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# Business Start-Ups and Closures: The Illinois Experience

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A significant economic transformation brought about by a combination of factors, including increased competition from foreign sources, growing reliance on services, and a serious economic downturn has adversely affected many parts of Illinois, especially rural areas. These trends have made replacing lost jobs a high priority for many, if not most, development practitioners in an effort to revitalize local economies.

Development strategies used by local officials and community leaders have changed from mainly focusing on attracting large employers to concentrating more on retaining and strengthening existing employers and attempting to foster business start-ups. An emphasis on small businesses is not new and has existed since the late 1970s with research suggesting that most employment growth was caused by relatively small businesses, however defined (Birch 1979).

While the small business emphasis has shifted in approach and direction, stimulating entrepreneurship has become popular during the past several years with special interest on youth entrepreneurs, minorities, immigrants, and other groups. The most recent thrust has been to identify ways to create an entrepreneurial community that fosters private investments (Hustedde 2007).

Most businesses, especially in rural areas, are relatively small due to limited markets or a lack of sufficient workforce to support large plants. Most start-up businesses also are small, and it takes a relatively large number of start-ups to replace the loss of a large company.

Small businesses are easily overlooked by development practitioners in business retention and expansion programs or in designing other local development incentives because of their small size. This is unfortunate given that very small businesses account for significant proportions of the employment in rural areas.

Economic analyses are often based on net changes in employment by industry, which can be affected by a large number of factors. This report examines business start-ups and closures in Illinois counties using a recent data set compiled at the county level. The data include start-ups and closures by the business sector, which makes the information especially useful in analyzing local economic development trends. The data also provide supplemental information to employment changes. The analysis of start-ups in this report is based on 2006 data and the closures cover a three-year average of 2004 to 2006.

Subsequent analyses shed light on patterns of start-ups and closures to provide insights into possible ways to foster local economic development and suggest areas that may experience growth or declines. Start-ups and closures can be used to augment analyses of employment changes which may be more cyclical in duration than start-ups and closures. An otherwise healthy business can lay employees off during a recession whereas a business closure is more likely to be permanent.

## Business Start-Ups

Business start-ups were calculated by comparing businesses in January 2007 with the same businesses existing one year earlier. Special attention was paid to make sure that the business sold a product or service rather than simply existing by name only and that the business did not just relocate from within the county under a new name. Also, the businesses had to be largely independent from a parent company and, thereby, have decisionmaking authority.

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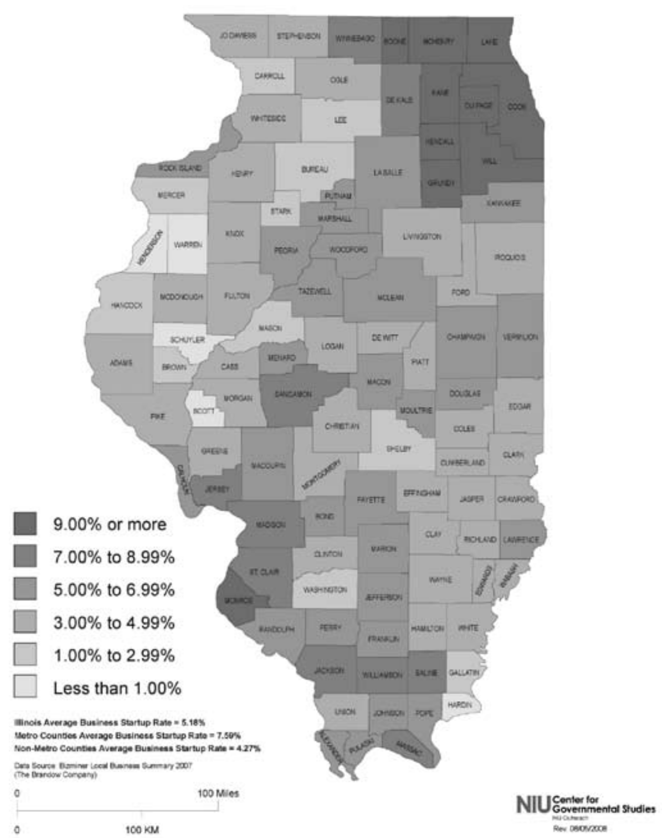
Two sets of information on business start-ups were included in subsequent analyses. First, *start-up rates* were based on a comparison of new businesses in a specific year with the number of known businesses existing in the previous year. Second, the *start-up index* compared the start-up rates in a county to national averages in order to place the start-ups in perspective to what is happening elsewhere in the United States.

The average start-up rate in Illinois was 6.4 percent in 2006. Counties within Illinois differ widely in business start-up activity, with several apparent influences at work (see Figure 1). First, the start-up rate was substantially higher in metro Illinois areas than in nonmetro areas, which may suggest the importance of proximity to other businesses and more opportunities for business investment. It is commonly understood in the entrepreneurship literature that an entrepreneurial culture is important, and small start-up businesses are often linked to existing companies seeking to outsource for various reasons (Dabson 2007). Thus, it only makes sense that the Chicago metro area might have higher start-up rates than less densely populated downstate areas.

**Figure 1. Illinois Business Start-Up Rates by County, 2006 to 2007**




The importance of interactions among businesses was further supported by the higher rates in Bloomington-Normal and Springfield, both large, downstate population centers. Economic activity in the St. Louis area clearly affect the Illinois counties in southwestern Illinois through spillover effects.

Somewhat of a surprise, however, was the relatively low start-up activity rate (5.25%) in Champaign County since one might have initially expected the University of Illinois to be a major stimulus or attraction for business development. Instead, it was slightly below the statewide average in 2006. This does not minimize the importance of higher education on local business creation; rather, existing companies may be expanding instead of new companies being formed. Likewise, some businesses may have formed outside of Champaign County for whatever reason and are therefore not counted.

Factors other than business density or population size are important in business start-ups, however, as was found in a multivariate regression analysis (Walzer, Hamm, and Harger 2007). Specifically, positive correlations were found between microenterprise increases and population size, females 25 to 34 years of age, owner-occupied housing, amenities, tax effort, and metro status (not shown in this report). The importance of population size has already been discussed. Plausible explanations for other influences are that the female cohort may be partly place-bound and that raising children who require supervision may limit the time available to spend starting up a business. The higher percentage of residents who own a home may indicate more wealth and resources to invest in a business. The presence of more local amenities may draw residents, including retirees, to an area and create additional markets for businesses. Likewise, amenities may attract entrepreneurs as described in the Creative Class literature popularized by Florida (2002) in recent years. Thus, a combination of larger markets and more entrepreneurs can possibly explain the positive correlation between amenities and business start-up rates.

Average wages may impact business start-up activity in two ways. First, counties with higher wages may be more urban, which would suggest a positive relationship between wages and start-ups. At the same time, however, higher wages may discourage business start-ups if residents have less incentive to engage in independent business because they are paid well. For those businesses who will have to hire employees, an area with higher wages may reduce the attractiveness for business development. A more complete understanding of these relationships will be important in helping to formulate effective local entrepreneurship policies.

## Manufacturing Start-Up Activity

Illinois has lost manufacturing employment in recent years, although rural counties have had more stability than metro areas (Walzer, Gruidl, and Sutton 2002). Manufacturing jobs typically pay more than other business sectors and are thus considered especially important in local development strategies. While manufacturing is sometimes thought of as mainly urban, this sector often represents a major employment source in nonmetro areas.

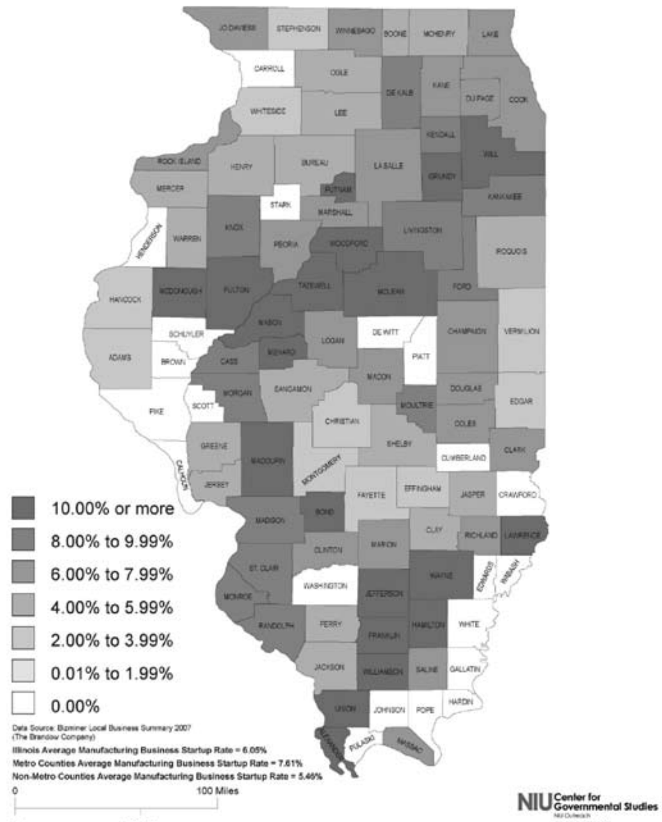
Manufacturing start-up rates differ widely among Illinois counties (see Figure 2). For instance, counties such as Fulton, McDonough, McLean (Bloomington-Normal), Peoria, and Tazewell have start-up rates above the statewide average of 6.0 percent. Contributing factors, such as four-lane highway access and the presence of major manufacturing companies in the region, could explain some of these trends.

Concurrently, the cities of Bloomington-Normal, Galesburg, and Peoria have had employment setbacks with layoffs or closures by Mitsubishi Motor Works (McLean County), Maytag (Knox County), and other companies, which may have pressured or encouraged residents to start businesses. Displaced workers with extensive knowledge or experience with manufacturing may lean to business start-ups.

Several counties in southern Illinois, such as Bond, Franklin, Hamilton, Jefferson, Union, Wayne, and Williamson reported above-average manufacturing start-up rates. In some instances, these numbers are difficult to interpret, especially in areas with small population sizes and small employment in manufacturing. In small counties, even a few businesses starting up can represent high percentages. Likewise, the presence of a city/cities with an aggressive economic development practitioner can make a substantial difference.

The importance of St. Louis is also apparent on neighboring Illinois counties in the comparison of manufacturing business start-ups, which may represent spillovers to Illinois suppliers. St. Louis-based companies may also spin off businesses to Illinois because of lower land prices, highway facilities, or other attractions. However, the above average growth in southern Illinois counties is especially interesting because it may signal somewhat of a reversal or revitalization of the local economy.

**Figure 2. Illinois Manufacturing Business Start-Up Rates by County, 2006 to 2007**



## Closure Rates

Also important is an understanding of counties experiencing business closures, which, in many ways, have an immediate and long-term impact. The average business closure rate during the three-year period of 2005 to 2007 was 18.2 percent when the data are based on number of establishments rather than size of employment (see Figure 3). A higher closure rate of small enterprises may not necessarily represent a major impact on the area when the businesses are small, but it may indicate economic difficulties nevertheless. Likewise, closures do not always represent failures; rather, they can indicate changing interests, people moving away, or people retiring.

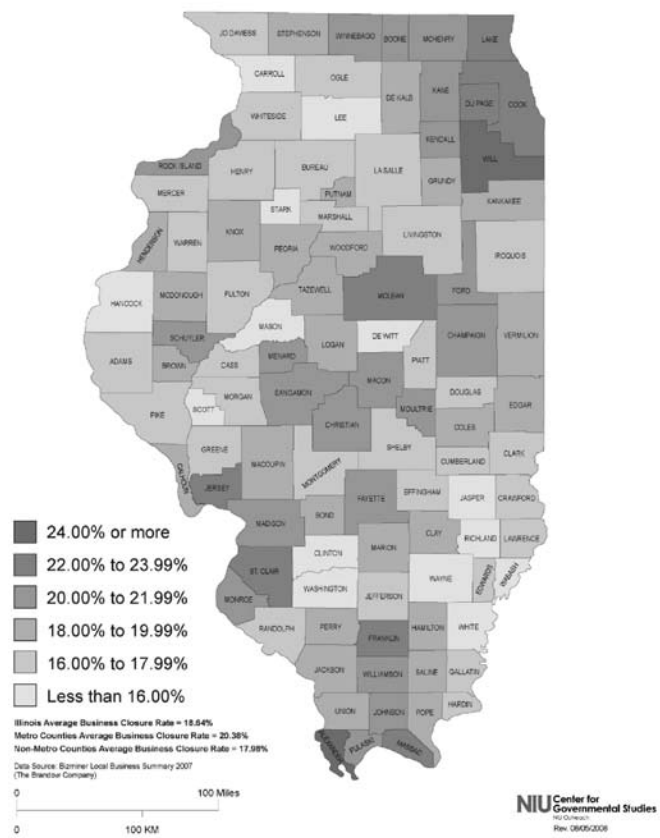
A review of the closure rates in Illinois shows that metro areas, such as Chicago, were at or above the state average, while remote rural counties typically reported lower closure rates. The low rates may reflect the relatively small number of businesses in these counties with perhaps less competition. The low rates may also reflect family-owned businesses that are less likely to leave during a temporary downturn but have a longer planning horizon instead. These families may have multiple businesses and ties to the community or region, causing them to remain in business even during relatively unprofitable times. A more detailed examination of the age, wealth, and other owner characteristics is required in order to better understand the factors at play in closures.

To the extent that family-owned businesses provide a higher proportion of businesses in a region, an issue of succession becomes important. It is not uncommon to find these business owners well past expected retirement age and still managing a profitable business. These operations may be somewhat dated, and the businesses may not be as profitable as they could be, but they are nevertheless still providing an essential service to residents of the community. If family members have moved away from the community, the business may be more likely to close when retirement occurs, causing communities to lose an essential business.

Low closure rates can sometimes be misleading—especially when the start-up rates are also low—since they may indicate relatively lower levels of entrepreneurship in the county. To some extent, business "churning" can be effective when businesses can learn from mistakes made in previous attempts. While business closings can be costly to entrepreneurs financially, they may be part of a process that ultimately leads to new and more successful business growth.

A second finding is that business closure rates are grouped in certain metro regions. The Champaign, McLean, and Springfield areas are obvious cases along with the counties bordering the Mississippi River adjacent to St. Louis. Again, higher start-ups along with closures may reflect more active entrepreneurship in metro areas.

**Figure 3. Illinois Business Closure Rates by County, 2005 to 2007**

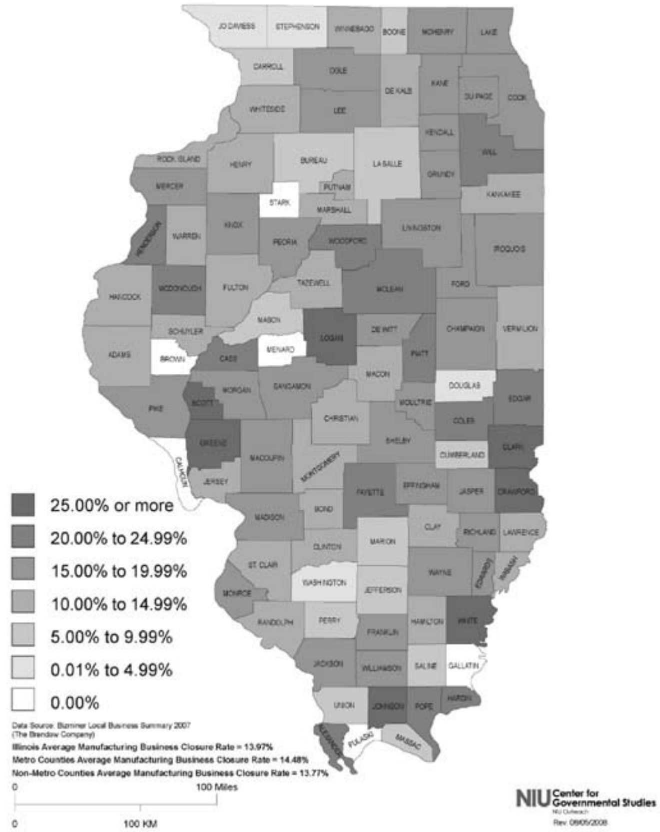



## Manufacturing Closure Rates

Overall, manufacturing closures are evident in most counties except for Brown, Calhoun, Menard, and Stark Counties (see Figure 4). Menard is the only county identified as part of a designated metropolitan area, even though it has a relatively low population density. The others are considered nonmetro areas without high concentrations of manufacturing. Since the data are for establishments rather than employment, it might seem obvious that areas with more manufacturing businesses will have more closures. However, these are rates which are adjusted for number of businesses, allowing counties of different sizes to be compared.

Nine counties (Brown, Clark, Crawford, Greene, Johnson, Logan, Pulaski, Scott, and White) reported closure rates of 25 percent or higher among manufacturing businesses. Most of these counties are small, are in southern Illinois, and have relatively low incomes. Several of these counties also reported low start-up rates of manufacturing businesses. This combination suggests that the local economy may be shifting away from higher-paying jobs to a lower-paying employment. This is not always true because in some instances, manufacturing jobs in rural areas do not pay well compared with their metro area counterparts.

**Figure 4. Illinois Manufacturing Business Closure Rates by County, 2005 to 2007**




## Policy Options

In light of the earlier discussions about start-ups and closures in Illinois counties, the obvious question is, “What options are available for rural counties to retain local business activity and employment?” The answer(s) depend on specific counties and situations. In cases where businesses depend mainly on local markets, further population declines will erode these markets, making the future for these businesses somewhat bleak. Closures will most likely increase, especially in a down economy. The main option available is for local development practitioners to try to attract or cause additional business start-ups in higher-paying jobs. Businesses that export to other markets will be especially attractive in these areas; however, replacing manufacturing in small, remote counties is often difficult. Development practitioners need to review the industries in the region to try to identify linkages with prosperous businesses as a way to identify potential businesses to start and/or expand operations.

Another important strategy is to work with manufacturing businesses to determine what can be done locally to make them more competitive. One common approach is a Business Retention and Expansion (BR and E) program in which business owners and/or operators are interviewed by local development representatives to uncover conditions that limit the ability of the company to prosper or, in some instances, to even remain viable.

The BR and E interviews can accomplish several useful outcomes. First, they can identify solvable issues that are relatively small now but could become serious in the future. Second, the discussions can bring to light pending business decisions and/or trends that local governments or development agencies can respond to in order to prevent an adverse outcome. All too often, local development groups are informed about business closures when the decision is all but finalized. In these instances, incentives and offers of assistance by the city or local development group may not be effective and may even lead to animosity between the business and local groups.

A third approach is for local development practitioners to work directly with existing businesses by providing technical assistance, market information, research on emerging trends, and other related factors. An Economic Gardening approach has been used successfully in Littleton, Colorado, for many years (Gibbons 2007). This is where a city agency responsible for economic development provides research regularly on business issues, including assistance in identifying future movements in markets, new technological advances, and other topics of interest to local businesses. The focus is to grow local businesses rather than attempting to attract outside investment. Other communities are now pursuing this approach.

A fourth alternative that is not just for manufacturing but for businesses in general is to promote local entrepreneurship within the community. This approach minimizes the obstacles, such as permits and regulations, to starting a business. It also creates an investment pool available to potential entrepreneurs. Lyons, Lichtenstein, and Kutzhanova (2007) present a strong case for using a program of education and technical assistance that is tailored to the skills and experiences of local entrepreneurs. This system also trains members of the community to be entrepreneurship scouts and coaches in an effort to identify potential entrepreneurs and to then help them succeed. Clearly, entrepreneurship will be an important economic development approach in many communities in the future, especially those unable to attract branch plants.

The national recession will adversely affect rural areas, probably more so than the more diversified metro areas that may have more resources and opportunities to replace lost jobs. This situation makes it all the more important for rural policymakers to understand trends in small businesses and to find ways to stimulate local entrepreneurship. This report provides information that can help with these efforts.

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