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EXPLODING MYTHS ABOUT RURAL ENTREPRENEURSHIP

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ABSTRACT

Using survey data of start-up entrepreneurs and administrative employment tax files in five states, Iowa, North Dakota, Michigan, Maine, and Arkansas, researchers challenge some of the conventional wisdom about rural entrepreneurship.

INTRODUCTION

The promotion of entrepreneurship as a strategy for revitalizing distressed rural economies is being hotly debated (DeSoto, 1989; Vaughan, Pollard, Dyer, 1984; Prestwich, 1988; Coffey and Polese, 1985; Miller, 1987; Malecki, 1986). But because few scientific studies have been conducted, the debate about rural entrepreneurship has generated more heat than light (Eisinger, 1988; Kale, 1989). Most of what is known about rural areas has been inferred either from anecdotes and case studies whose generalizability is limited or from extrapolations about urban economies which may be irrelevant (Frederick, 1988; Reid, 1987). Consequently, many myths have grown up around the apparent inability of rural economies to support new business and about the very nature of entrepreneurship itself (Osborne, 1988).

From 1985 to 1989, with funding from the Economic Development Administration, Ford Foundation/Aspen Institute, Northwest Area Foundation, and Michigan Department of Commerce, we set out to study five states-- Iowa, North Dakota, Maine, Arkansas, and Michigan-- with disparate rural economies to try to better understand rural new business entrepreneurship. We interviewed 1,428 entrepreneurs who had successfully started new businesses and studied state unemployment insurance tax files (ES202 files) (White, et al., 1990). Contrary to widely held perceptions about rural

economies, we discovered that rural new businesses contribute substantially to job creation, rural areas are as competitive as urban areas in developing new businesses, rural new businesses are as diversified as urban businesses, and rural new businesses have higher survival rates than urban businesses. Additionally, we found that rural entrepreneurs have access to bank financing, raise considerable capital to start, return more than poverty wages for the effort, serve more than local markets, provide health insurance for themselves and their families, and use technical assistance in getting started in business. Finally, we show that displaced workers play a major role in rural entrepreneurship.

Myths one through four, below, are based on ES202 data at the state and county level. Myths five through eleven are based on interviews with start-up entrepreneurs. The study methodology is presented in an appendix.

Myth 1: Rural New Businesses Do Not Contribute Much To Local Economies.

Many researchers have mourned the end of the short-lived rural renaissance of the early 1980's (Economic Research Service, 1987). Alarms of impending economic disaster are abundant. In a recent Federal Reserve Bank of Chicago study of the Iowa economy, researchers concluded: "With few exceptions, Iowa's economic performance in the 1980's has been poor-- whether measured by employment, income, or output growth-- whether compared with the United States, the Midwest, or Iowa's neighboring states-- whether focusing on goods-producing or service-producing sectors of its economy (Federal Reserve Bank of Chicago, 1987, p. iii)." This has lead to the perception that rural new businesses simply cannot carry the freight in generating jobs. The only hope for development is through attraction of branch plants and corporations from other areas (Miller, 1985; Martin, 1986; Siefried, 1982).

Rural new businesses constitute a large share of all businesses and contribute substantially to job creation (Lin, Buss, Popovich, 1990). For example:

* In Arkansas, 22,816 successful new businesses were formed between 1980 and 1987. They represented 36 percent of all private employers in the state in 1987. These new firms accounted for 130,000 jobs-- 20 percent of total jobs in 1987.

* In Iowa, 19,787 new enterprises were created between 1980 and 1986, about one-fourth of all enterprises in 1986. These generated 108,057 jobs, or 14 percent of the total.

* In Maine, there were 10,678 new businesses successfully formed between 1982 and 1986 generating employment of 51,899-- 14 percent of all employment in 1986.

* In North Dakota, 7,558 new businesses were successfully formed between 1980 and mid-1987. The new firms created 42,000 jobs statewide-- almost one-quarter (23%) of total state employment.

Myth 2: Urban Areas Boast Proportionately More New Firms and Jobs Than Do Rural Areas.

Many analysts perceive rural economies to be merely reservoirs of human capital to be drawn upon by metropolitan areas to stimulate urban growth and development (Thompson, 1965; Friedmann, 1986). Entrepreneurs leave rural areas for greater opportunity in cities, leaving rural areas continually in crisis.

In the states under study, rural economies produced new firms at about the same rate as metropolitan ones (Lin, Buss, Popovich, 1990). In Arkansas, the new firm rate was 47 percent in rural counties and 43 percent in metropolitan counties. In rural Iowa, new firms accounted for 24 percent of total firms, in rural Maine, 33 percent, and in rural North Dakota, 38 percent.

The level of urbanization for counties in the five states-- percentage metro as defined by the Economic Research Service of the U.S. Department of Agriculture-- was not correlated with either the rate of new firm formation or to new job creation. Of the population in Iowa, 42 percent lives in metropolitan areas, the highest among the four states. However, the new job rate was higher in Maine than in Iowa, and the new firm rate was almost identical.

Rural areas shared fully in employment growth from new business. The new job rate was identical for urban and rural counties. The new job rate was 20 percent in rural Arkansas compared to 21 percent in metropolitan counties. In rural Iowa, 13 percent of jobs created by new business compared with 13 percent in metropolitan counties. In Maine, the new job rate was 14 percent for metropolitan and 13 percent for rural counties. In North Dakota, rural new firms created 22 percent of total jobs, a rate comparable to metropolitan (23%) counties.

Myth 3: Urban Areas Are More Diversified Than Their Rural Counterparts.

Rural areas are often discussed as if they were dominated by either agricultural or natural resource-based economic activity (Reich, 1988), or branch plants or single

industries (Miller, 1987). Urban areas, by contrast, are seen as diversified, if for no other reason than their large size.

Table 1: Delta Between Metro and Rural Counties.

State:	Firms	Employment
Arkansas	0.11	0.13
Maine	0.15	0.17
N. Dakota	0.13	NA

Note: Iowa and Michigan not available.

New rural businesses were just as diversified as new urban ones (Lin, Buss, Popovich, 1990). Using the measurement, delta, an index of dissimilarity (Grieder and Krannich, 1984), metropolitan and rural county scores ranged from .09 to .17 for employment and from .04 to .15 for new firms, showing that rural and urban areas were similar (i.e., total similarity equals 0.0). An index of qualitative variation (IQV), a measure of diversification (Mueller, et al., 1970), ranged from .88 to .92 for firms and from .87 to .95 for employment, showing high diversification (i.e., total diversification equals 1.0) and similarity between rural and urban areas.

Myth 4: Start-up Entrepreneurs Face Greater Risks In Rural Than Urban Areas.

Rural markets are small, infrastructure (e.g., roads, water, and sewers) is often limited, qualified workers are in short supply, quality of life (measured by present of the theater, ballet, urban shopping malls, and so on) is poor, business support from universities, networks of entrepreneurs, and economic development corporations is not available, and rural economies are unstable (Malecki, 1986). Starting a new business in a rural area is much riskier than starting in an urban area.

Rural new businesses had high survival rates, even in states that are not perceived to be entrepreneurial. In rural Arkansas, for example, 15,124 new firms formed between 1980-1987 were still operating at the end of our study period, while 14,110 new firms were closed-- a survival rate of 52 percent. In rural Maine, 1,536 new firms formed between 1982-1986 were successful and only 183 were closed-- a survival rate of 90 percent. In rural North Dakota, survival rates averaged 65 percent. These survival rates compared favorably with rates of 50 to 60 percent reported in the literature for the nation.

Starting a business in rural areas is no riskier than in urban areas (Buss and Lin, 1990). New business survival rates were comparable in urban and rural economies. In Arkansas, the survival rate of new business is 52 percent for rural counties and 48 percent for metropolitan counties. The 89 percent survival rate in rural Maine was competitive with rates of 93 percent in metropolitan counties.

Myth 5: Rural Entrepreneurs Do Not Have Access to Bank-financing.

Because rural economies are small and remote, capital to start new businesses tends to be scarce (Shaffer and Pulver, 1985). Where capital is available, bankers are conservative, tending to invest in sure things.

Table 2: Dimensions of Rural Entrepreneurship

Dimension:	ND	Iowa	AR	ME	MI
% bank financed	55	52	60	60	55
% market > 50 miles	29	16	18	22	14
X start-up capital ($1,000's)	85	43	79	85	99
% receiving TA	20	NA	42	47	30
% displaced worker	19	16	14	11	9
% women	37	42	33	33	32
% covered by health insurance		NA			
% below poverty	7	NA	7	6	10

More than half of all successful new businesses were financed by bank loans (see Table 2). The percentage of entrepreneurs obtaining bank loans was consistent across the states. In addition, 75 percent (on average across the states) of those turned down for loans eventually obtained bank financing. Importantly, less than 10 percent of the entrepreneurs obtained bank financing outside the community. There appears to be no "capital stress" in the communities.

Myth 6: Rural Enterprises Require Little Capital to Start.

Because rural new businesses are small (Miller, 1985) and serve more limited markets, especially in comparison to their urban counterparts, they do not require much capital to start-up (Malecki, 1986).

Rural new businesses required what appears to us to be large capital investments at start-up. The average start-up capital required in the states was $78,000 with some states averaging more than others: North Dakota ($85,000), Arkansas ($79,000), Michigan ($99,000), Iowa ($43,000) and Maine ($85,000).

Myth 7: Rural Entrepreneurs Earn Littles Return On Their Business Ventures.

Rural businesses employ part-time people and family members at low wages (Reid, 1987). Rural per capita income is lower and poverty rates are higher than in urban areas. Consequently, analysts have assumed that earnings from rural new business will also be low, if not at official poverty levels.

On average, only eight percent of successful new business entrepreneurs earned at or below federal poverty income levels from their businesses. Nearly all of those earning poverty-level incomes were reinvesting returns in their businesses or failing to take a salary to get the business up and running.

Myth 8: Rural Businesses Do Not Provide Health Insurance.

Because rural businesses are small, yield little income, use part-time, seasonal, or uncompensated labor, they will not offer health insurance benefits.

Some 31 percent of new businesses provided health insurance benefits to entrepreneurs and employees. But this did not mean that entrepreneurs and their families were not covered by health insurance. When all sources were taken into account, about 90 percent of entrepreneurs and their families were covered. This reveals an important characteristic of rural economies: many people have multiple sources of employment and therefore, are covered by health insurance in some jobs but not others. Others appear to be independent: five percent did not want health insurance. Only five percent remained uncovered.

Myth 9: Rural Entrepreneurs Serve Only Rural Markets.

Analysts have proposed numerous theories or models to explain rural economies (Kale, 1989), but export base theories seem to predominate. Basically, rural economies are stagnant because they do not export enough goods and services to grow.

Rural entrepreneurs, even in the remotest rural areas, serve markets which extend more than 50 miles. For the five states, at least one in five of all successful new businesses served wider markets. Rural new businesses are not simply taking in each other's laundry.

Myth 10: Rural Entrepreneurs Do Not Have Access To Technical Assistance.

Rural areas are so small that they cannot support business technical assistance providers (either university, non-profit, or for profit) which might help new businesses overcome problems, especially at start-up (Malecki, 1986; Thompson, 1965).

Technical assistance was widely available in rural areas, even in the remotest areas. From one-fifth to one-half of all new start-up entrepreneurs used some form of technical assistance. The lion's share of those not using services felt that they did not require the services offered.

Entrepreneurs consumed a variety of technical assistance services: workshops or courses in starting a business, specialized training, preparing a business plan, management counseling, and preparing a marketing plan.

Importantly, technical assistance was offered equally by the public and private sectors. In Arkansas, for example, 48 percent of all technical assistance was provided by the private sector. This may be one reason why technical assistance appears to be lacking-- the public sector is not offering the service.

Myth 11: Rural Displaced Workers Contribute Little To New Businesses.

Because opportunities are limited, business experience is lacking, and because entrepreneurial role models are rare, rural displaced workers will opt to move to urban areas to work rather than remaining at home to start a new business (Reich, 1988; Thompson, 1965).

Displaced workers, not including farmers who had lost their farms, on average across the states, accounted for 14 percent of all successful new businesses. Displaced worker contributions varied slightly by state: North Dakota (19%), Arkansas (14%), Michigan (9%), Iowa (16%), and Maine (11%). Displaced workers probably are leaving rural areas, but those who remain are making a major contribution.

CONCLUSION

Data from five disparate states suggest that rural economies are not as hostile to new business entrepreneurship as some analysts have assumed and that new business entrepreneurs are important contributors to local economies. Importantly, data show that rural new start-up businesses are not dominated by mom and pop enterprises which return only sub-

sistence income. Many new businesses are exporters of goods and services.

It is the case that rural America is worse off than the Nation and urban areas generally: poverty rates are higher, more people are dependent through disability, social security, welfare, and unemployment, work is often part-time, temporary, and low paying, skilled and educated people are leaving rural areas and not being replaced, infrastructure is lacking or inferior, and social amenities and quality of life is sometimes lacking (Buss and Vaughan, 1987). But in spite of these disadvantages, rural new businesses are as competitive as their urban counterparts. Some may argue that rural new businesses are even more competitive because of the environment in which they must compete. The substantial number of successful displaced worker entrepreneurs may also highlight this competitiveness.

More empirical work needs to be done before rural entrepreneurship can be understood. This study is intended to create more interest among analysts in looking closely at how rural entrepreneurship really works.

APPENDIX

Background

In 1987, the U.S. Economic Development Administration funded a pilot project to develop a methodology to study rural new business development. The pilot project was conducted in Iowa (Popovich and Buss, 1987). The lessons learned in Iowa were separately applied in four states in projects funded as follows: North Dakota with funding from the Northwest Area Foundation (Buss and Popovich, 1988); Maine and Arkansas with funding from the Ford Foundation (Buss and Popovich, 1989 and Popovich and Buss, 1989, respectively); and Michigan with funding from the Michigan with funding from the Michigan Department of Commerce (Buss, Vaughan, Gemmel, 1989). A complete description of the methodology is presented in the reports referenced above.

Successful New Businesses Defined

New businesses are those which started and were still operating in the 1980s. Each state was studied during slightly different timeperiods: Iowa, 1980-1986; Arkansas, 1980-1987; Maine, 1982-1988; North Dakota, 1980-1987; and Michigan, 1982-1988. Because firms tend to have a high survival rate only after 5 to 6 years (Phillips and Kirchhoff, 1988), a 7-8 year period nets a wide variety of new firms, some of which have succeeded, and others likely to fail.

This definition intentionally narrows the inquiry. The target population is not all new businesses, but instead only those which are successful. Because firms ranging from zero to eight years of age (0-1 yr.= 8.7%; 2 yrs.= 13.6%; 3 yrs.= 14.2%; 4 yrs.= 16.6%; 5 yrs.= 12.9%; 6 yrs.= 9.6%; 7 yrs.= 8.3% and 8 yrs.= 15.8%) are included, many (53.1%) can be expected to fail before the five-year threshold. Therefore, the sample of successful new firms does not include only those who have survived so long that they are different from new start-ups which are yet to be tested in the market. The advantage of a cohort design is that it includes this variety.

The sample does not include failed firms, only those at risk. As part of this study, an attempt was made to identify and interview entrepreneurs from failed businesses (e.g., Buss and Popovich, 1988). As others have discovered (e.g., Cooper, et al., 1988), it is virtually impossible to enumerate cases in this population and then produce a scientific probability sample for analysis. Importantly, failed businesses are represented in two places in the sample--about 13 percent of new firms in our study were started from once-failed businesses <u>and</u> another 15 percent of entrepreneurs reported having failed at least once in another business over the same study period. Nothing can be said about those who failed in business but never tried again.

Would-be entrepreneurs who attempted to start a business but did not get very far (e.g., filing paperwork with the state bureau of employment security) might be targets of public policy. Because this group leaves virtually no public record of their activities and can only be identified through surveys of the general population, they are nearly impossible to study. Resources did not permit a comprehensive five-state study.

But why study these firms? Firms successful according to our definition are cornerstones of rural economies (see Lin, Buss, Popovich, 1990). They produce about one-fifth of all jobs and have a high survival rate. From a policy perspective, then, it makes sense to understand these successful new businesses.

<u>Establishments Defined</u>

The unit of analysis is the establishment not the enterprise. Establishments are businesses operating at single locations. Establishments operating as parts of larger business enterprises, are treated as separate entities. In rural areas, where there are few large enterprises, nearly all businesses are establishments. The concepts-- establishment, firm, and business-- are used interchangeably.

Rural Defined

Rural economies in each state were defined by excluding metropolitan areas. Initially, all state metropolitan statistical areas (MSAs) designated by the U.S. Bureau of Census were identified and the central city located. A circle representing a 60-mile radius from the central city was drawn around the MSA. Counties outside the MSA, but within the 60-mile radius, were classified "adjacent." Adjacent counties were excluded from this analysis but are included in the reports above. Counties located more than 60 miles from a metro area were classified "rural". The 60-mile criterion insures that rural economies were not extensions of major urban areas (see Friedmann and Miller, 1965). Michigan was an exception. In Michigan, the Upper Peninsula was selected as the target for analysis.

Telephone Survey

The basis for the study is a telephone survey of start-up entrepreneurs in four states. Telephone interviews were conducted with 1,428 successful new business owners in five states -- North Dakota (n=315), Maine (n=310), Arkansas (n=287), Iowa (n=300), and Michigan (n=199).

Survey Sample Design

Researchers met with knowledgeable state officials to devise a sampling framework to represent state rural economies. Studies were undertaken in partnership with the Governor's office. Governors in each state convened a task force of from 10 to 15 experts to provide guidance in designing the state sample and questionnaire. Representatives included the Governor's chief policy advisor, Director of Employment Services and Director of Labor Market Information, Director of Development or Commerce, Department of Agriculture, University researchers and state business leaders. The only exception was Michigan which operated the project out of its Upper Peninsula Steering Committee of the Michigan Department of Commerce. Counties were selected at random using cluster sampling.

Resulting county samples illustrated the diversity in rural economies among the states. North Dakota included: energy, cattle, and farm counties in the Northwest; rich agricultural counties of the Red River Valley in the Northeast; and in the South Central. During the study period, North Dakota experienced precipitous economic decline when oil prices dropped in the mid-1980's. Maine included the two northern-most counties, which are dominated by forestry and other natural resource-based industry. Maines's economy was gradually expanding because of shipbuilding and natural

resource-based activities. Arkansas included two county clusters: the south-central and the Mississippi Delta-- one of the Nation's poorest regions. Michigan included the entire Upper Peninsula which boasts mining, recreation, and government employment. Largely because of mining and recreation, this region experienced modest growth during the 1980's.

For each sample county, states provided individual firm-level data from the state's ES202 Unemployment Insurance administrative files. ES202 files were made available for research purposes. North Dakota provided a list of all active business for the sample counties; Iowa, Maine and Arkansas provided county lists of new businesses using our definition; and Michigan provided aggregate level data for the Upper Peninsula. The methodological issues associated with using ES202 files are discussed in separate state reports and in several studies (see Buss, Popovich, Lundell, 1990; Aldrich, et al., 1988; Jacobson, 1987). This list of new businesses was supplemented by information gleaned systematically from telephone directories, local key informants, site surveys, and postal records. Albert Shapiro's method (1982) of comparing telephone listings for various directory listings was used. Lists of proposed new businesses were presented to local Chambers of Commerce, Employment Service officials, newspaper offices, realtors, and others. These key informants were asked to add new businesses to the list as appropriate. Researchers walked or drove each county to produce a list of suspected new businesses. Businesses which were difficult to find were located through the Post Office where possible. An analysis of the efficacy of this enumeration process has been conducted by the authors (Buss, Popovich, Lundell, 1990).

We are confident that nearly every new business in each county was enumerated. A simple random sample of new businesses was drawn for each county. Each county was proportionally represented in the completed sample.

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