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Restructuring of the Financial Industry: The Disappearance of Locally Owned Traditional Financial Services in Rural America*

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ABSTRACT Restructuring in the financial services industry has altered the relationship between small business owners and capital. In the past small businesses have relied on relational, or soft data, lending from locally owned banks for capital. The proliferation of absentee-owned local branch networks brought standardized practices, thus eliminating the autonomy of local loan officers to utilize soft data in loan decisions. In this article we examine the changes in the percentage of traditional financial services that are locally owned in three county types: metropolitan, micropolitan, and noncore. We utilize the Longitudinal Business Database at the U.S. Census Bureau Center for Economic Studies. We examine changes in local ownership of traditional financial services between 1976 and 2007. We find that the rate of decline of local ownership has been greatest in the noncore (most rural) counties. We also explore to what extent these patterns are related to the emergence of alternative financial services during the same period. We find that such alternative services are growing in all three county types, but at rates not significantly different than the population growth for these county types. We supplement our analysis with data from qualitative interviews with small business owners throughout rural Texas. We conclude with a discussion of implications and plans for future research.

Introduction

In our ongoing work we have established that locally oriented businesses, such as small manufacturing establishments and retail outlets, are

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associated with a number of beneficial local outcomes and promote rural community resilience (Blanchard and Matthews 2006; Blanchard, Tolbert, and Mencken 2012; Lyson and Tolbert 2004; Mencken, Bader, and Polson 2006; Tolbert et al. 2002; Tolbert, Lyson, and Irwin 1998). At the core of our research on local rural community development is the concept of "civic capitalism," or the theory that a thriving locally oriented business class composed of local entrepreneurs and small businesses creates an environment most conducive to community development. In our model of civic capitalism, the local small business owner is an agent of economic and social development. But the local small business owner needs access to financing (Black and Strahan 2002; Davis, Haltiwanger, and Jarmin 2008). Changes in the financial services sector, and banking in particular, have caused concern for the plight of small businesses and rural communities (Devaney and Weber 1995; Neff and Ellinger 1996).

The civic capitalism model of local development examines the interconnections between local economic and noneconomic institutions (see Tolbert et al. 2002). In this model, locally oriented capitalism and civic structures function to promote civic community, or trust and cooperation among local citizens. This civic community, in turn, promotes civic welfare and economic development in small towns and rural communities (higher incomes, less poverty, less outmigration, less crime). Locally oriented capitalism comprises a thriving small retail and small manufacturing business sector and family farms oriented toward the local community. The noneconomic institutions that promote civic community include civically engaged places of worship, national volunteer associations, and third places. Research has empirically supported the positive socioeconomic benefits of civic capitalism (see Blanchard and Matthews 2006; Blanchard et al. 2012; Irwin et al. 2004; Irwin, Tolbert, and Lyson 1999; Lee 2008; Tolbert 2005; Tolbert et al. 1998). This article focuses on the implications of financial industry restructuring for locally oriented capitalism.

We are concerned that restructuring of the financial services sector has altered the nature of the traditional relationship between small business owners and entrepreneurs and financial capital in rural communities. Small town lending has a long history of relational or "soft data" lending, in which concepts such as trust, networks, and community reputation were very important for securing loans and credit lines from local banks (Berger and Udell 2002). This symbiotic relationship between local banks and local businesses is vital for rural communities to sustain locally oriented capitalism. The expansion of large national, state, and multiregional financial institutions into small towns and rural communities brings a different metric with which to evaluate potential commercial customers. Multisite financial institutions are more likely to use network-wide standardized operating procedures and asset or hard data criteria to evaluate loan and credit applications. These institutions avoid relational data gathering (Berger and Black 2007). We propose that this transition has made it more difficult for rural small businesses to get access to credit and start-up capital.

We have seen evidence that these changes are having an impact on small business owners in rural areas. In 2010–11 we conducted a series of focus groups with local business owners in a variety of rural small towns in Texas. The following quote from the owner of a small family grocery store and catering business captures many of the sentiments expressed by participants in our sessions:

> Used to be you would know the loan officer at the bank, you could go in, chat with him, and settle your business with minimal paper work. He knew I would make good on the loan. Today, the loan officer don't live here. He drives in everyday from—[nearby metropolitan area]. It is a ton of paperwork and a huge mess, and many people get turned down because they got bad paper [past credit problems].

The consolidation of the financial services industry can create, and it seems has created, disparities in access to capital across space. While there are some policy and legal lending requirements intended to minimize this effect,[1] places with higher risks are not going to attract capital from larger, nonlocal financial services establishments as easily (Graves 2003; Kilkenny 2002; Shaffer and Collender 2008). Local banks and their practices of relational lending have been a leading source of capital for rural entrepreneurs. However, the restructuring of the financial services industry over the last 30 years has serious implications for the sources of local rural business capital. In this article we examine the extent to which restructuring in the financial services industry has affected the rate of local ownership of traditional financial institutions (banks, thrifts, and savings and loans). We also show the transition from local to absentee ownership in traditional financial services (TFS) in urban and rural America between 1976 and 2007, as well as the spatial emergence of alternative financial services (AFS) over the same time period as a possible substitute for TFS. We tie this analysis back to the impact on rural small businesses and entrepreneurs by examining some of the qualitative

[1] These include the Small Business Administration guaranteed lending, the Community Reinvestment Act of 1977, and the Gramm-Leach-Bliley Act of 1999 provision allowing small bank access to Federal Home Loan Banks.

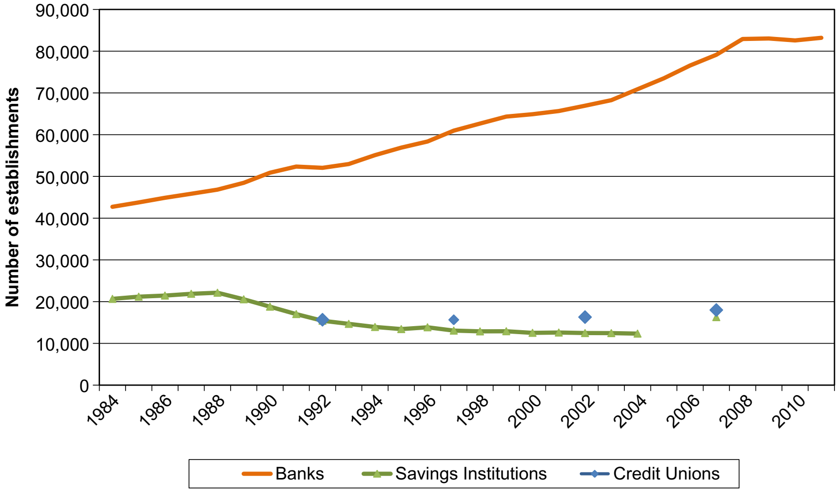

Figure 1. Traditional Financial Services: Establishments.

input we have gathered through our interviews with small business owners and entrepreneurs throughout rural Texas.

Background

Since 1980, depository institutions (banks, credit unions, and savings and loans) in the United States, and elsewhere, have gone through several iterations of changes (Collender and Shaffer 2003; Nicolo et al. 2003). The net result (see Figures 1 and 2) has been significant consolidation at the firm level and proliferation at the establishment (branch) level (Berger and Black 2007; Collender and Frizell 2002; Collender and Shaffer 2009). Between 1984 and 2011, the number of bank firms reported by the Federal Deposit Insurance Corporation declined from 14,496 to 6,291 (more than halving the number of firms), while the number of banking establishments grew from 42,717 to 83,209 (almost doubling the number of establishments).[2] Figure 1 shows that savings and loan establishments declined slightly over time until 2004 when establishment-level data were no longer published. Our counts of credit unions in Figure 1 hold relatively constant and are available at the establishment level only in economic census years. Clearly, the great expansion of traditional financial establishments was primarily driven by banks.

[2] Data retrieved on September 16, 2012, from http://www2.fdic.gov/hsob/HSOBRpt.asp.

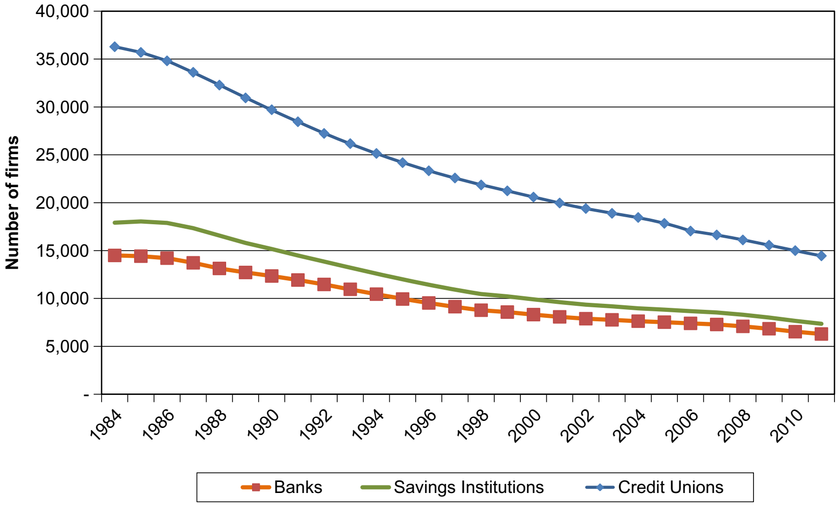

Figure 2. Traditional Financial Services: Firms.

Moreover, according to the economic census conducted by the Census Bureau, the top four commercial banks in the United States owned 12.6 percent of all establishments in 2002; in 2007, this number had grown to 31.8 percent. As Figures 1 and 2 show, credit unions and savings and loan institutions also experienced similar reductions in the number of firms, but unlike banks, they had no growth in establishments (see Berger, Demsetz, and Strahan 1999).[3] These aggregate numbers show trends for the entire United States, generally; however, in this article, we examine whether these changes occurred differentially for different parts of the country. Specifically, we look at these trends in urban and rural areas from 1976 to 2007.

Consolidation at the financial services firm level was accelerated by deregulation and changes in banking laws (e.g., the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994) that eased geographical restrictions on international, interstate, and intrastate branch banking (Hughes et al. 1999; Wheelock and Wilson 2000). However, several issues motivated merger and acquisition behavior (see Berger et al. 1999). First, well-capitalized firms acquired undercapitalized or less efficient banks to increase market concentration and power in order to set local prices for retail services (Cetorelli and Strahan 2006). Second,

[3] The trend lines for credit unions and savings institutions are interrupted because data are not complete for all years in the sequence.

structural isomorphism forced many firms to get into merger and acquisitions in order to keep pace with field leaders and to avoid relinquishing their previous market power. Third, merger and acquisition can move a greater percentage of a firm's assets under the government safety net. That is, the larger the bank, the more likely it is to be deemed "too large to fail," thus increasing the chances for regulator intervention in a crisis.

Restructuring was also made possible, in part, by improvements in technology (Whaling 1996). New technology allowed financial services in general, and banking in particular, to achieve scale economies through increased efficiency; to restructure the branch bank office, with less need for face-to-face interactions with depositors (because of ATMs, online banking, and direct deposit); and to standardize and apply "best practices" procedures (e.g., credit scoring) throughout the network. From an efficiency standpoint, these changes are positive improvements; however, the restructuring that occurred has also changed the relationship between borrower and lender, as demonstrated by the quote from the small grocery business owner whom we interviewed and by research in this area (DeYoung, Glennon, and Nigro 2008).

Relational versus Transactions Lending

This change in the relationship between borrowers and lenders has caused concern about small firms' access to capital since small firms are more dependent on financial institutions for external funding (Berger and Udell 2002; DeYoung, Hunter, and Udell 2002; Petersen and Rajan 1994).[4] Asset-based lending to small firms, however, is quite expensive for the lender and the borrower, as it requires an intense amount of monitoring by the lender and substantial liquid assets on behalf of the borrower. Small businesses, and particularly those in rural economies, have tended to rely on small, locally owned depository institutions (vs. larger, nonlocal institutions) and their practices of relational (i.e., judgment or "soft" data) lending practices for financing (Berger and Black 2007; Berger and Udell 1996; Boot 2011; Collender and Frizell 2002; Devaney and Weber 1995). Relational lending is based on long-standing relationships between lenders and the small business, and between particular loan officers and business owners. Often, the loan officer has extensive personal and professional relationships in the community and uses her or his networks to gather additional information about the business from customers and suppliers. This "embeddedness" also allows the loan officer to take into account the reputation of the person seeking

[4] Berger and Udell (2002) find that the principal owner of the small firm is the source of 31.33 percent of total equity financing.

a loan—the person's standing in the community, trustworthiness, and so on. Empirical research has shown the importance of relationship lending for small firms (see Berger and Udell 1995, 2002). In particular, relational lending is linked to lower interest rates, reduced collateral requirements, and increased credit availability.

However, the restructuring of the financial services industries has led to concerns about the future of relationship lending and the implications for small firms in urban and rural areas (Cetorelli and Strahan 2006; Neff and Ellinger 1996). Relationship lending requires that the lending firm place greater decision authority in the hands of local loan officers. Moreover, because relationship lending decisions are based on qualitative data, operating procedures and incentive structures are unique for each loan officer (Berger et al. 1999). When loan officers acquire more authority, new levels of bureaucratic administration and monitoring are required. These added costs are incentives for large financial firms that have recently acquired local financial networks to utilize lending strategies based on standardized and portable data (i.e., hard data), thus reducing the autonomy local branch managers have to make lending decisions (Brickley, Linck, and Smith 2003). Furthermore, some lending institutions may abandon relationship lending because restructuring and mergers have increased the geographical and social distance between lender and borrower (Berger et al. 2005; Brevoort and Hannan 2004; DeYoung et al. 2008).

Alternative Financial Services

For individual consumers, particularly low-income consumers, alternative financial services have emerged as a more convenient, and occasionally more cost-effective, means of finances (Blank 2008; Caskey 2002; Graves 2003; but see Fellowes and Mabanta 2008). While AFS can be a difficult category to define, most operationalizations include high-interest nondepository institutions, such as check-cashing businesses, local pawnshops, car title loan businesses, and payday loan operations (Blank 2008; Praeger 2009). Studies on why consumers use AFS indicate that ease with the process, nearby locations, lack of a credit check, and smoothing income gaps are primary reasons (see Berry 2005; Blank 2008; Caskey 2002; Fellowes and Mabanta 2008). These studies also point out that many low-income consumers utilize a mix of both TFS and AFS.

Graves (2003) argues that a two-tiered system of finance has emerged. Traditional financial services reorganized around affluent neighborhoods, and AFS emerged on the fringes of neighborhoods in transition. The highest levels of AFS concentration is in poor neighborhoods. AFS provide access to credit and banking that has become more difficult for low-income borrowers to secure and afford. Moreover, AFS are spatially more convenient to those in low-income areas. However, Fellowes and Mabanta (2008) find a dual system of traditional and alternative financial services coexisting in the same space, but serving different clienteles.

While these studies focused on individual consumers, the findings are transferable to small businesses, particularly nascent businesses. In many ways, nascent employers experience the same credit-access frustrations as low-income workers (see Graves 2003; Markley, Macke, and Luther 2005). Research on enclave economies in major cities has shown that sole proprietorships and small businesses are less likely to depend on banks for capital than they are on informal sources, such as family and friends or alternative financial services (Bond and Townsend 1996; Huck et al. 1999; Li et al. 2002).

Financial capital can be quite difficult for nascent entrepreneurs. New entrepreneurs typically do not have the hard data transactions or lending portfolios to secure standard loans. Moreover, new businesses do not have a history to make them a solid candidate for relationship lending. In their analysis of the 1998 Panel Study of Entrepreneurial Dynamics, Campbell and De Nardi (2009) find less than half of those nascent entrepreneurs who applied for bank loans to help finance their ventures were approved for loans. Most entrepreneurs rely on self-financing and informal credit markets (see also Berger and Udell 2002). Restructuring in the financial services industry, with increased absentee ownership and diminished importance of relational lending, creates the possibility that small businesses in rural America may face reduced access to credit and higher costs for that which is available. As with low-income consumers, AFS may serve as a substitute for the credit needs of small businesses and nascent entrepreneurs.

This review of the literature indicates that significant restructuring in the financial services industry led to a significant reduction in the percentage of locally owned, traditional financial services. These locally owned services and their histories of relational lending practices are vital to local small businesses and to the welfare of the communities in which these businesses operate. While extensive research has been done on the spatial distribution of restructuring in the financial services industries, less has been done with recent data on the loss of locally owned financial institutions. We seek to fill this void. We examine the changes in locally owned traditional financial services in urban and rural America. Moreover, we follow this analysis with an examination of the change in the proportions of TFS and AFS establishments. If the loss of locally owned banks created a credit void, then we expect to find some shift in the ratio of TFS to AFS establishments during the same periods.

Data and Methodology

In the analysis we used the Longitudinal Business Database (LBD), a database developed at the U.S. Census Bureau's Center for Economic Studies (see Jarmin and Miranda 2002). The LBD provides basic information on an annual basis for legally operating employers in all sectors of the U.S. economy from 1976 to 2007. The underlying data for the LBD come from the Census Bureau's Business Register, also known as the Standard Statistical Establishment List. This list is derived from administrative records from other agencies (e.g., the Internal Revenue Service, Social Security Administration, and Bureau of Labor Statistics) and is updated based on information collected by the Census Bureau from its economic surveys and censuses. However, these data are primarily based on payroll tax records and receipts data from tax records provided by the IRS.

We use the LBD to identify establishments in the financial services sector to examine the development of this sector during 1976–2007. Establishments traditionally thought of as financial services include banks, credit unions, savings and loans, and business credit establishments. We used establishments with the following 1987 Standard Industrial Classification (SIC) categories:

602 (U.S. commercial banks)
603 (savings institutions)
606 (credit unions)
611 (federal and federally sponsored credit agencies)
615 (business credit institutions)

It is important to note that some of these establishments had been categorized incorrectly, and we reclassified them using the name of the establishment when possible. For example, a large proportion of credit unions were misclassified prior to 1992, so we used string searches of establishment names in combination with industry codes to classify them. In general, however, we used industry codes to classify establishments as traditional establishments.

Changes in industry classification systems were significant over this time for these sectors for both the change in SIC coding in 1987 (from the coding used in 1977) and for the change from SIC codes to codes of the North American Industrial Classification System (NAICS) in 1997, especially for depository institutions. In 1997, the Census Bureau adopted the NAICS; however, in the LBD, SIC codes persisted through

2002. In the LBD, 1992 is the first year where the 1987 SIC codes take effect, and 2002 is the first year where the NAICS changes take effect. For these analyses, we standardized the coding to the 1987 SIC system when possible, converting the 1977 SIC codes to 1987 SIC codes.[5] For data after 2002, we converted the NAICS codes for traditional financial services to 1987 SIC codes.[6]

The establishment data are aggregated by county and county equivalent for this analysis. We classified counties by their 2003 Office of Management and Budget metropolitan status: metropolitan, micropolitan, and nonmetropolitan (www.whitehouse.gov/OMB). To be sure, there is much variability in the rural territory of the United States. We opt here for the government standard definition because our aim is to develop policy-relevant findings that can sustain and promote rural

[5] There were two problems that hindered exact matches from 1977 to 1987 SIC coding. First, the finest level of detail available for some establishments was the two-digit level (e.g., 60), despite having six-digit codes. To examine the issue more closely, we merged establishments from 1977 with the SIC code 600000 to future economic census years of the LBD since the economic census years typically have the most accuracy. Approximately 65 percent of these 1977 establishments were still in the database in 1982, with close to 90 percent still coded as 600000. Approximately 40 percent of these 1977 establishments had records in 1987, with close to 60 percent still coded as 600000. In 1992, 25 percent of the 1977 establishments had records; however, all of these had been recoded and no longer had the generic 600000 code. Moreover, for a majority of these establishments, the establishment's most frequent four-digit SIC code was 6000. So for imputation purposes, the most frequent four-digit SIC code was not a good substitute; however, the variable "best SIC" seemed to be a better approximation and we used it as a substitute when it was available. For establishments with the generic code 600000 even after the "best SIC" substitution, we set the SIC code to "missing" and replaced it with the closest lagged value that was not 600000. The second problem that arose in recategorizing from SIC 1977 to SIC 1987 occurred when four-digit categories were split into two different three-digit categories and the finest level of detail for the establishment industry was at the three-digit level. This was problematic for the 1977 SIC code 605 since this category was split into two very distinct categories in 1987: foreign banking and branches and agencies of foreign banks (608) and functions related to depository banking (609). This was also problematic in converting the 1977 SIC code 614, since it contained both credit unions (1987 SIC 606) and some personal credit institutions (1987 SIC 614). For both cases, we used the names of the establishments to flag the type of establishment. For the first case, we identified check-cashing establishments based on a variety of strings commonly seen in the names of these establishments, and in the second case, we identified credit unions (e.g., "credit," "union") using establishments' names. These establishments were then reclassified into the appropriate category. After the reclassification, we conducted a thorough review of the names of the reclassified establishments to ensure that establishments were being correctly classified.

[6] In financial services, NAICS codes often provide more detailed classifications than SIC codes. However, we chose the 1987 SIC codes as the standard because it would have been very difficult to use the less detailed SIC codes to reclassify an establishment into a more detailed category. For these analyses, the additional granularity provided by NAICS would not have provided relevant distinctions in many cases. As an example, NAICS distinguishes banks that primarily issue credit cards from other banks; however, both types of banks are typically thought of as traditional lenders.

socioeconomic vitality. Using a standard enhances the initial credibility of our findings while leaving room for further detailed exploration of rural areas' financial services. It is also the case that—under any definition of rurality—we are limited in the amount of geographic gradation (categories of rural) by Census Bureau disclosure rules. The 2003 standard identifies metropolitan areas (single counties or groups of related counties) as having a core-based statistical area (CBSA) of at least 50,000 persons. Micropolitan counties have a CBSA of less than 50,000, but more than 9,999. Last, there is a residual category of those counties that do not contain a CBSA. These counties are sometimes referred to as "noncore" counties. We view micropolitan (small town) and nonmetropolitan as "rural" in our analysis, though we typically report results separately for both.

We use location quotients to gauge the relative over- or under-representation of traditional financial services for four periods: 1976–92, 1992–97, 1997–2002, and 2002–2007.[7] The location quotient computes the local (county) share of such establishments nationally and compares that to the local share of national population:

$$LQ_{ijt} = \frac{Estabs_{ijt}}{Estabs_{iUSt}} \Bigg/ \frac{Pop_{jt}}{Pop_{USt}}$$

where i = financial institution type, j = county, and t = period. We present the data for the change in local ownership of traditional financial services for the entire period.

Results

The data in Figure 3 show the change in local TFS between 1976 and 2007. Local financial service establishments are defined as establishments where all the establishments of the same firm are located in the same county. In 1976, approximately 50 percent of metropolitan TFS establishments were. By 2007, the percentage was less than 15 percent. For the nonmetropolitan counties the rate of change of the 1976–2007 time frame is more dramatic. Micropolitan counties saw the numbers shift from approximately 70 percent in 1976 to just below 20 percent in 2007. In 1976, close to 80 percent of TFS in noncore counties were

[7] We selected these time periods to coincide with economic census years (years that end in -2 and -7) since those years typically are most accurate in number of establishments. The first period, 1976–92, represents the period before financial services were in the scope of the economic census. These are the years that have required so much work to discern SIC classification. When we used three periods (1976–85, 1986–95, and 1996–2007), we found similar trends.

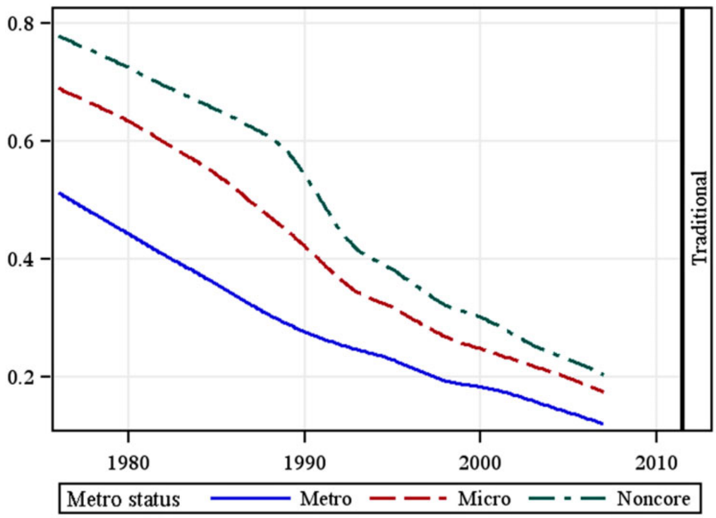

Figure 3. Proportion of Traditional Financial Establishments Locally Owned by Year and County Type.

local. By 1990 that percentage had dropped to slightly more than 50 percent, and by 2000 it had declined to approximately 30 percent. In 2007, approximately 20 percent of TFS were locally owned in noncore counties.

The data in Figure 3 indicate that local ownership of TFS has declined significantly over the period for all counties. Moreover, the rate of decline in locally owned TFS establishments was (–1.7 percent) per annum for noncore counties, (–1.5 percent) per annum for micropolitan counties, and (–.9 percent) for metropolitan counties. Compared to metropolitan counties, the rate of decline in TFS establishments was 88 percent greater in noncore counties.

Table 1 presents the median percentage change in locally owned TFS. These data show that at the center of the distributions, the rate of decline in local ownership was much greater in noncore counties, and a more recent phenomenon. Between 1976 and 1992, noncore counties had a median local ownership rate of slightly more than 50 percent. For 2002–2007, the comparable median rate of TFS local ownership was a little under half the earlier rate. For metropolitan and micropolitan counties, the transition from local to absentee ownership occurred earlier. By 1992, the median rate of local ownership was less than 40 percent in metropolitan counties and micropolitan counties. During the U.S. farm crisis, Green (1984, 1986) noted important structural

Table 1. Median Percentage TFS by County Type and Period.

	Period	Median
Metropolitan	1976–92	36.61
	1992–97	29.58
	1997–2002	26.34
	2002–2007	23.14
Micropolitan	1976–92	37.48
	1992–97	32.11
	1997–2002	27.82
	2002–2007	26.95
Noncore	1976–92	52.94
	1992–97	34.64
	1997–2002	31.25
	2002–2007	25

transformations in the banking industry of Missouri that limited the availability of credit in rural areas. Our national data suggest that the disappearance of locally owned banks accelerated even further after the farm crisis.

The 1990s was the decade of significant transition for noncore counties, the period in which the median rate of local ownership of TFS establishments declined below 50 percent. While TFS establishments changed from local to absentee owned during 1976–2007, the data in Table 2 indicate that this transition did not affect the concentration of TFS establishments, and in fact, increased the concentration of establishments in noncore counties. These data show location quotients in metropolitan, micropolitan, and noncore counties for the four periods. The concentration of TFS establishments changed minimally from 1976 to 2007. In metropolitan counties, the median number of traditional financial services for 1976–92 was 32, with a median location quotient of 0.64, and over the next three periods that number nearly doubled by 2002–2007, with a similar corresponding median location quotient.

The data for the micropolitan counties show a very similar pattern, with a median number of establishments of 18 for 1976–92 increasing to 26 for 2002–2007, with very similar median location quotients. It appears that in both metropolitan and micropolitan counties the growth in establishments is, at the center, matching population change. The noncore data show that the median number of traditional financial services increased from 5 (1976–92) to 8 (2002–2007). The noncore location quotients remained above 1 for all four periods, indicating a slight overconcentration of traditional financial services at the center of the distribution. What the data for noncore counties show is that bank consolidation did not change the representation of TFS in noncore counties.

Table 2. U.S. Traditional and Alternative Financial Services by Metropolitan Status and Period.

			Establishment Counts		Location Quotients	
		Population	Traditional	AFS	Traditional	AFS
Status	Period	Median[a]	Median	Median	Median	Median
Metropolitan	1976–92	68,000	32	9	0.64	0.56
	1992–97	80,000	43	12	0.57	0.56
	1997–2002	87,000	50	14	0.59	0.53
	2002–2007	93,000	59	16	0.64	0.50
Micropolitan	1976–92	34,000	18	5	0.78	0.75
	1992–97	36,000	23	6	0.73	0.82
	1997–2002	37,000	24	7	0.75	0.86
	2002–2007	38,000	26	9	0.80	0.81
Nonmetropolitan	1976–92	11,000	5	0	1.24	0.18
	1992–97	11,000	7	0	1.09	0
	1997–2002	12,000	7	0	1.08	0.14
	2002–2007	12,000	8	1	1.17	0.46

[a] County population figures rounded to thousands to facilitate disclosure.

In order to assess whether the decline in locally owned TFS establishments was a by-product of other socioeconomic trends during 1976–2007, we also examined the trends in per worker wages and per capita income (adjusted to 2007 dollars) over time for the three county types (Figures 4 and 5). These data show a growing gap between metropolitan and noncore counties over time, but income and wages in noncore counties grew in real dollars over time. The TFS establishments in noncore counties were not transferring ownership because of declines in worker wages or personal incomes. An analysis of total farm earnings (not reported but available on request) show a decline of 13 percent in real dollars between 1990 and 2005. However, this rate of decline is much smaller than the rate of decline in local TFS ownership for the same time period.

The final set of data we present is the change in TFS and AFS establishments for the four periods. The working assumption is that AFS are filling a void created by the transformation of the TFS sector and the loss of locally owned banks. The data in Table 2 show that AFS establishments have been growing in all three county types. For metropolitan counties the median number of AFS nearly doubled over 1976–2007. However, the location quotients did not change significantly, indicating that the expansion of these services is keeping pace with the change in population. In the rural county types, however, we do see an increase in number of AFS establishments. The median number of AFS establish-

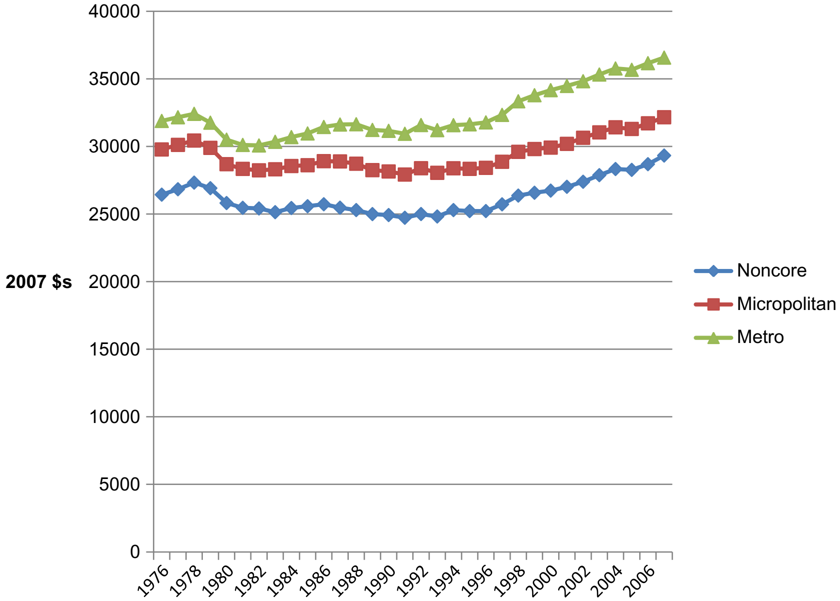

Figure 4. Per Worker Wages, 1976–2007.

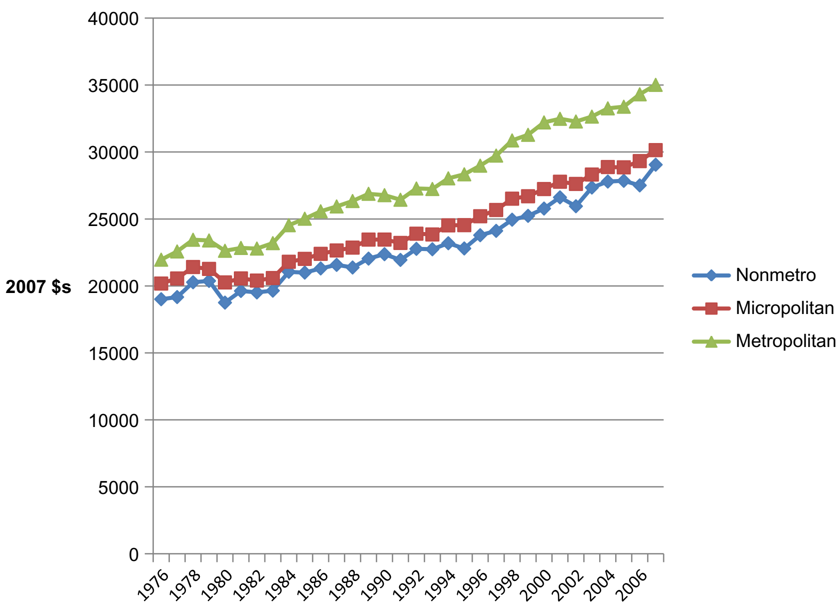

Figure 5. Per Capita Income by County Type, 1976–2007.

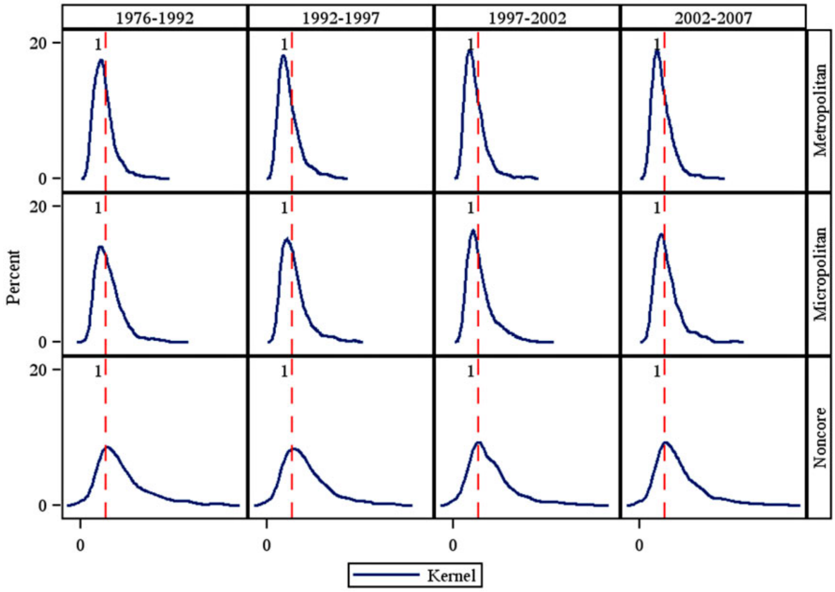

Figure 6. Distribution of Location Quotients, Traditional Financial Services.

ments also almost doubled in micropolitan counties, with a parallel increase in the location quotients. This indicates a slight increase in the concentration of AFS in these county types. However, there was a simultaneous similar increase in TFS median establishment counts and location quotients for micropolitan counties. The growth of both TFS and AFS establishments in metropolitan and micropolitan counties is highly consistent with the findings of Fellowes and Mabanta (2008): there is a dual system of financial services that have different sets of clients.

Noncore counties had the largest change in AFS establishments, and this is the only county type that had a decrease in the location quotients in TFS. A peak of 1 in Figures 6 and 7 represents just representation. A peak greater than 1 represents overconcentration. The data in Figure 6 show slight underrepresentation for TFS in metro and micro counties, and the peaks do not change over time. For noncore counties the peak shows just representation of TFS, but it also shows a long right-hand tail, indicating significant variation in location quotients within noncore county types.

The data for AFS show a different pattern. The median count of AFS moved from 0 for 1976–2002 to 1 in 2002–2007. Not only has the median changed dramatically, but the entire distribution of the location

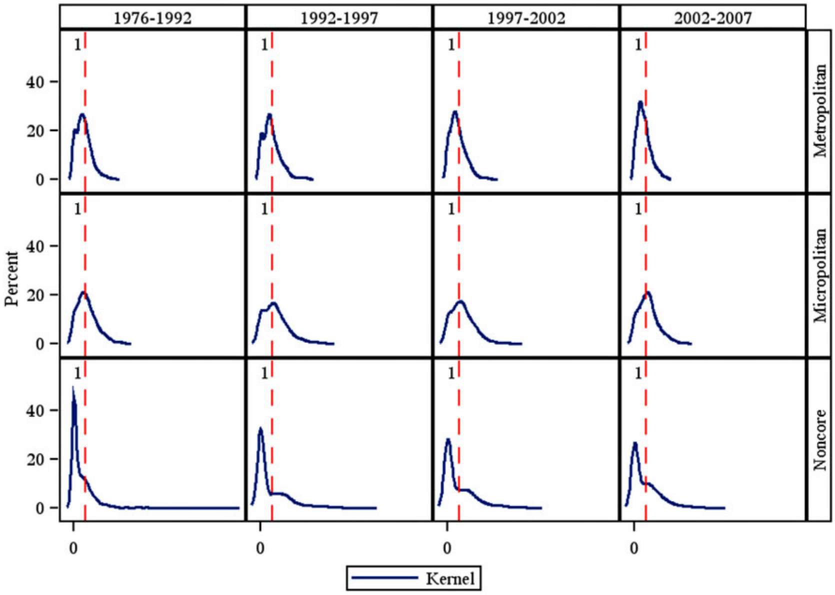

Figure 7. The Distribution of Alternative Financial Services Location Quotients.

quotient for AFS has changed dramatically as well, as Figure 7 demonstrates. The peak of the distribution in noncore counties is near zero in all four periods, but the height of the peak decreases significantly over time with the right tail becoming fatter and shorter. In the first period, the right tail is much longer and decreases over time. This indicates that while the number of counties overrepresented in AFS relative to their populations is increasing, the amount by which they are overrepresented is decreasing. In metro and micro counties, AFS growth has kept pace with population change. It is in noncore counties where AFS have proliferated at a rate greater than population change. If this is a substitution trend in which AFS are filling a void in financial lending created in part by the changes in TFS over the last 30 years, data from post 2007 will be needed to document better these trends.

Discussion

We began this analysis working from the assumption that changes in local ownership in traditional financial institutions would harm rural communities because absentee ownership would limit relational or soft data lending. Our analysis of macro trends in traditional financial services industries shows that there has been a significant restructuring in the industry since the mid-1970s, with significant proliferation of TFS establishments and simultaneous decline in local ownership. We also discussed the possibility that small business operators may be turning to alternative financial services to tide them over during tough times.

However, our macro data cannot speak well to the issue of how this change affects local business owners and those seeking to start new businesses, particularly in rural America. Over the last four years we have been conducting semistructured interviews with business owners and nascent entrepreneurs throughout rural Texas to understand the challenges that they face. Some, but not all, of these conversations have included discussions about finances. We can say that we do not detect any trend toward the use of alternative financial services. Each person to whom we spoke held the opinion that AFS represent a credit trap. The high interest rates and unreasonable terms would only make a bad situation worse. Participants in our discussions also had different experiences with traditional financial services, some good, some bad.

Collectively, what is known about nascent business finances comes from surveys of business owners. Our analysis of longitudinal employer household data show that 50 percent of new business start-ups rely on personal finances, while 30 percent rely on TFS loans.[8] From our conversations we have gleaned that access to capital is more difficult than it used to be. In 2009 a 23-year-old white Hispanic woman ("Anna") in a noncore Texas county who had been selling specialty cakes out of her parents' house to pay for community college decided to expand her business after graduation. She opened an updated and well-appointed 1,200-square-foot shop in the town's main strip of storefronts. Her shop had a very high-end feel, with new solid wood tables and chairs, original art, and refurbished hardwood floors.

She was excited and very nervous about her new adventure. The conversation eventually turned to finances. She has wanted to take out a small business loan from a local bank and also get some help from the Small Business Administration. In the end, she resorted to a plan familiar to a number of small business start-ups. In regard to her finances, she reported:

> I was a student and I had no money. My father and I talked to the local bank, and they discouraged us from even applying for credit because of my lack of experience and collateral. The whole SBA thing was a mess, impossible to figure out. I got the

[8] These data are highly sensitive data analyzed at the Regional Data Center (RDC) secure lab in Chicago.

> money because my dad cashed in part of his 401K. I used the money to buy used ovens and furniture for the store and a few months rent. The owner [of the property] wants the stores to look nice. I cannot afford employees so my sister-in-law works part-time in the store for free. My brother (an accountant) does my books for free. The owner promised to cut me a break on the rent if business is too slow.

In contrast to Anna is "Martha." An elderly white woman, she and her husband have spent the better part of their lives building a fortune operating a collection of home-based small businesses, primarily in finance, insurance, and real estate. Instead of leasing space, Martha had purchased a large section of storefront on the opposite end of the town's main strip. She built a restaurant (with 13 full-time employees) with an accompanying banquet hall that she would lease for special events, such as wedding receptions. She spared no expense in outfitting the place with a western theme. She spoke freely of her finances:

> I invested my own money. I spoke with a few banks, and could have gotten a loan, but the terms, the interest rates, were not attractive. I said "no thank you" and paid cash for this 10,000-square-foot storefront. I did supplement with a small low-interest USDA economic development loan. But money is not really an issue. We're patient and are waiting three years for this place to start to turn a profit. We're close.

"Cheryl," a middle-aged white female, owns and operates an antique and secondhand furniture store in a rural town northwest of Fort Worth, Texas. Now retired, her father had owned the only new furniture store in town, which he opened in the early 1970s. We spoke with both of them about today's small business challenges. Cheryl has been in business for six years. It is clear from our conversations that her father (Jim) is the major financial supporter of her store. He proudly informed us that he had set all of his children up in small businesses. While Cheryl reported that she is pleased at the way her store is doing, it is not what she wanted to do.

> I really wanted to open up a flower shop. I like to garden. Our town does not have a florist and the only place people can buy flowers is from the HEB [state-wide big-box grocery store] out on Route ——. About 10 years ago a nice place came open on the square. It was the perfect location for a flower shop. I put together a good business plan. I went to the [local branch of regional bank] bank and they turned me down for a loan, with no real explanation. Loan denied. I was shocked. Daddy was

> really mad because he has been banking there for years. We have lived here all our lives. I thought getting the loan would be the easy part because Daddy had a successful business and we are known people in town. While this was going on, someone else opened a business in the storefront, so I kind of forgot about the flower shop. About four businesses have come and gone in that spot since then. But things are going good in my store. Maybe not getting that loan was a blessing.

We also spoke with "Alex," a senior white female who lives in a small town east of Dallas. Alex has owned and operated small businesses for over 40 years. She also served recently as the president of a statewide small business association. She is a small business consultant, and devotes considerable time and effort to helping other people start small businesses. She spoke openly about the changes in banking and how this affects access to capital for local businesses.

> It is not like it used to be—go in and give them your business plan and that would do it. With a good reputation in the community you could get an unsecured loan to get started. Today to get a loan from the regional banks you need collateral. The total assets of your plan, the building, equipment, office computers, whatever, must be 80 percent of what you are asking for. You also need to have six months' escrow. The loans are easiest to get for those that do not really need them.

Her thoughts on big national banks underscore our points in this article.

> The big national banks do not offer much for small businesses. Bank —— [a national bank with over $1 billion in assets] is adding branches all throughout east Texas. They do not give small business loans. —— Bank [a national bank with over $1 billion in assets] has two branches in —— County. It does give small business loans, but they call them "high-risk" loans. Interest rates start at 15 percent.

She seemed quite peeved at the regional and local banks.

> They are trying to chase the big dollars. They are more interested in lending to large commercial businesses than small businesses. There is only one bank in town that will even discuss your small business plan with you. —— Bank, which has been in this town for over 50 years, is trying to be like the big national banks. They are only interested in lending to companies that will bring in large manufacturing. They turned *me* down for a small

> business loan recently. I marched straight over to — Bank and got the loan that day.

As for what advice she would give those trying to start a small business in rural communities today, she suggests the following:

> It will be tough, but not impossible. You will need collateral other than the business itself. Your best bet is to get an unsecured credit line from the bank you use and have a good history with. In today's world you cannot start [a small business] from zero. If you have a great credit score and have kept a high balance for a considerable period of time, you can most likely get the unsecured credit line at 13.75 percent interest. If you need a lot of cash to start, you may need to put the equity in your home up as collateral. That is risky.

What Alex and the others we have interviewed have emphasized is our contention that the transition from locally owned banks to regional, state, and national ownership has shifted the way in which banks operate at the local level. A smaller percentage of banks are giving out small business loans. Those that do are not offering affordable interest rates, and much more emphasis today is placed on hard data banking, such as credit scores and collateral. History and personal relationships with the bank are important for access to credit, according to Alex, our small business consultant. But what happens when the bank is bought out by an outside entity? Personnel turn over, and the relationships disappear. Business owners have to form a new history with the new ownership. A strong locally oriented small business sector is an important component of healthy rural communities (Blanchard and Matthews 2006; Blanchard et al. 2012; Lyson and Tolbert 2004; Mencken et al. 2006; Tolbert et al. 1998, 2002). It is not just the emergence of big-box retail trade that has placed many small rural businesses at risk but also the macrostructural changes that have altered the relationships between local people and the institutions that provide them credit.

Conclusion

The restructuring of the financial services industry over the last 30 years has created concern among many proponents of rural economic development that these changes could lead to a decrease in access to the capital necessary to sustain and start new small businesses. Much of the past research has been concerned about the impact of these changes on relationship lending, a vital component of lending for small businesses

(Cetorelli and Strahan 2006; Neff and Ellinger 1996). Our analysis shows that the rate of locally owned TFS has declined faster in the most rural counties since 1976.

Many small, local businesses, especially nascent companies, do not have a transactional lending portfolio (hard data on earnings, credit scores, etc.) in order to compete for loans from big, nonlocal banks (Brewer et al. 1996). As noted in our interview with Alex, some of the nation's largest banks are not interested in small business loan customers. In the past, lending decisions were often left to the discretion of the local loan officer, who is likely to have a personal relationship with the borrower, and extensive nontraditional information about the creditworthiness of the borrower. The consolidation of smaller, locally owned banks into larger firms, and the loss of other depository institutions, could mean less access to capital for local entrepreneurs, especially those seeking to start new businesses.

Our quantitative and qualitative findings have significant theoretical implications for the development of the civic capitalism model used to frame the research question. Locally oriented capitalism is a key concept in this model, and a healthy, locally oriented retail and small manufacturing business sector is vital to the development of civic welfare. However, a thriving local business sector cannot be sustained without the symbiotic relationship between local banks and local businesses. Access to financial capital via local banks, particularly that which in the past has been secured through soft data (personal relationships, community reputation) is at risk. Large national banks are not inclined to make small business loans (Akhavein, Goldberg, and White 2004). We believe that there is a real concern for the development of "credit deserts" in small towns and rural communities. Local retailers, who are at risk of big-box retail competition in many places, may now face the challenge of trying to secure credit from absentee-owned financial institutions that do not utilize relationship spending practices (Elyasiani and Goldberg 2004). The model of civic capitalism and the path to civic welfare must now include a measure of local access to financial support for locally oriented businesses and entrepreneurs.

The restructuring of the financial services industry over the last 30 years has created new challenges for economic development in rural America. This is our first examination of establishment-level financial services data. We have documented that locally owned financial services are significantly rarer than in years past. We have also confirmed what others have concluded about the nature of AFS growth (Fellowes and Mabanta 2008). We have provided qualitative reports from rural small business owners about their experiences with finding finances. Our next step in this research agenda is to examine the relationships between changes in local financial institutions and other county-level socioeconomic outcomes, such as earnings, employment growth, poverty, and income inequality.

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