Local, Traditional, and Non-Traditional Financial Institutions in Rural America: 1976-2007

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Importance of Local Businesses

- Locally-oriented businesses (e.g., small manufacturing and retail) associated with beneficial local outcomes and promote rural community resilience
- Thriving locally-oriented business class creates environment conducive to community development
- Our confidential business data permit us to distinguish local firms (all enterprise parts in one county) from non-local firms (scattered)
- Access to financing of local entrepreneurs is key
Changing Composition of Financial Services

- Spatial and temporal shifts in the traditional financial services (TFS) and alternative financial services (AFS) for rural America?
  - TFS: commercial banks, savings institutions, credit unions
  - AFS: pawn shops, check cashing stores, car title businesses, pay-day loans
- Potential impact of these shifts for rural America?
Changes in Traditional Financial Institutions

- Since 1980 depository institutions have gone through major changes
- Number of establishments has grown while the number of firms has declined
- Increased consolidation has led to absentee ownership trend at local level
  - Top 4 commercial banks in 2002 owned 12.6% of establishments (Source: 2002 EC)
  - Top 4 commercial banks in 2007 owned 31.8% of establishments (Source: 2007 EC)
TFS: Growth in Establishments

Source: United States Credit Union Statistics (CUNA), Federal Deposit Insurance Corporation, Economic Census (US Census Bureau).
TFS: Decline in Number of Depository Firms

Source: United States Credit Union Statistics (CUNA), Federal Deposit Insurance Corporation.
Impacts of Consolidation

- Increased geographical and social distance between lender and borrower
  - (DeYoung 2008)
- Inverse relationship between geographical distance of lending bank and lender and the volume of interaction between them
  - Berger et al. (2005)
- Reduction in relationship lending
  - Historically, small businesses relied on small, locally-owned depository institutions
    - Boot 2011; Devaney and Weber 1995; Berger and Udell 1996; Berger and Black 2007; Collender and Frizell 2002
Where will rural nascent entrepreneurs find capital?

- Half of all nascent entrepreneurs who applied for loans to help finance their ventures were turned down
  - Campbell and De Nardi (2009)
- Nascent business owners are very similar to low income workers in terms of access to credit
- Sole proprietorships and small businesses more likely to depend on informal sources than on banks
  - Li et al. 2002; Huck et al. 1999; Bond and Townsend 1996
## Sources of Capital

<table>
<thead>
<tr>
<th>2002 Survey of Business Owners: Sources of Capital for Firm</th>
<th>Start-up</th>
<th>Expansion or Improvements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal/family savings</td>
<td>54.6%</td>
<td>25.5%</td>
</tr>
<tr>
<td>Other personal/family assets</td>
<td>9.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Personal/business credit card</td>
<td>8.8%</td>
<td>11.4%</td>
</tr>
<tr>
<td>Business loan from bank</td>
<td>11.4%</td>
<td>9.2%</td>
</tr>
</tbody>
</table>
The next phase of the project

- How does mix of local financial institution impact small business performance?
- Modeling over time (1976-2007) and space (U.S. counties)