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## Commercial Bank Financing for Industrial Development

L. W. Tauer

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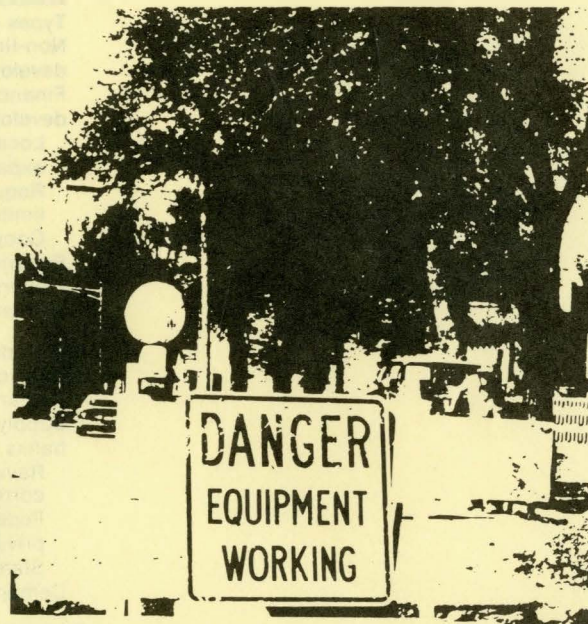
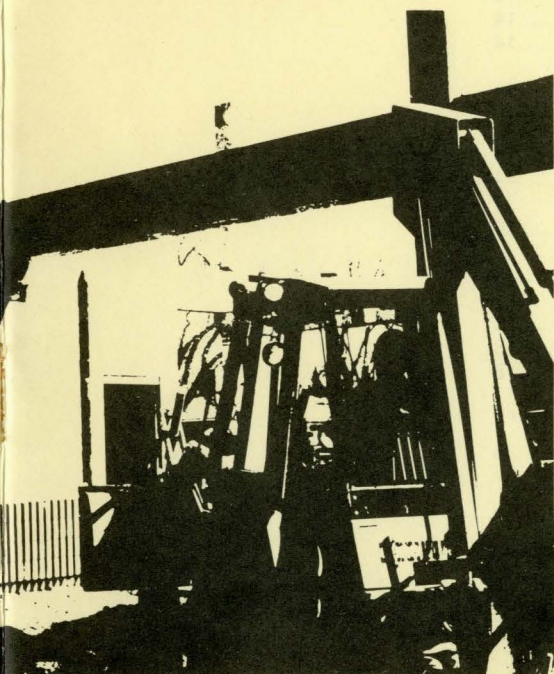
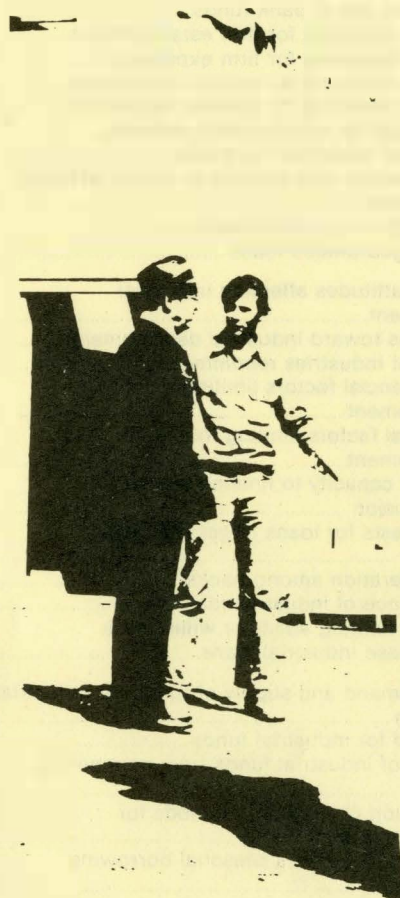
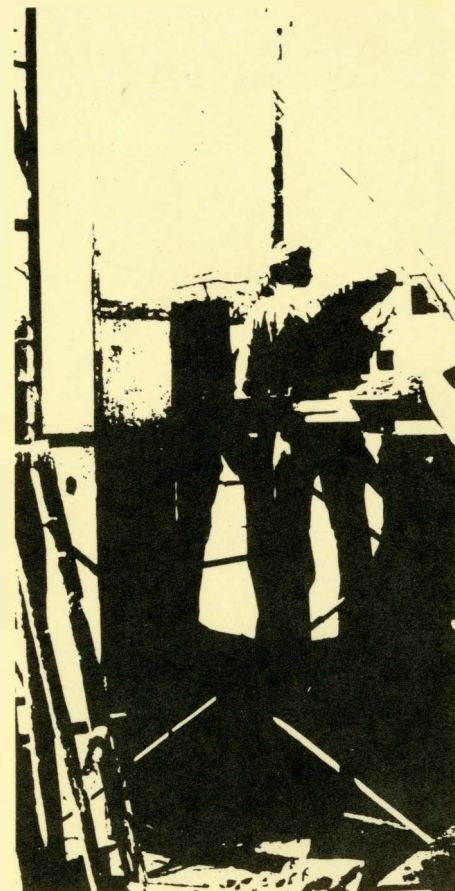
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# Commercial bank financing for industrial development



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# Commercial bank financing for industrial development

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Loren W. Tauer and Thomas E. Daves

South Dakota has been—and remains—a one-industry state. But where hands once performed farming and ranching chores, machines now complete those tasks in a much shorter time. To a large extent, capital investment has replaced labor in South Dakota agriculture.

Seeking employment, many of our most able young people have left the state. Those that remain earn less than their counterparts in other states (15)<sup>1</sup>.

For South Dakota with its sparse population and limited market, perhaps the only way that a reversal of these trends can be accomplished is by expansion of the manufacturing-processing industry. Of all the major export industries (which also include agriculture), this sector of our economy has the greatest potential for diversification and stabilization of the state's economy.

However, most manufacturing or processing plants require relatively large amounts of capital investment per unit of employment or income generated. Many people have felt that such money simply isn't available, that lack of investment funds has hindered, and will continue to hinder, growth in manufacturing and processing firms in South Dakota. They further believe that the local banks are unable to supply these loans. This bulletin investigates these beliefs.

Because firms in South Dakota are relatively small, they are more dependent upon local financing than are most other industrial firms in the United States. Of the 768 manufacturers and processors listed in South Dakota in 1974, only 64 employed more than 100 persons, while 629 employed fewer than 25 (6, p 3).

Within the local community, the most important source of financing is the town's commercial bank. In some areas, 50% or more of the rural non-farm sector is dependent upon local bank financing (11, p 10). Some researchers believe that agriculture is adequately financed by a variety of sources including commercial banks, the Federal Farm Credit system, insurance companies, and private individuals. The efficiency or inefficiency of the commercial bank system may therefore have a greater effect outside of the agricultural sector (11, p 22; 8).

If a bank fails to broaden its loan portfolio to include local industries, the long-range effects may be severe for both the bankers and the public. A declining community can result in declining bank deposits and income. Rational bank policies should be compatible with improvements in the level and stability of state income.

Relative to other states, South Dakota has low levels of annual capital expenditures per capita in manufacturing.<sup>2</sup> All capital expenditure within a state is not financed by banks, especially by local banks; however, the ratio of capital expenditures in manufacturing to total bank deposits is significant.

In 1971, which was a year of low capital expenditures, capital expenditures per person and capital

expenditure to bank deposit ratios for the following states and the nation were: South Dakota, \$20 per person and 0.008; Nebraska, \$58 per person and 0.021; Minnesota, \$71 per person and 0.026; North Dakota, \$16 per person and 0.002; and for all states, \$147 per person and 0.220.

Manufacturing employment in South Dakota in 1970 was 7.4% of the civilian labor force: 17,767 persons (17, p 417). The national average was 25.9%. Only five states had a lower percentage of their civilian labor force employed by the manufacturing sector than South Dakota.<sup>3</sup>

Many factors such as remote location, a small and inexperienced industrial labor force, lack of markets, lack of raw materials, and unavailability of funds may be responsible for the low level of industrialization. If insufficient funds is a limiting factor, it is within the ability of the public and private policymakers to increase the availability of funds.

## Objectives

Has industrial development in South Dakota been hampered by financial constraints? Will the capital sufficient for future industrial financing needs be available? Focusing on commercial banks and their role in financing industrial development, the study which this bulletin reports specifically sought:

1. to describe the structure, past, and probable future growth of manufacturing and processing industries in South Dakota.
2. to determine to what extent industrial firms are hampered by lack of funds for construction of new facilities, for expansion of present facilities, and for operating expenses; and to determine the basis of restriction.
3. to determine the present role of commercial banks in financing industrial development.
4. to determine attitudes that bankers have toward industrial development within their community and their attitudes and policies in financing this development.
5. to explore the potential and future role of the commercial banks in financing industrial development.

## Procedure

All manufacturing and processing firms in South Dakota were surveyed by mail. The questionnaire requested information about location and expansion activities, and about financial impediments and structure. Another questionnaire, sent to all banks in the state, requested information about industrial development and loan activities, practices and attitudes.<sup>4</sup> Other data were obtained from the Industrial Development Expansion Agency of South Dakota, from published data of the Federal Deposit Insurance Corporation, and from published call statements of individual banks.

Research methods involved descriptive and categorical analyses of the questionnaire responses and other data. When applicable, chi square analysis

<sup>1</sup>For a discussion of outmigration and income differentials, see the thesis by Tauer (15). Numbers in parentheses refer to sources listed in the Literature Cited section.

<sup>2</sup>North Dakota and Wyoming were the only states that had lower per capita levels of capital expenditure in the manufacturing sector in 1970 and 1971. They have also experienced the same migration and income differential pattern that South Dakota has experienced.

<sup>3</sup>Two of these were North Dakota with 4.7 and Wyoming with 6.4%. The other three states were Mountain states.

<sup>4</sup>Copies of the questionnaire forms used, description of data collection procedures, and response rates are available at the Department of Economics, SDSU.

was used to investigate whether conditions or attitudes differed among groups of banks or firms or localities. The least squares technique was applied to published investment and capital availability data to obtain linear projections to 1980 and 1985.

## Characteristics of banks and industrial firms

### Banks

There are 158 commercial banks in South Dakota. Of these, 126 have state charters, and 32 have national charters. Besides the 32 national banks that are automatically members of the Federal Reserve System, 29 state banks are also members. All banks in the state are insured by the Federal Deposit Insurance Corporation. South Dakota allows statewide branch banking, and 45 banks operate a total of 117 branch banks.

Of the 158 banks, 98 have less than \$10 million in deposits, but this majority holds only 19% of total deposits in the state. The four largest banks collectively hold over \$970 million in deposits, or 32% of the total deposits of all banks. The number of banks by deposit size categories and the total deposits of banks in each category are shown in Table 1. The table also shows that banks became larger and total bank deposits of the state increased from 1971 to 1975.

Table 1. Number and deposits of South Dakota banks by deposit size, 1971-1975.

Year	All banks	Deposit Size (\$ millions)				Four largest banks
		0-5	5-10	10-25	over 25	
Number of Banks						
1971	159	85	38	17	15	4
1972	159	78	42	24	17	4
1973	159	60	48	32	19	4
1974	158	50	51	37	20	4
1975	158	37	62	35	24	4
Deposits (\$ millions)						
1971	1974	276	279	262	947	589
1972	2017	247	291	340	1138	684
1973	2368	206	323	458	1381	808
1974	2614	181	339	543	1551	884
1975	3002	136	424	528	1915	970

Source: FDIC Annual Reports 1971-1974 (3); 1976 Bank Directory of the Ninth Federal Reserve District (1).

The number and types of banks in South Dakota and in each of the state's planning and development districts (Figure 1) are summarized in Table 2. Location of branch banks and the home offices are shown in Table 3.

District II, which includes the city of Sioux Falls, has more banks with deposits over \$20 million than any other district. The district is also the location of the home office for 59 of the 117 branch banks. Many banks in other planning and development districts have branches within their own planning district, but only banks in the Second District have branches in all other districts. District VI, which includes Rapid City, a major banking center for western South Dakota and adjacent out-of-state areas, has fewer

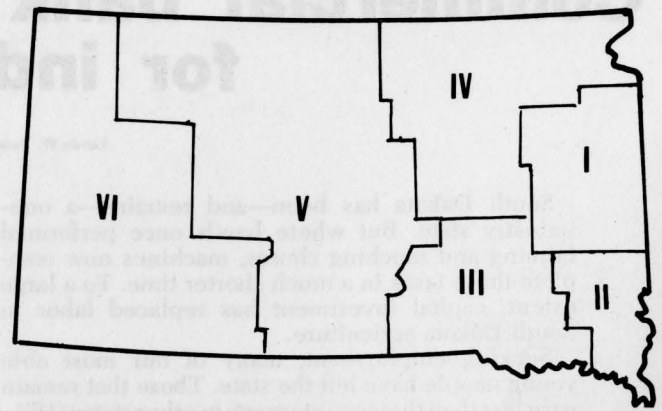


Figure 1. Planning and development districts of South Dakota

Table 2. Location and characteristics of South Dakota banks, 1975.

Planning district	Total number	Charter		Federal Reserve members	Deposit size (\$ millions)			
		National	State		0-5	5-10	10-20	Over 20
I	31	7	24	11	11	12	5	3
II	25	8	17	12	4	7	7	7
III	30	3	27	9	5	10	10	5
IV	34	6	28	11	14	12	3	5
V	29	7	22	12	3	15	7	4
VI	9	1	8	6	0	6	1	2
Total	158	32	126	60	37	62	33	26

Source: 1976 Bank Directory of the Ninth Federal Reserve District (1).

Table 3. Location of bank branches and home offices in South Dakota by planning and development district, December 31, 1975.

Branches by district	Home office of branches by district						Total
	I	II	III	IV	V	VI	
I	9	4	—	1	—	—	14
II	—	27	1	—	—	—	28
III	—	11	9	—	—	—	20
IV	—	3	2	13	—	—	18
V	—	1	—	1	8	—	10
VI	—	13	—	—	—	14	27
Total	9	59	12	15	8	14	117

Source: Derived from: 1976 Bank Directory of the Ninth Federal Reserve District (1).

banks than any other district and has more branches than main banks. Only one main office bank is a national bank, but half of the state banks in the district are members of the Federal Reserve. Two of the branch banks are major offices of national bank holding companies headquartered in Sioux Falls and the Twin Cities.

The seven counties of Minnehaha, Pennington, Brown, Codington, Beadle, Brookings, and Davison, where the major cities of the state are located, are the source of approximately 43% of total deposits in the state.<sup>5</sup> The banks in these counties may actually con-

<sup>5</sup> Deposits of branches are included in the county where the branches are located, and not the county of the home offices.

trol over 50% of the state's deposits because they have branches in other counties. This is especially true for Minnehaha County, which is the source of only about 15% of the state's deposits, but whose banks control between 30 and 40% of the state's deposits.

### Manufacturing - processing firms

There are about 836 manufacturing and processing firms in South Dakota (Table 4). The majority of these (642) employ fewer than 25 persons; 129 employ 25 to 99 persons; and 65 employ 100 or more persons. Four firms, each employing more than 500 persons, collectively employ over 5,000 persons, or 30 % of the total manufacturing and processing employees in the state.

Table 4. Number of industrial plants in South Dakota by location and employment size, June 1, 1974 (Standard Industrial Classification=018 and 019, 10, 14, 20-39).

Location	Employment size (Number of Employees)				
	Total	0-24	25-99	100 or more	
Planning district	I	143	107	26	10
	II	196	137	40	19
	III	128	104	13	11
	IV	130	104	18	8
	V	70	62	8	0
	VI	167	130	23	14
Major cities	Sioux Falls	111	62	24	15
	Rapid City	75	55	9	11
	Aberdeen	33	24	5	4
	State total	836	642	129	65

Source: *South Dakota Directory of Manufacturers and Processors: 1974-75* (6) and unpublished data from the South Dakota Department of Economic and Tourism Development.

The food processing industry and printing and publishing industry historically have been the largest contributors to total manufacturing—processing employment and number of firms.

Table 5 lists the numbers and employment of all firms by industry group.

District II has the greatest number of firms that employ 100 or more persons. The Sixth District has the second greatest number of firms. The Fifth District in the central part of the state has the fewest firms.

Industrial expansion was extensive in South Dakota between 1969 and 1974 (Table 6). During that period 220 new firms began operations. Nineteen of these new firms employ 100 or more persons, and 47 employ 25 to 99 persons. Between 1969 and 1974 there were 240 recorded plant expansions.<sup>6</sup>

Although 220 new firms began operations, 65 also ceased operations during this period. Of the 65 firms that closed, 32 had begun operations since 1969. This is a mortality rate of 14 % for new firms. This

<sup>6</sup> An incident of industrial expansion may consist of either capital addition of \$10 thousand to millions and/or an employment addition of a couple persons to hundreds. Some firms have expanded more than once since 1969.

was most prevalent in District V, where many of the firms were located on Indian reservations. District IV also lost a large number of industries, but most of the firms closed in that district had begun operations before 1969.

Table 5. Employment and number of industrial firms in South Dakota by industry, 1972.

SIC code	Major industry group	Number of employees mid-March	Total reporting units
<b>Mining</b>			
10	Metal mining	2,287 (D)	34
14	Non-metallic minerals	(D)	26
<b>Manufacturing</b>		17,042	529
20	Food and kindred products	7,374	117
23	Apparel and other textile products	(D)	11
24	Lumber and wool products	702	38
27	Printing and publishing	1,832	157
28	Chemical and allied products	148	9
30	Rubber and plastic products	288	7
31	Leather and leather products	(D)	2
32	Stone, clay, and glass products	682	51
33	Primary metal products	(D)	1
34	Fabricated metal products	686	27
35	Machinery, except electrical	1,856	40
36	Electrical equipment and supplies	758	8
37	Transportation equipment	940	22
38	Instruments and related products	(D)	4
39	Miscellaneous manufacturing industries	304	18

(D) denotes figures withheld to avoid disclosure of operations of individual reporting units.

Source: U. S. Bureau of the Census, *County Business Patterns*, 1972 (18).

Table 6. South Dakota industrial expansion activities, 1969-June 1974, and number of firms operating, June 1974.

Employment size group	Planning district					
	I	II	III	IV	V	VI
<b>New firms, 1969-June 1974</b>						
0-24	31	35	15	19	17	37
25-99	15	12	4	5	5	6
100 or more	3	4	5	2	2	3
<b>Expanded firms, 1969-June 1974*</b>						
0-24	13	22	14	13	5	19
25-99	11	15	7	10	11	23
100 or more	22	22	6	11	1	15
<b>Closed firms, 1969-June 1974</b>						
0-24	6	9	6	8	8	15
25-99	2	1	1	0	3	2
100 or more	0	2	0	0	0	2
<b>Firms operating, June 1974</b>						
0-24	107	137	104	104	62	130
25-99	26	40	13	18	8	23
100 or more	10	19	11	8	0	14

\* After expansion, plant size was used in placing plants within size groups.

Sources: *South Dakota, 1969-1975* editions (13) and *South Dakota Directory of Manufacturers and Processors: 1974-75*, (6) and unpublished data provided by the Industrial Division of the South Dakota Department of Economic and Tourism Development.

Forty-five firms are located in communities that do not have a bank office. Most of these are newspaper and agricultural processing firms serving only the local community. All but five of these firms employ fewer than 25 persons, and most are located in the western half of the state, in Districts V and VI. The numbers of these firms by size category and by planning district are shown in Table 7.

Table 7. Number of firms in South Dakota communities with no banks, by location, 1974.

Planning district	Number of employees				Percent of total industries*
	Total	0-24	25-99	100 or more	
I	7	6	1	0	5%
II	5	5	0	0	2%
III	6	5	1	0	5%
IV	7	6	1	0	5%
V	5	5	0	0	7%
VI	15	13	1	1	9%
Total	45	39	4	1	5%

Source: *South Dakota Directory of Manufacturers and Processors, 1974-75*, (6).

\* Base = total number of industries in 1974.

## Factors affecting location and expansion decisions by firms

Knowledge of factors affecting firm location and expansion decisions is necessary for sound forecasting, planning, and promoting of industrial activity. In this section factors influencing firms to locate in South Dakota are identified.<sup>7</sup> Past expansion decisions and expansion plans of firms located in the state are analyzed.

### Location decision factors

Firms were asked to rank the four most important factors affecting their decision to locate in South Dakota. Ten possible factors were listed in the question and space was provided to list additional ones.

These factors can be considered as important influences on firm decisions to locate in South Dakota. However, they are not necessarily the most important factors considered by firms when choosing a location within the state.<sup>8</sup>

It should be noted that the numerical values assigned to the various factors (Table 8) are not absolute measures of importance. Rather, they are aggregations of rankings of **relative** importance assigned by the survey respondents. Thus, in column 1, the rating for "home community of owner," 126, indicates that this factor was ranked as more important by the typical firm than was "local funds were available," with a rating of 42. However, the relative ratings do not necessarily mean that the home community factor is three times as important as the local funds factor.

### Historical changes in location factors

Table 8 shows factors affecting location of firms in South Dakota during various time periods. The firms

<sup>7</sup> Although most plants in the state are home office firms with no branch operations, there are approximately 50 branch plants in the state. The term firm is used in the text for both types of operations.

<sup>8</sup> Less than a third of the respondents answered the second part of the questions—rank the four most important factors that were responsible for the location of your firm at the present site in South Dakota. For the most part, these firms that did answer the second part of the question responded with the same answer that they gave in the first part.

Table 8. Evaluation\* of factors affecting the location of industrial firms in South Dakota, by time period.

Reason for location	Rating by year of establishment			
	before 1948	1949-1963	1964-1968	1969-1974
Close to market	79	64	16	44
Close to raw materials	105	55	8	32
Good transportation	43	23	6	31
Abundant labor	46	33	10	38
Low labor cost	27	18	16	20
Low power cost	10	0	5	3
Local funds were available	42	20	17	21
Favorable tax policy	22	15	6	24
Home community of owner	126	89	34	62
Quality of life	74	36	18	30
Other	13	4	8	23

\* Each firm chose the four most important location factors, by priority order, from the factors listed. A score of 4 was assigned to a factor given first priority, a score of 3 to a factor given second priority, etc. If a factor was not one of the four factors for a firm it was assigned a score of zero for that plant. Evaluation of each factor was then obtained by summing the factor scores for all firms. The higher the score the more important the factor was considered to be as an influence affecting location.

are separated into four categories according to date of establishment: before 1948, 1949 to 1963, 1964 to 1968, and 1969 to 1974. For all four periods the location factor rated as most important was that the community was the home community of the owner. The next most important location factors for the earlier firms were closeness to raw materials and closeness to markets.

These factors continued to influence location decisions of more recently established firms, but abundant labor and low labor costs apparently became more important factors than for earlier established firms. Quality of life was also rated as an important factor for most time periods.

### Factors influencing present plant location

It is probable that the same factors affecting the establishment of firms in South Dakota in the recent past will also have an important influence on the decisions of firms considering whether to locate in South Dakota in the near future. Hence, rankings of location factors by the 38 responding firms that located in South Dakota since 1969 were identified and evaluated. For analysis, these firms were classified according to employment size, city population, location (by planning and development district), location of home office, and type of industry (Table 9).

#### Employment size

For firms that employ fewer than 25 persons, the location factor rated most important was that the city was the home community of the owner. The next most important factors were closeness to markets and good transportation facilities. For firms that employ 25 to 99 persons the factor rated most important was abundant labor. Other factors rated important were closeness to raw materials, favorable tax policies, and that the community was the home community of the owner. Firms that employ 100 or more persons indicated that closeness to markets was of prime importance followed by abundant labor and favorable tax policies.

Table 9. Evaluation\* of factors affecting location of industrial firms in South Dakota since 1969.

Reason for location	Employment size				Planning district					City size				Home office outside S.D.	Standard Industrial classification (SIC)**						
	Total	Under 25	25-99	100 or more	I	II	III	IV	V	VI	Under 1,000	1,000-2,500	2,500-10,000		Over 10,000	14, 32	20	27	31	28,30	34-39
Close to markets	44	34	3	7	7	18	6	0	7	6	7	2	5	30	20	8	11	5	3	14	4
Close to raw materials	32	22	8	12	8	4	4	2	0	14	4	12	4	12	16	8	14	0	0	10	0
Good transportation	31	25	4	2	0	14	6	5	0	6	4	6	6	15	8	2	12	0	1	12	0
Abundant labor	38	22	10	6	13	7	8	9	0	1	4	5	2	27	21	3	5	3	6	1	20
Low labor cost	20	13	4	3	5	6	0	7	0	3	8	5	3	4	11	0	3	0	2	8	7
Low power cost	3	3	0	0	2	1	0	0	0	0	2	0	0	1	1	1	0	0	0	0	2
Local funds were available	21	15	6	0	3	3	7	8	0	0	0	9	0	12	4	0	3	7	0	3	4
Favorable tax policy	24	11	8	5	4	3	6	11	0	0	2	7	1	14	17	0	2	0	4	1	17
Home community of owner	62	54	8	0	5	27	12	16	0	2	16	11	12	23	0	9	5	8	4	8	28
Quality of life	30	20	6	4	5	16	6	1	0	2	8	3	7	12	5	5	1	5	1	5	13
Other	23	13	4	7	2	9	0	2	0	10	6	0	4	13	6	2	4	2	4	5	6

\*\* For an explanation of the meaning of ratings, see footnote to Table 8.

\*\* The types of firms in each SIC are listed in Table 5.

### City population

Factors found to importantly influence firms to locate in communities of under 1,000 population were home community of owner, low labor costs, and quality of life. In towns with populations of between 1,000 and 2,500, factors rated most important were closeness to raw materials, home community of owner, and availability of local funds. In towns of 2,500 to 10,000 population, important factors were home community of owner, quality of life, and good transportation. In cities with population over 10,000, factors of importance were closeness to markets, abundant labor supply, and home community of owner.

### Planning and development district

The factor rated as most importantly affecting firm location in Planning and Development District I was abundant labor supply. In Districts II, III, and IV the most important factor was that the community was the home of the owner. In District V the only factor rated important was closeness to raw materials. Other important factors by district were closeness to markets in District II, abundant labor force in District III, and favorable tax policies in District IV.

The districts in the eastern half of the state seem to be chosen for firm location because the owners are living in the city, because there is an abundant labor supply, and because markets are close. Firms locate in the western half of the state because raw materials are available and markets are close by.

### Location of home office

For those firms whose home office is located outside the state, location factors rated important were abundant labor supply, closeness to markets, and favorable tax policies. Unimportant factors were low power costs and availability of local funds.

### Type of production (according to SIC)<sup>9</sup>

Of the firms responding, those producing sand and gravel (SIC = 14) and stone and cement (SIC = 32) indicated that the most important fac-

tors influencing them to locate in South Dakota were that the city was the home community of the owner and that markets and raw materials were close. Food processing firms (SIC = 20) located in South Dakota primarily because raw materials and markets were close and because of good transportation. Printing and publishing firms (SIC = 27) were influenced to locate in South Dakota because the city of location was the home community of the owner, because local funds were available, and markets were close. Clothing (SIC = 28) and rubber (SIC = 30) firms located in South Dakota because markets were close, good transportation was available, and raw materials were close. Machine and other miscellaneous firms (SIC = 34 to 39) located in South Dakota because the city was the home community of the owner, abundant labor was available, and quality of life was good.

### Expansion decision factors

#### Reasons firms did not expand

The industry questionnaire asked firms that did not expand within the last 5 years to indicate the reason or reasons that no expansion occurred (Table 10).

Table 10. Reasons industrial firms in South Dakota did not expand during 1969 to 1974.\*

Employment size Reason	Number of responses			Total
	0-24	25-99	100 or more	
Satisfied with present size	38	2	4	44
Shortage of labor	6	1	0	7
Shortage of raw materials	7	2	2	11
Lack of market for more production	19	2	1	22
Unavailability of financing	12	1	1	14
Others	8	1	1	10

\* A few firms checked more than one reason.

<sup>9</sup>The Standard Industrial Classification (SIC) is used to separate firms by type of product.



The most cited reason for non-expansion was satisfaction with present size. This reason for a non-expansion decision can be classified as being internal to the firm, while the other reasons are external constraints upon potential expansion. Lack of markets for increased production, and unavailability of financing were the first and second most cited external constraints. Shortage of raw materials and shortage of labor were the third and fourth most cited reasons. The most common other reason given for lack of expansion was that the firm had expanded just before the 5-year period.

More firms that employ fewer than 25 persons than the larger firms stated that expansion did not occur because of satisfaction with present size. Contrary to normal expectation, shortage of labor was a reason given by more small firms than large firms. Lack of markets for more production also was more of a problem for the small firms than for the large ones. Shortage of raw materials affected the large firms as well as the small firms. Unavailability of financing was a constraint for 12 firms that employ fewer than 25 persons, for one firm that employs 25 to 99 persons, and for one firm that employs more than 99 persons.

#### Future expansion plans

Plans for expansion by firm employment size and by city population are shown in Table 11. A larger percentage of the large firms than of the small firms plan to expand within the next 5 years. The majority of firms that employ 100 persons or more plan to expand in cities over 10,000 population. The majority of firms that fall within the employment ranges of 25 to 99 and of fewer than 25 plan to expand either in cities over 10,000 population or in cities under 1,000 population.

Fifteen of the firms that have expansion plans will not expand in the city in which they are currently located. Of the 15, 11 still plan to expand in South Dakota. Opportunity to purchase existing plants and facilities, desire to disperse operations, and labor shortages were the main reasons cited by firms for plans to expand in other cities.

### Financial restrictions to industrial development

A discussion of methods to increase the current supply of funds for industrial development is meaningless unless economic demand for these funds exists. Therefore, the purpose of the following analysis is to determine if there is an unmet demand for funds for industrial expansion and/or production, and if so, to determine the magnitude of the unmet demand. Also, an attempt is made to evaluate factors associated with the problem of unmet demand.

#### The extent of financial restrictions

The industry questionnaire asked if a shortage of funds had restricted the size of the present plant. A possible yes or no response was provided. Of the 260 questionnaire respondents, 236 answered the question; 42 responded yes and 194 responded no.

When responses of those firms with plants constructed since 1969 are isolated from all respondents, the question essentially determines if construction of new plants has been hindered because of inadequate financing. Fifty-seven new firms answered the questionnaire; 54 answered this question. Twenty of these firms answered yes and 34 answered no. Thus, 37% of the new firms indicated that a shortage of funds restricted the size of their present plant.

Table 11. Plans for expansion of South Dakota firms between 1975 and 1980, by firm size and community size.

Employment size	Number of firms					
	Population of community where expansion will occur*					
	Expansion plans		Under 1,000	1,000-2,400	2,500-9,999	Over 10,000
	No	Yes				
Under 25	62	105	45	17	6	37
25-99	7	40	12	1	3	21
100 or more	5	25	2	5	1	14
Total	74	170	59	23	10	72

\* Fifteen of the firms that plan to expand will not expand in the community where they are currently located. Of these, 11 plan to expand in South Dakota. Twelve of the firms did not indicate the population of the community in which they plan to expand.

The industry questionnaire also asked if a shortage of funds had restricted expansion of plant size. Of the 260 questionnaire respondents, 227 answered the question; 54 responded yes and 173 responded no. Thus, 24% of the firms indicated that a shortage of funds restricted expansion activities.

Another question asked if production has been limited because of lack of operating funds. Of the 260 questionnaire respondents, 250 answered the question; 52 answered yes and 198 answered no. Thus, 21% of the firms indicated that a shortage of funds restricted output of their plant.

Many firms answered yes to two or all three of the above questions and thus indicated that they had problems obtaining funds for more than one activity. In total, 67 different firms, 26% of those responding, indicated that they had problems obtaining funds for one or more use.

Data necessary to estimate the amounts of funds that these firms desired but were unable to obtain are not available. However, 14 firms indicated that funding difficulties prevented them from any expansion activities at all. Problems for the other firms, while not this severe, still may have been substantial.

#### Factors associated with financial restrictions

Certain characteristics of firms or their locations may be associated with financing problems. Discovery of these characteristics or location factors will help determine what types of firms or locations are experiencing difficulties obtaining funds and will narrow the search for causes of the problems. Identification of areas of inadequate financing will facilitate design and implementation of programs to correct the financing problem even if its causes are not determined.

The following factors were evaluated to determine if they are associated with the problem of inadequate financing: employment size of the firm, population of the community where the firm is located, location within the state, longevity of the firm, and whether the firm is a branch (subsidiary) or home firm.<sup>10</sup> Each of these factors were tested for association with difficulties in obtaining funds for new plants, expansion, and operations.<sup>11</sup>

<sup>10</sup> Three other factors originally hypothesized to be important were: type of product, change in output during the last 5 years, and annual sales or output. Difficulties with grouping firms within these three factors prevented any conclusive analysis, although preliminary results showed that these factors probably were not important.

<sup>11</sup> Interested readers are referred to Appendix C of Tauer's thesis (15) for the data and numerical chi square results obtained.

### Financing new firms

The factor found to have a significant influence on the ability of new firms to obtain funds is whether the firm is a branch or home firm. Only 2 of the 17 branch or subsidiary firms indicated problems obtaining funds. Employment size, community population, and location were not found to be related significantly to financing difficulties for new firms.

### Financing expansion

Of the 54 firms that expressed difficulties in obtaining funds for expansion, only 9 employed more than 25 persons. Because a small percentage of the two larger employment categories of firms had difficulties in obtaining funds for expansion, no dependable pattern could be found for these employment sizes. Consequently, the two larger employment categories were removed from the data when the other factors were tested.

The factor that appears to influence the ability to obtain expansion funds for firms with employment of fewer than 25 persons is whether the firms are branch or home office firms.

### Financing operations

The employment factor was significant for those firms indicating that a shortage of funds restricted output. Again, because only eight of the firms that indicated problems employ more than 25 persons, only the firms that employ fewer than 25 persons were used to test the other factors.

The factors found to affect a small firm's ability to obtain funds for operation are longevity of the firm and whether the plant is a branch or home firm. The smaller firms have difficulties obtaining funds, and the younger of these firms experience the most problems. Once again, branch and subsidiary firms do not experience the difficulties obtaining funds that home firms experience.

### Reasons given for difficulties

Insufficient equity was the reason most commonly given to firms by prospective lenders when refusing requests for funds (Table 12). The next cited reason was lack of interest in promoting that type of industry. Low probability of the firm's success and prior commitment of loan funds were less cited reasons.

Table 12. Reasons given to firms by potential lenders for not providing funds\*

Reasons	Number of responses
Insufficient equity of firm	22
Lack of interest in promoting that type of industry	19
Prior commitment of loan funds	13
Low probability of success	10
Other reasons	5

\* A few firms checked more than one reason.

## The role of banks in financing industrial activities

Commercial banks comprise the major part of the financial system in South Dakota, both in terms of number of offices and in deposits held. In most communities the bank is the only local financial institution. In this section the financial role of banks in industrial activities within the state is examined.

First, the types of industries that use bank funds for different types of industrial activities are described. Then the percentages of total bank loans that are industrial loans and the time length and other industrial loan characteristics are examined. An estimate is made of the total amount of industrial loans held by the banks in the state.

### Industrial use of bank funds

In the industrial questionnaire, firms were asked to list the percentage of funds obtained from different sources for establishment of the firm, for expansion, for current operations, and for projected expansion. Included among these sources were local banks, other state banks, and out-of-state banks. Local banks were further separated into home office and branch categories.

### Bank financing for firm establishment

Of the 57 respondent firms established since 1969, (from a possible 188), 32 completed this section of the questionnaire. Average proportions of funds obtained from the bank sources with different characteristics of the respondent firms are presented in Tables 13-15.<sup>12</sup>

An average firm from among the 32 respondents obtained 17 % of its funds from South Dakota banks, none from out-of-state banks. Most bank funds were obtained from local home-office banks.

In general, respondent firms that employ fewer than 25 persons used more bank financing than did firms in the two larger employment groups. In fact, the three respondents that employ 100 or more persons did not use any bank financing. Bank funds used by firms that employ 25 to 99 persons came entirely from local banks. Respondent firms that employ fewer than 25 persons used some branch bank and some non-local bank financing.

Home-office firms did a higher average percentage of their borrowing from South Dakota banks than did branch and subsidiary firms. The small amount (percentages) of funds that the branch and subsidiary firms obtained from banks came from local home-office banks.

Respondent firms that indicated problems obtaining funds got about the same proportion of their funds from South Dakota banks as did those firms that did not have problems. Firms that did have problems used some non-local bank funds, while those firms that had no problems used only local home-office bank funds.

### Bank financing for firm expansion

Of the 260 questionnaire respondents, 230 indicated that their firms had expanded in the last 5 years. Of these 230 firms, 110 completed this section of the questionnaire.

The typical firm among the 110 respondents obtained 32% of its funds for expansion from South Dakota banks and 2% from out-of-state banks. Most of the funds from South Dakota banks were obtained from local home-office banks.

Respondents who employ fewer than 25 persons obtained 40% of their expansion funds from South Dakota banks, considerably more than the 18 and

<sup>12</sup> To calculate average proportions, the percentages of total investment obtained from bank sources for each industrial firm were used, not the actual amounts of investment. Thus, the averages do not represent percentages of total industrial financing from each of the various bank sources; rather they represent averages of the individual firm's borrowing distributions among the various bank sources. Standard deviations of averages were also calculated. Most of these standard deviations are quite large, indicating that percentages given by firms varied widely. Since a small percentage of all firms completed the questionnaire, the data only show general trends and are not necessarily representative of the population.

Table 13. Funds obtained from bank sources for financing establishment of industrial firms in South Dakota, 1969 to 1974, by firm characteristic.

Source	Average percentage of total investment*							
	All firms	Employment size			Office		Had problems obtaining funds	Did not have problems
		0-24	25-99	100 or more	Home	Branch		
South Dakota banks	17 (30)	20 (33)	15 (13)	0	22 (34)	6 (11)	17 (35)	18 (20)
Local banks	16 (30)	18 (33)	15 (13)	0	20 (34)	6 (11)	17 (35)	13 (18)
Home office	13 (26)	14 (29)	15 (13)	0	15 (30)	6 (11)	17 (35)	10 (16)
Branch	1 (7)	2 (8)	0	0	2 (8)	0	0	3 (12)
Other in-state banks	2 (9)	2 (10)	0	0	2 (10)	0	0	4 (14)
Out-of-state banks	0	0	0	0	0	0	0	0
Number of respondents	32	25	4	3	23	9	20	12

\* Standard deviation is given below each average.

22% for the other employment sizes. The majority of these funds were obtained from local home-office banks. Firms that employ 25 to 99 persons obtained 8% of their funds for expansion from out-of-state banks compared to 2% and none for the smaller and larger firms.

Respondent firms that are between 5 and 10 years old typically obtained 17% of their expansion funds from South Dakota banks. Firms in other age groups obtained approximately 34% from this source. Again, most of these funds were from local home-office banks. Firms over 25 years old were the only age

group that indicated use of financing from out-of-state banks for expansion purposes.

Typical home-firm respondents obtained a larger percentage of their funds for expansion from South Dakota banks than did branch and subsidiary plants. Only home-firm respondents obtained any funds from out-of-state banks.

In general, those firms that indicated difficulties financing expansion obtained a larger percentage of their funds from South Dakota banks than did firms that did not indicate problems. No firms using out-of-state banks had difficulties financing expansion.

Table 14. Funds obtained from bank sources for financing expansion of industrial firms in South Dakota, 1969 to 1974, by firm characteristic.

Source	Average percentage of total investment*											
	All firms	Employment size			Age of firm in years				Office		Had problems obtaining funds	Did not have problems
		0 to 24	25 to 99	100 or more	Over 25	25 to 10	10 to 5	Under 5	Home	Branch		
South Dakota banks	32 (40)	40 (42)	18 (27)	22 (40)	34 (41)	35 (40)	17 (34)	34 (41)	34 (39)	24 (40)	28 (39)	44 (41)
Local banks	30 (40)	37 (43)	16 (26)	22 (40)	31 (41)	33 (41)	17 (34)	31 (43)	31 (40)	23 (40)	26 (39)	39 (42)
Home office	27 (39)	33 (42)	16 (27)	22 (40)	30 (40)	28 (39)	13 (34)	28 (40)	27 (38)	23 (40)	24 (37)	36 (43)
Branch	3 (12)	4 (15)	2 (6)	0	2 (12)	5 (14)	4 (15)	0	4 (14)	0	3 (13)	3 (11)
Other state banks	2 (11)	3 (12)	2 (8)	0	2 (13)	2 (10)	0	3 (8)	2 (12)	1 (6)	2 (8)	4 (17)
Out-of-state banks	2 (13)	0 (1)	8 (27)	0	4 (19)	0	0	0	2 (15)	0	1 (11)	0
Number of respondents	110	67	27	16	52	23	16	19	82	27	77	25

\* Standard deviation is given below each average.

Table 15. Funds obtained from bank sources for financing current assets of industrial firms in South Dakota, by firm characteristic.

Source	Average percentage of total current assets*											
	Employment size				Age of firm in years				Office		Had problems obtaining funds	Did not have problems
	All firms	0 to 24	25 to 99	100 or more	Over 25	25 to 10	10 to 5	Under 5	Home	Branch		
South Dakota banks	22 (33)	20 (30)	18 (27)	36 (45)	16 (30)	34 (37)	33 (42)	19 (28)	24 (34)	14 (27)	22 (34)	22 (29)
Local banks	20 (33)	18 (30)	18 (27)	32 (46)	16 (30)	34 (37)	33 (42)	13 (27)	24 (34)	10 (26)	20 (34)	19 (28)
Home office	17 (32)	13 (28)	19 (28)	32 (47)	13 (26)	26 (41)	29 (43)	13 (26)	20 (33)	10 (25)	18 (33)	16 (28)
Branch	4 (14)	5 (17)	2 (6)	0	4 (18)	8 (14)	4 (14)	0	5 (16)	0	3 (14)	4 (12)
Other state banks	2 (8)	2 (8)	0	4 (13)	0	0	0	6 (15)	0	4 (13)	1 (7)	3 (12)
Out-of-state banks	3 (15)	0	1 (38)	1 (12)	4 (22)	8	0	0	4 (16)	0	4 (16)	0
Number of respondents	88	55	19	14	35	14	13	23	67	20	70	18

\* Standard deviation is given below each average.

#### Bank financing for current operations

Eighty-eight of the 260 questionnaire respondents completed the section concerning bank financing for current operations. The 88 respondents typically obtain 22% of their funds to finance current assets from South Dakota banks, and 3% from out-of-state banks. Most of the funds from South Dakota banks are obtained from local home-office banks.

Respondents who employ 100 persons or more obtain a higher proportion of their operating funds from South Dakota banks than do the other two employment groups.

Firms that are from 5 to 25 years old obtain a greater proportion of their funds from South Dakota banks than do either younger or older firms. Only those respondent firms that have been established longer than 25 years use out-of-state financing.

Home firms obtain a higher percentage of their operating funds from South Dakota banks than do branch and subsidiary plants. Only the home firms obtain any operating funds from out-of-state banks.

There were no differences between firms that indicated difficulties obtaining funds and those that did not, with respect to the average percentage of operating funds obtained from South Dakota banks. Firms that did not experience problems obtained some funds from out-of-state banks.

#### Bank financing for planned expansion

Of the 260 questionnaire respondents, 170 indicate that they plan to expand in the next 5 years. Sixty-seven of these firms completed this section of the questionnaire (Table 16).

On average, these 67 firms plan to obtain 24% of the funds for expansion from South Dakota banks and 5% from out-of-state banks. Firms in all three employment sizes plan to obtain approximately the same percentage of needed funds from South Dakota banks, but firms in the employment size 25 to 99 plan to obtain a higher percentage from out-of-state banks than do firms in the other two employment sizes.

#### Mortgages on non-business property

The industry questionnaire asked firms to give the percentage of borrowed funds from all sources secured by mortgages on non-business property. One

Table 16. Funds to be obtained from bank sources for financing planned expansion of industrial firms in South Dakota.

Source	Average percentage of total planned investment			
	All firms	Employment size		
		0-24	25-99	Over 100
South Dakota banks	24 (35)	27 (36)	17 (30)	25 (38)
Local banks	23 (35)	25 (37)	17 (30)	25 (38)
Home office	22 (34)	26 (37)	11 (23)	23 (39)
Branch	3 (14)	2 (9)	6 (23)	2 (6)
Other state banks	1 (6)	2 (9)	0	0
Out-of-state banks	5 (18)	2 (12)	11 (27)	4 (14)
Number of respondents	67	37	18	12

\* Standard deviation is given below each average.

hundred and ninety-nine of the 260 questionnaire respondents completed the question.

Eighty percent of the firms responding indicated that they did not have mortgages on non-business property. As would be expected, few of the larger firms have mortgages on non-business property, and these mortgages are a smaller percentage of total borrowed funds than is the case for smaller firms. A typical respondent firm has 9% of borrowed funds secured by mortgages on non-business property. This average ranges from 10.1% for those respondents who employ fewer than 25 persons to a low of 2.8% for firms who employ 100 or more persons.

#### Industrial loans held by banks

##### Percentage and amount of industrial loans of banks

The bank questionnaire asked banks to give the percentage of their total loans that are industrial

loans. All but 2 of the 97 main-office bank respondents (of 159 banks) completed the question.

Fifty-five of the bank respondents indicated that they did not have any industrial loans. A higher proportion of the banks in the deposit size \$10 to \$20 million and over \$20 million than in the two smaller deposit sizes have industrial loans, but only banks with deposits over \$20 million have a significantly greater average percentage of industrial loans than do the other deposit sizes. The ratio of industrial loans to total loans averages 0.04 for all responding banks, ranging from 0.10 for banks with over \$20 million in deposits to 0.02 for banks with \$10 to \$20 million in deposits.

For respondent banks, industrial loans were estimated to total \$90.8 million.<sup>13</sup> For non-respondent banks, industrial loans of \$34.9 million were estimated. The total of these two estimates is \$125.7 million. On December 31, 1973, commercial banks in South Dakota had total industrial and commercial loans amounting to \$274.1 million (4). Thus, the value of industrial loans is estimated to be approximately 46% of the commercial and industrial loan total.

#### Length of industrial loans

The bank questionnaire also asked banks to list the percentage of the total value of their industrial loans that are less than a year in length, 1-5 years in length, and over 5 years in length.<sup>14</sup>

Responses to the question indicated that for the average bank 41% of the industrial loans are made for periods of 1-5 years, 29% are for less than one year and 29% are for greater than 5 years. However, as indicated by a large standard deviation, the average length of loan payment period varies greatly among banks.

A second part of this question asked banks to list the 1969 to 1973 average percentage of loans in the three loan length categories. For those banks that completed this part of the question, the response did not differ greatly from their response for current loans.

#### SBA guaranteed loans

An average bank has 31% of its industrial loans guaranteed by the Small Business Administration. The average is larger for the two bank size groups over \$10 million in deposits than for those size groups under \$10 million. The range is from 67% for banks with \$10-\$20 million in deposits to 20% for banks with under \$5 million in deposits. Apparently, banks with over \$10 million in deposits use the SBA to a greater extent than do smaller banks. This may be because larger banks have more industrial loans, and thus have an opportunity to be more familiar with the SBA program.

## Bankers' attitudes affecting industrial development

Industrial firms in South Dakota, especially the small ones, obtain a substantial amount of funds from commercial banks in the state. This important role of banks in funding industry means that attitudes of the banker or bankers will affect the rate of industrial development in the community. Because of the banker's leadership role, he often influences the attitudes of the community. Hence, the banker can act as a catalyst in promoting development.

Statistical comparisons of questionnaire responses between specific groups of banks were performed to determine differences in attitudes and practices. Some of the factors used to distinguish groups are population of the community where the bank is located, location by planning and development district, main or branch bank, type of charter, membership in the Federal Reserve System, deposit size, loan-to-deposit ratio, and number of banks in the community. Except where noted, both branch banks and main banks are included in the analysis. Chi square is the statistical test used throughout.<sup>15</sup> Banks are separated into one of two bank population categories: either the bank, or branch, is the only bank office in the community, or there are two or more bank offices in the community.

#### Attitudes toward industrial development

Eighty-seven percent of the bankers responding to the bank questionnaire indicated that industrial development would improve the quality of life for the citizens of their community; 13% said that it would not. Neither community size or bank location had an effect upon response.

Fifty-nine percent of the bankers said that a local industrial development group or corporation would assist greatly in attaining industrial development; 34% indicated slightly; and 7% answered no. All 10 "no" answers came from communities under 1,000 population. Again, community population and location within a planning district were not related to response. As would be expected, those banks that did not think that industrial development would help their community also did not think that a development group would help.

#### Types of industries recommended by banks

Tables 17 and 18 show, by community size and planning district, types of industries that bankers indicate might be established or expanded in their community. Most bankers in all community sizes and planning districts think that light manufacturing and agricultural processing could be established or expanded in their community.

Only bankers in the First and Sixth Planning Districts indicate that mining could be established or expanded in their community. Heavy manufacturing might be established or expanded in only a few communities. A large number of bankers in the Fifth District indicate that tourism might be established or expanded in their area. Transportation related industry might be established or expanded in all city sizes, and all planning districts.

<sup>13</sup> To estimate total industrial loans of the banks in South Dakota, the dollar amount of total loans for each respondent bank as of December 31, 1973, was multiplied by the percentage of loans for industrial purposes indicated by that respondent bank. For those banks who did not complete the questionnaire, the average percentage of industrial loans to total loans calculated for the different deposit sizes of the respondents were multiplied by the actual loans of each non-respondent bank in that deposit size. The amounts for all banks were then summed.

<sup>14</sup> This question was asked in order to identify in rough fashion the proportions of bank financing used for investment in plant and equipment and for operating needs. Bankers interviewed in the pretesting of the questionnaire were unable to tell us what proportion of their loans to industrial firms were for investment as opposed to operating capital uses. However, they agreed that, in general, loans for more than 5 years are for investment, those for less than one year are for operating capital, and those of intermediate length are split among the two uses.

<sup>15</sup> Results of the chi square tests supporting conclusions expressed in this section are given in Tauer's thesis (15, Appendix C).

Table 17. Type of industries seen by bankers as appropriate for establishment or expansion in their community, by community population.

Community population	Response*	Number of replies					
		Agricultural processing	Mining	Light manufacturing and assembly	Heavy manufacturing	Tourism	Transportation
Under 1,000	Established	44	1	49	4	2	4
	Expanded	19	2	22	0	8	4
1,000-2,500	Established	13	0	11	1	2	3
	Expanded	8	0	10	0	1	1
2,501-10,000	Established	4	1	5	3	0	1
	Expanded	5	2	8	0	7	2
Over 10,000	Established	3	0	1	0	0	2
	Expanded	9	1	14	4	7	5

\* A response of "might be established" indicated that no firms of that type are located in the area but might be. "Might be expanded" that a firm of that type is now located in the area and might be expanded.

Four respondents listed types of industries other than those given. Most of these were recreation industries which would be grouped with tourism.

Table 18. Type of industries seen by bankers as appropriate for establishment or expansion in their community, by planning and development district.

District	Response*	Number of replies					
		Agricultural processing	Mining	Light manufacturing and assembly	Heavy manufacturing	Tourism	Transportation
I	Established	13	2	13	4	0	3
	Expanded	8	1	12	0	2	1
II	Established	7	0	7	1	0	3
	Expanded	8	0	11	1	3	1
III	Established	13	0	14	1	0	0
	Expanded	4	0	7	0	2	2
IV	Established	15	0	14	0	0	2
	Expanded	10	0	11	1	5	4
V	Established	14	0	15	1	4	2
	Expanded	4	0	6	0	6	1
VI	Established	2	0	3	1	0	0
	Expanded	7	0	7	2	5	3

\* See footnote to Table 15.

### Non-financial factors limiting industrial development

The most common factors that bankers indicated as limiting industrial and economic development in their community were small labor force, lack of adequate service facilities, and lack of adequate developed sites and buildings.

The second most common factors were associated with location of the community in the state, i.e., poor transportation and small local markets. The third common type of factors dealt with the need for and limited availability of risk capital for industrial financing.

Other important factors cited were a lack of local interest in industrial development, insufficient legal and economic information, and insufficient knowledge about the community to allow an effective program to sell the community.

### Financial factors limiting industrial development

#### Local capacity to finance industrial expansion

Fifty-six percent of the bankers responding to the questionnaire indicated that their community does

not have the capacity to finance industrial expansion from local sources; 44% said that their community does have the capacity.

A greater number of bankers from small communities than from large communities do not think that local sources of funds are sufficient to finance industrial expansion. Differences between responses by planning district were not found to be significant.

#### Requests for loans larger than legal limits

The maximum amount that a bank can lend to a single borrower is dependent on the charter of the bank and on the capital and surplus accounts of the bank.<sup>16</sup> Although there are legal minimums for capital accounts which all banks must meet, often capital accounts required of a specific bank are higher than the legal minimum because other factors are also

<sup>16</sup> The minimum capital requirement for state chartered banks is listed in *South Dakota Compiled Laws*, Title 51. For state banks no loan to a single individual, partnership or corporation may exceed 20% of paid-up capital and surplus. For national banks the maximum loan is 10% of capital and surplus.

considered by the examination agency. Some of these factors are bank charter, city population, deposit size, and amount of loans.

The legal limit for credit to one individual by a bank is established on the basis of the factors previously mentioned, but the sizes of industrial loans depend on the sizes and needs of the industrial firms seeking financing. Thus, a bank with a low maximum credit limit may not be limiting industrial development in its community if it never receives requests for large loans.

Of the 86 main-office banks that responded, 33 received requests for industrial loans larger than the maximum loan limit that their bank can make to a single borrower, and 53 received no such requests. The 33 banks receiving loan requests exceeding their legal maximum range from small to large deposit size banks and are located in all sizes of communities.

Of the 33 banks that received requests for large loans, 23 stated that they used correspondent banks to handle the request, while 7 did not use correspondent banks. Ten of the correspondent banks normally used by the 23 banks are in South Dakota; 13 are located outside the state.

#### Cooperation among banks

Eighty-five of the bank respondents are located in communities in which they are the only bank in the community. Of these 85 banks, 57 stated that they cooperate with other banks or non-bank lenders in their locality for the financing of industrial enterprises having credit needs greater than the capacity of a single source.

Twenty-nine of the bank respondents are located in communities in which there are two or more full service bank offices. Twenty-six of these cooperate with other banks or financial institutions in the locality to extend credit to industrial users.

These figures suggest a high degree of cooperation among banks and between banks and other lenders, especially if the various institutions are located in the same community.

#### Experience of industrial loan officer

Nine percent of the bankers rate the experience of their industrial loan officer with industrial development as extensive, 47% rate his experience as moderate, and 44% rate his experience as slight.

Banks were separated by deposit sizes, loan-to-deposit ratio, city populations, and main offices or branches to determine if these different groups of banks responded differently to the question.

Banks in larger cities rated the experience of their industrial loan officers higher than did banks in smaller cities. Large banks rated the experience of their industrial loan officer higher than did small banks. And banks with high loan-to-deposit ratios rated the experience of the industrial loan officer higher than did banks with lower loan-to-deposit ratios.

#### Factors limiting ability or willingness to increase industrial loans

Eight reasons which might affect the ability or willingness of a bank to increase industrial loans were listed on the questionnaire. The bankers were asked to rate the importance of each of the eight reasons by giving it a rating of very important, important, or not important. Results of the rating for all respondents are shown in Table 19.

A shortage of applicants and insufficient equity of loan applicants were the most important of the eight reasons. Other important reasons were deficient management experience of loan applicants and high rates of business failures. Cost of administering industrial loans was the least important reason. Other

non-important reasons were interest and/or experience of loan officer(s), legal maximum loan limit, and prior commitment of available loan funds to other uses.

Table 19. Importance of factors limiting a bank's ability or willingness to increase industrial loans, all bank offices.

Factor	Number of responses		
	Very important	Important	Not important
Insufficient equity of loan applicants	68	43	6
A shortage of applicants	66	45	15
Deficient management experience of loan applicant	48	61	5
Prior commitment of loan funds to other users	available		
Legal maximum loan limit	26	44	44
High rates of business failures	24	47	41
Interests and/or experience of officer(s)	23	63	28
Cost of administering industrial loans	17	56	41
	6	42	65

Thus, bankers indicated that their ability or willingness to increase industrial loans is dependent on the demand for loans and the quality of applicants rather than on conditions affecting the supply of funds.

Numerous characteristics of the banks were tested with respect to each of the reasons listed in Table 19 to determine if a relationship exists between types of banks and ability or willingness to increase industrial loans.

Only the relationship between the loan-to-deposit ratio of a bank and prior commitment of available loan funds to other uses was found to be significant. Not only did banks with high loan-to-deposit ratios indicate that prior commitment of funds was an important reason, but banks with low loan-to-deposit ratios (and thus a higher level of investment in securities) also indicated that it was an important reason. That is, banks with high loan-to-deposit ratios have funds committed to other loan uses; banks with low loan-to-deposit ratios have funds committed to security investments.

#### Future demand and supply of funds for industrial expansion

Among important assumptions of this study are that increased employment in the manufacturing sector of the economy would help decrease out-migration and income differentials and that a substantial increase in employment can be generated only through establishment of new firms or expansion of present facilities. Clearly, if these assumptions are correct, funds are needed for establishment and expansion activities.

This section examines some of the forces that may affect the demand for industrial funds in the next few years. The ability of commercial banks to adequately provide these funds is evaluated.

### Demand for industrial funds

As shown in Table 20, new investment expenditures in manufacturing have varied widely over the past few years. This makes expenditure projections difficult. Yet although there has been fluctuation in expenditures, over the last 10 years the general linear trend has been upward at an average annual rate of \$2.8 million a year.

Since 1970, annual investment has been increasing \$5.3 million a year. Figure 2 shows investment expenditures between 1965 and 1974, and displays linear projections to 1985 at both the 10-year (1965-1974) and most recent 5-year (1970-1974) rates of increase. If investment continues at the same rates as the last 10 years or the last 5 years, investment in 1980 would be \$42.8 or \$66.0 million, respectively. By 1985 annual investment would be \$56.8 or \$92.5 million, respectively.

Rather than study past expenditures it may be more appropriate to study the number of expansions occurring and the forces affecting past industrial expansion activities to obtain insights as to what expansion activities are likely to continue.

South Dakota's economy is not isolated from the national economy. This is especially true for the state's manufacturing sector, since demand for manufactured products generally depends upon national conditions. However, there is an important aspect of South Dakota's industrial sector that offsets cyclical

Table 20. New capital expenditures in manufacturing in South Dakota, 1965 to 1974.

\$ millions			
Year	Amount	Year	Amount
1965	10.9	1970	14.0
1966	7.7	1971	15.4
1967	8.2	1972	21.6
1968	10.7	1973	36.2
1969	6.6	1974	30.0

Sources: Industrial Division, S.D. Department of Economic and Tourism Development; Census Bureau, *Annual Survey of Manufacturers*, 1970 and 1971 (16).

variations caused by the national economy. Historically, non-durable goods manufacturing groups (food, clothing, paper products) have experienced smaller cyclical variations in employment than durable groups. South Dakota has more employment in non-durable goods groups than durable goods groups. In fact, the food and kindred product group, a very stable non-durable group, has almost half the total manufacturing employment in the state (18).

Between 1969 and 1974, 220 firms located in South Dakota; 188 are still operational. These 188 firms constitute 22% of the firms now in the state. This increase in the number of firms will provide a nucleus to attract more industry. Some of the new

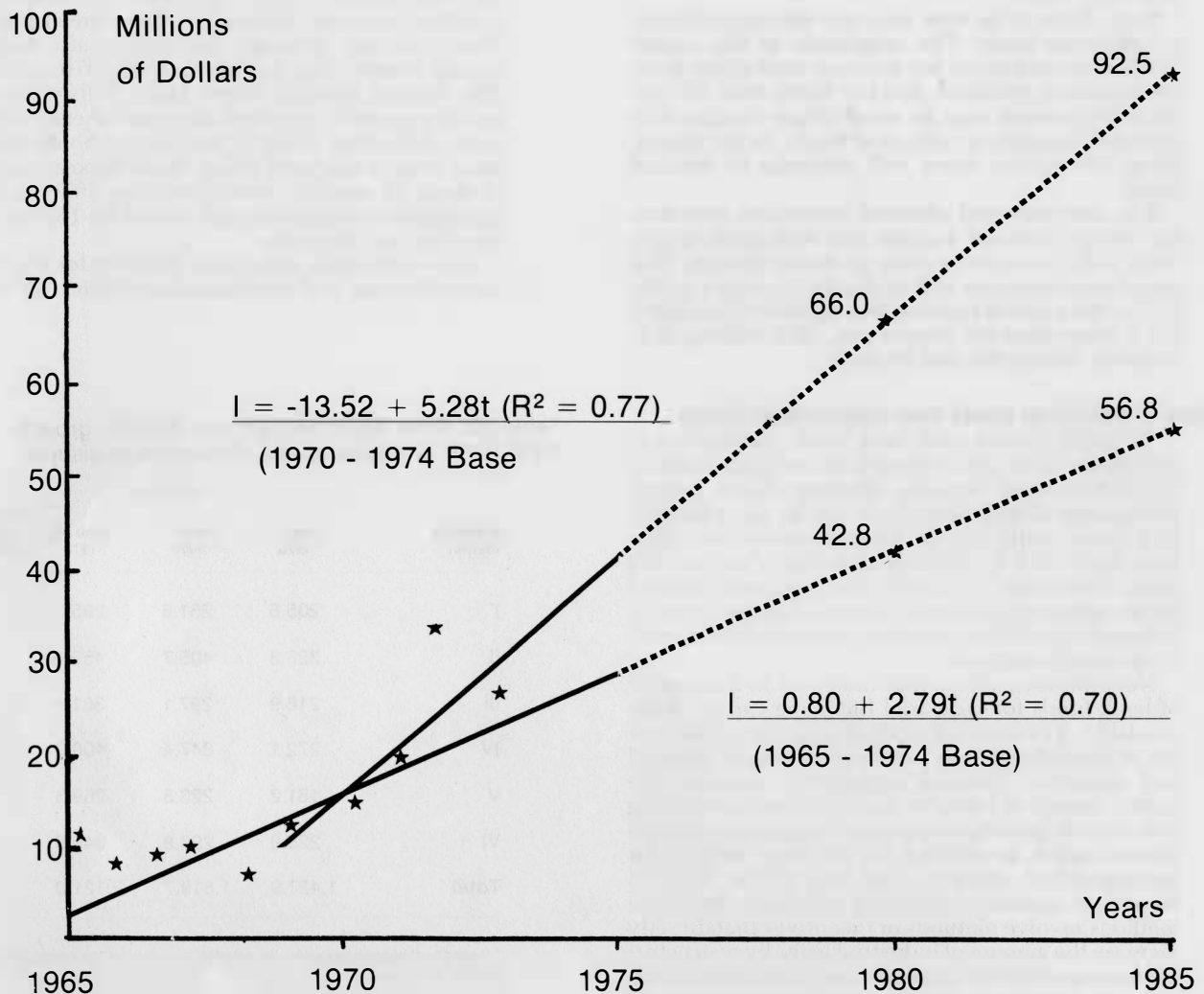


Figure 2. New capital expenditures in manufacturing, 1965-1974, and projections to 1980 and 1985.



firms are subsidiaries of major national corporations. An apparent trend of major corporations to locate plants outside metropolitan areas that has emerged in recent years suggests that this phenomenon may continue. Other new firms in the state have been home-grown industries. These types of firms will continue to be formed as individuals attempt to produce and market products that they design.

Expansion within the next 5 years is planned by at least 170 firms in the state. Typically, these firms plan to obtain about one-fourth of the funds needed for expansion from banks in the state. Many of these expansion activities will occur in communities with fewer than 1,000 inhabitants, communities where industrial activity is relatively new. Although plans are not known for the 592 non-responding firms in the state, a substantial number may also have expansion plans.

As in the past, certain locations within the state will experience the bulk of expansion activities. This may create a substantial demand for industrial funds in these locations, although as a state aggregate the demand may be small. Table 6 lists the number of new firms and firm expansions by planning and development district. Not only are Districts I, II, and VI the location of the greatest number of new firms and expansion activities since 1969, but also of the greatest number of new firms and firm expansions as a percent of total previous firms. This indicates that these districts are experiencing the greatest increase in industrial expansion, both in number of incidents and rate. With a continuation of this pattern, industrial demand for funds in these districts may become relatively great.

Some firms in the state are experiencing problems in obtaining funds. The magnitude of this unmet demand is not known; but because most of the firms experiencing problems employ fewer than 25 persons, the amount may be small when compared to the total demand for industrial funds. In the future, these and similar firms will continue to demand funds.

The previous and planned expansion activities and forces outlined suggest that industrial investment will continue to grow in South Dakota. The investment increase will probably be closer to the \$5.3 million rate of increase that occurred during the last 5 years than the slower rate, \$2.8 million, that occurred during the last 10 years.

### Supply of industrial funds from commercial banks

In South Dakota total bank loans outstanding to industrial firms are estimated to be approximately 4% of total bank deposits. Because this is a small percentage of total deposits, it would seem feasible that banks could handle future requests for industrial funds. But the industrial sector is only one of many in the state's economy. An increase in demand for investment funds in all sectors may occur simultaneously, and place pressure upon the banks' ability to handle requests.

Nevertheless, substantial increases in the supply of bank funds for industrial financing can be made available. Two types of methods to increase the supply of funds to industry can be indentified—general and selective. General methods to increase the banks' supply of loanable funds without specifying use include growth in deposits, increase in loan-to-deposit ratios, revision of the payment method for correspondent services, and use of the Federal Reserve's seasonal borrowing privilege. Selective methods involve methods or incentives that directly increase the amount of industrial loans by restructuring bank portfolios to increase industrial loans at the expense of other holdings and/or by making new money available to banks specifically for industrial

loan purposes. One such proposal is a state industrial loan guarantee program.

### Growth in deposits

As shown in Table 21, total bank deposits in South Dakota more than doubled from 1965 to 1974. The linear rate of increase over these years was \$179 million a year. As illustrated by Figure 3, bank deposits grew even faster during the last 5 years of this period, \$269 million a year. If bank deposits continue to grow within the range established by these rates, deposits in 1980 would be from \$3,504 to \$4,219 million. By 1985 deposits would be between \$4,398 and \$5,564 million.

Table 21. Bank deposits in South Dakota, 1965-1974.

Year	\$ millions		Year	Amount
	Amount	Amount		
1965	1,059		1970	1,571
1966	1,055		1971	1,764
1967	1,114		1972	2,017
1968	1,325		1973	2,368
1969	1,439		1974	2,614

Sources: FDIC, *Annual Reports*, 1971-1974 (3); U.S. Census Bureau, *Statistical Abstract of the U.S.* 1966-1975 (19).

Bank deposits by planning and development district for 1970 and 1973 are shown in Table 22. Bank deposits increased substantially between 1970 and 1973 for each of the six districts. The percentage increase between 1970 and 1973 was greatest in the Third District, although this district also had the second lowest total deposits in both 1970 and 1973. The Second District, where Sioux Falls is located, had the greatest amount of deposits for each of the 3 years. Sixty-four of the 67 counties in South Dakota have at least one bank office. Bank deposits in each of these 64 counties increased from 1970 to 1973. During the same period, only one of the 159 banks in the state lost deposits.

This continuous growth in deposits for the state, each planning and development district, all coun-

Table 22. Total bank deposit and deposit growth, 1970-1973, by planning and development district.

Planning district	\$ millions*			Percentage growth 1970-1973
	June 31, 1970	June 31, 1972	June 31, 1973	
I	205.6	251.8	295.1	44%
II	326.3	405.7	459.4	41%
III	216.9	297.1	351.4	62%
IV	272.1	347.4	400.0	47%
V	181.2	223.5	269.3	49%
VI	225.6	293.9	345.5	53%
Total	1,427.9	1,819.7	2,121.0	48%

\* Deposits of branch banks are included in the totals for the regions where the branch is located.

Source: Federal Deposit Insurance Corporation, *Summary of Deposits in All Commercial and Mutual Savings Banks*, 1970-1973 (5).

ties, and essentially all banks, has meant that increased funds have been, and may be available in all parts of the state. Also, extensive state-wide branch banking will permit these locally derived deposit funds to be moved to areas of large demand.

#### Increases in loan-to-deposit ratios

The average loan-to-deposit ratio for banks in South Dakota is 56.1 (Table 23). This average ranges from a low of 52.7 for banks with deposits under \$5 million to a high of 67.7 for banks with deposits over \$20 million.

The questionnaire asked bankers to list the highest loan-to-deposit ratio with which they would feel comfortable. The highest average was 62.2, and ranged from a low of 57.8 for banks with deposits between \$5 to \$10 million, to a high of 69.9 for banks with deposits over \$20 million.

The difference between this figure and the actual average ratio is 6.1, ranging from a high difference of 8.4 for banks with under \$5 million in deposits to a low of 2.2 for banks with over \$20 million in deposits. Although increasing loans to the maximum acceptable ratio for the largest deposit size group would involve a large amount of loans, the average percentage increase in loans for the group would be only 3%. In contrast, the average percentage increase in

Table 23. Actual and highest acceptable loan-to-deposit ratio by deposit size.

Loan-to-deposit ratios	Deposit size (\$ millions)				
	Total	Under 5	5-10	10-20	Over 20
Average highest acceptable	62.2	61.1	57.8	65.9	69.9
Standard deviation	(8.1)	(6.6)	(8.0)	(8.0)	(4.5)
Actual*	56.1	52.7	53.3	60.8**	67.7***
Difference	6.1	8.4	4.5	5.1	2.2

\* Source: FDIC, *Bank Operating Statistics - 1973* (4).

\*\* Taken from size group \$10 to \$25 million in deposits.

\*\*\* The average of the two groups \$25 to \$100 million (64.5) and over \$100 million (70.8).

loans for those banks with less than \$5 million in deposits could be 16%.

If all respondent banks would increase their loans so that their actual loan-to-deposit ratio would be equal to the highest ratio acceptable to them indi-

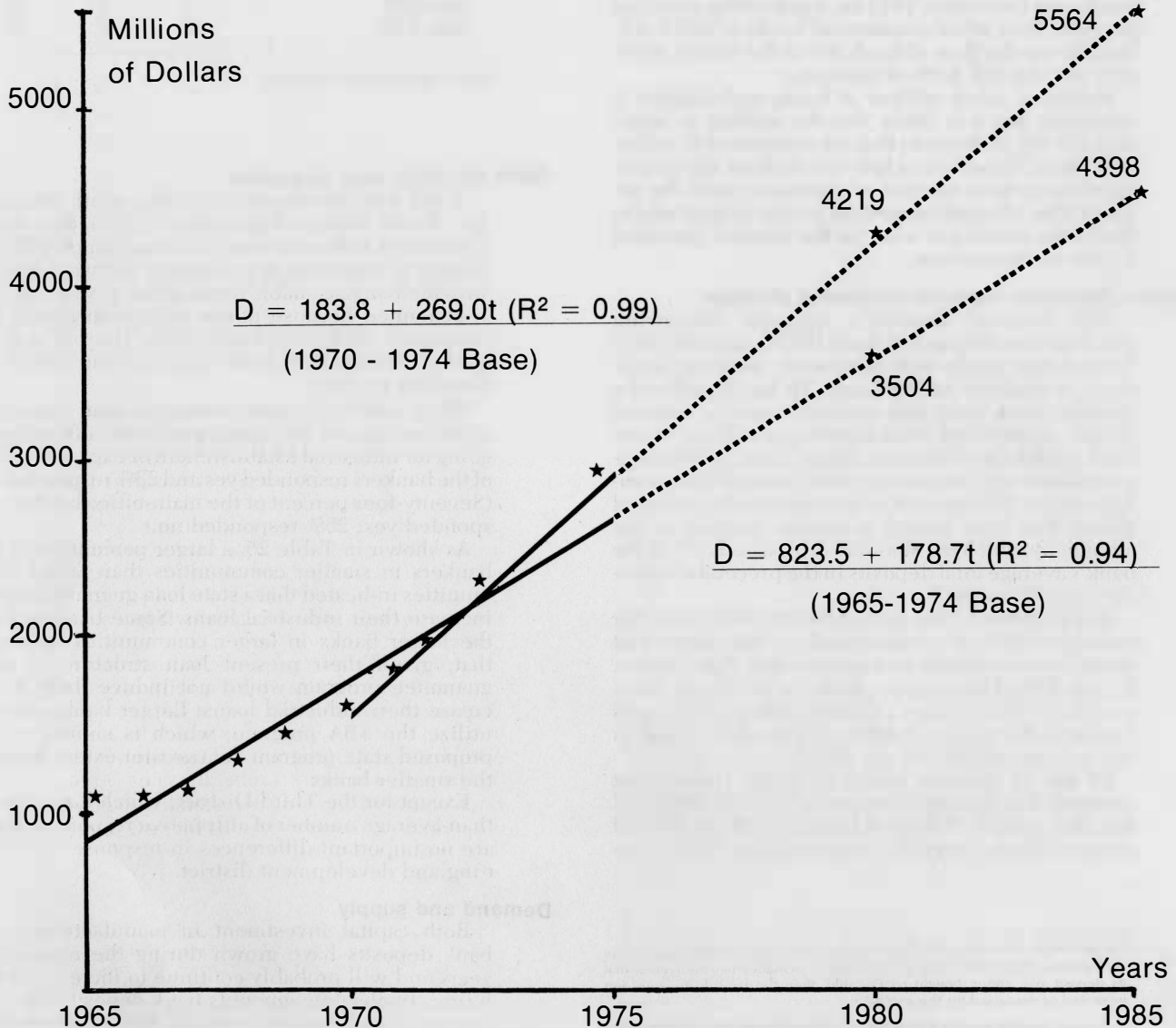


Figure 3. Bank deposits, 1965-1974, and projections to 1980 and 1985.

vidually, loans in the state could increase by \$109.6 million.<sup>17</sup> If the non-respondents would increase their loans so that their actual loan-to-deposit ratio would be equal to the average highest ratio rated acceptable by their deposit size, \$71.7 million in additional loans could be made. The additional loan capacity of \$181.3 million potentially could increase total loans by 12%, from \$1,498 to \$1,680 million.

#### Revision of payment method for correspondent services

Banks in South Dakota keep funds on deposit with larger, correspondent banks in exchange for services provided. Because many of these correspondent banks are located outside the state, a flow of funds outside the state results.

In a study of the flow of funds through the commercial banking system between Minnesota and North Dakota, Mathew Shane of the University of Minnesota determined that during the last decade between \$37 and \$59 million left the state of North Dakota each year (10). This amounted to 3 to 4% of the total bank deposits of North Dakota. The bank structure of South Dakota is similar to that of North Dakota; thus it is probable that a similar magnitude of funds also left South Dakota. In fact, among the banks in South Dakota whose home office is outside Minnehaha County, the correspondent balances as a percentage of deposits is 5.3% (2, p.80). Some of these balances are held in other South Dakota banks—in December 1973 the banks of the state had deposits from other commercial banks of \$26.7 million (4)—so the flow of funds out of the state is probably not the full 5.3% of deposits.

However, some outflow of funds undoubtedly is occurring and it is likely that the outflow is larger than the 4% of deposits that are committed to industrial loans. To reduce or halt this outflow, the correspondent system method of payment could be revised. One alternative method is a fee system where the banks would pay a fee for the services provided by the correspondent.

#### Federal Reserve's seasonal borrowing privilege

The Federal Reserve's seasonal borrowing privilege was initiated in April 1973 to provide relief for member banks that experience seasonal variations in deposits and/or loans. To be considered a member bank must lack reliable access to national money markets and must experience a dip in its net fund availability (deposits minus loans) at about the same time each year for a period of at least 8 consecutive weeks. The amount of seasonal credit extended during this time period is usually limited to the amount by which the seasonal dip exceeds 5% of the bank's average total deposits in the preceding calendar year (8, pp. 5-7).

By using data for the period 1968 to 1972, Melichar found that 26% of member banks in the nation that would have qualified are located in the Plains states. In fact, 50% of the member banks in the Plains states qualified. The number of banks that qualified was lowest in the winter months, and reached a peak in the summer months (8, pp. 12-13).

Of the 33 member banks in South Dakota that responded to the questionnaire all but two indicated that they qualify.<sup>18</sup> Thus at least 31 of 56, or 55%, of member banks meet the requirements. Some non-

responding member banks undoubtedly also qualify, especially since many are smaller, rural banks, so that the percentage of qualifying banks is greater than 55% and may be close to 94%.

Although 31 member banks indicated that they qualify for the seasonal borrowing privilege, 24 do not use this privilege at all, and the 7 banks that do use the privilege use it only slightly. As shown by Table 24, banks that do use the privilege tend to be larger banks, and to have higher loan-to-deposit ratios than those banks that do not use the privilege.

Table 24. Use of the Federal Reserve's seasonal borrowing privilege by qualifying banks in South Dakota.

Bank characteristic	Number using privilege		
	Not at all	Slight	Extensive
<b>Deposit size (\$ millions)</b>			
Under 5	3	0	0
5-10	8	1	0
10-20	6	4	0
Over 20	7	2	0
<b>Loan-to-deposit ratio</b>			
Under 0.40	3	0	0
0.41-0.50	5	1	0
0.51-0.60	9	1	0
0.61-0.70	7	3	0
Over 0.70	0	2	0

Source: Questionnaire responses.

#### State industrial loan guarantee

A bill was introduced in the forty-ninth Session of the South Dakota Legislature (1974) that would "provide a state guarantee for loans which will contribute to economic development but would not be provided on reasonable terms in the absence of such a guarantee because of the real or imagined risk associated with such loans" (14). The bill was not passed. Similar bills failed to pass in the fiftieth and fifty-first sessions.

When asked if a state industrial loan guarantee would increase their current proportion of total loans going for industrial establishment or expansion, 76% of the bankers responded yes and 23% responded no. (Seventy-four percent of the main-office bankers responded yes; 26% responded no.)

As shown in Table 25, a larger percentage of the bankers in smaller communities than larger communities indicated that a state loan guarantee would increase their industrial loans. Some bankers from the larger banks in larger communities indicated that, given their present loan structure, a state guarantee program would not induce them to increase their industrial loans. Larger banks already utilize the SBA program, which is similar to the proposed state program, to a greater extent than do the smaller banks.

Except for the Third District, which has a lower-than-average number of affirmative responses, there are no important differences in responses by planning and development district.

#### Demand and supply

Both capital investment in manufacturing and bank deposits have grown during the recent few years and will probably continue to increase in the future. In absolute amounts bank deposits have increased faster than investment, but in percentage amounts, investment has increased faster. This rela-

<sup>17</sup> Bank data for December 31, 1973, was used. If the actual loan-to-deposit ratio of a bank was higher than it thought comfortable, or higher than the average that its deposit size group thought comfortable, then the bank loans were not increased or decreased for this estimate.

<sup>18</sup> The two banks that indicated that they did not qualify are located in cities over 10,000 population and have deposits over \$20 million.

tionship is shown in Figure 4, where past and projected ratios of investment to bank deposits in percentage terms are plotted. The full amount of investment is not the amount borrowed from banks, since funds for investment are not all borrowed from banks, and since additional funds may be borrowed for current assets. Nevertheless, the projections suggest that more funds will be demanded from banks in the state by manufacturing firms in future years. Yet, the amount will still be a small percentage of total deposits, and the methods for expanding the industrial loan capacity of banks discussed previously should provide sufficient loanable funds to banks to meet even the high projected demand.

Table 25. The effect of a state industrial loan guarantee on bank lending practices.

Bank location	Response			
	Increase Industrial loans		No effect	
	Number of banks	Percent of banks	Number	Percent
Community size (persons)				
Under 1,000	56	78	16	22
1,001-2,500	15	88	3	12
2,501-10,000	6	60	4	40
Over 10,000	10	67	5	33
Planning and development district				
I	17	77	5	23
II	13	76	4	24
III	10	53	9	47
IV	23	82	5	18
V	14	88	2	12
VI	10	83	2	17

Source: Questionnaire responses.

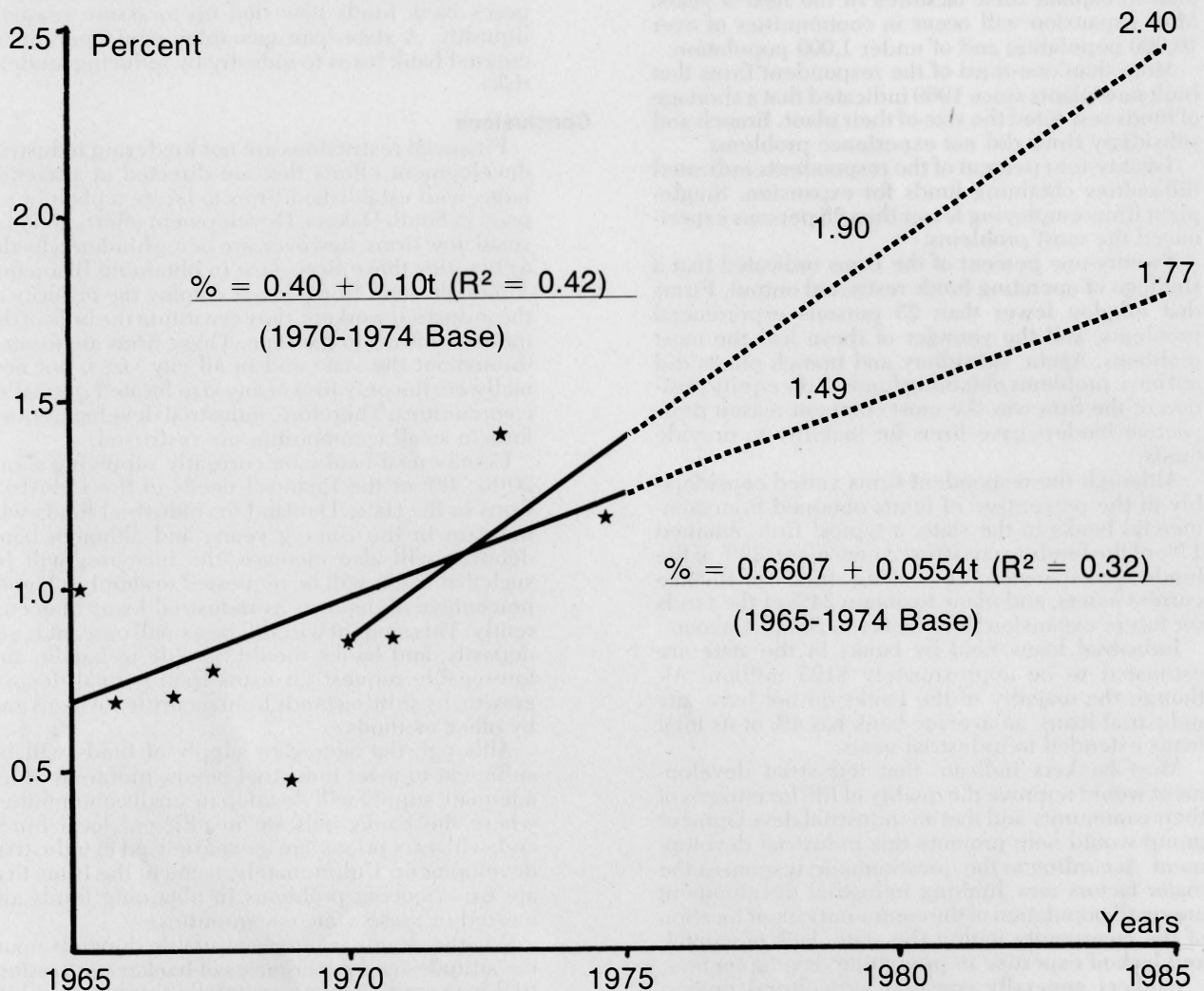


Figure 4. New capital expenditures in manufacturing as a percentage of total bank deposits, 1965-1974, and projections to 1980 and 1985 (1965-1974 percentages are based on data in Tables 20 and 21).

## Summary and conclusions

### Summary

During the last decade, South Dakota experienced out-migration of its younger population and per capita income levels lower than the national median. One method to stem out-migration and reduce income differentials is to increase employment and income levels of export industries that can induce employment and income multiplier effects throughout the local economy.

Objectives of this study were to determine if financial impediments to growth of the manufacturing industry in South Dakota exist or are likely to emerge in the near future, and to describe the role of banks in financing industrial development.

The study described the structure and past and future growth of the banking and manufacturing-processing industries in South Dakota.

Historically, industrial firms have located in South Dakota because the city of location was the home community of the owner and because raw materials and markets were close. Although these location factors continue to be important factors affecting establishment of firms in the state, abundant labor and favorable tax policies have also become important, especially for those firms whose home office is located outside the state.

Many firms did not expand during the last 5 years because they were satisfied with their present size. Lack of markets for more production and unavailability of financing were also reasons some firms did not expand. The majority of the respondent firms plan to expand their facilities in the next 5 years. Most expansion will occur in communities of over 10,000 population and of under 1,000 population.

More than one-third of the respondent firms that built new plants since 1969 indicated that a shortage of funds restricted the size of their plant. Branch and subsidiary firms did not experience problems.

Twenty-four percent of the respondents indicated difficulties obtaining funds for expansion. Single-plant firms employing fewer than 25 persons experienced the most problems.

Twenty-one percent of the firms indicated that a shortage of operating funds restricted output. Firms that employ fewer than 25 persons experienced problems, and the younger of these had the most problems. Again, subsidiary and branch plants did not have problems obtaining funds. Low equity position of the firm was the most common reason prospective lenders gave firms for inability to provide funds.

Although the respondent firms varied considerably in the percentage of funds obtained from commercial banks in the state, a typical firm obtained 17% of the funds to construct a new plant, 32% of the funds for expansion, 22% of the funds to finance current assets, and plans to obtain 24% of the funds for future expansion from banks in South Dakota.

Industrial loans held by banks in the state are estimated to be approximately \$125 million. Although the majority of the banks do not have any industrial loans, an average bank has 4% of its total loans extended to industrial users.

Most bankers indicate that industrial development would improve the quality of life for citizens of their community and that an industrial development group would help promote this industrial development. According to the questionnaire responses the major factors now limiting industrial development are small population of the community, poor location of the community within the state, lack of capital, and lack of expertise in promoting development.

Bankers generally consider agricultural processing and light manufacturing as most appropriate for their community. More bankers in small com-

munities than in large communities do not think their community has the capacity to finance industrial development from local sources. There is a high degree of cooperation among banks and between banks and other lenders to meet the needs of industrial borrowers. Small banks and banks in small communities rated the experience of their loan officer in industrial development lower than did large banks and banks in large communities.

Important factors limiting bankers' abilities or willingness to increase industrial loans are lack of demand for industrial loans and quality of applicants. Both banks with high loan-to-deposit ratios and those with low loan-to-deposit ratios indicate that prior commitment of funds is an important factor limiting their ability to increase industrial loans.

The demand for industrial funds in South Dakota is projected to increase by about \$3 million to \$6 million per year over the next few years. Banks might be requested to lend a larger percentage of their deposits to industrial firms than during past years. However, the amount required will still be a small percentage of total deposits and of total loans. Banks should be able to meet requests for funds.

Methods for expanding the industrial loan capacity of banks include increasing loan-to-deposit ratios, use of the Federal Reserve's seasonal borrowing privilege, and enactment of a State Industrial Loan Guarantee program. If banks would increase loan-to-deposit ratios to the highest ratio acceptable to them, loans in the state could increase 12%. Increased use of the Federal Reserve's seasonal borrowing privilege could release for industrial purposes bank funds now tied up to assure seasonal liquidity. A state loan guarantee could permit increased bank loans to industry by reducing lender's risks.

### Conclusions

Financial restrictions are not hindering industrial development efforts that are directed at attracting large, well established firms to locate a plant or expand in South Dakota. Development efforts aimed at small new firms, however, are being hindered by the difficulties these firms face in obtaining financing. Although small firms do not employ the majority of the industrial workers, they constitute the bulk of the industrial firms in the state. These firms are located throughout the state and in all city sizes, but normally are the only firm of any size located in smaller communities. Therefore, industrial development efforts in small communities are restricted.

Commercial banks are currently supplying about 20 to 30% of the financial needs of the industrial firms in the state. Demand for industrial funds will increase in the coming years; and although bank deposits will also increase, the increases will be such that banks will be requested to supply a higher percentage of deposits as industrial loans than currently. This amount will still be a small percentage of deposits, and banks should be able to handle any foreseeable request for loans from normal deposit growth, by shifting funds from securities to loans and by other methods.

Although the aggregate supply of funds will be sufficient to meet industrial needs, problems of inadequate supply will develop in small communities where the banks indicate insufficient local funds and, with exceptions, are inexperienced in industrial development. Unfortunately, some of the firms that are experiencing problems in obtaining funds are located in these same communities.

Whether funds are made available depends upon the attitudes and experiences of bankers and industrial managers. Bankers generally think that industrial development will improve the quality of life for their community; however insufficient equity and

management experience of loan applicants are reasons limiting their ability to increase loans. For each bank, regardless of whether these reasons may be real or imagined, the extension of funds to industrial firms in the state is restricted.

As banks cannot be expected to engage in risky lending operations, a state loan or loan guarantee program that would provide funds for firms that are unable to secure funds by normal procedures might prove useful in promoting industrial and general economic development. However, the probable effects of state industrial loan guarantees cannot be predicted without further research to explore why

the SBA loan guarantee and Federal Reserve seasonal borrowing programs are not more widely used. Also needed are estimates of the magnitude of additional funds which could be made available through expanded use of existing or proposed programs. In any case, for such a program to be effective, it should be narrowly defined and focused to meet the needs of those firms not adequately served by existing financial institutions. Furthermore, the state must be willing to risk some loss of monies since if the program is to serve the target firms it should not substitute for nor compete with clearly profitable lending activities of other private or public sources.

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