Unlocking Entrepreneurship

The Role of Credit Access in the Small Business Recovery

October 2021

Executive Summary

- Small businesses are essential to the U.S. economy, employing nearly half of U.S. workers and accounting for more than 40% of U.S. gross domestic product (GDP). In order to open, survive, and expand, small businesses need access to affordable credit. Prior to the COVID-19 pandemic and related recession, small businesses were experiencing a period of expansion after recovering from losses and tight credit during the 2008-09 Great Recession.
- The pandemic, along with the shutdowns and restrictions that accompanied it, had a profound effect on small businesses. In spring 2020, the federal government stepped in to help with credit access through programs like the Paycheck Protection Program (PPP), Emergency Injury Disaster Loans (EIDL), and the Main Street Lending Program.
- While these programs helped many small businesses survive the downturn, funds were not distributed equitably among all firms. Because of systemic barriers, minority- and women-owned firms were less likely to apply for assistance, and they were less likely to receive the funds they requested. Just 6-in-10 Black-owned firms applied for PPP funds, compared to 85% of Asian-owned and 82% of White-owned firms. Further, most (80%) of White-owned firms received all the funding they requested, compared to just 43% of Black-owned, 61% of Hispanic-owned, and 68% of Asian-owned firms.[1]
- The pandemic exacerbated inequities in credit access that already affected women- and minority-owned businesses. For this project, Equifax profiled minority- and women-owned community partners to provide greater insight into the unique challenges their businesses face. These community partners highlighted the issues minority- and women-owned businesses face in accessing credit, the novel approaches their businesses are taking to help combat those issues, and the impact of the pandemic on their businesses specifically and small business credit access in general.
- As the country emerges from the 2020 recession, small businesses have recovered much faster than they did after the 2008–09 recession. Business applications were filed at a record pace during the pandemic, as creative entrepreneurs looked to make the best out of their circumstances. Looking forward, both pre-existing small businesses and those founded during the pandemic need continued access to capital to survive and grow.

Introduction

The spread of the COVID-19 virus, along with lockdowns and the health and safety protocols aimed at stopping the spread, had major impacts on Main Street businesses. Small businesses typically have slim margins and are disproportionately likely to operate in high-touch service sector industries. Women- and minority-owned businesses were particularly impacted, due in part to their higher concentrations in affected industries as well as pre-existing inequities in credit access and small business outcomes. As credit tightened during the downturn, an unprecedented level of government aid for the sector—as well as support from consumers and accommodations from lenders—helped small businesses avoid the most drastic consequences that were initially feared.

Now, as emergency support measures wind down, small businesses find themselves in an uncertain environment. Alongside typical business operations, owners have devoted time and attention to pandemic-specific challenges such as mask and capacity restrictions, work-from-home arrangements, and the extent to which the "new normal" may differ from the past. Some businesses are boosting their online presence, others are investing in new payments technologies, and many just need additional operating cash. Regardless of the business or industry, financing these endeavors is likely to require new lines of credit. As the recession subsides, access to credit is critical to supporting Main Street growth and success through the economic recovery and beyond.

Pre-Pandemic Background

Role of Small Businesses in the U.S. Economy

Small businesses form the backbone of the U.S. economy, and their success is crucial to employment and economic growth and development across the country. There are 31.7 million small businesses in the United States, representing more than 99% of all U.S. businesses.[2] These firms employ more than 60 million people—almost half of the country's labor force— and account for a major share of the country's economic output, contributing to roughly 44% of total GDP (see Figure 1).[3] Further, small businesses are some of the most productive businesses in the country. When start-up small businesses survive, they create more net jobs than established businesses, with higher rates of employment and productivity growth.[4]

Figure 1: Share of Workforce and GDP from Small Businesses

Source: Small Business Administration, 2018 and 2020

The impact of small businesses goes beyond macroeconomic benefits to U.S. growth, productivity, and employment. They are also engines of wealth creation, equity, and financial inclusion among underserved groups. Business equity is the second-largest source of wealth for American households, with the median net worth of business owners more than double that of non-owners.[5] This discrepancy is even more pronounced among owners of color: the median net worth for Black women entrepreneurs is ten times greater than those who do not own a business.[6] As such, encouraging small business to form—and, as they develop, facilitating their growth by ensuring they are well-capitalized—not only promotes general economic expansion and productivity, but also helps to narrow the gender and racial wealth gaps.

Importance of Credit Access

Small businesses are important from both a general economic perspective and an equity standpoint, and critical to the success of small businesses is access to adequate, affordable capital. Significant academic research points to credit access as essential to small business survival and growth.[7] Similarly, revenues and cash liquidity are strongly related to small business survival, and a major constraint limiting growth, expansion, and wealth creation of small firms is inadequate capital.

However, access to credit alone is not enough. Credit must be reasonably priced so that small businesses with low levels of capital, especially those from traditionally underbanked communities, can afford to use it. As Randi Zeller of Equifax community partner MoCaFi, a Black-owned firm in the consumer finance space, said: "There is no lack of capital. If you're willing to borrow at predatory rates, you can get capital. What we need is access to *affordable* capital." As addressed in the Spotlight on Women- and Minority-Owned Businesses (p. 11), these issues of credit access and small business success tend to be more pronounced for women and small business owners of color.

Credit Conditions Approaching the Pandemic

After a modest recession in 2001, small businesses thrived during the first half of the decade. The National Federation of Independent Business (NFIB) Small Business Optimism Index peaked at a then-record high of 107.4 in November 2004.[8] However, the onset of the mortgage market crisis in 2008 marked a downward turn. Though most small businesses were initially able to weather the storm, conditions began to worsen in late 2008 and early 2009. By the time business optimism bottomed out in March 2009, the NFIB's index had declined nearly a quarter from its pre-recession peak. Concurrently, taps began to dry up on small business lending as the Equifax Small Business Lending Index (SBLI) fell 30% from May 2008 to an all-time low in May 2009.

Although the steep slide in sales and collapse in real estate values—rather than the lack of credit—were the primary drivers of the Main Street collapse during the Great Recession, the deterioration of financial conditions led to fewer attractive small business prospects for lenders.[9] Borrowers previously designated as creditworthy became increasingly risky and were priced out. In 2009, the share of small businesses holding a business loan or line of credit fell by 20%, and only 40% of applicants had all their credit needs met while nearly a quarter had none of their credit needs met (by comparison, during the mid-2000s up to 90% of businesses had their most recent credit request approved).[10]

The reduction in credit availability for Main Street businesses was exceptional. At the peak of the recession in Q4 2008, the net share of banks tightening standards to small firms surged to 74.5%, nearly doubling the level of the prior downturn when the same metric peaked at 45.5% in Q1 2001.[11] Unsurprisingly, with the vast majority of banks tightening lending standards while the U.S. economic outlook rapidly deteriorated, confidence among small business owners tumbled in 2009 — the NFIB Small Business Optimism Index fell to an all-time low in March 2009 — and the number of SMB loans declined 16%.[12] By 2010, nearly one-in-ten small firms did not even attempt to borrow out of fear they would be rejected.[13]

The recovery from the Great Recession was unusually slow. On Main Street, negative sentiment persisted for years and did not begin to improve in earnest until 2012–2013. In the summer of 2013, the Equifax SBLI finally reached its pre-recession level for the first time, nearly six years after the recession officially began in December 2007.[14] Other estimates of small business lending suggest that a full recovery may not have occurred until 2017.[15] Eventually, though, small business growth did recover. With the exception of a brief manufacturing downturn and "growth pause" in late 2014 and early 2015, metrics of small business lending and optimism rose steadily throughout the 2010s.

More than a decade after the financial crisis, the small business credit landscape looked quite different than it had 10–20 years prior. The aftermath of the recession left the banking industry in a state of turmoil, and significant consolidation followed. Historically, smaller community banks had been a key component of the small business lending apparatus, but by 2012 roughly 400 small banks had closed, likely contributing to the reduced levels of credit availability in the years that followed. Indeed, while 31% of small businesses used a community bank as their primary lender in 2009, the share fell to 25% in 2010 and 20% in 2011.[16] The financial crisis and the regulatory changes that followed were a major blow to small banks: from 2006–2019, the number of banks with less than $1 billion in assets fell by 38%, leading to a doubling in the market share of the largest banks over the same period. The loss of small banks accounted for the entire net decline of 2,500 banking institutions that occurred during that time period.[17]

Sources: Federal Reserve Small Business Credit Survey. Totals for chart exceed 100% because respondents could provide multiple answers.

More recently, online lenders and Fintech companies have contributed to the changing landscape of small business credit. Technological innovations in the financial industry have created opportunities for new companies to play increasingly prominent roles in this space. By 2016, increases in small business lending by Fintech and finance companies offset most of the decrease in bank lending following the Great Recession,[18] and the market share for online lenders increased from 21% to 32% from 2016 to 2018.[19] As a result, valuations and loan volumes from Fintech lenders such as Kabbage, BlueVine, and SmartBiz Loans began to soar. For example, by the end of 2018, Kabbage had loaned out nearly $6 billion to small businesses since its founding ten years earlier — including $2 billion alone in 2018.[20]

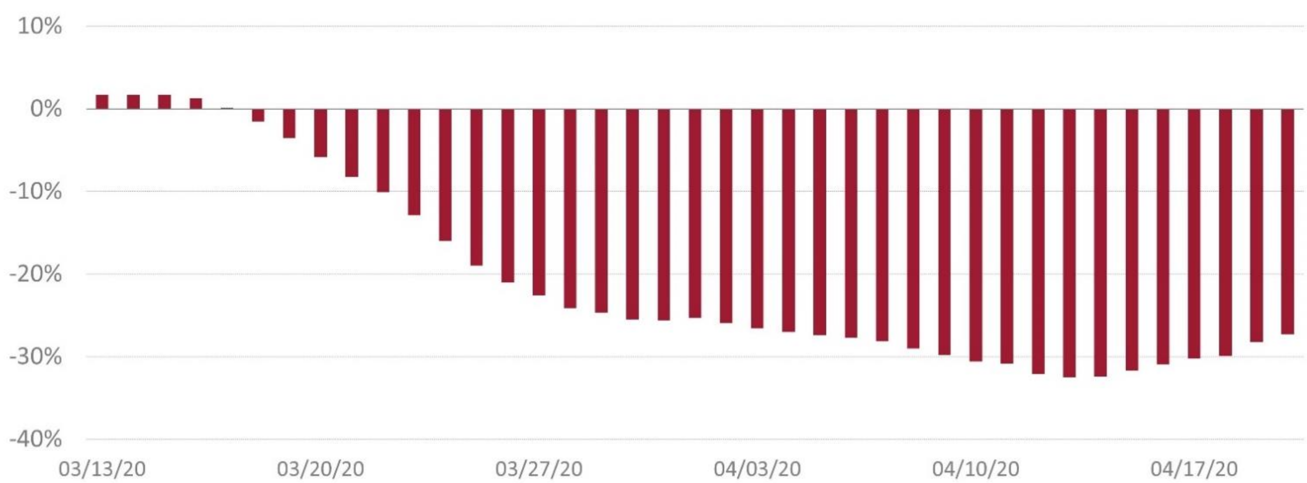
As 2020 began, signs of an impending slowdown were beginning to develop. Although there was no smoking gun, the U.S. economy was eleven years into its longest economic expansion on record and was showing signs of entering a late stage in the business cycle. For example, in January 2020, 19% of banks expected loan performance from small firms to deteriorate in 2020 while just 1% expected it to improve.[21] There were also concerns regarding the impact of the trade war with China on U.S. businesses and their customers, as well as a slowdown in the manufacturing sector. Nonetheless, measures of small business optimism and lending were generally strong and Main Street was on relatively solid footing prior to the COVID-19 pandemic.

Impact of the Covid-19 Pandemic

Immediate Effects on Small Businesses (March - April 2020)

As COVID-19 began to spread throughout the United States in early 2020, the potential damage to small businesses quickly became apparent. By mid-March, an NFIB survey found that roughly 3 in 4 small business had already been negatively impacted,[22] and a Goldman Sachs survey determined that 96% of small firms were feeling the consequences of the pandemic and the associated restrictions on normal business operations.[23] After a National Emergency was declared on March 13, 2020, the number of small business closures had increased 6% compared to January 2020 levels. As shown in Figure 2, three weeks later almost one-third of small businesses that were operating in January 2020 were closed.[24]

Figure 2: Percent Change in Number of U.S. Small Businesses Open
Compared to January 2020; 7-day moving average



Source: Womply via Opportunity Insights

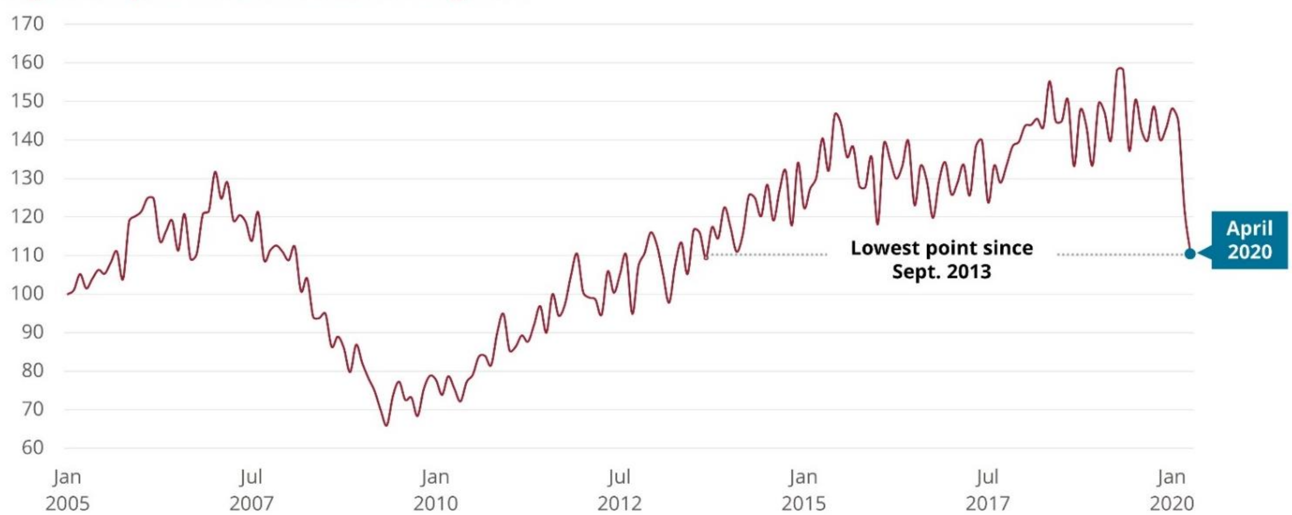
While businesses of all sizes were impacted by lockdowns and social distancing restrictions, Main Street was particularly affected due to lower financial flexibility and overrepresentation in high-contact service industries. Small business employment forms a disproportionate share of some of the most COVID-impacted industries, including Accommodation and Food Services (61%) and Arts, Entertainment, and Recreation (60%).[25] Notably, many small businesses in these industries have few or no employees, so these industries may be even more disproportionately dominated by small businesses than employment figures would suggest.[26] **Moreover, in early April 2020, while small business revenues fell by half compared to pre-pandemic levels, the Leisure and Hospitality sector fared even worse, losing 75% of its normal revenues.**[27] The massive impact had a predictable effect on small business optimism: in April 2020, the WSJ/Vistage Small Business Confidence index plummeted from 91.7 to a record-low of 44.7,[28] while an April NFIB survey found that a net 42% of small businesses expected lower sales over the following three months—12 percentage points higher than the peak of the Great Recession in early 2009.[29]

Public Policy Response

In the early days of the pandemic, financial markets were in turmoil with the S&P 500 dropping nearly 20% from February to March 2020. The Federal Reserve acted quickly to restore calm to equity and debt markets, purchasing trillions of dollars in bonds amid other liquidity injections. These actions stunted the rise of higher yield treasury bond spreads, which had been skyrocketing leading up to the Fed's announcements.

Still, while Fed actions allowed distressed corporations to continue to access financing at reasonable prices, small business lending remained fraught. In spring 2020, more small businesses had less than a month's worth of cash on hand than greater than a month's worth, and 16% had less than a week's worth of cash.[30] At the same time, credit tightened as lenders reverted to "risk off" positions, avoiding traditionally riskier investments such as small business loans. The result was a net 40% of banks tightening standards (43% tightened while 3% eased) on small business loans in Q2 2020—the largest Q/Q change in Fed Senior Loan Officer Survey history and twice the size of the previous highest quarterly change.[31] This tightening resulted in a severe contraction in small business lending, with the Equifax SBLI falling by a quarter from February 2020 to April 2020 (see Figure 3).

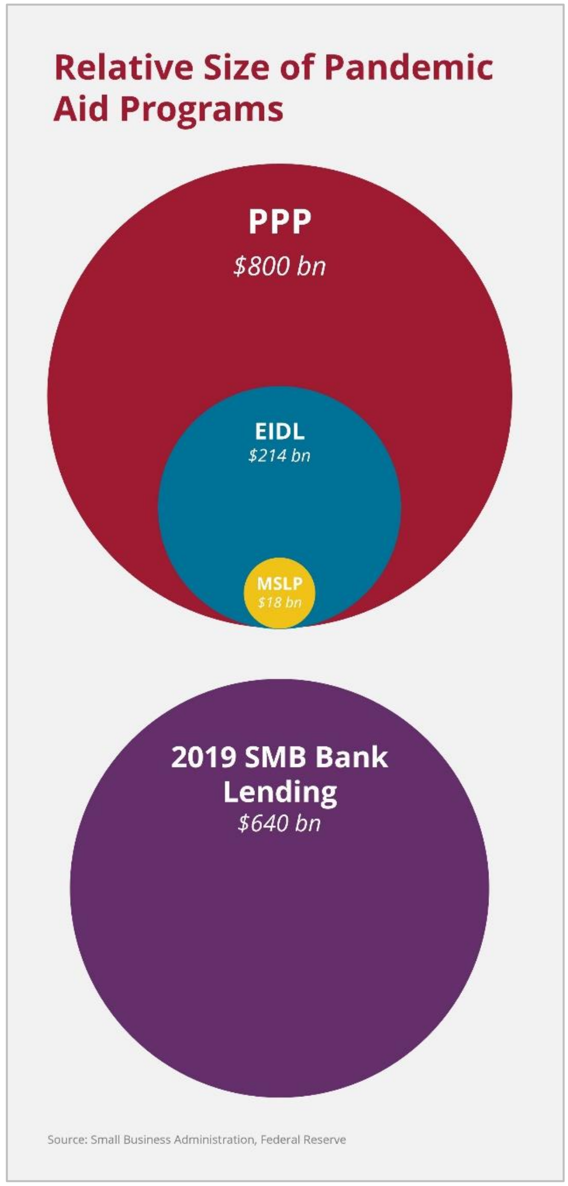
Figure 3: Equifax Small Business Lending Index



Source: Equifax

The federal government's response to the COVID-19 recession was substantially larger and swifter than what occurred during prior downturns, including the Great Recession. After passing an $8.3 billion bill for vaccine R&D and an $104 billion package focused on unemployment insurance and sick leave, Congress and the Trump Administration enacted the $2.2 trillion CARES Act in late March, just two weeks after the declaration of a National Emergency. One of the key features of the CARES Act aimed at helping small businesses survive the pandemic was the Paycheck Protection Program (PPP). Designed as an employment retention program to avoid mass layoffs, the $350 billion PPP also provided credit access and liquidity for small businesses. A key feature of PPP was the forgivable nature of the loans: as long as certain criteria were met (e.g., using 75% of the loan on payroll costs, though this restriction was later relaxed), recipients did not have to repay the loans. This feature greatly increased demand for the program, along with banks' willingness to participate in it.

Estimates of PPP's impact on employment are mixed, ranging from a couple million jobs saved to nearly 20 million.[32] However, PPP offered other benefits to small businesses in addition to employee retention, including providing cash-starved and revenue-dry small businesses with essential funding. While the program's rollout was not seamless, it played a critical role for the millions that were able to access it, especially in the early months of the pandemic.[33] A June NFIB survey found that two-thirds of loan recipients cited the program as "very helpful" to their business.[34] More recently, an analysis conducted by economists at the Federal Reserve found that business closures during the pandemic were much lower than anticipated, in part due to measures like PPP.[35] **When PPP ended in May 2021, 11.8 million small businesses (37% of the sector) had accessed PPP loans, totaling $800 billion**.[36] As of July 30, 2021, $442 billion (56%) of the total PPP loan value had been forgiven, including 80% of the total 2020 PPP loan value. This amounts to 94% of total forgiveness requested.[37]



While PPP was the largest and most well-known small business assistance program, other policies also helped smaller firms shore up their cash flows. For example,

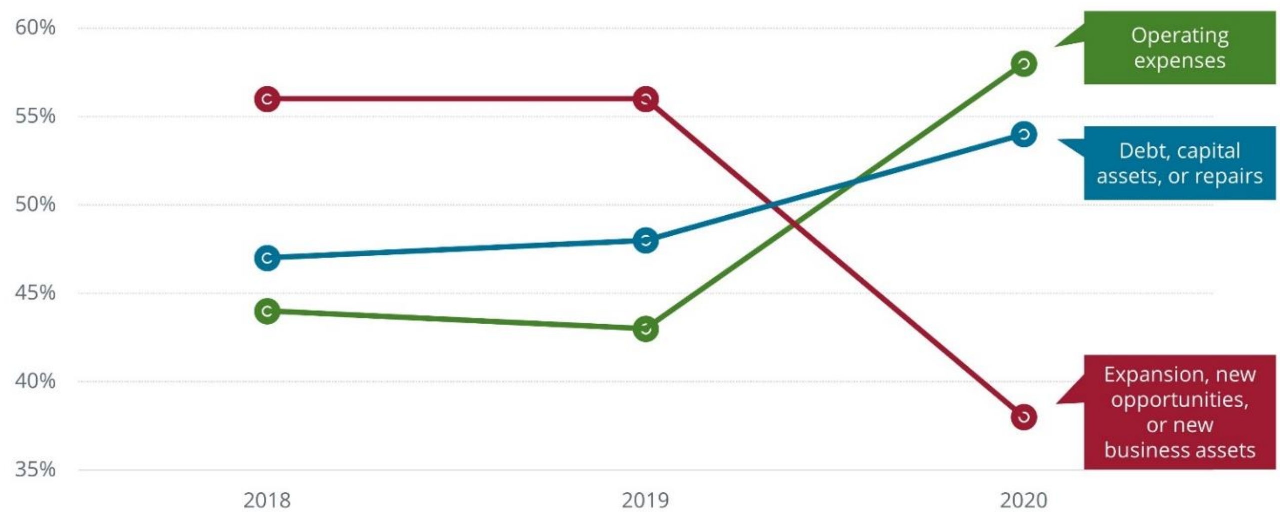
- Emergency Injury Disaster Loans (EIDL) were provided in one of two forms: small (up to $10,000) forgivable cash advances and low-interest fixed loans. Amid the slow initial rollout of PPP, many small businesses applied for an EIDL advance to get cash quickly while waiting for their PPP application to process. Although the relative size of EIDL advances was small (251,594 loans for $2.1 billion), the full loan program has included over 3.8 million approved loans totaling nearly $215 billion (as of June 30, 2021) intended to provide small businesses with working capital and to meet their normal operating expenses.[38] While the forgivable advance payments have been fully allocated, the loan program is ongoing with the totals cited comprising 16 months of lending dating back to April 2020.
- The Main Street Lending Program (MSLP) was established by the Fed as an emergency lending facility specifically targeted at small and mid-sized businesses. While the program had enough funding to make $600 billion in loans, it tapped just 3% of it, lending $17.5 billion to 1,830 businesses over the six months of operation July – December 2020.[39] The lack of demand from both lenders and borrowers was related to the perceived onerousness of loan terms (particularly compared with alternative lending programs) and insufficient incentives for lenders to participate.[40] Though its impact was comparatively modest, Fed economists found that the program contributed to the supply of credit to medium-sized borrowers, especially those with smaller revenues and limited access to large banks.[41]

Even into 2021, the policy response persisted as private lenders remained cautious. A July 2021 survey from the Census Bureau's Small Business Pulse found that while 42% of small businesses had received assistance in 2021 via PPP and 10% via EIDL, just 2.7% had received assistance from a bank or other financial institution.[42] The federal government's transition to the primary Main Street lender during the crisis was unprecedented. Further, the level of aid provided was massive; PPP and EIDL supplied Main Street with over $1 trillion in 2020, nearly double the amount lent to small businesses by private banks in 2019 according to FDIC data.[43]

Impacts on Credit Access

Despite unprecedented federal government support, many small businesses struggled during the pandemic-induced recession. For example, the share of small businesses experiencing financial challenges rose from 66% to 80% in 2020.[44] Further, although two in five firms sought non-emergency financing last year, they were much less likely to be fully financed in comparison to years past (37% received all the financing they sought, compared to 51% in 2019). Demand for credit rose as cash reserves and sales declined, yet fewer firms were approved for credit — and of those, fewer said they had sufficient financing.

Figure 4: Percentage of Survey Respondents Applying for Financing For...



Sources: Federal Reserve Small Business Credit Survey. Totals for chart exceed 100% because respondents could provide multiple reasons/answers.

Unsurprisingly, the primary purpose for capital shifted during the pandemic as small businesses transitioned into survival mode. In years past, small businesses applied for financing primarily to fund expansion or new business opportunities, while in 2020 the purpose shifted to covering operating expenses (see Figure 4). This shift from thriving to surviving can also be seen in the increasing number of small business owners dipping into their personal finances to cover costs. According to a Federal Reserve survey, 63% of owners dealt with financial challenges by reducing or eliminating their salary, while 51% used personal funds to cover business expenses.[45]

The Main Street response to the pandemic highlights the core challenges of operating a small business. When forced to shut down or restrict operations, most small businesses do not have the capacity to tap large credit markets for funding. Government support provided a critical stopgap, but this assistance was only able to go so far — and as the next section will explore in greater detail, it favored some businesses over others.

Spotlight On Women- And Minority-Owned Small Businesses

Even prior to the pandemic, women and small business owners of color have faced additional challenges in opening and running businesses. Women- and minority-owned small businesses are less likely to grow and survive than businesses owned by White men—and many small business owners fit into both categories, facing the dual challenges of running a business as both a woman and a person of color.

Women- and minority-owned businesses start with less capital, they are smaller (both in terms of revenue and number of employees), and they stay smaller. As shown in Figure 5, among firms with employees, those owned by men and White business owners are much more likely to have annual revenues above $1 million.[46] Small business revenue is closely associated with firms' financial well-being, resiliency, and profitability. This relationship is particularly relevant to firms of color, which generate considerably smaller revenues on average and employ fewer people*:* minority-owned business had 32% fewer employees and 47% lower receipts than White owners.[47]

Figure 5: Annual Revenue at Employer Businesses

Source: Federal Reserve Small Business Credit Survey

And small business ownership is key to promoting the financial health of communities and building wealth among frequently underserved populations. **For example, among Black women, entrepreneurs have ten times the median net worth of those who do not own a business.**[48] Further, when they have comparable revenues and cash reserves, Black- and Hispanic-owned businesses are just as likely to survive as White-owned businesses.[49] Small business ownership could serve as a tool to close the racial and gender-based wealth gaps, but only if would-be business owners can access the credit necessary to start and grow a business.

Community Partner: MOCAFI

Equifax interviewed several community partners about the challenges of leading a business as a woman or a person of color. MoCaFi is a Black-owned financial services firm dedicated to closing the racial wealth gap by connecting with unbanked and underbanked communities and helping consumers build credit.

They are also developing a new small business product targeted at microbusinesses in select cities with small revenues and 1-2 employees.

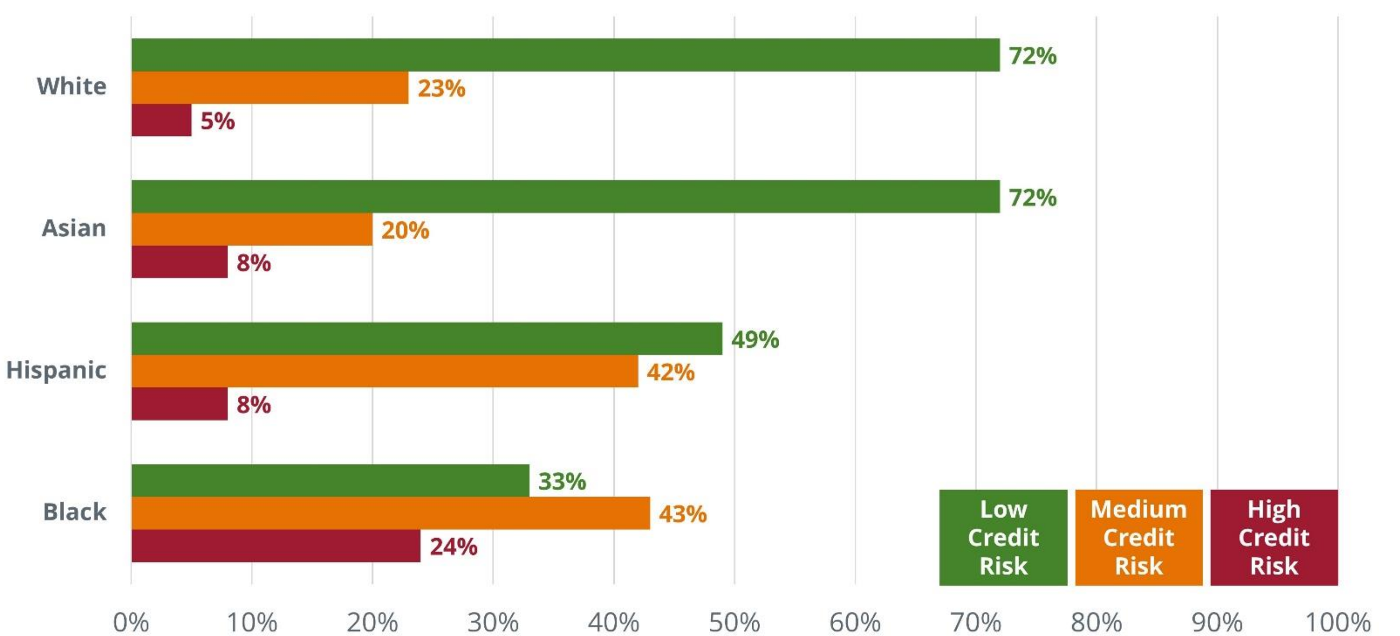
Randi Zeller, consultant for Small Business Solutions at MoCaFi, emphasized the need for affordable capital for small businesses, especially in Black communities. Alternative, innovative credit ratings—combined with financial education and technical assistance—could dramatically improve the credit access problem for small business owners of color.

Credit Access Among Minority-Owned Businesses

Despite the importance of small business ownership to communities of color, access to credit is a significant problem. According to pre-pandemic data from the Federal Reserve, large banks tend to approve about 60% of loan applications from White business owners, compared to 50% from Hispanic owners and just 29% from Black business owners.[50]

Black- and Hispanic-owned businesses, in particular, have a harder time accessing credit from traditional sources, in part because they tend to be evaluated as higher credit risks. For example, according to a study

Figure 6: Credit Risk of Firm by Demographic



Source: Federal Reserve.

from the Federal Reserve, 28% of White- and Asian-owned firms present a medium or high credit risk, compared to 50% of Hispanic-owned firms and 67% of Black-owned firms (see Figure 6). These risks are determined in part by lower owner wealth, lower business revenues, and insufficient credit histories among Black- and Hispanic-owned firms, creating a cycle that has proven difficult to break.[51] However, even controlling for credit score, industry, and owner experience, Black and Hispanic business owners are less likely to access bank financing, suggesting that other factors may also be playing a role.[52]

Because they are less likely to receive business investment from traditional sources, business owners of color are more likely to rely on personal funds to start and grow their businesses.[53] However, compounding the credit access disparity problem, Black and Hispanic Americans tend to have substantially less personal wealth and more personal debt than their White counterparts.[54] According to a report from JP Morgan, the typical White business owner has over 2.5 times the liquid wealth of the typical Black business owner in the first four years of operation.[55]

Entrepreneurs of color face lower access to bank finance, leading to businesses with less initial capital and more personal debt, and at a scale that constrains growth and profitability.[56] Still, while people of color tend to face more difficulty getting a business off the ground, once the business has survived for four years, exit rates are similar among White- and minority-owned businesses — suggesting that access to capital is particularly important in the early stages of a minority-owned business's operation.[57]

Community Partner:

Kiddie Kredit aims to address economic inequality by improving financial literacy from a young age. A Black-owned Equifax community partner, Kiddie Kredit is an interactive app that teaches children about credit scores through the lens of household chores. It is focused on families with limited access to capital.

Evan Leaphart, founder of Kiddie Kredit, believes that wealth gaps are best addressed via entrepreneurship. He underscored that many people have great ideas for businesses, but not everyone—especially people of color—has a wealthy community around to provide initial funding.

Because of this, he emphasized the importance of building credit from an early age. Many small business owners rely on personal finances as they start out, so they need good credit to get their businesses off the ground. As such, the app seeks to teach about credit before it becomes a problem, taking a "vitamin, rather than pain pill approach." He also stressed the importance of education regarding the lending process and the need to streamline and simplify loan applications. especially for business owners coming from underbanked communities.

Credit Access Among Women-Owned Businesses

Women-owned small businesses also faced significant challenges prior to the pandemic, leading to an "entrepreneurship gender gap." Historically, women-owned businesses have had lower survival rates, profits, employment, and sales than businesses owned by men. Similar to minority-owned businesses, these disparities are due in part to difficulty accessing capital, as well as less appealing terms on loans when they can access them.[58]

Beyond discrimination or biases, women may have a harder time accessing credit through traditional bank loans because their businesses tend to be smaller, they may be less likely to take on major financial risks, and they face a gender gap in knowledge about financial management.[59] Still, they are even less likely to access capital through venture capital funds or angel investors than traditional sources. In fact, men are three times more likely to access equity financing through these means, which often rely on opaque metrics and the personal decisions of fund managers—and just 13% of decision-makers at large American venture capital firms are women.[60,61]

Because they are less likely to obtain capital from external sources, many women rely on their own personal wealth to start and grow their businesses. However, women (particularly women of color) have substantially less wealth on average than men. They are much more likely to work lower-wage jobs prior to starting a business, and they are more likely to have taken time off from working outside the home to care for children and family members.[62] Because of this, women face a double disadvantage: they need to rely more on personal funds than men, and they have fewer of those personal funds to start.

Community Partner: launchpad2X

ROCKET FUEL FOR WOMEN ENTREPRENEURS

Launchpad2X, one of Equifax's community partners, is a nonprofit program that trains women entrepreneurs to grow and scale their companies. More than half of Launchpad2X members (called founders) are women of color.

In 2020, Launchpad2X began to raise funding to establish a grant vehicle to help founders access capital to influence purchases and help them grow. They plan to launch this program in 2022. To qualify for the funds, business owners will go through an approval process and complete a financial management education program.

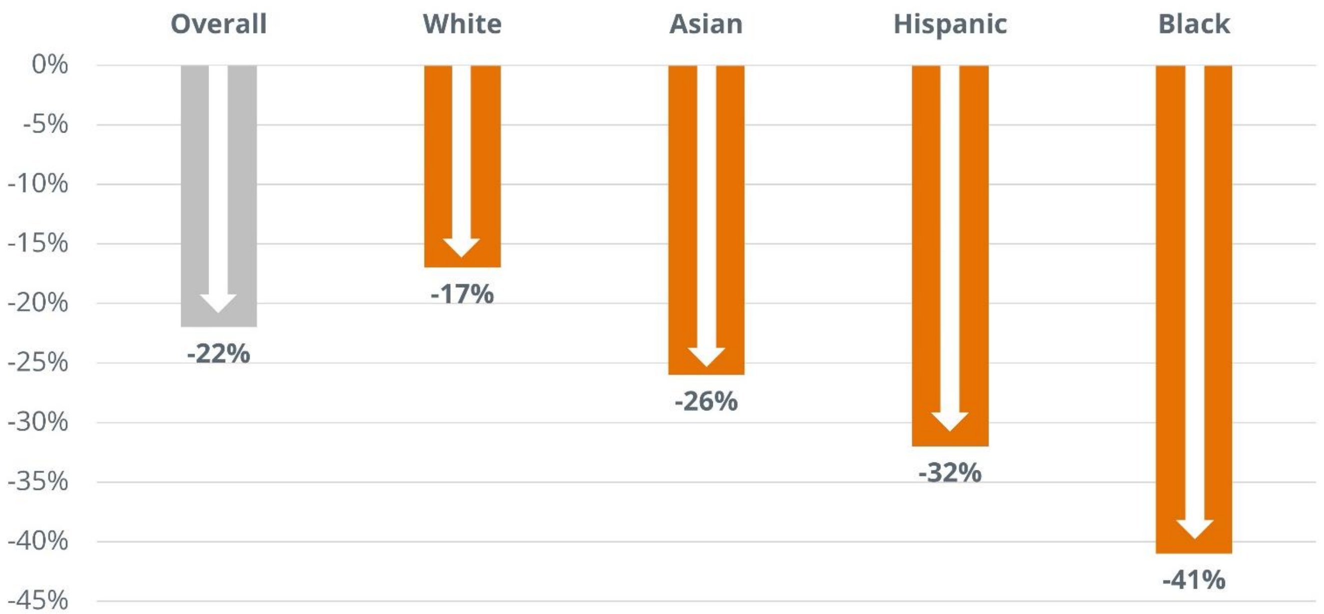
Christy Brown, president of Launchpad2X, highlighted the importance of transparency in the business lending process. When women entrepreneurs are denied loans without explanation, it can cause them to become discouraged. Brown emphasized that many women already have successful, revenue-producing businesses; what they need is capital to help them scale.

COVID-19's Impact on Women- and Minority-Owned Businesses

The pandemic exacerbated long-standing disparities for women- and minority-owned businesses. Survey data collected during the pandemic by the Federal Reserve showed that nearly 80% of Asian-owned and Black-owned small businesses characterized their financial conditions as "fair" or "poor" compared to 54% of all White-owned firms.[63]

Firms owned by women and people of color were also much more likely to close their doors during the first few months of the pandemic. As shown in Figure 7, the number of active Black-owned businesses fell by 41 percent from February – April 2020, while active Hispanic-owned and Asian-owned businesses dropped by 32% and 26%, respectively, during the same period — far more severe than the decline among active White-owned businesses (17%).[64] Women-owned businesses, meanwhile, were 5 percentage points more likely to be closed than those owned by men, and those that managed to stay in operation were 7 percentage points more likely to have reported a drop in sales.[65]

Figure 7: Initial Drop in Businesses, by Race or Ethnicity of Owner
February – April 2020



Source: Federal Reserve Small Business Credit Survey

Firms owned by women and people of color were more affected by the pandemic and related recession for several reasons.

- **Minority- and women-owned businesses are disproportionately in high-touch service sector industries**, which were directly affected by lockdowns and low demand during the pandemic. Industries such as food services, transportation, and retail have lower entry costs, making it more likely that entrepreneurs with lower starting capital could compete.[66]
- **Women- and minority-owned businesses were also less likely to be in sectors that could more easily implement remote work arrangements**.[67] According to a report from McKinsey, five of the six most COVID-vulnerable small business industries have a disproportionate share of minority-owned businesses.[68]
- **Women (including women of color) also faced increased responsibilities and time commitments away from work**, as school-aged children were taught remotely from home. These increased responsibilities affected not only women in the traditional labor force but also business owners, especially because nearly 9 in 10 women-owned businesses are nonemployer firms, with women completing all operating responsibilities on their own.[69,70]
- **Longstanding inequities in access to credit for these businesses also played a major role in the outlook for businesses owned by women and people of color during the pandemic**. Credit access issues were not unique to women- and minority-owned businesses during the pandemic, but the impacts were more pronounced. While PPP provided essential funding for many small businesses, it did not reach all firms equally. **Compared to firms with White owners, Black-owned firms were three times less**

likely to have received all of the funding they sought in 2020, and Hispanic-owned firms were half as likely.[71] Further, 30% of Black-owned small businesses indicated that credit availability was the single most important challenge of the pandemic, compared to just 12% of White-owned firms.[72]

PPP funds were not distributed equitably across race and gender for numerous reasons. First, the program was set up primarily to support payrolls at small businesses with paid employees. Women- and minority-owned businesses are significantly more likely to be nonemployer firms, impacting their abilities to access initial PPP funds. More than 90% of Black-owned and Hispanic-owned small businesses are nonemployer firms, along with 88% of women-owned small businesses.[73]

Next, PPP operated through existing banking channels. Because the funds needed to be distributed as quickly as possible during the first few months of the pandemic, the Small Business Administration set up the program to run through current banking relationships. However, this decision effectively excluded firms in underserved communities, especially Black-owned firms. Among Black-owned firms, 61% applied for PPP funds, compared to 85% of Asian-owned and 82% of White-owned firms.[74]

Black-owned firms were

2.4x as likely as white-owned firms to **close** in the first months of the pandemic

5x to receive **no PPP** funds after applying

Hispanic-owned firms were

1.9x as likely as white-owned firms to **close** in the first months of the pandemic

2x to receive **no PPP** funds after applying

Even among those who had the relationships to apply for loans, inequities remained. Nearly 80% of White-owned firms got all the PPP funding they sought, compared to 43% of Black-owned, 61% of Hispanic-owned, and 68% of Asian-owned firms.[75] And almost all White-owned firms received at least *some* of the funding they applied for, compared to 1 in 5 Black-owned firms that were denied funding altogether.[76]

Representatives from Equifax community partners MoCaFi, Kiddie Kredit, and Launchpad2X pointed to the lack of relationships with large banks, lower expertise in writing loan applications, and discouraged borrowers as major reasons for the disparity. They also recommended involving community banks, credit unions, and other trusted local organizations earlier in the process to target minority- and women-owned businesses. Fortunately, PPP was later amended to be more targeted by industry and more tailored to sole proprietorships, but these firms largely missed out during the most acute period of distress in the spring and early summer of 2020, and some closed permanently as a result.

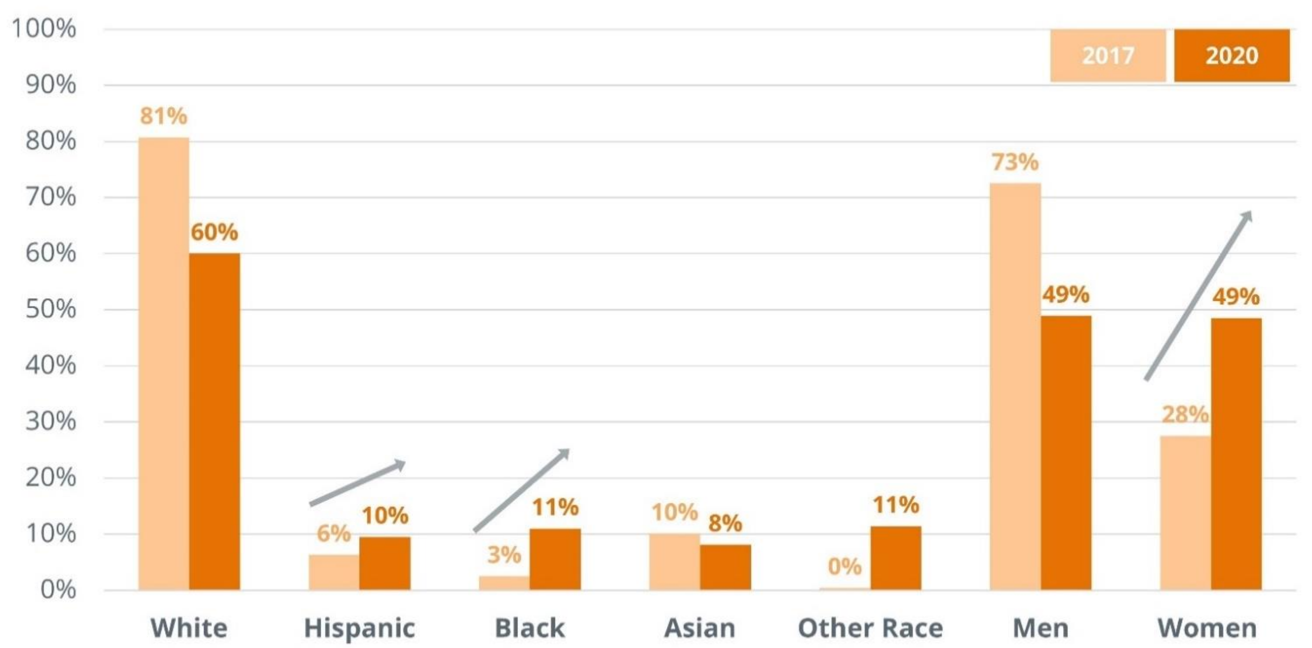
Despite long-standing credit access barriers that woman- and minority-owned small businesses regularly confront, growth in FinTech and online lending has been a positive development.[77] For example, Black-owned firms were three times as likely as White-owned firms to apply for a PPP loan through an online lender, though they reported lower levels of acceptance and satisfaction with online lenders compared to traditional banks.[78] Still, even with lower satisfaction rates, Fintech firms likely helped ensure that those businesses received at least some funding; recent research showed that Fintech's role in PPP lending was more additive than substitutive.[79] The non-profit sector also played a role; for example, Equifax community partner Launchpad2X started a small-dollar, short-term funding program for women-owned businesses during the pandemic.

COVID-19 Entrepreneurship Boom

Despite the challenges brought by the COVID-19 pandemic to businesses owned by women and people of color, there were also some positive developments. Entrepreneurship experienced a significant boom during the pandemic, with more than 4.3 million new business applications filed in 2020—almost a million more than in 2019.[80] Since mid-2020, new business applications have been increasing at the fastest pace on record, and it is possible that new businesses will outnumber closures during the pandemic.[81,82]

More of these new ventures were started by women or entrepreneurs of color than in years past. As shown in Figure 8, 11% of new business owners were Black, and 49% were women.[83] The pandemic-induced recession stands out from previous economic downturns in this way. Usually, new business formations fall during recessions rather than rise to multi-decade highs. Still, many of these start-ups were formed out of necessity during the pandemic, with about half of owners starting businesses out of economic need and one-third because they lost their jobs. Necessity-borne businesses more than doubled in 2020, from 13% of new businesses to 30%. These data align with anecdotes from Equifax community partner MoCaFi, which observed that, during the pandemic, small businesses that had previously served as “side hustles” became the primary source of income for many people of color. Further, the surge in new businesses coincided with stimulus payments, with the strongest impacts in Black communities.[84]

Figure 8: Share of New Businesses Opened by Demographic, 2017 vs 2020



Source: Gusto (2020 data) and Census Bureau (2017 data).

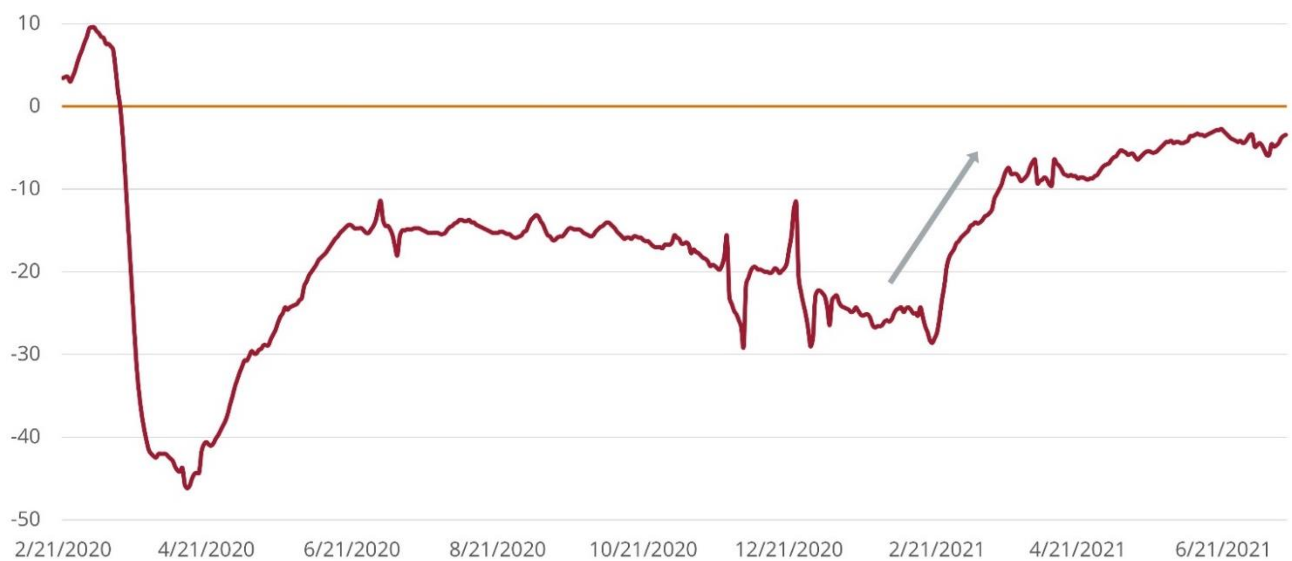
While the surge in new business creation is encouraging, sufficient access to credit is critical in ensuring that these new ventures survive and grow. In a recent Fed survey, a quarter of Black-owned businesses reported “credit availability” as the top business challenge due to COVID-19, more than double the rate of Asian- and White-owned businesses.[85] Further, recent start-ups did not receive the additional capital injection available to existing businesses from PPP funds. Just over half of new small business owners expect to fail within 12 months without additional support, including nearly three-quarters of Black-owned and more than 70% of Asian-owned firms.[86]

Recovery and Outlook for Small Businesses

Economic Recovery (April 2021 – Present)

The development and distribution of the various COVID-19 vaccines changed the game for small businesses and the economy at large. Combined with multiple rounds of stimulus payments to U.S. consumers, the small business outlook began to brighten in early spring 2021. By the end of April, the number of small businesses that expected to close in the subsequent six months had fallen in half from December levels (from 25% to 12%), while the share of business reporting that conditions had normalized tripled to 15 percent.[87] By the end of June, nearly a quarter of small business owners were reporting normal economic conditions in their communities.[88] Google's high-frequency retail & recreation mobility data provided further evidence of the progression of economic conditions, improving dramatically from -29% below normal at the end of February to -2% the first week in August (see Figure 9).

Figure 9: Google Recreation & Retail Mobility Index

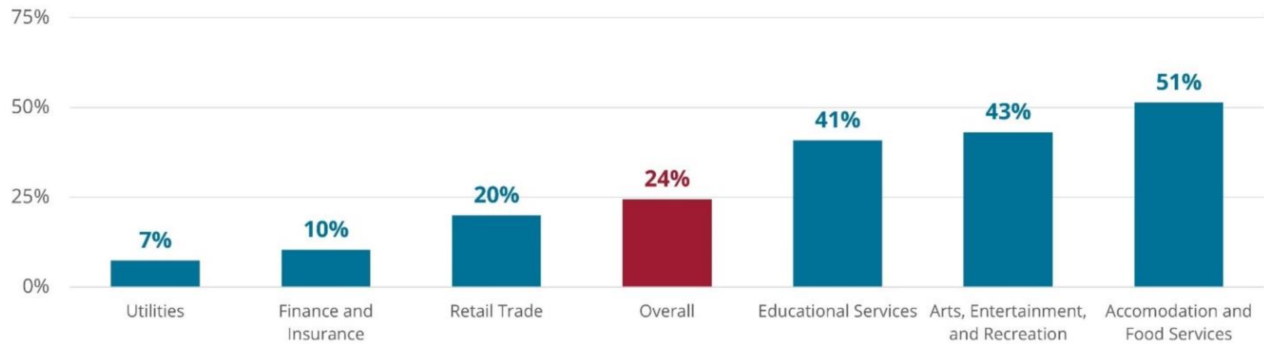


Source: Google Recreation and Retail mobility index

The arrival of vaccines and renewed business confidence led to increased small business lending. In Q2 2021, according to the Fed Senior Loan Officer Survey, a net share of banks (13%) loosened standards on small business loans for the first time since the pandemic began while in Q3 this metric reached an all-time high (26%).[89] Accordingly, small business lending surged: the Equifax SBLI jumped to an all-time high in April before dipping slightly to its fourth-highest reading in June.[90] Meanwhile, indicators of small business employment suggested a full labor market recovery by April as the Paychex Small Business Job Index returned to pre-pandemic levels and has since increased to its highest level since Summer 2018.[91]

However, while the small business outlook has improved dramatically since the beginning of 2021, the recovery has not been uniform. According to an early July Census Bureau Pulse Survey, more than 18% of Educational Services small businesses and 14% of Arts, Entertainment, and Recreation firms were still operating with less than half the capacity they had prior to the pandemic.[92] Similarly, while financial outlooks have improved dramatically, some of the most COVID-impacted industries had significant financial difficulties through the summer. According to the July Equifax Small Business Default Index, defaults in Accommodations (6.12%) were still 264 basis points above their January 2020 levels, while defaults in Healthcare (3.23%) were 111 basis points above pre-COVID levels. Though the default situation has improved each month since January 2021, significant backsliding could leave many small businesses in these industries in a precarious position.

Figure 10: Has the Pandemic Had a "Large Negative Effect" on Your Business?

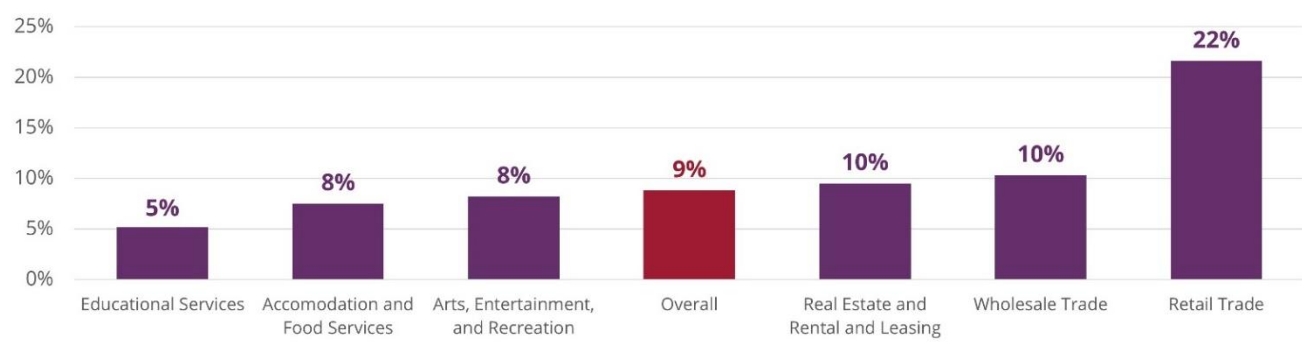


Source: Census Bureau Small Business Pulse Survey, July 5 -11, 2021.

Still, while industries such as Accommodations and Education were heavily burdened by lockdown and social distancing measures, some businesses benefited, including over 20% of those in the retail trade industry. The pandemic accelerated the transition from brick-and-mortar retail to e-commerce and increased automation, and in response e-commerce retail sales jumped nearly 32% in 2020—though many of those gains were concentrated among large retailers.[93]

Throughout the pandemic small business owners demonstrated their resiliency and adaptability as many effectively adjusted to novel business challenges. According to an April 2021 Goldman Sachs survey of small businesses, 55% expect to make permanent business model changes after the pandemic.[94] Indeed, while it was easier for businesses in some industries to adjust to the pandemic's challenges than others, even the most hard-hit industries include some businesses for which the pandemic had a positive impact (Figure 11).

Figure 11: Has the Pandemic Had a "Positive Effect" on Your Business?



Source: Census Bureau Small Business Pulse Survey, July 5 – 11, 2021.

Evaluating the Economic Recovery

The pace of recovery for the small business sector over the last year has been impressive, especially compared to the period following the Great Recession. While the impacts of the 2007–2008 recession lingered for years, less than 18 months after the country entered lockdowns, many small business indicators pointed towards a robust recovery. For example, it took just over a year for the Equifax SBLI to surpass its pre-COVID rolling average. In contrast, small business lending took five years to recover to its December 2007 level at the onset of the recession, and an additional two-plus years to surpass its pre-recession high (see Figure 12).[95]

Figure 12: Equifax Small Business Lending Index Recovery

COVID-19 Recession vs. 2008-09 Financial Crisis

Source: Equifax

A key determinant of the exceptional COVID-19 recovery was the robust policy response; in fact, the most significant difference between the last financial crisis and the current one was the level of liquid capital available to businesses.[96] Between PPP and other small business relief programs, over $1 trillion in low or no-interest loans flowed to small businesses, in addition to the stimulus checks and unemployment insurance aid that shored up cash flows and provided personal start-up capital for business formation.[97] Moreover, robust small business support in the wake of the pandemic came from more than just government aid. Flexible lenders set up forbearance programs that allowed small businesses to defer loan repayments, while successful marketing efforts from online platforms led consumers to increasingly support local small businesses. In particular, the heightened levels of awareness of racial inequities produced by the pandemic and other events of the last year led to concerted efforts by consumers to buy specifically from minority-owned businesses as a form of activism.

The COVID-19 recession was also fundamentally different from the financial crisis: one was a function of systemic issues in the financial sector, while the other was brought on by a global pandemic. As a result, it is not surprising that the former would have decimated the small business sector and led to a weak small business recovery, while the latter would have led to a faster recovery following the availability of vaccines. A recent Fed report found that 130,000 firms went out of business in the first year of the pandemic. While up between a quarter and a third from normal levels, this decrease is still much lower than many feared.[98]

The pandemic also accelerated pre-existing trends around small business lending, as Fintech lending continued to climb. Whether this trend ends up being a net positive for small business credit access remains to be seen. While online lending can reach borrowers with medium and high credit risk—in part because it uses alternative credit risk management—it also tends to be more expensive and leaves borrowers less satisfied than traditional sources.[99]

Conclusions

Small businesses are a vital part of the U.S. economy, and they faced immense challenges during the COVID-19 pandemic and recession. Even as many small business owners struggled to keep their businesses afloat by taking pay cuts and dipping into personal finances, Main Street businesses by and large supported consumers and employees throughout the downturn.

The 2020 recession and the rapid recovery that followed demonstrates the importance of access to affordable credit among small businesses. As the pandemic showed, small businesses are particularly susceptible to revenue shocks, and without unprecedented levels of federal support via PPP, EIDL, and other programs, many more small businesses would have closed permanently. However, as Equifax's Bill Phelan noted in 2020, "we've never really fixed the access to capital problem to small businesses. It probably has been alleviated by PPP, but that won't last forever."[100]

As such, now is the time for policymakers to focus small business support efforts beyond just disaster response, particularly for minority- and women-owned businesses. Further efforts should be taken to gather input from small business owners, as sufficient credit access is key to ensuring their survival, particularly in underserved communities.

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