Access to Capital in Rural America
Supporting Business Startup, Growth and Job Creation in the Wake of the Great Recession

Insights from the Field and Policy Recommendations
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INTRODUCTION

The first phase of this project assessed what current economic research and data suggest about capital access for businesses in the U.S. with particular attention to rural businesses and entrepreneurs. The review focused on two distinct parts of the capital market – the supply side including both debt and equity capital, and the demand side including the quality of both the entrepreneurs and the ventures they create. Phase one produced two key deliverables – Access to Capital in Rural America Literature Review and Map and Data Library.¹

The first phase of this research produced numerous insights, with several key conclusions outstanding. Capital access challenges and “performance” (i.e., the ability of firms to access appropriate funds when needed) varied greatly across various rural landscapes. In many cases, these differences had fairly clear causes. For example, low rates of business investing in Central Appalachia appear to be correlated with the region’s higher poverty rates, lower startup rates, and slower business growth rates. Meanwhile, many “high-performing” regions clearly benefited from the ongoing shale gas boom and other resource extraction opportunities that have spurred demand and business growth.

While economic circumstances, business cycle dynamics, and natural resource endowments explain much of this regional variation, other factors may also be at work. In particular, many “high-performing” states and regions also appear to be home to high-capacity intermediaries and support organizations that help groom entrepreneurs and connect them to capital resources.

The second phase of this project was designed to help us illuminate one central finding from our Phase 1 research – combining capital and business support services matters, and certain states/regions seem to excel at building these connections. We sought to understand how states and regions with large rural populations can build effective capital networks and increase the impact of existing programs. To that end, we conducted field interviews and focus groups in four states – Oklahoma, Oregon, Virginia and Washington. These states not only demonstrated strong

¹ These and other deliverables are available in the eLibrary created for this project - http://www.energizingentrepreneurs.org/site/index.php?option=com_content&view=article&id=105&Itemid=34.
USDA or SBA capital programs, but also showed that they are effective in tapping into private debt and equity capital.

In each state, we:

- Identified the connections between various capital sources and demand side intermediaries, and how USDA staff and programs are integrated into these networks.
- Conducted interviews and focus groups with government program staff, providers of debt and equity capital, service providers and business and community development nonprofits to understand how these capital networks operate and what capital providers and intermediaries view as critical connection points and program elements.
- Identified specific program or policy innovations that have increased the effectiveness of capital and the economic impact to the region.
- Identified where critical leverage points may exist for USDA.

These interviews were supplemented with additional research and focus groups with key service providers. These focus groups included discussions with microenterprise organizations, managers of various public business loan funds, economic developers, non-profit entrepreneurial development organizations, bankers, private sector loan packagers, USDA and SBA state and regional staff, and organizations engaged in supporting angel capital investments.

To organize the insights from this fieldwork, we used a framework that focused on key leverage points that will make the greatest impact in terms of improving both the supply and deployment of business capital in rural America. In a time of scarce resources, it becomes even more critical to identify interventions that offer the greatest potential return on investment in terms of improved economic outcomes for rural places. We considered leverage points on three levels:

- Policy Levers – What are the changes or enhancements to policies that would strengthen the distribution and coverage of capital programs?
- Program Levers – What are the lessons learned from high performing regions that could be applied to help develop or enhance programs in underserved capital regions?
- Infrastructure Levers – What are the most critical elements of the capital market ecosystem or infrastructure of a region that can enhance the outcomes of federal capital programs, in particular?

This report captures the key insights from the field and presents some recommendations for action related to these three areas of leverage. As part of those recommendations, we have developed case examples of effective practice that demonstrate how some parts of the country are already moving to design policy, practice and infrastructure to create a more effective and functional capital market ecosystem in rural America.
THE CAPITAL MARKET ECOSYSTEM

While the term “ecosystem” most often refers to the natural environment, it is increasingly used to describe any complex set of interactions between a group of organizations and individuals and their environment. As defined in this project, the capital market ecosystem consists of the array of organizations that supply capital (e.g., banks, micro loan funds, venture capital funds) along with the diverse set of entities that provide business development services and support (e.g., Small Business Development Centers, accountants, private consultants, incubators). But, as our previous research indicated and as we confirmed through our fieldwork, it is not only the presence of the ecosystem pieces that is important, but how well they are connected. Effective ecosystems rely on effective connectors. Simply amassing a mix of programs does not create an ecosystem. It only emerges when these pieces are connected and linked in a coherent and transparent network. Our fieldwork in Oklahoma, Oregon, Virginia, and Washington has helped us understand that how various regions organize to create an integrated capital ecosystem varies and depends, in large part, on the capacity of existing institutions.

Regional capital market ecosystems emerge in diverse ways, but they all share some common elements. Both debt and equity capital are needed. Suppliers of debt capital provide a range of financing from microlending to expansion and working capital to large scale project financing. Equity capital financing ranges from resources for product development to startup and seed capital to growth stage and expansion/mezzanine capital. The following chart illustrates these financing vehicles and the typical amounts of capital associated with each.

**CHART 1. SOURCES OF CAPITAL IN THE ECOSYSTEM**

<table>
<thead>
<tr>
<th>Debt (non-bank) Vehicles</th>
<th>Equity Vehicles</th>
</tr>
</thead>
<tbody>
<tr>
<td>Microlenders</td>
<td>Revolving loan funds</td>
</tr>
<tr>
<td>&lt;$50K</td>
<td>$50-250K</td>
</tr>
<tr>
<td>Public seed $</td>
<td>Angels</td>
</tr>
</tbody>
</table>

Chart 1 demonstrates that the diversity of capital sources – and the attendant ability to fund firms at all stages of the business lifecycle – matters. For example, without effective angel networks, startup ventures, even those with growth potential in sectors attractive to equity providers (e.g., high tech, energy development, biomedical) may be starved for growth capital. Without large and well-managed revolving loan funds, it may be difficult for small rural manufacturers or main street businesses to find the $50-$250K in expansion capital they need. Yet, even in well-served markets, persistent capital market gaps exist. As Table 1 shows, firms in the product development and
startup phases nearly always face fundraising challenges. Fieldwork also identified a particular gap for loans and equity vehicles in the $50-250K range.

**TABLE 1. SOURCES OF CAPITAL ACROSS THE BUSINESS LIFECYCLE**

<table>
<thead>
<tr>
<th></th>
<th>Product development</th>
<th>Startup</th>
<th>Operations/working capital</th>
<th>Expansion: Equipment/technology</th>
<th>Expansion: Real Estate/construction</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DEBT</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks: Term loans</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Banks: Lines of Credit</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Microlending Programs</td>
<td>X</td>
<td>(&lt; $35-50K)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Revolving Loans</td>
<td>X</td>
<td></td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>SBA 504</td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>SBA 7(a)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>USDA B&amp;I</td>
<td>X</td>
<td></td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>USDA IRP</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>EQUITY</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Seed funds</td>
<td>X</td>
<td></td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Angels</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Venture capital firms</td>
<td>X</td>
<td></td>
<td>X</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private Equity</td>
<td>X</td>
<td></td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Capital alone does not constitute an ecosystem. The other critical actors are those who provide the business or advisory services that help business owners and entrepreneurs effectively connect to and use capital for growth. Most regions have a range of service providers who support different types of entrepreneurs/business owners and Chart 2 below identifies some common service providers for three general stages of business development. Often, organizations serve businesses at multiple stages of development; some are quite specialized to particular types of businesses and situations. An effective ecosystem, however, requires a range of service providers who can provide support across the business lifecycle.

One observation that continues to stand out for this project is that **successful regions have found ways to develop an integrated capital market ecosystem, using organizations and relationships unique to their area.** Fieldwork in Oklahoma, Oregon, Virginia and Washington shows how each state has built a unique ecosystem to meet business needs. These states were selected for deeper assessment because they tended to perform at or above average in terms of capital deployment per business establishment. These states also rely on different leading industries and clusters, thus allowing us to assess how capital access challenges vary across different industries.
**INSIGHTS FROM THE FIELD**

We have organized the insights gained through our fieldwork into four sections:

- Understanding business demand for capital
- Understanding the supply of debt capital
- Understanding the supply of equity capital
- Understanding the role of intermediaries in connecting supply and demand

The sections below combine to paint a composite picture of the capital market ecosystem based on lessons learned in Oklahoma, Oregon, Virginia, and Washington.

**UNDERSTANDING BUSINESS DEMAND FOR CAPITAL**

The key to the effectiveness of any capital market ecosystem is how well the supply and demand side components connect to meet the needs of businesses. Based on the literature and our fieldwork, regional capital market performance depends on alignment with business lifecycles and local industry dynamics. We can assess the business financing landscape across three key dimensions: the type of investment sought (debt vs. equity), the business’ stage in the lifecycle, and whether the firm operates in a capital intensive sector and is thus more likely to have available collateral.

Based on our fieldwork, we identified four distinct categories of rural businesses that typically approach banks or other investors for outside capital:
- **Highly collateralized businesses** in sectors such as manufacturing, hotels, hospitals and health care facilities, logistics/transportation, agriculture, natural resources, and energy. Many of these businesses operate in traditional traded sectors where business growth is tied to national and international markets. Many rural capital providers have years of experience assessing and lending to businesses in these sectors.

- **Transaction-oriented businesses** such as retail and food services, construction, local services, and health services. Many of these businesses derive their revenues from the local economy and depend on regional population growth and local economic factors as key market drivers. Limited business collateral may make accessing capital more difficult or more dependent upon personal collateral.

- **Businesses with new technology or emerging markets in energy and industrial applications** that have unproven products yet may require large scale operation financing. These businesses can be found in renewable energy sectors, advanced materials and mechanical systems, and sustainable waste management systems, and so on. Some local financial institutions may have limited experience with these new sectors, making capital access more difficult.

- **Businesses in knowledge-based sectors** including technology, Internet, biosciences, media, and professional/technical services. Almost all of these companies export their goods and services outside the region and are less dependent on local economic factors for growth. They also are most likely to have non-traditional forms of collateral, including intellectual property and human capital.

Table 2 summarizes our findings in terms of the general experience of these three categories of businesses in accessing adequate capital. It is certainly the case that individual businesses may have greater success and/or challenges in accessing capital depending upon their own competitive assets as well as the structure and effectiveness of the local or regional ecosystem.

Key participants in the capital market ecosystems in Oklahoma, Oregon, Virginia and Washington identified additional demand side constraints on capital access for existing companies. In all cases, interviewees highlighted lingering effects of the Great Recession. Borrowers were described as more cautious about taking on new debt and also less likely to have the collateral needed to meet bank lending standards. Service providers, such as SBDCs, are seeing increased client loads while the funds to support those programs are shrinking. In Virginia, it was noted that there is limited lending to support business capital needs in sectors dependent on discretionary income, e.g., tourism, retail, and restaurants. Even in Oklahoma, where the impact of the recession has been tempered by continued strength in energy and agricultural development, interviewees noted caution on the part of both small and large businesses.
TABLE 2. PRIMARY SOURCE OF CAPITAL BY RURAL BUSINESS CATEGORY

<table>
<thead>
<tr>
<th>Primary Capital Source</th>
<th>Debt</th>
<th>Equity</th>
<th>Ease of Financing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highly collateralized businesses (sectors include manufacturing, hotels, agriculture, hospitals/clinics, logistics/transportation, etc.)</td>
<td>X</td>
<td></td>
<td>Fewest difficulties in finding debt capital; gaps found for startups and working capital ($50K-250K); some gaps $250K-$1M for expansion capital</td>
</tr>
<tr>
<td>Transaction-based businesses (sectors include retail, food and local services, construction, health services, insurance, etc.)</td>
<td>X</td>
<td></td>
<td>Financing based largely on accounts receivable; need multiple years of history; gaps found for startups and working capital</td>
</tr>
<tr>
<td>New to market energy and industrial technologies</td>
<td></td>
<td>X</td>
<td>Hardest to finance; require large scale project financing similar to traditional industrial sectors yet with limited track record for markets or technologies</td>
</tr>
<tr>
<td>Knowledge-based businesses (sectors include technology, bio and life sciences, media and Internet, professional services, etc.)</td>
<td></td>
<td>X</td>
<td>Difficult to finance; gaps throughout the capital continuum; rely on equity $ to fill gaps in debt vehicles</td>
</tr>
</tbody>
</table>

On a positive note, many interviewees noted some improvement in the condition of their business borrowers. However, even these growing businesses faced challenges in returning to growth after years of downsizing. Because they have retrenched during the Great Recession, their performance over the last several years has been spotty at best. Because many banks use recent business data to assess “bankability,” numerous firms with growth potential are deemed too risky. Ramping up to meet that demand requires some type of bridge financing which may not be readily available. In Virginia and Oregon, interviewees noted new businesses emerging in non-traditional sectors for rural areas – e.g., healthy foods, alternative energy, heritage tourism, high tech. These sectors do not always fit the risk profile and experience base of banking institutions, creating an important role for alternative institutions including CDFIs and microenterprise organizations.

UNDERSTANDING THE SUPPLY OF DEBT CAPITAL

The capital access experience varies greatly by the type of business and their capital needs, but it is also affected by the specific organizations operating in a given region or state. What types of capital do they provide, what types of businesses do they target, and where do they access both customers and investors? This section offers additional market insights from several key types of capital providers. Our previous literature review covered many of these issues in great detail; the material below adds additional insights based on field research and project interviews.

- **Microenterprise Organizations.** Targeting new and small firms with fewer than five employees, primarily in transaction-based sectors.
- **Community Development Financial Institutions.** Targeting early stage firms and other companies not deemed “bankable” by traditional funding sources.
- **Public Loan Funds.** Targeting a wide range of existing businesses, often in a particularly geographic area.
- **Angel/Venture Capital.** Targeting startup and growth businesses in knowledge-based and new industrial sectors not served by traditional financing.

**Microenterprise Organizations**

Most U.S. firms – and most rural firms – are microenterprises (i.e., they employ less than five workers). These firms are the backbone of rural communities, and provide critical services such as the local drycleaner, pharmacy or auto repair shop. Many of these firms use traditional banks to obtain working capital or to support new investments in equipment or real estate. Typically, they seek small loans, often in the $35,000-$50,000 range. However, their business model and less robust growth potential may make them less attractive to most traditional lenders. The small loan size also creates problems for more traditional lenders, such as banks, since the cost of making a small loan is often at least as great as that associated with a larger loan.

Because of these challenges with traditional sources of capital, a whole host of other investment opportunities have been created for microenterprises. These firms can access funds from CDFIs, loan funds, and microenterprise development organizations, among others. Given the high touch nature of both the lending and support that microenterprise organizations provide, they tend to work close to home. In our fieldwork, we found that microlending services were provided by organizations either based in the region or with an understanding of the unique role small businesses play in rural communities (see box on eDev). Each organization tends to reflect and respond to its local circumstances. While there are “best practices” for how to manage microenterprise services, there is no one single “best practice” that is applicable across the diversity of rural America.

In addition to tailoring programs to local needs, we find different organizations, investors and partners providing capital access and services to microentrepreneurs in different landscapes. For example:

- In Oklahoma, a state with a large number of community and small regional banks, these small bank lenders were actively making micro loans. This experience was in contrast to Oregon and Washington where larger and national banks are more prevalent and expressed the view that “we don’t make loans to startups.”
- In areas with established nonprofits such as Rural Enterprises Inc. in southern Oklahoma, eDev is a non-profit microenterprise development organization located in Eugene, Oregon and serving surrounding rural communities. It seeks to help those who want to start a business “work smarter, not harder.” Committed to understanding the process of entrepreneurial learning, eDev offers a range of assistance to new and growing businesses – one-on-one assessment, training classes, technical assistance – designed to complement access to microloans. They also operate an Individual Development Account (IDA) program, a matched savings account that provides an incentive for low income individuals and families to save for business startup, education, and homeownership. Coupling the IDA program with microlending is helping to build an important part of the capital ecosystem in this region.
In the Willamette Valley of Oregon, these intermediaries were the active microlenders.

- In southern and central Oregon and rural areas of Washington, microlending came mostly from a combination of credit unions and statewide microlenders.

Nearly every microlender also offered some level of business advisory services. Banks and credit unions provided more limited advisory services, often citing lender liability concerns, while many microenterprise organizations viewed the capital they provided as secondary to their advisory services. As one microlender noted, "capital is an enabler that helps to buy goods and services for your businesses, yet it's the advisory services that actually builds your business." Several microlenders noted the importance of having both pre- and post-loan services available to businesses. This observation is consistent with the concept of the capital market ecosystem – services need to be available to help businesses access capital and then effectively use that capital to grow. While these services may be provided by microlenders, it is also possible that as microenterprises grow, they may become bank customers, access private sector services, or use other service providers such as Small Business Development Centers.

We also heard a note of caution from microlenders. In some regions, local governments have been quick to establish small loan funds as a way to grow their communities out of the recession, often without understanding the need for technical assistance as a hedge against the risk associated with microlending. Established microlenders are concerned that the market will be flooded with capital that is not well managed, potentially increasing the failure rates of small borrowers and negatively impacting the reputation of all microlenders. This cautionary note reinforces the need to view the capital market as an ecosystem of capital and services, not simply a pool of dollars.

**Community Development Financial Institutions**

An important capital gap in rural areas relates to funding companies with less than three to five years of operating history. While microlending can accommodate some capital needs for startups, there is often a gap for businesses as they grow and require between $50,000 and $250,000. This gap transcends geography; interviewees identified this gap in all the fieldwork states. Traditional lenders view these young companies as too risky, citing small business failure rates.

Firms at this stage have always faced capital access challenges. In fact, many of the early economic development initiatives, such as EDA’s Revolving Loan Fund (RLF) program, and small business development programs, such as the SBA 7(a) and 504 lending programs, targeted this gap. Yet, for a variety of reasons, these older initiatives failed to adequately meet the needs of growing firms, especially those working in knowledge-intensive sectors. As a result, in many places, alternative lending sources including CDFIs are stepping in to partially fill this gap.
Most CDFIs recognize the importance of providing an array of technical assistance to help businesses make more effective use of capital (see box on Community Capital Development). This support is especially critical for startups and new entrepreneurs that typically require far greater assistance or "hand holding" than established businesses. While research and data clearly show that businesses receiving assistance and capital are far more likely to be successful, most CDFIs and other alternative lenders struggle to find the resources to cover the cost of providing these services. Few public programs that provide loan capital also provide support to cover these advisory services. As one respondent said, "they expect that you'll find local funds but these places [rural communities] do not have those funds." The USDA IRP program was frequently cited as a program that provides no upfront administration or technical assistance funds, and limited the amount of revolved funds that can be used for administration-related activities. In rural areas where other sources of technical assistance are limited, the provision of advisory services by CDFIs and other capital providers becomes critical to business and lending success.

One option for providers of startup and early stage capital is to pursue capacity-building grants from USDA, SBA and EDA to help offset the costs of providing technical and advisory services. These grants, however, are very competitive, and often provide insufficient levels of funds. Developing technical assistance programs and getting them to scale takes time. Single year grants are often ineffective for such uses, as are grants of $25,000 or less.

Furthermore, some interviewees noted they were penalized or scored lower in grant applications because they had already received funding or were partnering with urban-based resources to provide services that are not found in rural areas. These situations affect the continuity of services and can impact both access to capital and business success within rural communities. From a policy perspective, the importance of the capital market ecosystem suggests the need to consider how effectively public programs make loan capital available to local and regional partners as well as whether capacity building grants are being deployed most effectively to enhance the business services infrastructure associated with a well functioning ecosystem.

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Community Capital Development in the state of Washington is a collaborative of three economic development organizations that brings together a Community Development Financial Institution, a Certified Development Company, and a technical assistance provider. Together, they model some key elements of a capital market ecosystem. Collectively, they administer a microloan program, a USDA Intermediary Relending Program (IRP) and SBA guarantee program targeting women, minorities and low income populations. Their non-SBA loans range from $5,000 to $100,000, targeted to 23 low-income and underserved counties throughout the state. Community Capital Development’s Access to Capital Programs focus on loans and technical assistance for 1) startup businesses (0-6 months), 2) businesses under 2 years in operation, not yet bankable, and 3) established businesses, in operation greater than 2 years, but facing new challenges. As importantly, business assistance officers help guide loan applicants through the process by assisting them in developing their business or marketing plans, cash flow and other financial projections, and assembling and completing the required documentation. New borrowers must attend a technical assistance workshop, prior to loan application, as a way to build the skills needed to manage an infusion of debt capital.

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2 For more information on the connection between capital and advisory services, see Access to Capital in Rural America Literature Review, in the eLibrary.
Innovation Example – Virginia Community Capital Model for CDFI Innovation

While the field of community development investing first took shape in the 1960s and 1970s, major expansion and the development of a more formal Community Development Financial Institutions (CDFI) industry dates to the 1990s. At that point, creation of the Federal CDFI Fund and new rules related to the Community Revitalization Act led to a boom in the industry. Today, more than 950 CDFIs are officially recognized across the US.

As CDFIs have evolved, the industry has undergone many challenges, especially in the wake of the Great Recession which affected financial institutions of all types. Because CDFIs have had less extensive track records and work with more “at-risk” customers, the downturn has created significant financial and management challenges. As a recent Carsey Institute study noted, “CDFIs have been ‘stepping into the breach’ ... during the recession, and have paid a price for doing so.” Net income and earnings are down, delinquencies are up, and a large number of CDFIs face severe financial risk. In today’s market, the most effective and resilient CDFIs are those that have succeeded in scaling up, i.e., in building up larger funding pools and providing a more diverse set of services and programs to customers. In fact, these scaling effects are more pronounced for CDFIs than for any other type of financial institution.

Virginia Community Capital’s (VCC) recent history illustrates the benefits of developing scale, capturing new markets, and developing a broad portfolio of services and programs. VCC began operations in 1995 as a state-backed lender, providing services to a small three-county region in southwest Virginia. In 2005, it expanded statewide and received major financial infusions from a variety of Federal and state sources. Since then, VCC has grown rapidly. Today, it operates across Virginia and, in 2011, it invested more than $50 million in projects across the state. Its commitment to wealth building has remained constant – “VCC is dedicated to the prospect of building wealth for all through our lending, savings, and advisory services.”

Researchers have found that, in addition to building scale, successful CDFIs also focus on providing “high-touch development services” to educate and counsel borrowers. Because CDFIs invest in riskier deals, these services are essential to creating better deals and better business outcomes. VCC staff described their borrowers as having “gone through net worth” during the recession. As a result, technical assistance is viewed as “credit enhancement” – VCC increasingly views advisory services as essential to successful lending. They are working with partners, including the SBDCs, who can provide these services so that VCC can provide a “loan with a TA wrapper.” As VCC has grown, it has heavily invested in the development of these critical services. In 2011, VCC unveiled Pathfinders, a community advisory service designed to help rural regions identify new approaches to community development, including bringing multiple partners to the table to better align services, capital and other resources for the community. At present, Pathfinders is operating in two locations, Onancock and Glade Spring, and will soon expand to other parts of the state.

As the VCC story illustrates, scaling up by offering a more diverse and coordinated set of programs and services produces a more resilient organization. More importantly, it produces better products, services, and outcomes for customers. For example, in one VCC program, their business advisory services have helped ten firms create 141 new jobs in just two years and generated average annual revenue increases of more than fifty percent. These outcomes result from a combination of capital and support. VCC continues to innovate and identify the niche they can fill in the small business lending ecosystem in Virginia.

Public Loan Funds

Many rural communities and regions have few alternative financial institutions. In fact, they may be served by only a small number of traditional banking institutions. One alternative source of capital for existing businesses is a publicly funded business loan fund. In most cases, these funds were capitalized initially by a Federal program such as USDA's IRP, EDA's RLF program, or HUD's Community Development Block Grant (CDBG) program. A regional or statewide intermediary manages the funds and provides loans to small businesses and entrepreneurs, often focused on key industries (e.g. manufacturing) or to meet specific community needs such as disaster recovery. These funds typically require the creation of jobs as a condition of the loan.

Particularly in a time of recession, these business loan funds can work hand-in-hand with a commercial bank, helping to reduce the risk to the bank of lending to an existing, but perhaps under-capitalized or under-collateralized, business. In the fieldwork states, most of the important intermediaries were actively managing a range of loan funds, including IRP, EDA RLFs, and others. For example, REI in Oklahoma has received 11 IRP investments since 1990. In these states, high capacity intermediaries, such as REI and Virginia Community Capital, actively tapped Federal programs to build regional and statewide loan funds that were, in turn, effectively used to meet the capital needs of existing businesses in their target markets. A 2007 study conducted for the Appalachian Regional Commission found that business loan funds were the second most important source of business financing after banking institutions in that very rural region.³

A recent study by the National Association of Development Organizations (NADO) suggests that this positive experience is not universal. Many community-based loan funds have insufficient capacity to monitor and manage the lending process and, as a result, funds are not deployed to meet the capital needs in the local area. In an era of reduced Federal discretionary dollars for most programs, the presence of underutilized funds to support business growth and job creation is unacceptable. A number of the recommendations of the NADO study were echoed in field interviews:

- RLF pools, whether created by IRP or other programs, comprised only one part of a diverse portfolio of capital access programs that intermediaries provided to their regions. For example, REI in southeastern Oklahoma managed a number of IRP pools in addition to providing micro finance, operating as a CDFI, packaging SBA 7(a) and USDA B&I loans, and operating the SBA Women's Business Center and a Native American Business Center. These intermediaries played a key role in the region's overall economic development and the RLF funds were but one tool in a well-developed toolkit in support of regional development.
- Intermediaries partnered with technical assistance providers, banking institutions, and other organizations to provide the technical assistance and other programs needed to complement the RLF capital.
- Intermediaries built strong relationships with banking institutions and Federal program staff, particularly USDA business staff, so that the RLF dollars were deployed effectively. In most cases, the states we considered routinely deployed their entire state IRP allocation before the end of the year and then brought deals to the Federal level for consideration.

Innovation Example – Revolving Loan Fund Consolidation and Management

Since the 1960s, Federal agencies, like USDA, EDA, and HUD, have capitalized hundreds of revolving loan fund (RLFs) programs across the U.S. These funds have been designated to serve general economic development purposes and have also been designated for special needs such as disaster response or in reaction to a major plant closing. While exact numbers on total investments are lacking, we can reasonably project that various public-backed revolving loan funds presently hold and manage more than $1 billion.

Many RLF programs are viewed in their communities as core parts of the business finance landscape or ecosystem. Yet, at the same time, dozens, if not hundreds of programs, are failing to invest previously appropriated dollars. The causes for this inaction take many forms. In some cases, the RLF rules and regulations are too stringent or limiting. In other cases, local organizations lack the staff capacity to market, underwrite, and manage loans. Whatever the cause, it makes no sense that these already obligated funds are not being directed to worthy and underserved small businesses.

The Northwest Wisconsin Regional Planning and Development Commission (NWRPDC), serving a ten county region near Spooner, WI, has pioneered a host of innovative approaches that create a more efficient system for managing RLF portfolios, and, most importantly, investing in local businesses. Wisconsin is chock full of RLF programs. In 2005, when the state authorized regional RLF consolidation, more than 200 RLF programs operated across the state. The NWRPC was one of the first regional agencies to embrace this streamlining effort. Over time, it consolidated seven large RLFs to create a fund pool worth $5.3 million. Today, this fund has grown to $8.3 million. The success of this effort in Wisconsin and elsewhere has prompted Michigan’s Strategic Fund Board to approve consolidation of its 42 CDBG-backed RLFs into a new set of 9 regional loan funds.

Consolidation is not just about larger loan pools. This new consolidated RLF creates numerous other benefits. The fund is now managed by professional staff that focuses full-time on business lending. At the same time, the region can make larger loans that combine funds from various sources. In the past, these individual sources were all restricted due to Federal and state limits on the size of individual loans. For example, by pooling funds, local organizations can make larger and more consequential loans. Lastly, the pooled funds, which combined state and Federal dollars, qualified more quickly for “defederalization.” Once revolving loan funds have been loaned out and “revolved,” they may become exempt from federal restrictions, i.e. they are “defederalized.” This process reduces administrative burdens for local leaders and Federal agencies, but, more importantly, provides more local discretion on the use of funds. In NWRPDC’s case, defederalization allowed the agency to shift funds previously earmarked for façade improvement to be used to capitalize a community development venture capital fund.

RLF managers, under the auspices of the National Association of Development Organizations (NADO), have developed a series of five recommendations for improving RLF performance. They include:

1) Strengthen flexibility and local control of RLF funds, especially high-performing organizations.
2) Encourage voluntary loan fund consolidation and sharing of administrative services.
3) Modify rules and regulations to reflect changes in the economy, particularly as they relate to funding for technology and knowledge-based firms.
4) Improve Federal interagency collaboration on policies and reporting requirements.
5) Dedicate new dollars to recapitalize high performing funds.

The NADO report, Public Sector Business Loan Funds: Views and Recommendations from Practitioners, provides more on these recommendations and other examples of regional innovation related to RLFs.
Federal Guarantee Programs

Federal guarantee programs, such as the SBA 7(a) Small/Rural Lender Advantage program and the USDA B&I program, provide a mechanism for making business loans in rural regions that might not otherwise be made. The guarantees work in partnership with banking institutions, helping to expand the risk tolerance of private sector institutions through loan guarantees that range from 75-85% of the value of the loan, depending upon the program. Over the years, there has been a perception on the part of many banks, particularly smaller institutions, that the paperwork required to obtain a guarantee was onerous. SBA, in particular, has introduced new, more streamlined processes and simplified paperwork to address these concerns. As part of our fieldwork, we identified some more recent trends in the use of guarantees in rural regions:

- USDA staff and their partners report increased interest in B&I guarantees, in particular. Economic uncertainty has made these loan guarantees more attractive to bankers and, as a result, they are looking to partner with USDA in ways they have not done in the past.
- Guarantees are particularly important in rural markets and for the smaller banks that serve those markets. The guarantee can make the difference in a smaller bank’s ability to make a business loan in a way that minimizes their risk while still providing access to capital. Guarantee programs provide a win-win; banks are able to better manage risk and business borrowers receive the capital they need to grow. In both cases, the community benefits as well.
- In spite of the win-win opportunity that loan guarantee programs provide, interviewees shared a regulatory obstacle that stands in the way of expanded use of these programs. USDA staff, bankers, and others explained that FDIC regulators view a loan guarantee as evidence of a “problem loan.” As shared during the interviews, the rationale is that if the loan needs a guarantee, it is a weak loan. This reasoning, however, does not consider the broader capital market and economic environment within which these banks operate. Loan guarantees may provide a mechanism to manage the lending risk associated with operating in a less diversified rural economy, with fewer options to sell business collateral when needed, and with market/sector uncertainty, among other challenges. With greater regulatory flexibility relative to guarantees, other innovative partnerships may need to be explored (see box).
- Interviewees offered a cautionary note about increased interest in USDA B&I guarantees in particular. In our fieldwork states, these programs have typically been oversubscribed – these states have used their entire allocation of B&I dollars long before the end of the year. Promoting B&I usage among banks only to deny applications because of lack of funding creates ill will with banking institutions. A stronger public-private partnership between USDA and the banks will require consistent funding that becomes a stable and reliable part of the capital market ecosystem.

West Central Initiative Foundation’s Access to Capital program is a way for the foundation to partner with banks to address small business capital gaps. WCIF will match bank loans up to $75,000, helping banks make small business loans that they would not otherwise make. The foundation’s capital plays a similar role to a public sector guarantee – it works to reduce the risk and close the capital gaps that exist for many small businesses in rural areas.
**Loan Packagers**

In a time of resource constraints, public agencies and private organizations must do more with less. USDA state business lending staff faces the same pressures. Recent USDA Rural Development staff reductions have resulted in fewer points of contact for banks, economic development organizations, and businesses seeking to tap into loan and loan guarantee programs. For example, in the recent past, both Washington and Oregon had “circuit riders,” either through state agencies or federal programs, to help businesses in sparsely populated areas connect to financial and economic development resources. These circuit riders served as intermediaries between businesses and lenders/economic development resources and helped to keep rural financial institutions and local governments up to date on available programs. Most of these positions have been cut and focus group participants expressed concern that both access to capital and local understanding of available Federal programs was suffering as a result.

One approach to addressing these capacity challenges is to partner with loan packagers. In addition to packaging loans internally, some lenders used outside companies or individuals to package their loans. Across our fieldwork states, however, the practice varied widely; the practice was more prevalent in Oklahoma than in other states. One reason for this difference might be attributed to differences in the structure of banking across states. In contrast to the Pacific Northwest, for example, Oklahoma has many small regional and community banks that may have more limited capacity and/or opportunity to use USDA or SBA guarantee programs. These smaller institutions are unlikely to have the specialized expertise that a larger bank might have to package these loans.

Regardless of size, focus group participants, including bankers and economic development partners, mentioned that an important reason to use packagers was their own lack of understanding about different guarantee programs. In all four of the fieldwork states, interviewees indicated that USDA business lending staff is proactive in reaching out to share program information and to make it easier to access and use loan and loan guarantee programs. The B&I program received high marks as being relatively easy to use compared to the SBA 7(a) program. In spite of these resources, Oklahoma’s use of packagers is notable.

**UNDERSTANDING THE SUPPLY OF EQUITY CAPITAL**

Equity capital is used to finance companies with high growth potential, which means that they must produce a good or service with a large market or have a business model that is scalable or franchised in multiple locations. Currently, less than 3% of all businesses in the U.S. receive equity financing. In rural communities where knowledge-based companies are few and workforce and infrastructure limitations place natural restrictions on growth, equity financing can be even scarcer. Equity capital, like debt financing, operates along a continuum where different players target different investment needs. While venture capital gets the most publicity, it is later stage capital with an average investment of $8 million in the last quarter of 2011. More often than not, this later stage capital is preceded by other forms of equity, especially angel investments that typically range from $200,000 to $1,000,000. In rural communities, where the scale of investment may be smaller, angel investors can play an even greater role in providing access to equity capital. For this reason,

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we focused our fieldwork on understanding how each state utilized angel networks to build resident equity capital.

The conversation about equity capital varied greatly across states. The understanding of and need for equity capital appeared to be driven by both demand and supply side factors:

- **The broader economy of the state and surrounding states.** In Oregon and Washington, the presence of equity-backed high tech companies clearly had spillover effects in the more rural parts of the states. For example, Southern Oregon is reported to have ten times the average concentration of Internet retailers and Central Oregon is well known for software companies. In Oklahoma, in contrast, the major industries were not primary users of equity capital and there was much less awareness of equity capital options. The presence of sectors with the potential for high growth and high returns clearly drives the demand for equity capital, and those sectors are not broadly distributed across rural regions.

- **The presence of serial entrepreneurs and equity investors.** Select rural communities tend to attract seasoned entrepreneurs that you might expect to see in urban regions. These areas tend to be attractive lifestyle communities where wealthy individuals and serial entrepreneurs relocate or have second homes. Bend, Oregon is one example where numerous recreational amenities have attracted an array of software and media companies along with investors. These entrepreneurs can become a potential source of angel investment, as well as mentoring, for startup entrepreneurs. Without them, a critical piece of the equity capital supply may be missing. In fact, Bend, Oregon was named by *Entrepreneur* magazine as the most entrepreneurial city in the nation, competing with large metropolitan areas.

- **The presence of organized angel groups.** In Virginia, numerous organized angel groups operate, especially in Northern Virginia and in the regions surrounding Richmond, Charlottesville, and Roanoke-Blacksburg. These angel groups are primarily focused on information technology and life science investments.

**Organized Angel Groups**

Successful equity capital investing is a numbers game – there needs to be a minimum level of deal flow for these investments to work. It is difficult to generate this type of deal flow in more rural regions, even considering angel capital investments vs. more traditional venture capital. More frequently, angel groups are considering investments that fall outside of the “four hour drive radius” rule of thumb that used to describe angel investment territory. As a result, more and more angel networks are covering statewide or larger geographies. At the same time, while the majority of rural communities do not have a concentration of high-growth companies or serial entrepreneurs, they may have a handful of high net worth individuals that could invest in growth companies. The question is how to balance the need for a statewide reach and the interest in drawing more angel capital into rural investments.
Two approaches to building angel networks were identified through our fieldwork. In Oregon, regional angel networks are being established in the Columbia Gorge, Central Oregon and Southern Oregon as part of a statewide investment network run by the Oregon Entrepreneurs Network (see box).

In Oklahoma, SeedStep Angels was established in 2009 with help from an EDA grant and multiple regional economic development organizations. While the group is managed out of Oklahoma City, the angel investors are located throughout Oklahoma, as are the companies that seek investment. These rural connections are due in large part to economic development organizations that actively seek out high net worth individuals in their communities to participate in these networks. These broader urban-rural angel networks have multiple spillover effects on rural communities:

- Because investors see deal flow from other parts of the state, they are exposed to different types of companies and take back a “why can’t we do this here” attitude that increases the community’s exposure to emerging sectors and other examples of entrepreneurship.
- Another benefit is the expanded network of professional talent and business resources that are associated with angel networks. For example, because the economic development director in Ardmore, Oklahoma is engaged with SeedStep Angels, he now has access to intellectual property attorneys and other resources in Oklahoma City and Tulsa, which he can use to help other companies in his region.
- Participating in deals in other parts of the state helps to build the skills of rural angel investors. Many of these high net worth individuals may be new to angel investing and the statewide network provides an opportunity for mentoring and partnering with more experienced investors.
- Ultimately, rural angels expand the network of potential investors who may invest in local high growth firms, increasing access to equity capital that might did not exist previously in the local area.

Over a five year period, the Oregon Entrepreneurs Network developed and piloted a regional angel network model using a three year, $250,000 grant from SBA (matched with local resources and hundreds of volunteer hours). The model was designed to demonstrate how to build regional capacity for angel investing connected to broader statewide funding and resources. The Oregon model illustrates the level of resources and time commitment it takes to establish equity programs on a regional scale. To build the infrastructure required for equity investment, investors needed to be identified and educated on equity financing, intermediaries needed to expand their services to fit the needs of high growth equity-oriented businesses, and outreach channels and education needed to be provided to businesses seeking equity capital. These pieces were brought together in an annual venture forum in each region where businesses pitched their ideas to investors from within and outside the region. Once these regional networks were in place, they were connected to statewide resources and other regional angel networks to leverage both financing and business expertise. To date, the Gorge Angel Investor Network (GAIN, LLC), the Bend Venture Conference, and the Southern Oregon Venture conference are up and running alongside a set of advisory services.
Advisory Services

Equity financing also requires an expanded set of advisory services that are not typically provided by traditional small business assistance programs found in rural places. As one interviewee noted, “equity financing is based on revenue growth and future market potential while debt financing is largely decided by past performance and cost containment of operations; two very different models requiring different expertise.” Equity based companies tend to have some form of intellectual property and are more export driven, requiring additional professional expertise. In addition to assistance with product development and business planning, mentoring and peer networks have been very beneficial to high growth companies. Again, these types of networks are more difficult to start and manage in more isolated rural areas where there are fewer high growth entrepreneurs, fewer experienced mentors, and more challenges to maintaining an effective network. While there are good urban-based examples of accelerator models that combine one-on-one and group activities, virtual accelerators are slowly being tried in more rural areas. The Founder’s Pad model in Bend (see box), Oregon is one such program.

Whether advisory services are focused on equity or debt based capital clients, the region’s entrepreneurial attitude appears to have a direct correlation to the activity level and health of the start-up community. Throughout the country, one reads about pockets of rural innovation clusters which are far away from Silicon Valley or Boston. This year in fact, Entrepreneur Magazine named Bend, Oregon the most entrepreneurial city in the country, beating out its much larger rivals including Charlotte, NC and Salt Lake City, UT. In 1979, Bend had a population of 20,000 and an economy floundering from a decline in the natural resource industry. Over the past decade, the business and economic leaders focused attention on startups and now their entrepreneur programs serve more than 150 new startups each year, the venture conference attracts 300 entrepreneurs and investors, and the stable of business mentors includes more than 70 seasoned professionals. Similar pockets of entrepreneurial excellence exist across rural America.

UNDERSTANDING THE ROLE OF INTERMEDIARIES IN CONNECTING SUPPLY AND DEMAND

Most assessments of capital markets, rural and urban, focus on the supply side of the market – on the amount and type of capital available to businesses. With the proliferation of non-bank financial intermediaries, including microenterprise organizations and CDFIs, there has been greater attention paid to building effective demand for capital – identifying and developing deals and

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6 To read the article in Entrepreneur Magazine, go to www.entrepreneur.com/article/223997.
building the skills of entrepreneurs and business owners to put capital to work in their businesses. What is often overlooked is the connective tissue between the two sides of the capital market. One of the key insights from our fieldwork is the important role that intermediaries play in connecting supply and demand in the capital market ecosystem. While the role is central, the specific kind of organization that fills this intermediary role varies across states and across regions within states. In some cases, this role is assumed by a non-profit organization; in others, public sector economic development groups lead. Intermediaries often serve a particular and limited geography, such as a county or multi-county economic development group, while in other cases the organization has a statewide footprint. Regardless of the structure, effective intermediaries link sources of capital with business service providers to insure that local businesses have the skills and capacities needed to most effectively use capital. In some cases, this is accomplished through partnerships, while in others a single entity provides both capital and services. Depending on the type of businesses most prevalent in a particular region, this single entity might be a microenterprise development organization (assisting locally-oriented, mom-and-pop type businesses) or an entrepreneurial support organization (assisting growth-oriented and high tech ventures).

To illustrate the role of intermediaries, we highlight four unique organizations that play this role in the fieldwork states: Logan County Economic Development Corporation (Oklahoma); Southern Oregon Economic Development Inc.; Rural Enterprises (Oklahoma); Virginia Community Capital (see earlier box).
Logan County Economic Development Corporation – Oklahoma

Logan County Economic Development Corporation was established in 1994 to help bring capital, including state and federal resources, and services to a 14-county region centered around Guthrie, OK. The organization was created by private sector leaders and includes the nine community banks that serve Logan County and the surrounding region. The presence of these bankers as members of the EDC is critical for the organization to function as the hub of a capital network across the region.

In its first year, the EDC applied for and received its first $1 million IRP loan from USDA. Those initial funds have revolved several times and the organization has received two additional allocations. In partnership with its community bank members, Logan County EDC has used these IRP funds to make deals happen. These dollars are more flexible and can be used to fund parts of a deal that the bankers cannot pursue on their own. Their loan committee includes a representative from each of the local banks, creating seamless communication and better understanding of how Federal dollars can work with private sector funds to support business development.

The important intermediary role that the Logan County EDC plays in providing access to support and capital was highlighted during field interviews. It was noted that a strong bank, working with USDA state staff, can effectively use B&I guarantees. IRP loans, however, require an organization that has relationships with the banking and business communities and can provide or facilitate technical assistance for business borrowers. Logan County EDC’s Executive Director, Kay Wade, plays that role throughout the 14-county region. And, managing one or more IRP portfolios requires a level of capacity that many small local economic development organizations do not have. As a regional entity with strong private sector participation, Logan County EDC has built the capacity, track record and relationships to put these USDA dollars to work – providing working capital to a young cell tower company; providing an equipment loan to a cement company; providing expansion capital to a propane tank distributor serving Wal-Mart and others; participating on a loan to purchase an existing greenhouse business.
Southern Oregon Economic Development Inc. (SOREDI) is a multi-county organization headquartered in Medford, OR. What makes SOREDI different from other economic development organizations is that it has combined functions typically provided by two to three organizations. It manages traditional recruitment and expansion programs, and it also is responsible for managing capital programs including the EDA revolving loan program and several state business finance efforts. Because it is a member organization as well as a provider of capital and technical assistance, it can tap its members as mentors and match them to companies needing assistance. The bankers in the community are especially grateful to SOREDI for helping local businesses become more credit worthy and better managers of their companies.

SOREDI is a key player in the area’s startup and technology community, sponsoring the regional venture capital conference and co-sponsoring entrepreneurial networks and events, and the regional accelerator/mentoring program. In addition to capitalizing on its traditional manufacturing and food processing industries, it has sought to find new ways of diversifying the regional economy by promoting Internet-based companies. Now, the region boasts a concentration of high wage, online wholesalers that is ten times higher than the national average.

Compared to lenders in other states targeted in this research project, the financial community appears to be more embracing of these alternative businesses. One reason mentioned was that through SOREDI actively seeks to pull together traditional bankers and large companies along side angel investors and high tech startups, all helping one another maximize opportunity and reduce risk. They do this through their Board of Directors and their events and networks. This same type of model is present in Central Oregon as well, where Economic Development of Central Oregon (EDCO) houses both traditional economic development efforts and the technology and equity capital programs. One lesson learned in rural Oregon is that you do not have to be big to be entrepreneurial, or on the cutting edge of industries; you do, however, need to have the attitude that you can change things and the committed intermediaries to make it happen.
Rural Enterprises, Inc. – Oklahoma

Rural Enterprises Inc. (REI) has a thirty year history of providing business lending, technical assistance, and broad economic development support to communities throughout Oklahoma. While its roots are in small business lending, the organization has expanded both the range of available business services and its geographic footprint by opening new offices across the state to serve additional rural areas. Most importantly, REI works across the capital market ecosystem, serving as an intermediary partner for a number of Federal business lending and technical programs including:

- Micro lending
- Multiple IRP allocations
- B&I packager for USDA
- CDC for SBA 504 lending
- SBA 7(a) packager
- CDFI (revolving loan fund)
- New Markets Tax Credit allocation
- SBA Women’s Business Center
- Native American Business Center

REI has grown into these roles, accessing new programs and resources in response to needs in the community. By facilitating access to these programs, REI is often able to bring a more flexible source of funding to a deal, for example working capital, in participation with a bank. This broad range of funding also allows REI to tap different programs depending on the needs of a business borrower. For example, most of their CDFI loan portfolio is large loans; B&I packages with USDA are similarly large deals, often up to $5 million. At the opposite end of the continuum, REI provides SBA micro lending with loans as small as $1,500.

As an intermediary, REI also plays an important role in bringing together organizations that work across the ecosystem. In addition to its Federal partners, REI is working with banks, local and regional economic development organizations, including those associated with Oklahoma’s tribal nations, and state agencies. Two important partners with REI are the state’s Small Business Development Centers and the career tech system business centers. These partners help to provide the technical assistance and support that is so important for insuring that business customers can make effective use of the capital resources that REI has to offer.

While bigger is not always better, REI has grown as a statewide intermediary partly in response to service gaps in more rural regions such as the western counties. In some ways, REI plays a circuit rider role, trying to bring their services to underserved parts of the state. REI’s size and long history also play an important role in providing the stable operating support needed to provide technical assistance to business loan customers. Newer intermediaries are at a decided disadvantage in covering these costs since fees associated with Federal programs are often inadequate or nonexistent. High capacity, experienced intermediaries such as REI may have a role to play as mentors and even partners to new, start-up organizations as a way to share their core competencies and build stronger institutional capacity in more rural regions across a state and the country.
GOING “FROM GOOD TO GREAT” – RECOMMENDATIONS FOR USDA

Based on our review of the literature and our fieldwork in Oklahoma, Oregon, Virginia, and Washington, we have developed a set of recommendations for consideration by USDA staff. What actions related to policy, program and infrastructure might contribute to the more effective deployment and use of USDA business lending resources to support business startup, growth and job creation across rural America?

RECOMMENDATIONS RELATED TO OPERATIONAL INFRASTRUCTURE

- **Recognize and reward state operations with exemplary customer service.** Lenders and intermediaries alike noted that the attitude and approach of USDA business program staff was instrumental in how much business they did with USDA. Many lenders, packagers and service providers worked in multiple states, and noted a wide variation in staff attitude. In Oregon, Washington, Oklahoma and Virginia, USDA was described as being proactive with an approach that started with “how can we make this work” versus other states where the approach was “what’s wrong with this application.” When asked how someone from the outside would be able to tell if the staff had a can-do attitude, one lender replied, “It’s pretty simple to me. Look for the states that continually run out of their allocation and turn projects around in shorter periods of time and I bet you will find lenders that think highly of those USDA people.” USDA may wish to consider additional performance or resource allocation arrangements that reward this positive attitude and results.

- **Develop more venues to share best practices among state offices.** In these high performing states, USDA staff had a well-deserved reputation of being knowledgeable about USDA programs and being well connected to regional, state and other Federal programs. State USDA staff was noted for outreach to other public agencies, such as SBA, as well as with state agencies and private sector groups, such as non-profit economic development intermediaries. Rather than remain siloed in USDA programs, USDA in these states works hard to understand the other programs and to partner as needed to make deals happen. For example, the Oregon USDA website was mentioned in interviews in Oklahoma as a model for being a user-friendly, well organized place to go for resources. These models for outreach and collaboration could be captured and shared with other states through opportunities for peer learning and exchange.
RECOMMENDATIONS RELATED TO PROGRAMS

- **Provide a technical assistance/advisory service set-aside for programs serving start-up and growth companies.** Given the importance of business support services to the effective deployment and use of capital, USDA should consider technical assistance set-asides for programs such as IRP. Currently, IRP funds cannot be used to cover the costs of administering the loan fund, and to many providers, administrative funds help pay for advisory services not just loan processing. Intermediaries must have some other source of funds to cover the technical assistance that should go hand-in-hand with lending to rural business owners. The purpose of the IRP program, according to the USDA website, is to “increase economic activity and employment in rural communities.” Helping rural business owners grow their businesses so that they can employ others requires more than capital alone. USDA should explore alternatives for covering the cost of assistance on a consistent basis.

- **Enhance the impact of capacity-building grants.** RBEG and RBOG grant programs are valued for their flexibility by the intermediaries interviewed. A number, however, noted that more could be done to target RBEG and RBOG toward building sustained capacity in the capital market ecosystem. In an effort to provide broader coverage with these programs, some states, including Oregon and Washington, are making relatively small grants for a short period of time (one year). In fact, USDA notes a preference for smaller grants on its website. In other states, including Oklahoma, an effort is being made to provide larger loans that can go further toward building capacity to support business loan programs. One example of this approach can be found in West Virginia (see box), where RBEG money in combination with philanthropic dollars is being used to underwrite business development support. Two specific recommendations were mentioned in almost every location we visited: 1) combine RBEG and RBOG into one program, and 2) increase the total allocation to the program and encourage states to provide at least a portion of their funds toward larger multi-year projects.

- **Ensure IRP providers have the capacity to effectively manage the program.** IRP is an effective tool for economic development intermediaries to use to support business development. It does, however, require specialized or acquired expertise in managing the program. As one interviewee stated, **“I need a full time employee to manage the paperwork for the program so I can get out and market it.”** Others noted that small organizations seek IRP funding and then do not have the capacity to manage the funds effectively. One more experienced intermediary noted that a smaller organization had sought them out to manage their IRP funds. These insights suggest the need for increased due diligence on the part of USDA in assessing the capacity of intermediaries to manage IRP funds. It also suggests the potential for peer exchange related to effective tools and practices for IRP lending.
RECOMMENDATIONS RELATED TO POLICY

- **Create a needs based and more consistent definition of “rural”.** Multiple definitions of rural are associated with different USDA programs. This creates confusion and limits opportunities to get good deals done in rural America. Effective intermediaries who work across USDA programs often feel handcuffed in communities that are defined as rural for one program but not for another. It is even more exacerbated when a business program needs to be combined with a community development program, which can be the case when business expansions put strains on water and sewer infrastructure. It was also a constraint in regions that were isolated from metro areas. It was suggested that serious consideration be given to redefining the population restrictions on programs; specifically, having all business development programs use the same population threshold, and increasing community development thresholds to be more in line with business development. The other suggestion was to have some type of special consideration given to communities that are more than 250 miles from a metropolitan region with more than 200,000. This was especially important in larger but more isolated rural communities that have few alternative lenders, making Federal capital programs more important. These communities might score high in terms of need while not meeting a population threshold.

- **Revise CDFI criteria to provide better service to under-represented areas.** As pointed out in the literature review, there are about 25 community development venture capital funds that provide equity or near equity to rural communities. Almost all are CDFI-fund certified, and almost all serve markets in the eastern part of the US. One reason for the lack of geographic distribution may be the criteria used by programs like New Market Tax Credits where investments must be made in census tracts that have 80% of a state’s average wage. Because metro regions typically have higher wages and more skewed income distributions, states with larger metro area concentrations are home to more localities that meet these criteria. In states with large rural populations, typically in the mountain and western regions of the U.S., smaller large-metro concentrations may often mean less skewed income distributions as well. These requirements result in different policies even within states. Rural Enterprises noted that they have more difficulty deploying their NMTC resources in the western part of Oklahoma as compared to the southeastern part because of the 80% requirement. Policy flexibility, such as an alternative definition for more rural or less densely populated states, might lead to more targeted deployment of existing resources to rural America.

- **Maintain guarantee programs and use direct lending sparingly.** The policy decision to move more Community Facilities funding from guarantees into direct lending creates competition with banking organizations that are critical partners on business lending. Allocating more resources to the guarantee program and working in partnership with banks creates trust and relationships (social capital) that will spill over into other USDA business lending programs. In considering such policy changes, USDA may want to take a portfolio approach, assessing how policy changes in one program may impact the effectiveness of other lending programs. Given the importance of partnerships to the effective implementation of USDA programs, it is also important to consider how policy either enables or inhibits partnership building between USDA and other private and nonprofit business finance and support intermediaries.
Provide flexibility to consolidate administration processes for related programs. Multiple pools of IRP funding are difficult to manage and create high transaction costs for intermediaries. For example, Rural Enterprises received a number of IRP allocations over time and managed multiple accounts in 4-5 different banking institutions – an administrative challenge. USDA should consider providing more flexibility to consolidate these individual allocations for high capacity intermediaries with a proven track record of effectively using the program. This change would create similar efficiencies and effectiveness as the changes suggested in the NADO report on consolidating public loan funds.