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WHAT DRIVES FUNDING FOR RURAL ENTREPRENEURSHIP IN THE UNITED STATES? A LITERATURE REVIEW

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ABSTRACT

Funding startups, particularly rural entrepreneurial ventures in the United States, is not a simple binary process of checking off items on a list. There are many factors that impact whether a rural entrepreneur receives funding, from the type of rural venture, the location of the venture, to the skill sets of the entrepreneur, the social capital and networks an entrepreneur has, to existing business clusters, and to the policies of the government, private/public ventures, and private ventures.

This paper begins as a funding question; however, it ventures into the deep body of literature on the various considerations that affect funding. It is impossible to come to a formal conclusion on the exact reason, as there is no one specific answer. What this paper provides, however, is a much larger, but clearer, insight into the complexities that make up rural entrepreneurship and the potential reasons funding is a challenge.

Keywords*: Rural Entrepreneurship, Rural Venture Capital, Social Capital, Business Clusters*

INTRODUCTION

(M. L. Pato & Teixeira, 2016)) boldly state that,

> *Entrepreneurship has become a dynamic field of research in the last two decades. However, 'rural entrepreneurship' has been largely overlooked. Based on 181 articles on rural entrepreneurship published in journals indexed in Scopus, we found that rural entrepreneurship is an essentially European concern, whose most prolific authors are affiliated with institutions in the UK and Spain. (p. 3)*

This sentiment is echoed by much of the literature on rural entrepreneurship in the United States. (Fortunato, 2014; Goetz et al., 2010; Pato and Teixeira, 2016; Acs & Malecki, 2003). Interestingly, even the Global Entrepreneurship Monitor's (GEM), 2019 assessment of entrepreneurship in the United States fails to even mention the word 'rural' let alone study it (Bosma et al., 2020.)

If there is little research, and it isn't on the radar of GEM, is there really a problem? The answers vary and include references to the diminishing economic support of agriculture, mineral

extraction, lumber, and retail, as well as the need for economic development so as to stop the "brain drain". A "brain drain" (i.e., being the loss of college-educated people from the area) measurement can be seen in the following statistic: American counties in total lost 11% of their population between 1970 and 2000. Ninety-six percent of those counties experienced brain drain, with 95% being nonmetropolitan or rural (Macke & Markley, 2006). Additionally, much of the economic development community supports the concept of entrepreneurship for rural communities. It is suggested that creating entrepreneurial communities is the most practical policy option to stimulate organic growth in these rural communities (Stephens & Partridge, 2011).

But there is a recurring theme to these cries of support for rural entrepreneurship, and that is rural entrepreneurship is significantly different in a myriad of ways from that of traditional urban entrepreneurship (Macke & Markley, 2006; Jolley, Uzuegbunam & Glazer, 2018). It is important for community developers to recognize that urban policies and practices are not suited for the special social and economic conditions of rural areas (Fortunato, 2014). Funding is often to blame for the lack of successful venture creation. In rural areas, typically a firm's founder may not have sufficient means to finance the project alone. It is the substantial capital requirements that deter entrepreneurs—a one-two punch of high requirements of capital needed for production processes and the limited access to capital (Ho & Wong, 2007; Lerner, 2009).

With the availability of venture capital, governmental funding, and foundational support such as the Kellogg Foundation and the Ewing Marion Kauffman Foundation, why is financial support a problem? The hypothesis is that it is much more than an issue of lack of capital for rural entrepreneurs or an irrelevancy of startup ideas. There are a host of factors each having different levels of effect on each situation. The purpose of this paper is to identify the factors that affect funding, financial support, and/or equity financing of rural entrepreneurship. Included is a discussion of what constitutes rural entrepreneurship, what a rural entrepreneur looks like and how does one practice entrepreneurship; whether social capital impacts success; the effect of regional clusters, and how public policy affects the success of rural entrepreneurs.

LITERATURE REVIEW

To understand more clearly the issues behind funding rural entrepreneurship, it is helpful to have a clearer understanding of the concept. There are many definitions of rural, entrepreneurship, and rural entrepreneurship. The literature is somewhat consistent; however, there are differences in connotation as well as denotation. Macke and Markley describe a "third rural America", one that came after the urbanization of originally rural areas, and the development of "high amenity" rural areas. This "third rural America" is characterized often by extraction work, with industries such as agriculture, forestry, fishing, mining, energy production, and manufacturing. Often these communities are less prosperous, economically and socially challenged and in chronic decline (Macke & Markley, 2006). In addition to the connotations of a hard and rough life, rural is also defined by typologies. Pato and Teixeira describe two of them as spatial, based on demographic criteria such as settlement size, population density, or the population active in agriculture; and socioeconomic, performance typologies based on indicators such as institutional, social, and economic and environmental conditions and performance (Pato and Teixeira, 2016). Rural areas are defined by the absence of dense environments of customers and suppliers, knowledge spill-overs, urban agglomeration advantages such as an abundant labor

market, transportation, both public and shipping, capital investment (venture), and the ability for face-to-face contact (Acs & Malecki, 2003).

Entrepreneurship is also defined in many ways. From a simple perspective, Shane (2008), in a seminal piece called, *The Illusions of Entrepreneurship* uses a simple Merriam-Webster definition of "one who organizes, manages, and assumes the risks of a business or enterprise" (p. 2). There are several definitions of entrepreneurship including the National Commission on Entrepreneurship's definition of entrepreneurial growth companies—small businesses that have the potential to grow rapidly, developing new technologies, products, and services; creating jobs; and stimulating economic growth and investment (Dabson, Brian, 2001); or one who applies an entrepreneurial mindset, tools, skills, and techniques to transform an idea into an enterprise that creates value for profit and/or social good (Markley et al., 2015); or the other extreme of a subset of a variety of different disciplines, including economics, business management, sociology, and psychology. The fragmented nature of entrepreneurship research means that entrepreneurship is a necessarily broad term that captures a whole range of behaviors, attitudes, motivations, and activities (Fortunato, 2014)). Given not only the fragmentation of the research but also the various definitions, it becomes important to resist lumping rural entrepreneurs into the high growth and profit categories, because not all rural entrepreneurship fits.

What constitutes, then, *rural entrepreneurship*? Wortman's study of rural entrepreneurship described it as 'the creation of a new organization that introduces a new product, serves or creates a new market, or utilizes a new technology in a rural environment" (1990, p. 330). Pato and Teixeira provide a laundry list of various definitions, including the creation of firms in rural areas, the development of small firms, and finally, an entrepreneur living in a rural environment who is community-based and influenced by social networking and social traits of that rural locality. This excludes businesses that have a rural location but do not do business locally, and do not contribute to the rural economy (Pato & Teixeira, 2016). It is posited that a "rural enterprise" is measured by indicators such as new firm formation rates, and has been correlated with the economic prosperity and growth of rural areas (Pato & Teixeira, 2018). Given the dearth of mainstream literature, it is contended that there might not be such a "thing" as rural entrepreneurship. Rather than defining it, it is described as moving away from economic traits based in rational action for profit maximization, and personality traits and characteristics of a successful firm founder toward an approach that sees ventures as part of the locally dynamic defined networks that focus on the relationship of the entrepreneur and the local community (Fortunato, 2014).

It is here that a natural segue into factors affecting the financing of rural entrepreneurship can be made. Much of the following literature will describe the various impacts on rural entrepreneurship which, in the end, affects the ability to be sufficiently funded, if at all.

Funding

Prior to the creation of venture capital, the only sources an entrepreneur had were family, friends, and high-wealth individuals. Banks and stockbrokers rarely, if ever, took risks on firms

with little or no collateral (von Burg & Kenney, 2000). Venture capital, created in the post-war economy, was meant specifically for high-growth, disruptive, technologically sophisticated companies. Venture capitalists being very discerning, finance less than 3% of all new businesses founded in the US every year (Shane, 2008).

Already "behind the 8-ball", rural entrepreneurs struggle for funding sources. And while the failure rate of new business is no different from that of urban or "suburban" startups, (Renski, 2008), rural entrepreneurship still finds itself looking at bootstrapping or personal funding as a method of funding. Lenzi describes a lack of "vital" resources including capital. Some of the types of firms that can't get adequate financing include those outside the local geographic service area of the bank; firms considered high-risk firms because of limited access to equity capital and the lender's unwillingness to use participation and guarantees to spread risk; pre-venture or start-up firms needing debt capital; and fast-growing firms seeking expansion loans (Lenzi, 2016). In a survey of forty Midwest Venture Capitalists, half of them had not invested in businesses in cities with populations under 50,000. Of 318 firms seeking at least $100,000 62% of the firms that were successful in obtaining funding were urban compared to only 37% being rural (Lenzi, 2016). While there is a local bias toward existing residents to be able to obtain local funding (Goetz et al., 2010), it is based significantly on manufacturing and not on entrepreneurial ventures. Of the $300 million awarded to community development since 1994, only 11 percent has gone to rural America (Dabson, Brian, 2001). Resources exist, as documented by the literature. Why does it not filter down to rural entrepreneurship?

Funding Entrepreneurs

There are two positions to funding entrepreneurs. The first is the position of Shane who claims that people start marginal businesses that are likely to fail and have little economic impact, generating little employment (Shane, 2008). Think of a coffee shop. The belief is that investing an hour or a dollar is a worse use of resources than investing the same in the expansion of an existing business. His overall position is that traditional entrepreneurship, and in particular, that of non-technology, is a fallacy and that the encouragement of these types of startups is a grave error. Adding more fuel to this fire is the empirically demonstrated fact that serial entrepreneurs, those that have created companies before, have access to venture capital funding more easily than nascent entrepreneurs. Venture capitalists recognize that when they invest in a business, they are investing in a person. The individual leading the venture is considered to be more important than the enterprise's products, which ultimately must be adapted over time to changing market conditions. This is primarily due to the experienced entrepreneur having a relationship with the VC players (Lichtenstein & Lyons, 2001; Zhang, 2011).

Juxtaposed to this is the literature that says proper resources, including capital, is the necessary support rural entrepreneurship needs. Sarasvathy (2001), in her seminal work about effectuation versus causation in entrepreneurial ventures, says that the creation of a market is more beneficial than the observation of an opportunity to capture. She states:

> *The essential agent of entrepreneurship, as I argue here, however, is an effectuator: an imaginative actor who seizes contingent opportunities and exploits any and all means at hand to fulfill a plurality of current and future aspirations, many of which are shaped and created through the very process of economic decision making and are not given a priori. (p.262)*

One of the four conjectures she makes is that "effectuators" fail, but can manage the failure and make good out of it, more quickly and more efficiently (Sarasvathy, 2001). For clarification, the definition of effectuation and causation is provided by Sarasvathy (2001):

> *Causation processes take a particular effect as given and focus on selecting between means to create that effect. Effectuation processes take a set of means as given and focus on selecting between possible effects that can be created with that set of means. (p.245)*

Anecdotally, a colleague describes it as, "Causation is when you see the need in the market and then create the product; versus, effectuation which is where you create the product and apply it, thereby creating the market." The point in this juxtaposition is that Shane believes that all small business is wasted investment, whereas Sarasvathy believes small business can be trained to effectuate and grow. The effect of networks (social capital) on effectuation is discussed later in the paper.

A slightly different perspective is the position of the community with respect to development. Extractive communities suffer from a "them versus us" mentality causing residents to feel helpless to change their economic situation or consider alternative community development due to experiencing generations of boom and bust cycles and the exploitive and arbitrary hiring and firing of labor. Capitalist activities, like entrepreneurship and investment, are identified with the elite class and rarely attempted by the working class (Fortunato, 2014).

Tangential to rural entrepreneurship and the types of businesses funded, an interesting GEM study showed that three sectors account for 65% of all startup activity for women: wholesale/retail, health and education—business to consumer; whereas men are more focused on business-to-business and capital-intensive sectors, such as manufacturing and transportation, agriculture and mining, and information and communications technology (GEM, 2020).

In a study on entrepreneurial social identity by Alsos, Clausen, Hytti, and Solvoll (2016), the findings revealed that entrepreneurs are a heterogeneous group and a combination of effectual and causal behavior is observed, with the implications being "Communitarians" (people concerned about the community) who were not 100 percent motivated by profit. Those that were motivated by profit, "Darwinians", were more causal and thereby more "traditional" in their behaviors (Alsos et al., 2016). Morris, Neumeyer, and Kuratko (2016) contend that the lifestyle entrepreneur and the small business entrepreneur should not be ignored to support only the high-growth "gazelles" described by Shane. They believe all venture types should be encouraged as they play fundamentally different roles in the economy (Morris, 2016). Manimala's (2002) study of founder characteristics, observes that the policies and practices of the enterprise are determined by the nature of the project, the type of business environments, and the personality of the entrepreneur He concludes that cultural differences impact the personality profile more than

enterprise policies and strategies (Manimala, 2002). To that end, then, what impact does cultural and social capital have on the ability to attract funding?

Social Capital

In a search for the reasons for the lack of funding for rural entrepreneurship, a great deal of literature presented itself on the concept of social capital. De Carolis & Saparito (2006) described social capital in two ways—bonding and bridging. Bonding explores the impact of a collective's internal ties and the substance of the network relationships. Bridging, also referred to as the private-goods model of social capital, focuses on individuals and their network relationships. Stam, Arzlanian, and Elfring in a meta-analysis of social capital and small firm performance, find there is a significant positive correlation between the two. What this means is that even though entrepreneurs must invest substantial resources to cultivate their networks, social capital does create value for these small firms (Stam et al., 2014).

Deakins and Bensemann's study on the location of a startup found that it is the founding entrepreneur's approach to looking for resources and information that will affect the business's success. They relate Social Network Theory to the Resource Based View and suggest that business networks in rural locations are likely to be thinly dispersed and limited in the extent of strong ties that build trust and weak ties that transfer information. The firms involved may lack centrality and networks are more likely to have structural holes. (Deakins & Bensemann, 2019). Tying social capital, in the form of networks, back to effectuation and the ability of a rural entrepreneur to practice it, Kerr and Coviello find that pre-existing networks can influence the cognitive and behavioral aspects of effectuation in myriad ways (Kerr & Coviello, 2020). At other times, network influencers can provide positive input and role modeling. Lyons states that social capital is the relationships between individuals and organizations based on expectations, obligations, and trust (Lyons, 2002), and is thought to be the 4th form of capital behind financial, human, and physical, but is not subordinated as such (Lyons, 2002).

Barriers to social capital can be great including, but not limited to, lack of availability, visibility, affordability, and skill of the entrepreneur. In addition, it is often difficult to build, let alone maintain, strong networks due to the location of the rural enterprise (Lyons, 2002). Firms that are created by locals are bigger both in terms of capital and employment, operate with more capital-intensive technologies, and are able to obtain greater financing per unit of capital invested than firms created by non-locals (Michelacci & Silva, 2007).

On a disconcerting note, Fortunato addresses the role of "deep bonding" social structures that could be an impediment due to a 'tight-knit, strong-tie kinship group' (Fortunato, 2014, p. 392). Additionally, analysis of bank relationships provided empirical support for the fact that social capital, in the form of bank relationships, decreased the probability of default. Comparing rural loans to urban loans found that a higher frequency of social interaction in rural areas reduces loan defaults because borrowers work harder to avoid default and lenders are better able to screen and monitor loans because the cost of information is low (DeYoung et al., 2019). An interesting aside, however, is that for one standard deviation increase in local social capital, the probability of an SBA loan default declines by only 5% (DeYoung, et al., 2019). They theorize that it's not simply social capital at work but rather the close-knit relationships and culture of the community.

Flora, (1998) asks if social networks are a community issue or something for an individual to use for their own self-interest (rational choice view). Discussing "embeddedness", the conclusion was that communities did not become civic because they were rich, rather historical records strongly suggest that they have become rich because they were civic. Social capital embodied in norms and networks of civic engagement seems to be a precondition for economic development. Korsgaard, Ferguson, and Gaddafors concluded that not only were social networks and social capital important, but more so was the ability of the startup to develop external networks for marketing, process education, and other specialized knowledge (Korsgaard et al., 2015). Ironically, however, they found that placial embeddedness is a central enabler of entrepreneurial activities, but then one has to consider the limitations that placial embeddedness imposes on rural entrepreneurship activities. With the exception of one business, none of the entrepreneurs in their study demonstrated any ambition for growth very much beyond their current activities (Korsgaard et al, 2015). Ironically, this study was based on the food industry which relies heavily on industry clusters and social networks.

Flora makes the case not only for social capital but for Entrepreneurial Social Infrastructure (ESI) as the precursor for the successful development of business. "ESI can be changed through explicit collective effort. It links social capital to *agency*. A community that has a well-developed social infrastructure tends to engage in collective action for community betterment" (Flora, 1998, p. 489). ESI is based on agency, diversity, and horizontal participation, not hierarchy (Flora, 1998).

Clusters

Clusters, an agglomeration of closely related industries, provide significant social capital and intellectual capital to an entrepreneur. According to Delgado, Porter, and Stern (2010), startup employment and startup establishments are growing due to Regional Clusters. They posit that a cluster of related industries in one location will foster entrepreneurship by lowering the cost of starting a business, enhancing opportunities for innovations, and enabling better access to a more diverse range of inputs and complementary products (Delgado et al., 2010). While their study focuses on entrepreneurs and startups, as well as existing firms, and empirically proves that clusters improve performance, it fails to address rural considerations. Munnich and Schrock, in *The American Midwest* (2003) address rural knowledge and industry clusters. They theorize that industry clusters can be used as a model for regional development and also provide support to rural entrepreneurs (Munnich & Schrock, 2003). Explaining the contradiction of "rural industry clusters", they provide anecdotal and empirical examples of successful clusters such as the RV industry in Indiana, the carpet industry in Georgia, furniture in Tupelo, Mississippi, fishing gear in Woodland, Washington, and sporting goods in Hood River, Oregon (Munnich & Schrock, 2003). They use the term micro-clusters or extensions of metropolitan clusters. The risk, however, is if the industry declines so does a significant base of employment with it. Do clusters, or lack thereof, affect the funding ability of a rural entrepreneur? Should local and regional policymakers focus on that?

Policy

Shane opens Chapter 10 with the words, "How Valuable is the Average Start-Up?" (Shane, 2008, p. 146). That is the question all policymakers must consider. Is a rural start-up valuable? Shane cites the Global Entrepreneurship Monitor and takes issue with a statistic. He asserts that one cannot infer that having more start-up activity makes GDP grow faster in some countries than in others. He then asks if this evidence really means that new firm formation *causes* economic growth?" (Shane, 2008). Shane would say no. Yet, for every statistic that Shane takes issue with, there is literature espousing the opposing side, in support of non-high-tech entrepreneurship. Shane insists that policy should focus on supporting high growth, high dollar, high tech enterprises, and reduce incentives for the marginal entrepreneur to start businesses by reducing the transfer payments, loans, subsidies, regulatory exemptions, and tax benefits that encourage people to start businesses (Shane, 2008). Yet according to the 2020 GEM study:

> *Entrepreneurs and entrepreneurship are often portrayed as being contingent on innovation. While this may be the case for founders and firms portrayed in the media, such entrepreneurs and their firms are outliers. The vast majority of new ventures across the globe do not depend on new products or services. These numbers bear out for the United States as well, where 70% of respondents do not have a new product or service as their foundational offering. (p.34)*

Additionally, with regard to rural entrepreneurship, Fortunato asserts, "There is a growing recognition that urban policy and practice approaches may not be well suited to the special social and economic conditions of many rural areas" (Fortunato, 2014, p.387).

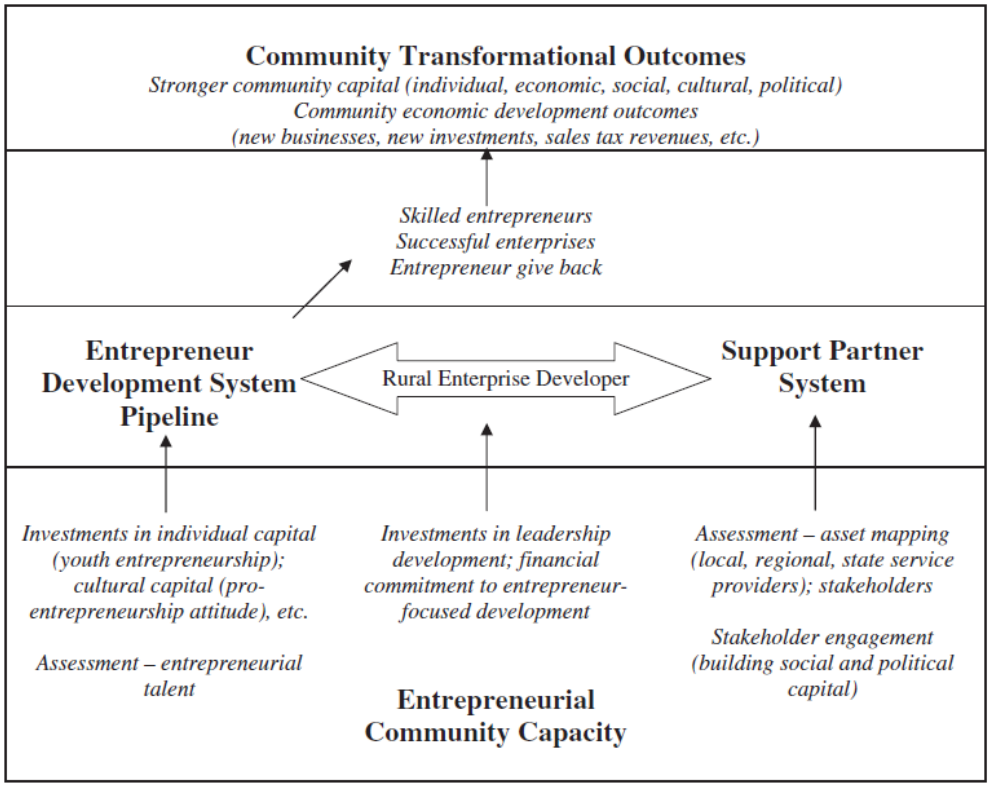
Looking from another perspective, Dabson (2001) counters with entrepreneurship being one of the main hopes for reviving and strengthening America's rural economies, despite it attracting little attention from rural policymakers. Stephens and Partridge take some middle ground with the concept that self-employment, while not the ideal standard for new business startups, still contributes to economic growth. They present evidence that the self-employed contribute to net economic growth. Even in remote rural regions, self-employment and the associated entrepreneurial capacity are positively linked to growth. However, they make note that there is no statistical linkage between the number of small businesses and growth, which implies that it's the type of business that is more important than the size (Stephens & Partridge, 2011). They also note that while the area being discussed (the Appalachian region) lags behind in proprietor formations, it also has fewer "firm deaths" and higher rates of startup survival (Stephens & Partridge, 2011).

Jolley, et al., discuss the concept of public venture capital for startups in Ohio. They estimate that venture capital firms owned or supported by governments participated in over $4 billion per year of investments in privately held firms, globally (Jolley, et al., 2017). They contend that public VCs can energize the private markets, fill gaps in the areas where private VCs would be reticent, provide seed money to get the investor to the next stage for second-round VC involvement, and bridge the information asymmetries that are found between private VC and

entrepreneurs. It is a complimentary function according to the proponents (Jolley, et al., 2017). The success of their program, Tech Growth Ohio, can be demonstrated by "the creation of over 575 direct jobs in the region with an average salary of $53,750 in a region where median household income is $33,823. TGO has achieved a leverage ratio of $17.8 for every $1 of State spending" (Jolley et al., 2017, p. 16). As an aside, Tech Growth Ohio supports the Southeast portion of Ohio, typically known for its rural poor. In a report from The Federal Reserve of Minneapolis (Foster, 2001) it is suggested that capital opportunities are expanded along each "rung" of a firm's capital "ladder". A company on the first rung when it is starting out needs seed capital; on the second rung businesses need assistance with operating expenses; and on the third rung, the company needs venture capital, which would be millions of dollars of investment.

Goetz, et al, believe that the positive message in the existing literature is that, using the measures of entrepreneurship available, government policy can influence economic startup activities (Goetz et al., 2010). Macke and Markley, in their *Illinois Institute for Rural Affairs Rural Research Report* (2006), make it clear that a systems approach is necessary for the successful creation of entrepreneurs. They state that development spending needs to be balanced to direct more investment into entrepreneurship strategies with proven track records. Markley, et al., contend that to have successful economic development, communities have to invest in human and financial capital and have the ability to "stay the course" long enough to build capacity and then achieve results. (Markley et al., 2015). This is one component of what they call "ecosystem development". They contend that it's not a matter of simply legislating funding, but rather creating an ecosystem—a holistic approach—for the entrepreneur to help them be successful. Enterprise development efforts must shift from the providing of services to the development of the entrepreneur (Markley, et al, 2015). See Figure 1 below.

Figure 1 Place Based Entrepreneurial Development EcoSystem (Markley, et. al, 2015)



Goetz, et al, bring up many interesting points in evaluating US rural policy. While not the primary argument, but one of interest, is that there is a definite correlation between high health insurance costs and the lack of startups in a state. Foremost, Goetz, et al., (2010) emphasize the importance of public policy objectives. They exhort whether the efforts are aimed at increasing small business formation, numbers of proprietors, profits, and regional output or whether entrepreneurship is a means to an end specifically, policy enhances entrepreneurship in order to improve overall local and regional economic conditions such as greater population and job growth. Yu and Artz clearly note that entrepreneurship is place-based (in their own community), involves using available resources, and can "create, renew, and reinvent purposeful identity for place" (Yu & Artz, 2019, p. 665). Their concern is that it becomes, then, a regional issue as it is almost impossible to grow with existing social capital.

And finally, the issue of job creation, whether in a rural or urban context is always the tip of every public policymaker's tongue. A paper from E^2 Entrepreneurial Ecosystems brings up the great jobs creation debate. Determining who is creating jobs – small businesses, large ventures, growth entrepreneurs – is an important question. A community's development strategy should be built with an understanding of the jobs creators as one of the key metrics (Macke, 2020).

Kang, Edelman, and Ku provide empirical research demonstrating that VC does not always contribute to jobs. Governmental funding, in the case of this study, the NIH, creates

more jobs directly than that of a VC. While the context is intellectual capital—much coming from research institutions—the evidence points to governmental funding having more positive effects. The positive effects are more conspicuous when there is a plethora of intellectual capital in the region. Venture capital tends to interact with intellectual capital in the short term, NIH funding does so in the long term (Kang et al., 2019).

CONCLUSION

Funding startups, particularly rural entrepreneurial ventures, is not a simple binary process of checking off items on a list. There are many factors that impact whether a rural entrepreneur receives funding, from the type of rural venture, the location of the venture, the skill sets of the entrepreneur, the social capital and networks an entrepreneur has, to existing business clusters, and to the policies of the government, private/public ventures, and private ventures. This paper began as a funding question but subsequently ventured into the deep body of literature on the various considerations that affect funding. It would be impossible to come to a formal conclusion on the why, as there is no one specific reason. What this provides, however, is a much deeper look into the complexities that make up rural entrepreneurship and the potential reasons funding is a challenge.

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