

New Strategies for Rural Economic Development

INTRODUCTION

In these days of tight budgets and reduced federal assistance to rural areas, it is important to identify economic development strategies that can be effective in smaller cities and rural areas without large infusions of federal dollars. Our review of the literature on economic development in smaller cities and rural areas found a conspicuous absence of information on such strategies. Consequently, we set out to identify model rural development strategies which could be initiated and supported locally or by state governments.

In each of seven states, we interviewed staff of local development organizations and state officials to get a description of their economic development efforts. We uncovered a wide range of activities including small business assistance, innovative developmental finance institutions, industrial parks built by local development corporations, and state programs that provide technical assistance to local development organizations.

Local economic development is a process whereby local businesses, community-based organizations and state and local governments influence economic activity for the benefit of all local residents. To guide our assessment of these actors' efforts to shape local economic development, we used the following definition:

Local economic development is a process that increases income, employment and self-employment opportunities, and net tax revenues; improves the long-term stability of the local economy; improves, or at least maintains, the local quality of life and work; and otherwise enhances the well-being of the local population.

Within smaller cities and rural areas, the study identified many projects that fit this definition of local economic development. These projects represent locally controlled, community-based economic development efforts. They build on resources that already exist in the local economy: natural resources, existing businesses, and, most importantly, the talents, skills, and energies of the local population. They are small-scale projects initiated to strengthen the local business sector, and guided by people living in the area, often with help from state or federal government or other out-

side sources. In most cases, project leadership is furnished by a local development organization (LDO): a private agency with close ties to both the private and public sectors.

Joint public-private initiative was found to be essential in local economic development efforts. Many projects are not sufficiently profitable to attract strictly private investment, yet they require an approach that is more flexible and entrepreneurial than the sort public agencies usually follow.

JOINT PUBLIC-PRIVATE INITIATIVE WAS FOUND TO BE ESSENTIAL IN LOCAL ECONOMIC DEVELOPMENT EFFORTS.

The three specific local economic development strategies presented in this article are industrial expansion, small business development, and new enterprise development. Under the first strategy a local development organization helps local manufacturing firms expand by providing assistance with infrastructure development, financing and skills-training. The second strategy involves helping existing retail, service, and small manufacturing enterprises stabilize or expand and helping new businesses start. Under this strategy, LDOs provide business counseling and assist in obtaining financing. With the third strategy, the local development organization identifies feasible business ventures and people to initiate them.

STRATEGY I: INDUSTRIAL EXPANSION

In smaller cities and rural areas that have manufacturing bases, opportunities often exist for assisting individual companies to expand. The companies under discussion here are distinguished from small retail, service, and light manufacturing firms (discussed below under "Small Business Development") in two major ways. First, they have greater needs for physical capital: land, infrastructure (roads, water lines, rail spurs, etc.), buildings, and equip-

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ment. Second, they are likely to be more stable enterprises, with greater financial solvency and more solid management. These stable enterprises often have trouble financing growth. Consequently, programs for expanding industries generally offer two types of assistance: infrastructure contributions, and financing for plants and equipment purchases. A third type of assistance, presently underutilized, is skills-training for a company that is increasing its work force.

Helping local industries expand can be quite worthwhile in areas that have a manufacturing base and a relatively healthy economy. The approach builds on existing investment in the community; it is low-risk, since it targets existing companies of some proven permanence; it can result in the creation of relatively large numbers of jobs; and it bolsters local companies that already have some commitment to the area. Expansions can have significant multiplier effects in the local economy when the expanding firm has links with local suppliers and distributors.

Infrastructure Development

There is a role for the public sector in providing infrastructure for industry, particularly in smaller cities and rural areas where basic facilities like water and sewer services may be lacking. Industrial parks are particularly appropriate in rural areas because they are economical, and because they concentrate industrial activity in a small area and thus save land for agriculture, forestry, and other nonindustrial uses.

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Developing industrial infrastructure makes most sense when it is part of a larger economic development strategy or when it is designed to meet the needs of locally owned plants that have already made a commitment to expand in the area. Hundreds of smaller cities that constructed industrial parks in the past, usually with federal aid, learned that lesson; many went looking for tenants and found none. Today they own idle but costly infrastructure.

Financing

It is well known that many businesses have trouble obtaining long-term loans for the purchase of land, buildings and equipment. The public sector has tried to provide long-term financing for growth through, for example, industrial revenue bonds, state industrial development authorities, local development corpo-

rations, etc. Another public sector vehicle for responding to capital needs of expanding businesses is the revolving loan fund (discussed below under "Small Business Development").

Training

Skills-training is most often used as a means of meeting the work force needs of expanding businesses. In some cases, the absence of an appropriately trained work force has caused plants to seek new locations for expansion. A publicly funded training program may allow a company to expand locally.

A second role for subsidized training is helping to ensure that a number of economically disadvantaged people are hired when local industries expand.

Public support for expanding industries can be an effective approach to local economic development when there is a healthy local economy, a solid base of locally owned industries, and local support for industrial development. When these conditions obtain, public assistance with infrastructure development and financing can make the expansion of local industries more affordable. The training component provides a ready work force and helps ensure that economically disadvantaged people benefit from publicly supported expansion efforts.

STRATEGY II: SMALL BUSINESS DEVELOPMENT

In most smaller cities and rural areas, small businesses (fifty or fewer workers) are the mainstay of the local economy. These businesses are usually in the retail, service, or light manufacturing sectors, and most are owner-operated. Many have low capital investments and low rates of profit. Many of the owners have little or no business training. In management capability, the businesses can range from tiny "microbusinesses" with only a few employees, in which the owner may lack even basic skills in bookkeeping, financial planning, and marketing, to larger businesses whose owner-managers are beset by more complex management burdens, such as personnel and tax problems, and the concomitant need for more sophisticated planning and marketing skills. All of these small businesses rely heavily on commercial bank financing, but for several reasons, they have considerable difficulty in borrowing capital at affordable rates: they lack sufficient collateral, they cannot present a convincing business prospectus, and they are perceived in general as high-risk ventures.

An effective small business development strategy must address the basic needs of small businesses for financial, managerial and technical assistance. It aims to help new businesses start up and to help existing small businesses

expand into more profitable and viable ventures. As these needs are met, new jobs are created, incomes of owners and workers increase, and an important component of the local employment equation becomes more stable.

Business Counseling

Business counseling is the least expensive and possibly the most cost-effective approach to small business development, particularly in areas where many small business owners are untrained in financial analysis, marketing, and business planning. Efforts to assist them need not always be sophisticated or complex to be of real help. A program staffed by a generalist who has access to consultants for specialized problems can be quite effective in helping businesses improve their profitability, assess their potential for expansion, and even obtain bank financing. It seems more important to hire a person who can communicate well with local business owners than one who has formal business training.

The essence of counseling and technical assistance programs lies in helping the business owner to identify and solve his or her specific problems. The programs often utilize tools such as the Business Planning Guide, developed for the Business Information Center program in New England, which leads the business owner through a series of questions about goals (short-term and long-term), the current state of business, known risks and other basic issues.

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Financial Assistance

Although business counseling programs can help small businesses obtain bank financing, there is often a need to supplement commercially available assistance. Supplemental financial assistance for small businesses can take several forms, the most prevalent of which are direct loans, loan guarantees, and equity investments.

All the forms discussed here are variations of the direct loan, which is the most common type of financial assistance offered by local organizations to small businesses. In the past, money to set up revolving funds for making direct loans has come from the Economic Development Administration (EDA), Community Services Administration (CSA), Department of Housing and Urban Development (HUD) block grants, federally supported regional development commissions, and state appropriations. The revolving funds serve several interrelated functions: they can make capital available to businesses that could not otherwise get a loan; they can increase the amount of money a business can borrow by leveraging bank financing; and they can lower the cost of capital by offering below-market interest rates.

Vermont's Job Start Program, for instance, a \$500,000 fund which was capitalized by state appropriations, lends money at 8% interest to very small businesses that cannot qualify for private financing, and helps them get off the ground by offering low interest loans. The

Mountain Association for Community Economic Development (MACED) in eastern Kentucky draws on a \$500,000 revolving loan fund capitalized by EDA and has access to additional funds from the Appalachian Regional Commission, made available through the state development finance authority. For every \$1,000 it has loaned to local businesses, MACED has leveraged \$5,000 in private financing.

The most effective kind of small business development program is one which combines business counseling with financing services. In the coming years, however, the establishment of revolving loan funds will be a more difficult matter for local development organizations. Of the traditional sources of financing for revolving loan funds (EDA, CSA, the regional commissions, and HUD block grants), only the HUD grants remain viable. Local organizations should still be able to argue effectively for state capitalization of revolving loan funds, particularly in depressed rural areas. State governments, it is hoped, will recognize revolving loan funds as a good investment, since they allow a one-time commitment of funds to be recycled through the local economy for years to come.

AN ECONOMIC DEVELOPMENT STRATEGY THAT
BUILDS ON LOCAL RESOURCES AND TALENTS
CAN BE QUITE EFFECTIVE IN DEPRESSED AREAS.

The success of business counseling and revolving loan programs indicates that, in many smaller cities and rural areas, a supportive climate can draw out viable business proposals and help business firms start up or expand. In other localities, though, that result may not follow, or the effort may not be adequate to reverse a pervasive atmosphere of decline and pessimism. In those cases, it makes sense for local organizations to go beyond counseling, technical assistance and financing, and to take more active roles as initiators of new enterprises.

STRATEGY III: NEW ENTERPRISE DEVELOPMENT

The less economic activity there is in an area, the smaller the foundation to build on through industrial expansion and small business development, but the greater the role for a proactive organization interested in initiating new enterprises. The new enterprise development approach requires a local organization to research local opportunities for new businesses and to actively seek people to start such businesses, or even start the ventures itself. The approach requires a stronger local organization than does a technical assistance or loan program, but it can also have a greater impact

on the local economy. At its best, this strategy can lead to the creation of a network of local businesses that build on local resources and provide mutual support.

Research and Development/Venture Identification

In seeking opportunities for new enterprise development, the LDO should begin by conducting an inventory of the local economy. The first thing to look for is underutilized resources: natural resources, human resources, or infrastructure that could provide the bases for new businesses.

Natural resource-based development is of particular interest because so many rural areas have renewable resources that have never been tapped to their full potential. Natural resource-based development not only creates new jobs by spawning new ventures; it also enables people who are already making a marginal living through farming, fishing, logging, and similar occupations to raise their incomes and gain a more stable livelihood. Development based on natural resources may utilize waste products, turning them into marketable goods. It may build on skills already present in the local population, and often generates labor-intensive activities. Finally, the creation of one natural resource-based business often stimulates other businesses, thus creating linkages felt throughout the local economy.

The inventory of the local economy should consider the input requirements of local businesses, especially manufacturers. Local businesses may be importing items that could be produced locally. It may also be appropriate to investigate new product ideas for local manufacturers.

Start-up

After a product or service has been identified, developed and test-marketed, the LDO either finds an individual to operate the business or founds the enterprise itself. To initiate the venture, the LDO must arrange and structure properly both debt and equity financing.

While the strategies presented here have relevance to all smaller cities and rural areas, they may be absolutely essential for revitalizing economically depressed areas and places unattractive as locations for new branch plants recruited to the state. As the case studies of eastern Kentucky, northern California, south-eastern Oklahoma, and other states show, an economic development strategy that builds on local resources and talents can be quite effective in depressed areas. The full study offers more guidance on how various strategies can be pursued.

LOCAL DEVELOPMENT ORGANIZATIONS

As noted, these three strategies require a local development organization to initiate and implement them. Since economic development is a long, protracted process, it requires strong committed leadership to sustain the effort. This leadership can be exercised more effectively if it operates through and is supported by a local organization.

Many of the economic development opportunities in smaller cities and rural areas are not profitable enough to sustain a strictly for-profit organization. Thus, a local development organization (LDO) might take the form of a community development corporation, a local development corporation, or a private nonprofit association, federation, cooperative, or multi-purpose corporation.

Successful LDOs of whatever form, share certain characteristics. The characteristics most important to success are: flexibility, strong and creative leadership, solid local support, adequate funding, and competent, dedicated staff.

Flexibility

Flexibility includes a willingness to experiment, an ability to learn from mistakes, to respond to changing circumstances, and to seize opportunities when they arise. The Mendocino Fisheries Improvement Program exemplifies these traits. It has evolved over a short time from a one-shot, CETA-funded forestry demonstration project into a permanent stream clearance and wood salvage operation financed jointly by large timber companies and the State of California. The program's leaders have continually reassessed project activities and explored new ideas in seeking the right mix of marketable activities that would provide a stable base of program support. After an unsuccessful venture with marketing wood-waste products, the program has moved gradually into stream reclamation, redwood salvage, advising timber companies on land use policy, salmon population counts, and other activities.

Some development organizations carry flexibility too far. They take on a wide range of disparate activities based on the availability of funding. An organization with limited staff may spread itself too thin and lose its primary focus on economic development.

Leadership

Effective leaders of LDOs have a vision of how the local economy can be developed. The leadership's commitment must be sustained over a long time period and it must realize that rewards will be slow in coming.

A classic example of strong leadership resulting in a strong organization is demonstrated by the Economic Development Corporation of Shasta County. The EDC's current director had from the first a clear notion of how to achieve development in the local economy. He believed that the process had to start with a period of intensive community education, that new investment could only be attracted by a well-prepared community, and that fostering expansion of locally based companies was the area's best strategy. He also believed that the organization had to cultivate a good relationship with bankers and business leaders and stay aloof from politics. Pursuing this philosophy steadfastly and patiently over several years, he has enabled the EDC to develop an extremely successful industrial park, become an aggressive packager of SBA and EDA loans, and act as a respected intermediary between industrial and environmental interests.

Local Support

Since an LDO functions best as catalyst and facilitator, rather than as independent actor, it needs a broad base of local support to be successful.

One of the first audiences with whom a development organization must win credibility is the local business community, and particularly the bankers and investors. If the organization is to gain support in that quarter, it must make clear that it intends to help local businesses and banks, not compete with them. It must convince the local financial/business establishment that the operation of a revolving loan fund, for example, will not take business away from local banks, but will instead open up new deals for bank participation and help develop new businesses. Political support should follow acceptance by the local business community.



Natural resource-based development enables people who are already making a marginal living through farming, fishing and similar occupations to raise their incomes.

Closely related to the issue of local support is the question of the amount of territory a development organization should attempt to serve. From the standpoint of maintaining a strong local presence and achieving a visible impact, a smaller geographic area is better. From the standpoint of serving populations large enough to secure political strength and a solid funding base, a larger territory is more sensible.

Funding

Fund raising is a constant struggle for LDOs. Most of them have relied on state and federal grants to help cover administrative and staff costs and to help in financing their projects. Federally funded CETA and HUD programs have provided the start-up money for many LDOs, enabling them to operate their first projects and plan succeeding ones. With cut-backs in and elimination of several of the primary federal funding sources, LDOs will have to find new sources of support. Some organizations have obtained funds from foundations, churches, local governments and other local sources. Others subsist partly with the aid of small annual membership dues or contributions from local corporations.

Regardless of the overall funding picture, local fund raising is a good strategy, since it allows the organization to build local support while it is raising money. The EDC of Shasta County spent three years educating local business and community leaders about the potential for a local development corporation; it raised \$250,000 from local businesspeople and bankers as seed money for an industrial park in the process.

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An innovative funding approach is utilized by the Maine Development Foundation, a statewide private nonprofit development organization with close ties to both state government and private industry. The Foundation solicits annual contributions from corporations, towns, and other public and private entities, who in return for their contribution become voting members of the Foundation. Money from the solicitation is matched equally by a state appropriation.

Staff

Although LDOs are often formed largely of and by volunteers, the organizations need paid staff in order to operate successfully. As discussed earlier, many successful development organizations believe that it is most important to hire staff who know the local area and who

can communicate with local people. Technical skills such as business counseling or loan packaging can be learned on the job (especially if there are experienced local people willing to advise the staff); basic interpersonal skills are harder to acquire.

The ideal LDO serves as an initiator, catalyst, and facilitator of development projects and as a source of technical and financial assistance to local businesses. In so serving, the organization may take on a number of functions: business counseling, research and venture initiation, facilitation/intermediation, loan packaging/financing, and industrial development. The particular range of activities that an organization undertakes should depend on local circumstances: the services lacking in the area, the capacity of the local economy to use new services, and the ability and resources of the organization itself. Few organizations, of course, spring up full-blown, performing the complete array of development functions. They evolve over a period of years, adding some functions and dropping others on the basis of what works most effectively.

THE STATE ROLE

The traditional state role in promoting economic development focuses on recruiting new industry and helping to finance industrial development, while additional influences are implicit in its taxing, spending and regulatory policies. In recent years, this traditional approach has come under criticism for several reasons.

In many cases, state government provides financing at below market rates, waives or defers taxes, trains workers at public expense, widens roads, extends water lines and improves waste treatment facilities, all for a company that might have located in the same area without those incentives. Furthermore, since state efforts are targeted to major corporations, they assist companies that may need help the least and bypass the smaller, locally owned firms most in need of assistance. Finally, recruitment and industrial development have not been successful in certain types of places, particularly smaller cities and rural areas that are far from urban centers and remote from transportation networks. Many local development groups in such areas have carried out expensive promotional campaigns and developed even more expensive industrial sites only to end up as the owners of unused infrastructure and vacant industrial parks.

This study sought out models for a different kind of state role: state support for locally initiated, locally controlled economic development efforts. There are four categories of supportive state activities: formulation of

a development strategy; provision of capacity-building services, technical assistance, and funding for local development organizations; financing for local business development; and coordination. Every state revealed a dominant motif in supporting local economic development.

As the states come to play a larger role in economic development, it is important for them to develop conscious, explicit strategies to guide their actions. A state government does not need to develop a formal, comprehensive economic development or small city and rural area policy; it does, however, need to reach internal agreement on a basic approach to local economic development.

In settling on its basic approach, the state (or key state agencies) must consider three issues: the types of economic development activities it will support, the types of entities that can best carry out those activities, and the basis for allocating assistance for those activities throughout the state. The dominant approach in most states--industrial development--can be characterized as follows: the primary economic development activities supported by the state are plant expansion and plant recruitment; the major actors are private corporations, assisted by local and state industrial development agencies; and the distribution of state assistance reflects corporate decisions on plant siting.

California offers a different model, one more in line with the perspective of this study. There, two state agencies have in recent years pursued an approach to economic development that is based on building up the capability of local development organizations and nurturing small businesses. The Employment Development Department has a well thought out rural economic development strategy based on the recognition that economic development is a protracted process requiring local commitment and support. Over the years, it has supported fledgling organizations and tolerated the short-term mistakes of those organizations as part of the learning process. Many of the economic development projects discussed in the California case study owe their existence to start-up funding from this agency. Similarly, the Office of Local Development has helped build up LDOs by contracting with some of them for the provision of technical assistance to other local development groups.

If it were to adopt the approach advocated in this study, a state would concentrate on helping LDOs promote industrial expansion, small business development, and new enterprise development. It would target its assistance to areas in which there were organizations ready to take local initiative, giving priority to economically depressed parts of the state, and it would be prepared to respond quickly to local

economic crises. A state would carry out this approach to local economic development through two sets of activities: capacity-building/technical assistance, and financial support.

Capacity-building services and technical assistance from the state are especially crucial to smaller cities and rural areas where local sources of assistance are often inadequate. As much as possible, the state should help build skills within local organizations and increase their self-reliance; in some cases, though, it is also necessary for the state to provide specific technical assistance through consultants, state personnel, university staff, or other resources. The state's role in this area can range from the modest one of educating local organizations about project ideas to the ambitious one of helping to create local organizations where none exists. In the latter case, the key steps are to identify local leadership and to support that leadership in its efforts to build an organization. Massachusetts' Community Economic Development Assistance Corporation illustrates how a state can provide a nearly complete package of technical assistance and capacity-building services to local organizations.

The question of state financing for local economic development projects is a complex one and a subject about which much has been written in recent years. From the evidence of the financing programs examined in this study, two points can be made. First, federally supported revolving loan funds in rural areas have been effective in leveraging bank loans for businesses that otherwise could not have started up or expanded. Since federal funds are no longer available to capitalize new revolving loan funds, states ought to consider establishing



Small businesses rely heavily on commercial bank financing.

revolving loan funds in smaller cities and rural areas. Second, state financing works best when it is accompanied by a strong local presence in the form of a local staff which can help develop business opportunities, counsel local businesses on their expansion plans, and ensure that local workers benefit from business development. This suggests that states would be wise to use substate development organizations as intermediaries for state financing programs targeted to smaller cities and rural areas.

Central to all these state activities--setting policy, determining strategies, and providing financing and technical support for LDOs--is the issue of coordination. To achieve success in economic development efforts, the state must coordinate its actions with local organizations and with federal programs; state agencies must cooperate with each other; and, most important, the public and private sectors must work together. Coordination in this sense means the linking and meshing of an overall state strategy with capacity-building and financing activities to form an effective total package of state support for local economic development.

CONCLUSION

In the face of diminishing federal resources for economic development, it is impor-

tant for states and localities to realize that there are effective local economic development strategies that they can initiate and sustain. These strategies, outlined here and discussed more fully in the study, involve relatively small scale projects which are locally controlled and which build on local attributes--the natural resource base, existing business entities, and the talents of the local population. These projects can be successful particularly where they are initiated by a joint public-private local development organization and supported with coordinated financial and technical assistance from the state.

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