



NC
RURAL
CENTER



THREAD
CAPITAL

SMALL BUSINESS
DYNAMISM IN NORTH CAROLINA

It's a fact that can easily get lost in the frequent news coverage of a state's high-profile efforts to recruit the next big business: small business owners and local entrepreneurs make up the heart of most rural economies, not the big win of the online retailer, mammoth data farm, or large-scale automotive manufacturer.

Whether they are machine shops, retail operations, or small-scale manufacturing operations, rural entrepreneurship—the creation of small businesses¹ by creative risk-takers—is the positive change that keeps rural economies moving and growing. Every community and county wants to land the next big industry, but ask any economic developer and they will tell you: Small businesses are simply the lifeblood of any small town or rural community.

While our society values small businesses, we have been slow to recognize that today all is not well. The long-term decline of new business formations has been noted in national research by prominent think tanks, foundations, and even the United States Federal Reserve. The Hamilton Project of the Brookings Institution noted that declining economic dynamism² is a restraint on wage growth.³ The Chicago, Philadelphia, Richmond, and Atlanta Federal Reserve Bank Districts all have increasingly turned their formidable economic analysis to the decline in business formation and its possible causes.⁴ Most visible by federal policy makers and the national press is the Economic Innovation Group's 2017 report, *Dynamism in Retreat*,⁵ which documents, among a range of findings, that business formation has diminished with each of the past four economic recoveries following a recession.

What has the change in the number of very small business establishments looked like in rural North Carolina? And what might be the cause of that change across the state, whether positive or negative?

¹ Data used for this report is non-farm business data only. All dollar values are adjusted to 2017 real dollars.

² “Dynamism” is increasingly used as a broad term to denote economic vitality spurred by new firm creation, which increases employment growth, wage growth, and labor mobility.

³ Shambaugh, Nunn, and Liu. *How Declining Dynamism Affects Wages*. The Hamilton Project of the Brookings Institution. February 2018.

⁴ See the following publications: *Keeping up with the Gazelles, Part 1: Is the Herd Thinning?* Federal Reserve Bank of Atlanta. 2015; Gourio, Messer, and Siemer. *What is the economic impact of the slowdown in new business formation?* The Federal Reserve Bank of Chicago. 2014; and Ambrose, Cordell, and Ma. *Working Paper No. 15-26: The Impact of Student Loan Debt on Small Business Formation*. Federal Reserve Bank of Philadelphia. 2015.

⁵ *Dynamism in Retreat*. Economic Innovation Group. February 2017.

CHANGE IN VERY SMALL BUSINESS ESTABLISHMENTS

The Great Recession in North Carolina had repercussions far beyond the official time frame of December 2007 to June 2009. It is arguable that due to the high loss of manufacturing and financial services jobs, no state suffered more than North Carolina.

Defining a “small” business is a slippery task. The U.S. Small Business Administration defines a small business as any business with less than 500 employees. This is an exceptionally expansive definition.

At the NC Rural Center, we focus on the other end of the spectrum—very small firms with less than 10 employees. We do this to draw attention to data that indicates changes in new business creation. The Census Bureau’s County Business Pattern data indicates that rural North Carolina lost 4,289 very small businesses between 2005 and 2015, a decline of seven percent. This is in marked contrast to an increase of 5,534 small businesses in our six core urban counties—a growth of nine percent. Figure 1 shows this divergence clearly. The uneven geographic recovery in small business creation reflects the hyper-population growth in the Charlotte and the Triangle Metropolitan areas that quickly regained steam immediately after the Great Recession ended.



↓7%

Between 2005 and 2015, there was a 7% decline in very small business establishments in rural North Carolina.

4,289

very small businesses lost in rural NC between 2005 and 2015.

FIGURE 1: PERCENTAGE CHANGE IN NUMBER OF BUSINESSES WITH LESS THAN 10 EMPLOYEES (2005-2015)

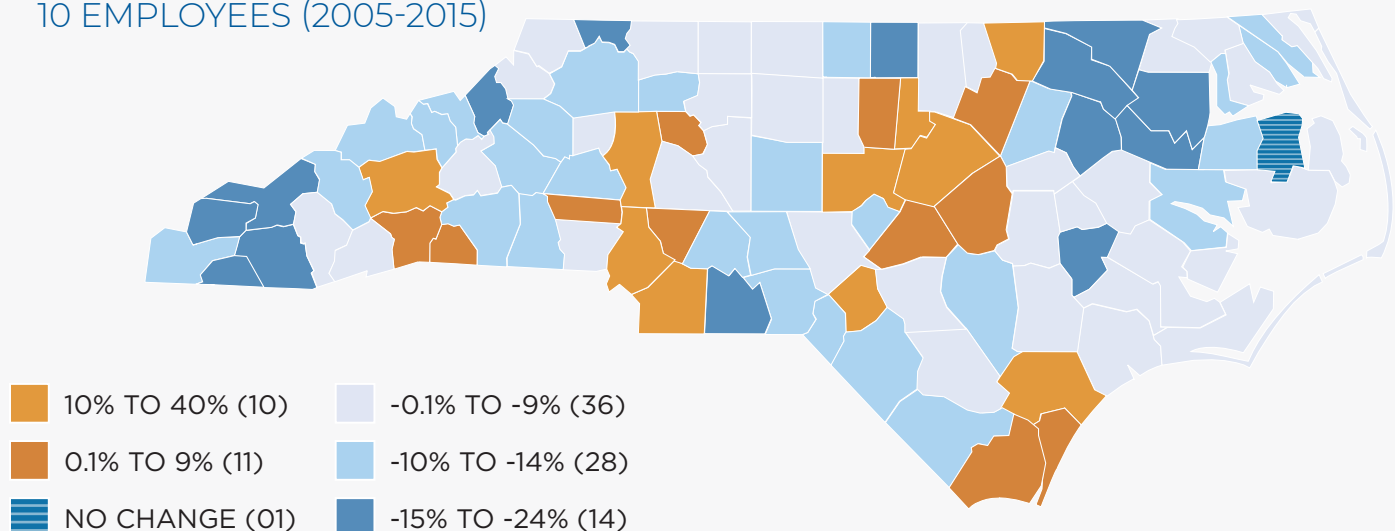


FIGURE 1: CONTINUED

RURAL CENTER COUNTY CLASSIFICATION	NUMBER OF BUSINESSES WITH LESS THAN 10 EMPLOYEES		NUMERIC CHANGE	% CHANGE
	2005	2015	2005-2015	2005-2015
6 URBAN COUNTIES	59,722	65,256	+ 5,534	+ 9.3%
14 REGIONAL CITY/SUBURBAN COUNTIES	37,706	38,854	+ 1,148	+ 3.0%
80 RURAL COUNTIES	60,527	56,238	- 4,289	- 7.1%

Insights come from specific data sources but also from the time frame of analysis. Post 2010, small business numbers began to **grow strongly** (plus 3,180, or five percent) in urban counties and **slightly** in regional city/suburban counties. At the same time, however, there was a divergent path for rural North Carolina's small businesses, which continued to **decline** in number between 2010 and 2015. In that time frame, businesses in rural counties with less than 10 employees declined by 2,657, or five percent.

The reasons for this decline in rural small business establishments are complex, a mix of converging trends such as sectoral shifts away from durable goods, consolidation and vertical integration within industries, and growth that has been more concentrated in and around fast-growing urban areas. However complex and nuanced the recovery has been in rural North Carolina, one significant driver that is consistent across sector and geography for growth and formation is access to capital for small businesses to start, sustain, or expand.

After 2010, small businesses in urban counties began to grow

↑5%

ACCESS TO CAPITAL

is a significant driver for growth in rural NC

REDUCTIONS IN RURAL BANK BRANCHES

The banking industry has changed significantly in recent years. Historically low interest rates reduced bank profit margins. The cost efficiencies of online banking challenged the traditional reliance on the local brick-and-mortar bank branch relationship between lender and borrower. In North Carolina, between 2005 and 2015, there was a total state net decline of 17 bank branches. All county types gained branches between 2005 and 2010, even during the Great Recession. However, from 2010 to 2015, the total number of bank branches declined by a total of 252.



From 2010 to 2015, the total number of bank branches declined by a total of

252



For every net reduction in an urban bank branch, there were five rural net reductions. Over a five-year period, rural branches declined in number by 14 percent.

The exceptionally anemic economic recovery in a number of rural counties likely accounts for the overall decline, but care must be taken. In many counties that lost branches there was an increase in bank assets. The shift to online banking has, for many, made the traditional trip to the local bank branch unnecessary. There are other possible shifts in underwriting and regulatory standards that contribute to branch consolidation as well.

But bank branch net reductions are only part of the challenge. Another variable, which may influence access to capital, is the availability of commercial loan officers who know the local business conditions and work directly with the local small business community. A February 2017 symposium hosted by Durham-based Reinvestment Partners included presentations by U.S. Federal Reserve staff, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency, and others, highlighting the real but difficult challenge of bank branch closures.⁶ There is still much we don't know about the factors influencing local bank branch closures. Supplemental research is needed to better understand these trends.

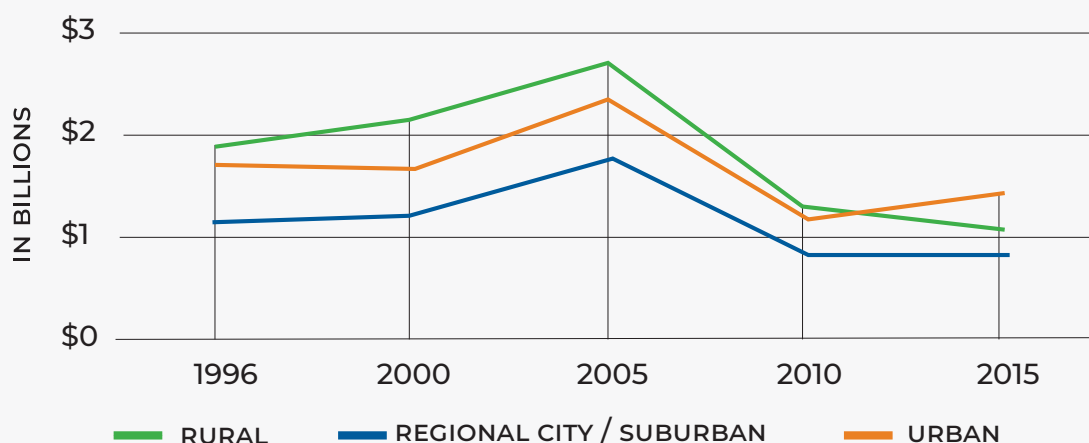
⁶ Most of the presentations from this Symposium are available online at: <https://reinvestmentpartners.org/what-we-do/advocacy-and-research/symposium-presentations.html>.

COMMERCIAL LENDING TO SMALL BUSINESSES

The Community Reinvestment Act data collected by banks and reported to the Federal Financial Institutions Examinations Council (FFIEC), the federal regulatory agency, includes loans made to small businesses with gross annual revenues of \$1 million or less. This does not match up perfectly with the Census Bureau's County Business Patterns data, but it is a reasonable substitute.

Figure 2 shows the **total loan volume** to businesses with gross annual revenues of \$1 million or less. The graph includes data from 1996 to give context to the historic change experienced due to the Great Recession. It is interesting to see the steady increase in rural small business loans between 1996 and the peak in 2005. All three of the Rural Center's county classifications experienced small business lending declines between 2005 and 2010. By 2010, rural small business lending had decreased by 53 percent—a decline of **\$1.4 billion** dollars.

FIGURE 2: DOLLAR AMOUNT OF LOANS TO SMALL BUSINESSES WITH GROSS ANNUAL REVENUES OF \$1 MILLION OR LESS



As with the decline in local bank branches, there are distinctly different trends in lending patterns post 2010. Small business lending in the urban counties rebounded quite well, though not yet approaching lending levels of 2005. Lending in the regional city/suburban counties declined by only one percent. Rural counties, however, continued to experience a decline, a loss of **17 percent** for a total of **\$218 million** by 2015.

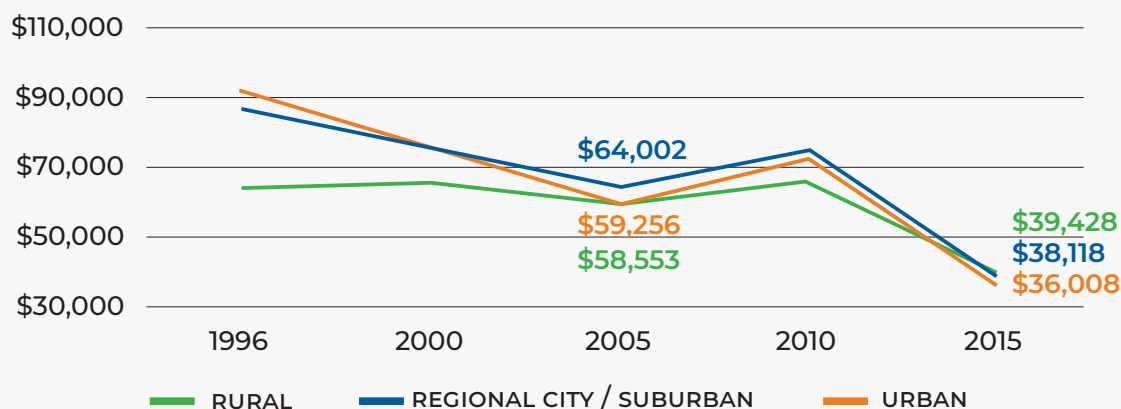
The **number of loans** made to small businesses with gross revenues of \$1 million or less increased after 2010, significantly so for the six core urban counties. However, Figure 3 shows the **average size of loans** to small businesses declined substantially, regardless of the county classification.

Rural counties experienced a 17% decline in small business lending from 2010 to 2015.

↓ 17%

Here, misery loves company: the average loan size for all county classifications declined substantially after 2010. In fact, the decline in average loan size was greatest in the core urban counties, with a decline of 50 percent, and 49 percent for the state's 14 regional city and suburban counties. In North Carolina's 80 rural counties, average loan size declined by 40 percent.

FIGURE 3: AVERAGE LOANS ORIGINATED TO SMALL BUSINESSES WITH GROSS ANNUAL REVENUES OF \$1 MILLION OR LESS



Further analysis of the reasons for this decline is needed, but we suspect that a shift by banks from traditional commercial loans to expanded use of credit cards by small business owners starting in the Great Recession is driving much of the change.

CONCLUSION

This report gives a paint-by-numbers portrait of the relationship between small business lending and the change in the numbers of very small business establishments. While correlation is not causation, even a cautious assessment of the data leads to the reasonable conclusion that the inability to access capital by small rural businesses is real and in need of urgent attention by our state's leaders, local governments, and private lenders.

Rural places and the lending industry are – and have always been – in constant change. The Rural Center's Loan Participation Program and our small business lending subsidiary, Thread Capital, is our way of contributing to entrepreneurial development and small business development across rural North Carolina. We invite you to learn more at www.ncruralcenter.org and www.threadcap.org.

► To learn more about small business changes in your county, visit <http://bit.ly/loandecline>.



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