Virginia's
Rural Economic Analysis Program

REAP Policy Paper No. 9

Is Access to Credit Limiting Diversification and Economic Development in Rural Virginia?

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Respondents to a survey generally expressed the opinion that financial markets have the capability to provide the credit they need for their rural small businesses, even though their requests may actually have been denied. However, when the data from their more objective responses were analyzed, the results strongly suggested that perceptions and reality were not the same. Available debt and venture capital may not be lacking in all areas of the Commonwealth, but in some localities, small business owners needing access to financing cannot get the money they need. This situation presents barriers to economic development for those localities, especially the tobacco-producing counties, which face imminent needs to diversify and adjust. These barriers need to be removed if localities are to remain economically viable. And the Commonwealth should examine its proper role in ensuring access to credit.

When tobacco growers have been asked what limitations they face when trying to generate income comparable to tobacco from other crops or enterprises, they often respond that their inability to obtain credit limits their alternatives. The meetings where this information was obtained were held from 1994 to 1996 by the Rural Economic Analysis Program (REAP) and the Tobacco Communities Project, with the Institute for Quality Health (IQH) at the University of Virginia as project coordinator. With tobacco providing a significant part of the economic base in many Southside Virginia counties, the potential loss of the crop and the related industries could precipitate an economic crisis in these counties. Recognizing the potential economic devastation and valuing the efforts of these focus groups, the Virginia Legislature agreed in House Joint Resolution Number 34, February 1996, to examine the accessibility of capital in rural communities and to determine the proper role of the state, if any, in ensuring access to credit.

In the research to identify any prevailing financial market inadequacies and inefficiencies,[1] adequate and efficient capital markets were assumed to be an important basis for rural development. Rural economic development literature consistently identifies reasonable access to debt and venture and equity capital[2] as a necessary condition for viable and robust rural communities. Knowing what financial market inadequacies and inefficiencies exist and how they influence rural development in Virginia is valuable for policy makers, state agencies, and state and local leadership as they plan for Virginia's future. The basic criterion used in this study to identify market inadequacies and

[1] Inadequate markets are defined as those markets that have no mechanism in place to provide the necessary services. Inefficient markets are defined as those markets that have the necessary mechanisms in place to provide financing services, but information related to them is lacking, or for other reasons, the markets are not working well.
[2]Venture capital is money made available for investment in innovative enterprises or research, in which both the risk of loss and the potential for profit may be considerable.

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inefficiencies is the risk characteristics associated with the business which should be the only determinant of the borrower's access to capital.

A critical limitation of this study, sponsored by the Rural Economic Analysis Program (REAP), is that the businesses surveyed are those which have survived with the current conditions of the rural financial markets. The study would have been more complete, and potentially more starkly revealing, if information from entrepreneurs unable to begin business or exiting business because of the lack of debt financing, venture capital, or both could have been obtained and analyzed. Such information, however, was not available.

A 1997 survey of lenders and farm and non-farm businesses in five rural Virginia counties provided the information for the research. The purpose of this research was to determine if extraordinary difficulties exist for entrepreneurs when they attempt to obtain financing or venture or equity capital. If such difficulties exist, knowing the source of the problems is important in providing appropriate solutions. An important part of developing solutions is to identify the appropriate role for the state, if any.

Among the possible market inadequacies and inefficiencies are (1) a lack of available capital; (2) a lack of information on the part of potential borrowers, lenders, or both; (3) a mismatch between the type of financing requested and the type available; (4) non-risk characteristics of either borrowers or lenders that contribute to loan rejections; or (5) some combination of these.

An analytical model was used to analyze the data collected. Four types of information were used to represent different measures of financing difficulty:

1) data on loan rejections;
2) data on the use of non-local financing, which suggest local financing was not available under conditions acceptable to both borrower and lender;
3) opinions of survey respondents on the adequacy of local capital markets; and
4) respondents' expectations of future performance of the local capital market.

The effectiveness of the rural financial markets in Virginia is based on the postulate that the only reason for denying credit should be the financial risk characteristics of potential borrowers. If nonfinancial risk characteristics of local businesses or of the local capital markets are significant determinants of financing difficulty, the capital markets are functioning inefficiently or inadequately.

The results of the analysis indicate that in Virginia, capital market inefficiencies and inadequacies exist and that, potentially, additional inefficiencies and inadequacies will occur. Rural businesses, both agricultural and nonagricultural, are constrained in their diversification, growth, and adjustment efforts by a lack of financing. Recommendations to address these problems and to suggest how a governmental presence in rural capital markets might help achieve better access to capital are included in this publication.

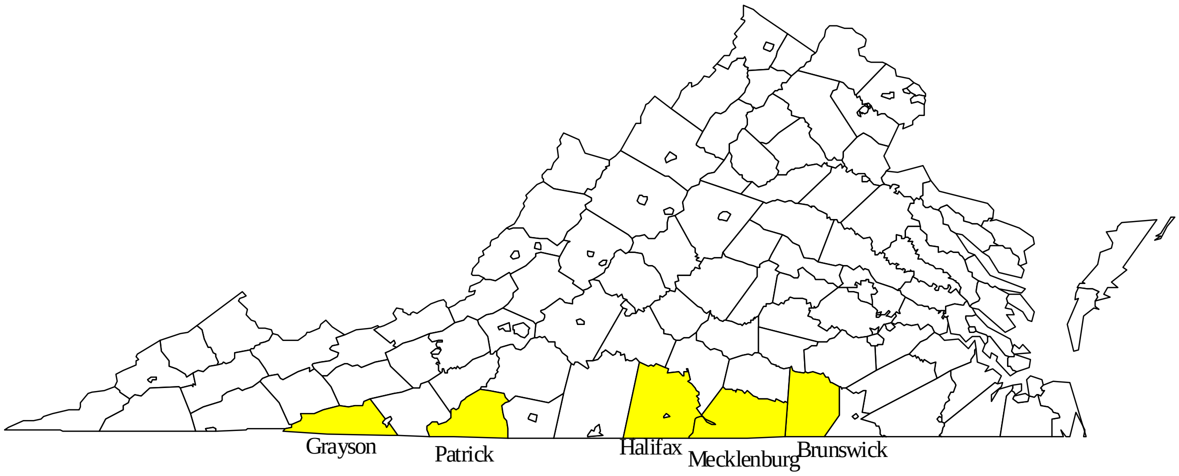
A study by the United States Department of Agriculture (USDA), *Credit in Rural America,* "failed to uncover any evidence that serious market failures are . . . epidemic in rural areas. Nonetheless, based on the structure of rural credit markets and anecdotal evidence, it is likely that market imperfections persist in many rural areas." (p. 33)

How the Study Was Done

A substantial base of information was collected from counties representative of the diverse economic conditions found in Virginia. The question, "Are there problems in access to debt and venture or equity capital?" is answered by this extensive, firsthand information.

The five counties chosen to be sent surveys--Brunswick, Grayson, Halifax, Mecklenburg, and Patrick--represent widely differing levels of economic development, rates of economic growth, and combinations of agricultural and nonagricultural business enterprises (Figure 1). The primary income-producing agricultural crop in Brunswick, Halifax, Mecklenburg, and Patrick counties is flue-cured tobacco. The principal agricultural enterprises in Grayson County are burley tobacco and beef cattle. Only Halifax County has experienced a greater than the state average population increase of 5 to 7 percent from 1990 to 1995. Brunswick, Grayson, and Patrick counties have had lower than the state average

Figure 1. Counties Surveyed: Grayson, Patrick, Halifax, Mecklenburg, Brunswick.



population increases, and the population change in Mecklenburg is equal to the state average. In addition, Brunswick is described as having persistent poverty (McDowell, Alwang, and Chandler).

A total of 2,000 farm and non-farm businesses located in the 5 counties were included in the random sample. The Virginia Agricultural Statistics Service (VASS) database of farm businesses, the Virginia Employment Commission (VEC) database of businesses registered for unemployment insurance purposes, and the business telephone directory were the sources of addresses for the mail survey. The survey asked for general information about the company and the respondent's experience with financing the business. The major focus of the questionnaire was on respondents' experiences as they sought and either obtained or were denied credit or venture or equity capital.

Two methods were used to collect information from local financial institutions. First, a questionnaire was mailed to all 38 bank headquarters and branch offices located in the sample counties and active in providing financing to local businesses. Second, a telephone survey, using a condensed version of the written survey, was used to collect information from the lenders who did not respond to the written survey. (See Kruja for survey questionnaires.)

What Was Found

Lenders perceive recent changes in local financial markets to be indicative of increased local competition. Furthermore, they perceive expanded financial product lines, easier terms, and lenders accepting greater credit risk to be characteristic of this increased competition.

All responding lenders having more than $3 billion in total assets expected an increase in their small business loan portfolios, given the current expanding state and national economy. Almost all responding lenders reported pre-venture and start-up stages of a business to be the most difficult, costly, and time-consuming stages to finance. They spend more time developing financial and marketing forecasts, making on-site visits and counseling, providing personal finance and tax planning, and arranging outside assistance for new or start-up businesses than for businesses in other stages. Both the increased time

Stages in the Life Cycle of a Business

- Pre-venture stage begins with a concept, idea, or invention.
- Start-up stage begins with obtaining capital, starting the business activity, and putting the idea into production.
- On-going stage is characterized by rapid growth, management adjustments, and possible under-capitalization.
- Stable stage has seasoned management, established markets, and adequate capital.
- Declining stage is characterized by declining profits, poor management, uncertain sales, and weak capital base.
- Transfer stage occurs when the business is sold rather than shut down.

spent and the need to assure that market analyses and forecasts are reasonable raise the cost of the loan to the banker, thereby increasing the total costs associated with that loan.

The banking community is divided in its responses toward government loan guarantees. Most lenders prefer making loans without government guarantees because of the added burden of paperwork and the increased time required to process the loan. But according to local lenders, guarantees are more important in the pre-venture and start-up stages than in other stages. Since local lending institutions are frequently the primary or only source of information about financing and since they tend to prefer direct loans to guaranteed loans, their advice may influence how borrowers and potential borrowers view the presence and role of state or federal agencies in local financial markets. Lender's negative perceptions of guaranteed loans, when conveyed to borrowers, can result in market inefficiency because the borrower is without adequate information to make an informed judgment.

Sources of Financing

Commercial banks were identified by respondents as the primary source of credit. And, in general, the rural Virginia loan market is characterized by limited use of loans and by loans of less than $100,000, with the majority of loans under $50,000. Debt-to-equity ratios well below national norms were reported, and the results of the survey indicate that rural Virginia entrepreneurs tend to be very conservative when using debt financing. Because of this conservatism, entrepreneurs are not likely to aggressively seek new or alternative sources of financing to enhance the economic vitality of their rural businesses. *Conservative attitudes toward borrowing money may preserve the financial integrity of the business, but those same conservative attitudes may also block new investments at the very time the community needs an economic boost.*

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The Small Business Administration has developed an index to measure the small business lending activity by banks. In the sample of financial institutions, only 3 of the 38 banks scored higher than the national average in small business lending activity. Two of these banks are in Grayson County, and the third is in Patrick County. *The small business lending activity of many of the banks surveyed was significantly below the national average for their size category*.

> Rural small business owners tend to be very conservative in acquiring debt, requesting only small loans. Lenders are not anxious to provide smaller loans needed by rural small businesses because the relatively high total costs per loan do not allow for the time, a variable cost, needed to evaluate the business plan, financial reports, and management of that rural small business. Consequently, small loans for start-up businesses may be difficult to obtain, and usually venture capital must be relied upon for start-up businesses.

Debt, Equity, and Venture Financing

Debt financing involves borrowing money that is either secured or unsecured. Venture financing involves the sale of stock by a corporation or an infusion of capital from existing or new partners in a partnership.

Of all business firms responding, 66 percent reported new debt financing during the last 2 years, while equity financing was reported by only 26 percent of respondents. Venture capital, according to the responses, is generally not available for beginning small businesses. The majority (86 percent) of new venture financing was reported by businesses in the on-going and stable stages. Thus, most venture capital seems to be made available to finance the expansion of on-going businesses. Small Business Development Centers (SBDC) reported many applications and initiatives for which they sought investors to provide venture or equity capital for small businesses, but investors were not interested, especially for new and perhaps unfamiliar business activities.

Loan Denial

In general, the rate of loan denials was above national averages. Furthermore, the percentage of loan denials appears to differ among counties: 13 percent of respondents in Halifax County reported loan denials, and 9 percent of Patrick County respondents reported loan denials. *The most common reasons reported by both lenders and borrowers for loans being rejected were poor cash flow projections, weak financial statements, insufficient equity, and limited or poor collateral.*

In addition, three characteristics of small businesses in rural Virginia, *unrelated to the creditworthiness of an individual firm,* proved to be statistically significant determinants of loan rejections: the number of non-local, small business locations; the number of business competitors in the local market; and the total amount of short-term loans held by the lender.

The fewer non-local locations the business firm has, the more likely loans are to be denied by local banks. This non-risk characteristic seems to suggest local banks are concerned that a business with many non-local locations will obtain financing from another locality, and they approve the loan requests, at least partly, for that reason.

Secondly, the fewer business competitors in the local market, the less familiar the bank is likely to be with the type of business, and hence, the more likely the loan will be denied. Firms with less than ten competitors locally are more likely to be denied financing. Part of this reluctance to lend appears to be lack of familiarity by the banker with business activity that is not traditional for that community, especially some of the emerging high tech or service-type business activities. Lenders have no benchmarks against which to compare the applicant's financial position and financial performance, making it difficult to evaluate the loan request. *This limitation may be especially important for firms seeking to diversify into locally unfamiliar types of economic activity (technical consulting, computer services, telecommunications, and so forth) or for firms interested in moving into a community and engaged in enterprises that are not traditional for that community.*

The third non-risk characteristic, the total amount of short-term loans held by a lender, is a risk factor for the bank but not of the business applicant. But if problems with portfolio diversification by the lender is the real basis for the loan rejection, not the riskiness of a specific loan request, this action suggests insufficient competition in the local financial market and potentially significant market inadequacies. Internal bank policies may also affect the total amount of short-term loans a bank will hold or make to a single borrower. Such policies can result in market inadequacies.

Of the new debt financing reported, 63 percent of respondents used only local financing (within 50 miles), and only 6 percent used only non-local financing (beyond 50 miles).[3] The remaining 31 percent used a combination of local and non-local financing. The need to resort to non-local financing can indicate inadequate or inefficient local capital markets. The data analysis indicated that those borrowers using non-local sources tended to be the borrowers most often denied loans locally. Some of the reasons for these loan rejections were clearly non-risk factors.

> A high rate of loan rejections is indicative of problems in adjusting to and preparing for the future. Unless the proposed business activity has well-documented sales projections, cash flow analysis, and some equity capital, a loan will be hard to get. For these reasons, small loans are especially difficult to obtain.

Based on the answers to several questions, the data show that businesses most likely to face loan rejection by local banks include companies with sales over $100,000, sole proprietors, and corporations. The data show that firms with annual sales over $100,000 are also more likely to search for non-local financing than are smaller businesses.

Since increasing sales are an indication of a viable business, the finding that businesses with a 5 percent sales increase in the last 2 years are less likely to have loan applications rejected is not surprising. However, if a business is downsizing to remain viable, has declining sales but still shows excellent firm-level performance in a sector experiencing economic difficulties at the time of the request, or is too new to be able to report changing sales, loan requests are often denied.

[3] Local and non-local were defined by survey questions.

Loan denials occur more with some types of businesses than others. For example, retail, service, and manufacturing sectors are more likely to face loan rejection than are farmers and agricultural businesses, and local construction businesses appear to have even fewer loan denials than agricultural businesses.

A mismatch between the type of financing requested and the type of financing available is yet another market inadequacy that was identified. Several characteristics are associated with this mismatch:

- Well-established businesses are sometimes unable to finance growth and expansion.
- Potential borrowers sometimes know about various state and federal programs for which they are eligible, but they do not use these financing sources.
- Some creditworthy businesses needing small loans ($5,000 to $20,000) are unable to obtain them.
- Some businesses are unable to obtain operating funds.
- Local banks, not familiar with a type of business activity, often deny the loan requests on that basis.

> A number of non-risk factors appear to determine whether a small agribusiness or nonagricultural firm can borrow money. Among these factors are size and type of business the borrower is engaged in and his/her potential access to non-local banking sources.

Borrowers' Attitudes

Opinions expressed by respondents whose businesses generated more than $100,000 in annual sales indicated they were also more likely to be satisfied with the local financial market conditions than those respondents whose firms had sales less than $100,000. These higher levels of satisfaction with the local markets might be the result of larger firms having relatively better access to venture or equity capital and their being more likely to look to non-local banks for financing; therefore, they are less negatively impacted by having a loan request rejected locally.

Smaller firms, on the other hand, are less satisfied with the local financial market conditions. The higher total cost of loan origination and servicing associated with smaller loans is often passed on to borrowers in the form of higher interest rates. These higher total costs can be exacerbated by the cost to the bank in dealing with loans for start-up businesses. All these additional costs could contribute to small firm dissatisfaction. And the borrower-lender working relationship can, of course, be adversely affected by the higher interest rates.

Lender size also appears to be a significant determinant of the satisfaction of a business with financial market performance. The larger banks generally have higher lending limits and more available capital than the smaller ones. The smaller the business is relative to the largest lender present in the local market, the more likely the business will be satisfied with local financial market performance. Apparently, then, adequate or more than adequate lending capacity exists in local markets where large lenders are present.

While adequate lending capacity may exist in local markets if large lenders are present, the absence of these larger lenders may lead to loan rejections because the total exposure resulting from numerous small loans to a single borrower may trigger internal bank policy limitations. *A potential borrower should not be denied credit because of internal bank policies not related to the riskiness of the loan.*

Patrick County businesses had the highest percentage of respondents who were not satisfied with the local financial market performance. The banking industry in Patrick County is highly concentrated with an index of 0.75 where 1.0 indicates a sole lender in the county. As the banking industry becomes more concentrated in a county, a tendency to dictate approaches and practices rather than responding to local needs may occur.

Although management experience would ordinarily be expected to result in less difficulty in obtaining financing, the survey data suggest banks apparently do not recognize experience as an asset. According to survey responses, more experienced managers appear to face more financing difficulty in the local market than less experienced managers. This counter-intuitive situation suggests a market inefficiency since management experience and expertise should be an important factor in determining the creditworthiness of a company, other factors being equal. Perhaps, however, experienced managers do not face more difficulties compared to less experienced managers: They may simply have experienced better times and better relationships with lenders in the past, making them more dissatisfied with present market conditions. *Regardless of the rationale, the result indicates possible market inadequacies*.

Non-risk factors, such as internal bank policies and bank size, influence satisfaction with local capital market performance**.**

Government Involvement

Volunteer and governmental programs are already available to provide technical assistance to rural businesses. Programs that offer assistance in loan application preparation, cash flow analysis, and sales and market projections are available. Other governmental programs provide loan guarantees or direct financing (Mundy and Purcell). Is the presence of the state government fulfilling the mission for which it was designed? Are side effects of its presence being felt in the market?

In spite of the assistance available to potential borrowers, *the results of the study clearly show reluctance on the part of respondents to use state or federal loan guarantee programs*. Only a small percentage of rural businesses reported using governmental programs. Most respondents who think obtaining financing would be more difficult when the banks use these programs have never used them. Even those respondents who use these programs do not see any advantage compared to bank financing without government guarantees. Furthermore, most respondents who used the state programs are not in favor of governmental involvement. Whether the respondents are simply misinformed or whether more information about how the programs operate would help to increase their use cannot be answered from the survey results.

The overwhelming response to questions about state agency activities was that potential borrowers simply do not know about available resources, especially for programs like the Virginia Small Business Financing Authority, the Virginia Economic Development Revolving Loan Fund, and Loan Guarantee Programs. These programs can help people start or expand small businesses or improve existing sites and buildings either through loan guarantees, bonds, or reduced interest rates. Generally, these programs are not available to business owners to refinance existing debt or to move a business from one Virginia community to another. *That people do not know about the resources available to them clearly points to market inefficiency and to the need to advertise and market the programs--provided economic vitality is a goal.*

In addition, recognizing the sensitivity of people to governmental involvement is extremely important. Many respondents think that a governmental presence is necessary in a facilitative role. But other respondents became almost aggressive in their opposition to the government's trying to improve the functioning of rural capital markets. Most respondents accompanied their answer with a statement about the tax system: The *only* thing government can do, they say, is to reduce taxes so that rural small businesses would be more motivated to produce, expand, and create additional jobs. They are against the establishment of new governmental institutions that will "only drain away the taxpayers' money."

Policy Issues and Recommendations

Several policy issues emerge from the findings of this survey. *One important policy issue is whether existing state government programs for either capital or technical assistance are correctly designed.* If neither the lender nor the borrower perceives any difference between the use of these programs and direct bank financing without state agency assistance, what is the economic reason for having the programs?

Virginia Cooperative Extension, recognized as a major source of information and technical support, has a program designed to provide assistance to rural businesses. Volunteer and state governmental agencies providing similar assistance are virtually unknown. Continuing problems include how to make a state agency's presence known in rural areas and how to assure that it can assist rural businesses, especially small businesses, in overcoming the difficulties imposed by apparent capital market inadequacies or inefficiencies.

A second policy issue evolves from significant variations in the way financing needs are met in different rural economic sectors. Nonagricultural businesses seem to face more financing difficulty than agricultural businesses. Hence, agricultural businesses are more likely to be satisfied with local market performance than nonagricultural businesses. This study confirms the suggestions of Drabenstott who believes that financing rural small businesses could be facilitated if methods similar to those used to finance agricultural businesses were adopted. Access to capital appears to be easier for businesses in the agricultural sector because the Farm Credit System (FCS) and the Farm Service Agency (formerly Farmers' Home Administration) are dedicated to the agricultural sector. *However, rural development and overall economic well-being depend crucially on the success of both agricultural and nonagricultural businesses.*

Assessing existing governmental programs for their direct and indirect effects in supporting rural development is especially important now that tobacco farmers may need to diversify into non-farm businesses, find employment with rural-based, nonagricultural businesses, or both. Should the same kinds of assistance and services offered to agricultural producers be offered to nonagricultural rural businesses as well? Would doing so interfere with the level of competition in rural financial markets? Commercial banks currently see the presence of FCS as a threat to their market share, but the presence of competitors has the potential to improve the performance of all financial institutions.

A third policy issue arises because collateral requirements and poor cash flow projections are the most common reasons for loan denial. Should the state offer guarantees to alleviate the restrictions imposed by these credit limitations? Collateral requirements are especially restrictive for businesses that need start-up or expansion capital but because they are new or can only offer collateral with low market value. High technology equipment, equipment that could be obsolete in a short time, and equipment with no broad marketability provide poor loan collateral. Yet, rural communities may be ideal settings for service-type business activities using just such equipment in telecommunications and computer services or for businesses working on contractual bases with non-local firms wanting to out-source part of their work load. State action may be required to satisfy the need for alternatives to collateral-based loans.

Since a start-up business normally lacks the necessary collateral, providing assistance to these businesses and offering to guarantee part of their initial capital needs may be very important and could make major contributions to economic activity in rural communities. Economic development grants could be considered for this purpose. If this assistance is accompanied by rigorous analysis of the business plan and the loan application, then encouraging these small businesses, without interfering with the normal functioning of financial markets, would appear to be both possible and advisable.

> State programs to provide assistance are not effective. These programs are not being used, even by the borrowers who most need technical assistance.

The issues surrounding cash flow and market projections need to be addressed by providing education rather than loan programs. Rigorous cash flow forecasts and market projections are difficult for new and some existing small businesses to develop. The survey responses indicated that market projections are the specific area where respondents most need technical assistance. Benefits could be derived from state involvement in providing or facilitating this technical assistance. Furthermore, the education provided would not interfere with existing financial markets.

The majority of new financing is provided locally. This finding is the basis for a fourth policy issue. That the banking industry is undergoing a trend toward consolidation is widely known. *As* *consolidations occur, what will happen to the small businesses which currently meet most of their debt capital needs through local banks?* Will the large banks be interested in and able to evaluate their loan applications? Will the consolidated banks want the small loans that are less cost efficient for them to originate and service? If the answer to any of these questions is "no," what course of action is open to these rural small businesses? Should state government have a role in helping these businesses?

Finally, a market cannot be efficient if information is not available. Some respondents, who borrowed money during the last year, did not offer any opinion on the interest rates and other loan conditions in the local market. The lack of response suggests information about alternative funding sources is lacking. And local banks were frequently the only source of financing information about competitive programs. The need for some type of financial information clearinghouse is clearly indicated. The local bank is currently providing this function. But the local bank may or may not be willing or knowledgeable enough itself to direct small businesses to other sources of financing or to state programs that could help with funding needs or that could provide technical assistance.

Educating borrowers and lenders so that available programs are used might involve creating new centers of information, giving information functions to existing governmental institutions, or using certified public accountants.

Can a less expensive alternative to make this kind of information available be found? If banks can be motivated to use existing state programs, the natural clearinghouse function of banks, providing information on financing sources, could be employed. Encouraging banks to use these programs involves both setting up attractive programs and making sure that guarantees promised to the banks are forthcoming in a timely manner and with minimal paper work.

If the government helps provide debt capital, the uses of that debt capital could be small loans to meet the needs of rural small businesses. Further, since venture capital also appears to be needed in the rural areas, *a pool of start-up and expansion venture capital might be created*. Given the relative satisfaction of agricultural businesses with the current access to capital, experience from agricultural financial markets could be used to develop governmentally sponsored programs for nonagricultural rural businesses.

The debt-to-asset ratio of a firm is a better measure of the ability of a borrower to repay a loan than the dollar amount of the debt. The lack of willingness by a local lender to continue investment in a firm because of total debt to that lending institution might result from the need for the lending institution to diversify its loan portfolio or from internal bank policies. Capital users should not be penalized for reasons other than their own underlying credit risk. Risk-pooling mechanisms might be considered. These mechanisms, such as a capital access program like Michigan's, could increase loan participations and enable banks to accept all viable loan applications. Michigan's capital access program has worked well and served as a model for several other states. *A state presence is a necessary part of such a program, however, and that presence will occur only if Virginia's leadership and the state agencies involved recognize the seriousness of the need.*

Analysis of loan applications from nontraditional businesses clearly needs attention if economic investment in an objective. Non-local banks could be given incentives to provide the needed expertise to assist local lenders lacking knowledge of a particular type of business. Governmental assistance in analyzing nontraditional loan applications is another possibility.

An Overall Observation

Rural Virginia is not well positioned to move into a difficult period of diversification, new investments, and change. Financing, especially for start-up businesses, is expensive and often virtually impossible to obtain. Loans are denied, in some instances, for what appear to be factors not related to the riskiness of the loan. Loans are also denied because venture capital to meet requests does not appear to be available. Significant inadequacies and inefficiencies occur in the financial markets in rural Virginia. An expanded state presence appears to be needed. The needs for state facilitation are greatest in ensuring technical assistance for developing business plans which include cash flow and market projections and in developing and maintaining a capital access program. Michigan's capital access program is, perhaps, a good model. In the Michigan program, critically important start-up and expansion financing is insured in a three-way involvement of borrower, bank, and the state as a guarantor.

Until the financial market inadequacies and inefficiencies identified in this analysis are addressed, businesses in rural communities in Virginia will be constrained in their capacity to respond to inevitable economic pressures. Agriculture, in general, is moving to a global exposure and the tobacco sector, in particular, is facing national settlements that will force radical change in Virginia's Southside and Southwest counties. If these communities are to avoid huge economic and social problems and disruptions, access to capital is essential. Unless the state adopts a more aggressive and more visible posture, avoiding or even mitigating the impact of these many problems and disruptions is not likely.

Problem areas identified:

1) *Lack of technical assistance available to develop business plans, including cash flow projections and market analyses for potential borrowers with businesses in the pre-venture and start-up stages.*
2) *A banking policy based primarily on collateral lending when, in some areas of economic activity, the collateral has little or no market value.*
3) *Incorrectly designed state programs that lead to a mismatch of funds and lending requests resulting in programs not being used.*
4) *Limited sources of venture and equity capital.*
5) *Lack of information on the part of lenders about innovative business activities that are often nontraditional in the local area.*

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Virginia Cooperative Extension

1998 Publication 448-309/REAP P009

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