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Establishing and Maintaining a Business-Friendly Environment: A Literature Review

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For too long and for too many policymakers, being "pro-business" has come to represent favoring big business. When government acts to help American businesses, support is heavily skewed toward established businesses – not scrappy and striving new business owners and entrepreneurs. This is despite of the fact that new businesses created by entrepreneurs are the primary source of almost all net new jobs.

Ewing Marion Kauffman Foundation
America's New Business Plan Expands What It Means to be 'Pro-Business'

Establishing and Maintaining a Business-Friendly Environment: A Literature Review

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Introduction and Report Summary

As part of the FY22 Office of Legislative Oversight (OLO) work program, the County Council assigned OLO with the task of preparing a report that examines government practices intended to assist the creation or relocation of businesses or franchises. The Council requested information on economic development strategies that have been determined to establish and maintain a "business-friendly" environment that supports entrepreneurs and existing companies that do business in Montgomery County.

To complete this assignment, OLO conducted a review of literature on a series of economic development policies and strategies that purport to foster an environment that promotes the successful creation and growth of businesses, particularly new businesses. More specifically, OLO reviewed literature related to the following ten economic development policies and strategies:

1. Business Tax Rates
2. Business Tax Incentives
3. Cost and Ease of Regulatory Compliance
4. Business Grants and Loans
5. Access to Capital
6. Business Incubators
7. Mentoring, Technical Assistance, and Accelerators
8. Business Clusters and Innovation Districts
9. Workforce Development
10. Quality of Life

In the literature review, OLO focused primarily on academic and institutional sources, particularly those that involved critical evaluation of the outcomes of each policy or strategy. While a vast amount of literature exists for many of the above topics, OLO curated the body of literature to identify text that most concisely present the researcher's/author's findings and conclusions. This report includes verbatim excerpts from the literature that, in the view of OLO, are most relevant to economic development considerations in Montgomery County.

OLO notes that the Covid pandemic has disrupted and reshaped many business practices. For some of the topics included in this report, a body of literature exists that reflect the economic and social changes spawned by the pandemic. For other topics, much of the literature reflects pre-pandemic conditions. Where appropriate, this report notes which policies and strategies may be affected by pandemic-induced economic and social changes.

At the conclusion of the section describing each of the ten policies and strategies listed above, this report presents a "takeaway" paragraph summarizing OLO's essential findings from the literature. The following pages list OLO takeaways for each of the ten topics discussed in this report.

Summary of OLO "Takeaways": Establishing and Maintaining a Business-Friendly Environment

Policy/Strategy	OLO Takeaway
Business Tax Rates	Low corporate tax rates reduce business operating costs and, as such, must be considered a "business friendly" policy. In addition, states with lower corporate tax rates may be at a competitive advantage in attracting and retaining large businesses compared to states with higher tax rates. Nonetheless, business-friendly tax rates do not necessarily improve the overall local economic conditions. Much of the literature indicates that scant evidence exists to justify corporate tax cuts as a means to promote economic growth and job creation.
Business Tax Incentives	Tax incentives are a "friendly" policy to those businesses that receive them; businesses that do not receive similar incentives may face a competitive disadvantage and may pay higher taxes to offset public revenues lost to tax incentives. For the overall economy, tax incentives may not generate increased spending, but, if crafted properly, may be a useful tool to support local business activity and direct jobs to disadvantaged community members. Tax incentives should be routinely re-evaluated to measure the degree to which they achieve the intended outcomes.
Cost and Ease of Regulatory Compliance	Government regulatory, permitting, and licensing policies necessarily involve a trade-off between achieving public goods and fostering unfettered business autonomy. State and local policymakers weigh the relative value of the safety, health, environmental, or other benefits of regulations against their potential effect on business growth, investment, and job creation and then select the level of regulation that best balances local priorities. At any level of regulation, governments can achieve a more friendly business climate by continually reviewing implementation practices to achieve efficiencies and reduce the cost of compliance.
Business Grants and Loans	Grants and loans can provide invaluable assistance to emerging small businesses that face high initial start-up costs but lack access to investors and capital. The existence of robust state and local government grant and loan programs signal that a community encourages emergent small business growth, particularly when public resources are strategically directed toward industry sectors that serve local economic interests.

Policy/Strategy	OLO Takeaway
Access to Capital	Insufficient access to capital often is a significant barrier to business creation and expansion, especially for small businesses with large start-up costs. Access to credit is a particular challenge for entrepreneurs of color who have experienced discrimination in lending, resulting in wealth gaps and a scarcity of willing investors. By its very nature, credit assistance involves a level of risk. Nonetheless, strategies exist for state and local governments to provide a step-up to emerging small businesses while minimizing risk. In particular, the public sector can foster an environment that cultivates small business entrepreneurship by offering credit assistance programs that are: targeted toward the needs of local, disadvantaged entrepreneurs; integrated with other types of business support; and diversified over a relatively broad range of ventures.
Business Incubators	Business incubators reduce the risk to entrepreneurs seeking to cultivate the development of an incipient product or service. Incubator sponsors shoulder the cost of providing physical space, equipment, training, and guidance, and so, assume the risk should the entrepreneur's product or service ultimately fail. Incubator space and equipment help sustain prospective businesses during their start-up phase but may also artificially prolong ventures that are unlikely to succeed absent external support. According to several analyses, the most essential business incubator service is the conveyance of relevant training, mentorship, and networking necessary to assess the ultimate marketability of the entrepreneur's product or service.
Mentoring, Technical Assistance, and Accelerators	Mentorship and technical assistance from experienced experts offer new entrepreneurs with critical knowledge and contacts to overcome the early-stage hurdles of business development. Further, the education, mentorship, and introduction to financing resources provided through business accelerators can expedite the successful commercialization of a business venture. Most significantly, mentors familiar with industry-specific market conditions and trends may evaluate the underlying soundness of a business plan and its likelihood of attracting investors. Mentorship and technical assistance may be of particular value to disadvantaged, minority entrepreneurs who lack access to financing, training, and other business resources.

Policy/Strategy	OLO Takeaway
Business Clusters and Innovation Districts	Clustering of businesses, particularly those technology-based ventures, near anchor institutions (such as universities and research and development agencies) may establish an ecosystem of economic activity and growth that serves both entrepreneurs and the host community. An "innovation district" is a business clustering approach that promotes co-location of technology-based businesses near anchor institutions within a mixed-use land use environment. Local governments can best support business innovation districts policies that promote collaborative in-person interactions among employees of similar industries within an accessible area of concentrated office, retail, recreation, and housing opportunities.
Workforce Development	As worker training efforts serve to create a supply of qualified employees for skilled jobs, the presence of robust workforce development programs contributes to a business-friendly environment. Given the ever-changing nature of the modern job market, routine re-evaluation of workforce development training curriculum is vital to assure alignment with the evolving skill sets in demand by both existing and emerging businesses. In addition, workforce development programs that address the needs of both workers and their families present an opportunity to serve the business community while simultaneously alleviating social concerns such as poverty and racially-based wealth gaps.
Quality of Life	Businesses that require in-demand, high-skilled workers may prefer to locate in areas with attributes that appeal to current and potential future employees. Quality of life attributes include good schools, efficient mobility options, low crime rates, cultural and recreational amenities, and a diverse and tolerant community. Quality of life may not be the dominant business site selection criteria but may be a vital consideration for technology-based industries with a highly educated and highly paid workforce seeking a location for a headquarters or other major facility.

After reviewing academic and organizational literature on different strategies to create a "business-friendly" environment, OLO presents six principles to guide economic development practices in Maryland and the County. These principles are discussed in greater detail in Section 11 of this report.

1. *Distinguish between helping businesses and cultivating economic growth*. Some government policies may be beneficial to businesses' profit margins but do not necessarily promote overall local economic growth.

2. *Implement economic development programs based on evaluation and evidence.* Some economic development initiatives may seem sound intuitively but lack evidence to confirm these programs indeed promote economic growth. Government efforts should be directed toward programs shown to help businesses develop and maintain marketable goods and services and achieve sustained economic growth and job creation.

3. *Customize and update government programs consistent with current local business needs.* Government economic development efforts best support business when programs adjust to the needs of locally-based industries.

4. *Reduce barriers to economic activity and promote synergies among businesses.* State and County actions can support business creation and growth by simplifying interactions with government and among businesses.

5. *Let the market determine winners and losers*. State and local governments should assist business creation and growth without trying to predict which specific businesses and entrepreneurs will develop a commercially successful product or service.

6. *Expand entrepreneurial assistance to populations that have been excluded from economic opportunities because of discrimination.* Some demographic groups, particularly people of color, have encountered profound and long-standing discrimination that has severely constrained their ability to access economic opportunity and amass wealth. Government economic development policies and programs can help address some of these inequities.

Section 1: Business Tax Rates

In the United States, most businesses are subject to Federal income tax payments. Many states also impose taxes on businesses. In the State of Maryland, income, real property, and personal property taxes are the primary taxes levied on business activity. Some economists advocate for reduction of the business tax burden as a means of promoting economic growth and job creation. In recent years, several states have reduced their corporate tax rates in an attempt to spur economic activity. One proponent of lowering business tax rates is the tax policy think tank, the Tax Foundation.[1] According to the Tax Foundation:

> *[S]ubstantial revenue can be raised with low tax rates. Such tax systems reduce political distortions of economic decision-making and promote overall economic growth.*[2]

As an example, the Tax Foundation cites the difference between Virginia's and Maryland's corporate tax rates as a factor in the 2010 decision by Northrop Grumman to locate its headquarters in Virginia.[3]

However, several economic studies dispute the effectiveness of business tax cuts as a means of promoting economic growth. In regard to Federal corporate taxes, studies by both the Congressional Budget Office (CBO) and the Congressional Research Service (CRS) question whether general corporate tax cuts achieve their intended goal of stimulating economic activity. In a 2008 study, the CBO concluded that a general cut in the corporate tax rate "is not a particularly cost-effective method of stimulating business spending. Increasing the after-tax income of businesses typically does not create an incentive for them to spend more on labor or to produce more, because production depends on the ability to sell output."[4] Similarly, a CRS analysis found little evidence that reduction in the Federal corporate tax rates would stimulate economic growth:

> *The effectiveness of tax cuts also depends on their nature…. [T]ax cuts received by lower income individuals are more likely to be spent…. Most evidence does not suggest that business tax cuts would provide significant short-term stimulus…. This lack of effectiveness may occur because of planning lags or because stimulus is generally provided during economic slowdowns when excess capacity may already exist.*[5]

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[1] *Politico* characterizes the Tax Foundation as a "conservative-leaning" organization. See https://www.politico.com/story/2016/07/tax-foundation-house-gop-tax-plan-225088.

[2] Bishop-Henchman, Joseph, The Tax Foundation, *Income Tax Reform*, June 14, 2012, https://taxfoundation.org/trend-2-income-tax-reform.

[3] Bishop-Henchman, Joseph, The Tax Foundation, *Reality Crashing on Maryland Post-Northrop Rejection*, April 30, 2010, https://taxfoundation.org/reality-crashing-maryland-post-northrop-rejection.

[4] Congressional Budget Office, *Options for Responding to Short-Term Economic Weakness*, page 13, January 2008, https://www.cbo.gov/sites/default/files/110th-congress-2007-2008/reports/01-15-econ_stimulus.pdf.

[5] Gravelle, Jane G., Hungerford, Thomas L., Labont, Marc, Congressional Research Service, *Economic Stimulus: Issues and Policies*, page 12, November 10, 2009, https://www.everycrsreport.com/files/20091110_R40104_e7d6d7fd8675db3cccbe048857bf4b08bdc19c26.pdf.

At the state level, a similar debate has occurred over the effect of business tax cuts on overall economic activity. While several states have enacted business tax cuts during the past two decades, an analysis by the Center on Budget and Policy Priorities (CBPP) [6] questions the economic soundness of this approach. Among other conclusions, the CBPP analysis asserts that state business tax cuts:

- ***Produce no net short-term stimulus, due to state balanced-budget requirements.*** *Since nearly every state is required to balance its budget, states must offset the revenue loss from corporate tax cuts by removing an equal amount of spending from the state economy through cuts in state spending on services and/or tax increases. Thus, there would be no net stimulus in the short run.*

- ***Could lead to a near-term drop in total in-state economic activity because corporations are unlikely to spend the full amount of the tax cut in-state.*** *Instead of spending the full amount of any tax cut they receive in-state, corporations likely will distribute some of their tax savings to out-of-state owners in the form of higher dividends.*

- ***Create little or no added incentive for corporate investment in the long run.*** *Cutting state corporate income taxes might in theory encourage additional investment in a state by increasing the after-tax profitability of new investments. Numerous statistical studies suggest, however, that any such "supply-side" effect would be small and take several years to materialize. The consensus of these studies is that cutting total state and local taxes paid by businesses in a state by 10 percent — a very large reduction — is likely to boost economic output and jobs by only 2 percent to 3 percent.*

- ***Do not pay for themselves.*** *The small economic impacts of state corporate tax cuts and the large loss of revenue mean that such cuts do not stimulate enough new taxable economic activity — and thus enough new revenues — to fully offset the revenues lost from the tax cut. Indeed, two state economic models concluded that additional economic activity would recoup only 16 percent of the initial revenue loss. Thus, corporate tax cuts would require significant household tax increases or substantial cuts in state services to balance the state budget.*[7]

A 2012 large-scale survey of small business owners throughout the United States also found that tax rates are not a good indicator of "business friendliness." The survey received more than 2,400 responses to the open-ended question: "Please let us know any experiences or thoughts you have regarding the ease of doing business in your state." In reviewing the responses, survey analysts concluded:

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[6] *Politico* characterizes the CBPP as a "left-leaning" organization. See https://www.politico.com/news/2021/07/31/eviction-moratorium-rental-assistance-biden-501917.

[7] Mazerov, Michael, Center of Budget and Policy Priorities, *Cutting State Corporate Income Taxes Is Unlikely to Create Many Jobs*, September 14, 2010, https://www.cbpp.org/research/cutting-state-corporate-income-taxes-is-unlikely-to-create-many-jobs#:~:text=The%20consensus%20of%20these%20studies,2%20percent%20to%203%20percent.

> *Tax rates, while important, do not significantly affect overall business friendliness and should not be the single focus for both policy discussions and state competitiveness rankings.*[8]

The Takeaway: Low corporate tax rates reduce business operating costs and, as such, must be considered a "business friendly" policy. In addition, states with lower corporate tax rates may be at a competitive advantage in attracting and retaining large businesses compared to states with higher tax rates. Nonetheless, business-friendly tax rates do not necessarily improve the overall local economic conditions. Much of the literature indicates that scant evidence exists to justify corporate tax cuts as a means to promote economic growth and job creation.

[8] Maxwell, Kate and Motoyama, Yasuyuki, *Voices of Small Businesses: Discussion and Policy Implications*, Ewing Marion Kauffman Foundation, October 2012, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2166537.

Section 2: Business Tax Incentives

All states and many local governments offer businesses tax credits and other tax incentives to encourage a particular type of corporate behavior. Some tax incentives apply to a wide range of business sectors to support broad outcomes such as job creation. Other tax incentives are targeted to achieve particular outcomes such as investment in a particular industry type, investment in specific geographical areas, or hiring of workers from certain population groups. On occasion, state and local governments offer generous tax incentives to lure large employers, such as the up to $750 million (over 15 years) provided by the State of Virginia for Amazon to locate their second headquarters in Arlington.[9]

In recent years, state and local governments have expanded the use of business tax incentives as an economic development tool. Indeed, the total number of these incentives tripled from 1990 to 2015.[10] According to the Council for Community Economic Research, the State of Maryland offers 86 different business tax incentives, the largest number of state business tax incentives in the United States.[11] Montgomery County offers a series of business incentives including grants and loans for businesses that lease space or retain/create jobs as well as tax credits for businesses in the biotechnology and cybersecurity sectors.

In addition, many state and local governments provide tax incentives to businesses that undertake capital investments in designated geographic areas. The Maryland Enterprise Zone Tax Credit is an example of this type of incentive.[12] While capital investment tax credits remain a popular economic development tool, a report from the Congressional Research Service casts doubt on their effectiveness.

> *Investment incentives are attractive, if they work, because increasing investment does not trade off short term stimulus benefits for a reduction in capital formation, as do provisions stimulating consumption. Nevertheless, most evidence does not suggest these provisions work very well to induce short-term spending. This lack of effectiveness may occur because of planning lags or because stimulus is generally provided during economic slowdowns when excess capacity may already exist.* [13]

Tax incentives divert revenues that may have been used for the purpose of improving economic conditions for local businesses and residents. As such, tax incentives, at least in the short-term,

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[9] Norwood Candice, Amazon HQ2 Tax Incentive Package Approved by Virginia Senate, Governing, January 22, 2019, https://www.governing.com/archive/amazon-hq2-tax-incentives-package-approved-by-virginia-senate.html.

[10] Bartik, Timothy J. and Austin John C., *Most Business Incentives Don't Work. Here's How to Fix Them*, The Brookings Institution, November 4, 2019, https://www.brookings.edu/blog/the-avenue/2019/11/01/most-business-incentives-dont-work-heres-how-to-fix-them/.

[11] Council for Community and Economic Data, State Business Incentive Database, https://www.stateincentives.org/, accessed May 12, 2022.

[12] See OLO Report 2016-10, *The Experience and Effect of County-Administered Enterprise Zones, https://www.montgomerycountymd.gov/OLO/Resources/Files/2016%20Reports/OLO%202016-10%20Enterprise%20Zone%20Report.pdf,* for an analysis of the effectiveness of Enterprise Zones in Montgomery County.

[13] *Op. Cit*., Gravelle, Jane G., Hungerford, Thomas L., Labont, Marc.

involve a tradeoff among alternative uses of public resources. To understand the level of tradeoff, state and local governments must track the fiscal effect of the business tax incentives. In 2015, the Government Accounting Standard Board issued Statement #77 that requires state and local governments disclose information about the dollar amount of revenues foregone through tax abatements.

While endorsing low corporate tax rates as a means to promote economic growth, the Tax Foundation discourages state and local governments from adopting targeted tax incentives for some businesses to the exclusion of others.

> *Economic development and job creation tax credits complicate the tax system, narrow the tax base, drive up tax rates for companies that do not qualify, distort the free market, and often fail to achieve economic growth.*[14]

Economists from the Columbia Business School and Princeton University suggest that tax incentives to attract new businesses may produce job gains at the beneficiary firm but may not result in a "spillover" effect whereby the tax incentive grows the overall local economy.

> *While we find some evidence of direct employment gains from attracting a firm, we do not find strong evidence that firm-specific tax incentives increase broader economic growth at the state and local level. Although these incentives are often intended to attract and retain high-spillover firms, the evidence on spillovers and productivity effects of incentives appears mixed. As subsidy-giving has become more prevalent, subsidies are no longer as closely tied to firm investment.*[15]

Similarly, a recent article by Brookings Institution[16] economists question whether business tax incentives influence business site selection decisions. In addition, these economists question the degree to which business tax incentives benefit the existing local workforce.

> *Research suggests that at least 75% of the time, typical incentives do not affect a business's decision on where to locate and create jobs—they're all cost and no benefit. Furthermore, even when incentives do tip a location decision, they do not pay for themselves. They may create new jobs, but frequently they also bring in new workers from outside the city or state, which raises costs to public services that offset at least 90% of any increased revenue. On average, only 10-30% of new jobs go to state residents who are not already employed.* [17]

However, the Brookings Institution article concludes that business incentives may produce positive economic outcomes under certain conditions:

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[14] Drenkard, Scott and Borean, Richard, The Tax Foundation, State Business Incentives, October 21, 2013, https://taxfoundation.org/monday-map-state-business-incentives/.

[15] Slattery, Cailin and Zidar, Owen, *Evaluating State and Local Business Incentives*, Journal of Economic Perspectives, Volume 34, Number 2 (Spring 2020), https://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.34.2.90.

[16] *Politico* characterizes the Brookings Institution as "politically in the center.". See https://www.politico.com/news/2021/04/13/unions-brookings-urban-institute-organized-labor-481116.

[17] *Op. cit*., Bartik, Timothy J., Austin John C.

> *State residents can benefit from incentives to boost job creation—but not at any cost, or with poorly designed incentives. Effective incentives target economically distressed communities and truly high-multiplier firms. They include customized business services, which can do more per dollar to boost job creation. Lastly, they focus on creating jobs that go to the local unemployed—their largest potential social benefit.* [18]

According to the Brookings Institution analysis, business incentives successfully spur local economic growth and job creation when, among other things, the incentives:

- Target locally-owned businesses that buy from local suppliers, but primarily sell their goods and services outside the state or community;
- Target economically distressed local areas with available labor that is not employed;
- Include requirements to hire local residents;
- Are structured with upfront incentives (which are more likely to influence business location decisions because business decision-makers focus on the short term); and
- Do not decrease public spending on education, training, or infrastructure (which produce negative economic development effects that may exceed the benefits from the incentives).[19]

Guidance from both the Brookings Institution and the Pew Charitable Trusts calls for state and local governments to establish ongoing methods to measure the effectiveness of business tax incentives. As advised in the Pew article:

> [S]tates should establish plans to evaluate their incentives regularly and rigorously so policymakers have up-to-date, reliable information about how well they are working and how they can be improved.[20]

In 2021, the Maryland General Assembly approved a revision to State law[21] that, among other things, requires the Department of Legislative Services to evaluate business tax credits with an annual fiscal impact exceeding $5 million at least once every ten years.

Analysis of tax incentive data need not be solely a retrospective tool, but also a means to evaluate the efficacy of the incentives after the fact. Data analysis may also be performed prospectively to determine how best to apply tax incentives toward achieving priority goals, such as addressing long-standing racial inequities in acquiring wealth. As described in a Brookings Institution policy paper:

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[18] *Op. cit*., Bartik, Timothy J., Austin John C.
[19] *Ibid*.
[20] Pew Charitable Trusts, *How States Can Design Effective Tax Incentive Evaluation Plans*, April 30, 2020, https://www.pewtrusts.org/en/research-and-analysis/articles/2020/04/30/how-states-can-design-effective-tax-incentive-evaluation-plans.
[21] HB 1086, Maryland Tax Credit Evaluation Act-Alterations, enacted May 30, 2021.

> *As cities look to evolve incentive policies in ways that spur more equitable economic development, a common challenge is uncertainty about needs and trends. Without data establishing a baseline understanding of a city's unique equity landscape, thinking about which outcomes that incentives should focus on is difficult…. Drawing on public data from federal and local sources as well as administrative data from local agencies and organizations, cities across the country have developed custom equity indicators tailored to their specific priorities…. Using this granular data that reveals areas of great inequity, a city's economic development team can proactively tie incentive policies to urgent needs. When companies knock on the city's door asking for tax incentives, officials can respond using a data-driven strategic framework that puts money to work where it's most needed.*
>
> *Developing and implementing new data-driven tools and practices takes time and effort. But the implications are significant. Tax incentive policies and programs can be better designed around equity-based goals and inform fiscal choices. Businesses can be held accountable for specific targets that meaningfully change their investments. That, in turn, increases the likelihood that incentives spark economic development that would not otherwise have occurred—inclusive growth that enhances both cities' fiscal health and equity outcomes.* [22]

<u>The Takeaway</u>: Tax incentives are a "friendly" policy to those businesses that receive them; businesses that do not receive similar incentives may face a competitive disadvantage and may pay higher taxes to offset public revenues lost to tax incentives. For the overall economy, tax incentives may not generate increased spending, but, if crafted properly, may be a useful tool to support local business activity and direct jobs to disadvantaged community members. Tax incentives should be routinely re-evaluated to measure the degree to which they achieve the intended outcomes.

[22] Germán, Lourdes, and Parilla, Joseph, *How Tax Incentives Can Power More Equitable, Inclusive Growth*, The Brookings Institution, May 5, 2021, https://www.brookings.edu/blog/the-avenue/2021/05/05/how-tax-incentives-can-power-more-equitable-inclusive-growth/.

Section 3: Cost and Ease of Regulatory Compliance

Governments impose regulations on private businesses to achieve public goods such as fair competition, workplace safety, public health, and environmental protection. Governments attempt to balance the public benefits achieved by regulations against the desire to have businesses operated in a manner that maximizes economic growth. Supporters of minimal government involvement in private business practices contend that the current state of regulations is decidedly not "business friendly" as well as a drain on the economy. According to the U.S Chamber of Commerce Foundation:

> *While rules are needed to do business in modern economies, an excessive and complex regulatory system creates significant adverse effects on the economy. Unlike other business expenditures, such as research and development, regulatory spending is not an investment that generates growth for companies or the economy…. Beyond the federal level, small businesses have to deal with a maze of red tape from state and local governments to start a business, apply for a business license, hire employees, pay taxes, enforce contracts, and even close a business.… Data show that this entrenched regulatory environment negatively impacts entrepreneurship and business startups as increases in per capita regulatory expenditures are directly correlated with decreases in the number of small firms that employ between one and four persons.*[23]

Yet, the debate regarding the optimal level and type of business regulation does necessarily have to pit public good versus business success. Rather, some forms of regulatory reform can simultaneously be friendly to business while still affording protections to worker health, consumers, and the environment. A report by the Pew Charitable Trusts observed that:

> *Policymakers often focus their efforts on trying to reduce or eliminate requirements. Increasingly, however, they are finding that business leaders are less interested in eliminating regulations outright and more interested in getting help navigating the regulatory process and receiving timely and predictable regulatory decisions.*[24]

Several approaches exist to achieve a business-friendly environment while preserving regulatory protections.

<u>Proactive Regulatory Compliance</u>: Often, after-the-fact enforcement is the primary means of ensuring compliance with state and local government business regulations. However, government may also promote regulatory compliance through proactive consultation and guidance. As described in an article by the Pew Charitable Trusts:

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[23] U.S. Chamber of Commerce Foundation, *Understanding Small Business in America*, 2017, https://www.uschamberfoundation.org/smallbizregs/.

[24] Pew Charitable Trusts, *State Strategies to Help Businesses Launch and Expand*, August 16, 2018, https://www.pewtrusts.org/en/research-and-analysis/reports/2018/08/16/state-strategies-to-help-businesses-launch-and-expand.

> *Traditionally, regulators primarily interact with businesses only after regulators have identified a violation at a facility and imposed a citation or fine. But some states are dedicating resources to preventing potential violations before they cause harm and quickly resolving problems when they do happen.*[25]

For example, governments or economic development corporations could foster greater predictability in the regulatory process by providing navigators to advise businesses on the applicability of specific regulations, the steps of the permit application process, and the approximate cost and time needed to fulfill regulatory requirements. In addition, regulatory agencies make technical experts available to meet with businesses to identify potential obstacles before submission of a permit application. This approach shifts the focus from finding violations to partnering with businesses to help them achieve compliance. [26]

Improved Regulatory Efficiency: The method of implementing a regulation may affect the time and cost of compliance. Governments can assist businesses by streamlining regulatory and permitting processes to create greater efficiencies. Improving regulatory efficiency may help spur economic activity. As described by Pew:

> *State governments can undermine opportunities for investment and job creation when businesses spend too much time or money on inefficient regulatory processes, or when new business projects get delayed because firms don't understand how to comply with the rules…. Effective private-sector companies regularly review their production systems to identify opportunities for improvement. Otherwise, inefficiency and waste can take up resources that could be better invested in quality, innovation, and expansion. Regulatory processes are no different. When poor practices are allowed to calcify, there is an economic cost.* [27]

The timeline of the regulatory process can affect the ability of entrepreneurs to start new businesses. An extended period for zoning, building, occupancy, licensing, and other regulatory approvals prior at the outset may inhibit business creation. As described in a Kauffman Foundation[28] report on government policies that promote entrepreneurship:

> *Cumbersome and long decision-making processes can function as a de facto denial and are detrimental to entrepreneurs who have business ideas, operating cash, and customers, but must wait months to find out where they can locate their businesses*.[29]

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[25] *Ibid*.
[26] *Ibid*.
[27] *Ibid*.
[28] Politico describes the Kauffman Foundation as "a nonprofit that supports and studies entrepreneurship," see https://www.politico.com/blogs/politico-press/2018/09/27/now-live-politicos-what-works-next-how-women-are-making-nashville-hum-849274.
[29] Motoyama, Yasuyuki, and Wiens, Jason, Ewing Marion Kauffman Foundation, *Guidelines for Local and State Governments to Promote Entrepreneurship,* March 2015, https://www.kauffman.org/wp-content/uploads/2019/12/government_guideline_report.pdf.

With the onset of the Covid-19 pandemic, state and local governments rapidly altered many regulatory rules and practices to accommodate continued operations in an environment of social distancing. Some of these pandemic-induced modifications resulted in more efficient interactions between businesses and regulatory agencies that could reduce compliance costs even in a post-pandemic economy. A report by the National Governors Association (NGA) discusses how pandemic related actions could lead to greater efficiency in government regulation:

> *During the pandemic, state regulations have changed to help businesses handle the economic crisis while complying with restrictions related to the public health crisis. Regulations have been relaxed, modified or added to accommodate new ways of doing business… These changes have been crucial in helping businesses continue operations during the economic crisis, even helping some accelerate their growth... Quickly implementing regulatory changes has involved coordination across state agencies or with local governments, and states can study these experiences to learn how this coordination can be carried into streamlining efforts in the future*.[30]

Examples of improved and more efficient regulatory processes include:

- Using technology to reduce in-person requirements from the regulatory process. Allowing businesses and their consultants to submit permit applications and supporting materials electronically and to appear virtually at meetings can reduce compliance time and costs. In addition, these methods may assist in overcoming barriers to in-person participation such as issues with constraints related to transportation, childcare, or disability. [31]

- Establishing or expanding use of online "one-stop shops." An online one-stop shop is a single portal that provides businesses with practical regulatory information and guidance and allows for online submission of permit applications and compliance reports. The portal could also allow businesses to apply for grants, loans, or tax credits for which they are eligible. Most importantly, a one-stop shop approach would not only relate to one specific regulatory area (e.g., building code or environmental permits), but would consolidate information and applications covering the diverse range of government interactions with businesses.

Many state and local governments (including Maryland and Montgomery County) had begun to migrate away from in-person requirements and toward online one-stop shops before the pandemic. Nonetheless, the pandemic demonstrated the efficiencies that could be achieved by further expanding regulatory approaches that serve to reduce the time and cost of business compliance.

Simplifying the Tax Code: In addition to complying with regulatory requirements, business owners must be familiar (or hire an accountant who is familiar) with business tax payment rules

[30] National Governors Association, *Streamlining State Business Regulatory Processes to Support Economic Recovery*, 2022, https://www.nga.org/wp-content/uploads/2021/05/Reg-process-improvement-COVID19.pdf.
[31] *Ibid*.

and requirements. A relatively simple tax code contributes to a business-friendly environment. As summarized by the Kauffman Foundation:

> *Taxes matter, but what entrepreneurs are most concerned about is tax complexity. Simplifying tax codes and payment systems so they are easier to understand will relieve what many entrepreneurs feel is a burden on them and their businesses. For instance, different sales tax rates by different cities and counties, and different rules about taxing within the metropolitan area are frequently cited as barriers by entrepreneurs*.[32]

The 2012 national survey of small business owners revealed similar concern about business tax complexity. One finding of the survey found that:

> *[O]wners complain of overall [tax] complexity. First, taxes are assessed by multiple levels of political jurisdiction…. We find [the]… statement of "too many taxes" (in contrast to "taxes too high") in a number of states…. Second, many respondents stated that tax rules change too often.... Issues regarding the sales tax system came up more frequently than any other specific tax.* [33]

<u>Review of Licensing Requirements:</u> State and local governments licensure certain professionals to restrict practice to qualified individuals who have met specific standards of education, work experience, certification, and/or testing. The intent of these professional licensing requirements is to protect the public by ensuring that only qualified individuals perform these professional functions. The State of Maryland licenses professions such as architects, electricians, and real estate agents as well as barbers, cosmetologists, and interior designers. Some analysts consider certain professional licensing to be an impediment to entrepreneurial growth. According to the Kauffman Foundation:

> *Nearly one-third of American workers are required to have a government-issued license to do their jobs. Occupational licensing can act as a barrier to entrepreneurs seeking to bring new innovations and business models to market. While licensing is meant to ensure quality, other policy options exist that protect public health and safety, while fostering competition and new-business creation*.[34]

The Kauffman Foundation suggests reconsidering the government licensing policies to help promote entrepreneurial growth. For example, the Kauffman Foundation proposes that governments evaluate which professions require a license and, where public health is not seriously threatened, replace licensing with a less onerous form of regulation. In addition, the Kauffman Foundation recommends creating independent public committees to evaluate licensing boards and licensing standards as well as allowing mutual recognition of other licenses from other states.[35]

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[32] *Op. cit*., Motoyama and Wiens.
[33] *Op. cit*., Maxwell and Motoyama,
[34] *Op. cit*., Motoyama, Wiens, and Jackson.
[35] Wiens, Jason and Jackson, Chris, Ewing Marion Kauffman Foundation, *Occupational Licensing: A Barrier to Entrepreneurship,* November 24, 2014, https://www.kauffman.org/resources/entrepreneurship-policy-digest/occupational-licensing-a-barrier-to-entrepreneurship/.

The Takeaway: Government regulatory, permitting, and licensing policies necessarily involve a trade-off between achieving public goods and fostering unfettered business autonomy. State and local policymakers weigh the relative value of the safety, health, environmental, or other benefits of regulations against their potential effect on business growth, investment, and job creation and then select the level of regulation that best balances local priorities. At any level of regulation, governments can achieve a more friendly business climate by continually reviewing implementation practices to achieve efficiencies and reduce the cost of compliance.

Section 4: Business Grants and Loans

Grants and loans are the most direct form of government assistance to business. During the first two years of the Covid pandemic, the Federal, State of Maryland, and Montgomery County Governments each provided grants and/or loans to help businesses weather the economic effects of shutdowns. Most pandemic-related grants and loans were directed to assist small- and mid-sized businesses maintain payroll and avoid layoffs. Absent an economic crisis, governments may provide business assistance through grants and loans to support industries that serve public interests, hire new employees, or otherwise advance particular outcomes.

The State of Maryland offers a series of grant programs to promote capital investment and job creation as well as to attract and retain businesses in designated geographic areas. The State also provides grants and loans to incentivize certain types of investment such as the installation of energy conservation improvements or the purchase of renewable energy systems. Montgomery County also offers business grants and loans. For example, the County's Economic Development Fund offers grants and loans to assist private employers achieve capital expenditure and job creation/retention objectives. Similarly, the County's Make Office Vacancies Extinct (MOVE) program provides direct financial assistance to attract new businesses to occupy certain types of vacant properties such as Class A and B office space. A Brookings Institution policy paper describes how government grants assist businesses with high startup costs.

> *Grants—awarded by governments—can serve as a critical early financing mechanism to support companies operating in industries crucial to national or regional interests. Such awards can usefully complement venture capital by helping companies operating in sectors like advanced manufacturing that struggle to raise venture capital due to high upfront capital expenditure needs.* [36]

The above cited Brookings Institution analysis supports the practice of providing targeted direct financial assistance to businesses. More specifically, the analysis cites the advantages of early-stage assistance to particular types of businesses (such as those involved in research and development):

> *States and local governments can also leverage grants (funded by Washington or their own resources) to offer an attractive non-dilutive financing option to startups to support industries and initiatives critical to their economies, supporting such startups by de-risking the research and development phase for startups needing future risk financing. Such an approach may help regional economies that have a more concentrated industry mix in sectors that require large amounts of upfront capital to scale by attracting focused venture capital. However, funding the right grants at the right stages of a company's lifecycle will be critical. Research suggests that providing grants during the earliest stages—focused on establishing feasibility and commercial viability rather than*

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[36] Sarycheva, Aia and Muro, Mark, *Beyond VC: Financing technology entrepreneurship in the rest of America*, The Brookings Institution, September 29, 2021, https://www.brookings.edu/blog/the-avenue/2021/09/29/beyond-vc-financing-technology-entrepreneurship-in-the-rest-of-america/.

> *commercialization efforts—has a demonstrably stronger impact on the probability that a firm will receive venture capital, achieve revenue, and have a successful exit, versus later-stage awards.* [37]

Similarly, a 2017 paper published in the journal, *The American Economic Review*, concludes that public grants for research and development firms are particularly beneficial when targeted small, recently formed businesses:

> *A grant is useful because it enables the firm to invest in reducing technological uncertainty, which makes the firm a more viable investment opportunity…. To the extent public funds are used to subsidize applied private sector R&D, … more grants to small, young firms on a one-time basis may be more effective in stimulating innovation than fewer larger grants that follow firms through multiple stages of technology development.*[38]

At the Federal level, two of the most prominent business grant programs, the Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) programs, also support private sector research and development. The intent of these programs is to stimulate technological innovation through private sector research and development in support of the mission of Federal agencies. Under these "seed funding" programs, Federal agencies must allocate a percentage of their research and development budgets to provide grants to, or contract with, domestic companies of fewer than 500 employees to conduct relevant research and development.

No fewer than 22 state governments offer matching grants to the SBIR/STTR grant recipients located in their states.[39] A 2018 study published in the *Review of Economics and Statistics* found that state matches of SBIR/STTR grants increase the likelihood of business successfully advancing to subsequent phases of Federally-support research and development, particularly when strategically allocated.

> *[T]he value of state dollars varies across types of projects. Specifically, the state dollar is effective in assisting firms with less prior SBIR success that carry out projects within the broad fields of science and health. This is likely due to differences in the financial demands of research across different industries and to differences in the proportion of the firms' overall research budgets relative to the State Match award. These results offer compelling policy implications: rather than providing an equal amount of state matching funds, states ought to consider allocating funds more strategically.*[40]

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[37] *Ibid*.
[38] Howell, Sabrina T. 2017. "*Financing Innovation: Evidence from R&D Grants*" *American Economic Review*, 107 (4): 1136-64, https://www.aeaweb.org/articles?id=10.1257/aer.20150808.
[39] U.S. Small Business Administration, *Phase 0 & State Matching Programs*, September 2020, https://www.sbir.gov/sites/default/files/SBIR-Table_StateMatchingPhase0_Sept2020.pdf
[40] Lanahan, Lauren and Feldman, Maryann P., *Approximating Exogenous Variation in R&D: Evidence from the Kentucky and North Carolina SBIR State Match Programs*, 2018, https://maryannfeldman.web.unc.edu/wp-content/uploads/sites/1774/2011/11/Approximating-Exogenous-Variation-in-RD_Lanahan-Feldman.pdf.

Maryland does not provide SBIR/STTR matching grants. Legislation to create a matching grant program failed in the General Assembly in 2008 and 2012. However, in 2018, Montgomery County established a matching grant program for recipients of Phase I or Phase II Federal SBIR/STTR grants for research in medicine, biotechnology, or the life sciences. The County matches 25% of the Federal SBIR/STTR grant amount, up to a maximum of $25,000 for a Phase I grant and up to a maximum of $75,000 for a Phase II grant.

The Takeaway: Grants and loans can provide invaluable assistance to emerging small businesses that face high initial start-up costs but lack access to investors and capital. The existence of robust state and local government grant and loan programs signal that a community encourages emergent small business growth, particularly when public resources are strategically directed toward industry sectors that serve local economic interests.

Section 5: Access to Capital

Often, businesses, particularly new small businesses, must incur great cost and undertake significant risk to launch their venture. At the outset, access to external funding sources is critical to establishing the infrastructure needed to successfully initiate a business plan. Existing businesses may also require external funding to expand activities and add employees. Limited access to capital impedes entrepreneurial activity, creation of start-ups, and business expansion. As stated in a report by the Kauffman Foundation:

> *Access to capital plays an important role in entrepreneurship, in both direct and indirect ways. External private institutional capital—in other words, bank lending and venture capital—dominates the research and public discourse. Yet, at least 83 percent of entrepreneurs do not access bank loans or venture capital at the time of startup. Almost 65 percent rely on personal and family savings for startup capital, and close to 10 percent carry balances on their personal credit cards.* [41]

Women and minority entrepreneurs have experienced particular barriers to accessing credit. The policy document, *America's New Business Plan for 2022*, a nonpartisan policy roadmap to create a more inclusive economy sponsored by the Kauffman Foundation, summarizes the effects of discriminatory business lending:

> *The ongoing impact of past discriminatory policies, such as redlining, must be countered and new investments made to ensure we are supporting entrepreneurs of color as well as women and rural Americans who have less access to funding in the private market. When business owners do not have access to personal funds or quality capital, they are less able to take the risks necessary to grow their businesses, artificially stifling the marketplace*.[42]

In the wake of the pandemic, the Federal Government expanded the State Small Business Credit Initiative (SSBCI) that provides funding to states to offer credit and investment programs for existing and start-up small businesses. States may use the Federal SSBCI funding for loan guarantee, venture capital, and other programs that assist small businesses access capital. In Maryland, the Department of Housing and Community Development channels SSBCI funding "to support businesses with limited opportunities for growth" and to "target communities and areas with a high concentration of small, micro, and Socially and Economically Disadvantaged Individual (SEDI) businesses."[43]

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[41] Hwang, Victor, Desai, Sameeksha, and Baird, Ross, Ewing Marion Kauffman Foundation, *Access to Capital for Entrepreneurs: Removing Barriers,* April 2019, https://www.kauffman.org/wp-content/uploads/2019/12/CapitalReport_042519.pdf.

[42] StartUsUp, the Ewing Marion Kauffman Foundation, *America's New Business Plan: Access to Funding,* 2022, https://www.startusupnow.org/anbp/funding.

[43] Maryland Department of Housing and Community Development, *Maryland's State Small Business Credit Initiative (SSBCI) Program*, https://dhcd.maryland.gov/Business/Pages/SSBCI.aspx.

Governments may assist businesses access capital through various methods. This report discusses two of the more common approaches: credit support/loan guarantees and public sector venture capital funds.

Credit Support/Loan Guarantees: State and local governments may assist new or expanding businesses secure financing credit from third-party lenders. With a government-backed loan guarantee, for example, a public entity offers to assume all, or a portion of, a debt obligation should the borrower be unable to pay. Similarly, a government can promote private sector lending to target businesses by insuring lenders against debt default.

In 2012, Montgomery County established the "Small Business Plus!" program in partnership with local lenders. The County has deposited approximately $50 million in local community banks. The deposited funds earn interest and are secured by FDIC insurance. The deposits allow the banks to boost lending to local small businesses with the objective of increasing job opportunities for County residents.

In 2016, the U.S. Department of the Treasury commissioned a program evaluation of the SSBCI. The evaluation presented "lessons learned" about credit assistance programs that highlighted the benefits of targeted and adaptable credit support:

- *States endeavored to design credit support programs that addressed specific local credit gaps and responded to local market needs. The program designs reflected economic realities, adapted to local capital needs and state banking practices, and used flexible program designs and terms….*
- *The most widely used programs incorporated input from local banking and non-bank financial institutions in the design process. Lender input during both the design and implementation stages tended to influence key program features and increase lender interest in the program….*
- *Objectives changed in response to evolving economic conditions. Successful states designed multiple programs to meet a spectrum of small business credit needs…. Many states reallocated funds as new capital gaps emerged or market conditions changed….*[44]

Credit support and loan guarantees are particularly important to economically and socially disadvantaged entrepreneurs. The State of Maryland offers multiple credit support programs funded by Federal SSBCI dollars to disadvantaged business owners. In addition, a category of private lenders, known as Community Development Financial Institutions (CDFIs), provide access to capital to distressed communities and demographic groups that have encountered barriers to credit. In general, the goal of CDFIs is to expand economic opportunities for low-income and underserved residents and businesses by providing access to financial products and services. While CFDIs are non-government entities, state and local government can promote

[44] U.S. Department of the Treasury, *Program Evaluation of the US Department of Treasury State Small Business Credit Initiative*, October 2016, https://home.treasury.gov/system/files/256/SSBCI-Program-Evaluation-2016-Full-Report_1.pdf.

economic growth through policy and financial support of CFDIs. A policy paper by the Urban Institute[45] states:

> *Much like federal policy, state and local policy can influence CDFIs in three major ways: providing resources for the CDFI or for CDFI borrowers, setting the terms of business for CDFIs or their borrowers, and impacting the people and communities CDFIs work with…. [A] state policy environment that recognizes the value of mission-oriented alternative financing vehicles can improve outcomes for both CDFIs and borrowers.*[46]

A 2017 report by the non-partisan Aspen Institute addressed the relationship between business ownership and the racial wealth gap in the United States. The report included recommendations on how state and local governments can assist people of color access to capital. The recommendations included:

> *Expand targeted efforts to improve access to properly-structured credit for entrepreneurs of color…. but reaching substantial numbers of entrepreneurs of color with appropriate financing will also require the following:*
>
> - ***Deliberate and culturally competent outreach and service to communities of color.*** *Many small business lending (and service) programs have had limited effectiveness in reaching entrepreneurs of color…. Although the types of clients served by mission-based microlenders vary according to their missions and the geographic regions they serve, as a whole they serve more entrepreneurs of color because they deliberately develop marketing and outreach strategies, offer services in Spanish and other languages, and adjust their policies and programs in other ways (such as taking a more flexible approach to interpreting credit reports) in order to serve them.*
>
> - ***Apply loan underwriting and decision-making approaches that address the credit characteristics of many minority-owned firms****. The major quantifiable barriers to credit for African American and Latino borrowers are lower levels of owner equity (net worth) with which to leverage financing, lower levels of collateral (e.g., value of homes) with which to secure loans, and lower credit scores. Community development financial institutions (CDFIs) have expertise in responsibly underwriting and making loans to businesses with these credit deficiencies. The work of these CDFIs — particularly those that serve entrepreneurs of color — should be encouraged and expanded….*[47]

Public Venture Capital Funds: A venture capital fund is a fund that invests in early-stage businesses, that is, start-up businesses that need resources to initially develop and market their

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[45] *Politico* characterizes the Urban Institute as a "liberal" think tank. See https://www.politico.com/news/magazine/2022/04/01/capital-city-think-tank-unions-00022182.

[46] Theodos, Brett, Sediman, Ellen, Edmonds, Leiha, and Hangen, Eric, Urban Institute, *State and Local Policy: A Critical Concern for CDFIs*, December 2017, https://www.urban.org/sites/default/files/publication/95316/state_and_local_policy.pdf.

[47] Klein, Joyce A., *Bridging the Divide: How Business Ownership Can Help Close the Racial Wealth Gap*, Aspen Institute, January 2017, https://www.aspeninstitute.org/wp-content/uploads/2017/01/Bridging-the-Divide.pdf.

products or services. Though most venture capital funding is provided through private sector investors, many states manage funds that invest in start-up business. In Maryland, the Maryland Technology Investment Corporation (known as "TEDCO") uses taxpayer dollars to invest up to $2 million in an early-stage Maryland-based businesses.

A 2021 report by the Brookings Institution cites public venture capital funds (including TEDCO) as an effective tool to boost entrepreneurship, particularly for underserved and disadvantaged communities:

> *On the venture capital side, most states have existing venture development organizations with either statewide or regional service areas. These economic development partners were integral to the success of the original SSBCI program in both lending and venture capital programs and should be included in the design and implementation decisions for the relaunched initiative. … In smaller or less populated states, engaging with venture development organizations with a statewide mandate and service area is a smart strategy. For example, state-supported entities such as … TEDCO in Maryland … have a proven track record of investing in and providing technical assistance to entrepreneurs statewide. Again, states should ensure this outreach is inclusive of Black- and brown-led venture funds, accelerators, and incubators in addition to those entities that led SSBCI strategies a decade ago.* [48]

However, the Kauffman Institute's research report, *Guidelines for Local and State Governments to Promote Entrepreneurship*, suggests that venture capital investments may be too risky for governments:

> *The challenges of operating a successful venture fund are not unique to the public sector. Even privately managed venture capital funds take on considerable risk and often fail…. Selecting winners based on initial or early-stage business plans is a tremendous gamble, as half of all firms go bankrupt or exit within five years. And rapidly changing technologies and markets make this process even more difficult. The public sector often lacks the expertise to evaluate and support entrepreneurs. Consequently, these efforts are not the best use of public funds.* [49]

Notwithstanding their above words of caution, the Kauffman Institute report acknowledges that many local governments have already established venture capital funds and may not easily withdraw for this activity. The report, *Guidelines for Local and State Governments to Promote Entrepreneurship,* offers advice on how to better the outcomes of public venture capital funds:

> *Despite the research discouraging local governments from implementing public venture funds, many exist. As it may not be feasible to discontinue these efforts immediately, the*

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[48] Maxim, Robert, Cromwell, Eric, Schmisseur, Dan, Parilla, Joseph, and Muro, Mark, *How Cities, States, and Tribes Can Boost Entrepreneurship Via the American Rescue Plan*, The Brookings Institution, May 19, 2021, https://www.brookings.edu/research/how-cities-states-and-tribes-can-boost-entrepreneurship-via-the-american-rescue-plan/.

[49] *Op. cit*., Motoyama and Wiens.

guidelines below may be used to improve the performance of public venture funds and ensure that they serve a wider purpose more successfully.

- *Distribute multiple small investments in order to facilitate connections and learning for entrepreneurs in the community. Multiple small investments instead of one large investment will create a cohort of entrepreneurs who can network and learn from each other and who can be integrated with local organizations that provide entrepreneurial support….*
- *Establish reasonable expectations for timeframe. Conventional venture capital firms expect to exit in two or three years. If a public venture fund invests in earlier-stage companies than typical venture capital firms do, a longer period will be necessary before the evaluation. Policymakers should not see this investment with short-term results—or any results before the next election.*
- *Collect data about the companies receiving funds. Define clear criteria for success and communicate these criteria to all stakeholders. Criteria may include sustainability of the firm, sales growth, profitability, successful mergers, and IPOs. The number of firms invested and the number of jobs created are insufficient metrics because they do not address the effectiveness of investments.*
- *Integrate the recipient companies into the local ecosystem. Receiving the venture fund hardly starts the road for success by startups, and support by other stakeholders in the region will still be essential. If possible, arrange recipient companies to locate at local incubators. If possible, co-locate all the local support services with the recipient companies.* [50]

The U.S. Department of Treasury SSBCI evaluation also presented "lessons learned" for venture capital programs (VCPs). The evaluation emphasized the value of customizing VCPs to align with the range of capital needs within the local economic environment:

- *Many states customized SSBCI VCPs to work within local market conditions for equity investors, which can vary significantly from state to state and region to region. The success of VCPs depended on the ability of state program managers to accurately identify and address risk capital financing gaps within the unique entrepreneurial and investment ecosystems of their particular state. States vary greatly in terms of both entrepreneurial capacity (which creates demand for equity financing) and private investment capacity (which provides the local supply of capital), creating the need for customized VCP strategies.*
- *States often worked to develop a portfolio or "continuum" of state small business finance programs to address capital needs across the investment/development stages of high-growth potential businesses. States that developed a complementary portfolio of small business finance programs communicated the need to support businesses from the early-stage through the growth stages to increase the likelihood of success and keeping the business in state.*

[50] *Ibid*.

- *Establishing a base of local investors, specifically local venture capital funds, was a critical success factor for supporting high-growth entrepreneurship, innovation development, and regional economic diversification. SSBCI helped stimulate investment from different types of private investors, with many states intentionally supporting the formation of new investment funds or local offices for existing out-of-state investment funds.*[51]

The Takeaway: Insufficient access to capital often is a significant barrier to business creation and expansion, especially for small businesses with large start-up costs. Access to credit is a particular challenge for entrepreneurs of color who have experienced discrimination in lending, resulting in wealth gaps and a scarcity of willing investors. By its very nature, credit assistance involves a level of risk. Nonetheless, strategies exist for state and local governments to provide a step-up to emerging small businesses while minimizing risk. In particular, the public sector can foster an environment that cultivates small business entrepreneurship by offering credit assistance programs that are: targeted toward the needs of local, disadvantaged entrepreneurs; integrated with other types of business support; and diversified over a relatively broad range of ventures.

[51] *Op. cit.*, U.S. Department of the Treasury.

Section 6: Business Incubators

A business incubator is a program that offers start-up businesses access to a collection of resources including workspace, equipment, mentorship, collaboration, and training. The objective of a business incubator is to allow budding entrepreneurs to acquire knowledge and access a network of resources while developing competencies in business, financial, and human resource management. The County's Business Innovation Network (BIN) supports business incubators in Silver Spring, Rockville, and Germantown as well as an "incubator without walls."[52] The County also supports an incubator for non-profit organizations.

A report from the Kenan Institute of Private Enterprise at the University of North Carolina summarizes the purpose of business incubators as follows:

> *Business incubators support young businesses through three primary mechanisms — buffering, bridging, and curating. Through* buffering*, incubators protect young firms from competition and external threats. For example, shared basic business services help offset costs.* Bridging *connects firms to outside resources, knowledge and social capital. This often includes networking with mentors, investors with industry expertise, and early buyers and suppliers. When firms need help sifting through many available resources,* curating *connects them to the most appropriate ones.*[53]

The value of a business incubator to entrepreneurs may be dependent on local industry concentrations and economic conditions. As described in the Kenan Institute report:

> *Business incubators' success can vary widely from community to community.... The ability of an incubator to support businesses can be dependent on the type of community — rural versus urban — and the needs of the businesses within that community. In urban areas with strong industry specialization, firms benefit from knowledge spillovers, resource sharing, more affordable office space and better resource matching. Since firms in these areas can suffer from intense local competition and congestion, incubators can help protect young firms and provide valuable business connections.* [54]

An article in the *Harvard Business Review* addresses the essential conditions needed to incubate a start-up into a viable and sustainable business. The article's author suggests that principal element in business incubation is not providing space and equipment, but rather assistance in developing a marketable good or service.

> *Many incubators assume that cheap real estate, co-working spaces, used furniture, plus a phone and Internet connection equate with business incubation…. Neither are discounted*

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[52] An "incubator without walls" does not provide workspace and is similar to a business "accelerator" described in the next section.
[53] Kenan Institute of Private Enterprise, *Business Incubators: If You Build It, Will Entrepreneurs Succeed?*, September 2, 2020, https://kenaninstitute.unc.edu/kenan-insight/business-incubators-if-you-build-it-will-entrepreneurs-succeed/.
[54] *Ibid*.

> *legal services, accounting, or other kinds of commodity services. Two things determine whether a business can get off the ground successfully and sustainably: a validated market opportunity with customers willing to pay for a product or a service; and a product or service that addresses such an opportunity. The only incubators I consider "real" are the ones that help entrepreneurs achieve these two goals.*[55]

As with other forms of business assistance, a key challenge for evaluating business incubator success is developing quantifiable metrics to measure the effect of the services provided. The same *Harvard Business Review* article warns against establishing faulty measures of incubator success:

> *Most incubators use funding as a success metric, which is a somewhat flawed criterion. Over 99% of companies should operate as organically grown, self-sustaining businesses — bootstrapped, without external financing. For them the goal is to achieve customer validation, not financing. Yet if the incubator uses financing as its success metric, it will try to force inexperienced entrepreneurs into an unnecessary financing round. And more often than not, they will fail*"[56]

A Kauffman Foundation researcher reviewed more than 35 academic articles of business incubators and found multiple metrics for evaluating program success. Of note, the researcher discovered that most of the analyses did not answer a key elemental question:

> *Incubators are viewed by both the public and government officials as offering a helping hand to struggling startups, and much research has been done about what makes certain types or functions of incubators more successful. Overall, those studies tried to analyze factors thought to help incubators succeed, including connection to a university, length of time in an incubator, and an incubator's selection criteria. However, the essential question we ought to ask is: "Do incubated businesses perform better than unincubated businesses?" Unfortunately, most academic literature about incubators does not measure incubated businesses against a control group (in this case, comparable unincubated businesses).*[57]

One of the few studies that compared incubated versus non-incubated start-ups found that businesses that launched via an incubator failed sooner than others. The study from the Whitman School of Management at Syracuse University concluded:

> *For years, scholars have sought to know whether incubation has a discernable positive effect in the performance of their clients, while business incubators and policymakers have generally made claims that incubation is an effective service that helps firms survive and grow. This study used some of the best publicly available data, manipulated it using*

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[55] Mitra, Sramana, *The Problems with Incubators, and How to Solve Them*, Harvard Business Review, August 26, 2013, https://hbr.org/2013/08/the-problems-with-incubators-a.
[56] *Ibid*.
[57] Fetsch, Emily, *Are Incubators Beneficial to Emerging Businesses?*, Ewing Marion Kauffman Foundation, March 25, 2015, https://www.kauffman.org/currents/are-incubators-beneficial-to-emerging-businesses/.

> *sound assumptions, and estimated the impact of incubation with robust estimation techniques. The findings reveal that the effects of incubation are potentially deleterious to the long-term survival and performance of new ventures. Incubated firms outperform their peers in terms of employment and sales growth but fail sooner. These are important findings for policymakers who support incubation as a strategy to increase employment locally and for entrepreneurs who risk their livelihoods in order to earn a decent living.*[58]

One suggested explanation for the higher failure rate is that incubators support and sustain ventures that fundamentally are incapable of survival without ongoing assistance. As detailed in the Whitman School of Management study:

> *This analysis of predicted trends in survival, employment, and sales reveals that incubation stems a firm's economic loss in terms of employment and sales but that it does not contribute positively to economic growth. Firms in incubation are better off than had they not been incubated but they are still more likely to fail and not grow. What could explain these results? One explanation may lie in the signaling and guidance that incubated firms receive. Once a firm gets incubated, an incubator's close monitoring of the performance and changing competencies of its clients may generate information that leads incubated firms which are least likely to survive in the long-run to dissolve sooner. Therefore, the accelerated failure rates for incubated firms and the effect of this failure on net gains in employment and sales may be due to an incubator's ability to weed out failing businesses in the economy much sooner than the market would.* [59]

In a similar vein, the Kauffman Institute's *Guidelines for Local and State Governments to Promote Entrepreneurship* downplays an incubator's space and equipment offerings as meaningful factors in a start-up's success:

> *Like public venture funds, incubators are established in order to meet entrepreneurs' need for capital. The assumption is that providing office space and basic services will free up funds for entrepreneurs and allow them to focus on their core business functions. Office space and overhead, however, are hardly effective or vital functions, and this support will not necessarily lead to a surge in successful entrepreneurial ventures. Unless a startup requires capital-intensive equipment, such as nano-level precision machinery or a biotechnology laboratory, the incubator as a real estate facility model does not help entrepreneurs significantly, and may only serve to harbor businesses that would not otherwise survive.*[60]

The Kauffman Institute's *Guidelines for Local and State Governments to Promote Entrepreneurship* suggests that non-physical offerings, such as mentoring and skill development, are the more significant incubator contribution to a start-up:

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[58] Amezcua, Alejandro S., *Boon or Boondoggle? Business Incubation as Entrepreneurship Policy*, Whitman School of Management, Syracuse University, 2010, https://www.atlantafed.org/-/media/documents/news/conferences/2010/small-business/amezcua.pdf.
[59] *Ibid*.
[60] *Op. cit*., Motoyama and Wiens.

> *Existing incubators, like public venture funds, may be reconceived to connect entrepreneurs and enhance peer learning. A holistic system that integrates incubator employees, mentors, and peer entrepreneurs will facilitate the development of clients and allow them to acquire the skills, knowledge, and support they need.* [61]

The Takeaway: Business incubators reduce the risk to entrepreneurs seeking to cultivate the development of an incipient product or service. Incubator sponsors shoulder the cost of providing physical space, equipment, training, and guidance, and so, assume the risk should the entrepreneur's product or service ultimately fail. Incubator space and equipment help sustain prospective businesses during their start-up phase but may also artificially prolong ventures that are unlikely to succeed absent external support. According to several analyses, the most essential business incubator service is the conveyance of relevant training, mentorship, and networking necessary to assess the ultimate marketability of the entrepreneur's product or service.

[61] *Ibid*.

Section 7: Mentoring, Technical Assistance, and Accelerators

The success of an emerging businesses often requires non-financial external support to succeed. As described in the previous section on business incubators, new entrepreneurs often benefit from mentoring and technical assistance from more experienced and better-connected business experts. Many state and local government sponsor business mentorship and technical assistance programs. For example, TEDCO established its Network Advisors program that partners business consultants with start-up entrepreneurs in a variety of industries.

An article in the University of Pennsylvania Wharton School magazine summarizes how a mentorship program helps new businesses position themselves for success within an industry:

> *Startups should anticipate the future direction of its industry and position itself to prevail in that future state. Corporate mentors help startups by developing a vision for the industry, conveying it to entrepreneurs and thus helping them to connect the short-term tasks with the industry's future in a way that helps startups succeed.*[62]

As evidence that mentorship programs succeed, a Kauffman Foundation issue brief cites research that found that mentored businesses survive longer than unmentored businesses and that:

> *Business owners who have more hours of mentorship report more revenue and employment growth than business owners with fewer hours.*[63]

One role of a business mentor is to provide an entrepreneur with an independent assessment of a proposed venture's likelihood to succeed in a given industry, at a given time, and under specific market conditions. Mentors screen proposed start-ups to evaluate their potential to transition to commercialization and their worthiness to receive venture capital support. A Harvard Business School working paper concludes that mentor evaluations may be of greatest value to start-ups in industries with high initial fixed costs, such as research and development.

> *Early-stage business ideas are rudimentary in nature and reliant on many assumptions, but we find that they offer pertinent information on ventures' eventual commercial viability. In collaboration with MIT's Venture Mentoring Service, we collected and examined detailed data on 652 early-stage venture ideas in multiple industry sectors. The ideas that elicited more positive evaluations from mentors were significantly more likely to ultimately reach commercialization. The predictive power of mentors' subjective evaluations is strong for ventures in R&D-intensive sectors such as hardware, but weak for ventures in non-R&D-intensive industries such as consumer web / mobile and enterprise software.*

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[62] Cohan, Peter, *Seven Vital Pieces of Advice From Startup Mentors*, Wharton Magazine, February 25, 2013, https://magazine.wharton.upenn.edu/digital/seven-vital-pieces-of-advice-from-startup-mentors/.

[63] Ewing Marion Kauffman Foundation, *Mentoring in Entrepreneurship Support: Some Basics*, Entrepreneurship Issue Brief, 2020 No. 4, https://www.kauffman.org/wp-content/uploads/2021/07/Kauffman_Issue-Brief_Mentoring-in-Entrepreneurship_2020.pdf.

> *Our results suggest that firms in different sectors coalesce around different critical resources and that this pattern has strategic implications for the nature of venture financing across industries. In the absence of methods to reliably screen venture ideas, early-stage investors in non-R&D-intensive sectors may base their screening efforts on founding teams' human capital… In these sectors, small initial investments may enable investors to gain more valuable information on ventures' probability of success than is provided by early-stage evaluation of the venture idea. Here, careful pruning of early-stage venture ideas through venture evaluation appears less efficient than low-cost experimentation. In R&D-intensive sectors, by contrast, developing early-stage ideas that innovate on the technological frontier is typically associated with high fixed costs, which makes diligent screening of early-stage venture ideas more pragmatic than "spray-and-pray."*[64]

Business Accelerators: A business "accelerator" program is a type of assistance program that supports early-stage companies through education, mentorship, and connection to investment and financing resources. In November 2021, Montgomery County announced a partnership with M&T Bank to offer a business accelerator program to small businesses based in the County. The program will teach early-stage and minority entrepreneurs the essentials of business planning, operations, credit building, digital communication, and financial management.

A 2016 Brookings Institution report reviewed studies of some of the initial accelerator programs in the United States and found generally positive results:

> *In terms of the impact on the local startup community, early evidence shows that accelerators may have a big effect on attracting seed and early-stage financing, as well as additional investors to a community, including outside of the accelerated companies. This could bring additional spillover benefits to the wider regional economy.*[65]

However, the Brookings report cautioned that the research did not confirm the benefit of smaller, less established accelerators:

> *Accelerators can have a positive effect on the performance of the startups they work with, even compared with other key early-stage investors, such as leading angel investment groups. However, this finding is not universal. So far, positive effects have been only attributed to leading accelerators. Outside of those, the impact of participation in an accelerator may be ambiguous—or perhaps even negative.* [66]

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[64] Scott, Erin L., Shu, Pian, and Lubynsky, Roman M., Are *"Better" Ideas More Likely to Succeed? An Empirical Analysis of Startup Evaluation*, Harvard Business School Working Paper 16-013, s016, https://www.hbs.edu/ris/Publication%20Files/16-013_41f3750a-9d54-49be-a8f4-51a6489d514e.pdf.
[65] Hathaway, Ian, *Accelerating growth: Startup accelerator programs in the United States*, Brookings Institution, February 17, 2016, https://www.brookings.edu/research/accelerating-growth-startup-accelerator-programs-in-the-united-states/.
[66] *Ibid*.

The Brookings report presents guidance from an experienced and successful accelerator manager. The guidance stresses the importance of establishing a culture of on-going learning. Among other things, the guidance includes the following suggestions:

- *Create awareness of the stress and conflict points among and between the various participants (companies, founders, mentors) that will inevitably occur throughout the program, and strategically channeling those into learning opportunities embedded in the program itself.*
- *Build a culture and network around the accelerator that feeds on itself and perpetuates a lifetime process of learning.* [67]

The guidance also highlights some common pitfalls to avoid. According to the guidance in the Brookings report, problems arise when, among other things, accelerators:

- *Fail to set expectations at the outset around what the accelerator can do, and what is sensible given a company's individual situation.*
- *Fail to focus on the people, rather than idea … because it is the people that matter most and will be lasting, while the idea will morph a lot.*
- *Fail to understand how to scale their program (how fast do you want to grow? What is your strategy? To expand geographically? To expand the number of programs?).*
- *Fail to have a point of view about what they are trying to accomplish. Simply emulating what other accelerator programs are doing, for example, fails to understand that there is more than one approach.* [68]

A different Brookings Institute report discusses how business accelerators could help address the racial wealth gap that has widened as a result of disparate effects of the Covid pandemic on people of color.

> *Existing disparities do not reflect the intrinsic desire or talents of entrepreneurs of color themselves, but rather the structure of the systems they navigate. There are no differences between racial groups in their entrepreneurial capabilities or interests, as measured by degree of confidence, capacity to learn, appetite for risk, creativity, and determination. Prior research shows that a variety of factors adversely impact people of color as they consider starting and growing businesses, including disparities in educational attainment, personal wealth, access to mainstream capital, and exposure to entrepreneurship in family and social networks. Removing the pernicious race-specific barriers that tax the nation's entrepreneurship base would likely enhance dynamism and productivity.*[69]

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[67] *Ibid*.
[68] *Ibid*.
[69] Parilla, Joseph and Redus, Darrin, *How A New Minority Business Accelerator Grant Program Can Close The Racial Entrepreneurship Gap*, Brookings Institution, December 9, 2020, https://www.brookings.edu/research/how-a-new-minority-business-accelerator-grant-program-can-close-the-racial-entrepreneurship-gap/.

This Brookings report proposes establishing a national network of business accelerators to serve minority-owned businesses with at least $1 million in annual revenue, a level of revenue deemed to be sufficient for the venture to scale up to supply local "anchor institutions" such as universities and state and local governments. The report envisions a network of business accelerators that serve minority entrepreneurs and thereby help alleviate the racial wealth gap:

> *Accelerators can enable this growth in two ways. First, a highly experienced staff can prepare minority business owners to meet the needs of large customers and sizeable business opportunities, thus increasing the likelihood that businesses could win supply chain contracts with local anchor institutions. Second, the accelerator can connect businesses to the operating capital needed to execute against these larger supply chain opportunities.* [70]

The Takeaway: Mentorship and technical assistance from experienced experts offer new entrepreneurs with critical knowledge and contacts to overcome the early-stage hurdles of business development. Further, the education, mentorship, and introduction to financing resources provided through business accelerators can expedite the successful commercialization of a business venture. Most significantly, mentors familiar with industry-specific market conditions and trends may evaluate the underlying soundness of a business plan and its likelihood of attracting investors. Mentorship and technical assistance may be of particular value to disadvantaged, minority entrepreneurs who lack access to financing, training, and other business resources.

[70] *Ibid*.

Section 8: Business Clusters and Innovation Districts

Note: This section discusses government policies that promote geographic clustering of related businesses and the potential benefits derived from the close physical proximity of businesses in a particular industry and the skilled workers they employ. Much of the literature reviewed by OLO was based on pre-pandemic analyses. The pandemic has disrupted the presumption that a business' employees likely will co-locate in a single building, neighborhood, or community. The literature cited below may be less relevant to businesses that operate primarily in a remote work environment.

For some industries, a business-friendly environment is one that fosters connections among related firms, research institutions, suppliers, employees, and clients. Geographic clustering of interconnected businesses may establish an ecosystem of economic activity and growth that serves both entrepreneurs and the host community. Most typically, business clusters involve technologies supported by research and development institutions such as universities or government agencies.

A business cluster may develop organically; however, in many cases, state and local governments play a role in growing business clusters. As described in a 2016 report by the Brookings Institution, local policymakers play an important role in creating the proper environment for a successful business cluster:

> *There are many successful clusters in the United States and policymakers—universities and local leaders have contributed to that success…. Local leadership is essential. Successful clusters generally have a strategic plan that identifies a strong and capable leadership team. In turn, this team identifies a core competency around which the cluster will be built... A successful cluster is an attractive place to work and live for talented people and fosters a sharing community. It is best for the private sector to be involved in the infrastructure creation process. Access to skilled professionals is important for nascent technology clusters, which may require government supported university programs. As a cluster grows, it will require more skilled blue-collar workers and technicians, creating the need for training programs. All levels of government, from the federal to the local level, should support collaboration and cluster development…. It is helpful to a nascent cluster if the government is a buyer of the sophisticated products or services created in the cluster. Mapping out the market and the buyers should be part of the strategic plan for the cluster at the outset. Local or regional government can facilitate mentorship programs where established or retired business leaders can help new entrepreneurs. It is important to have measures in place to make sure that government funding (from any level of government) is allocated on the basis of merit and economic rationale.*[71]

[71] Baily, Martin Neil and Montalbano, Nicholas, *Clusters and Innovation Districts: Lessons from the United States Experience*, Brookings Institution, December 2017, https://www.brookings.edu/wp-content/uploads/2017/12/es_20171208_bailyclustersandinnovation.pdf.

In *Guidelines for Local and State Governments to Promote Entrepreneurship*, the Kauffman Institute develops the case for promoting business advancement through the geographic clustering of interrelated businesses.

> *Strategies anchored in investments and incubators have failed to foster entrepreneurship because the tactics are not suited to the experiential and collaborative process that characterizes entrepreneurship. Instead, there must be a long-term focus on entrepreneurs as individuals distinct from small businesses, who learn by doing and interacting with others. We suggest that policymakers seeking to promote entrepreneurship in their city or state embrace a new approach that puts entrepreneurs at the center, creating communities characterized by dense connections among entrepreneurs and organizations that support them…. Research indicates that local connections are far more important to entrepreneurs' success than are national or global contacts because entrepreneurs in the same business environment are the best sources of specific information and knowledge for those starting new businesses and because entrepreneurs need to interact and learn frequently and on an ad-hoc basis for their emerging challenges. While books and courses may inform continuous learning, there is no substitute for advice from local business owners as entrepreneurs navigate the complicated decisions they face at each stage of their businesses' development. Other entrepreneurs can offer the most effective advice that is specific to the new business's situation and locality.* [72]

While advocating for government to facilitate interactions within business clusters, the Kauffman Institute's *Guidelines* warn against direct government collaboration in entrepreneurial partnerships:

> *While some connections may be made on an ad-hoc basis, local governments can facilitate networking between entrepreneurs and entrepreneurship support organizations by bringing entrepreneurs together in an environment that catalyzes learning and the formation of relationships, and offers opportunities for entrepreneurs to discuss their challenges candidly and receive feedback and advice from others…. Avoid creating a formal alliance between the city government and various entrepreneurship organizations. These strict partnerships rarely have a real effect on entrepreneurs. In fact, networks of entrepreneurs in successful regions are seldom the result of government-led endeavors of any kind.* [73]

An "innovation district" is a business clustering approach that promotes co-location of technology-based business near anchor institutions within a vibrant mixed-use (office, retail, recreation, and housing) land use environment that offers mobility options as well as business support services such as incubators and accelerators.

A Brookings Institution policy paper describes the economic benefits of innovation districts for both businesses and the host community:

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[72] *Op. cit*., Motoyama and Wiens.
[73] *Ibid*.

> *Innovation districts are a key part of the new wave of local economic development and advance several critical objectives. First, innovation districts further the ability of cities and metropolitan areas to grow jobs in ways that both align with disruptive forces in the economy and leverage their distinct economic position. Innovation districts enable companies, entrepreneurs, workers, researchers and investors to work across disparate sectors and institutions to commercialize ideas and co-invent and co-produce new discoveries for the market. They foster innovation across industries by concentrating people with different knowledge and expertise in dense urbanized areas; experts in technology, for example, work closely with experts in bioscience, finance, education, and energy. Innovation districts are, in essence, the vanguard of a new "convergence economy" which is galvanizing the growth of more competitive firms and higher quality jobs and spurring expansion in supportive professional and commercial service sectors.*
>
> *Second, innovation districts can specifically empower entrepreneurs as a key vehicle for economic growth and job creation. Studies show the important role that entrepreneurs and start-up companies play in urban and metropolitan job growth and innovation districts can support this trend in several ways. The rise of collaborative facilities and spaces can, for instance, reduce overhead costs by offering below rate, low risk work spaces and providing technical spaces where exorbitantly expensive technologies are shared. At the same time, imaginative programming and networking can support idea generation and efficiently link young firms to mentors, advisors with specialized expertise, and potential investors*.[74]

The Brookings policy paper describes multiple innovation district models including those centered around major anchor institutions, those sited in former industrial or warehouse districts, and those developed through urbanization of sprawling suburban style office parks. Each of the models involve the comingling of a variety of commercial, residential, retail, and restaurant land uses. As described by the Brookings policy paper, local government land use and infrastructure actions can help foster the evolution of an innovation district.

> *Successful practitioners routinely spoke of the need to transform the physical landscape of their districts to create the favored attributes of complexity, density, and mixed uses and activities. This has been particularly challenging in places that bear the indelible markings of 20th century development. Heavy infrastructure—highways and exposed railroad tracks—often divide natural districts. Euclidian zoning, originally intended to protect health and safety, segregated uses and isolated housing, office, commercial, and manufacturing activities from each other.* [75]

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[74] Katz, Bruce and Wagner, Julie, *The Rise of Innovation Districts: A New Geography of Innovation in America*, Brookings Institution, May 2014, https://c24215cec6c97b637db6-9c0895f07c3474f6636f95b6bf3db172.ssl.cf1.rackcdn.com/content/metro-innovation-districts/~/media/programs/metro/images/innovation/innovationdistricts1.pdf.

[75] *Ibid*.

<u>The Takeaway</u>: Clustering of businesses, particularly those technology-based ventures, near anchor institutions (such as universities and research and development agencies) may establish an ecosystem of economic activity and growth that serves both entrepreneurs and the host community. An "innovation district" is a business clustering approach that promotes co-location of technology-based businesses near anchor institutions within a mixed-use land use environment. Local governments can best support business innovation districts policies that promote collaborative in-person interactions among employees of similar industries within an accessible area of concentrated office, retail, recreation, and housing opportunities.

Section 9: Workforce Development

Note: This section discusses government programs that help train local residents to acquire skills in demand by existing and emerging local businesses. The pandemic has disrupted the presumption that the majority of a business' workforce must reside in the same geographic area as their employer. While much literature has been written about workforce development in the Covid era, some of the content of this section may be less relevant to businesses that operate primarily in a remote work environment.

The term "workforce development" refers to a series of programs designed to create and retain a workforce with the skill sets in demand by current and future local businesses. State and local governments sponsor workforce development programs as an economic development tool intended both to assist residents find meaningful employment and to provide businesses with a pool of skilled workers to fill available jobs. The 2014 Report of the Maryland Economic Development and Business Climate Commission (commonly known as the "Augustine Commission") succinctly summarized the import of workforce development in creating a business-friendly environment in Maryland.

> *Arguably, no factor is more important to a successful economy than its workforce. A workforce composed of people with diverse skill sets and education levels is critical if a business is to succeed in today's highly competitive, innovation-based marketplace.*[76]

The present-day challenge for workforce development programs is the ever-fluid nature of the job market. As described in a National Governors Association report issued early in the pandemic, the pace of change in the job market has accelerated rapidly over a short span of time.

> *Amid recent global economic shocks, technology's impact on the future of work has been resurrected as a critical area of focus for national and state policymakers. Overall job elimination is unlikely to be the dominant effect, but disruption will continue to present three major economic paradigms: (1) Jobs will be both created and eliminated at an accelerated rate; (2) existing roles will continue to be redefined, requiring a dramatic shift in skills training to develop the skills needed to interact with technology and skills that are uniquely human; (3) rates of participation in the on-demand workforce will evolve, especially as people increasingly rely on entrepreneurial or self-employed work.*[77]

As described in a report by the National Conference of State Legislatures (NCSL), the nature of workforce development must evolve to correspond to current industry job requirements:

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[76] Maryland Economic Development and Business Climate Commission, 2014 Interim Report, February 2015, https://msa.maryland.gov/megafile/msa/speccol/sc5300/sc5339/000113/020000/020859/unrestricted/20150235e.pdf.
[77] National Governors Association, *Reimagining Workforce Policy in the Age of Disruption - A State Guide for Preparing the Future Workforce Now*, July 2020, https://www.nga.org/wp-content/uploads/2020/07/State-Guide-for-Preparing-the-Future-Workforce_2020.pdf.

> *Past workforce development initiatives focused on job search and placement need to mirror the shifting economy and focus on longer term improvements to education and training for high-skilled jobs.*[78]

The above observation from the NCSL highlights the need to continually assess workforce development programs to assure they achieve the goal of suitably training workers to succeed in the jobs currently in local demand. The education non-profit organization, WestEd, notes the re-evaluation of the labor market is particularly important in the wake of business upheavals precipitated by the Covid pandemic:

> *States should immediately begin to re-examine the labor market data they have been citing from the past few years. Much of it is built on historical data sets that emphasize a past economy drastically different from 2020. COVID-19 has disrupted those patterns in ways that alter local and regional economies.*
>
> *Economists and staff from state labor agencies, workforce boards, and economic development organizations would benefit from conducting new labor market analyses to understand the types of jobs that were lost …., the regions most impacted by job losses, and the skills and credentials being required for current job openings.*[79]

WestEd further advises workforce development program sponsors conduct on-going evaluations to assure that finite resources are directed to the most effective programs:

> *Evaluating job training providers, programs, and practices is critical so programs that are effective at solving important problems are not the ones that are cut and programs without evidence of success beyond anecdotes are the ones sustained. Research and evaluation can also help inform where scarce resources should be invested. For example, as states start cutting budgets, it would be helpful to know which organizations or programs across the state are the most effective at getting out-of-school youth to work, getting adults to sustainable wages, or incorporating two-generation approaches with higher returns on investments.* [80]

The excerpt above references "two-generational" ("2Gen") approaches to workforce development. A two-generational approach addresses how an initiative affects both parents and children, particularly relating to interruption of the cycle of poverty. The Aspen Institute provides an example of how a two-generational approach could apply to workforce development:

> *A 2Gen approach can take many forms in policy and practice. One example of such an approach would be a college or career training program that connects adult caregivers with childcare programs. This way, a parent or caregiver can pursue higher education*

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[78] National Conference of State Legislatures, *Workforce Development Initiatives: Collaborating to Prepare for the Jobs of the Future,* 2013, https://www.ncsl.org/documents/fiscal/partnership_final03.pdf.
[79] Lamarre, Manny, WestEd, Five Post-COVID Workforce Development Strategies, September 2, 2020, https://www.wested.org/wested-insights/five-post-covid-workforce-development-strategies/#.
[80] *Ibid*.

> *while their child's development is also supported. Child-parent approaches focus primarily on the child but are moving toward a two-generation approach by including services and opportunities for the parent. This could look like a care center providing young children with early childhood education opportunities while also offering a workforce development program for parents and caregivers. Parent-child approaches focus primarily on the parent but are moving toward a two-generation approach by including services and opportunities for children. One example would be a place of employment that provides caregiving employees with child care referrals or a family resource renter.*[81]

A two-generational approach to workforce development enables more parents receive training for modern jobs, and so, increases the size of the potential employee pool, a distinct benefit to businesses seeking to expand during a period of worker shortages. At the same time, a two-generational approach also assists populations who have encountered race-based discrimination close the wealth gap that has been an impediment to economic success for their children.

The Takeaway: As worker training efforts serve to create a supply of qualified employees for skilled jobs, the presence of robust workforce development programs contributes to a business-friendly environment. Given the ever-changing nature of the modern job market, routine re-evaluation of workforce development training curriculum is vital to assure alignment with the evolving skill sets in demand by both existing and emerging businesses. In addition, workforce development programs that address the needs of both workers and their families present an opportunity to serve the business community while simultaneously alleviating social concerns such as poverty and racially-based wealth gaps.

[81] Aspen Institute, *The 2Gen Approach*, https://ascend.aspeninstitute.org/2gen-approach/.

Section 10: Quality of Life

Note: This section discusses the relationship between economic development and the quality of public services, cultural and recreational amenities, and mobility options in a geographic area. Much of the literature reviewed by OLO was based on pre-pandemic analyses. The pandemic has disrupted the presumption that a business' employees likely will co-locate in a single building, neighborhood, or community. The literature cited below may be less relevant to businesses that operate primarily in a remote work environment.

Some businesses have a choice of where to locate their headquarters, office(s), retails store(s) and other commercial facilities. In general, site selection factors include economic considerations such as the availability and cost of land or commercial space, the skills of the local workforce, tax rates, and resident disposable incomes. Nonetheless, for some companies, non-economic "quality of life" considerations also factor into site selection decisions. Quality of life considerations may be important both to the corporate management team as well as to the employees that the firm hopes to recruit and retain. As related in an article in the *Rutgers Business Review*:

> *The appropriate facility location does consider not only the benefit of the stockholders but also the benefit of other stakeholders such as employees. Employees when making choices about where to live consider economic and other qualitative factors such as school quality, cultural activities, quality of life, weather, and the possibility of career development. These qualitative factors are captured within place image.*[82]

Community characteristics that contribute to perceived quality of life include conventional elements such as the level of public services and the variety of nearby recreational and cultural amenities. An article in a publication focusing on corporate site selection and relocation, *Area Development*, summarizes the most significant quality of life attributes considered by businesses seeking to attract employees to a new location.

> *Key attributes for a high quality-of-life ranking include high-performing schools (public, private, and post-secondary), affordable housing in a variety of good neighborhoods, efficient public transportation, short commute times, low crime rates, high-quality healthcare, spouse employment opportunities, and competitive child-care costs. A good balance of lifestyle amenities - shopping, entertainment, sports, weather, alternative employment opportunities - is also highly regarded.*[83]

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[82] Dixit, Ashutosh, Clouse, Candice, and Turken, Nazli, Strategic Business Location Decisions: Importance of Economic Factors and Place Image, *Rutgers Business Review*, volume 4, number 1, Spring 2019, https://rbr.business.rutgers.edu/sites/default/files/documents/rbr-040106.pdf.

[83] Crawford, Mark, *When Quality of Life Closes the Location Decision Deal*, Area Development Magazine, December/January 2010, https://www.areadevelopment.com/siteSelection/dec09/quality-of-life-location-factors010.shtml.

Yet, non-economic site selection considerations compete with economic factors that draw a business to choose a particular location. According to *Area Development*, economic factors often predominate during the early stages of the site selection process; quality of life concerns primarily influence decisions near the end of the process.

> *For most site selection searches, quality of life does not become an important factor until the project reaches a short-list stage. "Normally, cost factors weigh more importance during the selection process," says David White, executive vice president of marketing for the Colorado Springs Regional Economic Development Corporation…."Quality of life can become the deciding factor later in the selection process, especially for an industry that must attract quality talent and young professionals," he says. "Typically, the higher the average salary of the company, the more critical a role quality of life plays."* [84]

Increasingly, business location searches also take into account social considerations that may be important to their workforce such as community diversity and tolerance.

> *For firms to make the final decision to locate their facilities in a certain region, the image of the place should match the image of the company and its employees. For example, a firm interested in attracting the best technical talent must not only provide economic benefits but also a place where the employees can grow their careers and imagine a full life for themselves. While economic benefits and a sense of place and identity may attract firms to a certain region, to retain people and firms, the brand, visual image, and the reputation of a region should be in line with the firm and its employees. Many times, a place is omitted due to one of the aspects of place image – for instance, if the state has a reputation of unfair legislation targeting the LGBTQ+ community as seen in North Carolina. The bottom line is that the C-Suite executives making the location decision will choose the place that they would most like to be; where they see themselves and their workforce will be the most successful and content.* [85]

The import of quality of life as a business site selection factor varies by worker demographics and industry type. An article in the journal of the Wharton School at the University of Pennsylvania describes the types of workers and industries for whom quality of life considerations most affect business site selection decisions.

> *"For most businesses, the issue of location choice now is driven by labor: Will we be able to attract the white collar skills we need?" says Wharton management professor Peter Cappelli, director of School's Center for Human Resources. "For unskilled or semi-skilled jobs, will we be able to get it at a price we want to pay? No business goes to the Silicon Valley or New York City because it is cheap; they go because of the labor supply."*
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> *"It boils down to access to clients, access to labor force, access to suppliers – these all play a role in these decisions," says Christopher Thornberg, founding partner of Los*

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[84] *Ibid*.
[85] *Op. Cit*. Dixit, Clouse, and Turken,

> *Angeles economics research firm Beacon Economics. That said, Amazon wants a labor force that is young and educated – which generally means millennials…."*
>
> *But what do millennials want? "They want everything," says Fernando V. Ferreira, Wharton professor of real estate and business economics and public policy. "They want a city with all the cultural amenities – theaters, museums, fairs, concerts, live music, all forms of entertainment. They don't want to be in the middle of nowhere; they don't like suburbs or exurbs. They want a lot of bars and restaurants so they can have fun in addition to work. And what they want, which is most important, is they want people like themselves. High-skilled workers want to live close to each other…"*[86]

Not surprisingly, the high-skilled workers who influence corporate site selection decisions tend to be concentrated in certain industries.

> *"Depending on the type of project, quality of life typically ranks somewhere in the bottom half of the list of site-location factors," says Larry Gigerich, managing director for Ginovus LLC, a consulting firm in Indianapolis, Indiana. "Quality-of-life issues typically have a much greater impact on projects that are trying to attract certain types of employees. As an example, he says companies planning information technology, life sciences, research and development, and corporate headquarters projects tend to rank quality-of-life issues higher on the list than those planning other types of projects.* [87]

<u>The Takeaway</u>: Businesses that require in-demand, high-skilled workers may prefer to locate in areas with attributes that appeal to current and potential future employees. Quality of life attributes include good schools, efficient mobility options, low crime rates, cultural and recreational amenities, and a diverse and tolerant community. Quality of life may not be the dominant business site selection criteria but may be a vital consideration for technology-based industries with a highly educated and highly paid workforce seeking a location for a headquarters or other major facility.

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[86] Ferreira, Fernando, Rosenkopf, Loir, and Cappelli, Peter, *The Headquarters Checklist: How Do Companies Pick a Location?*, Wharton School of the University of Pennsylvania, October 24, 2017, https://knowledge.wharton.upenn.edu/article/headquarters-checklist-companies-pick-location/.
[87] *Op. Cit.* Crawford.

Section 11: OLO Conclusions

Many economic forces that influence business activity lie beyond the control of state or local governments. State and local government leaders hold little sway on national and global microeconomic trends such as inflation, the cost of borrowing, and the impact of technology on productivity. Nonetheless, the State of Maryland and Montgomery County can adopt policies and practices that, within the larger microeconomic context, foster an environment that promote business development and growth.

After reviewing academic and organizational literature on different strategies to create a "business-friendly" environment, OLO presents the following six principles to guide economic development practices in Maryland and the County.

1. *Distinguish between helping businesses and cultivating economic growth*. Some government policies may be beneficial to businesses' profit margins but do not necessarily promote overall local economic growth. Initiatives that reduce the cost of doing business should be carefully evaluated to assess whether the benefits conferred on the recipients indeed generate new economic activity and job creation within the local community.

2. *Implement economic development programs based on evaluation and evidence.* Some economic development initiatives may seem sound intuitively but lack evidence to confirm these programs indeed promote economic growth. Government efforts should be directed toward programs shown to help businesses develop and maintain marketable goods and services and achieve sustained economic growth and job creation. For example, programs that improve entrepreneurs' access to capital have been demonstrated to be of particular benefit to small businesses with large start-up costs. Similarly, initiatives that offer mentorship and technical assistance for new businesspersons appear to result in more lasting economic success than programs that provide free or subsidized workspace.

3. *Customize and update government programs consistent with current local business needs.* Government economic development efforts best support business when programs adjust to the needs of locally-based industries. For example, workforce development must constantly evolve to align with the changing skill sets in demand by local businesses and industries. Government business grant and loan programs have the greatest prospect of promoting business growth and job creation when strategically directed toward industry sectors that serve current local economic interests.

4. *Reduce barriers to economic activity and promote synergies among businesses.* State and County actions can support business creation and growth by simplifying interactions with government and among businesses. For example, governments create a business-friendly climate by continually reviewing regulatory practices to achieve efficiencies and reduce the cost of compliance. Governments can promote symbiotic clustering of businesses through land use and infrastructure policies that support collaborative interactions among companies and employees in related industries. Moreover, a

community with quality schools, efficient mobility options, cultural and recreational and a diverse workforce may be seen as a preferred location for some businesses with a highly educated workforce.

5. *Let the market determine winners and losers*. State and local governments should assist business creation and growth without trying to predict which specific businesses and entrepreneurs will develop a commercially successful product or service. While governments may elect to support certain industries most suited to fit within the local economy, the State and County should avoid acting as venture capitalists by disproportionately directing public resources to invest in particular start-ups businesses. Grant, loan, and credit access programs should aim to diversify resources to support a relatively broad range of ventures and allow the market to determine which businesses ultimately succeed.

6. *Expand entrepreneurial assistance to populations that have been excluded from economic opportunities because of discrimination.* Some demographic groups, particularly people of color, have encountered profound and long-standing discrimination that has severely constrained their ability to access economic opportunity and amass wealth. Government economic development policies and programs can help address some of these inequities. For example, tax incentives may be a useful tool to support local business activity and direct jobs to disadvantaged community members. In addition, credit access programs could assist entrepreneurs of color who have experienced discrimination in lending. Similarly, workforce development programs that serve both workers and their families present an opportunity to alleviate poverty and racially based wealth gaps.