Small Business Covid-19 Assistance

Research Findings and Recommendation

The economic impact of Covid-19 has been devastating for most American businesses. It has been especially so for small businesses.

This is an existential problem because small businesses are the heart and soul of the American economy. If many of them disappear due to the coronavirus, it will greatly diminish this nation's strength and spirit.

Small Business by the Numbers

The [2020 Small Business Profile] produced by Small Business Administration Office of Advocacy reports that in 2017 there were 31.7 million small businesses in the U.S. Nearly 6 million of those businesses had employees. 25.7 million were non-employer firms.

For the employer firms, over 5.3 million had 1-19 employees and nearly 640 thousand had 20-499 employees. These businesses employed nearly 60.6 million people - 47.1% of the private sector workforce - and generated 1.6 million net jobs. Firms with less than 20 employees added 1.1 million of those jobs.

Those numbers attest to the central importance of small business for this country and its economic future. The coronavirus pandemic is putting that future at risk.

As the coronavirus pandemic unfolded, the Small Business Administration Office of Advocacy issued [a Small Business Facts report] in April headlined "Early Data Show Severe Disruption" which noted "...following the issuance of a declaration of a national emergency on March 13, 2020 applications (new business) fell by over 27 percent relative to the previous year, the largest decline in the history of the data series."

The Office of Advocacy report for May headlined "Restaurants and Bars Staggered by Pandemic" noted that "…employment in leisure and hospitality was down 41 percent relative to 2019." The report for June headlined "Small Business Employment Plummets noted that "The ADP Research Institute estimated national private employment to have fallen 15.7% between March and April…The largest decline…was for employers with 20 to 49 employees…21.5 percent."

Several other reports regarding the early time period of the pandemic paint a gloomy picture as well:

- A survey of 5,800 small businesses conducted in late March published by the National Bureau of Economic (NBER) in its working paper series issued in April found that 43 percent were closed temporarily and that the respondent businesses had reduced their employee counts by 40 percent compared to January. 72 percent of the businesses said they expected to be able to re-open if the "crisis" lasted for one month but only 47 percent if it lasted for four months.
- An NBER working paper issued in June found that "The number of active business owners in the United States plummeted by 3.3 million or 22 percent over the crucial two-month window from February to April 2020." A July working paper based upon May data found there had been a slight rebound, as the country started to re-open, with the number of active business owners down by 2.2. million or 15 percent.
- A report from Main Street America released in early April stated that "Of the nation's approximately 30 million small businesses, nearly 7.5 million small businesses may be at risk of closing permanently over the next five months, and 3.5 million are at risk of closure in the next two months."

The bottom line is that the impact of Covid-19 on small businesses has been and will be staggering. Millions of active small businesses have closed temporarily. Now, as the pandemic is in the second stage of its initial surge and blanketing the entire United States, it appears likely that eventually millions could close permanently as a consequence of the virus. Who are they?

Small Businesses at Risk of Closing

The small businesses most at risk of closing by **size** are those with fewer than 20 employees. In large part, this is the case because they constitute the bulk of small business employer firms – 89+ percent and an even greater number when small business non-employer firms are included – 98 percent.

Businesses in in all **industry sectors** were affected by the pandemic. The April NBER working paper found that retail, arts and entertainment, personal services, food services and hospitality businesses were most negatively affected in terms of closings and layoffs. There was less disruption for finance, professional services, and real estate-related businesses.

The NBER June working paper showed that there was an across the board drop in **active business owners**. Those business owners "especially hard hit" were African Americans (41 percent drop); immigrants (36 percent drop); and Latinx (32 percent). Asian business ownership dropped 26 percent and females dropped 25 percent). The follow-up July paper found that there was a partial rebound for these business owners, but they still remained disproportionately affected: African Americans (26 percent); immigrants (25 percent); Latinx (19 percent); and Asian (21 percent).

The Main Street America survey provided a targeted perspective and insights on what could be labeled classic **"mom and pop" establishments**. It was focused on older and historic commercial districts across the United States. Nearly 40 percent of the businesses surveyed were in towns with fewer than 10,000 residents.

These businesses: were 75 percent locally owned. 50 percent woman owned. Nearly 50 percent had been in business for more than ten years. 65.5 percent had fewer than 5 employees. The existence of many of them is threatened by the pandemic.

Federal Government Covid-19 Small Business Assistance: Round One

The Paycheck Protection Program (PPP) established by the CARES Act (signed into law on March 27) and implemented by the Small Business Administration (SBA) with the assistance of the Department of Treasury was the federal government's primary response to assist small businesses to cope with the economic crisis created by the coronavirus pandemic.

Less well publicized is the SBA's Economic Injury Disaster Loan (EIDL). These are low interest loans of up to $150,000 at an interest rate of 3.75% for up to 30 years. the EIDL includes a $10,000 advance grant. By May 18, the SBA had made 252,340 of these loans at an average of close to $100,000 each.

The PPP went into effect on April 3 with an initial tranche of $349 billon for low interest loans to help small businesses pay up to eight weeks of payroll costs and cover some other operating expenses.

This initial funding was almost completely burned through in only two weeks. The allocation of these funds in the first round received substantial criticism because many large loans were made to bigger small businesses such as Autoweb, Shake Shack, and Ruth's Chris, Marriott (some of which returned those dollars) and smaller businesses did not fare nearly as well.

Congress approved a second tranche of $310 billion on April 26. There was an initial rush in PPP applications again but after May 8 they declined substantially due to the restrictions on the use of PPP funds with more than 40 percent of the funding still available.

To address this situation, on June 4, the Paycheck Protection Program Flexibility Act was signed into law allowing businesses securing loans, among other things, to cover payroll costs for a longer period of time and to use a larger amount of the loan to cover operating expenses.

This increased the pace of applications again. And, through July 6 when the SBA released information on the PPP, nearly 5,500 lenders had distributed 4.9 million loans at an average of $106,000 totaling $521 billion - close to 80% of the available PPP funds)

The distribution of these loans came under criticism again, as some of them, as the *New York Times* reported, went to "lobbyists, law firms and trade groups" and politically connected businesses such as "a fancy sushi restaurant in the Trump International Hotel in Washington, Kanye West's company Yeezy; and President Trump's personal lawyer."

Joseph Parilla and Sifan Liu of the Brookings Institution were not as critical. In an article, based upon their analysis of the SBA data, they conclude:

> *If the data is accurate, it means that despite notable implementation challenges .... the PPP did what it intended to do: provide liquidity relief to a wide swath of small businesses in as short period of time as possible.*

Parilla and Liu point out, however, that the PPP applications and loans varied considerably in state and metro areas across the United States. Their analysis disclosed that 70 percent of the businesses in the U.S. received loans with West Coast states ranging around 60 percent on average and a group of southern states receiving 75 percent on average. There was a similar pattern by major and mid-size metro areas.

Most interestingly, Parilla and Liu found that "The cities in which the largest share of small businesses experienced revenue loss had the lowest share of small businesses receiving PPP loans. This was especially striking for the Bay area (San Francisco) and New York…"

A Main Street America follow-up survey provides a look at PPP's impact on smaller businesses in smaller locations. 48 percent of the survey respondents who had applied for loans received them. This breaks out as follows: Businesses with fewer than 6 employees (39 percent). Six employees or more (64 percent).

There was also a difference by size. 59 percent of businesses in cities or towns of 50,000 who applied received loans compared to 45 percent of businesses from cities or towns of 50,000 or less.

Add this to the finding from McKinsey & Company's Small Business Survey, that "…the smallest businesses, particularly those with annual revenues less than $250,000, were significantly less likely to apply to the US Small Business Administration Paycheck Program…, and it must be concluded that when it comes to covid-19 small is not beautiful. In fact, small may not be survivable.

Small Business in Decline Over Time

This is a troubling conclusion in and of itself. It is much more troubling when put into the context that small businesses have become less visible on the nation's radar screen for some time.

An analysis of available comparative data reveals the following:

- From 1998 to 2014, the small business share of GDP fell from 48.0 percent to 43.5 percent
- In 1987, relatively young firms (ages 0-10) and small firms (49 or fewer employees) accounted for about one-third of total employment. By 2014, this had dropped to 19.0 and 27.2 percent, respectively.

- Start-up rates across all industry sectors fell from a range of 15+ percent to 10+ percent in 1979 to well below 10 percent in 2014.
- Between 1996 and 2019, the share of new entrepreneurs aged 20-34 decreased from 34.3 percent to 27.2. The share aged 55-64 increased from 14.8 percent to 25.1 percent.
- The number of non-employer businesses rose 58 percent from 1997 (15.4 million) to 24.3 million in 2015. By 2017, there were 25.7 million non-employer businesses (an increase of nearly 6 percent over two years).

These are telling statistics about the changing nature of the small business playing field. They show that the playing field has been changing for some time.

The Great Recession, which began in December 2007 and ended officially in June 2009, accelerated those changes and had a carry-over effect on small businesses and start-ups until at least 2015. Another major change factor identified by the Brookings Institution in its' 2018 research paper on economic competition and dynamism is rising market concentration, with large businesses becoming more dominant and influential, and public policies that favor mergers and acquisitions and impede competition.

Small Business Opinions Regarding the Impact of Covid-19

In spite of the historic trend and the catastrophic economic impact of Covid-19 in the first half of 2020, two surveys released in June showed that small businesses had grown progressively more optimistic about economic conditions.

- The NFIB Small Business Optimism Index was 100.6 in June compared to 94.4. in May and 90.9 in April – a seven year low.
- The MetLife & U.S. Chamber of Commerce Small Business Coronavirus Impact Poll found that the number of businesses that were very concerned about the impact of the pandemic was 43% compared to 53% in May and 58% in April.

While the MetLife/Chamber of Commerce poll showed some improvement in many areas, it disclosed the opposite on when the economic climate would return to normal with 55% believing it will take six months to a year compared to 50% in May and 46% in April.

The Wells Fargo/Gallup Small Business Index released on June 19 also showed business owners predicting a slow recovery for the U.S. economy, with 32% of the respondents saying it would take "the rest of this year" and 44% replying it would take "longer than this year."

Surveys are taken at a point in time. The samples for these surveys were collected in late May and early June. At that time, the spread of the pandemic seemed to be slowing and the infection curve to be flattening slightly.

By mid-June, the pandemic had begun to explode in the Southern and Western states, and by mid-July it was surging throughout hot spots in states across the country. Given this, it seems probable that surveys of small businesses conducted in July and released in August will show a more pessimistic attitude.

When the economic impact was first felt, there was some speculation that this might be a V-shaped recession. That speculation is over. Opinions among economists now vary as to whether this recession/depression will be W-shaped, U-shaped or L-shaped. None of these shapes will be good for the American economy or Americans.

The Fate of and Future for Small Businesses

No matter what the shape of the recession/depression, it seems logical to forecast that covid-19 will be fatal for millions of small businesses. That is because Covid-19 will not go gently or quickly into that good night.

There are some promising signs regarding vaccines for the coronavirus. In early August of 2020, however, the U.S. continues to not have a national plan for testing-tracking and treatment or for ensuring the wearing of masks, washing of hands, and watching social distance rules.

The absence of a nationally coherent and cohesive approach, combined with the behavior of certain U.S. citizens who refuse to act responsibly, means that the pandemic will definitely not be brought under control in the near term. It will most likely persist into 2021 and possibly longer, if the vaccines prove to not be effective or not be used as widely or as quickly as they should be.

These conditions will be a death sentence for many small businesses. In mid-July, Eric Martin of Bloomberg reported that "More than one third of small businesses in the.... U.S. worry about viability or expect to close permanently within the next year, according to the Washington-based fund (International Monetary Fund)."

Those businesses most at risk are small, small businesses. They are microbusinesses – businesses with nine employees or less.

Close to 64 percent of the businesses who participated in the study described in the April NBER working paper had five employees or less. The study's authors concluded that the businesses in its survey were "financially fragile," with three quarters of its respondents having "only enough cash on hand to cover two months of expenses or less."

Some of those businesses are undoubtedly gone. Some were undoubtedly saved temporarily by the PPP. Others have undoubtedly struggled along on their own.

The vast majority of those businesses still around are most likely in survival mode. Others joining them in this mode that were identified earlier in this piece include:

- Main street "mom and pop establishments" in rural and disadvantaged urban neighborhoods
- Smaller businesses in the retail, arts and entertainment, personal services, food services and hospitality sectors
- Smaller businesses owned by females, African Americans, Latinx, immigrants, and Asians.

Finally, there are the non-employer businesses that have no paid employees except the owner. They businesses are generally small such as real estate agents and independent contractors.

About one third of these businesses are owned by minorities and 40 percent are owned by females. A 2012 Census Bureau survey found that these businesses were the primary source of income for 40 percent of the owners.

Covid-19 has already taken a toll on the small, small businesses and the bells are starting to toll for them. What is being done and should be done to change those tolling bells to chimes of freedom?

Federal Government Covid-19 Small Business Assistance: Round Two

While not perfect, the PPP – especially as modified through the Flexibility Act - created some breathing room for millions of small businesses. And when Congress finally agrees on what should be in the next stimulus package, it will be getting additional assistance.

At this point it is difficult to determine exactly when that will be. There are some significant differences between the House and the Senate about what should be in the next stimulus package to respond to the impact of the coronavirus.

The House under the control of a Democratic majority passed a $3+ trillion stimulus package in late May. And after resisting doing anything, the Senate, under Republican majority, reluctantly and after much internal squabbling put together a $1 trillion package in the week of July 27.

The good news for small businesses is that from the outset both Republicans and Democrats agreed that there should be continued support to small businesses through the PPP. The Republicans placed an emphasis on businesses that were struggling to survive. The Democrats placed an emphasis on business owners of color and females who were under-represented in the first round of PPP funding.

Targeted Microbusiness and Non-employer Businesses Recommendation

On July 10, David Leonhardt of the *New York Times* published an insightful article titled "It's 2022. What Does Life Look Like?"

In his set-up for the piece, Leonhardt states that:

The changes that I am imagining in this article are based on neither an unexpectedly fast or slow resolution, but instead on what many scientists consider the baseline. In this scenario, a vaccine will arrive sometime in 2021. Until then the world will endure waves of sickness, death and uncertainty."

Before we get into the details, there is one more caveat worth mentioning. Many things will <u>not</u> change. That's one of history's lessons."

As we have discussed and demonstrated in this blog, much has changed for small businesses over the past quarter century or so, and Covid-19 has wrought significant negative changes in less than one-half year. In general, microbusinesses (firms with 1-9 employees) and non-employer businesses (firms with no paid employee) have suffered the most from these negative changes.

Given this, and our understanding of the covid-19 assistance the federal government has provided to small businesses to date through PPP and EIDL, and the future plans for assistance, we recommend that Congress complement and support that assistance by authorizing and providing funds to the SBA to implement a direct loan program targeted at microbusinesses and non-employer businesses.

The program should place a priority focus on the businesses within these two categories that have been impacted most greatly by Covid-19:

- Businesses owned by females, African Americans, Latinx, immigrants, and Asians.
- Businesses in the retail, arts and entertainment, personal services, food services and hospitality sectors
- Main street "mom and pop establishments" in rural and disadvantaged urban neighborhoods

These direct loans should be long-term, low interest, and modeled after the EIDL. The loans should require no payment for the first six months after they are given.

The direct loan program should provide an initial grant that can be used for the operational support and sustenance of an ongoing business, for a business to re-start an enterprise that was caused to close by the pandemic, or to enable an entrepreneur to start-up a new venture to replace a business they have lost. It should also provide technical assistance to business owners and entrepreneurs to help them revise their business models and develop business plans for taking their businesses forward.

There are numerous reasons for developing a targeted micro- and non-employer businesses direct loan program. They include the following:

- These businesses are an essential part of the small business fabric. In 2016, there were 3.8 million microbusiness employers, nearly 75 percent of all private sector employers. In 2017, there were 25.7 million non-employer firms, constituting over 80 percent of small businesses.
- These businesses have the most difficulty securing traditional loans from banks and other lenders. One study showed the "Access to capital continues to be a driving factor that disproportionately affects minority-owned businesses, especially those owned by Blacks and Hispanics."
- Non-employer businesses tend to provide their own start-up and operating capital
- Although there is no definitive or conclusive data at this time, initial reports suggest small, small businesses have been the least likely to receive Covid-19 PPP or EIDL assistance.
- These businesses are on the corner block, in the neighborhood home, and spread throughout small towns and cities across this country.
- These businesses are truly main street businesses and would not qualify for the inappropriately named Federal Reserve Main Street Lending Program, which is open to medium and small businesses which have up to 15,000 employers or fewer and annual revenue in 2019 of less than 5 billion.
- For these businesses, the pandemic economic disaster has been the equivalent of a natural disaster. That is why a program modeled after the EIDL would be appropriate. Data on the nature of the SBA's Covid-19 EIDL loan recipients is currently not available. It is highly unlikely, however, given the loan size of approximately $100,000 that many of the recipients of these loans were micro- or non-employer businesses.

This targeted direct loan program will ensure there are millions of small businesses in existence across this country in the years to come that would not be there otherwise.

Those businesses will be revitalized. In return, they will help revitalize this nation.

Small, small businesses have made that contribution in the past. Properly supported they will make that contribution in the future. They will pay back the investment in them in dollars and cents and by keeping America whole and the American dream alive.