



FILLING THE SCALEUP GAP

How high-growth companies solve unemployment in Southeast Michigan

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FOR SOUTHEAST MICHIGAN



EXECUTIVE SUMMARY

SCALEUP COMPANIES drive economic growth around the world. Southeast Michigan is no different, with scaleup firms sitting at the core of the region's economic renaissance. To explore the relationship between employment and scaleup firms, Endeavor Insight, in partnership with the New Economy Initiative (NEI), initiated an in-depth study of the region's fastest growing entrepreneurs. We defined scaleup firms as companies with at least 10 employees and 20% or greater annual employment growth over the previous three years. In the process, we analyzed employment and company formation trends since 2007, revealing five key findings:

1 **SOUTHEAST MICHIGAN CREATED SOME OF THE 20TH CENTURY'S MOST ICONIC SCALEUPS.**

Southeast Michigan is home to some of the world's most iconic scaleup entrepreneurs. Henry Ford, John Francis Dodge, Walter Chrysler, and S.S. Kresge are just a few of the entrepreneurs who built world changing companies in Southeast Michigan. In the process, they helped usher in an era of scaleup companies that contributed to the growth of the American middle-class.

2 **SOUTHEAST MICHIGAN HAS NOT RECOVERED FROM THE 2008 FINANCIAL CRISIS.**

Despite playing a role in inventing scale-up entrepreneurship, Southeast Michigan's economy has declined in recent decades. The 2008 Financial Crisis caused a series of business failures, and sent regional unemployment up by nearly 10 percentage points at its peak. Now, six years after the crisis, the region's unemployment rate remains above its pre-crisis levels, and higher than that of peer cities like Pittsburgh and Cleveland.

3 SOUTHEAST MICHIGAN MUST OVERCOME A SCALEUP GAP.

Between 2007 and 2012, Southeast Michigan lost roughly 50% of its scaleup companies. In this same period, the region added 50,000 startups and other lower-growth firms. With a nearly 3% increase in the region's unemployment rate in that period, it is clear that not all types of firms have the same ability to create jobs and value for the local economy.

4 SCALEUP FIRMS DRIVE HIGH-QUALITY JOB GROWTH IN SOUTHEAST MICHIGAN.

Scaleup firms are larger, create more jobs, and are more durable than other types of company. In 2012, the average scaleup employed 69 people, compared to eight at lower-growth firms and just two at startups. Between 2007 and 2012, the average scaleup created nine jobs, while lower-growth firms and startup firms created two and one, respectively. Firms with at least one high-growth period between 1990 and 2012 were twice as durable as firms that never experienced high growth.

5 THERE IS A PROVEN CYCLE TO ACCELERATE SCALEUP COMPANIES.

Scaleup companies can return Southeast Michigan's unemployment rate to pre-crisis levels, and a proven cycle exists to accelerate their growth. Scaleup entrepreneurs need access to unique resources at each stage of their growth: the ambition to scale, the financial and human resources to grow, the commitment to stay in Southeast Michigan, and the desire to reinvest their success in the next generation. Each successful scaleup entrepreneur who reinvests in Southeast Michigan accelerates this cycle and closes the region's scaleup gap.



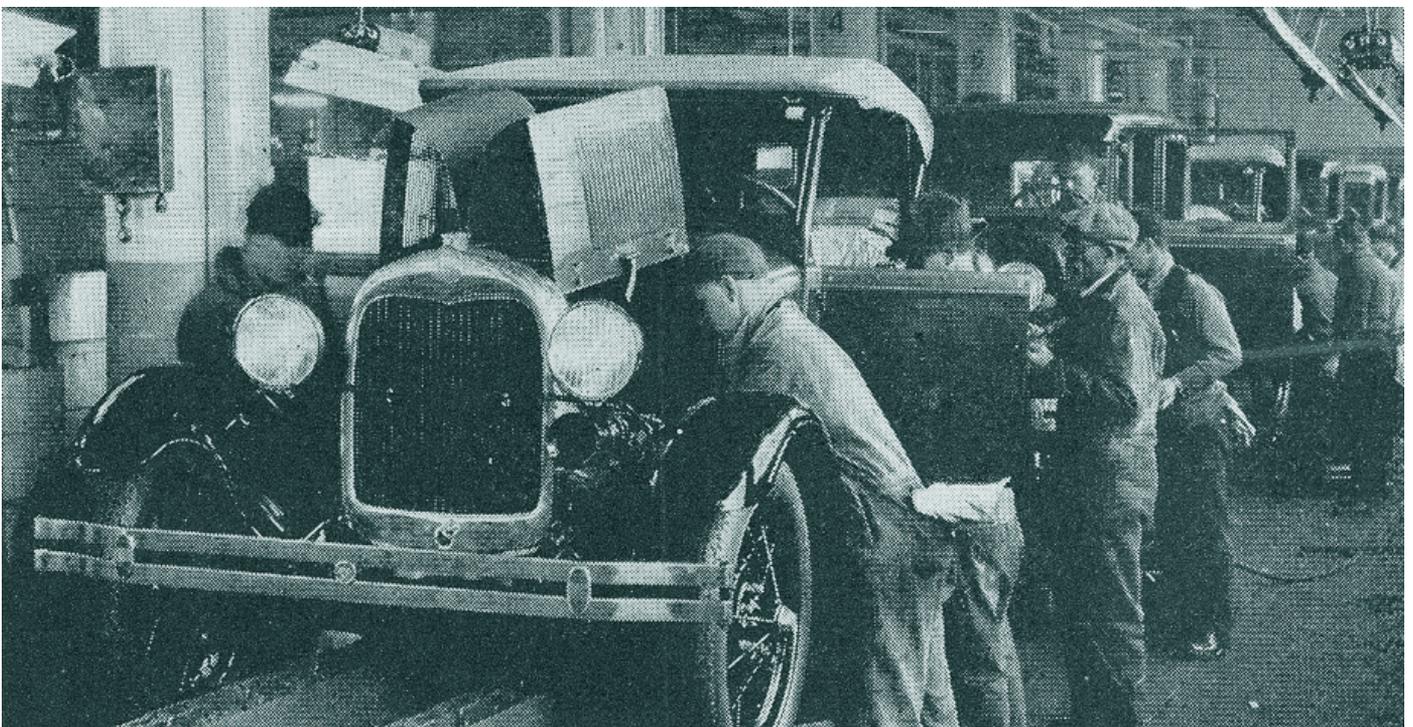
Southeast Michigan created some of the 20th century's most iconic scaleups.

HENRY FORD WAS one of the world's first scaleup entrepreneurs. In 1912, his company produced just 6,000 Model Ts. Six years later, Ford was producing 700,000 cars a year. To meet the demand for its cars, the company grew rapidly, and to keep up, Henry Ford doubled wages to \$5 per day for thousands of employees.¹ Ford's workers in turn became Ford's customers, joining the region's nascent middle class in the process. In just a decade, Ford created and then dominated an entirely new industry, scaling his business and changing the way people moved, worked, and lived in the process.

In just a few decades, Southeast Michigan became home to a newly minted automotive entrepreneurship ecosystem. A network of original equipment manufacturers (OEMs) arose to supply Ford, and entrepreneurs like John Francis Dodge and Walter Chrysler built

rival companies that piggybacked on the region's network of suppliers and accumulated talent. Between 1920 and 1950, these entrepreneurs' ambitions transformed the city, expanding its population fivefold from 286,000 to 1.5 million, and turning Southeast Michigan into a major center of U.S. economic power.²

This culture of scaleup entrepreneurship was responsible for the region's ascendance. As it diminished through the second half of the 20th century, so too did Southeast Michigan's economy. Punctuated by the 2008 financial crisis, the decline of scaleup businesses in the region now poses a serious threat to Southeast Michigan's recovery and rebirth. The next engine of growth in the region may not be automobiles, but it is scaleup businesses, regardless of the industry, that will revitalize the region's economy and create a new generation of scaleup entrepreneurs.





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Southeast Michigan has not recovered from the 2008 Financial Crisis.

THE 2008 FINANCIAL CRISIS HIT SOUTHEAST MICHIGAN as hard as any metro area in the country. Unemployment peaked at over 15%, its largest companies went bankrupt, and Detroit itself teetered on the precipice of insolvency. Even as the broader U.S. economy has found a new footing, Southeast Michigan continues to suffer from higher unemployment than it did before the crisis. The Financial Crisis is over, but many of the region’s fundamental economic challenges remain unsolved.

► **UNEMPLOYMENT STILL ABOVE PRE-CRISIS LEVELS.** The most troubling symptom of Southeast Michigan’s economic decline is its persistently high unemployment rate. While the broader U.S. economy has returned to its pre-crisis unemployment levels,

Southeast Michigan’s has not. The region, defined as the Detroit-Warren-Livonia, MI Metropolitan Statistical Area (MSA), has unemployment levels that exceed pre-crisis levels by almost a percentage point and its 2004 average by more than two percent.³

The human impact of persistent unemployment cannot be overstated. The long-term unemployed are more likely to earn less once they do find a job, have poorer health, and raise children with worse academic performance than their employed peers.⁴ Southeast Michigan’s unemployment rate has a deep human impact that will continue to impact the productivity of both the region and its people well into the future.

Data from the Bureau of Labor Statistics demonstrates the persistence of this problem.

Southeast Michigan unemployment rate: December 2007–October 2014



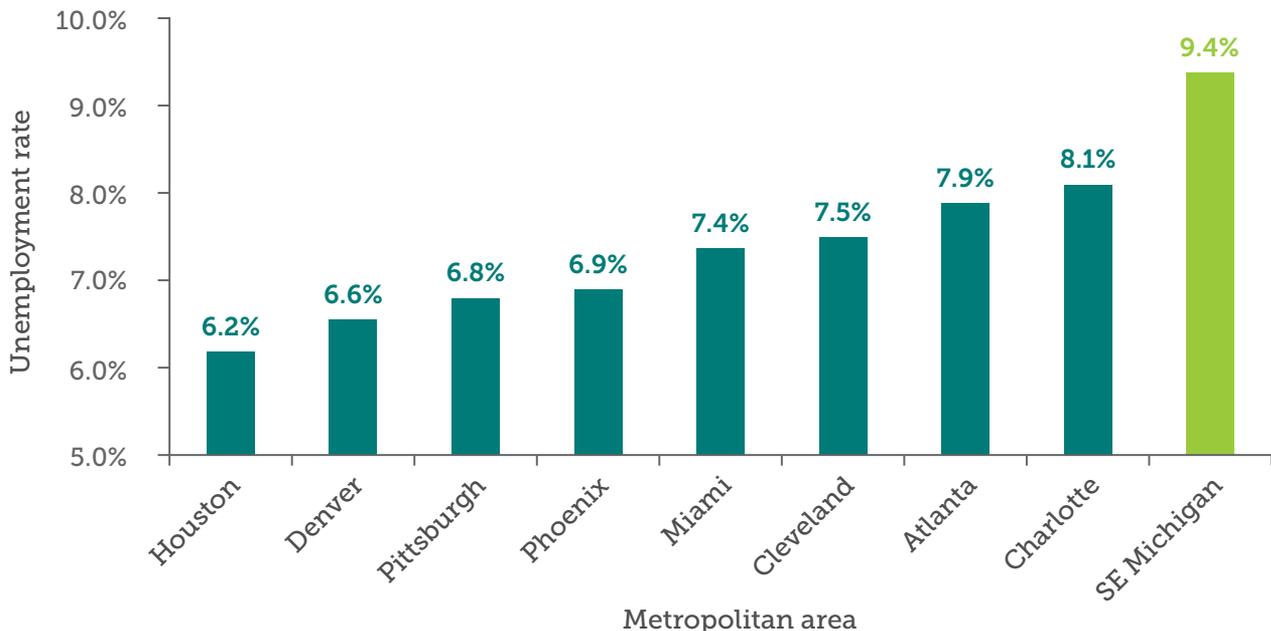
Note: Bureau of Labor Statistics (BLS) data for Detroit-Warren-Livonia Metropolitan Statistical Area (MSA). Unemployment rate reported monthly and seasonally adjusted except October 2014.

Between December 2007 and October 2014, Southeast Michigan’s labor force shrank from 2.14 million to 2.01 million, with more than 127,000 people either leaving Southeast Michigan or dropping out of the labor force.⁵ Despite the shrinking labor force, the number of unemployed people in the region increased by more than 3,000, from 163,000 to 166,000.⁶ Because of the shrinking labor force and increased unemployment, the region needs to create 14,000 new jobs to reduce unemployment to pre-crisis levels.

in 2013 for MSAs with a population between two and six million and similar median per capita income and poverty levels. Among these nine cities, Southeast Michigan has the highest unemployment rate by more than a full percentage point. On a list of the 49 largest metro areas in the U.S., Southeast Michigan ranks 46th by unemployment rate, ahead of only Providence, Las Vegas, and California’s Inland Empire.⁷ Peer cities across the US have begun their recovery from the recession, and Southeast Michigan must find for new engines of economic growth in order to join them.

► SOUTHEAST MICHIGAN LAGS PEER METRO AREAS. The severity and persistence of the region’s unemployment challenge is unique among its peer metropolitan areas. We compare the average unemployment rate

2013 unemployment rate for comparable metropolitan areas



Note: Bureau of Labor Statistics (BLS) data for Detroit-Warren-Livonia Metropolitan Statistical Area (MSA). Unemployment rate reported monthly and seasonally adjusted except October 2014.

Southeast Michigan must overcome a scaleup gap.

PEOPLE ARE LEAVING SOUTHEAST MICHIGAN because they can't find jobs, and those that stay confront one of the most challenging labor markets in the U.S. The total number of companies in Southeast Michigan has actually increased, but these companies are not creating new jobs, and many are in fact destroying them. Persistent unemployment is just a symptom of a much more important problem: the decline of scaleup firms in Southeast Michigan.

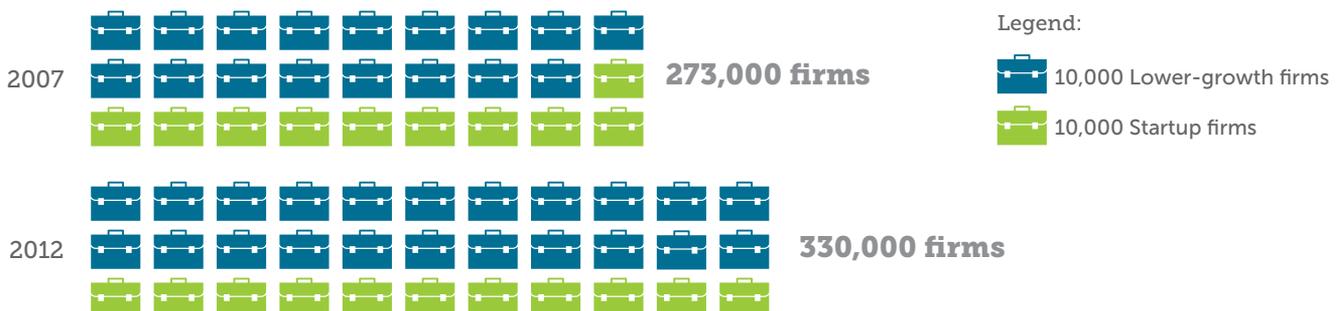
► MORE STARTUPS HAVE NOT LED TO MORE JOB GROWTH. We look at a dataset of over 600,000 Southeast Michigan companies in existence at some point between 2007 and 2012, and divide these companies into three categories: startups, scaleup firms, and lower-growth firms. In any given year, startups are those companies founded within the last three years and still operating, while scaleup firms are those that are not startups, have 10 or more employees, and had annual employment growth of at least 20% over the preceding three years.

By these definitions, there were nearly

7,000 more startups in 2012 than in 2007, an increase of almost 7%.⁸ In the same period, the number of lower-growth firms increased by more than 46,000, or 27%.⁹ Combined, Southeast Michigan has added over 50,000 new firms in just six years. Yet in the same period, the region saw its unemployment rate jump from 7.6% to 10.1%. Neither startups nor lower-growth firms are making a dent in Southeast Michigan's stubbornly high unemployment rate.

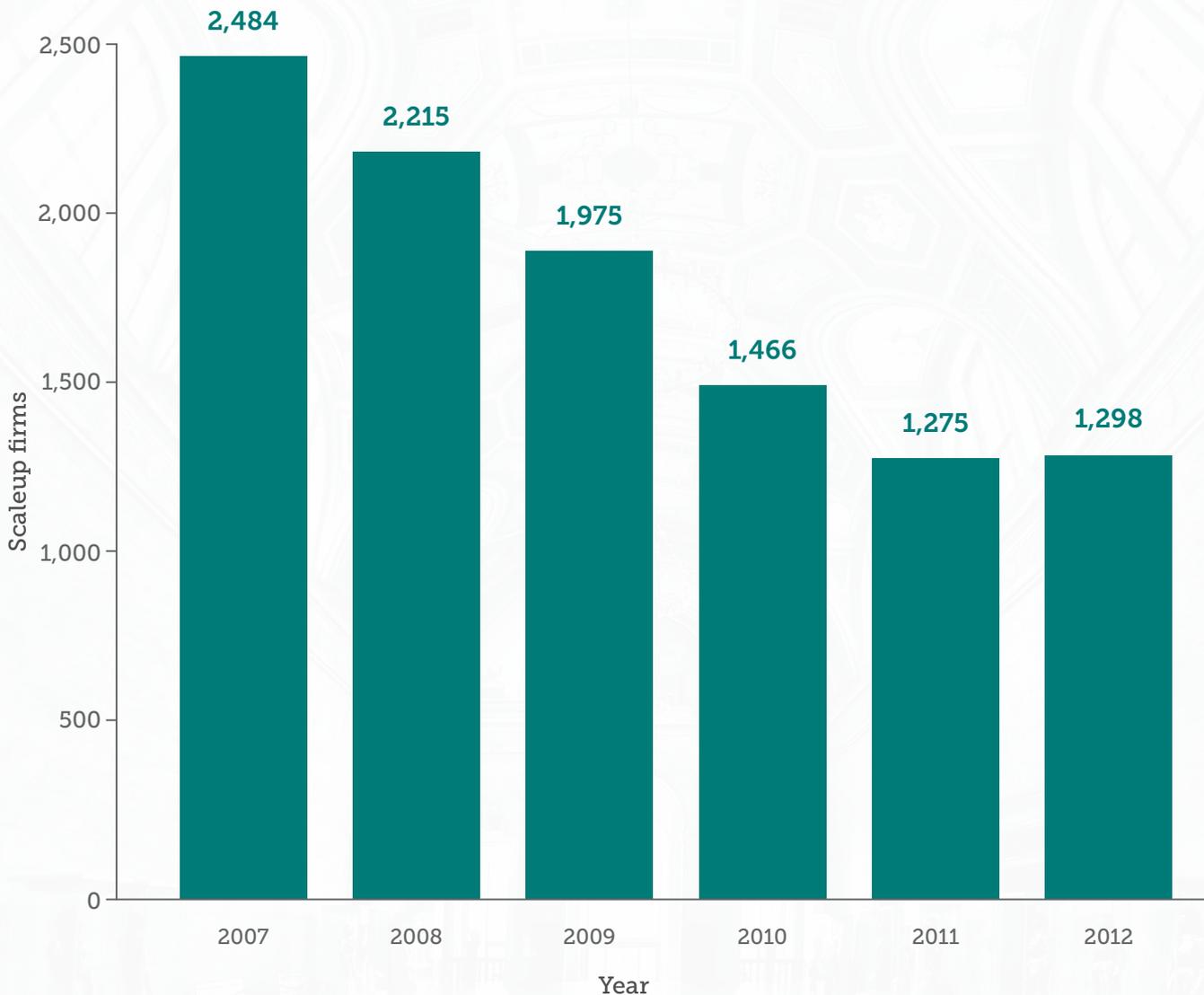
► SOUTHEAST MICHIGAN NEEDS SCALEUP FIRMS. The region suffers not from a lack of companies, but rather from a lack of scaleup firms. Their decline corresponds to the region's increased unemployment rate: between 2007 and 2012, the same period in which unemployment jumped more than 2%, the number of scaleup firms in the region declined 47%, from 2,484 in 2007 to just 1,286 in 2012.¹⁰ With more than a thousand fewer fast-growing firms, it is no surprise that Southeast Michigan has been unable to close its unemployment gap.

Total Southeast Michigan firms, 2007-2012



Note: Startup firms are three or fewer years old. Lower-growth firms are greater than three years old and did not have at least one three year period of employment growth greater than or equal to 20% between 2007 and 2012.

Total Southeast Michigan scaleup firms, 2007–2012



Note: Scaleup firms are greater than three years old, have more than 10 employees, and have at least one three year period of employment growth greater than or equal to 20% between 2007 and 2012.

Scaleup firms drive high-quality job growth in Southeast Michigan.

WHY IS THE DECLINE of scaleup firms in Southeast Michigan so problematic? It turns out that fast-growing firms not only generate lots of revenues, they also do most of the job creation. In the U.S., scaleup firms are responsible for most job creation, with the top 2-3% of fastest growing companies creating almost all new jobs.¹¹ These jobs, in turn, tend to be higher quality, with more opportunities for professional advancement, and last longer than jobs at slower growing companies. It is therefore unsurprising that Southeast Michigan's unemployment rate has increased as the number of regional scaleup companies has declined. These companies not only employ more people on average, but also create more jobs and last significantly longer than either startups or lower-growth companies in the region.

► **SCALEUP FIRMS ARE EMPLOYERS.**

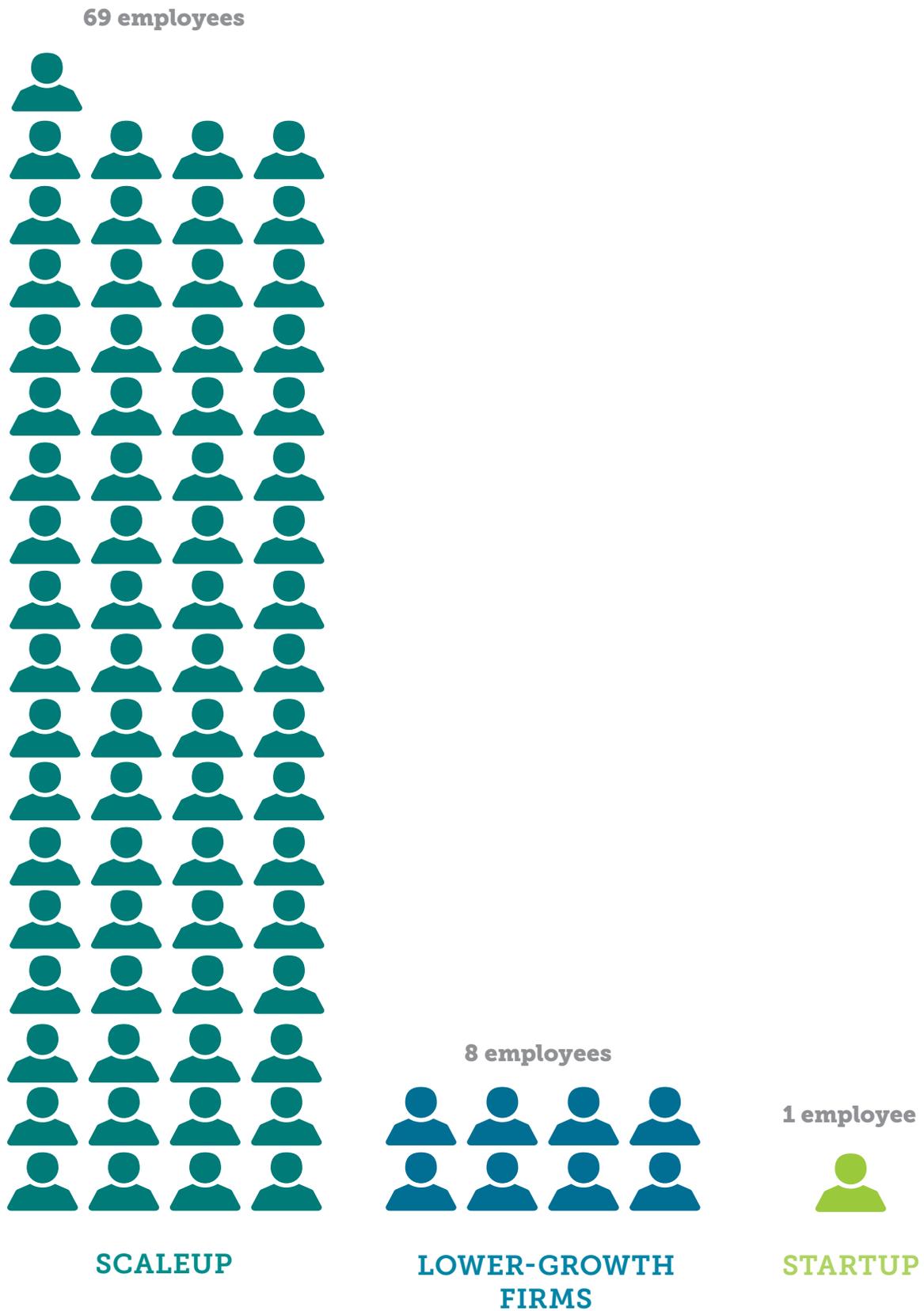
Southeast Michigan's scaleup firms employ large numbers of people. In 2012 alone, the average scaleup firm employed more than eight times as many people as the average lower-growth firm, and 35 times as many as the average startup.

► **SCALEUP FIRMS ARE JOB-CREATORS.**

Local scaleup firms don't just employ more people; they also create many more jobs than other types of companies. We looked at firms that created new jobs between 2007 and 2012, and among these job-creators, the average scaleup firm created nine jobs over the preceding six years, while the average lower-growth company created two. Startups barely registered, creating on average just one job per firm.¹²

► **SCALEUP FIRMS ARE DURABLE.** Scaleup firms last longer than other types of firms, and the jobs they produce are more stable as a result. We look at all firms in existence between 1990 and 2012 in Southeast Michigan, and find that firms that had at least one period of high-growth lasted on average 14 years, while those firms that did not have a high-growth period survived just seven years.¹³ A 2008 study from the U.S. Small Business Administration found similar results: only 3% of scaleup firms failed in the four years after they experienced high-growth.¹⁴ These firms last twice as long as lower-growth companies, and, throughout their lifecycle, employ more people, create more jobs, and are less likely to fail than their peers.

Avg. employees per Southeast Michigan company, 2012



There is a proven cycle to accelerate scaleup companies.

TO REDUCE UNEMPLOYMENT to 2007 levels, Southeast Michigan will need to create more than 14,000 new jobs. Entrepreneurship is an important vehicle for closing this gap, but only if the companies themselves are fast growing. Scaleup firms have a unique potential to create jobs, and finding ways to support them and the entrepreneurs who lead them can yield outsized benefits for Southeast Michigan.

► **THE ENTREPRENEURSHIP GROWTH CYCLE.** Scaleup firms are distinct from average companies, and at each stage of their growth, they have unique requirements. Entrepreneurs must have the ambition to scale their companies and access to the resources to make them grow. Once they have become successful, these entrepreneurs and their companies can accelerate the growth of other companies by staying engaged in the local entrepreneurship ecosystem and reinvesting their success in the next generation. This growth cycle is one that has been repeated all over the

world, from Silicon Valley's information technology sector to Nashville's healthcare companies.¹⁵ Southeast Michigan now has a unique opportunity to spur the growth of this cycle, supporting scaleup firms and creating thousands of jobs in the process.

► **SOUTHEAST MICHIGAN CAN SUPPORT SCALEUP FIRMS.** Policymakers can best support these firms by understanding the drivers and barriers to scaleup firms' growth. We interviewed over 50 regional scaleup entrepreneurs, and found that there are many opportunities to promote Southeast Michigan's strengths, as well as challenges preventing more entrepreneurs from following in their path. As part of a forthcoming assessment, we analyze these strengths and weaknesses, recommend pathways for improvement, and highlight six of these entrepreneurs in case studies, demonstrating the human face of high-growth entrepreneurship.

Scaleups employ:

8x

as many people as lower-growth firms

35x

as many people as startups

Scaleups create:

5x

as many jobs as lower-growth firms

9x

as many jobs as startups

Scaleups last:

2x

as long as other types of firms



METHODOLOGY

The region's economy extends well beyond Detroit, and for the purposes of this report, we define Southeast Michigan as the Detroit-Warren-Livonia Metropolitan Statistical Area (MSA). The regional MSA is defined as the six-county region of Lapeer, Livingston, Macomb, Oakland, St. Clair, and Wayne counties.¹⁶ This region had a total combined population of 3.7 million people as of the 2010 Census.

We draw data for this report from three principle sources. Firm-level data comes from the National Establishment Time-Series Database, a longitudinal database of job creation and destruction from over 900,000 establishments in the Detroit-Warren-Livonia MSA from 1990 to 2012. Unemployment statistics for Southeast Michigan and peer cities come from the Bureau of Labor Statistics (BLS). Data relating to the needs of Southeast Michigan's high-growth firms comes from interviews and surveys with over 100 high-growth entrepreneurs, investors, policymakers, and other entrepreneurship stakeholders conducted in Southeast Michigan between June and September 2014.

APPENDIX 1

Acknowledgements

This report was funded through the generous support of New Economy Initiative (NEI) and created in February 2015 by Michael Goodwin. He wishes to thank Devon Breton-Pakozdi, Ali El Azhary, Matt Lerner, and Stefan Schmidt for excellent research assistance, as well as Lauren Bigelow, Joanna Harries, Pam Lewis, and Rhett Morris who provided critical input and feedback during the research process. Special thanks to the entrepreneurs, investors, support organizations, and local universities who participated in roundtable discussions.

For more information regarding this report, please contact Michael Goodwin at michael.goodwin@endeavor.org.

APPENDIX 2

Participants

Representative from the following companies and organizations generously contributed their time to participate in focus groups:

Apjohn Ventures, Arboretum Ventures, Arctaris, AutoHarvest, Belle Capital, Benzinga, Bizdom, Blackstone LaunchPad, Center for Empowerment and Economic Development, Detroit Development Fund, Detroit Dirt, Detroit Labs, Detroit Regional Chamber, Detroit Venture Partners, Digerati, Diversified Restaurant Holdings, Eastern Market, FoodLab Detroit, Fontinalis Partners, The Front Door, GAPro System, GM Ventures, GrowDetroit, Inforum InGAGE, Invest Detroit, Just Baked, Lawrence Technical University, Michigan Economic Development Corporation, Mission Throttle, Movellus Circuits, North Coast Technology Investors, Renaissance Venture Capital Fund, Resonant Venture Partners, RTI Laboratories, Samuel Zell & Robert H. Lurie Institute for Entrepreneurial Studies, Shock Engine Works, Startgrid Detroit, TechTown Detroit, Vectorform, Venture for America, and Wayne State Tech Transfer.

ENDNOTES

1. "Henry Ford's \$5-a-Day Revolution." Ford Motor Company. Accessed 1 December 2014. <<http://corporate.ford.com/our-company/heritage/company-milestones-news-detail/677-5-dollar-a-day>>.
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3. 6.7% unemployment in January 2014. "Detroit-Warren-Livonia, MI Metropolitan Statistical Area." Bureau of Labor Statistics. 1 December 2014, accessed 1 December 2014. <<http://data.bls.gov/cgi-bin/surveymost?la+26>>.
4. Austin Nichols, Josh Mitchell, and Stephan Lindner. "Consequences of Long-Term Unemployment." Urban Institute. July 2013, accessed 1 December 2014. <<http://www.urban.org/uploadedpdf/412887-consequences-of-long-term-unemployment.pdf>>.
5. 2,139,782 people were in the Southeast Michigan labor force in December 2007, and 2,015,379 people in July 2014, a decline of 124,403 people. "Detroit-Warren-Livonia, MI Metropolitan Statistical Area." Bureau of Labor Statistics. 1 December 2014, accessed 1 December 2014. <<http://data.bls.gov/cgi-bin/surveymost?la+26>>.
6. 162,878 people were unemployed in Southeast Michigan in December 2007, and 166,382 people in October 2014, an increase of 3,504 people. "Detroit-Warren-Livonia, MI Metropolitan Statistical Area." Bureau of Labor Statistics. 1 December 2014, accessed 1 December 2014. <<http://data.bls.gov/cgi-bin/surveymost?la+26>>.
7. "Unemployment Rates for Large Metropolitan Areas." Bureau of Labor Statistics. 2013, accessed 1 December 2014. <<http://www.bls.gov/lau/malrgrank13.htm>>.
8. 6,926 more startups existed in 2012 than in 2007, an increase of 6.81%. Endeavor Insight analysis based on 2012 NETS Database data for the Detroit-Warren-Livonia Metropolitan Statistical Area.
9. 46,660 more non-high-growth firms existed in 2012 than in 2007, an increase of 26.93%. Endeavor Insight analysis based on 2012 NETS Database data for the Detroit-Warren-Livonia Metropolitan Statistical Area.
10. 1,198 fewer scaleup firms existed in 2012 than in 2007, a decrease of 48.23%. Endeavor Insight analysis based on 2012 NETS Database data for the Detroit-Warren-Livonia Metropolitan Statistical Area.
11. Zoltan J. Acs, William Parsons, and Spencer Tracy, *High-Impact Firms: Gazelles Revisited*, (Washington: Small Business Administration Office of Advocacy, 2008) 2.
12. High-growth firms created 9.29 jobs, non-high-growth firms created 1.93 jobs, and startups created 1.15 jobs. Endeavor Insight analysis based on 2012 NETS Database data for the Detroit-Warren-Livonia Metropolitan Statistical Area.
13. Firms with at least one high-growth period between 1990 and 2012 on average survived 14.10 years, while those without a high-growth period survived 6.66 years. Endeavor Insight analysis based on 2012 NETS Database data for the Detroit-Warren-Livonia Metropolitan Statistical Area.
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ABOUT US

ENDEAVOR is leading the global high-impact entrepreneurship movement to catalyze long-term economic growth. Over the past fifteen years, Endeavor has selected, mentored, and accelerated the best high-impact entrepreneurs around the world. To date, Endeavor has screened more than 30,000 entrepreneurs and selected 1,000+ individuals leading 600+ high-impact companies. These entrepreneurs represent over 400,000 jobs and over \$6.8 billion in revenues in 2013 and inspired future generations to innovate and become entrepreneurs too.

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ENDEAVOR INSIGHT, Endeavor's research arm, studies high-impact entrepreneurs and their contribution to job creation and economic growth. Its research educates policy makers and practitioners on how to accelerate entrepreneurs' success and support the development of strong entrepreneurship ecosystems. In 2013, Endeavor Insight joined with the Kauffman Foundation and the World Bank to co-found the Global Entrepreneurship Research Network (GERN).

endeavor INSIGHT

THE NEW ECONOMY INITIATIVE is a special project of the Community Foundation for Southeast Michigan. It is the largest economic development initiative of its kind, and is working to make thousands of ideas the next economic engine by building a network of support for entrepreneurs and small businesses. This unprecedented initiative is supported by the following national, regional and local foundations: the Community Foundation for Southeast Michigan (Detroit), the William Davidson Foundation (Southfield), the Max M. and Marjorie S. Fisher Foundation (Southfield, Michigan), the Ford Foundation (New York), the Hudson-Webber Foundation (Detroit), the W.K. Kellogg Foundation (Battle Creek, Michigan), the John S. and James L. Knight Foundation (Miami), The Kresge Foundation (Troy, Michigan), the McGregor Fund (Detroit), the Charles Stewart Mott Foundation (Flint, Michigan), the Skillman Foundation (Detroit), and the Surdna Foundation (New York). The Community Foundation for Southeast Michigan, which initiated the collaborative, is serving as its administrative home. For more information, please visit: www.neweconomyinitiative.org.



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