

Hot Cities 2006

Whether you're looking to expand, relocate or simply stay put, our 12th annual Hot Cities report will give you the lowdown on the nation's most dynamic cities for entrepreneurs.

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The Right Spot

Phoenix boasts some of the hottest temperatures around, but that's not all--it's also a hotbed of entrepreneurial activity. For the second year running, Phoenix has captured the top spot in Entrepreneur and NPRC's Annual Entrepreneurial Hot Cities rankings of the nation's best places to start and grow a business.

In the rest of the West, outside high-tech powerhouse San Diego, the high-cost Golden State is losing a bit of its luster these days. But an influx of house-rich California migrants has boosted the entrepreneurial energy level in surrounding states and cities, including top-ranked Phoenix.

Overall, Southern locales really stand out this year. In fact, seven of the top 10 states are in the South, according to data from the National Policy Research Council, a Washington, DC, think tank that calculated the Hot Cities rankings with Entrepreneur. With affordable home prices and lower-cost labor, many large and small Southern cities are drawing entrepreneurs. The South also bounced back from the downturn of 2001 and 2002 faster than other parts of the country--thanks to well-diversified economies that didn't rely too much on the high-tech sector.

The Midwest has fewer bright spots; manufacturing declines and auto-industry woes kept this region from returning to its pre-recession highs. The lagging Northeast, meanwhile, continues to struggle to rebuild its post-crash economy, hobbled by stagnant population growth and a dearth of available land.

There's more to the story, however. Read on for a region-by-region breakdown that highlights the hot spots, uncovers regional challenges and examines the economic trends every entrepreneur should know about--whether you're looking to expand, relocate or simply stay put.

West

In the West, the song has remained the same for decades. Californians continue to cash out their fat real estate profits and relocate to more affordable western states, says Lee McPheters, an Arizona State University business school dean and economist who contributes to the highly regarded Western Blue Chip Economic Forecast.

The California exodus is a major factor in the continued strength of the business climate in top-ranked Phoenix and number-four Las Vegas, McPheters says. Other cities in the West also continue to benefit, with Seattle and Portland both moving up the rankings this year, from 40th to 31st and 41st to 36th, respectively.

Meanwhile, back in the slightly tarnished Golden State, the Los Angeles metropolitan area, which includes Riverside and Orange Counties; San Francisco; and Sacramento all moved down the rankings, though none fell more than three places. Of California's major markets, only San Diego, with its booming and well-diversified high-tech sector, rose up the ranks this year. At 20th overall, San Diego was the highest-ranked big city in the state.

The study found six western states were better suited than California to sustain growing businesses, including top-ranked Arizona, Hawaii (15th) and Alaska (17th). Job growth in Idaho (34th), Nevada (10th) and Arizona averaged 5 percent in the past year, McPheters says, while in California, it's 1.5 per-cent, more on par with the national average.

Contrary to popular myth, Arizona's California migrants are not primarily retirees, McPheters says. Most are between 20 and 39 years old--prime entrepreneurial years. "There's a lot of opportunity for new businesses because of the population growth, especially in sectors [such as] real estate, food service, tourism, relocation businesses," he says. People are drawn by Arizona's vast tracts of available land and low-priced homes. But the California influx is changing that rapidly--

home prices in the greater Phoenix area, where 75 percent of Arizona's new residents settle, shot up 50 percent in the past year.

In the meantime, the California government is focused on improving the business climate in the state. At the Milken Institute in Santa Monica, director of regional economics Ross DeVol notes improvements such as cuts in workers' compensation insurance rates. Tech-focused regions such as San Francisco and San Jose/Silicon Valley continue to recover from the dotcom crash of the early 2000s. With big-city home prices through the roof, DeVol says more residents are commuting to jobs in Los Angeles' outlying northwestern valleys from cheaper but far-off Bakersfield and beyond, bringing new business opportunities to these towns.

One promising sign: As of June, the state's revenue was running \$7 billion over forecast. "Jobs are being created, and they're higher-paying jobs," DeVol says. "[California] is still a great place to start a business."

Growing in the Sun

Brenda McCaffrey, 52, worked in Southern California for years. But she returned to Phoenix--where she'd attended Arizona State University--to start her circuit-testing company, White Mountain Labs. The 7-year-old business projects \$3 million in sales this year.

Aside from the sunny, outdoorsy lifestyle Phoenix offers, McCaffrey says the city's advantages include low commercial rents and housing prices. There's also an easily accessible international airport for White Mountain's overseas clients. With major technology powerhouses such as Intel Corp. nearby, skilled workers abound.

"There's fantastic infrastructure here to run an international business," McCaffrey says. Another plus: The local banking community is highly receptive to loan pitches from growing businesses. The city of Phoenix even helped guarantee her first SBA loan through its Expansion Assistance and Development, or EXPAND, program.

MidWest

The Midwest region overall wasn't a strong performer in this year's study. But it has several business hot spots, including the Kansas City area, Chicago and Madison, Wisconsin, which ranked sixth among midsize cities.

Geoffrey Hewings, director of the Regional Economics Applications Laboratory, or REAL, at the University of Illinois, Urbana-Champaign, says Midwestern states aren't doing enough to encourage trade within the region. While the U.S. signs free-trade agreements with Canada and Mexico, trucks still need a license plate for each U.S. state they drive through, and each state has its own weight limits and regulations on interstate shipping. Some 40 per-cent of Midwestern out-of-state exports go to other Midwest states, Hewings says. Streamlined trade between the states could provide a substantial economic boost.

Though productivity has improved here over the past few years, employers still appear hesitant to add workers, says Hewings. At current growth rates, it will take top-ranked Midwestern state Illinois (ranked 12th nationwide) another 30 months to return to its pre-recession economic peak, he estimates. The rest of the Midwest still has three full years to go before its business community is back to its previous high.

The Midwest's economic black hole is Detroit, which came in 29th. The sagging fortunes of auto giants Ford and General Motors are having ripple effects in the business community, according to Hewings. A recent study by REAL estimates that the future negative economic impact of GM's planned pension cuts will run in the billions in Michigan alone.

In 12th-ranked Chicago, many city boosters are seeking to replace old-time manufacturing jobs and foster a more entrepreneurial, business-friendly climate. New institutions to support growing businesses have been springing up, says Paul O'Connor, executive director of economic development organization World Business Chicago. For instance, the Chicagoland Entrepreneurial Center and the University of Chicago's Polsky Center for Entrepreneurship both opened in 1999, and last year, the city created a small-business assistance office.

Chicago has its central location going for it, as well as its low business costs relative to major U.S. coastal cities. Downtown Chicago is humming with new activity, including the Wrigley Global Innovation Center, which was opened last year by gum and LifeSavers giant Wm. Wrigley Jr. Co.

For its part, 11th-ranked Kansas City boasts a longtime entrepreneurial climate, says O. Homer Erekson, dean and professor of economics and business policy at the University of Missouri-Kansas City's Bloch School. The culture of innovation here dates back decades, to tax giant H&R Block and Marion Laboratories. The charitable foundation created

by late Marion Labs founder Ewing Marion Kauffman continues to be a big supporter of growing businesses in the area and nationwide.

One recent Kansas City innovation that's being copied all over is KCSOURCELINK. Founded three years ago, KCSOURCELINK gives entrepreneurs easy, one-stop access to more than 140 service providers. A national version, U.S.SOURCELINK, is now rolling out around the country.

Revvng Up

With major employers including Applebee's, Hallmark and Sprint, Kansas City is humming with economic activity, says Gail Worth, 41. The owner of Gail's Harley-Davidson, which she bought six years ago, Worth says the company--located in the suburb of Grandview--will see \$21 million in sales this year.

Worth loves the city's four-season climate, with brief winters that keep shoppers browsing for bikes almost year-round. City government is highly accessible, and the business tax and regulatory burden is light.

"Politicians here are actually fun to be around," Worth says. "From the mayor to the city council, they get out there and meet with people. If I have an issue, I don't hesitate to pick up the phone."

She also cites a strong chamber of commerce, which helps connect businesses with specific expertise to others who might need help. There are plenty of business networking events, too.

South

With lower housing prices and cheaper labor, many areas of the South are drawing entrepreneurs. But the region's success in attracting and growing businesses is mostly concentrated in a few "hot spots," notes Randall Jackson, director of the Regional Research Institute at West Virginia University.

Case in point: Charlotte, North Carolina, which has ranked second two years running. Local chamber officials cite a steady immigration of young, educated workers and a large, business-friendly banking community as prime factors for the city's success.

Among Southern states, some are booming while others languish. Examining state gross product in the Southern states excluding Texas from 2001 to 2005, Jackson says Virginia--the study's second-highest-ranked state--and eighth-ranked Tennessee saw output grow 24.9 per-cent and 35.3 percent faster than the national rate, respectively. Alabama (3rd) and Arkansas (33rd) also outpaced the nation, by 17.9 percent and 21.7 percent, respectively. But most other Southern states are seeing output grow more slowly than the national rate of 12.2 percent.

With most Florida cities moving down the rankings, the state is clearly still struggling to overcome the effects of the recent hurricanes that caused widespread damage. The hard-hit Fort Myers-Cape Coral area, for instance, sank from 34th in 2005--before most hurricane impacts had been tallied--to 48th this year.

Jackson says the South's overall strong showing is the payoff from decades of migration of businesses and people to lower-cost Southern towns. As more business owners gained experience with the South's favorable working conditions, word spread. The region has gradually banished its past negative reputation as a racially tense area populated primarily by unskilled workers.

Some Southern cities have also become more aggressive in actively courting growing businesses in recent years. For instance, in Shelby County, Tennessee, home of seventh-ranked city Memphis, county mayor AC Wharton Jr. recently approved a program to offer cash-strapped small businesses legal and accounting help at county expense if they need assistance completing the required paperwork to qualify for government contracts. "The key is the signal it sends that in the government sector, we are serious about doing business with small business," Wharton says.

The South's rising star is Texas. With its economy firing on all cylinders, the state jumped from 17th in 2005 to 11th in this year's rankings. Where once oil prices could cause boom and bust, the economy is now well-diversified and strong in international exports, technology, financial services, and wholesale and retail trade, says Dallas Federal Reserve Bank economist Fiona Sigalla. At the moment, of course, with gas prices high, it's boom time in the oil industry, too. The rig count in the state recently hit 750, a level Sigalla says hasn't been seen there since the mid-1980s.

Other Texas advantages: lots of available land for building, a population growth rate nearly double the nation's, a relatively low cost of living and scant regulation. Texas also has no state income tax, which Sigalla says appeals to

entrepreneurs who are worried about their personal tax bills.

It's Got the Beat

Jonathan Epstein, 37, has a wide-angle view of thriving Memphis. The city native is co-founder of Running Pony Productions, a 12-year-old video production company that's grown to more than \$1 million in annual sales.

Tourism is booming here, thanks to renewed interest in Memphis' key role in American music history. Running Pony counts Elvis Presley Enterprises and Graceland as major clients.

Epstein describes the business climate as "regulation-light and easy to navigate." With big-city salaries and a median home price of about \$140,000, quality of life here can't be beat. "I've been thrilled to be able to stay home, build a business and do exactly what I love," he says.

The city is a major national distribution hub that boasts headquarters for AutoZone, FedEx and ServiceMaster. And International Paper just moved to town. There's ample opportunity here for growing businesses to work with the big boys, says Epstein.

Northeast

New Jersey is the shining light in the generally under-performing Northeast. The Garden State sank from second place last year to fourth, but it's still the highest-ranked Northeastern state. Strengths include easy access to scores of consumers in the New York/Philadelphia/Washington, DC, area and good infrastructure, including major airports and seaports, says Virginia Bauer, CEO of the state's Commerce, Economic Growth and Tourism Commission. The high level of economic activity means there's plenty of opportunity for startups to jump into the game.

The state's new governor, former Goldman Sachs CEO Jon Corzine, has asked for a review of the state's financial and tax incentive programs, with an eye to making sure growing businesses get their share, Bauer says.

Across the Hudson River in 35th-ranked market New York City, Federal Reserve Bank senior economist Rae Rosen says the city's small-business sector is often underestimated. Though our study tracked only businesses with five employees or more, Rosen says the city's large immigrant population teems with self-employed businesspeople.

"Within the 2nd District [of the Federal Reserve] of New York; New Jersey; and Fairfield, Connecticut, we see a far more robust picture," says Rosen. "These small businesses are under the radar."

But in upstate New York, Rosen says, as in much of New England, the outlook is bleaker as manufacturing plants continue to migrate southward and overseas.

Boston Federal Reserve Bank senior economist Katharine Bradbury, who studies the New England economy, says the region continues to struggle to recover from the economic downturn of the early 2000s, which hit hard here. New England's employment rate is still down 2 percent from its pre-recession peak, while the nation's employment rate has risen 2 percent above its bubble-bursting low.

The region suffers from a lack of affordable and available land, Bradbury notes, and the employment growth rate is about half that of the nation. One result of the fairly stagnant economy is low population growth--Massachusetts actually had a net population loss in both 2004 and 2005.

On the upside, the area boasts an unemployment rate lower than the national average: It was 4.5 percent in May 2006, vs. 4.6 percent nationwide.

University of Rhode Island economics professor Leonard Lardaro says lower-population states in the Northeast are grappling with ways to become more alluring to business owners. "Rhode Island is trying to find its way as far as its tax and cost structure," he says. "We're trying to be more competitive with Massachusetts and Connecticut." Among Northeastern cities, the Washington, DC-Baltimore area, which ranked sixth for the second year, is the region's top market. Chamber senior vice president of marketing and communications Chris Knudson says a boom in the redevelopment of blighted neighborhoods within the area has created ample opportunity for entrepreneurs.

Downtown Revival

At 2-year-old Moda Restaurant & Lounge in downtown Providence, Rhode Island, chef/owner Jules Ramos is benefiting

from his city's on-going urban-renewal efforts. Born in Angola, Ramos, 38, says his Portuguese-inspired waterfront eatery does nearly \$2 million in annual sales.

The city is coming back from a low point four years ago, when its longtime mayor was jailed after a scandal. Once a blighted urban core, downtown is now sprouting upscale condo towers. The city, which lost population from the 1970s on, began to gain residents again around 2000.

Because the economy is still recovering, Ramos says the city offers ample assistance to growing businesses. It has also introduced numerous special events--including WaterFire, a series of riverside-bonfire nights--that draw visitors downtown.

Seattle writer Carol Tice reports on business and finance for The Seattle Times, Seattle Magazine and other leading publications.

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