.

The low survival rates of new affiliates may indicate that large, absentee corporations were not only closing affiliates to

Figure 2
Survival and employment growth of new establishments in nonmetro areas, 1980-86



^{1/} Affiliates with out-of-State headquarters with 1000 or more employees.

reduce production, but were also actively streamlining their operations by selling off new affiliates in the 1980's. This would support the position taken by Hansen and by Schoenberger that large corporations have been vertically disintegrating and consolidating their operations.

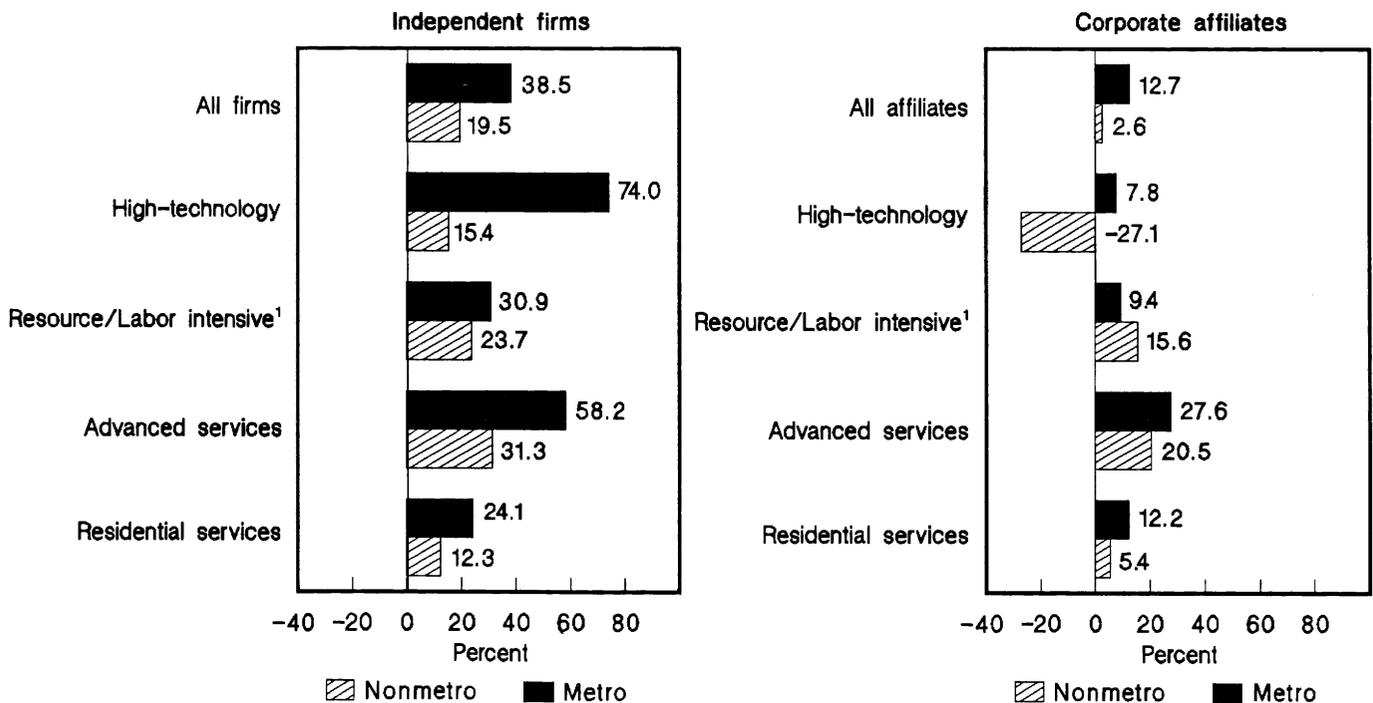
Differences by Industry Group

In six major industry groups in both nonmetro and metro areas, independent firms show a consistent pattern of higher survival and growth rates than do affiliates (fig. 3). However, there is considerable variation in employment expansion rates among industries.

New independent firms grew much faster in metro than in nonmetro areas, particularly in industries considered to be dominated by innovative, fast-growth, and high-paying firms. High-tech independent firms expanded employment 74 percent in metro areas, which was about five times the expansion rate for high-tech independents in nonmetro areas (fig. 3). Independent firms in advanced producer and distributive services industries grew about 58 percent, almost twice the rate in nonmetro areas.

The lowest rate of expansion by new businesses occurred in the corporate sector in nonmetro areas. Affiliates expanded less rapidly than independent firms in all industry categories, and

Figure 3
Employment growth rates of new establishments by Industry group, 1980-86



^{1/} Natural resource-based and labor-intensive industries.

employment declined by about 27 percent in high-tech manufacturing industries (fig. 3).

The decline of employment in new high-tech affiliates indicates that corporations were scaling down their operations during a period of slumping demand and intense competition for many high-tech products. As product demand falls and inventories accumulate, parent companies curtail production at marginal branch operations in nonmetro areas before doing so in main plants, which are usually in metro areas (Erickson). The incentive to cut back the more labor-intensive operations in nonmetro areas first may have decreased employment in new as well as old branches.

New affiliates in rural industries dependent on natural resources and low-wage labor expanded employment faster in nonmetro areas. The nonmetro employment growth rate was 15.6 percent, about twice the rate of new-affiliate employment growth in metro areas.

New businesses in nonmetro residential services did not expand much over the 6-year period. Independent firms expanded employment 12.3 percent, and affiliates, 5.4 percent. The small size and slow growth of rural markets might constrain the growth of new residential services. These businesses start small and do not expand much because of the small number of rural residents.

Recent Changes in Location and Organizational Structure

Survival and growth rates of new firms tell only part of the story of how new businesses are affecting rural America. Another critical question is whether the industrial base and its ownership structure in rural areas are changing as a result of these new businesses. Are recent employment shifts to or away from rural areas attributable mainly to new independent firms in new and innovative industries, or to externally controlled affiliates in traditional rural industries?

Employment location quotients indicate recent changes in the location of independent firms and affiliates of firms with out-of-State headquarters in various industry categories (figs. 4 and 5). The location quotients also indicate relative changes in the distribution of employment in surviving firms among regions and types of businesses. The quotients are obtained by dividing the share of 1986 employment resulting from 1978-80 starts that survived through 1986 by the shares of total employment in 1980. A location quotient greater than 1 shows that employment is becoming more concentrated in a particular type of business or industry in a specific Census division and type of county. A quotient less than 1 indicates that the industry is becoming less concentrated.

Independent Firms

Employment in independent firms in high-tech manufacturing and advanced services shifted little toward nonmetro areas. Location

quotients for the nonmetro portions of Census divisions were consistently below 1, except for high-tech manufacturing in adjacent metro counties in the East South Central division (fig. 4). The recent tendency, as expected, was for new high-tech and advanced-services employment in independent firms to concentrate in metro areas.⁶ Location quotients were above 1 in the metro portions of three Census divisions for high-tech manufacturing, and in five Census divisions for advanced services.

Employment in new locally owned firms in industries dependent on natural resources and low-wage labor tended mostly to remain located in nonmetro areas. Location quotients for the nonmetro portions of Census divisions were consistently above 1, except in the North Central and Mid-Atlantic divisions (fig. 4).

Nonmetro areas also appear to be attracting a relatively large share of independent residential activities. Location quotients were above 1 in the nonadjacent nonmetro portions of four Census divisions. Residential services (retail stores, service stations, fast-food franchises, and others) accounted for an increasing percentage of employment in small, remote rural communities.

Out-of-State Affiliates

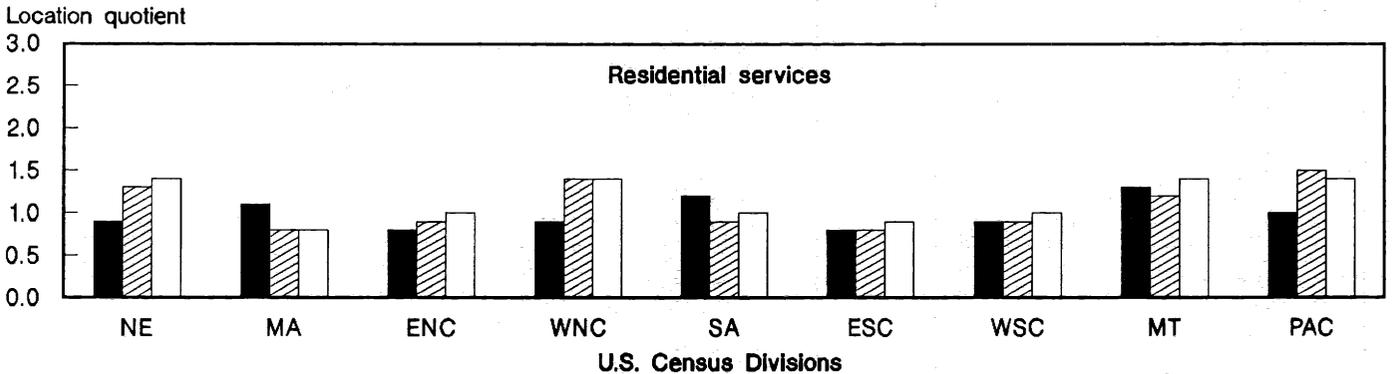
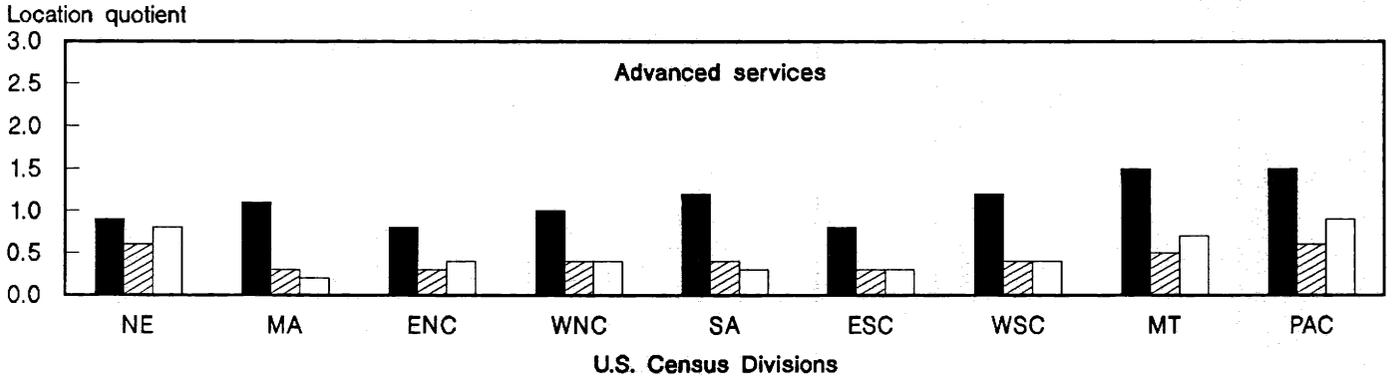
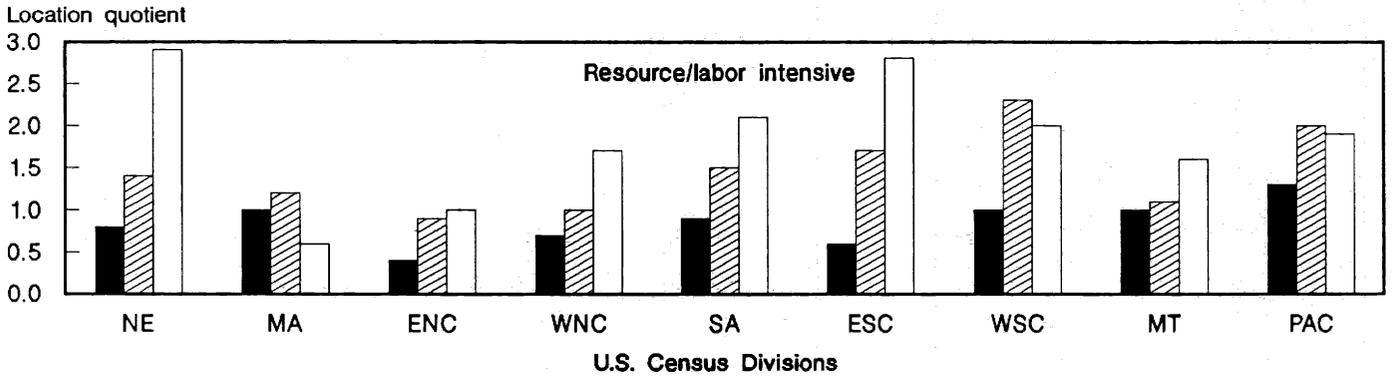
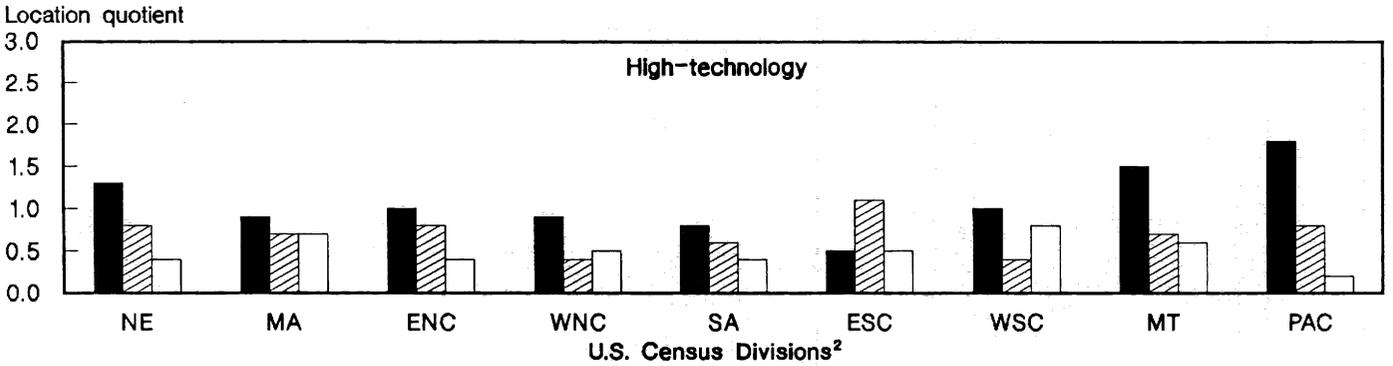
New affiliates of out-of-State firms in goods-producing industries are concentrating and surviving best in nonmetro areas. Location quotients for industries dependent on natural resources and low-wage labor were greater than 1 in the adjacent nonmetro portions of all Census divisions except the Pacific (fig. 5). Location quotients were also greater than 1 in the nonadjacent nonmetro portions of all Census divisions, except New England and the Mid-Atlantic. Location quotients were less than 1 for the metro portions of all Census divisions, except the East and the West South Central.

Nonmetro areas have also been the preferred location of new affiliates in high-tech manufacturing industries in recent years. But because most were controlled by out-of-State headquarters, affiliates were mainly routine manufacturing operations that were moved there by parent companies, mostly to reduce labor costs (Malecki, Miller). Fewer affiliates in advanced producer services industries have recently located and survived in nonmetro areas. Location quotients were less than 1 in all Census divisions, except in adjacent nonmetro portions of the New England and Pacific divisions (fig. 5).

⁶ Several recent studies have documented the tendency of innovative, high-tech firms and advanced producer services to locate in densely populated regions and urban areas. Malecki, Noyelle, Miller, and Miller and Bluestone found that these activities are typically not drawn to peripheral areas.

Figure 4
Location quotients of new independent firms, by industry

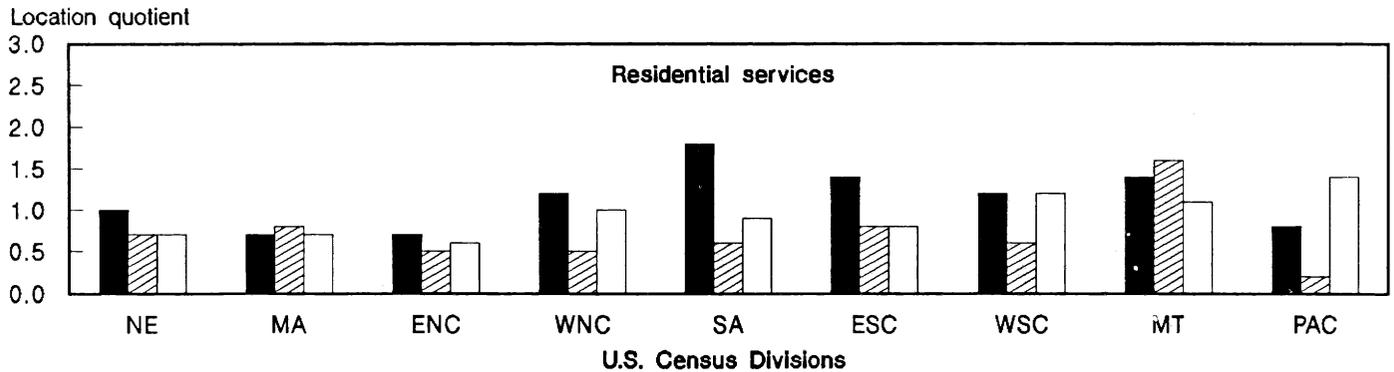
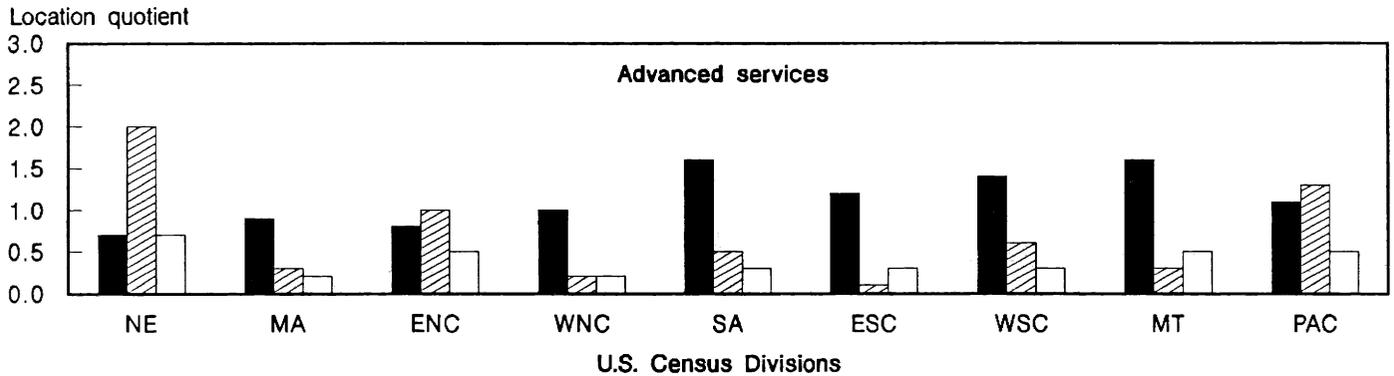
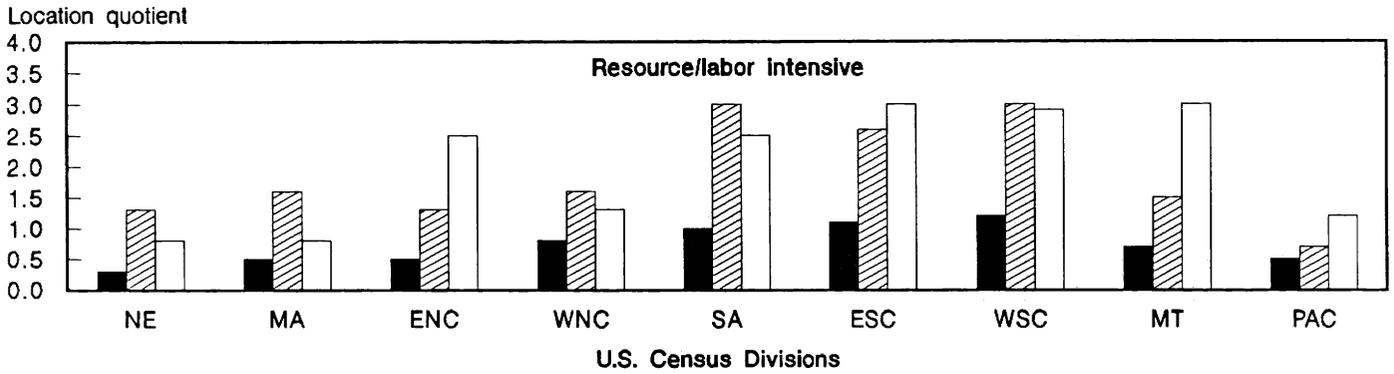
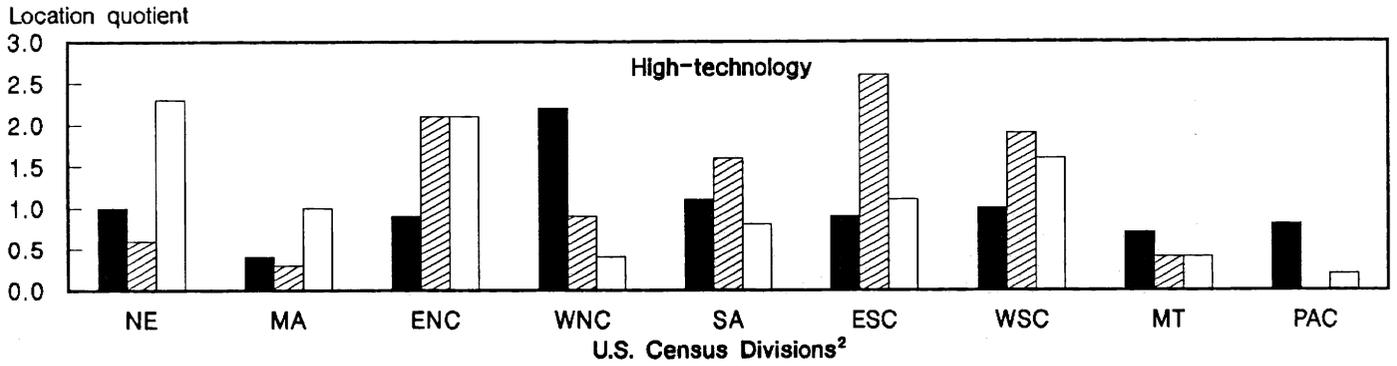
■ Metro ▨ Nonmetro adjacent to MSA¹ □ Nonmetro nonadjacent to MSA



1/ Metropolitan statistical area. 2/NE: New England, MA: Mid-Atlantic, ENC: East North Central, WNC: West North Central, SA: South Atlantic, ESC: East South Central, WSC: West South Central, MT: Mountain, PAC: Pacific.

Figure 5
Location quotients of new affiliates with out-of-State headquarters, by industry

■ Metro ▨ Nonmetro adjacent to MSA¹ □ Nonmetro nonadjacent to MSA



1/ Metropolitan statistical area. 2/ NE: New England, MA: Mid-Atlantic, ENC: East North Central, WNC: West North Central, SA: South Atlantic, ESC: East South Central, WSC: West South Central, MT: Mountain, PAC: Pacific.

Conclusions

Independent firms survive better than corporate affiliates in nonmetro areas. But independent firms, particularly in residential services industries, quickly reach their optimum size shortly after starting up. Independent firms' rate of expansion in nonmetro areas was about half the rate in metro areas. Most new independent firms are small and do not expand much in nonmetro areas because they are limited by the small size and slow growth of rural markets.

The hypothesized vertical disintegration by large corporations does not appear to be changing the traditional industrial base of rural America. Affiliates of out-of-State firms in industries dependent on natural resources and low-wage labor continued to locate mostly in nonmetro areas. The less sophisticated branch operations of high-tech firms also have begun to filter down to nonmetro areas. New independent firms and externally controlled affiliates in advanced producer services industries remained concentrated in metro areas.

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Appendix

The following is a list of major industry groups by standard industrial classification (SIC) code.

I. High-technology manufacturing

1. Chemicals and allied products (28)
2. Ordnance and accessories (348)
3. Machinery (except electrical) (35)
4. Electrical equipment (36)
5. Motor vehicles and equipment (371)
6. Aircraft and parts (372)
7. Guided missiles and space vehicles (376)
8. Instruments (38)

II. Resource-intensive industry/labor-intensive manufacturing

9. Agriculture/forestry/fishing (1-9)
10. Mining (10-14)
11. Food and kindred products (20)
12. Tobacco manufacture (21)
13. Textile mill products (22)
14. Apparel (23)
15. Lumber and wood products (24)
16. Furniture (25)
17. Paper and allied products (26)
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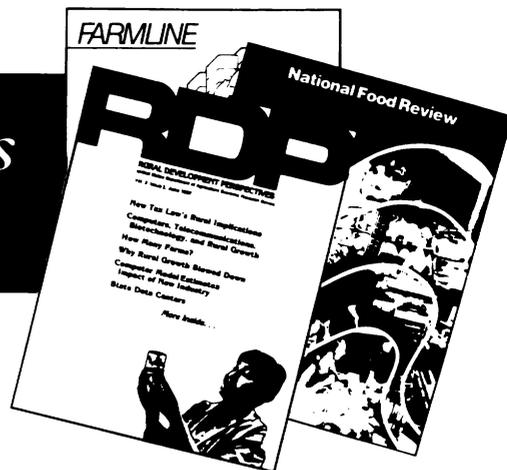
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