James P. Miller

New Rural Businesses Show Good Survival and Growth Rates

Local independent businesses foster self-identity in rural communities much more than do corporate affiliates, and data from 1980-86 show that they may also weather recession better. As sales fall, parent companies often close down rural branches to streamline operations. "Homegrown" rural firms benefit from low startup (land and labor) costs but, once established, their employment grows more slowly than metro businesses.

In seeking new ways to revitalize their economies, many rural communities are encouraging local entrepreneurship and "homegrown" job creation. Some planners even suggest that rural economic development depends fundamentally on investment in local independent businesses rather than investment in affiliates of national corporations. In recent years, many jobs in affiliates owned and controlled outside the community have been eliminated in nonmetro areas due to rapid advances in manufacturing technologies, foreign competition, and corporate reorganizations.

Nonmetro jobs in manufacturing affiliates of national corporations declined 34.4 percent due to closings between 1980 and 1986, a period of recession, recovery, and rapid structural change (table 1). The decline was identified using a new data source developed by the U.S. Small Business Administration (SBA). Net employment of nonmetro affiliates also declined 11.2 percent, about twice the net rate of decline for affiliates nationwide. By comparison, employment in independent manufacturing firms in nonmetro areas declined only 26.3 percent due to closings, 8 percentage points below the rate of decline of affiliate closings. Net employment of nonmetro independent establishments grew 4.1 percent, over twice the national net growth rate of independents.

Despite lower rates of closings of independent establishments, studies over the past 10 years have concluded that they are a risky means of economic growth. Most new establishments go out of business within the first years of operation, according to traditional thinking. Business failure data are imprecise, but as few as a third of all new establishments are thought to survive to their 5th birthday, and by the 10th year only about 1 in 5 are still operating. These low survival rates are daunting and often discourage initiatives in small business development (for example, enterprise zones, business incubator facilities, venture capi-

James Miller is an economist with the Agriculture and Rural Economy Division, ERS.

Nonmetro startups had better longevity than metro startups in every category

Figure 1
Survival rates of new establishments, 1978-86

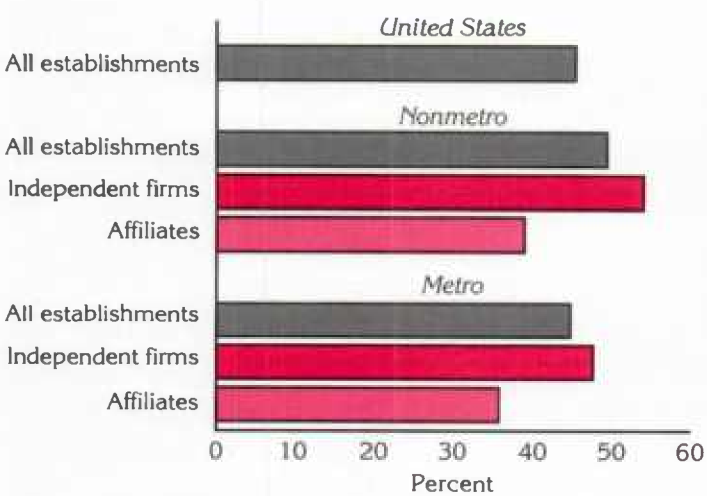
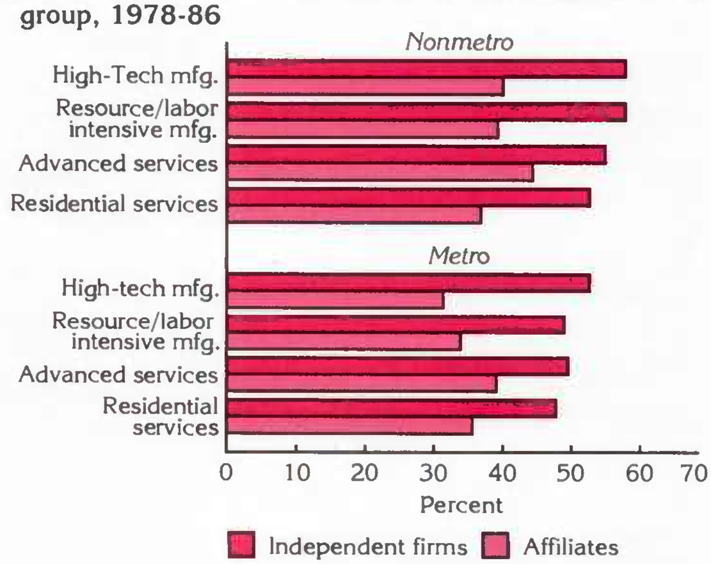


Figure 2
Survival rates of new establishments by major industry group, 1978-86



Source: U.S. Small Business Administration   Establishments starting 1978-80 tal corporations), particularly in rural areas where conditions for new firm formation are less favorable than in urban areas.

But the studies that yielded those conclusions had several data shortcomings: they were regional or statewide rather than national in scope, they could not track rural firms independently, and they could not track the performance of specific groups of firms. For this article, I analyzed the SBA data set (mentioned above), which remedies those shortcomings and so yields a much more precise picture of what is really going on among small firms in rural areas. The results may surprise those who believe that most small startup businesses are doomed.

New Business Survival Rates Surprisingly Strong in Rural Areas

Nearly half of all the 181,000 establishments that started in nonmetro areas between 1978 and 1980 survived at least 6 years (fig. 1). By comparison, only 44.1 percent of 743,000 startup businesses in metro areas survived that long. The relative health of nonmetro startups is somewhat surprising. New businesses, according to both theory and some empirical studies, should have a higher rate of survival and growth in metro areas where customers, suppliers, support services, and other businesses in similar trades tend to concentrate. Small startup businesses, according to recent studies, are supposed to be less successful in outlying areas where the costs of both transportation and contact with customers and suppliers can be prohibitive.

New independent establishments survived at higher rates than expected in nonmetro areas. Their 6-year survival rate was 53.5 percent, 5 percentage points above the rate of survival for independent establishments in metro areas. The nonmetro independent survival rate was also substantially higher than the 38.7-percent rate of survival for nonmetro corporate affiliates. The low survival rate for affiliates may relect short-term organizational changes among large domestic companies in the 1980's. Large companies were not only closing old branches to reduce costs and become more competitive, but were also streamlining operations by selling off some affiliates.

Independent establishments showed the highest survival rates in nonmetro areas. Nearly 60 percent of new independent high-tech establishments in manufacturing survived for at least 6 years. That rate is higher than both the 40-percent survival rate for high-tech affiliates in nonmetro areas and the 52-percent survival rate for independent high-tech establishments in metro areas (fig. 2). In advanced producer and distributive services industries, 55 percent of independent startups in nonmetro areas survived, a

Slow growth was the norm for rural startups, especially among the largest affiliates

Figure 3
Employment growth rates of new establishments 1978-86[1]

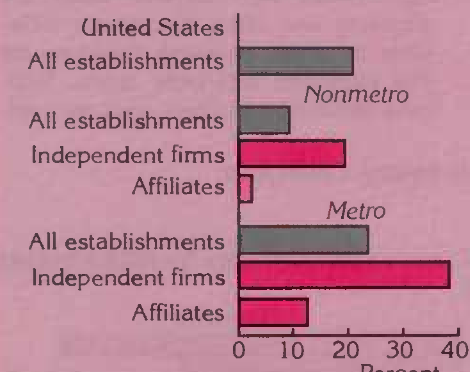
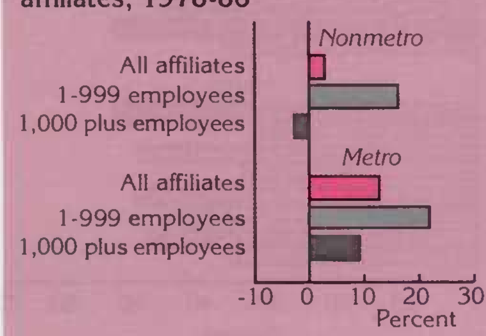
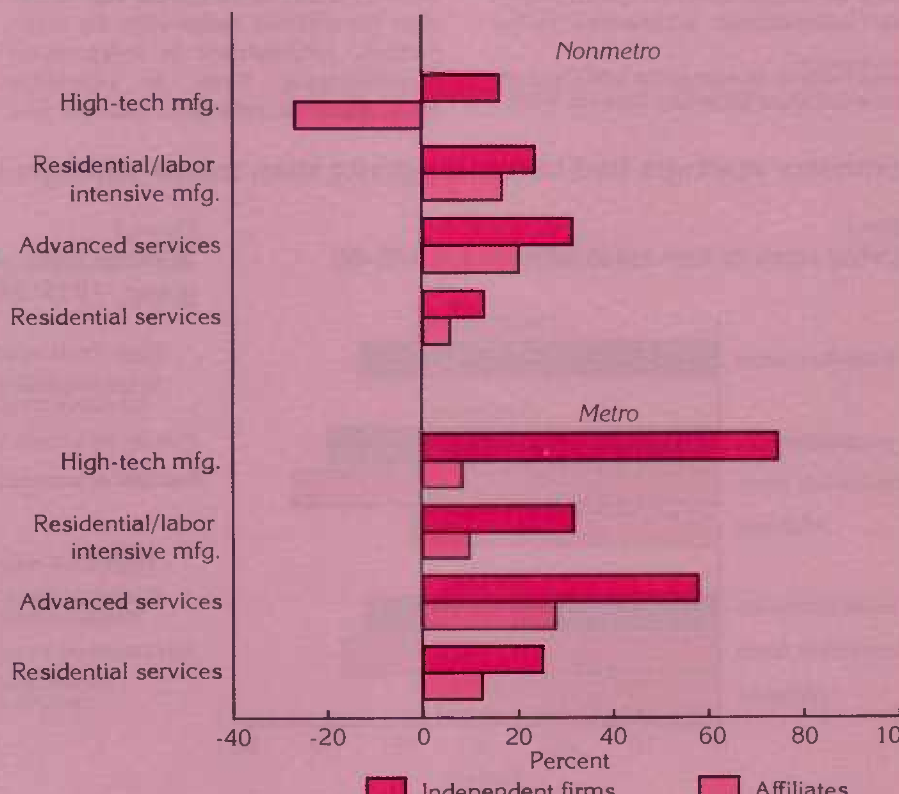


Figure 5
Employment growth rates of new affiliates, 1978-86[1]



[1]Number of employees refers to total employment of headquarters and all affiliates in the company.

Figure 4
Employment growth rates of new establishments by major industry group, 1978-86



Source: U.S. Small Business Administration Establishments starting 1978-80

Photo © David W. Sears

New independent establishments in residential services industries (like restaurants) expanded their employment at about half the metro rate during the early 1980's. But the overall survival rate of new rural businesses was better than the metro survival rate.

rate higher than both the survival rate for affiliates in nonmetro areas and for independent startups in these industries in metro areas.

The high survival rates of independent high-tech establishments and advanced service activities in nonmetro areas are difficult to explain and should be cautiously interpreted. New businesses, regardless of what they produce, apparently find it easier to survive and absorb losses in nonmetro areas than in metro areas during hard times. Rural land and labor costs are typically lower, with little pressure from other buyers or local unions.

On the other hand, lower survival rates in metro than nonmetro areas do not necessarily reflect a worse economic environment for new businesses. Entry and exit of new establishments are important to the growth process. Rapid growth usually occurs when there is a high turnover of businesses: survival rates are low and birth rates of new firms are high.

New Independent Businesses Grow Faster Than Affiliates in Rural Areas

Employment in independent establishments starting operations between 1978 and 1980 in nonmetro areas grew much faster than corporate affiliate employment over the 1980-86 period: 19.5 percent versus 2.6 percent (fig. 3). This pattern of growth was consistent among major industry groups. For example, in high-tech manufacturing industries, independent

Cautionary Remarks About the Data and Time Period

Policymakers must be careful not to interpret a cyclical pattern of independent-firm growth as an unconditional, unchanging fact of life. The contribution of small independent firms to job growth may change over a longer period. It may even decline. Part of the growth attributable to independent firms in 1980-86 was probably cyclical and part of it, as indicated by the resurgence of large firms in the late 1980's, may have had its roots in secular changes that were either just starting or peaking in the early 1980's. The large contribution of small independent firms to job growth in nonmetro areas during the 1980-86 period may have been largely "by default." The two recessions early in this period took a heavy toll on employment in large firms in manufacturing and natural resource-based industries. Jobs created by small firms helped to offset the job losses in these industries, but there is no guarantee that small firms will continue to create jobs at the same pace.

Independent businesses, as data in this article show, came through the 1981 recession quite well. Anecdotal evidence, however, suggests that small independent businesses in both metro and nonmetro areas have fared less well during the recent recession. First, deregulation of the financial sector helped finance independent business starts during the Reagan years (1980-88). However, the current savings and loan/banking crisis may have depleted traditional sources of financing for independent businesses. Second, many of the consumer markets, particularly in retailing and personal services, where many independent businesses found market niches during the 1980's, have declined as discretionary personal income declined. Third, the downsizing or "vertical disintegration" of large firms may have peaked in the early 1980's. The relative affiliate survival rates declined during the early 1980's as many corporate affiliates closed or moved offshore and were replaced by smaller, independent outside contractors. Survival rates are up for affiliates relative to independent firms in the late 1980's.

establishments expanded employment by 15.4 percent. Employment in new high-tech affiliates declined by 27.1 percent (fig. 4).

Many high-tech corporations were reorganizing and downscaling their operations and introducing new labor-saving technologies during the early 1980's, a period of slumping demand and intense foreign competition. As product demand falls and inventories accumulate, parent companies often curtail production at marginal branch operations in rural areas before doing so in headquarters plants, which are usually in metro areas. The incentive to cut back the more labor-intensive operations in nonmetro areas first may have reduced the rate of growth in new as well as old branches. Jobs in nonmetro branches of large companies are particularly at risk. New affiliate employment in firms with 1,000 or more employees declined by 3 percent (fig. 5). By comparison, affiliates of large companies expanded employment by 9 percent in metro areas and employment in new affiliates of smaller companies in nonmetro areas rose 16 percent.

Industry classifications:

High-technology manufacturing--chemicals, ordnance, machinery, motor vehicles, aircraft, guided missiles, and instruments.

Resource-intensive industry and labor-intensive manufacturing--agriculture, mining, food processing, textiles, apparel, wood products, paper products, petroleum, leather products, etc.

Miscellaneous goods-producing--construction and all other manufacturing.

Advanced producer and distributive services--air transportation, communication, wholesale trade, business services, nonresidential finance and insurance, colleges, vocational schools.

Residential (consumer/social/health) services--local passenger transportation, public utilities, local banks, insurance agencies and S&L's, restaurants, grocery stores, local personal services, health services, elementary and secondary schools, etc.

Other services-producing--all other services.

Independent Firms Expanded at a Faster Pace in Metro Areas

Independent startups expanded employment more rapidly in metro than nonmetro areas, particularly in industries dominated by innovative, fast-growth, and high-paying firms. High-tech independent establishments in metro areas, nurtured by large urban markets and supporting services, expanded employment by 74 percent, which was about 5 times the expansion rate for high-tech independent establishments in nonmetro areas (fig. 4). Independent establishments in advanced producer and distributive services industries grew about 58 percent, almost twice the nonmetro rate.

New independent establishments in residential services industries (retail stores, local banks, restaurants, motels, and so on) expanded their employment by the end of 6 years by 12.3 percent in nonmetro areas, about half the metro rate. Several factors contributed to this slower rate of nonmetro expansion. The small size and low density of the nonmetro residential population and the slow growth of rural markets meant that new independent consumer service firms tended to reach their optimum size shortly after starting up.

The growth of independent residentiary services in nonmetro areas may have been restrained by the small size of rural markets and by the decline of jobs in agriculture, mining, forestry, and manufacturing in the 1980's. Independent residentiary services in nonmetro areas typically depend on basic industries for survival and growth.

Summary and Policy Considerations

The stability of independent businesses as well as the number of jobs

Table 1–Jobs lost and net job growth by independents and affiliates in manufacturing, 1980-86

Area and type of establishment	1980 jobs	Jobs lost due to: Closings		Contractions		Net job growth		1986 jobs
		Jobs	Rate	Jobs	Rate	Jobs	Rate	
	------- 1,000 -------		Percent	1,000	Percent	1,000	Percent	1,000
United States	20,041	6,149	30.7	2,803	14.0	-607	-3.0	19,434
Independent firms	7,304	1,726	23.6	1,174	16.1	103	1.4	7,407
Affiliates	12,738	4,423	34	1,630	12.8	-710	-5.6	12,028
Nonmetro counties	5,059	1,626	32.1	648	12.8	-352	-7.0	4,707
Independent firms	1,412	372	26.3	198	14.0	58	4.1	1,470
Affiliates	3,647	1,254	34.4	450	12.3	-410	-11.2	3,237

Source: U.S. Establishment and Enterprise Microdata, U.S. Small Business Administration.

Growth by independent firms helped offset overall decline in manufacturing. In addition, nonmetro independents registered more than half of national growth by independent manufacturing firms.

they have created are issues for rural development policy. The performance of corporate affiliates is also relevant. The data reviewed here on new firm survival and growth during 1980-86, a period of a fairly deep recession (1980-81), recovery, and expansion lead to two major conclusions.

• ***In rural areas, independent establishments survived better and grew faster than corporate affiliates.*** The conventional wisdom is that small independent businesses have lower survival rates than large businesses. This means that independent firms offer less job security. Longitudinal analysis of business survival during the early 1980's, however, shows that small independent establishments survived better than corporate affiliates in nonmetro areas. Even more surprising, independent establishments survived better in nonmetro than in metro areas.

About the Data

These preliminary results are from a longitudinal study of approximately 924,000 new independent establishments and affiliates that started between 1978 and 1980. Data for the analysis were derived from the U.S. Establishment and Enterprise Microdata (USEEM) files of the U.S. Small Business Administration. The USEEM files cover approximately 93 percent of full-time business activity in the United States, generally establishments with at least one paid employee or with a Dun and Bradstreet credit rating. The USEEM data base is useful for examining how establishments behave after they are formed. USEEM data also identify whether the new establishments that survive in nonmetro areas are "homegrown" or headquartered in other areas. Finally, with the USEEM files, we can better focus on the sources of job growth and stability by classifying new firm survivors by size, ownership status, and industry group (SIC).

Readers who have further interest in the USEEM data should contact:

Director, Data Base Branch
Office of Advocacy
U.S. Small Business Administration, 5th Floor
409 3rd Street SW
Washington, DC 20416

It is not clear why the rate of survival was higher for independent establishments than corporate affiliates in nonmetro areas during a period of recession and recovery. One possible explanation is that survival rates of corporate affiliates, particularly in manufacturing and natural resource-based industries, were unusually low in the early 1980's. Many companies were reorganizing during this period, closing affiliates, either consolidating production or shifting it offshore to lower-cost locations. It is also possible that locally owned, independent businesses weathered recessions in the early 1980's better in rural than in urban areas. Many small local businesses may have been able to stay in business in rural areas because of lower operating costs (building leases, wages, and so on) and less local competition.

• ***Surviving independent businesses in nonmetro areas expanded employment by about 19 percent, half the metro rate.*** The small size and slow growth of rural markets might constrain the growth of independent establishments, particularly in residential services industries. Independent residential services activities such as retail stores and restaurants tend to start small and do not expand much given the small number of local residents. But employment growth was also slower for nonmetro independent establishments in the high-growth, innovative ("glamour") industries of the 1980's: high-tech manufacturing and advanced producer and distributive services. A well-established literature tells us that independent establishments, especially the more innovative ones, would be expected to "incubate" better and grow faster in metro than in nonmetro areas because of good access to markets, suppliers, services, and professional and technical workers.

The success of an indigenous business development strategy depends on whether rural areas can encourage and nurture independent businesses that will survive and grow. The data presented reveal a mixed picture but suggest that an indigenous development strategy may be moderately successful. Survival rates were much higher than expected, but growth rates were lower in nonmetro than metro areas, especially for exportable high-tech manufacturing and producer service activities. Thus, while some rural development practitioners may be too pessimistic about the survival of independent establishments in nonmetro areas, those who advocate indigenous development may overstate their growth potential. RDP

For Additional Reading...

W.A. Brock and S.D. Evans, "Small Business Economics," *Small Business Economics*, Vol. 1, No. 1, 1989, pp. 7-20.

C.J. Brown, J. Hamilton, and J. Medoff, *Employers Large and Small*, Cambridge, MA, Harvard Univ. Press, 1990.

R.A. Erickson and T.R. Leinbach, "Characteristics of Branch Plants Attracted to Nonmetropolitan Areas," *Nonmetropolitan Industrialization*, R.E. Lonsdale and H.L. Seyler, eds., New York, John Wiley & Sons, 1979.

J.P. Miller, *Recent Contributions of Small Businesses and Corporations to Rural Job Creation*, U.S. Dept. Agr., Econ. Res. Serv., Staff report no. AGES8612, Feb. 1987.

B.D. Phillips and B.A. Kirchoff, "Analysis of New Firm Survival and Growth," unpublished paper presented at the Babson Entrepreneurship Research Conference, Calgary, Canada, May 1988.

M.J. Piore and C.F. Sabel, *The Second Industrial Divide...Possibilities for Prosperity*, New York, Basic Books, 1990.

S. Solomon, *Small Business USA*, New York, Crown Publishers, 1986.

H.D. Watts, *The Branch Economy: A Study of External Control*, London, Longman Group Ltd., 1981.