



Growing Rural America Through Startups

Entrepreneurship creates many local benefits, but starting a new business in rural places can be challenging

BY TIM SABLİK

Rural places, by many measures, have tended to be less vibrant economically than metro areas, on average. Some small towns looking to create more job opportunities have tried to attract large businesses, while others have leaned on their natural amenities to draw residents and tourists. But another, less obvious, approach is in the running: entrepreneurship. New businesses contribute disproportionately to job and productivity growth, providing numerous benefits to a local community.

Entrepreneurship in America has become increasingly concentrated in cities. In a 2020 paper for the American Enterprise Institute, Mark Partridge, a professor of economics at Ohio State University, documented that the self-employment share of personal income was 12.3 percent in nonmetro areas and 7.7 percent in metro areas in 1969. By 2017, it had fallen to 7.2 percent in nonmetro areas and risen to 8.9 percent in metro areas. Likewise, job creation as a percentage of employment has fallen faster in rural places than urban areas since the 1970s. In the Fifth District, the number of rural startups created each year fell noticeably during the Great Recession and remained depressed through 2019. (See chart.)

One silver lining is that the nationwide startup slump seems to be reversing. Beginning in the summer of 2020, applications for new businesses soared to record highs. (See “A Pandemic-Era Startup Boom,” *Econ Focus*, Fourth Quarter 2021.) Can rural communities and small towns capitalize on this surge to build more dynamic and resilient economies?

A CHALLENGING ENVIRONMENT

When researchers and policymakers talk about promoting entrepreneurship, their focus has tended to be on the fast-growing success stories — the Apples, Googles, and Amazons that started in a garage or basement and grew into huge enterprises.

While there is no question that such firms have tremendous impact in terms of job creation, innovation, and productivity growth, it’s also true that small, locally owned businesses contribute a lot to economic health. In a 2013 Atlanta Fed discussion paper, Anil Rupasingha, now at the USDA’s Economic Research Service, found evidence that having a higher share of employment at small businesses with two to 99 employees was positively associated with local income and employment growth and poverty reduction. The impact of greater employment at larger firms was more mixed.

Historically, rural towns have had higher concentrations of self-employment than cities, owing largely to differences in population density. “If you have a business that fixes air conditioners and furnaces in a rural place, it’s not going to employ 1,000 people like it might in a major city,” explains Partridge. “So you tend to see more small businesses in rural areas.”

But rural entrepreneurs face significant hurdles when it comes to getting their businesses off the ground. The first is the low population density that traditionally encouraged

IMAGE: GETTY/ISTOCK

self-employment. More residents in a community means a bigger market for new businesses to serve, a deeper labor pool to draw from, and more opportunities to interact with and learn from other business owners — and fewer residents means the opposite.

“Entrepreneurial ecosystems are much thinner in rural areas than they are in urban areas,” says Stephan Goetz, an agricultural economist and director of the Northeast Regional Center for Rural Development at Pennsylvania State University. This means that rural entrepreneurs may struggle to find local support businesses, such as accountants or marketers, to help get their ventures started.

The drag of low population density on startup activity can become a self-reinforcing cycle. Would-be rural entrepreneurs may move to a bigger city to start their business or give up on their venture entirely. Each person who moves away makes it harder for the next new business to emerge.

As the 2020 census revealed, most rural places have lost people over the last decade. In the Fifth District, only rural counties in Virginia grew between 2010-2020, and then only slightly — increasing their population by just 1 percent in that time. In every other state in the District, rural areas lost population.

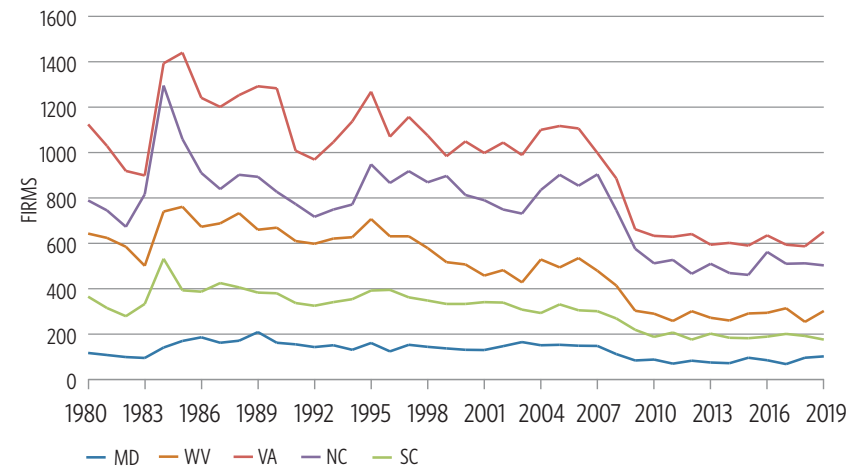
Another key ingredient for startups is access to capital. Historically, rural entrepreneurs have had some advantages in this area. The 2016 small business credit survey conducted by the Richmond and Atlanta Feds found that rural small businesses faced fewer financing constraints and were more financially stable than urban small businesses. The researchers concluded that this was partly because small community banks, which are more prevalent in rural areas, are more likely to approve requests for loans from local small businesses.

That advantage may be eroding, however. The number of banks in the United States has fallen by more than half since the 1980s, the result of both rapid industry consolidation and a drought in new banks being formed. (See “Who Wants to Start a Bank?” *Econ Focus*, First Quarter 2016.)

Large banks may still have branches in rural places, but they don’t necessarily serve the same function as local community banks, Partridge explains. Community bank managers may be more inclined to lend to entrepreneurs in their community because they have local knowledge that enables them to better assess the risks of local business ventures. Managers of bank branches whose headquarters are in large cities may be less willing to lend to rural businesses because they lack that specialized knowledge. “That makes it even harder for rural businesses to get working capital,” he says.

Rural Startups in the Fifth District

New Firms Created in Non-Metro/Non-Micropolitan Areas



NOTE: Metropolitan Statistical Areas have at least one urbanized area of 50,000 or more inhabitants. Micropolitan Statistical Areas have at least one urban cluster of at least 10,000 but fewer than 50,000 people. A firm is a business organization consisting of one or more domestic establishments in the same geographic area and industry under common ownership or control.
SOURCE: U.S. Census Bureau Business Dynamics Statistics

For entrepreneurs in small towns hoping to build the next Apple or Google, access to large-scale venture capital is even harder to come by. Venture capital investing, angel investing, and other startup investing has long been tied heavily to geography. A 2020 National Bureau of Economic Research working paper looked at data from social networks on Facebook and found that institutional investors were more likely to invest in firms from regions where they had the strongest social ties. This has tended to concentrate investors and startups in big cities, like New York.

“If you’re in Silicon Valley and you walk into an investor’s office with a great idea, they are going to lavish you with a mountain of cash long before you even produce anything,” says Russ Seagle. “In rural America, you’ve got to prove yourself.” Seagle is a lifelong entrepreneur who, for the past dozen years, has managed the Sequoyah Fund, a community development financial institution that makes loans primarily to Cherokee-owned businesses in western North Carolina. (The fund takes its name from the creator of the Cherokee system of writing and isn’t related to Sequoia Capital, a prominent Silicon Valley venture capital firm.)

LAYING THE GROUNDWORK

For rural communities hoping to encourage more local businesses, overcoming these and other barriers is a challenge. One way that both rural and urban places have tried to build their own entrepreneurial ecosystems is by first attracting large firms to the area through various incentives. In theory, those firms both create jobs in the community and spur the creation of other local support businesses.

But a 2020 article in *Economic Development Quarterly* by Partridge and co-authors Alexandra Tsvetokova of the OECD Trento Centre for Local Development, Sydney Schreiner

Wertz of the U.S. Treasury Department's Office of Economic Policy, and Carlianne Patrick of Georgia State University called into question the effectiveness of this approach. They found that providing incentives to attract firms to an area has a negative effect on local startup rates. Based on these results, Partridge argues that localities hoping to spur business growth shouldn't focus on providing tax incentives to attract big firms at the expense of small ones.

"Instead, lower taxes for all businesses a little bit and encourage startups that way," says Partridge.

Every town is different, and there is no secret recipe to building an innovative economy. But researchers have identified some key ingredients to creating an environment where startups can thrive.

Broadband is increasingly crucial to the success of businesses, and it can be hard to come by in parts of rural America. Geography, both distance and terrain, has made it difficult to bring fast and reliable wired internet to many rural places. (See "Closing the Digital Divide," *Econ Focus*, Second/Third Quarter 2020.) Seagle notes that in some rural places, it can be expensive and time consuming to connect a new business to local water and sewer systems, let alone get broadband access or even a phone line.

"You don't have to be at the confluence of major rivers or highways anymore," Seagle says. "But if you're not digitally connected to the rest of the world, it's a tough row to hoe."

Digital connections may also open doors to new funding opportunities for rural entrepreneurs. In a 2021 article in *Research Policy*, Sandy Yu of the University of Minnesota and Lee Fleming of the University of California, Berkeley found that crowdfunding through platforms like Kickstarter enables entrepreneurs across regions to gain early funding, support and advice, and inexpensive market feedback. While more crowdfunding campaigns per capita happen in big cities, Yu and Fleming estimated that the impact per campaign was greatest in poorer, more rural regions.

Seagle says that the Sequoyah Fund worked with a client who developed an educational video game that taught players how to speak Cherokee. The game developer started a Kickstarter campaign to fund the project. When it became apparent that he needed more time to reach his crowdfunding goal, Sequoyah Fund loaned him the money to get started, telling him that he could repay the loan once the Kickstarter campaign ended.

"Before Kickstarter, he wouldn't have had a whole lot of other options," says Seagle. "It's possible to do these kinds of things in rural America now."

While building out broadband to every rural home and business to connect entrepreneurs to the web is a continuing process, some communities have found a solution in the form of business incubators, which can provide rentable office space with internet and phone access already set up. The Gould Business Incubator, which launched in 2013, grew out of the Southeastern Institute of Manufacturing and Technology (SiMT), a division of Florence-Darlington Technical College in Florence, S.C. The incubator offers fully equipped office facilities for rent to both established and new businesses, raising money for the college while also supporting local

entrepreneurs. While it took a little while to win locals over to the concept of an incubator, says Tressa Gardner, associate vice president of SiMT, now the incubator is completely full, housing 35 businesses that range from sole proprietorships to the local baseball team — the Florence Flamings.

"We used to say that it was worth coming into the incubator because the Wi-Fi was already set up," says Gardner. Now, entrepreneurs come in to take classes, access the 3D printing facility at SiMT to make product prototypes, and just be around other small-business owners.

BUILDING A COMMUNITY

In addition to providing access to crucial infrastructure, business incubators and similar organizations help foster a culture of entrepreneurship in places where people may never have thought about starting a business.

The WV Hive Network, headquartered in Beckley, W.Va., supports startups across 12 counties in the southern part of the state, an area that has historically been economically reliant on the coal industry. That kind of industry concentration can prove detrimental to entrepreneurship. A 2015 *Energy Economics* article by Partridge, Michael Betz and Linda Lobao of Ohio State University, and Michael Farren of the Mercatus Center at George Mason University found that coal mining in Appalachia reduced population growth and entrepreneurship.

"When we started, many entrepreneurs and small-business owners weren't aware that there were organizations that could support them in their entrepreneurial journeys," says Judy Moore, executive director of the WV Hive. "One of the first things we did was to help create that mindset and then layer in the other educational opportunities and workshops we offer now."

Building a support community may be an important component of keeping local startups local. Connectivity with broader markets, whether through physical or digital highways, can help rural businesses grow, but it can also be a double-edged sword.

"If you bring broadband into a community, it can help the local businesses sell their products elsewhere, but it also helps local consumers find alternative products elsewhere in the country," says Goetz.

Having an environment that supports local businesses means that entrepreneurs don't necessarily have to look elsewhere to succeed. It may even help bring back some who left. Dan Cox's grandfather grew up in West Virginia but moved to Pennsylvania after returning from the Korean War. Cox grew up in Pennsylvania, but his grandparents ended up moving back to West Virginia, and he visited often. He also grew familiar with the area through his work doing cellular service upgrades. Seeing the need for better telecom service in the region, he decided to move to Oak Hill, W.Va., and start his own business, Cox Telecom, with help from WV Hive.

Once a community starts supporting entrepreneurs, it can become a self-reinforcing process. In a 2013 article in the *Journal of Regional Science*, Partridge, Heather

Stephens of West Virginia University, and Alessandra Faggian of Gran Sasso Science Institute found that having more entrepreneurs in a region was associated with even greater levels of self-employment 20 years later. Additionally, they concluded that entrepreneurship was one of the best ways to boost wages and jobs in places that were lagging economically.

One way to cultivate an entrepreneurial environment is through education. That includes investments in general education. Evidence suggests that a town doesn't need a top-tier university to become a startup hub — just having higher levels of high school completion is associated with more entrepreneurship. Teaching entrepreneurship in schools can also get students thinking from an early age about running their own business as a career option and equip them with the skills to succeed. For instance, a 2017 article in *Teaching and Teacher Education* examined a program in Mexico in which fifth and sixth graders created their own small businesses with the help of teachers; the authors found that the experience enhanced entrepreneurial knowledge, values, and skills in the students.

In 2015, Seagle led the Sequoyah Fund to take over REAL (Rural Entrepreneurship through Action Learning), an entrepreneurship education program that started in North Carolina high schools in the 1980s. The program is now taught around the world to students from kindergarten to college as well as new business owners. Students learn how to think like entrepreneurs and acquire the skills needed to run their own business. Seagle became a certified teacher of REAL in 1999, and when the organization behind it ran into financial difficulties, he knew he had to step in to keep the program alive.

"I've seen people come into the program who had to take over a family business but didn't know how to do it. By the end of the program, they had a skillset they never imagined they could have," says Seagle. "It's important for us to teach people how to create jobs rather than just seek jobs. And if they decide that starting a business isn't for them, this training still makes them better employees, because now they understand their boss's mindset and how their work affects the bottom line."

SEIZING NEW OPPORTUNITIES

The pandemic seems to have prompted many people to rethink their relationship with their job, a movement that pundits have called the "Great Resignation." Some have been forced out of work by the disruptions of the pandemic while others are reevaluating what they want to do with their careers.

Gardner recently visited a tenant at the Gould Business Incubator who runs an insurance company. His office had become a makeshift playroom for his grandchildren after their day care sent the children home because of a staffing shortage.

"Everybody's life is in flux right now," says Gardner. "If you can't provide flexibility, you're going to lose your employees. I think a lot of people are deciding that if they are going to work this hard, they're going to work for themselves."

Can rural places attract some of these new entrepreneurs to their communities? For many places, it may be an uphill battle. In their research, both Goetz and Partridge note that the worsening picture of rural America painted by the data is partly an artifact of how researchers define rural and urban — by population density. Rural towns that succeed and grow "graduate" to metro status, leaving behind communities that are still struggling. In a recent interview, Edward Glaeser of Harvard University suggested that small towns with desirable natural amenities may benefit from a pandemic-induced migration away from cities, but the ability of small towns without those attractive amenities to benefit from this reshuffling is less clear. (See "Interview: Edward Glaeser," *Econ Focus*, Fourth Quarter 2021.)

Still, there are rural places that have managed to build a thriving entrepreneurial climate seemingly in the middle of nowhere. Partridge cites the example of Holmes County, Ohio, a predominantly Amish region about halfway between Columbus and Cleveland. Out of necessity, locals cultivated a thriving small-business environment where entrepreneurs support one another.

"Having good public schools or a nearby medical center can help retain population," he says. "But just having the right attitude really makes a difference." **EF**

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