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## Illinois' business climate outshines its neighbors'

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Constant talk of corporate taxes and fiscal uncertainty clouds an important fact: Illinois is a better place to do business than surrounding states.

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"It's not just taxes or a patch of land: It's all about the people and the human capital," says Gregory Brown, CEO of Schaumburg-based Motorola Solutions Inc., which employs about 5,000 in the state. "The incentive is higher to stay and build on the base of talent here. There's great talent in Illinois."

Illinois' economic strengths mean the state has what it needs to remain a top business center, if it solves the fiscal problems eroding its edge in the competition for talent, jobs and capital.

At \$581.3 billion in annual output, the Illinois economy is twice the size of any of its neighbors'. It's home to 31 companies in the Fortune 500, triple the closest competitor. It has double the labor force of the largest bordering state, with 6.6 million workers, nearly one-third of whom have at least a bachelor's degree. And it's connected to the rest of the country — and the world — by the nation's second-biggest airport and its largest railroad hubs.

Of course, those assets are concentrated in the Chicago area. They don't do much for Downstate businesses, which still contend with the fiscal problems — deficit spending and unfunded state pension liabilities — that threaten to overwhelm Illinois' inherent advantages as a business locale.

**Rob Lowe, CEO of software startup Wellspring Worldwide LLC, picked Chicago over Philadelphia, Denver and Seattle, moving Wellspring from Pittsburgh early this year. "We'll need to raise money at some point, and access to capital is a lot better" in Chicago, he says.** Photo: Erik Unger

"All the other good stuff doesn't make up for the calamity that's on the way," warns Jim Farrell, former CEO of Glenview-based manufacturing conglomerate Illinois Tool Works Inc., who is leading a budget-reform campaign by the Chicago-based Civic Committee of the Commercial Club called "Illinois is Broke."

Lost amid headlines about rising corporate taxes, companies threatening to leave the state and rival governors wooing others is an important fact: Illinois is a better place to do business than surrounding states.

A *Crain's* analysis of the factors most important to a healthy business climate shows that Illinois outranks Wisconsin, Indiana, Missouri and Iowa. Dozens of interviews with CEOs, entrepreneurs and experts in corporate site selection confirm that Illinois has more of what businesses need to thrive.

The state has a larger pool of talented workers, bigger markets, more money for investment and better transportation. Together, these advantages outweigh the rising taxes and state budget deficits that have put Illinois in an unwelcome spotlight.

He says the state will have to cut pension benefits drastically, and likely raise income taxes again in the coming years, to deal with more than \$90 billion in unfunded pension liabilities.

"We know that they're not addressing the real problem yet. Another round of tax increases, people will say, 'Wow, this is starting to hurt.' "

### TAXES: A CLOSER LOOK

Illinois has the second-highest corporate income tax of neighboring states at 9.5%. Iowa is highest, at 12%. But the corporate income tax rate doesn't tell the whole story. The 30% increase earlier this year put Illinois at the fifth-highest rate in the nation. But when all taxes are figured in, it has one of the lowest overall effective tax rates on new investment in the country, according to a study by New York-based Ernst & Young LLP for the Council on State Taxation, a Washington, D.C.-based taxpayer lobbying group. (See sidebar, below.)



"Tax costs are just one of many considerations," says John Gremer, a Chicago-based partner who advises companies on site selection at KPMG LLP.

Bigger drivers are talent, transportation, access to customers and capital — all significant advantages for Illinois over its neighbors.

In December, SunCoke Energy Inc., a supplier of coke for steelmaking, chose Lisle over Atlanta for its new headquarters, even though it was clear Illinois was going to raise tax rates. Transportation, talent and location were crucial, says Mark Sweeney, a site-selection consultant in Greenville, S.C., who advised SunCoke on the move. "The tax climate wasn't a good thing, but the advantages that were critical to this project outweighed it."

Illinois has these advantages because it has Chicago and its suburbs, the nation's third-largest metropolitan area. No neighboring state has a city even half as large.

"Chicago's the obvious choice for the things we do," says Jim Lidbury, who opened the Chicago office of Ropes & Gray LLP, a Boston-based law firm that specializes in private equity, mergers and patent law, in 2008. The firm employs 54 here. "We have no plans to open offices in other cities in the Midwest."

### 'TALENT MAGNET'

For many businesses — especially tech companies, professional services firms and ad agencies, which need highly skilled workers and pay them well — talent is the critical factor in deciding where to set up shop.

Accenture PLC, the global consulting firm, announced last week it would add 500 jobs in Chicago, its largest operation in North America, with 5,000 workers.

"It's a real talent magnet for all the kids who go to college in the Midwest," says Jorge Benitez, Miami-based CEO of Accenture's U.S. business. "Getting the best people is paramount to what we do."

The state's top-flight universities, such as Northwestern University, the University of Chicago and the University of Illinois, churn out a steady stream of well-educated workers.

About 31% of Illinois' workforce has at least a bachelor's degree, and 11.5% a graduate degree — both above the national average, according to federal data. Wisconsin and Missouri come closest at about 26% with a bachelor's degree or more, followed by Iowa at 25% and Indiana, 23%.

Google Inc. chose Chicago as its Midwest outpost and now employs 500 here.

"We have a significant office in Chicago because it is a world-class business city that has world-class customers and world-class talent," a spokesman for the Mountain View, Calif.-based Internet search giant says. "We locate our offices where top talent wants to live and work, and that is Chicago."

The state also has deep pockets of specialized expertise — pharmaceuticals and medical devices, manufacturing, logistics, consumer products and advertising — that companies value.

Hil-Rom Holdings Inc., a hospital-equipment supplier based in rural Batesville, Ind., opened executive offices in Chicago in 2010 after hiring CEO John Greisch from Deerfield-based Baxter International Inc. It now employs 35 of its 6,000 workers here.

"The whole point was to get access to talent," a spokeswoman says.

## GETTING AROUND

Chicago's central location and extensive transportation network make the city a destination of choice for companies that need to move employees around the country and the globe. It's home to regional headquarters for a wide range of national and foreign-based firms like Siemens A.G. The German manufacturer's U.S. building-technologies division is based in Buffalo Grove and employs 3,000 people in the Chicago area. Recently it spent \$10 million upgrading a West Chicago plant that makes solar equipment.

Chicago is unique among the nation's big cities as a hub to three major carriers: United Airlines and American Airlines at O'Hare International Airport and Southwest Airlines at Midway Airport.

There are 60 carriers flying non-stop from Chicago to 192 cities, compared with eight airlines and 31 non-stops from Indianapolis, 13 carriers and 61 non-stops from St. Louis, seven airlines and 17 non-stops from Des Moines, Iowa, and nine carriers and 49 non-stops from Milwaukee.

Air connections are a big reason Evraz Inc., a Russian steelmaker, moved its North American headquarters to Chicago from Portland, Ore., in June.

"We needed a place with easy access to multiple locations across North America," CEO Mike Rehwinkel says. He adds that Evraz already has found 60 new staffers to fill vacancies created by employees who didn't want to make the move. "Chicago has a deep pool of executives with heavy manufacturing experience."

Direct air service to Asia and Latin America is a big draw for global companies such as South Korea's LG Electronics, which recently opened a \$6.5-million appliance-testing center with 40 employees in Buffalo Grove, alongside a research lab it acquired from Zenith Electronics in 1999.

"Chicago's a great place to do business, for talent and transportation," a spokesman says.

Illinois also is the country's top rail hub, with 7,313 miles of track served by 42 railroads, according to the Assn. of American Railroads in Washington, D.C. Indiana has 4,475 miles served by 42 carriers; Missouri has 4,050 miles and 17 railroad companies; Iowa has 3,925 and 16 carriers, and Wisconsin has 3,510 miles of track served by 10 operators.

## CAPITAL AND CUSTOMERS

Illinois also offers businesses greater access to customers and capital than its neighbors. Companies that sell everything from consulting services to candy benefit from a presence in one of the nation's biggest population centers. And startups that provide valuable new jobs, such as online-restaurant service GrubHub Inc. or facilities-maintenance provider SMS Assist LLC, need to be able to raise money to grow.

Thirty-one Fortune 500 companies are based here, compared with 10 in Missouri, nine in Wisconsin, five in Indiana and two in Iowa.

"A lot of companies also pass through Chicago, so we can meet with management teams," says David Klaskin, chairman of Chicago-based Oak Ridge Investments LLC, an investment advisory firm with \$3 billion under management. "That's not going to happen in Indianapolis or Milwaukee."

It's also a wealthier market. The average salary is \$47,888 in Illinois, compared with \$39,667 in Missouri, about \$38,000 in Wisconsin and Indiana, and \$36,140 in Iowa. Coupled with a larger population, that makes Illinois a prime target for retailers, such as H. H. Gregg Inc., an Indianapolis-based electronics chain that opened 14 stores in the Chicago area last month.

Illinois companies raised \$297 million in venture capital in the first half of 2011, compared with \$130 million in Indiana, \$52 million in Wisconsin, \$48 million in Missouri and zero in Iowa, according to Dow Jones Venture Source data.

## Tax burden in Illinois lower than neighbors

Illinois' decision earlier this year to jack up its corporate income tax rate made CEOs cringe and governors of nearby states drool.

The state vaulted into the top five nationally when it raised the rate to 9.5% from 7.3%, higher than any neighbor except Iowa.

But a business owner wondering where to open a new facility might be surprised to discover the overall tax burden actually could be lower in Illinois than in surrounding states. When all state and local taxes are considered, Illinois has the fifth-lowest effective tax rate in the country, at 4.6%, according to a 2011 study by Ernst & Young LLP. The study is based on data that don't reflect the recent income tax hike, but Ernst & Young says the impact of the increase on Illinois' effective tax rate would be relatively minor.

Among neighboring states, only Wisconsin is lower, at 4.5%. Missouri is highest, at 7.1%, followed by Indiana's 6.8% and Iowa's 6.4%.

How can that be? Corporate income taxes are just one piece of the overall tax burden — and not always the biggest. Franchise taxes, property taxes, sales taxes, gross-receipts taxes and levies on machinery and equipment add more to a company's total tax bill.

"The two biggest are sales and property taxes," says Donald Bruce, a University of Tennessee professor of

"It's a huge reason we came here," says Rob Lowe, CEO of Wellspring Worldwide LLC, a 30-person software startup that moved from Pittsburgh in February, choosing Chicago over Philadelphia, Denver and Seattle. "We'll need to raise money at some point, and access to capital is a lot better."

Groupon Inc. has raised capital from all over the world, but Chicago investors got it off the ground.

## HIGHER COSTS

There's a price to be paid, however. Chicago has higher operating costs, from wages and real estate to electricity and heating gas, than the biggest cities in neighboring states. Total operating costs for businesses in Chicago are 25% higher than in Des Moines, 20% higher than in Indianapolis, and 15% higher than in St. Louis and Milwaukee, according to BizCosts data from Boyd Co., a relocation firm based in Princeton, N.J.

Dave Bernstein, a co-owner of State Steel Supply Co. in Sioux City, Iowa, says lower costs for everything from land to labor give him an advantage. "When a competitor from Chicago quotes into our market, they're quoting the same prices as we do, but they have higher overhead," he says.

Still, he acknowledges that taxes and costs aren't everything. He could move his business just a few miles to either Nebraska or South Dakota and escape the nation's highest corporate income taxes. But "we'd lose the infrastructure," he says.

Catalyst Exhibits Inc., a trade-show exhibit management company, moved last week to Pleasant Prairie, Wis., from Crystal Lake to save money. The company, which employs 92, had been considering Elgin but chose Wisconsin, which provided a \$1.2-million low-interest loan and a \$500,000 grant.

"It wasn't completely incentives," says CEO Tim Roberts, who estimates he'll save 20% a month on building costs, not to mention savings on health insurance and workers compensation premiums.

Illinois has the third-highest workers compensation rates in the nation, at \$3.05 per \$100 in payroll, though recent reforms are expected to lower those costs by about 9%. Indiana has the lowest in the nation, at \$1.16. For a manufacturer, it could mean an extra \$900 per employee annually. Wisconsin is in the middle, at \$2.21 per \$100 of payroll.

"I have a manufacturing and distribution center in Wheeling," says Joe Beatty, CEO of Tellular Corp., a Chicago-based manufacturer of wireless communications equipment. "If I put it over the border in Indiana, it would save me money. We're considering it."

Illinois also is more unionized than neighboring states, with 16.4% of its workforce organized, compared with 15.1% in Wisconsin, 13.8% in Iowa, 12.2% in Indiana and 11.1% in Missouri, according to the Bureau of Labor Statistics. Unionized employees tend to have higher wages and more rigid work rules, driving up labor costs, which are the largest expense for most companies.

"The savings on operating costs alone made it worth it," Mr. Roberts says of a move he estimates will cost \$300,000. "What put me over the top was the tax increase. The business climate in Wisconsin is night and day. Right now, the two states are similar in tax, but I think they're heading in opposite directions."

## WARNING SIGNS

Business owners worry they'll have to pay the price for decades of fiscal mismanagement by Illinois' elected officials. A yawning state budget deficit led to this year's income tax hike. Even more ominous is the \$93.5-billion funding shortfall in state employee pension plans. Illinois' pensions are only 51% funded, the worst in the nation. Wisconsin's plans are fully funded, Missouri's and Iowa's are about 80% funded, and Indiana's is at 67%.

Indiana Gov. Mitch Daniels and Wisconsin Gov. Scott Walker have moved to rein in pension costs, pushing unions out of government work. Illinois Gov. Pat Quinn, who depended on unions for political support, has been unwilling to

business. "Income taxes are nowhere near the top of the list."

Illinois is one of only four states that don't charge property tax on equipment and machinery in manufacturing plants. It was dropped years ago but lives on as a 2.5% personal-property replacement tax that brings the state's total corporate income tax rate to 9.5%.

Indiana charges 2.75% on the value of commercial machinery and industrial equipment; Missouri levies 2.6%. Wisconsin taxes commercial equipment at 2.27% but not industrial machinery. Iowa doesn't tax equipment.

Illinois is in the middle on corporate real estate taxes, at 2.4% to 2.8%, depending on whether the property is categorized as commercial or industrial.

At 6.25%, Illinois has a higher sales tax rate than Missouri, Iowa and Wisconsin. But Illinois has more generous exemptions on sales taxes for sales to businesses than other states, says Bob Cline, director of state and local tax policy economics at Ernst & Young in Washington, D.C.

"There are so many deductions and writeoffs, very few companies pay the nominal rate," says John Boyd, a site-selection consultant and principal at Boyd Co. in Princeton, N.J.

*John Pletz*

go as far.

Mr. Roberts is one of many business owners who think they'll get stuck with the pension bill.

Illinois "won't have any choice but to raise taxes again, and they don't seem to be willing to cut," says Mr. Roberts, a Barrington village trustee. "As far as the next 10 years, the odds in Wisconsin are much better for us."

Wood Dale-based AAR Corp., an aircraft-maintenance provider, has received inquiries from other governors about moving since Illinois raised tax rates, CEO David Storch says.

"We're a Chicago company. We're not moving," he says. "The real question is growth — where do I grow my business?"

When AAR purchased an aviation-services company in North Carolina last year, it decided to find a new headquarters for the unit and its 300 employees. A half-dozen states pursued the deal, but not Illinois. Melbourne, Fla., won out with \$7 million in incentives and no income tax.

"We could have relocated it to Illinois," Mr. Storch says, mentioning air bases near St. Louis and in Downstate Rantoul. "We didn't. The state of Florida laid down the red carpet. They were paying attention."

AAR also operates a former United Airlines maintenance facility that employs 682 in Indianapolis. "It's an important property to the city and the state, and they've let us know it," Mr. Storch says. "I've had great relationships with Chicago's mayors. I've never met the governor of Illinois."

Warren Ribley, the state's director of economic development, acknowledges "a perceptual thing we have to be mindful of. It's more perception than reality. We're reaching out every single day."

It will take more than a sales pitch or incentives to convince companies that the state wants their business.

Neighboring states also are developing a reputation for being more business-friendly. "When I call the secretary of state or whatever agency in Indiana, I get a positive response," says Mark Winzenread, chief financial officer of Indianapolis-based Walker Information Inc., which previously had an Illinois office. "I don't get that in Illinois. It's generally a frustrating experience."

When the 180-person consulting firm moved its headquarters just a short distance a few years ago, the state provided \$600,000 to extend a road two miles. "We had one or two meetings and got it done," he says.

Mr. Farrell, the former ITW CEO, says Illinois will have to fix its attitude and its finances or risk losing business to other states.

"I love Chicago, I really do," he says. "Do you think I can look another CEO in the eye and say this is a great place to bring a plant? No. Most of the large companies in the state are very nervous about where we are."



**Tim Roberts, CEO of Catalyst Exhibits Inc., estimates he'll save 20% a month on building expenses, among other savings, now that his company has moved to Pleasant Prairie, Wis., from Crystal Lake.**

Photo: Stephen J. Serio



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**Jim Farrell**, former CEO, *Illinois Tool Works Inc.*



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**David Storch**, CEO, *AAR Corp.*

Illinois seems unlikely to lose its appeal as a location for corporate headquarters and companies willing to pay top dollar for the highest-skilled workers. The challenge is retaining cost-sensitive companies in industries like manufacturing and transportation that hire semi-skilled workers at decent wages.

Canadian National Railway, for example, is moving 250 jobs from a maintenance facility in Matteson to Gary, Ind. LEP Special Fasteners Inc., an Italian manufacturer with a U.S. headquarters in Frankfort, Ind., said last week it would move about 150 jobs from Elgin to Indiana. Each company received tax incentives. But tax policy also is an issue. Indiana plans to cut its corporate tax by nearly 25% over the next four years.

"The state of Illinois needs to get its act together," Motorola's Mr. Brown says. "Businesses want to see they are investing in a state that recognizes reality for what it is and is taking prescriptive action. Perpetuating the status quo is the worst thing you can do."

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