Business Boom, Business Bust... It's the Culture, Stupid

By Joel Kotkin

Back in 1994 when Andrew Segal graduated from New York University Law School, he had a big head start toward business success—a million dollars in family money burning a hole in his pocket. Young, aggressive, and full of entrepreneurial energy, Segal looked around the country for a way to leverage his million into a big-time real estate empire.

He went south, to the wide open spaces of Texas. It was not a conventionally clever choice. The Texas real estate market had been in the dumps for nearly a generation. "The whole real estate infrastructure here was dead," Segal recalls from his Boxer Properties office on downtown Houston's seedy Main Street. "These buildings had lost 90 percent of their value overnight in the oil bust. It was a totally open field."

Yet from the moment he got off the plane in Dallas, Segal knew he had made the right move. Owners of properties swarmed around him, eager to unload their buildings at a fraction of their original cost. With a lower debt structure, Segal then was able to lower rents and entice new tenants. As Dallas's economy began to pick up in 1994, so too did Segal's profits—buildings he had purchased at $4.75 a square foot now fetch $8 to $9.00. With seven Dallas properties in his portfolio, Segal turned his attention to Houston, whose property market seemed to most investors as flat as the bayou country itself. "It made Dallas look good," he recalls.

Today Segal's 26 Houston buildings are beginning to experience the same kind of turnaround. Over the past year, he has leased some 600,000 square feet and gained 400 new tenants. Nor was he alone: Last year Houston ranked second in the nation in net new office occupancies, driving vacancy rates downward.

Although he's not yet a Texas version of Donald Trump or Sam Zell, the 29-year-old Segal has seen his real estate revenues grow to an impressive $17 million annually. "There's the beginnings of explosive growth here but very few people have focused on it," he maintains. "People still look for oil companies that can buy up big blocks of space. What I did is turn my focus on smaller companies and startups, because that's where the growth is."

When looking for reasons behind regional success stories like Houston's, analysts usually point to such factors as universities, airports, and tax policies. But for entrepreneurs like Andrew Segal, business opportunity has more to do with what might be called *cultural* factors—for instance, a willingness to accept risk taking, and to help newcomers forge their way in the local economy.

In old business hubs such as New York, Segal believes, people are overly concerned with their place in the hierarchy, craving security and status more than profit. In Houston, he met older entrepreneurs willing to speak openly about making and losing fortunes, which made failure a less daunting prospect.

American history has long been a story of cities that developed such a risk-taking entrepreneurial culture, and those who lost it. In the early days of the Republic, it was Boston and then Philadelphia who were the commercial kings. Then they ceded the initiative to the less cultured, more aggressive New York. With the vast resources of a continent at its back, New York assaulted the world's financial markets, seizing the initiative from London by the 1920s.

But the focal point for America's entrepreneurial culture has now moved largely outside Gotham and other old eastern business capitals to newer frontiers, mostly in the south and west. In cities like Houston, new businesses are starting up at far faster rates than in places like New York, Boston, or Chicago.

At the same time, there has been a second basic migration away from established business centers even in the south and west, toward so-called "edge cities" along urban peripheries. More recently, some entrepreneurs have forsaken the metropolis entirely for new opportunities in smaller towns and rural areas.

Generally speaking, these emerging entrepreneurial cultures flourish in places with low taxes, light governmental regulation, moderate labor and housing costs, and good schools or infrastructure. But not all places with these characteristics enjoy strong entrepreneurial growth; low costs have not turned Buffalo or Rochester into entrepreneurial havens; low taxes and easy regulations haven't spared Omaha, New Orleans, Des Moines, or Birmingham from low levels of job creation and business start-ups. And on the other side of the ledger, California's Bay Area, Seattle, Boston, and Los Angeles—all high-cost, high-tax, high-regulation economies—are now enjoying robust small business and job growth. So economics matters. But so does the business "culture."

The secret of most entrepreneurial boom cities is that they boast low taxes and loose regulatory regimes *plus* large, growing populations of business-minded, hard-working, highly motivated people. (Immigrants are an important part of this mix in many places.) "It's like a bunch of squirrels looking for nuts," observes Charlie Wilson, a 27-year-old entrepreneur who has built his own successful salvage company in Houston. "Everyone is coming here because it's cheap, and people are getting into a lot of new businesses."

Houston boasts the kind of unabashedly egalitarian spirit that nurtures entrepreneurs and new companies. "This is the kind of city where nobody cares where you came from," says Debra Ward, whose ten-person public relations firm last year grossed roughly $1 million. "If you can produce, it doesn't matter who you are. When I talk to CEOs here, I find that a lot of them were brought up in a trailer park too."

This classlessness is reflected in the strong cooperative spirit that exists among Houston entrepreneurs. "Being an entrepreneur is essentially lonely, but here you can be part of a community too," Charlie Wilson explains. "These guys put me on the spot all the time, challenging how I do my business. They are always saying, 'don't get radical on me,"' Wilson says, with a boyish smile. "You build a real camaraderie with them. In some ways, Houston's still a small town where everyone knows everyone and people like to see other people succeed. It's part of the magic of the place."

Entrepreneurial souls come in decidedly different casings. While Houston entrepreneurs like Charlie Wilson talk unashamedly of religious and moral character as key to their success, in southern California, the spirit tends to be individualistic, creative, and anti-

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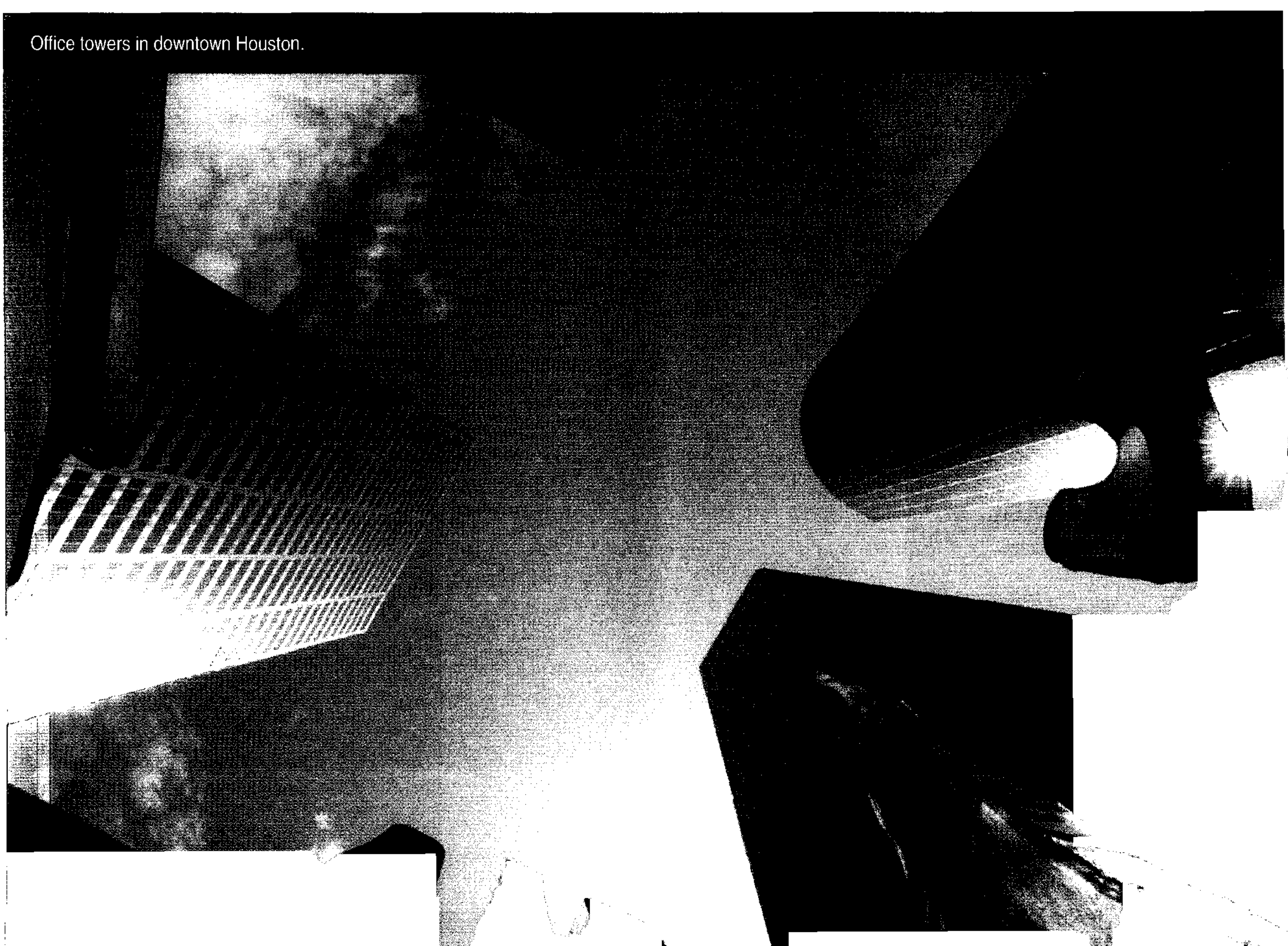

Office towers in downtown Houston.

Tim Thompson/Corbis

establishment. Southern California remains one of the nation's leading entrepreneurial hotbeds—last year producing the most new companies of any part of the country—in part because the region traditionally has little respect for established hierarchies.

In contrast to the generally supportive environment in Houston, L.A.'s business, media, and academic establishments reacted to hard times in the early 1990s by denouncing the city as a kind of Third World dystopia.

Yet the Los Angeles economy has recovered strongly, and in Houston, it's been little guys who have led the effort. "The expansion is all in the small companies. Nothing much is happening from the larger companies," observes Linda Griego, president of the economic development organization formed after L.A.'s 1992 riots.

Nowhere is this entrepreneurial resurgence clearer than in small, business friendly southern California cities like Burbank. Long the home of studios like Disney and Warner Brothers, the city of 98,000 now provides a comfortable base for over 1,000 smaller entertainment and technology firms. Its office and industrial vacancy rate is one-third that of big business-dominated downtown Los Angeles, right next door.

One key, as in Houston, lies with politics. When Burbank's largest employer, Lockheed, deserted town in the early 1990s, taking with them 14,000 high-paying aerospace jobs, the city streamlined regulations and offered business incentives in order to bolster their second largest source of jobs, the movie and television business. Meanwhile politicians in Los Angeles, Burbank's main competition, decided to keep fees high and the regulatory regime in place. Burbank became the unlikely first choice over Hollywood for many expanding entertainment firms.

Burbank's business taxes total less than $20 per employee, compared to over $140 in L.A. Perhaps more importantly for a fast-paced business such as entertainment, Burbank can complete a conditional use permit or zoning change at about one-third to one-quarter the time required by the City of Angels.

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Kansas City native Bob Tague, Burbank's beefy community development director, notes over cappuccinos that "We still have a blue collar image—you don't have the ocean breezes and the big estates." But what they have may be more important, as Theo Mayer, who moved his small entertainment company called Metavision from Hollywood to Burbank in 1990, notes: "I'm a middle class yuppie and I like to be comfortable. Hollywood was getting creepy," Mayer recalls. "We were losing equipment and had to walk people to their cars at night. I loved it when the cops in Burbank gave me a jaywalking ticket."

Not all entrepreneurial cultures flourish amidst great metropolitan regions. For many entrepreneurs, the friendliest places to live and build a business are in suburb-like "edge cities." Today nearly two-thirds of the nation's office space is located in such places, roughly four-fifths of which did not even exist 25 years ago. According to demographer David Birch, president of Cognetics, areas 25 miles out of a city center have enjoyed job growth rates of over two percent annually since 1990, while those within ten miles expanded at roughly 1.5 percent and those within five miles grew 0.5 percent. In inner cities themselves, job growth has been negative.

The most successful edge cities combine lifestyle, cost, and security attractions with a first-class business infrastructure. Science-based hubs Austin, San Jose, Orange County, California, and the Raleigh-Durham "Research Triangle" provide a highly ordered business culture that is perfectly suited to the high-tech crowd. "Engineers and software people are folks whose whole lives are based on logic and order, so this place appeals to them," observes David Russo, director of human resources at Sass Institute, a Raleigh-Durham software firm with revenues of over $500 million.

Raleigh-Durham added 87,000 new residents between 1990 and 1995, with companies and people surging in particularly from the northeastern U.S. So heavy is the migration that Cary, a fast-growing local edge city, has been dubbed "Containment Area for Relocating Yankees." The lure has been development of a series of northeastern parks close by three local universities—Duke, the University of North Carolina, and North Carolina State. The arrival of a massive IBM facility in 1973, now Big Blue's biggest outpost in the world, put the region on the map. Other big firms like Burroughs, Glaxo, Wellcome, and Northern Telecom followed.

More recently there have been downsizings in some large firms, and the big company orientation has given way to a more entrepreneurial configuration. Many of the smaller companies have based their growth on a talent pool lured initially by large companies.

With annual sales approaching $1 billion, Quintiles is a quintessential Research Triangle company specializing in bio-statistics. Here advanced mathematics computer modeling is applied to the needs of biomedical, pharmaceutical, and chemical firms. Most of the 600 employees at the North Carolina headquarters are highly trained white-collar workers—doctors, pharmacologists, computer programmers.

"We're a very fast growth company and we are recruiting in occupations where there's often a scarcity," company founder and CEO Dennis Gillings explains. "But the good news is we can get people locally. We don't relocate a lot of people. This area tends to keep people because they like it here."

Another place that appeals to propeller heads, geeks, and scientists is the city of Irvine in southern California, concocted three decades ago as the antidote to chaotic Los Angeles 40 miles to the north. Today where only rolling Cal-

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ifornia savanna stood, a city of 118,000 residents and companies employing over 165,000 people has evolved. Like the Research Triangle, its development was begun by bigger firms, such as Baxter Laboratories, Mazda, and Toyota, but its company roster increasingly reflects smaller, growing concerns. Last year, the city produced nine firms on the *Inc.* 500 roster of fastest growing businesses, more than any community—large or small—in the nation.

Like many of Irvine's entrepreneurs, Angel Cordero, founder of Powerwave Technologies, a firm with 1996 sales of roughly $50 million, didn't start in Irvine. He started Powerwave, which makes amplifiers for the telecommunications industry, in 1985 in Garden Grove, an older industrial area southeast of Irvine. It was a convenient, cost-effective location. But Cordero would sometimes leave his office and find drunken revelers on the lawn in front of his building. "It wasn't the atmosphere we were looking for," says Cordero, an engineer originally from Mexico. "People started finding their cars broken into and women didn't want to stay there at night to work."

So in 1993 Cordero moved Powerwave to Irvine, which boasts the lowest local crime rate of any American city over 100,000. Over 50 percent of Irvine's adults possess at least a college degree, well over twice the national average. Irvine also has the advantage of being located amidst a dense concentration of technology companies—including such firms as Western Digital, Toshiba, ALR, and AST Research—providing a talent base critical for rapidly expanding firms.

In the 1990s, a dramatic new locale for entrepreneurial activity lies in predominately white, small town and rural communities far from traditional commercial centers. After dropping for decades, the U.S. rural population has been accelerating, fueled largely by ex-urbanites.

Like the Edge Cities, rural Valhallas have outperformed the rest of the nation as centers for entrepreneurial growth. Even in the midst of the early 1990s recession, 82 percent of manufacturing-oriented rural counties experienced growth. Indeed Calvin Beale, a researcher with the U.S. Department of Agriculture, notes that the 1990s downturn constituted essentially a "metropolitan recession," with businesses and individuals packing off for the hinterlands. "People want to get out because of the high costs, the turmoil, the crime, the pollution, the changing racial mix," Beale explains.

Valhalla migration has occurred in a broad array of locales, varying from Flagler County in eastern Florida to Arizona's Mojave County to Pike County, Pennsylvania. These areas have attracted entrepreneurs interested in the "lifestyle" aspects of rural locations.

"Am I sorry I moved?" asks Staten Island native Steve Valenti, President of South Florida Bank. "Never, never, never. I was at 42nd and Park Avenue, and one day I left the office and half-way across the street almost got run over. I realized that at some point you have to put some price on the quality of life—and my quality back there stunk."

It's largely professionals like Valenti—already successful and "liquid"—who are bringing new entrepreneurial life to America's Valhallas. Carol Conway, a former IBM executive who spent much of her earlier career in such high-tech hotbeds as Orange County, San Jose, San Francisco, and Dallas, migrated with her husband to the flat marshy coastlands of southwest Florida seeking a place that would be pleasant to live in as well as meeting their economic needs.

For years this area—home to the cities of Naples and Fort Myers—has been a destination for retirees and vacationers, but Conway also discovered a low cost locale, with median home prices under $80,000, and a surging full-time resident population, with 10,000 people now moving in annually. Though not on the cutting edge of the high-tech revolution, southwest Florida had an expanding number of home-based and service businesses requiring reliable experts to help maintain their computer systems.

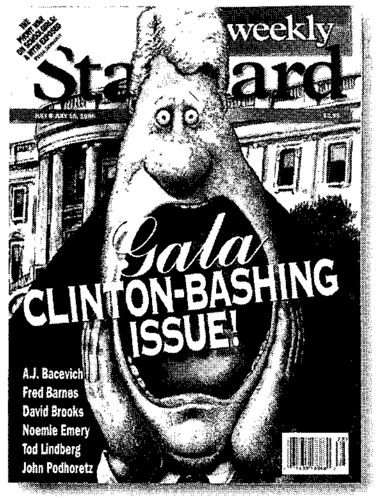
With these factors in mind, Conway in 1993 bought a struggling "mom and pop" computer repair shop for $125,000 and renamed it The Computer Rescue Squad. Since then, it has grown to 18 employees, serving 605 clients spread throughout the sprawling region. Sales last year were $2.1 million, more than double the previous year.

"There was nobody around here with a background in on-site network support," says Conway. "Many businesses here—the bread and butter of our community—are smaller companies with five to 25 PCs. Companies big enough to need help, but not so big as to have their own information service managers. It's not Silicon Valley, but it's turned out to be a nice little market for us."

Ultimately, though, Carol Conway says it's the cultural aspects of doing business in the Naples area that brings her the most satisfaction. "In a growing place like this there is really no established pecking order," she observes. "You feel you can come here, roll up your sleeve, build a business, and share in the growth of a great community. You're not just a shooting star out alone, but part of a network of people."

Perhaps more than anything else, it is that sense of connectedness that marks all great entrepreneurial cultures, whether along Florida's humid coast, amidst the creative studios of Burbank, the sleek high-tech facilities of a Raleigh-Durham, or the gritty streets of downtown Houston.

"At the end of the day, it boils down to people who share values and know how to deal with adversity without losing faith," Houston's Charlie Wilson says. "You have to have the faith that if you work hard together, you can make it better. And we can, you know."



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ADDING THE FUEL OF ECONOMIC INTEREST TO THE FIRE OF INVENTION

By Michael Novak

On a cold winter day in February 1859, in Jacksonville, Illinois, Abraham Lincoln delivered a "Lecture on Discoveries and Inventions," in which he described six great steps in the history of liberty since the time of Adam. The last of these great steps, Lincoln held, is the law of copyrights and patents. Until I read Lincoln on this point, I had never encountered anyone who gave patents and copyrights such high importance.

On that cold day on the Illinois prairie, you must imagine Lincoln, tall and gangling, gazing across the stove- heated room. "Look around at Young America," he says. "Look at his apparel, and you shall see cotton fabrics from Manchester and Lowell; flaxlinen from Ireland; wool-cloth from Spain; silk from France; furs from the Arctic regions, with a buffalo robe from the Rocky Mountains." On Young America's table, one can find

> besides plain bread and meat made at home...sugar from Louisiana; coffee and fruits from the tropics; salt from Turk's Island; fish from New-foundland; tea from China, and spices from the Indies. The whale of the Pacific furnishes his candle-light; he has a diamond-ring from Brazil; a gold-watch from California, and a Spanish cigar from Havanna.

Not only does Young America have a sufficient, indeed more than sufficient, supply of these goods, but, Lincoln adds, "thousands of hands are engaged in producing fresh supplies, and other thousands, in bringing them to him."

Thousands of years, however, were needed to develop the habit of observing, reflecting, and experimenting, and then to spread that art throughout society. Some societies develop that habit socially, and some do not. Why, Lincoln asks, when Indians and Mexicans trod over the gold of California for centuries without finding it, did Yankees almost instantly discover it? (The Indians had not failed to discover it in South America.) "Goldmines are not the only mines overlooked in the same way," Lincoln notes. Indeed, there are more "mines" to be found above the surface of the earth than below: "All nature—the whole world, material, moral, and intellectual—is a mine.... It was the destined work of Adam's race to develop, by discoveries, inventions, and improvements, the hidden treasures of this mine."

The crucial step in opening up America's wealth mine was the adoption of our Constitution—in which the word *right* occurs only once, and that in Article I, section 8, which recognizes the natural rights of authors and inventors to the fruits of their ingenuity. Among the few powers expressly granted to Congress, the Framers inserted this one: "To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."

"Before then," Lincoln says, "any man might instantly use what another had invented; so that the inventor had no special advantage from his own invention." Lincoln cuts to the essential: "The patent system changed this; secured to the inventor, for a limited time, the exclusive use of his invention; and thereby added the fuel of *interest* to the *fire* of genius, in the discovery and production of new and useful things."

"The fuel of *interest* added to the *fire* of genius!" Ever the realist, Lincoln knew what is in the human being: to be a genius is one thing, to be motivated is quite another, and then to be supported in this motivation by a wise regime is an unprecedented blessing. By contrast, a regime that does not secure natural rights depresses human energy. Natural rights are not mere legal puffs of air; they formalize capacities for action that in some societies lie dormant and in others are fueled into ignition.

The United States, Lincoln believed, lit a fire to the practical genius of its people, among the high-born and the low-born alike, wherever God in His wisdom had implanted it. In the same year as his lecture, 1859, Lincoln himself won a U.S. patent, number 6469, for a "device to buoy vessels over shoals." That patent is not a bad metaphor for the effect of patents on inventions: to buoy them over difficulties.

The effect of America's patent and copyright clause on world history has been remarkable. During most of human history, land had been the most important source of wealth; in America, intellect and know-how became the major source. The dynamism of the system ceased to be primarily material and became, so to speak, intellectual and spiritual, born of the creative mind. In favoring the Homestead Act and the patent clause, Lincoln aimed to prevent the American frontier from being dominated by large estates and great landowners, so that it might become a society of many freemen and many practical, inventive minds. And so it has: More than 5 million patents have been issued in the United States since the first patent law of 1790.

This is excerpted from a September 1996 Pfizer Lecture delivered at the American Enterprise Institute by the institute's George Frederick Jewett scholar, Michael Novak.