

Fostering Rural Innovation: The Financial Challenge

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Fostering Rural Innovation: The Financial Challenge

- Challenges to rural innovation
 - The role of innovation
 - Essential elements for innovation
- Financial decisions in rural places
 - Uncertainty in the entrepreneurial economy
 - Funding innovation in rural places
 - Equity capital constraints in rural places
- Alternatives for funding rural innovation



Challenges to Rural Innovation

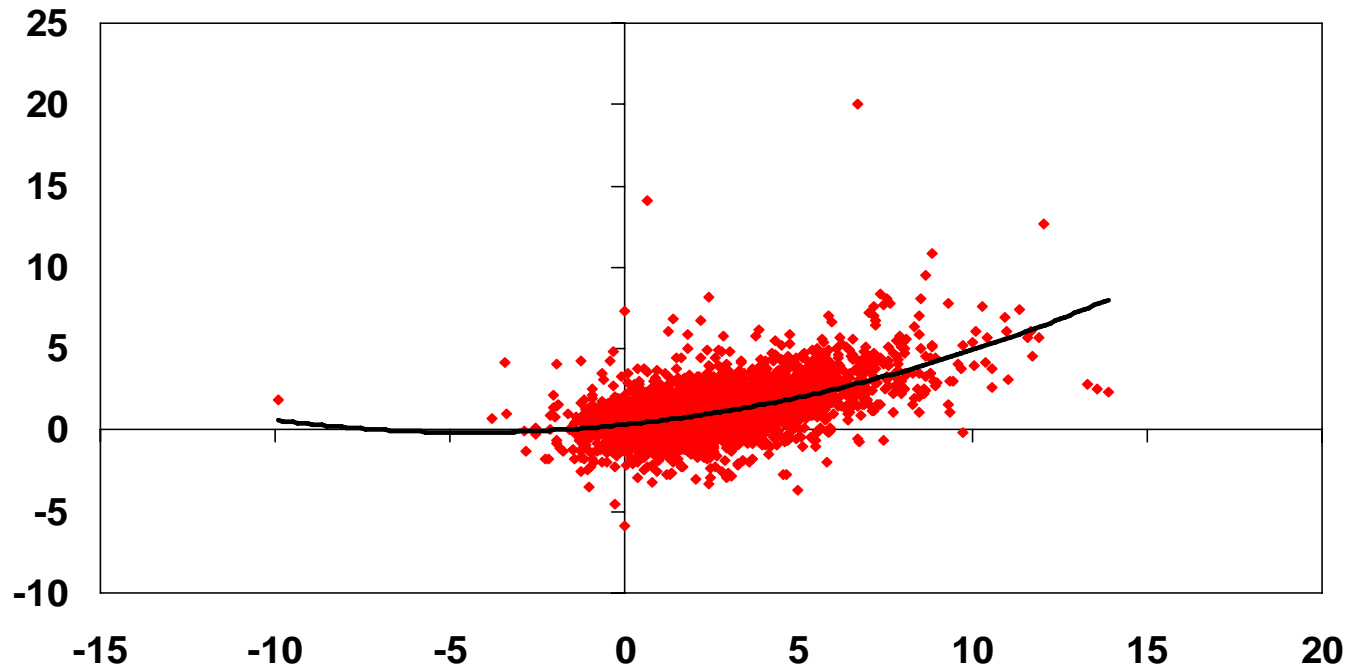


- The role of innovation
 - Schumpeter's creative destruction:
“...the sweeping out of old products, old enterprises, and old organizational forms by new ones”
 - Innovation, entrepreneurship, and economic gains are closely linked



Economic gains are faster in entrepreneurial counties

Employment growth, 1990-2004 (percent)



County Proprietor Growth (1970-1990)

Calculations based on BEA, Regional Economic Information System data



Challenges to Rural Innovation



- The role of innovation
- Essential elements for innovation
 - Agglomeration
 - Knowledge spillovers
 - Thick markets
 - Factors which are generally atypical of many rural places
 - Barkley, Henry, and Lee (2006)
 - Henderson and Abraham (2004)



Challenges to Rural Innovation



- The role of innovation
- Essential elements for innovation
 - Ready access to financial capital is an important element for innovation, although not the primary constraint in many rural places





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The Financier's Decision

		Funding Decision	
		Yes	No
Project Outcome	Success		Type 2 Error: Reject a Successful Project
	Failure	Type 1 Error: Fund a Failing Project	



Financial Decisions in Rural Areas



- Uncertainty in the entrepreneurial economy
 - Type I error: Fund a venture that fails
 - Immediate financial loss
 - Wasteful commitment of resources
 - Type II error: Reject a venture that could succeed
 - Missed financial opportunity
 - Constrained community prospects

Equity is preferred to fund high-risk, high-reward projects.



Financial Decisions in Rural Areas

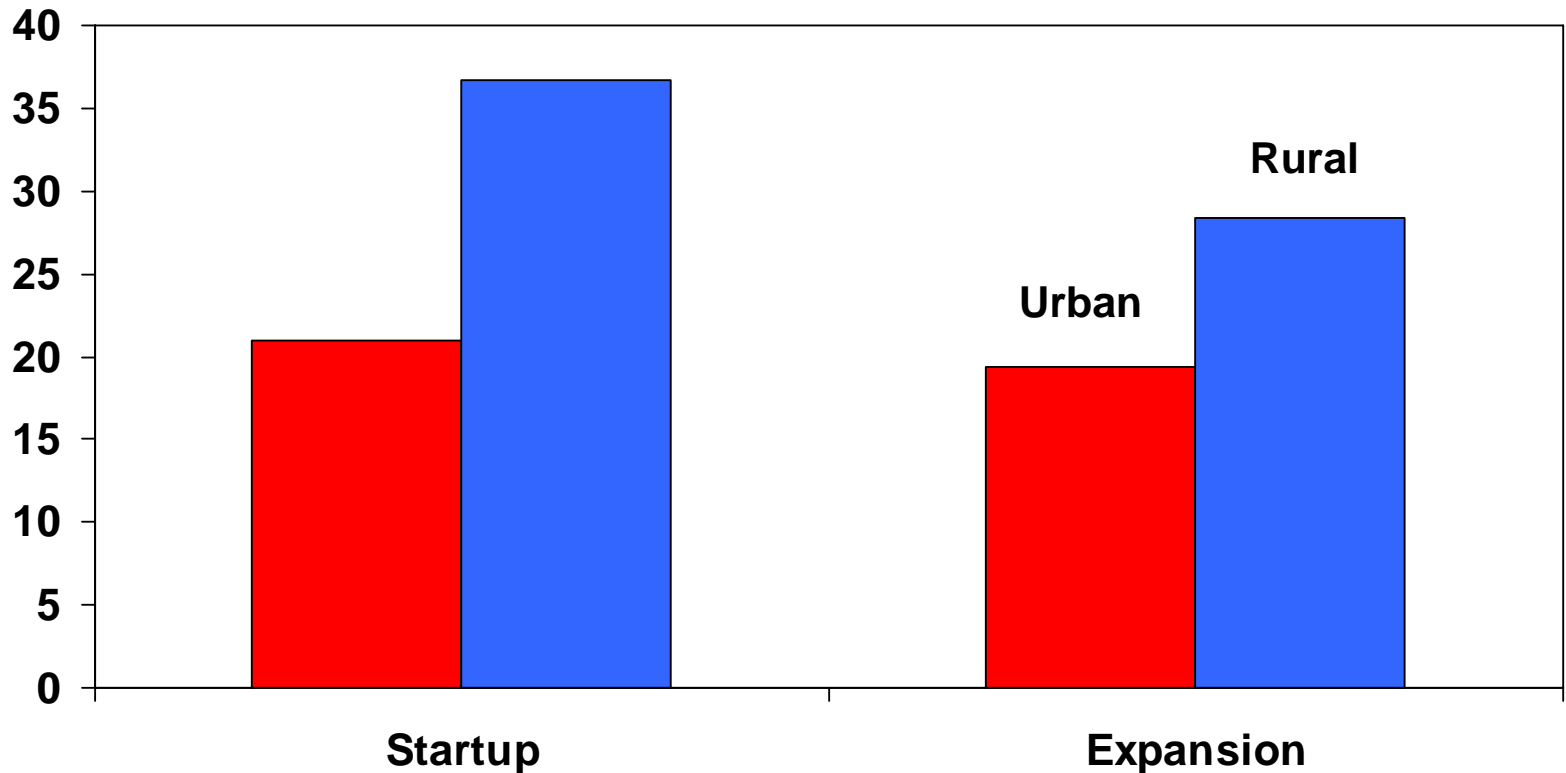


- Uncertainty in the entrepreneurial economy
- Funding innovation in rural places
 - Equity is the funding source of choice
 - Debt funding is relatively more common for rural innovation

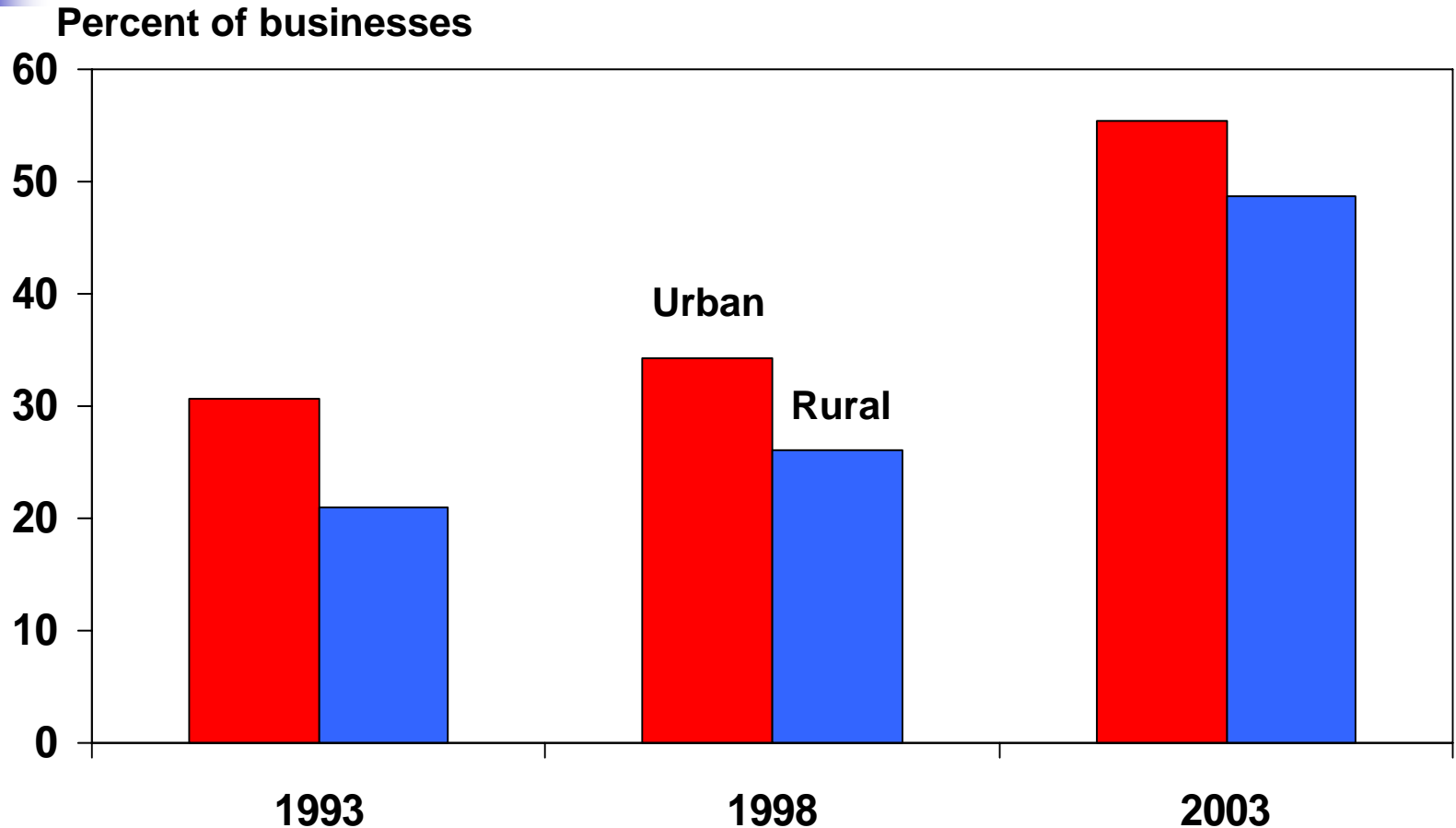


Funding with Bank Loans

Percent of firms using bank loan



Nonbank Funding of Small Business



Sources: Bitler, Robb, and Wolken, 2001; Cole and Wolken 1995; Glover 1999; Mach and Wolken 2006



Financial Decisions in Rural Areas



- Uncertainty in the entrepreneurial economy
- Funding innovation in rural places
- Equity capital constraints in rural places
 - Uncertainty dictates due diligence
 - Size and volume of deals are small
 - Information costs are high
 - Local lenders derive an information advantage





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Alternatives for Funding Rural Innovation

- Business networks
 - Cooperative business relationships
 - Synthesize knowledge spillovers and thick markets
 - Build scale and reduce information costs





Alternatives for Funding Rural Innovation

- Business networks
- Business development programs
 - Focus on entrepreneurs' skill sets
 - Boost number of viable startups





Alternatives for Funding Rural Innovation

- Business networks
- Business development programs

- Angel investors
 - Small equity investments, up to \$2 million
 - Typically invest locally
 - Angel networks build scale and trim costs





Alternatives for Funding Rural Innovation

- Business networks
- Business development programs
- Angel investors

- Community development venture capital
 - Social and profit objectives
 - Lower return accepted
 - Exit strategy a challenge





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■ Concluding Comments

- Financial capital is essential for rural innovation, but not the primary constraint
- Fundamental rural challenges are to boost deal flow and mitigate information costs
- Information on rural equity markets is limited
- An emerging wealth transfer from rural Baby Boomers to their urban descendants heightens interest in funding rural innovation



