
Growing the New Rural Economy: General Discussion

Moderator: Larry Meeker

Mr. Meeker: What a wonderful thing, the new economy, with challenges on all fronts, from the old world of banking to entrepreneurship. Once again, this is an opportunity for you to be a vital part of this discussion with your questions. Again, please state your name and affiliation, and I'll take three questions at a time.

Lisa Noble, Morgan County, Colorado, Economic Development Corporation: My question is related to the first presentation on helping entrepreneurs. As we look at public policy that deals with different grant opportunities for developing infrastructure for new businesses and for communities to encourage economic development, do you see a change in the job creation requirements that I think are so typically geared toward attracting companies with large numbers of jobs? Is there any movement toward changing those policies to encourage smaller enterprise development?

Lance Woodbury, Kennedy and Coe, LLC: As you consider the rural professional services environment, you think of CPAs and doctors and lawyers and bankers, and you notice a couple of things. One is a pretty strong relationship between those professional service providers and rural wealth and, thus, potentially angel capital. The second thing you notice is sometimes maybe a higher degree of investment in technology to link firms, or banks, or whatever. With these observations, what do you see for the rural professional services firm and its link to public policy?

Kyle Vickers, Missouri Department of Natural Resources: I think this is probably for Ms. Markley. In the past, as I understand it, capital was generally flowing out of rural areas and into the more urban areas and to the coasts. Is there still a net outflow of capital from rural areas to those places, or is the capital concentrated in those other areas so that we have to bring it back?

Mr. Meeker: Okay, thank you very much. Three questions: Do we see a change in the job creation requirements that are often out there to access public funds, grants, etc.? The firms that provide rural professional services—is there some correlation between wealth in those communities and investments? And are we continuing to see a capital outflow or must we attract new capital to rural America? Thank you.

Mr. Dabson: Let me have a go at the first question on public policy and job creation requirements. It is interesting because Debbie and I were talking about this very issue over coffee yesterday evening. Unfortunately, at least for the foreseeable future, job creation is still firmly fixed in the minds of people who want to evaluate the success of public programs. This is in spite of the fact that we have seen years and years of institutions, organizations of different types, making unrealistic and spurious claims for the number of jobs they have created. The fact is that in any given circumstance just about everyone can lay claim to at least a part of a job in a new business deal. Anybody who just uses job creation targets as the means of measuring the effectiveness

of a program is highly suspect. A whole range of issues needs to be looked at as part of a broader range of criteria. If you are looking for public policy to suddenly change and measure a broad range of criteria in the short term, you are going to be out of luck.

Mr. Malecki: Let me take a stab at the second question about professional services and people in the professions in rural communities. Leaving aside the issue of their wealth and being able to invest in new entrepreneurial ventures, let me talk about the technology side.

Two things continued to surface as I did the research for this paper. One is that, despite their wealth, people in the professions in rural areas are not necessarily so technologically advanced that they are on the cutting edge and can serve as models. They may be advanced in some cases, but probably not in most. More importantly, as they and their enterprises can grow and adapt to 21st century technology, what these firms need to do is to play the role of the social intermediary—not just take care of their own business, but take care of the community's business, and say collectively that we have the demand for high-end technology. It is going to be these highly educated professionals who are able to get out front and be spokespeople for the community, which perhaps even people in local government can't do. Partly because these people are in the private sector, they are able to communicate with the telecom providers in a way that often government can't. But one of the things that came up very clearly is that far too often both government agencies and individual firms take care of themselves and neglect the rest of the community. I have my broadband, let them figure out how to get theirs. I really think that the leadership role in the community is to think of *us* rather than of *me*.

Ms. Markley: Let me try to link those two questions and take off on something Ed just mentioned—the leadership issue with the professional

service providers. I'll try to use that as a way of responding to the question about the outflow of capital in rural America.

Clearly, there is equity capital and venture capital potential in rural America that doesn't get tapped, whether it is the wealth of individuals who have the potential to be angels and invest in their communities, or it is businesses within their communities that don't have an intermediary to bring them to the table to get their deals together. There are certainly innovations out there—ACENet is one of them—where an attempt is being made to match investors and entrepreneurs. We know a lot more about the debt capital side and the flows of funds on the debt capital side. I don't think we know as much about where rural equity is going and where it is being invested. We certainly know that traditional venture capital institutions aren't returning much of the money to rural America, because there isn't a lot of traditional venture capital investing going on there. Part of the problem is the lack of intermediation between individuals in rural communities who have equity and are interested in investing and the rural businesses that are in need of equity capital. Until we have that intermediation down, whether it is through an Internet-based matching service or through a physical venture capital fund to try to bring angels or private investors into contact with potential entrepreneurs, we are going to continue to see the venture going untapped. And we are going to see the venture equity money in rural America at a minimum going untapped and, at the other extreme, being put into institutions that make investments outside the community.

Gary Sipiorski, Wisconsin Governor's Growing Agriculture Task Force: I am the executive vice president of Citizens' State Bank of Lowell, Wisconsin, and also the chair of the governor's task force on growing agriculture in the state of Wisconsin. Deborah, my question relates primarily to your comments. Being a \$75 million bank, independently owned and with 100 stockholders, we are caught in

the middle of two things. We have the credit union on the one side, with a 75-basis-point advantage because of not having to pay taxes. We have the Farm Credit System and the large commercial banks on the other side. It seems that when we finance individual entrepreneurs and they are successful, they earn the right to go to a larger institution for lower rates. The other thing that I deal with is that by financing a \$300,000 venture—if I may put it in those terms—if it doesn't work I have the FDIC that says, "Gee, Gary, that disk that you have for collateral really doesn't mean very much." It looks like we are facing a \$300,000 loss. With a bank our size, it is pretty tough to do and pretty tough to convince the FDIC that this is a good deal. What kind of percentage of these startup businesses do succeed?

Paul Darby, *Southern States Cooperative Foundation*: It appears from our work in helping promote and nurture value-added cooperatives that major financial institutions have in the last six to nine months made a fundamental decision to pull out of rural America. They are redlining agriculture. I'd be interested in comments from the panel on that.

Julie Johnson, *South Dakota Rural Development Council*: Dr. Stauber's comments caused me to think about reformatting or changing the vocabulary on rural development policy. This panel gave me thought about who owns the economic development or the entrepreneurship infrastructure in this country, and the whole myriad of federal agencies that provide various pieces of the entrepreneurship continuum of services. So part of the rural development policy switch challenge may be how to get all those under one tent. I was interested if any of you have any comments about that. For an entrepreneur or small-business person it is almost a test to find your way through the federal alphabet soup gamut to find the resource that may help you, especially in small places.

Mr. Meeker: All right. Three questions: First, what can bankers themselves do—being sort of caught in

the middle, if you will, between the credit unions and the Farm Credit System? How can banks really lend in this new economy? And on the collateral side of it, what percent of startups actually succeed? And how can we arrive there safely, soundly, and have the regulators happy with us? Second, are financial institutions pulling out of rural America? And third, who owns the entrepreneurship infrastructure? Many, many federal programs provide different kinds of incentives and have a different role in supporting entrepreneurship. How can we pull this all together under one tent? Thank you.

Ms. Markley: I'll take a shot at the first question. I would suggest here, and I have probably done this in other forums in the past, that it is possible that those entrepreneurs coming to you with a diskette in hand are not really deals for commercial banking institutions. They are deals for a venture capital institution because the risk is relatively high and the collateral is relatively unknown, and the requirement for technical assistance to increase the probability of success for many of these startup ventures is relatively high. I'm not sure that is a role for commercial banks. I would suggest that, for some of those deals, we need to create partner organizations for commercial banking institutions so the business owner is not replacing imperfect debt for the venture capital investment they truly need. If you look at the venture capital portfolio, clearly investors don't expect to hit a home run with every investment they make. If they have one home run out of ten investments, they are doing remarkably well. If they have three or four that do marginally well, they feel good about it. And, if the other five just don't lose them too much, that is a pretty acceptable situation to be in. Because of the lack of capacity on the venture side of rural financial markets, it is really a question of whether we have commercial banks in the position of dealing with requests for capital that may not fall under the rubric of debt—and maybe it really is venture.

Mr. Dabson: I thought it a very interesting question about who owns the infrastructure. It has been a source of some concern for me for many years that any place you go to there is a succession of overlapping programs and agencies, which is a complete nightmare to sort out. Seven or eight years ago, I remember taking a thorough look at the state of Pennsylvania and its incentives and grant structures and what have you. I seem to recall that there were 235 different agencies delivering programs in Pennsylvania. At least 12 to 14 did basic debt financing of different forms, each with their own regulations, their own constituency, and the like. This is fairly common throughout the country and certainly applies to the overlapping federal incentives and initiatives. We tried to play with this a little bit in relation to revolving loan funds around the country and brought together six or seven federal agencies.

If I were given a wish, I would probably pursue the same line that Karl did with the land grant universities. I would probably want to start again and basically scrap the whole paraphernalia of support to economic development and begin with whole cloth to try to make something that really has relevance to businesses today and the communities and the region in which they operate. I am well aware that each of those federal agencies has a huge constituency of different forms. I don't think that rural America deserves to have to fight its way through the massive regulations and overlapping funding streams. You need something better.

In a way, the fact that we have to introduce a national rural development partnership and a whole series of state rural development councils was an admission that things had gotten out of control anyway. We just invented a new form of infrastructure to coordinate the existing infrastructures. I would love to start again.

Ms. Markley: I am not as expert on the farm lending side of rural financial markets as other folks in the audience. Certainly, with consolidation in the

industry just as you are losing the potential for relationship lending, in some of those institutions you are losing the capacity for really understanding the agricultural sector. Small community banks have done primarily agricultural loans or have had at least a significant portfolio of agricultural loans, and so they could develop expertise in the unique requirements of financing the agricultural sector. As those institutions are merged with larger institutions, as they lose the contact within that agricultural community, the capacity for making those agricultural loans is diminished. Whether there is true redlining around the agricultural sector I don't know. There may be some folks from the Farm Credit System or the commercial banking system that might want to throw out a response to that question.

Mr. Meeker: I may make one quick comment on the terms of these overlapping incentives. One of the products we have created at the Federal Reserve Bank of Kansas City is an interactive Internet site that gives quick access to the federal programs at this point and an opportunity to quickly explore what might be applicable to deals, whether they be housing or business development in communities. It doesn't solve the problem of pulling it all together, but at least it makes it easier to see what the mess looks like. Perhaps that will be something useful. We will make some business cards available out here that give you access to that site later on. Let's go to three more questions.

Harold Stones, Office of U.S. Senator (Kansas) Pat Roberts: One of the jobs I do for Senator Pat Roberts of Kansas is in the area of economic development. I get in touch with a lot of entrepreneurial types, and I try hard to introduce them to individuals and organizations for financing for their operations. I come into contact with a lot of people who have considerable wealth but who find they don't have the time or the stomach to be individual angels investing in entrepreneurial endeavors. Consequently, I have tried to work with a number of people to see if we could set up some nontraditional

venture capital companies. We would be talking now of a lot of individuals sitting on a considerable amount of wealth in the Tenth Federal Reserve District, who would gladly, I believe, invest \$100,000 to \$250,000 into a venture capital company, if they knew (1) it would do good for their local, regional, or state community, and (2) it would be managed by someone competent so that there was reasonable assurance of the return of their capital with a modest bit of profit. However, when you try to put that together and you wade through the SEC swamp, you have taken all your money for startup costs. Do you have tips for the minimum amount of capital that you might be able to find for subscriptions to these nontraditional companies? And do you have just a tip or two on how you go about getting them started? Thank you.

Herb Aarons, *California Coastal—RDC*: Our organization is basically a debt financier in central California. My question is to the panel, as well as to the moderator. That is, considering the lost opportunity cost for not having sufficient capital, especially equity capital in rural America, what can the Fed do to encourage banks to become active investors in community venture capital organizations?

Jason Gray, *Southern Rural Development Initiative*: My question is to Debbie and secondarily to Brian. Of the 535 persistently poor rural counties in the United States, 444 are in the South. A majority of those counties have significant minority populations—African-American and Latino. Were you able to evaluate the variable of race in the analysis that you performed with your work?

Mr. Meeker: Okay, three questions. What role does race play in this whole equation? The opportunity cost question—what role can the Fed play? (and I'll really let the panelists suggest opportunities for us). And finally, how do we get this thing started? There is a minefield, if you will, of SEC rules and regulations. Once you start putting these things together, is there a kit or some way we can

get on the road to make this happen more easily? Let me turn this over to our panel again.

Mr. Malecki: Let me take a first stab. It really addresses both the question about the angels out there, as well as an earlier question about successful community development. I strongly believe the private sector is the engine of economic development. Most of us in the room do, even if we work for a public agency. One of the things that hasn't been happening at the local level is to take inventory. I don't mean just of, as I suggested, the telecommunications infrastructure, although in many places people don't even know where the phone lines go. People say, well, that's U.S. West's job or SBC's or whatever the phone company is—and they don't even know. The same thing happens with regard to employers. Unless you have a list of big employers, sometimes no one really keeps tabs on who are the people running the businesses in a community. There will be a few squeaky wheels and they are going to be well-known, but a lot of the others are quietly going about their business and are not really sniffed out into any kind of a format, whether they have good ideas that might be targets for investment or could provide, in the context of my topic, part of the aggregate demand for broadband. So there is a number of ways in which just knowing more of what is going on locally can help communities move forward in the new economy.

Ms. Markley: Let me try to address the issue of startup, because I think it really is a very critical obstacle to creating additional venture capital capacity in rural America. I'll just offer a couple of suggestions. I know in Minnesota they have been trying to form regional angel capital networks.

At the time we did our case studies, there was only one angel network that had been created in the state. There were plans for more of them. The public sector role was really to help bring those people together and help them identify the minimum cap-

ital requirements—how you look at your market and technical assistance like that.

Another thing to consider is acquiring the human capital to help form an angel network. There are either two existing angel networks or venture capital funds that focus on areas outside of large urban centers. There is the capacity in some of these institutions to serve as consultants to this process.

We talked with one person at Colorado Venture Management and he estimated that with \$300,000 and a year's worth of time you could go in and really set up a venture capital institution. You could do the groundwork to understand where the deals were, you could get the base of information that you need to be able to attract the qualified fund managers—because you are not going to get a qualified, skilled private-sector manager to come in and run a fund unless they know there are deals out there to be done. So, there is this whole startup process that requires some outside expertise. If there is going to be a larger focus than just on the community, I don't think it is something that a group of angels can necessarily do on their own. That is where we need help from some of these other intermediaries. Through our case studies, we provide some examples, but I think it requires a lot more digging with those folks who have already “been there and done that” to figure out how they made it happen.

Mr. Dabson: Let me, with some trepidation, deal with the race question. From my experience, there is absolutely no intrinsic reason why African-Americans, Native-Americans, or Latinos should not be entrepreneurs—and good ones. What I've seen, unfortunately with my own eyes, are probably four characteristics that make it more difficult.

One is the lack of individual or family wealth for collateral. If you don't have a house, if you do not

have the benefits of intergenerational wealth transfer—which is certainly the case in African-American communities—then it is very difficult to even put in your own capital or get a business started.

The second is that I've seen in many rural communities, where there is a large African-American population, they do not have access to professional expertise that was referred to earlier in terms of the bankers, the accountants, the lawyers. There is almost a different way of operating in order to get business done.

The third issue is a question of education, particularly in the South, as that educational system has basically let large numbers of people down and not prepared them for the opportunities of developing businesses or any other form of wealth creation in the community.

All of that rolls together into the fourth issue, the absence of role models in many communities. If you don't see somebody in your peer group on the rise as an entrepreneur, then you are not going to go forward.

Now, all of this is about perception. It is about relationships. It is about trying to overcome the damage of successive generations of lack of action. I hope that with more and more good quality intermediary structures a lot of this stuff can be pushed away. There is evidence to show that in many communities there is entrepreneurial talent in every ethnic community in this country. It is a question of how do remove those extra barriers that minorities face, over and above everyone else, and move forward.

Mr. Meeker: Brian, Ed, Debbie—thank you for your forthrightness in approaching these issues and giving us all a lot to think about. Thank you all very much.