THE REGIONAL ECONOMY

OF UPSTATE NEW YORK

Winter 2001

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Upcoming Event
Inner-City Economic Development Conference
The Buffalo Branch and University at Buffalo will be hosting a conference titled "The Untapped Urban Market" in early Spring 2001. Details will be forthcoming.

Small Businesses in Upstate New York Rank Barriers to Growth

In 1997, small businesses with fewer than 100 workers accounted for almost 38 percent of all U.S. employment.[1] Indeed, evidence suggests that small firms now create more new jobs than their larger counterparts do.[2] In addition, small businesses appear to play two crucial roles in the American economy: incubators of new ideas that spark technological change and productivity growth, and providers of first-rung access to the mainstream economy for millions of minority, women, and immigrant entrepreneurs.

The ability of small firms to generate jobs takes on added significance in upstate New York, where large employers such as General Electric, Kodak, and IBM have made deep cuts in their workforces. Recognizing the growing importance of small firms to the U.S. economy and, specifically, to the upstate New York economy, the Buffalo Branch of the Federal Reserve Bank of New York and the Center for Governmental Research (CGR) recently surveyed small businesses in western and central New York State. The object of the survey was to identify what small business owners perceive to be the chief barriers to the growth of their companies.[3]

This issue of the Regional Economy provides an overview of the survey and its findings. The barriers to growth cited in upstate New York are similar to those cited nationwide: nonwage worker costs, state and federal taxes, and energy costs. Small business owners also see several advantages to their upstate New York locations, such as low property costs and a good quality of life.

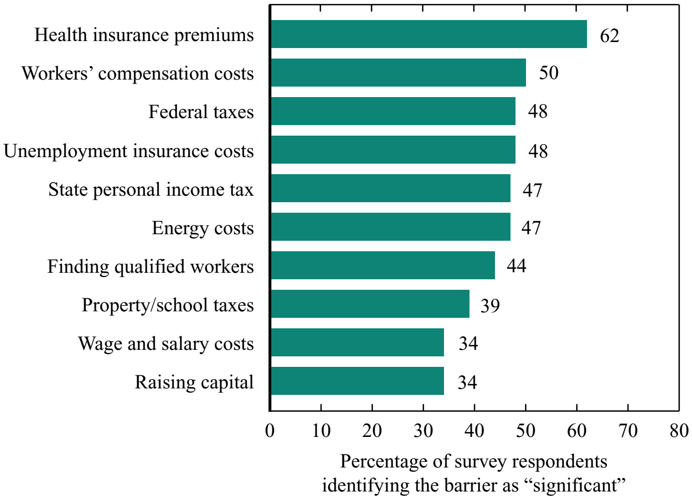
Barriers to Growth

Respondents evaluated twenty-four potential barriers to the growth of their companies on a seven-point scale, with one point indicating "not a barrier" and seven points indicating a "significant barrier." For the purpose of analysis, we interpret a barrier to growth to be "significant" if it is given a six- or seven-point ranking. Chart 1 shows the ten most significant barriers to growth, according to the 2000 Buffalo Branch-CGR survey. The table shows the rankings from two other surveys of small firms. One survey, "2000 Problems and Priorities Survey," was conducted nationwide in July 2000 by the National Federation of Independent Businesses (NFIB). The other survey, "Barriers to Small Business Growth in New York State: A Barometer of Opinion," was conducted statewide in November 1998 by the CGR. While these two studies and the 2000 Buffalo Branch-CGR survey vary somewhat in methodology, together they allow us to compare and contrast the opinions of small business owners in different areas and time periods.[4]

As shown in Chart 1, the 2000 Buffalo Branch-CGR survey finds health insurance premiums to be the foremost concern among small business owners in upstate New York, with 62 percent of the respondents citing this as a significant barrier to growth. Health insurance premiums rank high in the 2000 NFIB and 1998 CGR surveys as well, suggesting that the rising cost of worker health insurance is placing a burden on small firms nationwide. Respondents to all three surveys also express similar concern about federal and state income taxes.

Responses regarding two other nonwage labor costs—workers' compensation and unemployment insurance—differ across the surveys. Both are significant barriers according to about half of the respondents in the 2000 Buffalo Branch-CGR survey. Yet unemployment insurance is not cited as a potential barrier in the 1998 CGR survey and, in fact, is seldom mentioned in the business world as a critical obstacle to growth. Moreover, New York State's workers' compensation premiums rank only twelfth in the 1998 CGR survey. The 2000 NFIB survey

Chart 1
Chief Reported Barriers to Small Business Growth in Western and Central New York State



shows that these nonwage labor costs are a concern nationwide, but to a lesser extent than they are reported to be in upstate New York.

Another employee-related issue—finding qualified workers—is a significant barrier according to 44 percent of the respondents in the 2000 Buffalo Branch-CGR survey. This barrier ranks seventh—just as it did in the 1998 CGR survey. Tight labor markets have been a compelling problem nationwide and this is reflected in the results of the 2000 NFIB study. Finding qualified employees is the third most critical problem for the businesses responding to that national survey.

Local property taxes and energy costs are also viewed as important barriers by New York State small businesses. Local property taxes are a significant barrier according to 39 percent of small upstate firms, although the eighth-place ranking in the 2000 Buffalo Branch-CGR survey is considerably lower than property taxes' top spot in the 1998 CGR survey. Energy costs are cited as significant by 47 percent of respondents and tie for fifth place (with state personal income tax) in the 2000 Buffalo Branch-CGR report, a ranking similar to energy costs' fourth-place position in the 1998 CGR study. Comparisons with the NFIB survey are difficult in the energy and property tax categories because of the way these potential barriers are defined. Energy costs are divided into two components in the NFIB survey: electricity costs, which rank as the nineteenth most critical obstacle, and the cost of natural gas, gasoline, and fuel oil, which ranks tenth. Property taxes are bundled with rent and other property costs as a single barrier.

The potential barriers that respondents do not consider paramount are also notable. Two important categories of regulations—environmental and health—rank relatively low in the 2000 Buffalo Branch-CGR survey. Just 18 percent of the respondents cite environmental regulations as a significant barrier, while 11 percent cite health regulations. These small percentages might in part reflect the fact that such regulations affect only certain types of businesses. For example, environmental regulations are very important to a dry cleaner or gas station, but of little consequence to a software firm.

Barriers to Small Business Growth: Rankings from National and Statewide Surveys

Rank	National Federation of Independent Businesses, 2000 Nationwide	Center for Governmental Research, 1998 New York State
1	Cost of health insurance	Local property taxes
2	Federal taxes on business income	Health care costs
3	Locating qualified employees	State personal income tax
4	Unreasonable government regulations	Energy costs
5	FICA (Social Security) taxes	Wage and salary costs
6	State taxes on business income	Federal taxes
7	Workers' compensation costs	Finding qualified workers
8	Federal paperwork	Declining State population
9	Cash flow	State sales tax
10	Cost of natural gas, gasoline, fuel oil	Liability laws

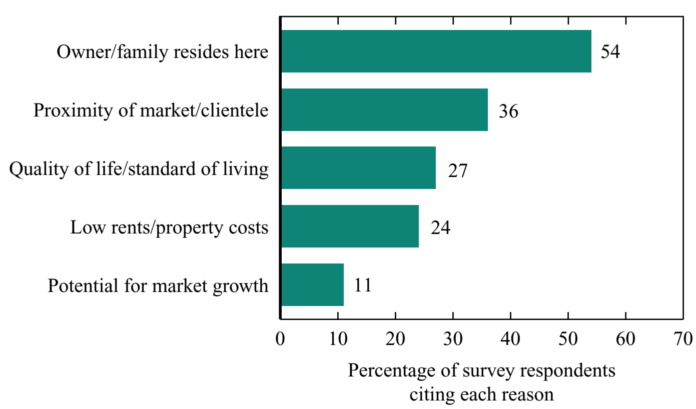
Sources: National Federation of Independent Businesses, Education Foundation, 2000 Problems & Priorities Survey, July 2000. Center for Governmental Research Inc., Barriers to Small Business Growth in New York State: A Barometer of Opinions, November 1998.

Note: The 2000 NFIB study sampled 25 percent of the organization's national membership. Ninety-seven percent of surveyed firms had fewer than 100 employees. The 1998 CGR study surveyed a representative sample of New York State firms with fewer than 100 employees.

What Do Small Businesses Like About Upstate New York?

Despite concerns about costs and other barriers, most small businesses continue to operate and thrive in upstate New York. The Buffalo Branch-CGR survey finds that over the past three years, only 22 percent of the respondents have considered relocating outside of New York State, while 35 percent have expanded their operations. When asked why they were at their current location, 54 percent reported that it is where they and their families reside, while 36 percent cite proximity to their

Chart 2
Reasons Cited for Current Business Location



customers (Chart 2). These results are closely tied to the nature of the very small businesses that dominate the survey. Many of these businesses (e.g. restaurants, automobile repair shops, and laundries) are homegrown family operations that provide services to their local markets.

A number of the surveyed businesses, however, export goods and services outside their local areas. For these firms to be successful and grow, they must rely on indigenous advantages that allow them to compete favorably with firms in other regions. Two such assets rank high among small business owners. First, 27 percent of the respondents pointed to the quality of life as a primary reason for locating their businesses in the region. An area's quality of life is seen as an important factor in attracting qualified workers. Although the stagnant population growth of the twenty-county upstate region seems at odds with the favorable perceptions of the surveyed small business owners, it is consistent with anecdotal reports of people who have moved away to find employment but desire to return to upstate New York. Second, 24 percent of owners like the low rents and property costs of their current settings. For the small firms participating in the survey, low property costs are clearly one advantage of operating in upstate New York.

Conclusion

Small business is an important component of the upstate economy. If the region is to continue to produce new jobs, small firms will play a vital role. Consequently, it is critical to understand and confront the factors that are perceived as impeding the start-up and sustainability of such firms. At the same time, we should recognize and capitalize on the assets that allow small businesses to succeed.

Results from the Buffalo Branch-CGR survey suggest that small businesses in western and central New York State face challenges similar to those confronting small businesses nationwide. According to survey respondents, the most significant barrier to the growth of their companies is the cost of employee health insurance. Other nonwage worker costs, such as workers' compensation and unemployment insurance, as well as energy costs and state and federal taxes, are also reported to be obstacles. However, environmental and health regulations rank low among the concerns of surveyed small business owners. Small firms also cite the advantages of their upstate New York locations, including low property costs and a good quality of life.

Access to Capital and Credit

One area of concern to the Federal Reserve is access to credit and capital. Thirty-four percent of small business owners identify difficulty in raising capital as a significant barrier to the growth of their firms. When asked about the difficulty of obtaining credit from different sources and for different purposes, thirty-seven percent of firms report difficulty in obtaining financing for technology-related investment, while 43 percent have had difficulty with export financing (chart 3). Also noted are the 52 percent who report difficulty in accessing venture and "angel" capital (venture capital from an individual investor).

In most instances, minority, women and non-minority owners report similar levels of concern about individual barriers to growth. Opinions diverge, however, in the case of access to traditional financing. As chart 4 indicates, 34 percent of non-minority-owned firms note difficulty in this area, while 44 percent of woman-owned and 48 percent of minority-owned businesses report difficulty in obtaining credit from traditional sources. These findings are consistent with some past studies conducted by the Federal Reserve System.[5]

Chart 3
Percentage of Respondents Reporting Difficulty in Accessing Various Types of Financing

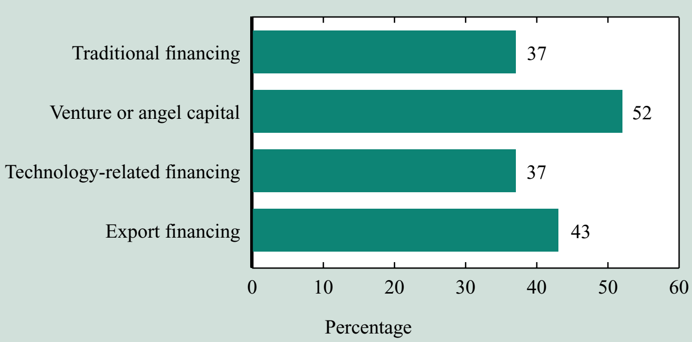
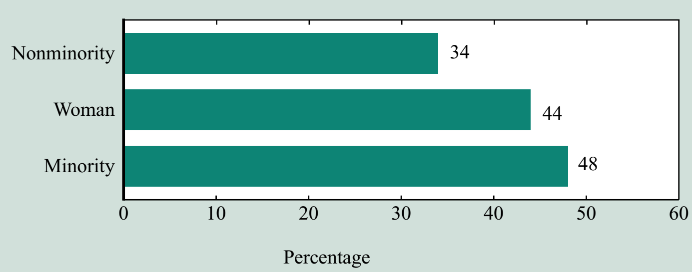


Chart 4
Percentage of Respondents in Each Ownership Group Reporting Difficulty in Obtaining Traditional Financing



Notes:

[1] U.S. Bureau of the Census, 1997 Economic Census, Table 2a.

[2] Zoltan J. Acs, Catherine Armington, and Alicia Robb, Measures of Job Flow Dynamics in the U.S. Economy, Small Business Administration, January 1999. According to this report, in 1994-95, small firms with fewer than 500 employees generated 72.7 percent of the 3.59 million new jobs, with the largest growth occurring at microbusinesses with one to four employees.

[3] In October 2000, a twenty-question survey was sent to 4,095 privately owned, for-profit businesses with fewer than 100 employees in a twenty-county region of upstate New York. The sample encompassed the western, central, and Finger Lakes regions of New York State. This universe included the four metropolitan areas of Buffalo-Niagara Falls, Jamestown, Rochester, and Syracuse, and comprised the following counties: Allegany, Cattaraugus, Cayuga, Chautauqua, Cortland, Erie, Genesee, Livingston, Madison, Monroe, Niagara, Onondaga, Ontario, Orleans, Oswego, Seneca, Steuben, Wayne, Wyoming, and Yates. A total of 288 questionnaires were returned as "bad addresses," resulting in a final sample size of 3,797. Of these, 822 businesses completed and returned questionnaires—a response rate of 21.6 percent. Such a response rate is considered respectable for a mail survey of this nature. The sample, drawn from Dun & Bradstreet's database of businesses, was stratified by employment size, industry type, and ownership type (woman, minority, or nonminority) to obtain a sufficient cross section of firms and to ensure the adequate representation of specific groups. Reported data have been weighted to reflect each group's proportional representation in the general population and to correct for differences in the three groups' response rates.

[4] The 2000 NFIB study sampled 25 percent of the organization's national membership. Ninety-seven percent of the surveyed firms had fewer than 100 employees. The 1998 CGR study surveyed a representative sample of New York State firms with fewer than 100 employees.

[5] For example, three research papers presented at a March 1999 Federal Reserve System conference on business access to capital and credit found that African-American-owned small businesses were less likely than white-owned businesses to receive loans, holding constant a number of other factors likely to account for differences in creditworthiness. However, the researchers differed widely in the extent to which they were prepared to draw conclusions from their findings. All three studies used data from the 1993 National Survey of Small Business Finances.

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