

Do Rankings Provide a True Picture of Metro Area Business Climates?

In December 2015, the Kauffman Foundation released their annual Index of Main Street Entrepreneurship (IMSE) that looks at the number of established small businesses as well as the count of business owners in forty U.S. metropolitan statistical areas (MSA). The Pittsburgh MSA did quite well ranking in the top ten. This follows the Foundation's June 2015 release of their Index of Startup Activity that ranks these same MSAs on entrepreneurship as it relates to the starting of a new business. For the second year in a row, the Pittsburgh MSA finished last on the startup index. With two separate rankings, and two dramatically different results, what conclusions can be made about Pittsburgh's entrepreneurial, or more importantly its business, environment?

As we wrote in *Policy Brief, Volume 15, Number 28*, the Index of Startup Activity is comprised of three measures of entrepreneurial activity, the rate of new entrepreneurs, the opportunity share of new entrepreneurs, and the startup density. The purpose being to see how conducive an area may be to new entrepreneurs in their quest to start a business. The Index's final result, after ranking the Pittsburgh metro area next to last in each of the three Index components, places Pittsburgh fortieth of the forty MSAs.

The IMSE examines the same MSAs, but this time looks at the number of business owners and the count of established firms (companies with fewer than 50 employees and more than five years old). Specifically, the two measures used are the rate of business owners and the density of established small businesses. Surprisingly, after the area's poor finish in the Index of Startup Activity ranking, the Pittsburgh MSA ranked eighth of forty in the IMSE.

The first component in the IMSE is the rate of business owners (per 100,000 adults) in an MSA. It is designed to capture the percentage of the adult population that owns a business. The Pittsburgh MSA's score of 5.09 percent means that 5,090 of every 100,000 adults in the area are business owners. According to the Foundation's narrative, "it captures all business owners, including those who own incorporated or unincorporated businesses, and those with or without employees."

Values for this component are calculated on a three year moving average with 2014 being the most recent year available (survey data from U.S. Census Bureau and Bureau of Labor Statistics). The highest score (8.69 percent) belonged to Miami while the lowest

score (3.81 percent) went to Cincinnati. Of the forty metro areas in the study, Pittsburgh's score ranked ninth *lowest* (31st of 40). For the country as a whole this rate is 6.02 percent, meaning that the Pittsburgh MSA is nearly a full point below the national average. For the seven years covered by the report the Pittsburgh MSA has been very consistent at about 5 percent.

Among the top ten ranked MSAs in the overall IMSE ranking, the Pittsburgh MSA rated lowest on the business ownership component.

The second IMSE component is the density of established small businesses. This component is the count of established small businesses per 100,000 people in the MSAs. It is derived from a yearly tally in the U.S. Census Bureau's Business Dynamics Statistics with 2012 being the most recent year available. By this measure, the Pittsburgh region does remarkably well. With a score of 1,165.8, it ranks as the fifth best of the forty MSAs studied, trailing New York (1,267.1), Boston (1,219.0), Providence (1,222.1), and San Francisco (1,169.8). According to the report, the density of established small businesses for the nation as a whole is 1,006.6.

It must be pointed out that there are serious questions about the methodology used to create the IMSE. First, the report on the IMSE notes that each measure was given equal weight in calculating the final combined ranking. Obviously, it must be asked: how can the Pittsburgh region finish fifth highest on small business density and thirty-first on the rate of business owners and still come up with a combined final ranking of eighth? Furthermore, there is a problem with the dates; they do not match up for the two IMSE components. The rate of business ownership is a three year moving average and goes through 2014 as its most recent data point while the small business density component has no data after 2012. How is it possible to get a combined IMSE for 2014? Rationale for the combined IMSE, if any, should explain this apparent anomaly.

To be sure, at first glance, the Pittsburgh MSA's top ten IMSE ranking sounds quite positive. However, is it really a reliable or useful indicator of the business environment? It is a question worth exploring.

A look at the growth in nonfarm jobs shows the Pittsburgh MSA did not fare well over the 2008 to 2012 time frame of the small business density component of the IMSE, growing a mere three quarters of a percent. But remarkably, of the MSAs ranked in the IMSE top ten, it was still the highest growth rate over the period. The only other top ten MSA with positive growth in nonfarm jobs is Boston (0.19 percent). For all the MSAs ranked in the top ten, the average employment growth for the period was a *negative* 1.73 percent.

Interestingly, a look at the MSAs in the overall bottom ten of the IMSE shows that four had very strong or solid job gains including; Houston (3.66 percent), San Antonio (3.48 percent), Dallas (1.31 percent) and Columbus, OH (1.13 percent). The average for the ten lowest ranked MSAs is negative 2.32 percent. While that number is fairly close to the average for those ranked in the IMSE top ten, consider that four of the bottom ranked

MSAs, Las Vegas (-9.56 percent), Sacramento (-6.16 percent), Phoenix (-5.89 percent), and Riverside, CA (-5.05 percent) all had very deep reductions in employment as their superheated housing markets collapsed and recovery took much longer than in the country as a whole.

In sum, for the forty MSAs studied, employment growth does not display any significant statistical correlation with the Kauffman Foundation's Index of Main Street Entrepreneurship. And therefore it offers little indication of an area's business environment and small business vitality. If an MSA has a solid job market, the need to strike out on one's own may not be as great or necessary. Keep in mind also that the data for established small businesses came from 2012. While it may be the most recent available at the time the Kauffman Foundation put study together, it is quite dated and not particularly useful in informing policy making decisions in 2016.

The two Kauffman studies released in 2015 contained virtually opposite rankings for the Pittsburgh MSA on the same topic. The takeaway from all this is that such rankings should be viewed carefully and used with caution. In our analysis of the Index of Startup Activity released last summer, we noted it "is not to be taken as the end-all and be-all of the story of the region's economic performance, but it is another wake up call." Nonetheless, there is enough that is negative in four of the five components of the two Indexes to suggest that the business environment in the Pittsburgh region has a lot of room for improvement.

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