Smalltown Businesses: Feeling the Effects of Farm Financial Stress

F. Larry Leistritz, Holly E. Bastow-Shoop, Brenda L. Ekstrom, and Arlen G. Leholm

The effects on farm operators of the changing agricultural economy is becoming well documented. But have the tough times on the farm been translated into tough times for business operators in the small towns of America? Have they also fallen victim to the same financial pressures as farmers? Just how interrelated are these two economies?

We attempted to answer these questions by first examining recent trends in retail sales in North Dakota and then comparing these trends with those in net cash farm income and cash receipts from farm marketings. Our next effort was to survey business operators in some representative towns.

The extent to which economic conditions in agriculture have been translated into hard economic times for smalltown businesses is a difficult issue because of the interrelationships that exist in any economy. One sector of the economy cannot be isolated and studied apart from the others. We can, however, examine the trends in both sectors, examine the economy as a whole, and describe the scenario that best fits the facts.

North Dakota has the highest percentage of agriculturally related counties in the nation. Almost three-fourths of the state's counties are ag-dependent[1]. Agriculture, in fact, accounted for 44 percent of the state's economic base in 1985. As such, we are in a unique position to study the interrelationship between agriculture and rural communities.

Retail sales trends reveal that North Dakota's communities have been experiencing a substantial recession. Taxable retail sales, adjusted for inflation, declined nearly 17 percent statewide from 1980 to 1986 (Table 1) and have receded to levels experienced in the early 1970s. Not all counties have participated equally in this decline. Total retail sales declined 28 percent for agricultural counties from 1980 to 1986 but declined only 14 percent for nonagricultural counties. Thus, not only has the retail sales "pie" been shrinking recently, but agriculturally dependent counties have been losing their share of that shrinking pie.

How closely do these retail sales trends mirror what has been happening in agriculture? Figure 1 illustrates the varying levels of net farm income, cash receipts from farm marketings, and retail sales in North Dakota. As the figure shows, the trends of net farm income and cash receipts are remarkably similar. Retail sales peaked slightly later than net farm income and have followed the same downward trend since the late 1970s. All three indicators have returned to levels of the early 1970s.

The decline in retail sales in ag-dependent counties is reflected in recent employment patterns except that the percentage changes are smaller. From 1980 to 1986, employment declined by 1 percent in agricultural counties but increased about 10 percent in nonagricultural counties and about 6 percent statewide (Table 2).

Table 1. Taxable retail sales down 28 percent in North Dakota's agricultural counties from 1980-1986 (constant 1986 dollars).

County type	Counties	Total retail sales 1980	Total retail sales 1986	Change 1980-86
	Number	--Million dollars--		Percent
Agricultural	39	825	596	– 27.75
Other	14	2,761	2,384	– 13.65
All	53	3,587	2,980	– 16.92

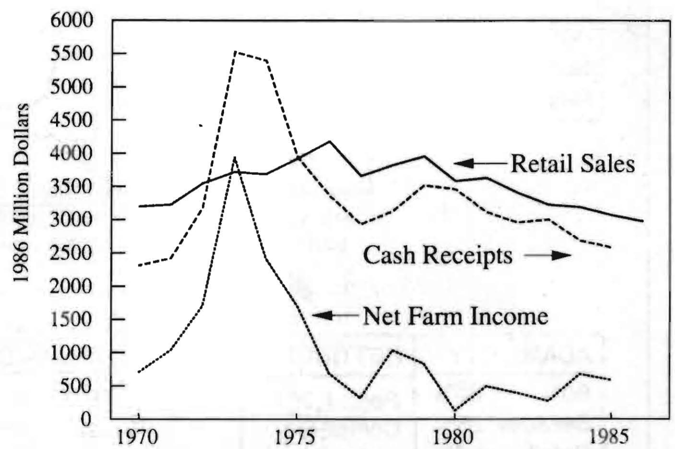

Figure 1. Total Cash Receipts from Farm Marketing, Net Farm Income, and Taxable Retail Sales, 1986 Dollars, North Dakota, 1970-1986.

Source: North Dakota Tax Department and ERS, various years

Leistritz is professor, Ekstrom is research assistant, Department of Agricultural Economics; Bastow-Shoop is assistant professor, Department of Apparel, Textiles and Interior Design.

[1]Agriculturally dependent counties are those in which farming contributed a weighted annual average of 20 percent or more to total labor and proprietor income from 1975 to 1979 (Bender et al., 1985).

Study Procedures

More than 600 current and former business operators responded to surveys in six communities: Carrington, Casselton, Grafton, Hettinger, Jamestown, and Stanley (Figure 2). The survey was administered to all local businesses in the five smaller towns and to half the businesses in Jamestown during the period March-July 1986. Overall, 48 percent of the businesses responded. The towns range in population from about 1,700 to 16,000. Survey questions covered finances, trade patterns of customers, inventory acquisition, number of employees, management practices, business outlook for expansion and continuation, and the effects of the farm crisis on businesses and on the community.

The six communities studied are all in heavily agricultural areas, and four are in counties that had a fourth or more of

Table 2. Total employment and employment change in North Dakota counties, 1980 and 1986.

County type	Counties	Total Employment 1980	Total Employment 1986	Change in Employment	
	Number				Percent[1]
Agricultural	39	109,643	108,558	− 1,085	− 0.99
Other	14	203,392	223,197	+ 19,805	+ 9.74
All	53	313,035	331,753	+ 18,718	+ 5.98

[1](1986 value minus 1980 value) divided by 1980 value.
Source: North Dakota Job Service, 1980, 1986.

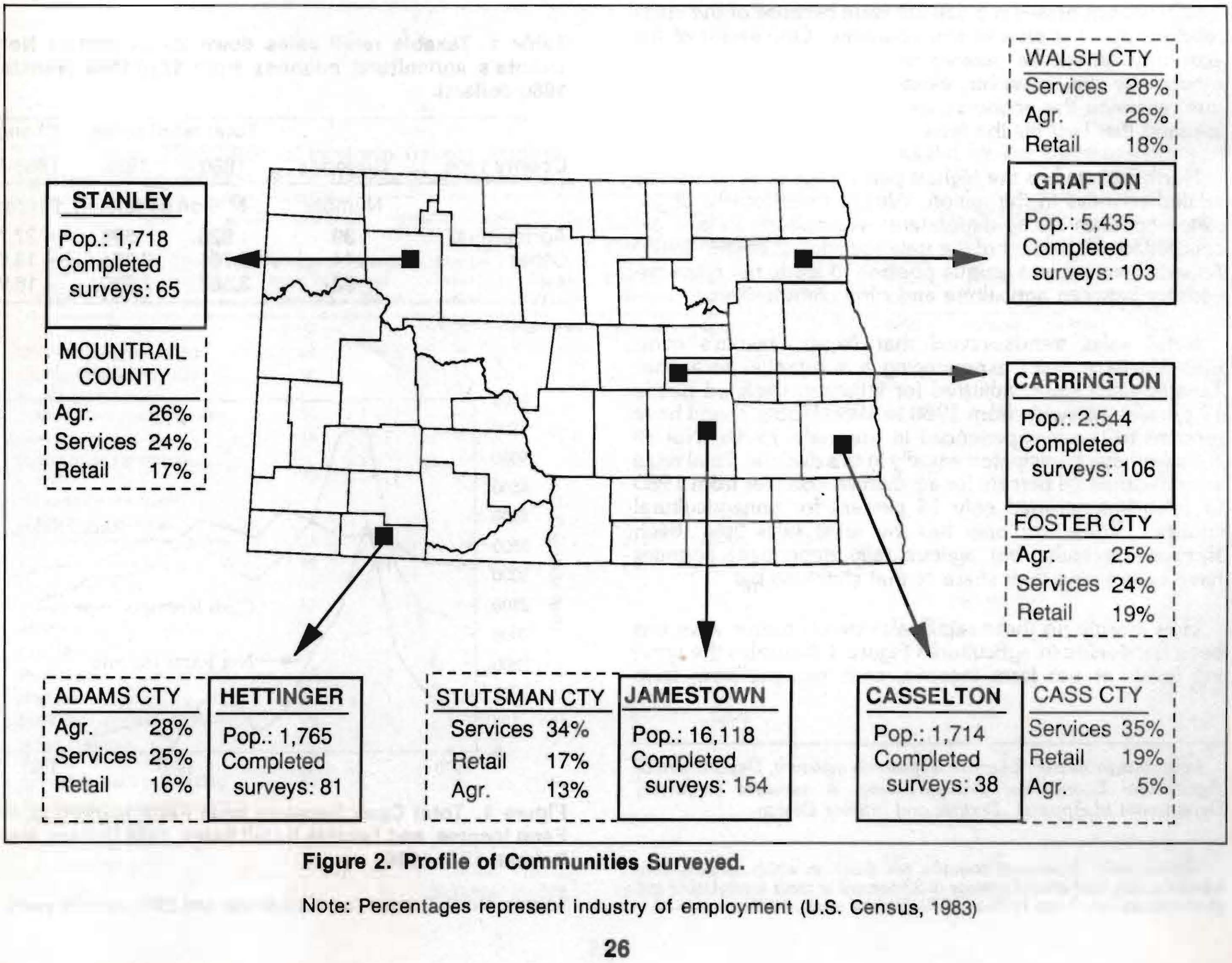

Figure 2. Profile of Communities Surveyed.

Note: Percentages represent industry of employment (U.S. Census, 1983) their labor force directly employed in agriculture in 1980. Several indicators suggest that the economies of the six communities have been experiencing negative effects associated with the farm crisis. Retail sales, measured in constant 1986 dollars, declined in all of the six communities between 1980 and 1986, and two of the associated counties experienced a drop in total employment (Leistritz et al., 1987).

Customers of Smalltown Businesses

The respondents reported that slightly more than 40 percent of their sales were made directly to farm families. The percentage of sales accounted for by farmers was smallest in Jamestown, the largest community studied. Nevertheless, the sum of sales to farmers and to local residents accounted for a relatively constant share (about three-fourths) of total sales in each town. Business operators reporting more than half of their sales to farmers included wholesalers of nondurable goods (largely grain elevators and farm supply outlets), agricultural service operators (such as chemical applicators), and manufacturers of durable goods (such as equipment).

Community Effects

The business operators also were asked their opinion about how the farm financial situation had affected their community. Effects on the business sector were the most frequently mentioned consequence of the farm situation. Many respondents mentioned closing of businesses and widespread loss of business volume as major effects.

Respondents also were asked how many businesses they thought had closed in their town in the last two years and how many had opened. They indicated that an average of almost seven businesses had closed and three had opened (Table 3). The types of businesses most frequently mentioned as having closed were clothing stores, hardware stores, and machinery and implement dealers. Eating places and clothing stores were most often mentioned as having opened. When we compared their perceptions to what had actually occurred in their towns, we found that the operators had slightly underestimated the number of openings and closings but had accurately identified the types of businesses affected.

Respondents also commented on the types of businesses that would be most and least affected if the current farm economic situation were to continue for two more years. Nearly 40 percent of the business operators indicated that farm machinery dealers would be most affected, while about 15 percent said that all types of businesses would suffer. About 46 percent of business operators identified grocery stores as being least affected.

Financial Characteristics

Selected 1985 financial characteristics of the businesses surveyed are summarized in Table 4. Because a few very large businesses had a substantial influence on the average (mean) figures, only the midpoint (median) figures are in the table. For example, the average value of assets was over $1 million, but the midpoint of responses was only a little over $125,000. The midpoint or median figure may be a much more realistic figure when describing the typical business.

The median figures, too, can mask the financial situation of many firms. For example, while the median net profit was $13,000, 21 percent reported a loss and another 22 percent reported less than $10,000 net profit. Losses were generally associated with high debt levels. Only 79 percent of those with over 70-percent debt were current on their debt repayments compared with 93 percent of those with less than 40-percent debt.

Substantial diversity in the leverage position (debt/asset ratio) of surveyed businesses is also apparent (Table 4 and Figure 3). About a third have no debt, yet nearly a fifth have debt/asset ratios exceeding 70 percent. The average debt/asset ratio is 39 percent, and about 37 percent of the businesses had ratios of 40 percent or higher. The businesses surveyed did not apear to have an excessive debt load compared with similar businesses nationwide. However, the data concerning net profit (reported previously) suggest that many of these firms may have difficulty servicing their debt under current conditions.

Adjusting to Hard Times

How are businesses adjusting to lower sales and delinquent accounts? The most frequently reported adjustments

Table 3. Survey responses on perception of business closures and formations, 1985-1986.

Number of businesses that closed:	
Mean	6.9
Types:[1]	
Clothing stores	19.8%
Hardware stores	13.5%
Machinery dealers	11.5%
Number of businesses that opened:	
Mean	3.0
Types:[1]	
Eating places	14.7%
Clothing stores	14.4%

[1]Includes only business types mentioned by 10 percent or more of respondents.

Table 4. Financial characteristics of North Dakota businesses, 1985.

Total assets:	
Median	$126,483
Total debt:	
Median	$ 21,000
Net worth:[1]	
Median	$ 75,000
Business debt/asset ratio:	
Average	39.0
Gross income:	
Median	$116,831
Gross profit:	
Median	$ 66,302
Net profit:	
Median	$ 13,000

[1]Median net worth is not equal to median assets minus median debt because some respondents reported their assets but not their debt or vice versa and were thus excluded from the net worth calculation.

Figure 3. Debt/Asset Ratios of Surveyed Business Operators.

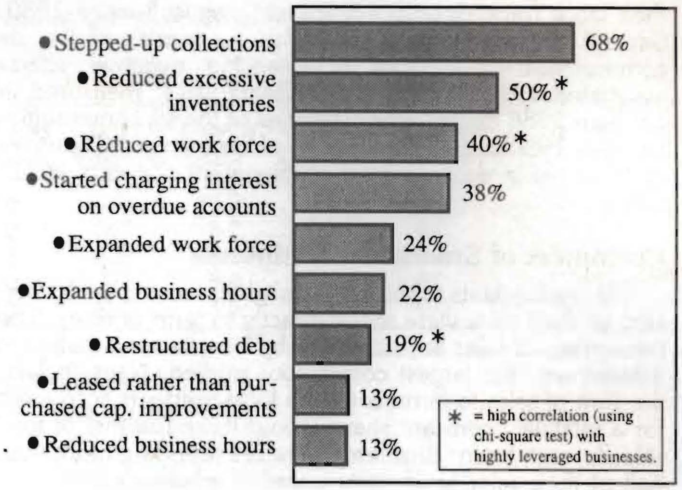

Figure 4. Management Responses to Falling Sales, 1982-1985.

were to increase collection efforts on overdue accounts, reduce inventories, reduce their work force, and charge interest on overdue accounts (Figure 4).

Some types of businesses intiated specific adjustments more often than other types. For example, reducing inventories was reported by almost 79 percent of retail firms and by 67 percent of wholesale durable goods firms. Wholesalers and firms that manufactured nondurable goods were more likely to charge interest on overdue accounts. Work force reductions were reported most often by construction and nondurable manufacturing firms. But not all firms were reducing their labor force; 45 percent of finance, insurance, and real estate firms and over 33 percent of professional service firms had expanded their work force. Adjustments that were significantly related to debt level included restructuring debt, reducing inventories, and reducing the work force.

What's Ahead?

How optimistic are North Dakota's business operators in the face of these challenging economic times? Their responses to several questions about future sales and expansion seem cautious but positive.

About 38 percent of the respondents had made major capital improvements in the last three years, and about 26 percent saw opportunities for expansion or growth (Table 5). Operators in Jamestown (the largest community surveyed) tended to be most optimistic; 34 percent identified growth opportunities compared with only 14 percent of operators in Carrington and 18 percent in Casselton.

Proprietors engaged in finance, insurance, and real estate or in professional services were most likely to see potential for expansion. More than 40 percent of these operators saw expansion opportunities in the next three years. In contrast, less than 25 percent of retailers saw such opportunities. Retail operators were also the least optimistic concerning the continuation of their business; about 20 percent did not know whether their business could continue for the next three years, and another 9 percent felt continuation was unlikely. Since retail trade accounts for most of the business activity in these small towns, their guarded optimism sets a cautious tone for the business community.

Table 5. Business operators' economic outlook in North Dakota, 1986.

	(Percent)
Major capital improvements in past 3 years	
No	62.1
Yes	37.9
Likelihood of expanding business in next 3 years:	
Very likely or Likely	26.3
Do not know	23.1
Unlikely or Very unlikely	50.6
Likelihood of continuing to operate business for next 3 years:	
Very likely or Likely	78.3
Do not know	16.5
Unlikely or Very unlikely	5.3
Expected change in sales or service volume in 1986 vs. 1985:	
− 20 percent or less	14.3
0 to − 19.9 percent	23.7
1 to 20 percent	50.7
21 percent or greater	11.3
Expected change in net profit in 1986 vs. 1985:	
− 20 percent or less	16.7
0 to − 19.9 percent	22.1
1 to 20 percent	51.8
21 percent or greater	9.4

On the positive side, about 60 percent believed their net profit would be greater in the future, and 62 percent expected their sales or service volume to increase. About 78 percent believed they could continue in business for at least the next three years, about 5 percent believed they could not, and 17 percent did not know.

Former Business Operators

Who better can describe the effects of dwindling retail sales than operators who have gone out of business in these six towns? The characteristics of the former business operators who responded to the survey were compared to those of the current business operators and former farmers. Our sample was small (N=68), but the survey did yield some interesting results.

Current and former business operators reported similar reasons for establishing their businesses. When we compared the types of businesses, we found that most former businesses were retail establishments. Fewer former businesses than current establishments were found in the professional services category and in the finance, insurance, and real estate category. Former business operators had been involved in their business for a much shorter period than those still operating, and their businesses had been established for a much shorter period. There was little difference in the types of customers they served; 40 percent of their customers also were farmers.

The dominant pattern that emerges is that the businesses that have failed were similar to but smaller and less well-established than other firms in the study communities. Because most of these failed businesses were started in the 1970s, the impact of economic stress in agriculture on business operators may be similar to its effects on farmers and ranchers. Business operators who established their firms in the 1970s, like persons who began farming during that period, appear to have been severely affected by declining revenue and falling equity. Circumstances, rather than individual actions, may thus have been the major cause of failure for many rural businesses.

Implications

Our results indicate that the business community of North Dakota's smalltown agricultural trade centers has been affected considerably by the slumping farm economy. Coping with the challenges posed by a declining economic base will require both individual action by business operators and collective efforts by local business and community groups.

Individual measures that some smalltown businesses have used include improved inventory control, intensified management of accounts receivable, and more effective use of personnel. In fact, the survey results reveal that many businesses have been taking such measures.

In addition, many smalltown businesses could benefit from an organized advertising and promotion plan designed to take advantage of a small store's strengths, such as superior service, convenience, and awareness of customers' special needs. Such firms may also be able to take advantage of buying groups or resident buying offices to reduce the cost of goods sold, and some vendors may be willing to provide assistance in advertising and promotional efforts.

Collective efforts by business or communitywide groups typically fall into two categories: (1) efforts to capture a larger share of local (or tourist) trade and (2) efforts to expand the area's economic base. Approaches falling into the first category include promotional campaigns (sometimes involving special entertainment events), measures by business associations to coordinate hours and improve the physical attractiveness of the business district, and efforts to recruit new or replacement businesses to "round out" the local trade and service sector.

Broadening the local economic base typically includes attempts to attract new basic employers, to retain or expand existing firms, and to encourage local entrepreneurs to establish new enterprises. While all of these strategies are appropriate for a community to pursue, many observers believe that efforts aimed at encouraging establishment and expansion of local firms deserve greater attention.

To summarize, in economically depressed rural areas, programs aimed at assisting communities to retain their existing businesses may require approaches that emphasize communitywide involvement as well as assistance to individual entrepreneurs. Since operators undergoing financial difficulty do not differ substantially from those experiencing less difficulty, it appears that programs aimed at addressing the economic and social environment of the community, as well as improving the skills of individual business managers, may be necessary. Whatever strategies are used, the desire to revitalize a community must be born from within and community leaders must recognize a need for a substantial and sustained commitment of monetary and human resources.

Bibliography

Bender, Lloyd D., Bernal L. Green, Thomas F. Hady, John A. Kuehn, Marlys K. Nelson, Leon B. Perkinson, and Peggy J. Ross. **The Diverse Social and Economic Structure of Nonmetropolitan American**, RDRR-49, Washington, D.C.: U.S. Department of Agriculture, Economic Research Service, September 1985.

Ekstrom, Brenda L., and F. Larry Leistritz. **Rural Community Decline and Revitalization: An Annotated Bibliography**l New York: Garland Publishing, 1988.

Leistritz, F. Larry, and Brenda L. Ekstrom. **Interdependencies of Agriculture and Rural Communities: An Annotated Bibliography**. New York: Garland Publishing, Inc., 1986.

Leistritz, F. Larry, Brenda L. Ekstrom, and Harvey G. Vreugdenhil. **Selected Characteristics of Business Operators in North Dakota**, Agricultural Trade Centers. Agr. Econ. Rpt. No. 217. Fargo: North Dakota Agricultural Experiment Station, 1987.