

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

Memorandum

To: Members, Subcommittees on Economic Growth, Tax, and Capital Access and
Agriculture, Energy, and Trade
From: Committee Staff
Date: June 23, 2018
Re: Hearing: “Investing in Rural America”

On Tuesday, July 24, 2018 at 10:00 A.M., the Subcommittee on Economic Growth, Tax, and Capital Access and the Subcommittee on Agriculture, Energy, and Trade will meet for a joint hearing titled, “Investing in Rural America.” Access to capital is one of the key ingredients to small business success. Early stage funding, such as venture capital, can help small businesses expand and hire more individuals in their community. However, venture capital is predominately awarded to businesses in larger cities on the coasts. Various groups, including public-private partnerships, trade associations, and university based groups, have emerged to help identify opportunities for private investors that support growing rural small businesses across the United States. This hearing will examine venture capital’s role in helping small businesses access capital and highlight success stories of organizations that provide resources to small businesses in rural America.

I. Rural America

A. Rural Demographics

According to the most recent Census, there are almost 60 million people, or about 19 percent of the American population, living in rural areas.¹ While metropolitan areas and the United States population are steadily increasing, the amount of people living in rural areas slightly declined from 2010 to 2016.² Factors contributing to the recent rural population decline include young adults leaving for urban areas, rural women having fewer children than the national average, and the increase of prescription medication abuse.³

¹ UNITED STATES CENSUS BUREAU, RURAL AMERICA, *available at* <https://storymaps.geo.census.gov/arcgis/apps/MapSeries/index.html?appid=9e459da9327b4c7e9a1248cb65ad942a&cid=16O104>.

² UNITED STATES DEPARTMENT OF AGRICULTURE, ECONOMIC RESEARCH SERVICE, RURAL ECONOMY (2018), *available at* <https://www.ers.usda.gov/data-products/ag-and-food-statistics-charting-the-essentials/rural-economy/>.

³ Persistently poor communities were defined by the United States Department of Agriculture as those with 20 percent or more of their populations living in poverty over approximately 30 years. UNITED STATES DEPARTMENT OF AGRICULTURE, RURAL AMERICA AT A GLANCE, 2-3 (2017), *available at* <https://www.ers.usda.gov/webdocs/publications/85740/eib-182.pdf?v=43054>.

Household income is considerably lower in rural areas than urban areas. According to the United States Department of Agriculture, rural median income is about 25 percent below urban median income.⁴ There is also a large amount of persistently poor rural counties in the United States. There are over 300 rural counties that are persistently poor, compared to just 50 urban counties.⁵ However, the income gap between urban and rural areas has narrowed over the past few decades. In 1960, the rural to urban poverty gap was about 17 percent, and that has declined to just 3.6 percent today.⁶ Rural educational attainment rates also trail metropolitan areas. According to the United States Department of Agriculture, in 2015, 33 percent of individuals in metropolitan areas held a Bachelor's degree or higher, while only 19 percent of individuals in non-metropolitan areas held a Bachelor's degree or higher.⁷

B. Rural Small Business and Entrepreneurship

Small business and entrepreneurship conditions between urban and rural areas are quite different. Individuals living in rural areas are more likely than their urban counterparts to be self-employed.⁸ While self-employment in urban areas has remained relatively constant, the amount of self-employed individuals in rural areas has declined by 2 percentage points over the past 25 years.⁹

Small businesses are also a vital component of the rural economy. Of the 2.1 million farms in the United States, 88 percent of them are considered small family farms with less than \$350,000 in gross cash farm income.¹⁰ Small farms also account for 48 percent of all farmland and hold 47 percent of farmland and building value.¹¹ In many rural areas, almost or all of businesses in the area are small businesses. For example, small businesses in rural areas of Wisconsin account for about 77 to 100 percent of the total employment in a county.¹²

Business startup rates in rural America are low. While 20 percent of new businesses were established in rural areas in 1977, only 10 percent of new businesses are established in rural areas today.¹³ Further, while counties with under 100,000 residents had higher establishment growth rates between 1992 and 1996 than counties with over 1 million residents, counties with

⁴ *Id.* at 4.

⁵ *Id.*

⁶ The rural-urban poverty gap is calculated by subtracting the urban poverty rate from the rural poverty rate. *Id.*

⁷ UNITED STATES DEPARTMENT OF AGRICULTURE, ECONOMIC RESEARCH SERVICE, NONMETRO EDUCATION LEVELS ARE IMPROVING, BUT STILL LAG METRO (2017), available at <https://www.ers.usda.gov/data-products/chart-gallery/gallery/chart-detail/?chartId=58306>.

⁸ SMALL BUSINESS ADMINISTRATION OFFICE OF ADVOCACY, THE RETREAT OF THE RURAL ENTREPRENEUR 4 (2017), available at https://www.sba.gov/sites/default/files/advocacy/Retreat-Rural-Entrepreneur.pdf?utm_medium=email&utm_source=govdelivery.

⁹ *Id.* At 5.

¹⁰ UNITED STATES DEPARTMENT OF AGRICULTURE, NATIONAL AGRICULTURAL STATISTICS SERVICE, SMALL FARMS (2016), available at https://www.agcensus.usda.gov/Publications/2012/Online_Resources/Highlights/SmallFamilyFarms.pdf.

¹¹ *Id.*

¹² <https://www.wmc.org/news/small-businesses-drive-wisconsin-u-s-economy/>.

¹³ KAUFFMAN FOUNDATION, ENTREPRENEURIAL ECOSYSTEM BUILDING PLAYBOOK 2.0 (2018), available at <https://www.kauffman.org/entrepreneurial-ecosystem-building-playbook-draft-2/i-why-do-entrepreneurs-matter#rural>.

over 1 million residents had the highest establishment growth rate from 2010 to 2014.¹⁴ Counties with less than 100,000 residents had an average establishment growth rate of 9 percent in the early 1990s, yet in those same counties, the number of establishments declined by 1 percent from 2010 to 2014.¹⁵

II. Venture Capital in the United States

Venture capital is a popular capital access method for smaller businesses looking to expand. Venture capital is a form of private equity that is focused on small businesses that have been identified as having high growth potential. It is used to help grow a business for both expense investments and for a business's balance sheet.¹⁶ In just the second quarter of 2018, venture capitalists invested over \$27 billion in United States businesses.¹⁷ The past two quarters have resulted in the highest quarterly deal values for venture capital in the last decade.¹⁸

Although venture capital is becoming increasingly popular, this form of access to capital almost exclusively goes to just a few industries located in major coastal and urban cities. In 2016, 75 percent of venture capital investments went to businesses located in California, New York, and Massachusetts.¹⁹ Also, of the 10 largest venture capital funds in the United States, 8 of them are either located in either California or Massachusetts.²⁰ On the other hand, there are several rural states that received minimal or no venture capital investment in 2017. States without any venture capital investment in 2017 include Kansas, Missouri, Oklahoma, and others.²¹

Venture capital is also concentrated in just a few key industries. Over 40 percent of all venture capital deals and deal value go to the software industry.²² Further, about 20 percent of all venture capital deals and over 26 percent of venture capital deal value goes to biotech, pharmaceuticals, and healthcare related industries.²³ Reasons for the geographic and industry concentrations include that many investors believe software and biotech have the greatest return

¹⁴ Establishment growth rate was the percent change of businesses in an area during an observed time period. *The Decline of Economic Opportunity in the United States: Causes and Consequences: Hearing Before the Joint Economic Committee*, 115th Congress, First Session (2017) (testimony of John Lettieri), available at https://www.jec.senate.gov/public/_cache/files/bbb53bfb-ef4c-4182-b729-64fc1965ce78/john-lettieri-testimony-040517.pdf.

¹⁵ *Id.*

¹⁶ Bob Zider, *How Venture Capital Works*, HARVARD BUSINESS REVIEW (December 1998), available at <https://hbr.org/1998/11/how-venture-capital-works>.

¹⁷ NATIONAL VENTURE CAPITAL ASSOCIATION, PITCHBOOK-NVCA 1Q 2018 VENTURE MONITOR 13 (2018) [hereinafter NVCA Monitor], available at <https://nvca.org/research/venture-monitor/>.

¹⁸ *Id.* at 4.

¹⁹ Rise of the Rest Seed Fund, REVOLUTION, available at <https://www.revolution.com/entity/rotr/>

²⁰ NATIONAL VENTURE CAPITAL ASSOCIATION, 2018 NVCA YEARBOOK 16 (2018), available at <https://nvca.org/research/research-resources/>.

²¹ *Id.* at 18.

²² NVCA Monitor, *supra* note 17, at 8.

²³ *Id.*

on investment, and that geographic proximity helps investors have a greater understanding of a potential investment.²⁴

III. Expanding Venture Capital Across the Country

Although venture capital is still largely concentrated in just a few industries and in the larger cities in the country, strides have been made to increase venture capital financing in other parts of the country. In 2017, smaller states such as Wyoming, Iowa, and Arkansas saw a marked year-over-year increase in the number of venture capital deals completed.²⁵ Also, while Oregon and Utah are both in the bottom half of the most populated states, Oregon had the 19th highest amount of venture capital invested and Utah had the 10th highest amount of venture capital invested in 2017.²⁶

A. Rural Specific Investment Programs

Both the private sector and public sector have made initiatives to create new avenues for small businesses in rural areas to access capital. For example, the Rural Business Investment Program within the United States Department of Agriculture helps facilitate capital investment in rural communities. The program grants a Rural Business Investment Company (RBIC) license to venture capital groups for the purpose of lending to small businesses in rural America. An RBIC fund is a diversified portfolio of junior capital investments and focus on growth-oriented small businesses involved in agriculture and rural and related industries.²⁷ The license requires RBICs to lend a minimum of 75 percent to rural areas with populations less than 50,000, and 50 percent of funds to be invested in small businesses.²⁸

Other groups are beginning to provide financing to rural businesses that do not follow typical business models. For example, food cooperatives, which are a collection of farmers that provide vital sources of produce and livestock for rural areas, are typically seen as an atypical business model and do not qualify for conventional small business financing.²⁹ CoBank, which is a national cooperative bank, partners with farm credit associations to provide financing and promote and support local food markets.³⁰ They also provide services such as mentoring and outreach initiatives for young and beginning small farmers.³¹

²⁴ Elizabeth MacBride, *Why We Need To Look For Innovation Outside America And Its Elites*, FORBES (September 30, 2017), available at <https://www.forbes.com/sites/elizabethmacbride/2017/09/30/6-reasons-to-worry-about-innovation-in-america/#4757b6c84fbc>.

²⁵ NVCA Monitor, *supra* note 17 at 23.

²⁶ *Id.* at 22.

²⁷ COBANK, PRODUCTS AND SERVICES, ADVANTAGE CAPITAL AGRIBUSINESS FUND, available at <http://www.cobank.com/Products-Services/Public-Private-Partnerships/Advantage-Capital-Agribusiness-Fund.aspx>

²⁸ UNITED STATES DEPARTMENT OF AGRICULTURE, RURAL DEVELOPMENT, RURAL BUSINESS INVESTMENT PROGRAM, available at <https://www.rd.usda.gov/programs-services/rural-business-investment-program>.

²⁹ UNITED STATES DEPARTMENT OF AGRICULTURE, CO-OPS: A KEY PART OF RURAL AMERICA, available at <https://www.usda.gov/topics/rural/co-ops-key-part-fabric-rural-america>.

³⁰ COBANK, GROWING RURAL AMERICA, available at http://www.cobank.com/~media/Files/Searchable%20PDF%20Files/About%20Cobank/Growing%20Rural%20America/GrowingRuralAmericaBrochure_v4.pdf.

³¹ *Id.*

B. Task Force on Agriculture and Rural Prosperity

On April 25, 2017, President Trump established the Interagency Task Force on Agriculture and Rural Prosperity through Executive Order 13790.³² In the United States Department of Agriculture report issued in accordance with Executive Order 13790, Secretary Sonny Perdue listed access to capital as one of the key components to improving rural economic development.³³ Recommendations in the report to improve rural access to capital included a renewed focus on public lending programs to rural areas, regional and state collaboration, and a legal or financial vehicle to bundle rural projects to attract private sector investment.³⁴

C. Advocacy Organizations

Nonprofits and universities are working to highlight some of the typically overlooked businesses that could be good candidates for venture capital. For example, VentureOhio, a nonprofit that advocates for increased venture capital investment in Ohio, has made significant efforts to help increase investment in the state. Their initiatives include showcasing state assets to investors, encouraging investor collaboration, and increasing the overall visibility of investment opportunities in the state. By increasing the awareness of investment opportunities in the state, Ohio venture capital increased by 26 percent in 2016 and by 46 percent over the previous 2 years.³⁵

The Rural Opportunity Initiative is another example of an organization that is trying to match rural small business owners with venture capital investors. Founded as a public-private partnership, the initiative is a collaboration with leaders at the United States Department of Agriculture, Georgetown University, Mississippi State University, and many others. Currently, many investors are unaware of potential investment opportunities in rural America. At the same time, the decline in small financial institutions has particularly hurt small businesses in rural areas looking for capital.³⁶ The Rural Opportunity Initiative's goal is to help investors become more aware of investment opportunities in rural America to help bridge the current gap.³⁷

IV. Conclusion

Economic conditions in rural areas vary from urban areas. Rural areas are typically poorer, and their population is declining. At the same time, rural areas have a higher percentage of self-employed individuals. Small businesses are also a critical component to the rural economy, but access to capital remains an issue for many rural small businesses. Venture capital has become a popular financing avenue for businesses looking to expand. Many initiatives both

³² Exec. Order No. 13790, 82 Fed. Reg. 20237, (April 28, 2017).

³³ UNITED STATES DEPARTMENT OF AGRICULTURE, REPORT TO THE PRESIDENT OF THE UNITED STATES FROM THE TASK FORCE ON AGRICULTURE AND RURAL PROSPERITY 16 (2017), available at <https://www.usda.gov/sites/default/files/documents/rural-prosperity-report.pdf>.

³⁴ *Id.* at 39.

³⁵ VENTUREOHIO, 2017 VENTURE REPORT 13 (2018), available at <https://ventureohio.org/wp-content/uploads/2017/06/2017-VentureReport-LR.pdf>.

³⁶ GEORGETOWN UNIVERSITY, RURAL OPPORTUNITY INITIATIVE, available at <http://socialenterprise.georgetown.edu/content/rural-opportunity-initiative>.

³⁷ *Id.*

in the public and private sector have been created to help small businesses across the country have access to venture capital. From creating new investment tools for rural co-ops, RBICs, and even simply advocating about the importance of venture capital in rural areas, investors are starting to look for investment opportunities all across the country.