

Acknowledgments

The topic of job creation and the role of new business is just one of many important issues facing those trying to better understand 21st century labor market dynamics. It is almost impossible to isolate small and entrepreneurial business dynamics from the larger macroeconomic picture, and yet the staff of the Labor Market and Career Information department was intrigued by the prospect of understanding how new and small business contributed to the bigger picture of Texas job creation. *An Atmosphere of Enterprise* is the result of that intellectual curiosity.

This effort could not have been undertaken without contributions from many people. Michael “Mick” Normington served as the primary author and project coordinator, blending his own academic interests with the research and analytical talents of colleague Ross Evans to create an independent and Texas-specific understanding of firm births and closings based on age and size using Texas unemployment insurance wage record data.

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Finally, the LMCI team thanks the dozens of Texas CEOs who discussed their adventures in business and agreed to give their insights on job creation. These executives helped us better contextualize and interpret our statistical analyses on firm birth and job creation and also reminded us that the Texas economy was built through the drive and determination of entrepreneurs, who have the courage to innovate and grow a business. We trust that Texas will always be a place that offers an atmosphere of enterprise for future entrepreneurs.

Richard Froeschle,
Editor and Director,
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| A Story of Job Growth

Ask the founders of Newtoy Inc. why they created 33 jobs in 3 years and they don't have a single answer. Newtoy is a company that makes games to play on cell phones. Company software programmers work in open offices inside a building that 100 years ago was a cotton mill. Newtoy illustrates how ephemeral and unpredictable is the nature of job creation.

Newtoy also illustrates the opportunity for job creation in this new economy.

This report is a look at job creation in Texas with two unique perspectives. First, this report relies on research that tapped the Texas Workforce Commission's massive databases on companies and employees to show new trends in the economy. Newtoy is an example of the "shrinking startup" in Texas, where a new company has fewer employees in its first year than similar startups had only a decade ago.

A second aspect of this report is that the researchers also interviewed executives at companies known to be growth companies in Texas to uncover key trends and traits as they add workers. For example, the building that houses Newtoy was filled a century ago with workers who had a strong back and an understanding of the quality differences in agriculture products. Now the Newtoy executives are quick to point out that a century later their building is now filled with workers who have a strong education in math and an understanding about the quality differences in electronic information.

Newtoy is a growth company that has recently confused and fascinated Texas economic developers. So that is where this story will begin.

Newtoy started in 2008 when brothers Paul and David Bettner, who were building battlefield video games like "Halo Wars" for game developer Ensemble Studios in Dallas, suddenly they lost their jobs in unexpected layoffs. Microsoft, the parent company of Ensemble Studios, closed down the Dallas operations in summer 2008. Paul Bettner had just bought a house in McKinney to be near his in-laws. Also, Paul and his wife just had a baby.

Without jobs and facing a national recession, David Bettner convinced his brother to finally try starting their own business, which they called Newtoy.

Beginning in August 2008, the brothers took their laptop computers each day to the McKinney Public Library where they wrote software code and quietly conducted video conferencing with their partner and cousin, Michael Chow.

The three partners didn't pay each other for a year. Instead they sat at the tables in the McKinney library where they wrote and launched their first game, Words With Friends, a Scrabble-like game that millions of people play on their iPhones.

In late 2009, Newtoy started making a profit from online subscribers to their game. Then the three partners started hiring employees, mostly other developers with whom they had worked at Ensemble Studios.

Meanwhile, the three partners approached a dozen banks in the Dallas area to get a line of credit on the company's growing accounts receivables from both subscribers and advertisers. But every bank said 'no.'

"The bankers were scared of the volatility of the business and how fast our revenues were going up. They just weren't willing to bet on us," said Michael Chow. "They just weren't familiar with our new business model."

Not only did the company not exist 5 years earlier, but the smart phone gaming industry didn't exist 5 years earlier.

The brothers also applied to the McKinney Economic Development Corp. for a \$50,000 rent subsidy to help their company lease space. But they said that process moved so slowly that each time they completed their lease documentation they had hired more workers and needed more space with a whole new lease.

Newtoy had gone from 3 employees to 20 employees in their second year then reached 35 employees in the company's third year.

"We had more ideas than we had employees to do them," said David Bettner.

The partners settled on renting 10,000 square feet of space in the refurbished 100-year-old cotton mill. The mill machinery and textile workers are long gone but the building still features the old wood floors and large windows as well as new high-speed Internet connections.

The unique workspace has helped Newtoy compete for skilled workers. The software industry, particularly for making mobile applications, has low barriers to entry so new small firms have been cropping up and larger companies have expanded into the young industry. Newtoy is competing for programmers with Triangle Studios, which is a software firm from the Netherlands that set up operations in 2010 in Dallas, where it found qualified skilled workers to help compete in the iPhone apps space. Yet extra competition has not hindered the growth at Newtoy.

"When we were growing, what we really needed was capital. Capital is always more useful than work space. If people really want to get their company going they'll find work space no matter what's available, they'll go to a living room or a garage or the library. But financing help is always needed," said Michael Chow, who noted that the partners got small business help – which was provided by local governments and regional angel investing groups in the McKinney area – only after they no longer needed that help.

David Bettner pointed out that their company was able to grow and add jobs due to a few key reasons:

- a) The three partners were willing to risk a lot. They spent all of their life savings, borrowed heavily from their family and friends, and worked for no pay for a year.
- b) The partners kept expenses low by staying in inexpensive McKinney.
- c) The partners had access to highly experienced workers who happened to be friends in the community.
- d) The partners had a business model that allowed them to avoid having to sell equity in their company while also being in a new industry with low barriers to entry and low capital investment.

Gaming giant Zynga Inc. of San Francisco bought out Newtoy in 2010 and allowed those operations to remain in McKinney under the direction of the Bettner brothers and their cousin – and allowed them to continue hiring. And while the Bettners and their cousin continue to hire in McKinney in 2012, they expect to grow payroll more in years to come. Zynga can help as it raise more than \$1 billion capital with its initial public offering, all for the company with only a few hundred workers.

PREFACE

Introduction for this publication

The story of Newtoy Inc. is reflective of many start-up businesses and is indicative of the relationship between entrepreneurship and job creation. And Newtoy also demonstrates that starting a successful business often requires great conviction, sacrifice and some good fortune.

Underlying Newtoy's success as a company, and as a job creator, is consumer demand for the firm's products and services. Any discussion about job creation must start with the realization that the demand for labor is a derived demand. In other words, hiring workers starts with the demand for their productive abilities to contribute to the creation of a product or service that is in demand. In the case of Newtoy Inc., the growing demand for innovative online gaming opened a window of entrepreneurial opportunity. This basic derived demand concept is what connects macroeconomic growth to job creation.

Derived demand applies to large corporations and small business alike. The contraction of demand for goods and services, as occurs during a recession, is a major cause of job loss for businesses of all sizes. This is also the unifying principle connecting the money economy and the labor market. As such, it is unlikely that there will be significant job creation in any industry or business of any size, without general economic growth.

Of course, economic growth – and any corresponding job growth – is a function of many diverse and complex phenomena and does not occur evenly across regions or industries. In the period after the Great Recession of 2007 some states, such as Texas, experienced superior economic and job growth while others continue to languish. Even during the depth of the recession in calendar 2009, the Texas gross domestic product grew at a 0.5% clip, while the nation as a whole declined by -2.6%. While it is nearly impossible to parse all the influences on job growth, certain aspects of a business-friendly environment such as low taxes, streamlined permitting, an effective regulatory and litigation system, status as a right-to-work state, and access to skilled workers are all recognized as positive influences on job growth.

There are many other factors that influence the numbers and types of jobs that are created. This report outlines some of the comparative advantages of regions within Texas, some of which are centered on natural amenities such as abundance of raw materials, proximity to markets or transportation access.

And while aggregate economic growth in the money economy is a pillar of labor market growth, the numbers of jobs created and the skill sets they require are a function of yet another set of complex phenomena. These include evolving business practices that value technology as much as physical labor, new engineering and scientific breakthroughs that rely on a technically educated workforce and the consumer needs of an expanding global economy.

Each of these diverse influencers warrants its own detailed discussion, some of which are presented in another LMCI publication *Working Texas Style*. For this effort we visit the role of small and young businesses and their role in job creation.