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Final Report

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Introduction

Standard economic development strategies are firmly based on an export-base model approach. According to this model, a region's growth depends upon the ability of its businesses to sell their goods or services to customers located outside their local region. This ability depends upon both the competitiveness of the regions' businesses and the strength of their national and international markets. A highly competitive firm in a struggling industry could bring in less economic activity to a region than a less-than-average competitive firm in a robust international or national industry.

One major exception to this general definition of an export industry occurs when an industry generates new income for the region by attracting out-of-the region customers into the region. In other words, the service or good stays but the customers move. This is the case with tourism, specialized medical care, and major retail centers. In these cases, quality often trumps price. It is the quality of the tourism activity, the uniqueness of the medical care, and quality of retailers' goods and selection e.g., Michigan Avenue in Chicago, that attracts customers into the region.

This report identifies the potential benefits to the greater Grand Rapids area[1] of exploring an alternative route—import substitution. Import substitution occurs when a product or service that was previously purchased from outside the region is instead supplied locally. This approach is based on the fact that retaining a dollar that would have been spent outside of the area has the same impact as a dollar brought in from outside the area.

In fact, Jane Jacobs and others argue that import substitution holds the potential to grow the area's future export-based sector.[2] Jacobs highlights the development of denim jeans in the San Francisco area at the time of the 1849 Gold Rush. The highly durable pants were originally created to compete against imported clothing. Indeed the company (Levi's) captured the lion's share of the market because its jeans met the demanding needs of the region's miners and ranchers. More importantly, as the company grew, it became a major exporter for the region. The same story is repeated for professional service firms which may start out as meeting the needs of local clients, but then take on national clients as their expertise, experience, and reputation grows.

[1] The greater Grand Rapids area includes the Grand Rapids–Wyoming MSA, Holland–Grand Haven MSA, and Muskegon–Northern Shores MSA.
[2] Jane Jacobs, *The Nature of Economies*, Modern Library, New York, 2000.

Import substitution is also an important ingredient in the development of the region's industrial clusters. Clusters excel due in large part to their superior and unique supply base that can provide the inputs, technology, and innovation to the cluster's final product producers. Suppliers outside the area are at both a logistical disadvantage making it difficult for them to meet demanding just-in-time delivery schedules and a networking disadvantage because they are less able to be in constant physical contact to their customers.

Import substitution strategies share much with "buy locally" campaigns. The only major difference is that "buy locally" campaigns typically focus on consumer retail purchases, local government procurement policies, and locally-grown agricultural produce, while import substitution strategies focus on business-to-business linkages as well as consumer-to-business transactions.[3]

Import Substitution Strategies—Regional vs. Neighborhood

This analysis explores the economic development potential of a region-wide import substitution program. Similar efforts can and are proposed and implemented on the neighborhood level as well. The Madison Square retail area in south Grand Rapids was developed to redirect neighborhood dollars that were being spent outside the neighborhood, to supporting a much-needed retail shopping area for the neighborhood which was underserved. Revitalization efforts for neighborhood shopping areas and small downtowns often contain a "buy locally" component.

These programs are very important because the health of all cities depends on the vitality of their neighborhoods and downtowns. The downtowns of Holland, Grand Haven and Rockford, along with the East Town neighborhood of Grand Rapids, the Gas Light Village of East Grand Rapids, and the numerous other unique shopping districts in the greater Grand Rapids-Muskegon-Holland area enhance the region's attractiveness. However, simply redistributing shopping patterns from suburban shopping areas back into urban retail districts does not attract new economic activity into the region's export base, and therefore is not the focus of this report. Moreover, many out-of-town shopping trips are triggered by the unique attributes of the competing area such as Chicago's "Magnificent Mile" which cannot be duplicated locally. The focus of this report is to evaluate the potential of import substitution efforts to enlarge this base, strengthening the overall regional economy.

[3] Many local governments have enacted local procurement preference policies. These typically take one of two forms. A "second chance" policy offers a local bidder, whose bid was very close to the winner bidder's price, the opportunity of getting the contract if they can meet the winner's bid. This policy costs the city little in terms of out-of-pocket expenses since the price to the city of the procured good or service does not change. The second option is to award the bid to a local bidder if he/she is within a set range, 1 to 5 percent, of the winning out-of-area bid. This policy can result in higher out-of-pocket costs as the city is paying a higher price for the good or service.
In general, economists are wary of local procurement preference policies because they can increase the cost of procurement by restricting competitive bidding. Out-of-area companies may not respond to bid requests because of the increased likelihood that they would not get the bid. In addition, local bidders have the incentive to be a little less competitive with their bids because they will either get a second chance or get the bid if they are simply "close" to the winning bid.

Import Substitution and Second-tier Metro Areas

In the past, manufacturing activities were the primary generators of income growth for many regions. However, as the national economy becomes more and more service-oriented, the ability of a region to provide services and produce ideas is growing in importance as a generator of new income.

Unfortunately, with this shift from manufacturing to services, smaller independent urban areas face serious challenges, the major one being the difficulty in attracting professional workers. Service industries depend on human capital to succeed; however, smaller regions may not be able to successfully compete for base-service functions against larger regions because of thin labor markets for professional workers.

Individuals possessing high-demand occupational skills can increasingly pick their residential locations. Professional workers seem to be attracted to regions which offer plentiful employment opportunities for themselves and their significant others. Second, professionals look for regions which hold the potential for advancement in skill development, career responsibility, and income growth. Some evidence suggests that in many professions advancements are inter-firm and not intra-firm, which puts regions with a greater breadth of companies at a competitive advantage. Finally, for workers with high incomes and high mobility, quality-of-life factors are playing an ever-increasing role in relocation decisions. In fact, some researchers have identified a trend among younger and more highly educated workers toward deciding on what city or region they want to live in before initiating a job search.[4]

An effective "import substitution" effort could make a difference. If a smaller regional area can fill in some of the common gaps in business and professional services found among similar-sized communities, then it would be able to offer more employment opportunities for professional workers. In addition, "buy locally" campaigns, as discussed above, can help create attractive and unique neighborhoods, which in turn can influence the local decisions of professionals. Still, for the effort to reach its full potential it would have to be integrated with a larger quality-of-life initiative as well.

Outsourcing vs. Import Substitution

The drive to outsource more and more manufacturing and service functions to either domestic or foreign providers continues to remain strong. Any non-core activity is a candidate for outsourcing. As reported in the July 2006 issue of *Industry Week*, a 2005 study prepared by AMR Research Incorporated found that 30 percent of the nearly 300 manufacturers it surveyed outsource at least a portion of their product-development activities, and more than 70 percent are planning to increase by 2008 the amount of their R&D and engineering process that is outsourced. Costs savings are, of course, one goal in outsourcing, but firms are also reportedly exploring outsourcing to increase efficiency and flexibility.

First it must be said that outsourcing is not the same as offshoring. Many outsourced activities remain in the country; a reasonable goal of an import substitution strategy would be to work to

[4] Richard Florida, *The Rise of the Creative Class*. Basic Books, New York, 2002.

have the outsourced activity remain in the community. In fact, outsourcing to a local supplier is attractive because it can provide expertise within shouting range if something goes wrong or needs attention.

By their very nature, many outsourced functions are local. Some of the most common examples include landscaping, building maintenance, and food services. The challenge is to capture the more professional activities such as accounting, advertising/media production, information technologies, and legal activities that may be outsourced by regional firms. Also, in manufacturing, there is a marked increase in the use of third-party logistics providers. More than half of the manufacturers who responded to the 2005 *Industry Week* Value Chain Survey revealed that they outsourced some of their logistics functions, such as trucking, warehousing, and distribution.

In short, if a region can recapture outsourced activities that are being awarded to firms outside the region, then its business activity will increase. This will also bring greater employment opportunities to the region and could make the difference for two-professional households when they consider Grand Rapids.

Organization of the Report

This report examines multiple aspects of import substitution, provides some basic assessment of the strengths and weaknesses of various approaches, and offers recommendations regarding the possible development of an import substitution strategy for the region. It is possible that millions of dollars in sales are leaking out of the greater Grand Rapids area annually simply because businesses and consumers purchase goods and services from businesses located outside the area, despite the fact that these goods and services are available locally. However, from a strict economic perspective, import substitution strategies should only be considered if there is strong evidence of a market failure in consumer and business transactions. Profit seeking businesses and bargain shopping consumers tend to uncover the lowest priced goods and services regardless of where they are sold. Of course, some will argue that this stance gives too much credence to the efficiency of the market place. Gaps do exist, and opportunities are missed. Moreover, not all market gaps promise new business opportunities. Issues of scale and cost factors will play a large part in determining if the identified gaps offer substantial business opportunities.

We first examine the economic potential of an effective import substitution program using our regional economic model for the greater Grand Rapids-Muskegon-Holland area. Second, we turn to Kent County's retail markets to explore possible retail gaps on the neighborhood level. Third, we present the findings of an employers' survey we conducted along with the follow-up focus groups and one-on-one interviews with area stakeholders and businesses. Finally, we offer our recommendations for the development of an import substitution program targeted at growing the economic base of the region.

Potential Economic Impact of Import Substitution

Theoretically, import substitution has the same potential impact as an increase in export trade. From the standpoint of a producer, it does not matter if the customer is located down the street or across the globe—except for the avoidance of logistical costs of transportation and communication. From the buyer's point of view, it is getting the lowest priced and or better quality item or service that matters, not where it is being produced. In short, as long as the dollars spent are "new" to the region—and not merely a shift in spending patterns within the region—they will generate a net increase in overall economic activity within the region.

In fact, some argue that buying and selling locally can generate a greater impact than relying on imported goods and services. As mentioned previously, the presence of local suppliers strengthens the region's core cluster activities. Any increase in local activity will thicken the area's labor markets and increase the depth of the area's business community.

Using a regional econometric and forecasting model (REMI) for the combined area of the Grand Rapids-Wyoming, Holland-Grand Haven, and Muskegon-Norton Shores MSAs, we estimated the economic impact of a 10 percent decrease in imports across 32 major goods-producing and service-providing sectors.[5] In other words, we ask the question what would be the overall economic impact if let's say 10 percent of the quantity of fabricated metals currently being shipped into the region were to be supplied locally instead.

As shown in Table 1, these 32 industries account for an estimated 45 percent of the region's total private sector employment and nearly 80 percent of the region's total output. Shown in the fourth column of the table is the estimated amount of additional orders for the region's firms if they were able to supply 10 percent of the current volume of imports coming into the region. For instance, output at the area's fabricated metals and machinery manufacturers would increase by just over $100 million dollars if they could capture just 10 percent of the current volume of fabricated metal and machinery imports. These increases would amount to a 3.8 percent increase in output for the region's fabricated metals producers and a 2.8 percent increase in machinery manufacturing. At these higher output levels, the regional firms in these industries would, respectively, capture 60.7 percent and 51.6 percent of the region's demand for their industry's products.

For several of the industries listed, capturing 10 percent of their industry's current estimated volume of imports would significantly increase their output volumes. This is especially true for the region's computer makers (18 percent output increase), beverage companies (29.7 percent increase) and appliance manufacturers (18.7 percent increase). This is not surprising and points to one of the limitations of this analysis. Regional demand for these industries covers a wide range of products, many of which cannot be produced locally. For instance, manufacturing even a small portion of the wide range of beverages, computers and calculators, and electronic appliances are beyond the scope for any region.

[5] A brief description of the REMI is presented in Appendix A.

Table 1
Production Impact of Reducing Imports by 10 percent

Industry	Current Activity Level: Employment	Current Activity Level: Output ($2006 millions)	Additional output if imports are reduced by 10%	Percent change in output	Local demand supplied locally with reduction in imports
Wood products	2,167	$443.3	$66.4	15.0%	23.9%
Nonmetallic minerals	5,722	$1,475.1	$34.5	2.3%	70.1%
Primary metals	4,929	$1,721.5	$151.4	8.8%	41.7%
Fabricated metals	14,711	$2,768.3	$104.4	3.8%	60.7%
Machinery	16,632	$3,716.0	$104.7	2.8%	51.6%
Computer, electronics	5,234	$2,319.2	$418.2	18.0%	20.6%
Electrical equip, appliances	1,091	$332.8	$62.3	18.7%	17.7%
Motor vehicles	22,935	$12,854.4	$350.9	2.7%	39.3%
Transp equip exc. motor veh	1,077	$234.9	$33.9	14.4%	15.0%
Furniture	16,372	$2,876.5	$16.8	0.6%	124.9%
Miscellaneous durables	3,423	$606.9	$64.4	10.6%	27.2%
Food mfg	9,026	$3,606.6	$157.5	4.4%	49.8%
Beverages	276	$126.7	$37.7	29.7%	21.9%
Paper	2,868	$895.9	$41.5	4.6%	60.0%
Printing	3,653	$529.7	$8.6	1.6%	87.0%
Chemicals	6,483	$3,831.1	$158.7	4.1%	55.3%
Plastics	9,774	$2,543.7	$60.8	2.4%	76.6%
Wholesale trade	31,210	$6,040.9	$169.2	2.8%	81.2%
Warehousing, storage	982	$91.0	$14.4	15.8%	29.9%
Publishing	2,792	$520.5	$47.7	9.2%	52.0%
Motion picture, sound recording	1,139	$131.3	$16.5	12.5%	45.5%
Internet serv, data proc, other	631	$89.8	$40.9	45.5%	25.9%
Broadcasting, exc Int; Telecomm	4,078	$1,399.1	$145.7	10.4%	42.3%
Monetary authorities, banking	10,002	$2,838.5	$118.6	4.2%	70.0%
Securities, investments	7,397	$670.2	$92.2	13.8%	42.7%
Insurance	10,124	$1,386.4	$88.8	6.4%	50.6%
Prof & tech services	31,235	$2,640.4	$148.8	5.6%	58.2%
Management of companies	8,342	$2,176.4	$101.7	4.7%	63.3%
Pvt. Educational services	14,774	$532.0	$29.7	5.6%	60.0%
Hospitals	20,167	$2,123.4	$9.0	0.4%	97.5%
Performing arts, sports	3,876	$63.3	$13.0	20.5%	37.2%
Amusement, gambling, recreation	7,813	$346.6	$9.2	2.7%	76.0%
Total employment	280,935	$61,932	$2,918	4.7%	
% of Region (private)	45.1%	79.7%			

Finally, the output estimate for the region's large furniture industry shown in the table also needs some clarification. If the region's office furniture manufacturers were able to capture 10 percent of the imported product coming into the region, it would cause less than a 1.0 percent increase in the industry's output. Still, it would produce 25 percent more than the local demand. This seemingly inconsistent estimate is due to two factors. First, the industry's furniture industry is a major export base for the region and simply produces more office furniture than the region can absorb. Second, local suppliers of furniture components are also included in these volumes; therefore, there can be some double counting occurring.

In Table 2, the economic impacts in terms of employment and personal income of each of the listed industries capturing 10 percent of the region's current purchases of imported products are presented. For example, if the region's fabricated metals industry were to capture 10 percent of the current volume of imported fabricated metal products, employment in the sector would increase by 268 workers. Regional employment would expand by 512 because of the consumer spending by the hired fabrication workers as well as the new orders to suppliers. It should be noted that the resulting increase in employment in the fabricated metals industry, 268 workers, is well below 3.8 percent of the industry's current workforce of 14,711 workers. An increase in orders would impact production workers but not administrative nor management personnel which would be taken as "fixed costs" and would not change significantly with output.

The potential for an import substitution approach to economic development may be best seen in the last column in Table 2 which shows the regional employment change per $1 million increase in self-supply production by industry. For example, if a regional primary metal company successfully wins a $10 million local contract that had previously been awarded to an out-of-the-region supplier, an estimated 25 new jobs will be created in the region. The impact of a successful import substitution effort varies between industries and depends upon:

1. How labor intensive the industry is—labor intensive sectors such as education will generate more jobs than sectors that rely heavily on capital.

2. The existing supplier base of the industry—industries with a more established regional supplier base will generate a larger economic impact.

3. The wage rates of the industry—higher-paying industries will generate greater consumer expenditures.

In summary, there is supporting evidence that an effective import substitution program could create additional revenue and jobs in the region. In fact, if the firms in these 32 industries were able to increase their local sales so that the volume of competing imports fell by 10 percent, a total of 10,900 new jobs would be created in the region.

Table 2
Employment and Income Impact of a 10 Percent Reduction in Imports

Industry Sector	Employment: Industry Only	Employment: Regional Total All Sectors	Regional Personal Income ($ millions)	Employment change per $1 million increase in self-supply
Wood products	41	82	$3.2	1.2
Nonmetallic minerals	65	143	$6.1	4.1
Primary metals	143	378	$16.3	2.5
Fabricated metals	268	512	$20.5	4.9
Machinery	185	429	$19.5	4.1
Computer, electronics	127	370	$15.2	0.9
Electrical equip, appliances	17	50	$2.3	0.8
Motor vehicles	196	726	$35.9	2.1
Transp equip exc. motor veh	6	15	$0.7	0.4
Furniture	51	104	$4.4	6.2
Miscellaneous durables	86	194	$9.3	3.0
Food mfg	112	267	$10.5	1.7
Beverages	9	24	$1.0	0.6
Paper	80	197	$8.8	4.8
Printing	44	81	$3.1	9.3
Chemicals	133	498	$24.7	3.1
Plastics	135	299	$12.1	4.9
Wholesale trade	552	1113	$44.8	6.6
Warehousing, storage	27	65	$3.9	4.6
Publishing	109	222	$8.8	4.7
Motion picture, sound recording	57	87	$2.3	5.2
Internet serv, data proc, other	44	80	$2.7	2.0
Broadcasting, exc Int; Telecomm	122	331	$13.3	2.3
Monetary authorities, banking	261	589	$23.9	5.0
Securities, investments	266	521	$19.6	5.7
Insurance	241	414	$17.4	4.7
Prof & tech services	927	1600	$68.7	10.8
Management of companies	175	417	$19.2	4.1
Pvt. Educational services	356	503	$12.7	16.9
Hospitals	67	127	$4.7	14.2
Performing arts, sports	236	281	$4.9	21.6
Amusement, gambling, recreation	155	185	$3.5	20.1

Retail Capture

The term "retail capture" refers to the percentage of an area's residents' disposable income that is spent within the same geographic area. This statistic acts as a measure of the adequacy and competitiveness of an area's retail offerings, both in meeting the needs of its own residents as well as attracting shoppers that reside outside the area. For example, many large urban centers offer a wide diversity of retail stores that are not only adequate to meet the needs of residents, but also attract shoppers residing in smaller towns and rural areas; thus thriving urban and suburban areas should generally report higher-than-average retail capture rates, while smaller urban places and rural areas would be expected to report lower-than-average rates of retail capture.

In general, the core of the Grand Rapids area—Kent County—has had a retail capture rate which exceeds the national average. Given that it is the center of the second-largest urban area in the state of Michigan, it is expected that the area serves as a retail hub to surrounding communities.

However, looking at the trend in retail capture rates over the past few years as well as the detailed retail capture trends within the core city of Grand Rapids, suggests that the competitiveness and adequacy of retail offerings may be softening. Between 2000 and 2005, the retail capture rate for Kent County has fallen seven percentage points from 82 percent to 75 percent. In the city of Grand Rapids, retail capture has declined over 15 percentage points, from 77 percent to 61.5 percent.

Table 3
Retail Capture Rate Trends

Year	Kent County	U.S.	Grand Rapids City	Kent Co. Outside GR City
2000	82.0%	69.9%	77.0%	83.9%
2001	78.3%	69.9%	77.9%	78.5%
2002	76.7%	68.4%	81.4%	75.0%
2003	74.9%	69.7%	77.1%	74.0%
2004	76.2%	71.5%	72.3%	77.6%
2005	75.0%	73.9%	61.5%	79.5%

Source: Sales & Marketing Management, *Survey of Buying Power.*

On the whole, although still above the national average, retail capture is declining in Kent County, suggesting that area shopping options have become less competitive with shopping regions outside the region (such as Internet sites and outlets in other areas), and/or the retail options available to shoppers who previously came to Kent County have improved closer to home (i.e. new shopping centers in Muskegon, Ionia, and Barry counties). In either case, Kent County is losing potential retail dollars as shopping which once took place within the county has moved to outside areas.

Additionally, the decline in retail capture within Kent County appears to be happening disproportionately within the city of Grand Rapids. This reflects the fact that retail activity is facing greater competitive struggles in the city than in suburban locations. It also suggests that some city retailers may have chosen to relocate from a city location to another part of the county during this period in order to remain competitive, since retail capture rates outside Grand Rapids proper have remained steadier—actually increasing slightly between 2003 and 2005.

An examination of other counties within the region provides further evidence of a trend of shifting retail patterns. Although each of these six counties that constitute the remainder of the Grand Rapids region has seen at least a one-year decline in retail capture since 2000, the majority of counties—four of the six—are capturing a greater share of resident purchasing power in 2005 than they were five years earlier.

On the surface, the decline of retail capture rates in Kent County and the rise of retail capture rates in many of the outlying areas—Muskegon, Ottawa, Allegan, and Ionia counties—would seem to suggest that the region is merely experiencing a shift in shopping patterns. However, when we calculate retail capture rates from a summation of retail sales and purchasing power across the seven-county region, it becomes clear that the region as a whole is experiencing a trend of diminished retail capture rates.

Table 4
Total Regional Retail Capture Rates

Year	Seven-county G.R. Region	Detroit - Ann Arbor - Flint Area	U.S.
2000	70.3%	75.9%	69.9%
2001	68.1%	76.4%	69.9%
2002	67.4%	68.8%	68.4%
2003	64.9%	68.9%	69.7%
2004	67.3%	71.2%	71.5%
2005	67.4%	71.1%	73.9%

Source: Sales & Marketing Management, *Survey of Buying Power.*

From 2000 to 2005, retail capture rates in the region declined nearly three points, from 70.3 percent to 67.4 percent. More importantly, while the region's retail capture rate was roughly equal to the national average only a few years ago in 2005, it was a full 6.5 percentage points lower. Ultimately, this suggests a weak competitive retail structure in the Grand Rapids area. Despite being the second-largest urban area in Michigan, the region is failing to attract a significant share of dollars as a shopping destination and is not adequately maintaining an environment of shopping options to prevent residents from shopping elsewhere. In comparison, the Detroit–Ann Arbor–Flint region has also suffered a decline in retail capture since 2000; however, the area remains in better shape than the Grand Rapids region and closer to the national average.

Retail Establishment Distribution

Retail capture rates measure the overall competitiveness and capacity of a region's retail sector; yet, within the greater geographical region, the distribution and accessibility of shopping facilities can impact whether or not opportunities exist for increased local purchasing patterns. In other words, if the distribution of retail stores is not well aligned with the distribution of residents and income within the larger community, opportunities will exist in the form of small-area underserved markets—e.g., neighborhood areas that could support a grocery store, general merchandise store, or other broadly used products and services.

To assess whether neighborhood-level opportunities potentially exist in the Grand Rapids region, data on population, income, and number of retail establishments was compared for a sample[6] of 49 postal zip code "neighborhoods" located within the seven-county region. The zip code unit of analysis is useful not only for data availability but also because it provides a reasonably sized geography of which the boundaries are primarily not determined by political, economic, or social factors.

As shown in Table 5, the ratio of residents-to-retail-establishments covers a wide range from a low of 42 in a clearly retail-concentrated area, to a high of 1,587 in a zip code that is low on both residents and retail establishments. However, only five zip code areas have residents-to-retail-establishments ratios greater than one standard deviation[7] above the group total. Individuals or firms interested in pursuing opportunities within these zip codes would need to more closely examine the types of stores present in the area to get an idea of what specific retail sub-sector, if any, is underserved.

Also, statistical correlation was used to examine the relationship between the population share and income share present in each zip code to the retail share. Both relationships came out relatively strong, with a correlation of 0.76 between population share and retail share, and a correlation of 0.73 between income share and retail share. This indicates that about 75 percent of shopping areas are appropriately related to the population and incomes of their immediate surroundings.

Finally, a comparison with the persons-per-retail-establishment ratios found at the state and national level provides some perspective on what kind of ratios can be expected to represent a sufficient level of retail providers in a given area. Overall, this suggests that the ratio of persons-per-retail-establishment for the Grand Rapids region is similar to that found nationally and in other mid-western states. It is possible that some small neighborhood areas are underserved, and could support expanded or relocated retail offerings. However, these opportunities are likely to be extremely narrow and difficult to identify, since some degree of retail shop clustering is likely the natural result of issues such as zoning regulations, transportation networks, and business clustering effects.

[6] The 49 zip codes represent about 69 percent of total regional population. It should be noted that this is a non-random sample, with zip codes eliminated from the grouping due to data limitations or their crossing over into other counties.
[7] Standard deviation is equal to approximately 299.

Table 5
Retail Establishments, Population, and Income by Zip

Zip Code	Resident Population	Per Capita Income	Number of Retail Estab.	Residents per Retail Estab.
48846	19,931	$14,925	75	266
48851	2,253	$18,975	3	751
48860	1,404	$15,400	2	702
48865	1,883	$17,699	5	377
48881	5,406	$18,449	13	416
49046	7,151	$19,218	14	511
49050	1,529	$21,725	1	1,529
49058	18,266	$20,050	77	237
49070	2,173	$17,925	8	272
49301	10,122	$40,837	30	337
49306	7,729	$27,043	15	515
49312	99	$14,005	1	99
49319	13,779	$18,296	45	306
49321	15,437	$21,830	70	221
49323	7,932	$19,089	17	467
49328	3,770	$17,829	10	377
49335	118	$17,368	2	59
49341	29,349	$25,428	78	376
49345	12,576	$18,865	36	349
49349	8,422	$14,027	19	443
49401	13,160	$14,300	27	487
49406	746	$27,557	12	62
49408	9,236	$20,350	19	486
49417	28,109	$23,258	125	225
49419	6,303	$20,396	14	450
49424	42,185	$23,207	204	207
49426	27,473	$21,477	61	450
49428	24,410	$21,736	83	294
49440	775	$15,045	15	52
49441	40,859	$20,189	143	286
49442	45,933	$14,521	120	383
49444	21,603	$15,295	185	117
49445	19,774	$21,533	68	291
49450	3,173	$12,303	2	1,587
49453	2,535	$30,226	49	52
49460	7,350	$20,967	10	735
49461	8,843	$21,873	46	192
49503	34,141	$17,028	134	255
49504	40,364	$18,665	144	280
49505	31,981	$19,500	80	400
49506	33,618	$27,937	82	410
49507	39,819	$13,991	87	458
49508	39,716	$21,677	140	284
49509	59,163	$18,790	179	331
49512	11,303	$25,606	266	42
49525	26,819	$22,914	80	335
49546	33,933	$29,365	86	395
49548	31,561	$17,233	159	198
49 Zip Code Area	**854,214**	**$20,462**	**3,141**	**272**

Source: 2000 Census and 2004 County Business Patterns.

Table 6
Population per Retail Establishment

Grand Rapids Region	274
Allegan County	290
Barry County	338
Ionia County	348
Kent County	259
Muskegon County	263
Newaygo County	288
Ottawa County	287
United States	251
Illinois	288
Indiana	256
Michigan	258
Ohio	273
Wisconsin	252

Source: 2000 Census and 2004 County Business Patterns.

Of course, this analysis does not address the type of shopping experiences which are available in the neighborhoods in the region. Two areas can generate the same level of retail activity, but their attractiveness, sustainability, and uniqueness can vary dramatically. One could be populated with locally-owned and operated establishments offering unique stores and restaurants in a pedestrian-friendly environment, while the other has only national chain outlets and eateries along a congested four-lane street. The former can be the heart of an unique neighborhood that is attractive to young professionals and may generate a greater economic impact because net revenues remain in the community. The latter offers outlets and services that can be found anywhere and does not add and could subtract from the uniqueness and quality of life to the area.

Retail Opportunities for Import Substitution

Our analysis of the retail sector and local purchasing patterns within the seven-county Grand Rapids region paints a mixed picture in regard to opportunities for using import substitution as a way of stimulating the local economy. On the one hand, the retail capture rate for the region has declined below the national average, suggesting that if local retailers were more competitive in their offerings, they could capture a larger share of the regional retail market.

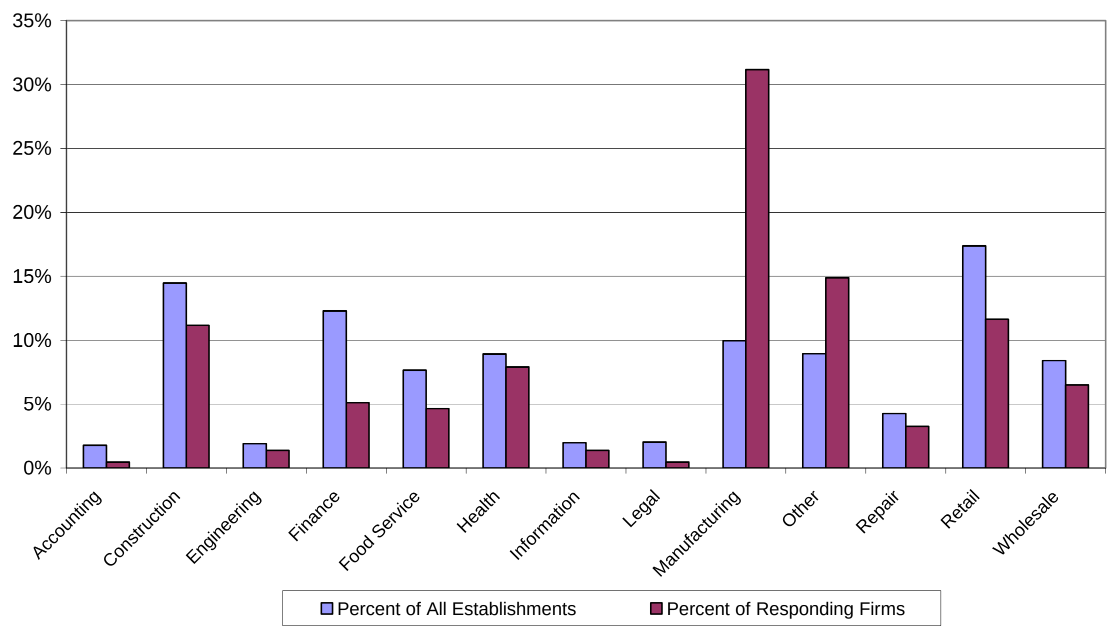
At the same time, the data fails to identify any glaring market failures that could be readily addressed. The overall ratio of residents-to-retail-establishments for the region falls within a reasonable range, close to the national average. Furthermore, while the zip code analysis points to some intra-region disparity in retail offerings, the opportunities presented at this level are unlikely to alter the overall import and self-supply character currently found in the region (although they may benefit individual businesses or groups of consumers).

Result of Business Survey and Focus Groups

In June, we mailed a short survey to 4,300 firms in Kent, Muskegon and Ottawa Counties regarding their current purchasing and sales patterns. In particular the survey was focused on identifying the challenges regional firms faced in both buying local services, materials or products as well as building a local customer base. Unfortunately, only 215 firms returned the survey for a disappointing 5 percent rate of return. This seriously dampens the usefulness of the survey results. A copy of this short survey is included in Appendix B.

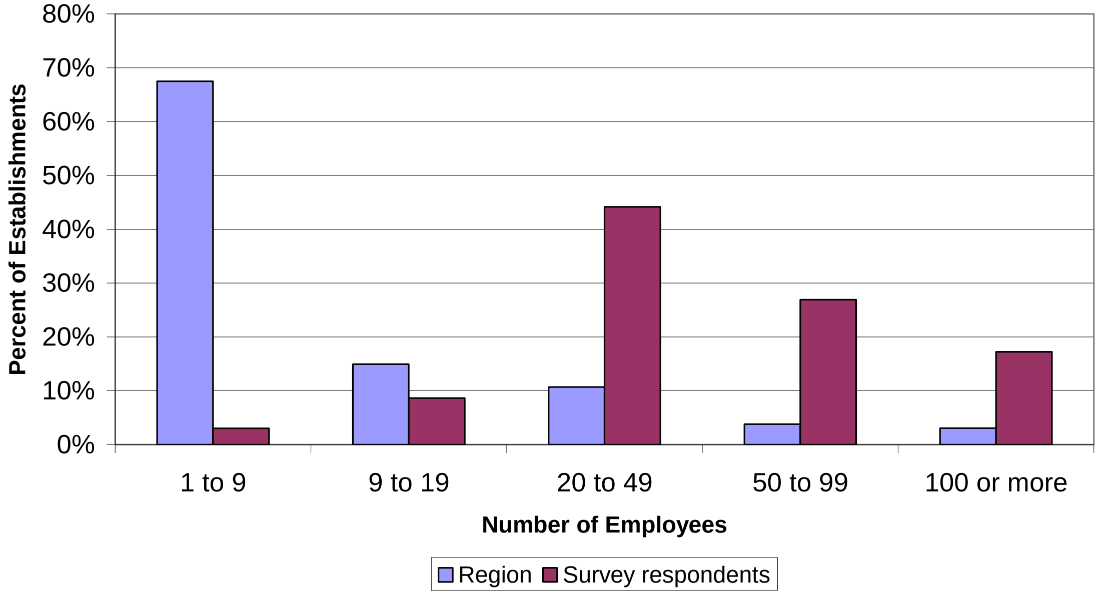
Manufacturing firms were over sampled in the survey. As shown in Chart 1, 30 percent of the responding firms were in manufacturing. In the three-county region, manufacturing firms account for only 10 percent of the total number of firms. Conversely, retailers and financial organizations were under represented in the survey. As such, these survey results cannot be generalized as representative of all businesses in the region; instead the results should be viewed in the light of the mix of respondents detailed in the following charts.

Chart 1
Distribution of Surveyed and Total Number of Firms in the Region



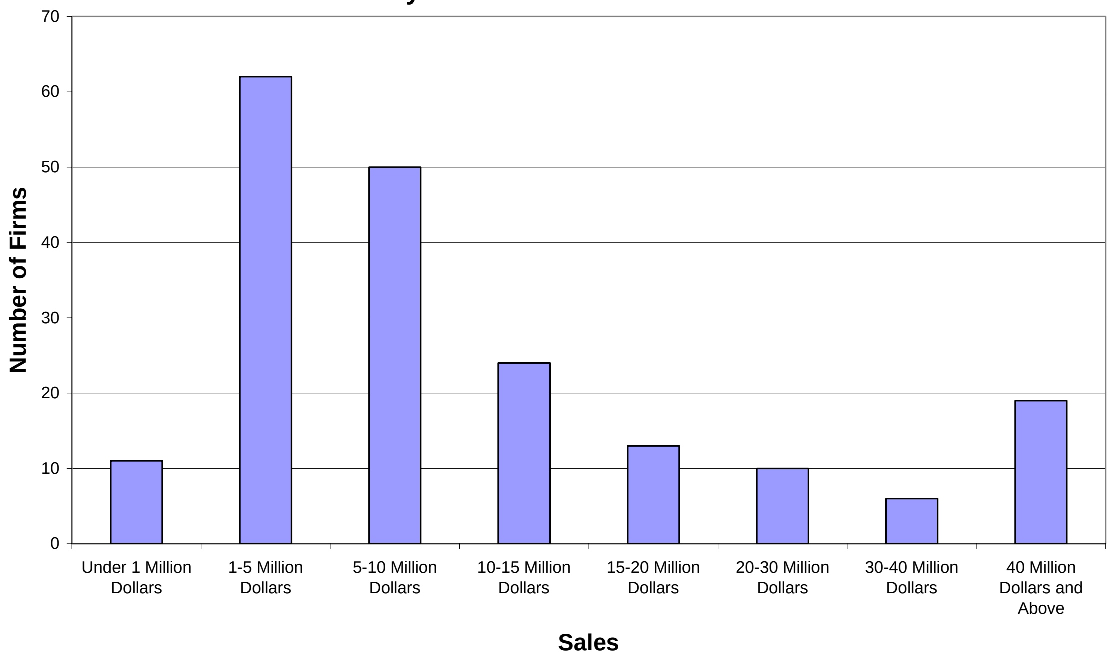
As shown in Chart 2, the survey respondents were more concentrated in firms that employ more than 20 workers, with 44 percent of the survey respondents employing between 20 and 49 workers, compared to 10.7 percent of all establishments in the three-county area. These results likely do not represent the views of small businesses, which were severely underrepresented amongst respondents.

Chart 2
Employment Size Category
Distribution of Surveyed Firms vs. the Region Distribution



As show in Chart 3, more than 50 percent of the surveyed firms had total sales of between $1 million and $10 million in 2005. The size distribution of the survey respondents most likely reflects the interest that mid-sized firms have in expanding their markets to local customers as well as exploring new suppliers. It is possible that most small firms sell locally already and may be legally tied to an existing supplier. For example, most retail franchises are locked into an established supplier base which provides supplies that meet the guidelines set by the franchising company. Larger establishments, if they are branch plants of national or international companies, may have their purchasing decision made at their national headquarters.

Chart 3
Surveyed Firms' Total Sales in 2005

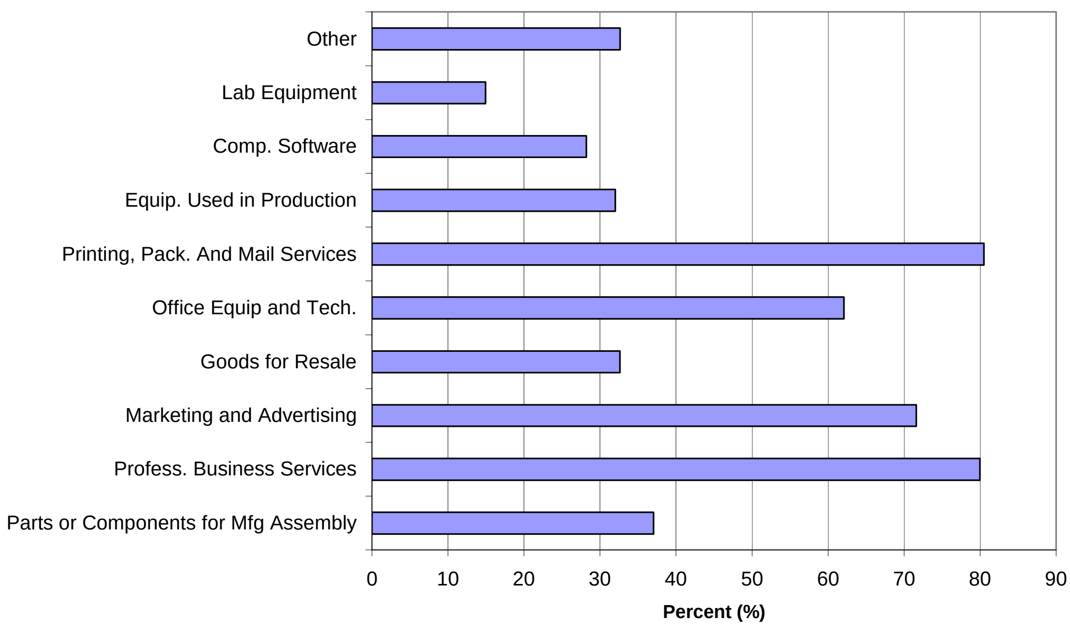


Current Purchasing Patterns

Surveyed firms identified four major areas where goods or services are already being purchased predominantly from local suppliers. As shown in Chart 4, more than 60 percent of the demand by surveyed firms for printing, packaging, and mail services; professional business services; office equipment and technical assistance; and marketing/advertising services is being fulfilled by local suppliers.

It is not too surprising that printing and packaging services are purchased locally given that these services are closely tied to day-to-day office operations as well as the marketing and shipment of the firm's final product. In addition, given the region's high concentration of manufacturing, it can only be expected that printing and packaging firms that specialize in meeting the needs of area manufacturers would locate in the region. Additionally, more than 70 percent of marketing/advertising and professional/business services are purchased locally as well. These are the types of activities that one would expect many firms to use nationwide companies to provide. This finding could be a factor of the size of firm responding to the survey. Mid-size companies employing 20 to 50 workers probably may not have unique marketing or professional services needs that warrant turning to a national provider.

Chart 4
Average Percent of Product or Service that Firms Purchase from Local Businesses



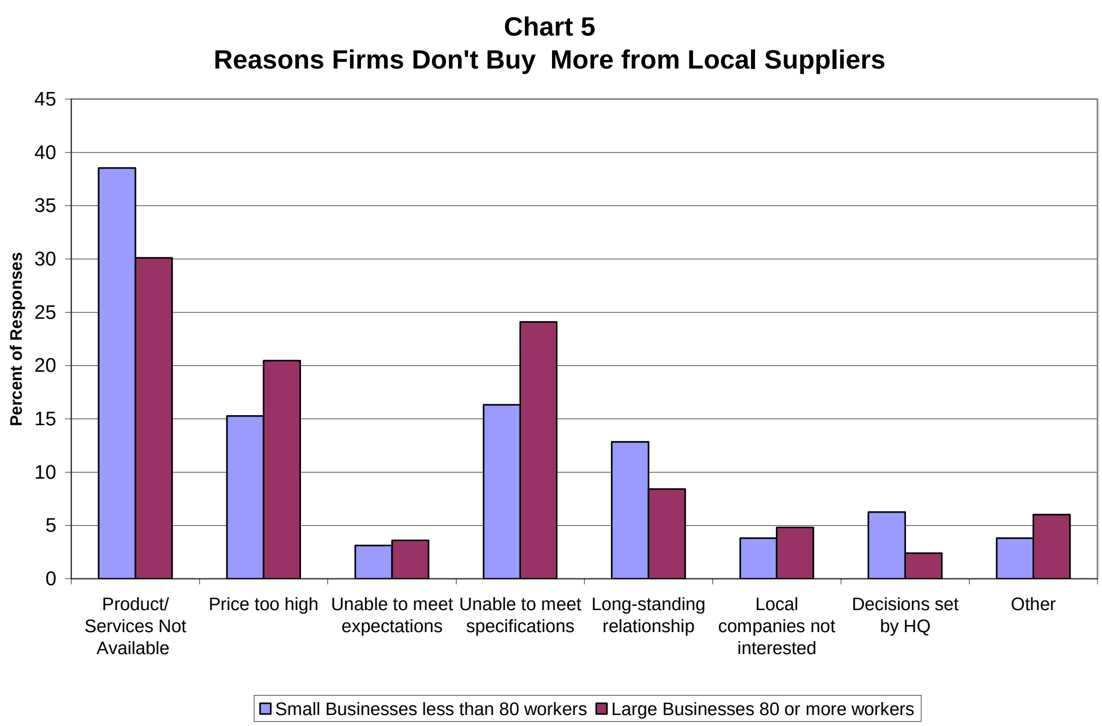
What is somewhat disturbing is that less than 40 percent of the manufacturing components which were purchased by local firms were supplied locally. Given the region's large and diverse industrial base, one would expect a higher self-supply ratio. This leads to the next question: why don't local firms buy more from local suppliers?

Why Don't Firms Buy More Locally?

This was one of the key questions asked in the mailed survey, and in Chart 5 the answers are broken out into firms that employ fewer than 80 workers (small firms) and firms employing more than 80 workers. Not surprisingly, non-availability was the major reason listed by local firms for not buying from local suppliers, with more than 30 percent of the firms in both size groupings citing this reason.

The second most often cited reason was being "unable to meet specifications", with nearly 25 percent of the larger firms and 16 percent of the smaller firms listing this as a barrier. While not being able to meet the product's specifications could be a quality issue (for instance, not being able to meet required stress tolerances), it can also be the result of a lack of access to a competitor's specific products or services. It is not unusual for a bid to require certain products or processes that are available only through a sole-source supplier. This is a very effective marketing tool that enables suppliers to hold on to customers.

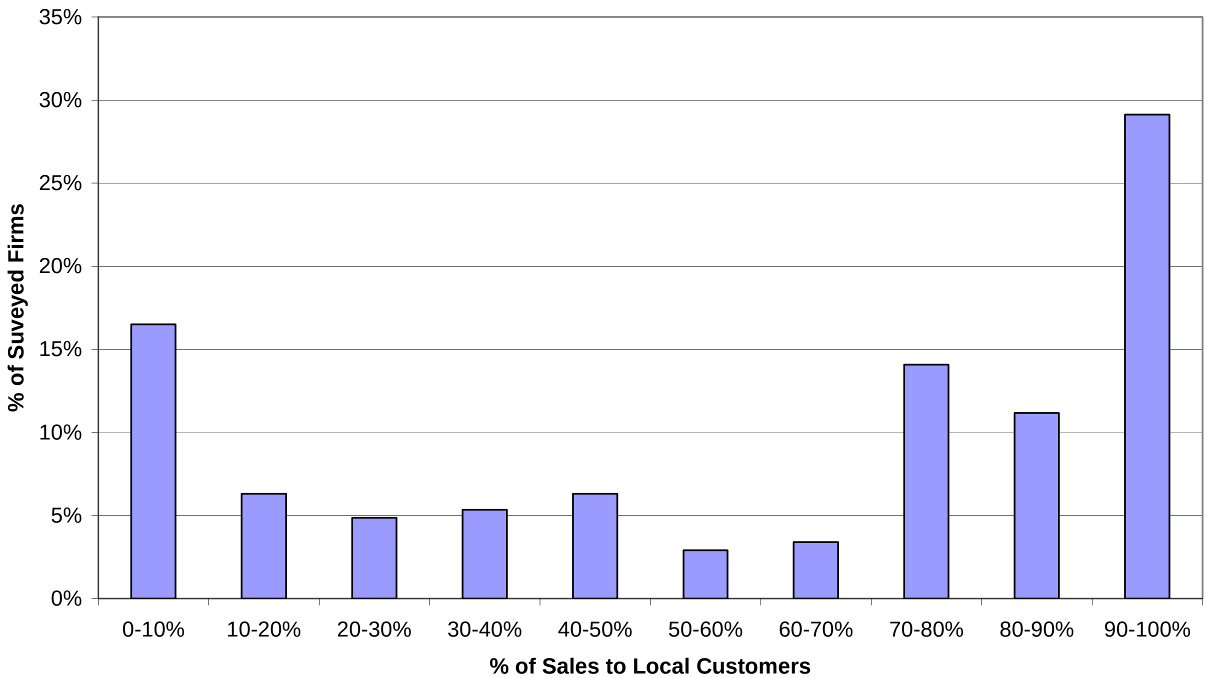
The third major barrier reason cited by surveyed firms is price. Local firms are simply not competitive. However, as revealed in the focus group discussion, part of the time this could be due to accounting procedures that do not properly reflect the cost of transportation associated with buying a product from sources outside the region. In some companies, logistical costs are paid as an overhead expense and, thus, disassociated with the procurement cost of buying the product.



Finally, long-standing relations with a supplier and the fact that in some companies procurement decisions are made at headquarters were also mentioned by a small percentage of respondents.

Overall, nearly 30 percent (60 firms) of those firms responding to the survey sell more than 90 percent of their goods or services to local customers. At the same time, 28 percent of the survey respondents sell less than 30 percent of their goods or services to local customers. Clearly some products and companies are better suited for local production and consumption than others.

Chart 6
Percent of Firm's Sales to Local Customers



Finally, we asked surveyed firms, what is the one product or service your company can't purchase locally, but wishes were available? Of the surveys returned, 58 percent left this question blank, 12 percent (28 percent of those that answered the question) answered that they were "happy" with the availability of local goods or services. Of the 30 percent that did respond with a product or service request, five requested assistance with customized software design. The remaining requests, which are summarized in Table 7, were scattered across many industries and services and did not, by themselves, suggest that there currently exists a clear gap in the local provision of goods or services. In fact, several of the products or services listed are already available locally but for some reason—perhaps price or a lack of knowledge regarding availability—they are currently obtaining the product or service from outside the region.

Table 7 Products and Services Currently Not Available	
Aluminum Ingots	Metal Fabricating Equipment
Anodize & Chromate Conversion Coating	Metric Die Components
Bottles (3)	Mirrors
Broadcast Components	Molding for Laboratory
Chrome Plating	Multi-Shot Molds
Coating-Industry Specific	Packaging (2)
Computers	Plaster Parts and Tooling
Custom Stampings	Printing (2)
Die Casting	ProShop Supplies
Durable Medical Goods	Prototype Circuit Boards
Flat Rocks	Resin
Food Distributors	Retail Equipment
Graphite	Screw Machine Products
Gray Iron Foundry	Slit Spring Flat Stock and Wire
Hardwood Lumber (2)	Software (5)
HVAC Equipment	Steel (3)
Insurance (2)	Surgical Supplies/Instrumentation
Internet/web site development	Tanning and Hair Prod.
Legal	Trailers
Magnetwire	Uniforms
Maintenance of Large Electrical Motors	Whole Sale Prescription Drugs
Marketing-Direct Mail	Wholesale Aluminum Distributors
Melomine	

( ) Number of times listed.

Results of Focus Group Sessions

From the mailed business survey, we also developed the invitation list for six focus groups—four in Grand Rapids, one in Zeeland, and one in Muskegon.

Discussions in the focus group sessions were centered on the following questions:

1. What has stopped you in the past from buying locally?
2. What barriers have you faced in getting customers to buy from you instead of from an out-of-area supplier?
3. What goods and services do you believe could be provided locally but are not?
4. What would be the elements of an effective "buy locally" marketing effort? We will discuss these results in our final, recommendation section.

What has stopped you in the past from buying locally?

Several major challenges and barriers were highlighted during the focus group sessions which effectively limited the potential for import substitution. Clearly, many products, resources, and services that are required for the production of goods or services in the region are simply not available. For example, Michigan is not an oil producing state.

Second, it was repeated that local companies were unable to meet the specifications for the product or service. Most often this is not a quality issue as much as the fact that these specifications can be established by the previous supplier giving them a built-in advantage of maintaining the contract. The required part or machinery may be only available through the previous supplier. This is a major barrier to switching suppliers. It is not the case that the local provider can't make the product; it is the fact the previous supplier set up unique criteria that, by definition, only they can meet. In these cases, significant cost or time investment may be necessary for a supplier to be able to supply a product, thus reducing the likelihood they will submit a bid to pursue new business.

Also, many manufacturers require that their suppliers become certified by an industry association or trade organization. Certification can cost up to $100,000 and for some companies it may not be worth it if there is little assurance that they will be able to grow this portion of the business.

Price is always a factor. However, incorrect accounting practices that are followed by many companies erase the competitive advantage local firms hold because the internal accounting of transportation costs in some firms. Respondents explained that in their firms project managers are not responsible for transportation costs, but only the per unit cost of the good or input. Therefore, foreign-made goods or goods that must be trucked cross-country are incorrectly priced because transportation costs are not included in the decision-making process.

Other respondents cited the importance of long-term relationships with customers and suppliers. Many business relationships are built over years. It can be difficult for a perfectly capable local supplier to break into the inner circle of suppliers. Conversely, the purchasing company does not know the expertise of the supplier, and if they are satisfied with the performance of their current suppliers, they do not have a strong incentive to explore new relationships.

Most disturbingly, however, was a lack of flexibility and interest in new business described during several of the sessions. Buyers mentioned that some manufacturers were unwilling to be flexible and take "short runs" or look at new products. One participant complained that some companies seem to be waiting for autos or office furniture orders to come back, instead of pursuing new markets and customers. They described having their purchase requests turned down by local firms despite a willingness to pay what the supplier desired and to provide steady orders.

What barriers have you faced in getting customers to buy from you rather than from outside of the area?

For participants who had tried to develop a new relationship with existing firms, they encountered numerous barriers. As cited above, preexisting relationships built on trust and friendships are hard to challenge. Several found that procurement decisions are made at corporate offices located outside the region. This is especially troubling given that the region has lost some headquarter operations in recent years.

Mindset was also mentioned as an issue for some companies, which feel that they must develop offshore suppliers in China, Mexico, or India to remain competitive in the future. Furthermore, some have a perception that firms in Grand Rapids will be unable to do as good of a job than firms in other larger or better known regions, i.e., somehow, the most effective advertising or best design work must come from New York or California.

What goods and services are not available that could be?

The following products were mentioned, at least once, as possible business development opportunities:

- Plastic blow-molding manufacturing to produce custom bottles and other products.
- Medical laboratory supply products.
- Off-the-shelf packaging.
- Short runs of many manufactured goods.

In general, although focus group participants mentioned many different types of items, the common theme was a demand for either greater specialization or greater generalization in business sectors that already exist in the Grand Rapids area. This suggests the real in-demand service for local companies is greater flexibility and adaptability.

Recommendations

Before turning to our recommendations, it must be said again that market forces are extremely effective in finding cost-effective market opportunities and relationships. Buyers and sellers have strong incentives to find each other. Only when there are clear signs of a market failure in the form of inadequate information flows, can a case be built that a new import substitution program is warranted.

While our modeling efforts show that an effective import-substitution strategy has the potential of creating hundreds of jobs in the region, we found little evidence to suggest that there are significant barriers standing in the way of businesses to capture unmet market opportunities. Businesses are constantly seeking suppliers that can offer better products or services for less than their current suppliers. In addition, during the focus group sessions, businesses repeatedly supported any effort to facilitate better information regarding local suppliers and local markets.

In theory, it is possible that seemingly unrelated industries could have a demand for a product or service that is too small individually to support a local firm; however, when the separate industries' demand are aggregated, it may be of a sufficient size to support a new business or expansion of a current operation. The problem is that for the many known generic products or services that are demanded by most industries such as maintenance services, landscaping, office suppliers, Internet/communication services, and shipping, the need has already been identified and addressed. For other products that appear to be demanded across many industries, the specific specializations required by each may make it possible for a firm to achieve sufficient scale to produce the product profitably.

With the sole exception of plastic blow-mold manufacturing, which was mentioned in two separate focus groups as a needed product that could feasibly be produced here, our research did not find any strong evidence that there exists large untapped markets in the Grand Rapids-Muskegon-Holland region. Moreover, we would have been surprised if we had, since we believe the region's business community is simply too responsive to allow many opportunities to fall fallow.

In conclusion, there are three very important factors that must be fully considered before making any recommendations regarding policy actions:

1. ***Price trumps location.*** Globalization is pushing prices down lower and squeezing domestic profit margins. While the struggles of the state's auto suppliers are well-known, with several larger ones being driven to bankruptcy by their struggling OEM customers, similar price-focused conditions exist in other industries as well. In the focus groups, it was mentioned more than once that buying locally was a good thing to do, but that at the same time there is often little or no flexibility when it comes to taking the lowest bid. Therefore, any import substitution effort must prove that local firms are competitive. This becomes more of a challenge if transportation and other costs are not being properly factored in by the customer.

2. ***The Internet rules***. For firms that do not have long-term relationships with their suppliers, the Internet has been the primary marketplace for acquiring new products and new suppliers. Therefore, a Web presence is mandatory for firms regardless of their market area. Furthermore, it takes more than merely having a Web site to make one's presence known as a supplier. Development of a good Internet Website with the right key words to bring up the site early in an Internet search engine is crucial.

3. ***Still, even in these demanding times, old-fashioned business networking has a place***. Several of the focus group participants felt that there may still be a place for networking clubs. Indeed, even at our focus group sessions, two businesses that could work together, but who did not know of each other, expressed surprise and pleasure at finally meeting. Clearly, information gaps can and do still exist.

Recommendations

The above analysis shows that if more of the region's demand for goods and services could be supplied locally, it would have a significant impact on the region's economy. It is our belief that the primary barrier stopping more import-substitution activities from occurring is a failure in local information flows. Firms are both unaware that potential and viable suppliers and customers are located in the region. Also, suppliers, in particular, underestimate local markets or overestimate the risks associated with responding to new opportunities.

There are several reasons for these information-related market failures. First, firms perceive that they do not have the time to explore alternative means to contact potential sellers or buyers. Second, they are comfortable with their current search procedures for suppliers. Finally, when there is a lack of information for firms to measure the potential of emerging or new markets for their products or processes, they tend to be overly risk averse and shy away from investing in the changes necessary to meet these markets.

It is with these barriers in mind that we recommend the following three initiatives.[8]

1. Encourage regional companies to have a strong and effective Web presence.

The Internet is today's marketplace for a growing number of firms. Not only do local firms sell over the Internet, but many also rely on Internet search engines to find new suppliers and items they wish to purchase. Attempts have been made to develop locally-based, one-stop commerce sites or business lists, however, in the past, similar business lists and web sites have not been widely utilized or successful in developing local commerce It is our feeling that such sites are frequently incomplete or out-of-date, which could potentially make them more damaging to the community and buy-locally efforts, since bad information may discourage potential participants.

[8] Michael H. Shuman is his recent book, *The Small-Mart Revolution* (Berrett-Koehler Pubishers, Inc., San Francisco 2006) offers a large and useful "checklist" of activities that can be pursued by consumers, investors and local policy makers to promote local markets and "buy locally" efforts. Our recommendations are more limited in nature and focus on improving the likelihood that local businesses can capture business contracts that are currently being awarded to out-of-region suppliers of goods and services.

Instead, we recommend the promotion and improvement of the business Web sites in the Grand Rapids region. For example, training classes could be offered for businesses to update and enhance their Web presence. Ensuring that regional companies' Web sites are well designed and specific in regard to their capabilities will improve their search engine ranking and may be the most effective means for neighboring businesses to find each other. This will require local firms' Web sites to have descriptive TITLE and ALT tags, good keywords, a strong annotative text (meta description tag), and relevant sites links[9]. Additionally, by ensuring that company Web sites feature location and contact information relevant to west Michigan should help potential customers performing searches with terms such as "Grand Rapids" or "West Michigan" bring up the Web sites of local companies first.

2. Promote and enhance business networking opportunities.

Certainly, many business networking groups and clubs currently exist in the Grand Rapids area. However, traditionally a lot of these groups have been based on a common industry (such as trade groups), social or community factors (such as rotary clubs), or groups aimed at a narrow geographic or demographic characteristic. A better approach would succeed in bringing together representatives from very different types of businesses who might otherwise not get to know each other. Identifying new opportunities in the local market will require thinking in new ways about whom to work with in the region.

3. Encourage the adoption of total cost pricing.

One of the most troubling stories we heard over and over again in the preparation of this report was that for too many businesses, the purchasing manager, logistic/transportation manager, and the inventory/distribution manager work in separate spheres. The purchasing manager is responsible for finding the lowest unit price of the needed product with considering transportation costs; the logistic manager's goal is to negotiate the lowest transportation fees associated with getting the product from the producer to the factory. In some instances, this will require buying the product in bulk. This can be a nightmare to the inventory manager who aims to keep inventory costs low and may force him/her to rent unwanted storage space. Without corporate leadership requiring these three separate functions to work together, they can and will generate a total cost that is higher than if the product were produced locally.

The area's Chamber of Commerce and Economic Development Programs should seriously consider providing seminars on the how to develop and install total cost pricing policies that will accurately measure the total cost of buying goods from firms located offshore or far outside the region. If the full price of buying offshore is known, it may open the door to local producers.

[9] Google Webmaster Help Center http://www.google.com/support/webmasters/bin/answer.py?answer=35769 accessed in March 2007.

Appendix A

REMI Model

In generating this report we used the W.E. Upjohn Institute's regional economic forecasting computer model which was especially constructed by Regional Economic Models Incorporated (REMI) for the metropolitan statistical areas of Grand Rapids-Wyoming, Holland-Grand Haven, and Muskegon-Norton Shores. The model contains three separate components that together capture the resulting total impact to the local economy due to a change in employment. These components are:

- An input-output model that estimates the impact on the local economy of changes in inter-industry purchases. This component of the model captures the impact of an increase in orders to local suppliers of goods and services as well as the impact of households increasing their purchases of consumer goods and services.

- A relative wage component that estimates the impact of the expected changes in the area's cost structure due to changes in economic activity. For instance, when a major employer moves into the area, it can cause wages to increase across most all industries due to the increased demand for workers and other local resources. This boost in wages, while generating additional consumption expenditures, increases the cost of doing business in the area, making the area slightly less attractive to other industries.

- A forecasting and demographic component that forecasts the resulting changes in future employment and population levels due to a change in economic activity.

Appendix B

Survey (Note: originally laid out as two-pages)

Survey of Grand Rapids Area Business Activity

Our question to you is this: Can we grow the economy by buying locally? The Grand Valley Metro Council, in conjunction with the W.E. Upjohn Institute for Employment Research, would like to ask for your assistance in learning more about the dynamics of regional trade. By answering a few brief questions about your company's customers and suppliers, it will help us understand how to support increased business activity throughout the Grand Rapids – Muskegon - Holland area.

Thank you for your support! If you're not sure about an answer, please provide your best estimate.

1. What general industry best describes your company?

- ☐ Manufacturing
- ☐ Construction trades
- ☐ Repair and maintenance services
- ☐ Wholesale
- ☐ Corporate HQ or business operations
- ☐ Retail
- ☐ Food service
- ☐ Health & medical services
- ☐ Legal
- ☐ Accounting
- ☐ Engineering, architecture, design
- ☐ Information (publishing, telecommunications, Internet service)
- ☐ Finance, insurance, real estate
- ☐ Other: ______________________________

2. Give a more specific description of your company: (i.e. plastics manufacturing, advertising agency, etc.):

____

____

3. Approximately what percent of your company's sales are to customers in Grand Rapids - Muskegon-Holland region? _____________%

4. Approximately what were your company's total sales in 2005? $__________________

5. How many company employees (full and part-time) work in the Grand Rapids area?

____

6. Please estimate the percent of each product or service your company purchases from businesses located in the Grand Rapids-Muskegon-Holland area (or mark "n/a" if not applicable). Include only those products or services that are actually produced, displayed or developed in the area. Exclude sales and services representatives who may visit your location, but whose company is located outside the area.

_____% Parts or components for manufacturing assembly
_____% Professional business services (accounting, legal, HR, IT, or other consulting services)
_____% Marketing and advertising
_____% Goods that your company resells on the retail or wholesale market
_____% Office equipment and technology (computers, telecommunications)
_____% Printing, packaging, and mailing services
_____% Equipment used in production (describe): ______________________________
_____% Computer Software
_____% Lab equipment
_____% Other (explain):____

Survey continues on the other side

7. Think about the products and services your company does *not* buy from firms or suppliers located in the Grand Rapids-Muskegon-Holland area. Please check off the reasons why (check all that apply):

- □ Product/service not available locally
- □ Price is too high
- □ Unable to meet quality expectations
- □ Local companies cannot fulfill unique specifications
- □ Long standing arrangement or personal relationship with out-of-area supplier
- □ No local company has ever submitted a bid or expressed interest
- □ No choice because purchasing is determined at headquarters
- □ Other (explain): ____________

8. What is the one product or service your company can't purchase locally, but wishes was available?

____

How much does your company currently spend on this product or service per year?
$____________

9. OPTIONAL:
Please fill out the next section *only* if you are interested in participating in an upcoming lunch-time focus group to be held in Grand Rapids**.** All information provided in this survey will be kept strictly confidential and no identifying information will be used for any purpose other than to contact interested parties about focus group participation.

Company Name:

____

Contact person:

____

Address:

____

____

City, State, Zip:

____

Phone number:

(_____)_____________________________

Please return this form as soon as possible! Surveys must be received by July 14, 2006.

THANK YOU!