CENTER *for* RURAL POLICY *and* DEVELOPMENT

Minnesota Technology, Inc.

positively Minnesota — Department of Employment and Economic Development

March 2004

Twin Cities and Greater Minnesota Connections: *A Business Perspective*

Greg Schrock*
Minnesota Technology Inc.

Introduction

After more than two years of shedding jobs, Minnesota's economy is finally showing the signs of an economic recovery. While job growth has remained sluggish, recent signs have pointed toward revitalized business production and investment. In particular, the high-tech services and manufacturing sectors appear poised to not only stop the job loss but also to resume growth. And although this growth is expected throughout the state, the Minneapolis-Saint Paul region, the state's hub of economic activity around high-tech manufacturing and service sectors like electronics, medical technology, biosciences, and information technology, appears likely to be the primary beneficiary of this rebound. Will Twin Cities businesses look to Greater Minnesota as they increase capacity in the form of new jobs, investment, and facilities?

Historically, the Twin Cities and "outstate" Minnesota have been closely interrelated economically, with the metro area serving as a market and distribution center for agricultural and resource-based commodities produced in rural areas. Many Twin Cities companies viewed Greater Minnesota as a viable location alternative for production and back-office activities. However, advancements in information and communications technologies have lowered the barriers for companies to establish operations in distant locations like Asia and Latin America, thus lessening their need to keep operations close to home.

This report examines the site location preferences of Twin Cities manufacturing and technology service businesses, especially in relation to Greater Minnesota. It addresses a number of different questions, such as: How does Greater Minnesota rank among potential investment locations? What are the relative strengths and weaknesses of Greater Minnesota as an investment location? And what factors, if improved, would make Twin Cities businesses more likely to invest in Greater Minnesota?

The Center for Rural Policy and Development, based in St. Peter, Minn., is a private, not-for-profit policy research organization providing an unbiased evaluation of issues from a rural perspective.

The Minnesota Department of Employment and Economic Development is the state's principal economic development agency, providing programs and services that support the economic success of individuals, businesses and communities.

Minnesota Technology Inc. is a leading provider of technology information and technical consulting services for manufacturers and other businesses using technology throughout the state.

**Jack Geller of the Center for Rural Policy and Development and Bob Isaacson of the Minnesota Department of Employment and Economic Development contributed to this report.*

A PDF of this report can be downloaded from the Center's web site at www.ruralmn.org.

Findings at a glance

- An overwhelming majority of Twin Cities companies are looking to make new investments in either capital equipment, job growth, or new or expanded facilities in the next year.
- In general, they prefer the Twin Cities as a place to invest, although larger companies and those in national and global markets were more likely to look elsewhere, especially outside the United States.
- Companies that presently have operations in Greater Minnesota were much more likely to consider it their first choice for new production investments relative to companies without an existing presence there.
- Availability of skilled labor, labor costs, and tax rates were considered the most important factors for companies in determining an optimal location for new investments.
- Business executives considered quality of life to be Greater Minnesota's strongest asset, while its tax rates received the lowest ratings. It fared relatively well on skilled labor availability, particularly among companies with operations in Greater Minnesota.
- Roughly one-third of respondents said they would be more likely to invest in Greater Minnesota if one or more location factors were improved; most commonly cited were tax rates. Among this one-third, nearly half said that Job Opportunity Building Zones (JOBZ), the state's recent tax-free zone initiative, would make them more likely to invest in Greater Minnesota.
- Respondents with Greater Minnesota operations were also much more responsive to JOBZ than those without a presence there, suggesting that marketing efforts might be most effectively targeted at this population.

Methodology

The findings from this report are based on a mailed survey administered by Minnesota Technology Inc. between October and December 2003. The survey was sent to all single-location and headquarters (i.e., non-branch[1]) locations in manufacturing and technology service industries[2] in the seven-county Twin Cities metropolitan region[3] with 50 or more employees companywide as of the 2nd quarter, 2003 (25 or more for technology services), based on data from Dun & Bradstreet, a private vendor of business information.

The initial survey mailing was followed by a reminder card and two replacement surveys. The survey was received by 974 eligible businesses, from which 165 valid responses were obtained, yielding an overall response of 16.9 percent. This response rate results in a sampling error of approximately ± 7 percent on estimates generated from the overall sample. Consequently, results from this survey should be considered exploratory and interpreted with some caution. However, response rates were generally even across size and industrial categories, suggesting that the respondent population can be considered reasonably representative of the larger survey population.

The figures and tables on page 7 show various characteristics of the responding businesses, including breakdowns by location type, company size, recent growth, market scope, broad industry sector, and Greater Minnesota status.

Orientation toward business investment

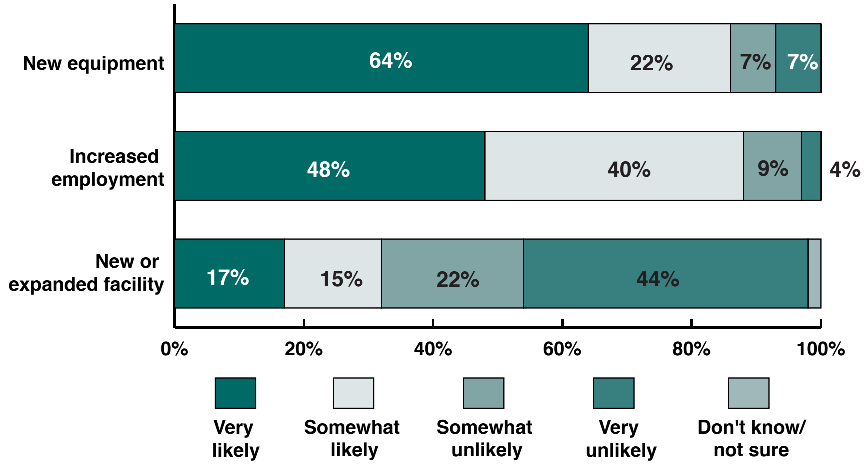
The survey found the vast majority of Twin Cities companies primed for growth in the coming year. Companies were asked to rate their likelihood of making new investments in capital equipment, job growth, and new or expanded facilities over the next 12 months (Figure 1, page 4). An overwhelming majority (86%) indicated that they were likely to make new capital equipment purchases, signaling a need to augment production capacity to keep pace with growing demand.

[1] A small number of subsidiary locations (i.e., establishments with parent companies but operating independently from them) were also included in the sample.

[2] Industries covered include all manufacturing sectors (SIC 20-39) and the following technology service industries: SICs 7371-74, 7379 (computer & data processing services), 8731 and 8734 (research & testing services).

[3] Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, and Washington Counties.

Figure 1: *Likelihood of new investments in next 12 months*



Their growth orientation extended to the job front, which has thus far lagged in the nascent economic recovery. Eighty-eight percent of companies reported that they were likely to increase employment in the next year, with almost half (48%) saying they were "very likely" to do so.

By contrast, a much lower share (32%) said they were likely to invest in a new or expanded facility in the next year. Still, this figure is much higher than would have been expected just a year ago, and reflects considerable optimism for the future on the part of Twin Cities businesses. A remarkable 95 percent of respondents anticipated new investments in either equipment, jobs, or facilities in the coming year.

Most likely investment locations

Respondents were asked to rate the locations where their companies would be most likely to invest in a new or expanded facility. They were asked to rate locations separately for different types of company functions, including research and development (R&D) and production activities.

In general, respondents rated the Twin Cities metro area the most likely place for new investments (Table 1). However, their enthusiasm for the Twin Cities varied considerably based on the types of activities. While 83 percent of respondents considered the Twin Cities their first choice for R&D activities, a somewhat lower share (50%) considered it their first choice for production activities. This difference may reflect a greater sensitivity of production investments to different cost- and non-cost location factors, a subject that will be addressed in a later section.

Company size and market scope were key

Table 1: *Most likely location for new production investments*

Location	All respondents	Respondents with Greater Minn. operations
Twin Cities metro	50%	10%
Greater Minnesota	10%	30%
Other US locations	19%	23%
Mexico	4%	3%
China	12%	23%
Other non-US locations	4%	10%
N	153	30

factors shaping respondents' site location preferences. Smaller companies and those serving local or regional markets were most likely to keep their investments close to home, while larger and more globally oriented companies expressed much greater interest in non-Minnesota locations. Seventy-two percent of respondent companies with annual sales of less than $25 million considered Minnesota their first choice for future investments, compared with only 38 percent of those over $25 million. Similarly, 35 percent of companies considering their markets "global" rated non-US locations like Mexico and China their most likely location for expansion, compared with 20 percent of those in national markets and 3 percent in local or regional markets.

Although these groups overlap to a significant extent, the motivations for larger companies to invest in remote locations can be interpreted somewhat differently from those of globally oriented ones, regardless of size. For larger companies, the decision to invest abroad may reflect a greater capacity to manage remote assets compared to smaller companies. For companies active in global markets, however, investments in emerging markets like China could be considered essential for gaining access to customers, including production facilities for other American companies operating there.

Interest in Greater Minnesota locations

Of primary concern for this study is whether Twin Cities companies consider Greater Minnesota an attractive location for investment and expansion. The results show that most Twin Cities companies do not place Greater Minnesota at the top of their list. Only 10 percent of respondents overall considered Greater Minnesota their first choice for future investments in production capacity; a slightly higher share (14%) ranked it first for back office functions, while a slightly lower share (7%) indicated this for R&D functions.

However, companies that currently have operations in Greater Minnesota – which represented approximately one in five respondents – were much more favorable toward making future investments there than companies without a presence in Greater Minnesota. Among these companies, 30 percent considered Greater Minnesota their first choice for future production investments, compared with only 6 percent of those not operating there. This compared favorably to all other locations, including China (23%) and "other U.S. locations" (23%), and the Twin Cities metro area (10%).

These results show that while most Twin Cities companies do not currently place Greater Minnesota at the top of their list for new investments, certain companies – namely, those with existing assets there – are much more favorable toward future investments in Greater Minnesota.

Factors influencing investment location decisions

One way of understanding the motivations of where companies invest is to know what location factors are important to them. Respondents were asked to rate the relative importance of several factors (Table 2) that might influence where they would choose to make investments. These factors would be expected to be relatively consistent within a given region, compared with factors such as schools, highway access, and land costs, which vary considerably within regions.

Table 2 documents the relative importance of these site location factors. Twin Cities business executives considered "availability of skilled labor" to be the most important location factor, with 73 percent citing it as "very important" to their location decisions. Labor costs (61%) and overall tax rates (58%) were second and third, respectively.

Differences among respondents could be found between smaller and larger companies. Larger companies (those with greater than $25 million in sales) were more likely to consider labor costs and transportation infrastructure important to their decisions, while smaller companies reported that quality of life was important to them. Both groups considered skilled labor availability to be their most important factor, and were equally responsive to tax rates.

Examining the factors important to companies looking to keep their investments in the Twin Cities versus those looking elsewhere reveals some interesting differences. Companies preferring the Twin Cities placed a greater value on skilled labor availability and quality of life, and much lower value on cost factors such as labor costs and tax levels, as well as transportation infrastructure. This finding is consistent with product-cycle theories that hold that early-stage activities that are typically more skill-intensive will cluster in core regions, while standardized, more cost-sensitive activities will disperse to peripheral regions.

Rating Greater Minnesota

Understanding what Twin Cities business executives like and dislike about Greater Minnesota as a place to do business offers us guidance about where its strengths lie as well as where it could improve. The survey asked them to rate Greater Minnesota on each of the factors discussed above, as well as its overall business climate.

Respondents considered quality of life to be Greater Minnesota's strongest factor, with 82 percent of respondents rating it "good" or "excellent" (Table 2). Skilled labor availability, IT infrastructure, and labor costs came in a distant second through fourth, with roughly 50-60 percent of respondents rating it good or excellent in Greater Minnesota. At the bottom of the list were taxes, with only 18 percent of respondents strongly correlated with their rating of tax levels there. This reflects a tendency for business owners to associate a place's tax levels with its business climate.

Respondents whose businesses presently maintain operations in Greater Minnesota tended to give it much more favorable ratings than those that did not. Eighty four percent of respondents with Greater Minnesota operations rated it good or excellent for skilled labor availability, compared with 49 percent of those not located there. Other factors where they rated Greater Minnesota better include access to training, transportation, and information technology infrastructure. Among the few places where companies operating in Greater Minnesota gave it lower marks was for labor costs and tax rates.

Table 2: *Location factors by importance and Greater Minnesota rating*

Location Factor	% Considering Factor Very Important	% Rating Greater Minn. Good or Excellent
Availability of skilled labor	73%	56%
Labor costs	61%	54%
Overall tax rates	58%	18%
IT/telecommunications infrastructure	49%	56%
Transportation infrastructure	45%	53%
Proximity to markets	40%	35%
Quality of life	38%	82%
Proximity to suppliers	17%	36%
Access to training	13%	43%
Proximity to parent or headquarters firm	11%	43%
Access to postsecondary research	6%	30%
Proximity to competitors/similar businesses	4%	25%
Overall business climate	-	32%

considering Greater Minnesota good or excellent on this factor.

In terms of the overall business climate in Greater Minnesota, only one in three (32%) considered it good or excellent. The largest share (46%) considered it "fair," while only 13 percent rated it as "poor." Interestingly but not surprisingly, respondents' rating of Greater Minnesota's business climate was most

Improving Greater Minnesota's business climate

Respondents were asked whether they would be more likely to invest in Greater Minnesota if one or more of the factors discussed above were improved. If so, they were asked to list up to three of those factors that they would need to be improved.

Almost one-third of respondents (32%) said that improvements would make them more likely to invest in Greater Minnesota. Of this group, a significant majority (77%) mentioned tax rates as a specific area of improvement. Labor costs (44%) and skilled labor availability (33%) were second and third on the list.

Given this concern regarding tax rates, would tax-free zones available under the state's Job Opportunity Building Zones (JOBZ) program make Twin Cities companies more likely to invest in Greater Minnesota? JOBZ, proposed by Gov. Tim Pawlenty and passed by the Minnesota Legislature, offers certain types of businesses exemptions from state and local taxes for up to 12 years for making new investments in one of several zones designated throughout Greater Minnesota.

The answer to this question appears mixed. Overall, 24 percent of Twin Cities business executives indicated that the availability of JOBZ zones would make them more likely to invest in Greater Minnesota. However, among companies with current operations there, nearly half (46%) said they would be more likely to expand there because of JOBZ. This suggests that the program might be most effectively marketed for expansion purposes to businesses with existing assets in Greater Minnesota, rather than those without a presence there currently.

One issue facing the state in promoting the JOBZ program is an apparent lack of awareness among Twin Cities businesses. The survey found that nearly half of all respondents (49%) had never heard of the program, with only a small share (9%) considering themselves "familiar with the details" of the JOBZ program. This suggests the need for greater marketing and education efforts on the part of state and local economic development officials.

Conclusion

The results of this exploratory survey should lend measured encouragement to those seeking to promote investment and economic development in Greater Minnesota communities.

Widespread optimism exists on the part of Twin Cities manufacturing and technology service firms regarding the potential for growth and expansion over the coming year. Although the overall share of metro-area businesses looking to grow in Greater Minnesota is relatively modest, it is much higher among companies that currently have operations there. This suggests that the most immediate opportunities for Greater Minnesota communities lie in encouraging those companies to expand regionally in Greater Minnesota, rather than seeking out businesses with no current ties to the region. In other words, a "build on what you have" approach is probably the smartest one.

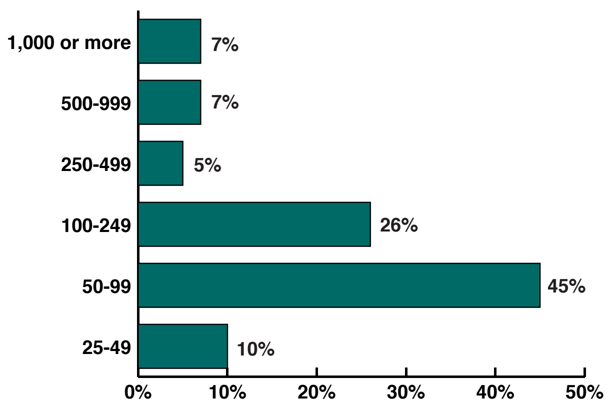
Overall, the business executives surveyed reported that Greater Minnesota has a number of assets to offer companies interested in investing there, including a high quality of life and good availability of skilled labor. Economic development marketing efforts should highlight and emphasize these and other positive factors, especially where negative perceptions currently exist. For example, it is apparent that many companies view taxes as an impediment to investing in Greater Minnesota. Efforts to educate these companies about the availability of tax-free JOBZ zones may be a valuable tool for inducing new investment that might have otherwise gone to lower cost locations. To the extent that this can be accomplished, Greater Minnesota stands to benefit.

Characteristics of Responding Businesses

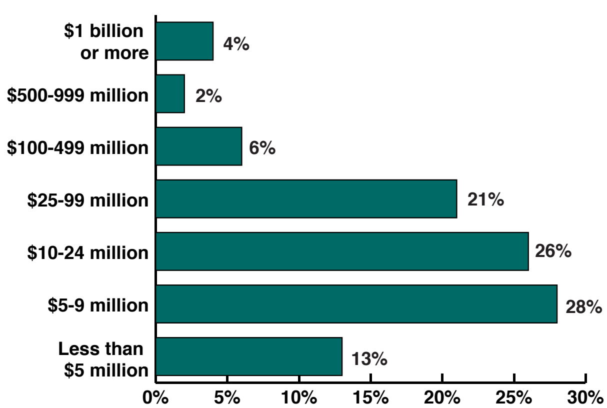
Respondents by Job Title

Respondent Job Title	% of Respondents
President or Owner	38%
Chief Executive Officer	22%
Other Executive/Managerial	12%
President/CEO	7%
Finance Officer	6%
Operations Manager	5%
Sales/Marketing Manager	3%
(None given)	6%

Employment Level, Q2, 2003



Annual Sales



Respondents by Business Location Type

Business location type	% of Respondents
Single-location enterprise	47%
Primary or HQ location	42%
Affiliate/subsidiary	11%

Respondents by Employment & Sales Growth, Last Two Years

Growth Range	Employment	Sales
25% or more growth	5%	9%
5-25% growth	22%	27%
<5% decline or <5% growth	30%	26%
5-25% decline	28%	23%
25% or more decline	16%	14%

Respondents by Greater Minnesota Operations Status

Does company have operations in Greater Minnesota?	% of Respondents
Yes, currently	19%
Not presently, but has within last 10 years	2%
No, never	79%

Respondents by Market Scope

Market Scope	% of Respondents
Local	9%
Regional	19%
National	38%
Global	35%

Respondents by Industry Sector

Industry Sector	% of Respondents
Technology Services	23%
Manufacturing, non High-Tech	53%
High-Tech Manufacturing	24%

Note: "High-Tech Manufacturing" defined as the following SIC codes: 28, 345, 357, 3599, 365, 366, 367, 369, 381, 382, 384, 385, 3873

CENTER *for*
RURAL POLICY
and DEVELOPMENT

600 S. FIFTH ST., SUITE 211 • ST. PETER MN 56082