Commentary: A Main Street Banker’s Perspective

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In a capitalist free-market society, communities grow and prosper when they experience a balance between the supply of, and demand for, free-flowing capital. These healthy communities enjoy low unemployment, a higher standard of living, and an overall sense of economic well being.

In this perfect world, private sector business invests capital in ventures that bring a predictable target rate of return on investment. Thus, capital flows naturally to opportunities that best support forecasts for success. Elements that are commonplace in such a model include market demand for product or service, raw material supply, transportation, available work force, and lower taxes. In the perfect free-market world, supply and demand find a balance and support the collective needs of community. Arguably, as a modern free-market society, America represents the best-case example of how quality of life and standards of living can be improved through robust economic development supported by the free flow of capital.

However, even in the best case example of the capitalist free-market system, there can be occasions when segments of the market get out of balance and require intervention to bring needed improvement in the flow of capital. Despite America’s success in sustaining overall growth in recent years, there are problems and challenges facing large regions of the country. One such challenge is the return flow of equity capital to rural America.

EQUITY CHALLENGES IN RURAL AMERICA

While much of the country has benefited in recent years from substantial gains in productivity, job growth, and an improved standard of living, rural America has experienced a loss of investment. As such, large geographic areas have entered a period of reversal and are experiencing decline in their communities. In simple terms, shifts in capital supply and demand have created an out-of-balance situation between urban and rural sectors. Rural areas have need for capital investment but the supply of capital flows to areas of demand that provide the highest rate of return. Urban demands, and the resulting price offered for capital, outweigh rural demand and create an imbalance in relation to what rural populations perceive their current needs to be. Since rural market needs and demand cannot presently change the balance of supply across broad market sectors, there appears to be a need for help in the form of social, or government, intervention.

It is clear to those studying the problem facing rural America that there are many complex factors to be considered. To explore the problem in great detail is beyond the scope of this paper. As such, only a select few of the many dynamics contributing to the economic equation will be explored. Two such factors that are worth considering are: 1) The growing shift in our society, away from a three-tiered structure wherein the middle class was the largest and most influential class of people, to a two-tier structure where the
rich get richer and the poor get poorer, and at the same time, 2) a shift in business structure has led to the virtual elimination of the entire middle management level of worker, leaving a thin layer of upper level executives and a very broad layer of working class laborers and service people.

**Changing class structure**

As the country has become divided into a two-class society, the problems associated with rural America appear to be compounded. Historically the middle class, middle management, segment of society, was a collection of individuals that worked very hard to advance their standard of living. They represented a tradition in America of hard work and determination, in combination with a bit of patience and fortitude. By living by those virtues, middle Americans could expect a fair shake in the way of job security, educational opportunity, and an improved standard of living. However, as society has become divided, and the middle ranks diminished, the problems facing rural America appear to be worsening.

The privileged upper class has used their wealth and capital to pursue quick returns and greater yield on their investment. As the pace of the world has quickened through gains in technology and transportation, their patience has waned. They have access to modern information tools and have tremendous knowledge available to them to help advance their goals related to the development of more wealth. Meanwhile, the lower class has the least opportunity to benefit from education, less access to new knowledge tools, and ultimately little access to the capital markets that could help advance their plight.

**Changing business structure**

Over the decades, wealth in America has continued to gravitate away from rural locations to more populated urban areas. The attraction of larger markets, bigger labor forces, distribution points, and mobilized knowledge and capital meant greater opportunity for gain on investment. Concurrent with this shift was the trend toward less patient capital. Investors became increasingly enamored with the quarter-to-quarter results of their businesses, rather than paying attention to what the long-term consequences of short-term decision making could be.

Keeping score in the new game of the current decade—the stock market—became all the rage. I believe it is more than coincidental that the growth of the stock market and the various new indexes such as the NASDAQ has occurred during a time in America when the popularity of keeping score and sports competition has exploded. The competitive sports world and the idea of winning as determined by a score have captivated the modern American. Scoring points in sports competition and the point gain or loss in the market can be seen as synonymous. Tracking and competing in the Dow or NASDAQ have become the sport of investors.

Just as many professional sporting events are divided into periods, quarters, and halves, so are business performance reports and stock movements. Quarterly shareholder reports are the driving force behind the point scoring system, constantly reinforcing the short-term and shortsighted perspective of making the quick gain versus the need in business for patient capital. The measure of success in business thus becomes not so much whether the business is showing growth in sales, employee development, product research and development, and other longer term measures of health and well-being, but rather, how is the stock performing.

**Loss of middle management.** The stock market game has led businesses to engage in practices
aimed at not just improving productivity, or developing sustaining employment trends, but more specifically winning the competition. Companies have become lean and mean—an appropriate sports metaphor for the times. In doing so, they have helped create a second phenomenon in America—the loss of middle management. Nowhere has the loss of human capital been felt more deeply than in rural sectors. As businesses strive to compete for quarterly results they find themselves needing to consolidate operations, reduce overhead burden, and ultimately downsize prior to merging into a larger, more centralized operating entity. While this activity has been resoundingly successful for America in terms of gain in production of goods and services in urban settings, it has compounded the problems facing rural America.

Commercial banking, as much as any other industry, is a clear example of the sea change that has taken place across the country. Unfortunately, the banking industry, with its combination of financial leverage capability and large middle management structure, which was human capital, was much of the glue that held rural America together.

**Barriers to the flow of capital.** With the loss of both the middle class masses and middle management in business structures there has been a number of interesting side effects develop related to the availability of equity capital. First, consider that much of rural America today remains conservative in their beliefs, and remain orientated to agriculture and related industries. By definition, then, rural Americans are independent, in many cases hard-headed, and wary of outside intervention. These traits have served ruralites well as they have struggled through economic cycles, natural disasters, and government regulation. Stubbornness, independence, and self-determination are the backbone of rural America. Second, consider that for capital to find its way into small business it needs to be facilitated by the mobilization of knowledge and the free-flow of information. Given the broad assumptions about the nature of people in rural areas noted above, it becomes clear that barriers to the flow of capital are prevalent.

**Diminished opportunities for alliances.** The nature of being independent tends to lead to a wariness that may even become fear of sharing information or losing control of events in a business or community. Communities, local business, and providers of financial services, therefore, find it increasingly difficult to build alliances among themselves. And, as the number of middle class and middle management players continues to decline, the opportunity to build alliances diminishes further. In many rural communities people are in a state of despair as they watch their local banks merge and close. Their neighbors, who were lenders, advisors, and friends, are downsized into larger and larger remote urban operations. As these community assets are forced to leave, the remaining residents are left with deepening fears and growing distrust of business, government, and particularly the financial services industry.

In many small towns the degradation of middle management and the middle class has evolved slowly over many years. This slow transition has tended to desensitize the population and obscure the view of the seriousness of the change that took place. For example, if a flood, tornado, or other disaster struck a community, the cause and effect of the event would be crystal clear. People would take immediate action to remedy the situation and recover as quickly as possible. However, the loss of middle America has been like the slow onset of a disease. It has sapped the life out of the community without an immediate noticeable effect. Only now are we realizing the condition of rural communities.
NEW DIRECTIONS FOR RURAL AMERICA

Some have offered the observation that the new age of information has or will soon provide the miracle cure. If having low-cost free flowing information is the vehicle for delivery of capital, then the Internet surely will lead to the revitalization of rural America. Sounds good, but simply having raw information or knowledge downloaded through the Internet, satellite television, or even a newspaper is not enough. It takes mobilization of that knowledge. What is needed are effective clearinghouses for information, providing people an opportunity to dissect, digest, and deliver the relevant knowledge.

Rural people as investors

It has also been suggested that rural folks have become investors in recent years and are somehow now going to use their newfound experience to change their community’s direction. I submit that while some may have found their way into the information and investing new age, most have not. Most have not become wired to the Internet, and most have not even dreamed of becoming true market investors. What has happened is many have become investors by default. They work for private businesses or public agencies that have taken their pension and profit sharing funds and invested on their behalf in a fund that may include equities, bonds, or derivatives. Their IRAs have swelled the coffers of many a mutual fund management company. Being a passive investor is a far cry from what it takes to invest capital prudently in small business throughout America.

In addition, even with good information, mobilized through an effective clearinghouse, there is the challenge of project size and threshold rates of return in rural sectors. As long as private capital has a game to play in urban areas that bring investors quarterly point gains and victory in the form of 30 percent to 40 percent rates of return, capital will not flow to the 10 percent average returns that may take years to materialize in rural America.

Outlook for the future

Although it may be contrary to what constitutes a perfect free-market world, during times of imbalance in our society’s structure we must find help through government. When markets have experienced fundamental shifts such as those seen throughout America in the past decade, and segments of society are caught in the wake, then intervention, support, and market manipulation may be in the best interest of the people. Temporary coordination and implementation of public agency programs become necessary. The combination of support from agencies such as the Federal Reserve System, Small Business Administration, Federal Housing Agency, and other GSAs, combined with state support, may provide sufficient opportunity for public capital to combine with private capital in a sufficient manner to support investment in smaller projects. Access to capital, and the opportunity to leverage it in public and private partnerships, therefore becomes the central theme for efforts aimed at reviving business in rural America.

Having accepted the premise that for capital to flow to rural projects there has to be a mobilization of information at a cost that is reasonable in relation to the size of the project, then a place to start is with state Departments of Commerce or Economic Development Departments (EDD). EDDs can function as the quarterback for the team effort that is necessary to coordinate the location and implementation of public and private capital. Not only do EDDs have access to knowledge of both federal and state programs; they should be the source and supporting
directors of the states’ economic development and marketing programs. Who else is better equipped to know the unique assets of the counties and communities within their states?

EDDs can coordinate and deliver information on projects and markets through networks of business development officers who have responsibility for serving local communities. At the local level a central source point—such as a Community Development Corporation (CDC) or the local Chamber of Commerce—picks up the ball. Effective leadership in those agencies is essential to bridging the gap between government support and what is already described as an independent and wary rural business community.

To be an effective clearinghouse of knowledge and a source point for capital flow, the CDC or Chamber must create a solid foundation of support in the form of a mix of businessmen, educators, labor, and government officials. With such a team in place, information and funding can flow from state and federal agencies to local opportunities, having overcome the hurdles of local skepticism and fear. At this point angel investors, small business investment corporations, foundations, and banks can be connected to the team network. In this environment, opportunity for leverage of both public and private capital can be explored and structured. For example, county real estate development property can be transferred to project ownership, with roads, sewer, and water provided as funded improvements. Then banks, with support from guarantee programs such as the SBA and foundation grants, can leverage the real estate equity into development of plant and equipment. Ultimately, private angel investors can come forward and fund the shorter term working capital requirements of the project, and potentially exit the deal quicker than the term debt lenders, having achieved their targeted investment goals.

In this oversimplified example the state sources the project through a central EDD and marketing program. The local CDC is given the lead and coordinates and facilitates the team approach of county government, local lenders, small-business administration support, and angel investor networks. Although simplistic in example, it is being used in locations throughout the country as a model of cooperation between federal, state and local governments and business. In this model, government can be represented to skeptical small towns as a partner, brought to the table by trusted local businessmen and community leaders. The key to the process is having the mobilization of information through consistent, trustworthy channels.

CONCLUSION

I believe that eventually, through the evolution of the age of information and the resulting ability for modern mankind to migrate back to his roots in rural America, we will experience a resurgence in patient, long-term capital investment in small business. The freedom to pursue making a living, and living a way of life through information management services in rural settings throughout this country, will lead capital to these small markets.

Until such time that the free markets complete the journey, we can benefit rural America by effectively using all available resources, such as federal, state, and local government programs, in partnership with private business, coordinated through community team effort.

Who knows, maybe one of these days a group of resourceful investors will capitalize a community bank on the street corner in your hometown. Then the neighbor kid that just graduated from the local community college might get hired and trained to be president of that bank someday.