

## **Industrial Diversification: Is Your Local Business Portfolio Balanced?**

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Like a personal investment portfolio, balance among different sizes and types of companies is the key to growing a resilient local business base that will weather national economic storms. Local economies are linked with regional, national and international economies, and local economic fortunes depend upon a confluence of events outside the local area, changes within specific industries, the region's economic history, as well as the factors that contribute to the local economy.

Economic development professionals that focus solely on local factors and look only at local events cannot develop effective long-term policies and goals that are in harmony with the powerful influences national and global events have on local economies.

A recent article in *Current Business Review* examined some of the significant economic literature related to the interaction between the national economy and the regional and local economies, and provided valuable insights into the complexity of these interactions (["A Confluence of Events? Explaining Fluctuations in Local Employment," by Gerald A. Carlino in Current Business Review, Quarter 1, 2003, pp 6-12](#)). Part of the complexity results from the influence of specific industries on the national economy. At the national level, about 50 percent of the economic fluctuation is a result of disturbances that have affected specific industrial sectors.

These industrial sector effects, however, affect multi-state regions to different extents, depending on each region's industrial makeup. About 80 to 90 percent of the fluctuation in a region's economic activity is a result of changes to economic factors critical to the region's industries. This analysis suggests some important guidelines for regional and local policymakers and economic development professionals.

Those wishing to encourage their region's economic health should develop strategies to diminish the impacts on the local area from shocks to specific industries. Although these shocks indicate that the area has a vital link to the national and global economies, local industrial concentrations will result in a more intense and longer-lasting economic shock. Some examples of regional industrial concentrations that could negatively affect a local area include:

- A region with a concentrated industry group dependent on external inputs or events, such as industries that heavily use foreign steel in production
- A region with industries that depend on military procurements from the federal government
- A region with a concentration of industries that are affected by stock market movements

The research also shows that negative shocks, such as a company closing, will have a larger impact on the region than a positive shock, such as a company of the same size moving into the area.

Additional economic shocks to a regional economy result from:

- Interest rate changes by the Federal Reserve - again, affecting some regions more than others, depending on each area's industrial makeup
- Changes in local or state legal structures, including:
  - The imposition or elimination of taxes by municipal governments

- Legislation that affects business costs

These analyses suggest that policymakers and economic development professionals pursue strategies that reduce risk by encouraging industrial diversity and establishing training programs to enhance the skills of workers in economically troubled industries. This will promote labor mobility across sectors and help develop an internationally competitive workforce.

While the need to develop local strategies in harmony with regional and national trends and the need to pursue a balanced industrial structure seems clear, significant challenges can exist. Two potential challenges could come from the current "champion industries" in the region that expect economic development policies to focus solely on them and from employers who perceive workforce cross-training as counterproductive. The good news is that these and other challenges to good economic development policies can be overcome through education about the value of a diversified industrial portfolio and through integrity and political fortitude.