



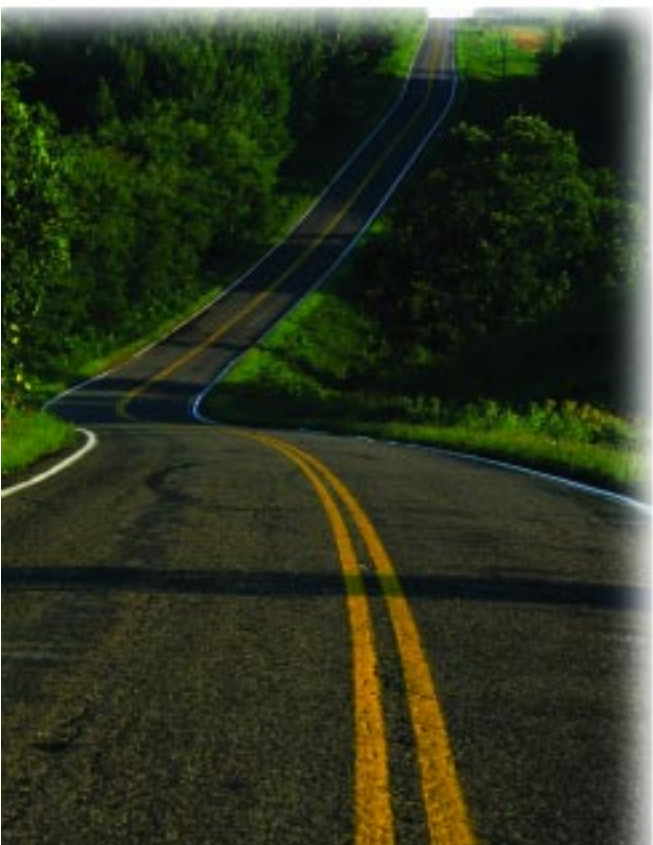
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The Main Street _____ Economist *Commentary on the rural economy*



Small Business in Rural America

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Small businesses are an important ingredient in the rural economy. They account for nearly two-thirds of rural jobs and almost all of rural establishments. Over the past decade, small rural firms added many jobs in a variety of industries across rural America. Small firms dominated job rolls in key rural industries. And they maintained a strong presence in high-growth rural areas near scenic amenities and metropolitan areas.

Still, small firms in rural America may not be performing as well as they could. Not only has their performance lagged their metropolitan counterparts, job growth at small rural firms has occurred mainly in lower paying industries. Many rural stakeholders suggest that three major challenges hinder small business expansion in rural America—infrastructure, labor, and capital. Creating new partnerships or networks among small businesses and public institutions could help rural America overcome these challenges.

How important are small firms to rural America?

The U.S. Small Business Administration often defines a small business as a firm with fewer than 500 employees. Firms of this size contributed greatly to the nation's economic prosperity during the 1990s. In fact, roughly three-fourths of the net new jobs created from 1990 to 1995 occurred in small firms (Chart 1). And in recent years, seven of the ten fastest growing industries were dominated by small businesses, including the high tech sector, where small firms employ 38

percent of the industry's workers.

In rural America, the vital role that small businesses play in the prosperity of many communities is undeniable. Small firms account for 90 percent of all rural establishments. In 1998, small firms employed 60 percent of rural workers and supplied half of rural payrolls (Chart 2). In all, nearly 1.2 million small firms called rural America home.

A closer look at small firms in rural America reveals another striking fact. Over a million rural firms—nearly three-fourths of all rural firms—have fewer than 20 employees. These small firms account for a quarter of all rural jobs and a fifth of rural payrolls. By virtue of their dominant role in many rural areas, these small firms figure prominently in helping rural America reach its fullest economic potential.

Small firms maintain a strong presence in high-growth rural areas near both scenic amenities and metro areas. For example, rural job growth in the Pacific and Mountain regions outpaced other rural regions in the 1990s. Most of the job gains occurred in small service-sector firms near mountains, coastlines, and outside metro areas. In 1998, small firms employed more than two thirds of rural workers in these two high-growth regions (Chart 3).

Small rural firms thrive in the services sector.¹ When all industries in this sector are combined, small firms

account for 89 percent of rural establishments and 64 percent of rural jobs (Chart 4). The fast-growing services industries typically dominated by small rural firms include accommodations, social services, retail, amusement and recreation.

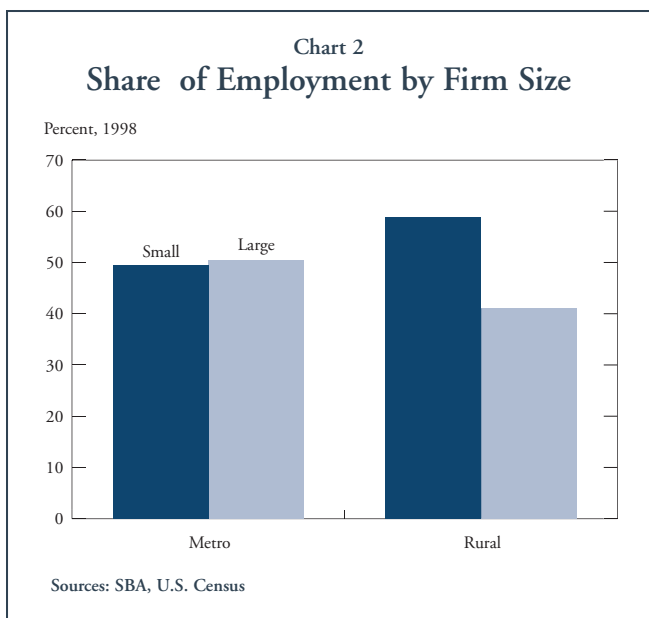
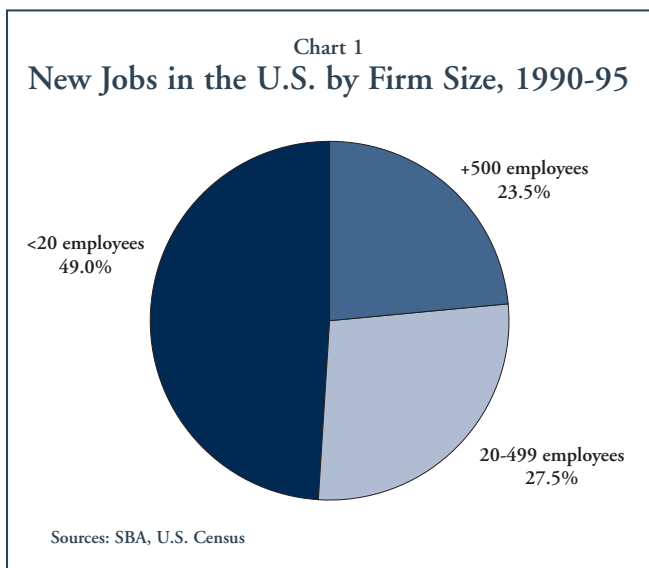
The presence of small firms in high-growth rural regions and industries offers these communities more than jobs—they can be a valuable resource for community leaders and policymakers. Surveys have shown that small firms are more apt to invest in the local community. Small firms relocate less often than larger firms do. They offer workers a wider range of job responsibilities and they typically fill leadership roles in the community. Small firms are also a key source of the creativity and ingenuity that leads to future high-growth industries.

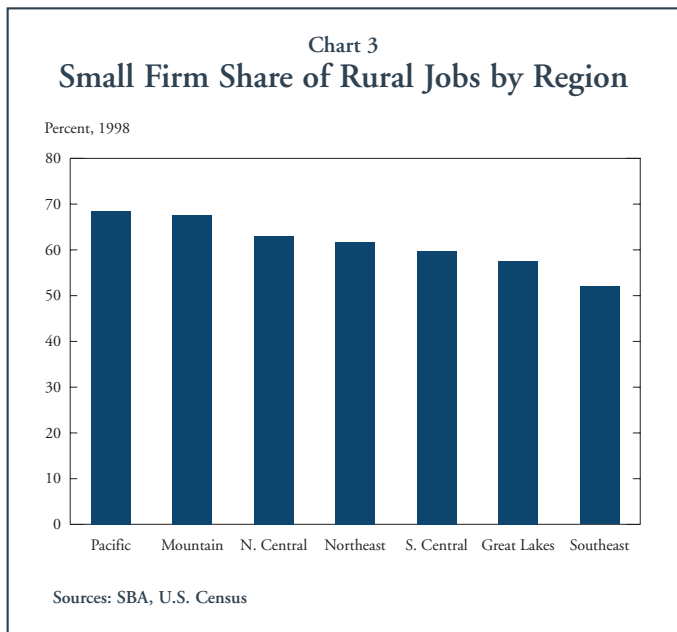
How do small rural firms compare to their metro counterparts?

Small firms are also important to metropolitan America, where they account for 86 percent of establishments. Metro job rolls are evenly split between small and large firms, however, with the larger firms funding two-thirds of metro payrolls. As a result, while small firms are an important element in metropolitan economies, they seem to play a greater role in rural economies.

During the 1990s, small metro firms generally performed better than small rural firms. The number of small rural firms was virtually unchanged from 1990 to 1998, with the employment level of small rural firms rising only 2.8 percent.² In metro areas, more than half a million small firms were established from 1990 to 1998, and the employment level of small metro firms surged 11.3 percent.

Another important difference between small metro firms and small rural firms was worker salaries. The jobs created by small rural firms were generally in lower-paying industries like accommodations, recreation, social services, and retail. In contrast, the jobs created by small metro firms were generally in higher paying





their reach beyond traditional products and markets enhance their ability to compete in today's global economy. But producing and delivering top-notch products still requires high-quality infrastructures, including roads, water, and schools—and high-speed Internet connections. Much of this infrastructure is lacking or deteriorating in rural America, tying many small businesses to traditional products and shrinking local markets.

Appalachian Center for Economic Networks (ACENet) is a widely recognized network resource center for specialty foods and information technology firms. ACENet operates a small business incubator, warehouse, venture capital fund and training programs.

Labor: Small firms also need larger pools of highly skilled labor to prosper in rural America. And they need the resources to offer higher wages and benefits, such as retirement plans, healthcare, or job training. Rural residents often rely more on individual insurance plans or coverage purchased through small employers than do their metropolitan counterparts. Lower wages and fewer benefits have driven many of rural America's educated youth from the countryside. These highly skilled workers take higher paying jobs with benefits in the city, robbing rural communities and businesses of future leaders.

industries like professional services, management, and technology.

As a result, there is a significant pay gap between small rural and small metro firms. In 1998, the average pay per worker of small metro firms was \$29,000 per year, nearly 50 percent higher than the average pay per worker of small rural firms (Chart 5). Thus, identifying ways to encourage small business expansion in higher paying industries could help rural communities boost their economies in the future.

Improving physical infrastructures and closing the digital divide could foster small business expansion in rural America. One way to do this is through networks of small businesses. Two familiar business networks are Florists' Transworld Delivery (FTD) and Teleflora, which provide marketing services, bookkeeping software, Internet services, and educational programs to florists around the world. Similarly, the

To attract and retain highly skilled workers, small businesses and policymakers must find ways to boost rural wages and offer top-notch benefits to rural workers. Some of the earliest network success stories in this area were cost savings achieved by small firms negotiating collectively on insurance policies, telephone rates, and

Fostering small business expansion in rural America

How can community leaders and policymakers encourage small business in rural America? The Center for the Study of Rural America has sponsored a series of conferences and roundtables over the past two years to help answer this question. Participants at the conferences and roundtables have identified three major challenges to entrepreneurial activity in rural America—infrastructure, labor, and capital. Improving infrastructures, boosting human capital, and expanding the menu of capital providers are three ways rural America could foster small business expansion in many of its communities.

Infrastructure: Small firms that expand

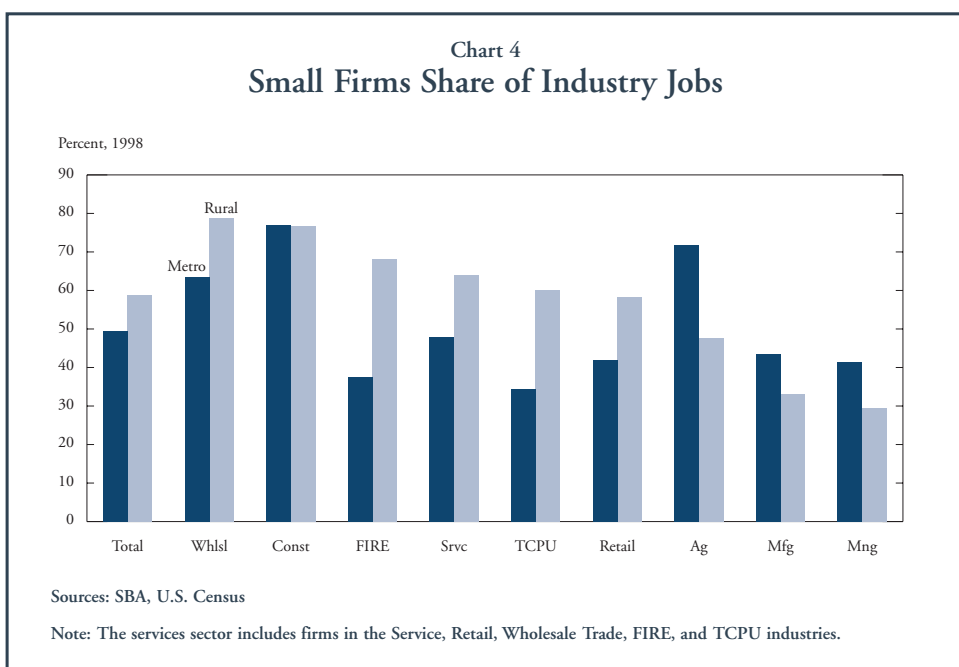
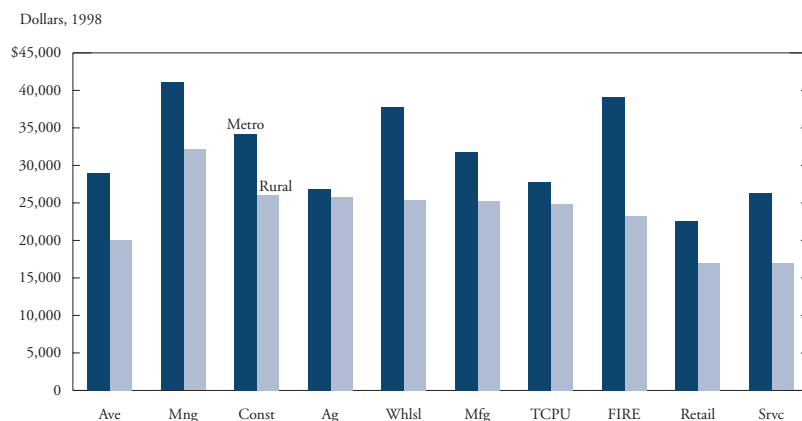


Chart 5
Average Annual Pay per Worker in Small Firms



Sources: SBA, U.S. Census

other joint purposes. One example of small firms and public institutions working together to meet skill and employment needs of local firms is the Northeast Oklahoma Manufacturers Association, which was created by a technical branch of Oklahoma State University and 30 companies in 1993. This partnership resulted in internship programs to acquaint youth with the high tech manufacturing industry, new contract opportunities for members, and training programs on e-commerce.

Capital: Just as in metro areas, small firms in rural areas need capital to expand or survive. Unfortunately, the menu of capital providers in rural America seems to be getting shorter rather than longer. From 1993 to 1998, the number of U.S. financial institutions shrank by 20 percent. Many of the banks that were merged with larger ones were in rural America. This is of particular concern to small rural firms as local banks are often the only source of capital in their community.

To offset the loss of small lenders as a source of capital, communities could form new partnerships like the North Carolina Rural Economic Development Center. This community-based economic development organization has partnered with over 25 banks to provide loans to small businesses. Another well-known partnership

between small firms, state entities, and the U.S. Small Business Administrations is the Small Business Development Center (SBDC). Typically located at community colleges, these centers offer small businesses assistance in obtaining capital as well as business counseling and planning services.

Creating new networks or partnerships between small businesses, other rural citizens, and public institutions can help many rural communities overcome the challenges of infrastructure, labor, and capital. Small firms networking with other small firms can minimize rural infrastructure and labor constraints. And partnerships between small firms and public institutions can boost worker skills, enhance business plans, identify new capital sources, and add workers to the rural labor force.

Conclusion

Small businesses are a vital part of rural America, but their ability to grow and reach new markets is hampered by aging infrastructures, lower skilled labor, and insufficient capital. Policymakers and community leaders must overcome these three rural challenges to foster small business expansion in rural America. By fostering small business expansion, many rural communities could develop new leaders,

expand job rolls, enhance worker skills, and boost local tax receipts. One way to approach these three rural challenges involves creating new partnerships or networks between small businesses, other rural citizens, and public institutions.

¹ Many of the rural job gains during the 1990s occurred in the broad services sector, which includes the following industries: service, retail, wholesale trade, finance, insurance, and real estate (FIRE) and transportation, communications, and public utilities (TCPU).

² This static data illustrates the changing importance of firm sizes over time. It does not illustrate job growth as firms can grow or decline and change firm size classes over time.

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