

Small Business on the Eve of COVID-19

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June 2020



DREXEL UNIVERSITY

Nowak Metro Finance Lab

Lindy Institute for Urban Innovation

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AMERICA**

ABOUT THE AUTHORS



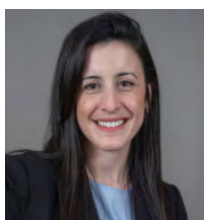
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ACKNOWLEDGEMENTS

DREXEL UNIVERSITY NOWAK METRO FINANCE LAB

The Nowak Metro Finance Lab was formed by Drexel University in July 2018. It is focused on helping cities find new ways to “finance the inclusive city” by making sustained investments in innovation, infrastructure, affordable housing, quality places, and the schooling and skilling of children and young adults. It is an initiative of Drexel University's Lindy Institute for Urban Innovation.

ACCELERATOR FOR AMERICA

Accelerator for America is a non-profit organization created by Los Angeles Mayor Eric Garcetti in November 2017. It seeks to provide strategic support to the best local initiatives to strengthen people's economic security, specifically those initiatives that connect people with existing jobs, create new opportunities and foster infrastructure development.

Cover Photo: 52nd Street in West Philadelphia, a major commercial corridor with a high concentration of Black-owned businesses. Credit: Flickr User 'camera_obscura.'

INTRODUCTION

Since the beginning of the COVID-19 crisis, the Nowak Metro Finance Lab has chronicled the impact of the economic shutdown on small businesses in general and on small businesses owned by people of color in particular. This research has taken on new significance in recent weeks with the civil unrest following the horrific death of George Floyd and the intensified focus on police brutality and entrenched racial disparities in income, health and wealth.

In May of 2020, the US Census Bureau released its 2018 Annual Business Survey, providing new data regarding the state of Black-owned business on the eve of COVID-19.ⁱ The Annual Business Survey provides information on selected economic and demographic characteristics for all businesses and business owners by sex, ethnicity, race, and veteran statusⁱⁱ. The Survey thus is the most recent national data source that establishes what the small business world looked like pre-crisesⁱⁱⁱ.

This report is intended to unveil the top-line national findings of the Nowak Lab's analysis of this data. It makes for sobering reading and, we hope, serves as a call to action at all levels of government and across all sectors of society. It is the first in a series and builds on the research expertise of a close colleague at Drexel University, Kevin Gillen, as well as the remarkable talents of a group of summer interns from MIT, the Harvard Kennedy School, the University of Pennsylvania and Yale Law School.

It also builds on the practical knowledge and inspiring work of a growing group of reflective practitioners at Accelerator for America, Forward Cities, Next Street, The Enterprise Center in Philadelphia and the Minority Business Accelerator in Cincinnati.

It should be caveated that the Annual Business Survey is an imperfect data source, representing a scaling back of Census-provided data from surveys in prior years. Historically, the Survey of Business Owners (SBO) was conducted every five years, and covered the universe of both employer and non-employer businesses; more than 2 million business owners were surveyed in 2007,^{iv} as compared to 850,000 in 2017 from the Annual Business Survey. This reduction likely stems from significant reductions in federal spending on the collection of economics statistics. While the US Census Bureau spent \$127 million on the Economic Census in Fiscal Year (FY) 2008, that number had shrunk to \$105 million in 2018, a reduction of 30% in real dollars. As the Annual Business Survey only covers employer businesses, it excludes 80% of all firms in the United States, and approximately 96% of Black-owned firms. With such a small sample size, the granularity of information has been reduced at small geographies. We're thus forced to evaluate the current state of businesses with subpar information, due to substantial lack of investment from the federal government in data-gathering on characteristics and trends for business owners.

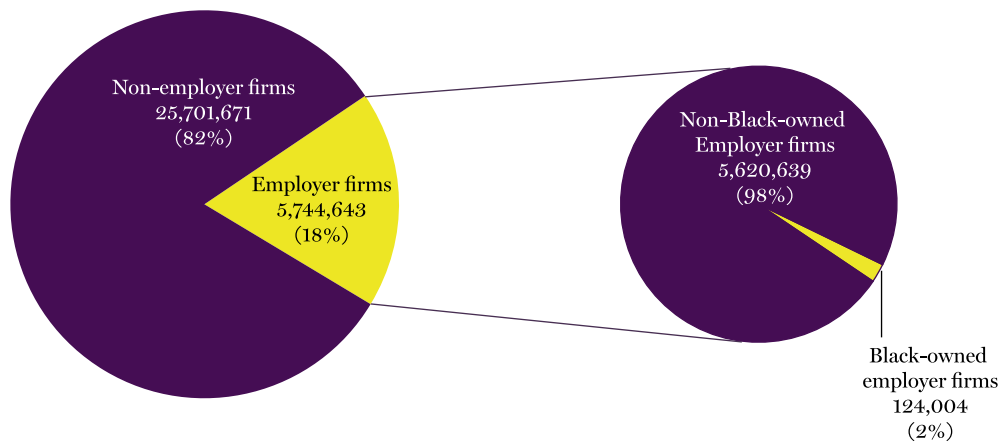


Figure 01: Number of Businesses in the US, 2017.
Source: US Census Bureau 2018 Annual Business Survey and 2017 Nonemployer Statistics.

INITIAL FINDINGS

In 2017, the most recent year for which data is available, there were 31.4 million businesses in the United States. Of those, approximately 5.7 million firms had employees, representing 18% of all firms in the US.

Out of the 5.7 million employer firms in the US, approximately 124,000 are Black-owned employer businesses, representing 2.2% of all employer businesses.^v As the US has a Black population of nearly 13%, it shows that Black Americans are vastly underrepresented among business owners. Since the Census Bureau began tracking the demographics of business owners in 1972, the number of Black-owned employer businesses has grown by 288%, barely outpacing overall business creation, which has grown by 260%.^{vi} **Black-owned employer businesses are smaller, with fewer employees, lower average revenues, and lower average payroll expenditures than businesses overall.^{vii}** Specifically, Black-owned businesses have average annual revenues of \$1 million, 84% smaller than average revenues for all firms, and 58% smaller than White-owned firms. They have an average of 10 employees, compared to 22 employees for all firms, and 12 employees for white-owned firms. Their annual payroll per employee is almost \$30,000, as compared to \$51,000 for firms overall, and \$42,000 for white-owned firms. These differences may be explained by industry and geography, but it points to a dire need for Black-owned businesses to scale both their number of employees and revenues in order to reach equity with overall US firm performance. Nonetheless, Black-owned employer businesses have been growing at a fast clip in recent years. Compared to 2012, Black-owned businesses saw total annual revenues grow by 23%, twice as fast as US employer businesses overall.

Black-owned businesses have also been adding employees, with the number of employees at Black-owned businesses growing at 24%, compared to 10.8% for all US businesses. Finally, the total annual payroll at Black-owned businesses increased by 30.4% compared to 24.8% at all U.S. businesses.

At the national level, data can be disaggregated by race and industry altogether. A main finding that emerges from this analysis is that **Black-owned businesses are highly concentrated in a few economic sectors.** Of the 20 industries analyzed, more than two thirds of Black-owned businesses can be found in only five sectors: health care and social assistance; professional, scientific and technical services; administrative, support, waste management and remediation; retail trade; and other services. By contrast, the top five firms for White-owned businesses represent only 57% of industry concentration, suggestion that White-owned firms are more evenly spread among the various sectors of the US economy. The top five sectors for Black-owned businesses are composed of smaller sized firms, and underperform in economic terms when compared to others: average sales and payrolls are lower than average levels (with the exception of retail trade and professional services respectively). Employment at Black-owned businesses exhibits an even higher degree of industry concentration, as only three sectors have 67% of the jobs generated by Black-owned businesses: health care and social assistance; administrative, support, waste management and remediation; and accommodation and food services. Past research from the Association from Enterprise Opportunity has shown that, within the sectoral clusters for Black-owned businesses, they are also concentrated within lower-revenue subsectors.

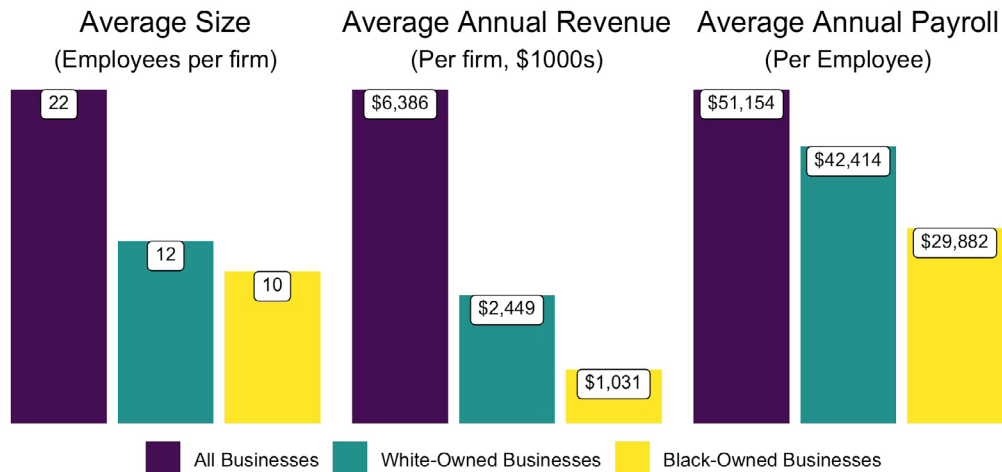


Figure 02: Average Size, Revenue and Payroll, U.S. Employer Firms 2017. Source: U.S. Census Bureau 2018 Annual Business Survey.

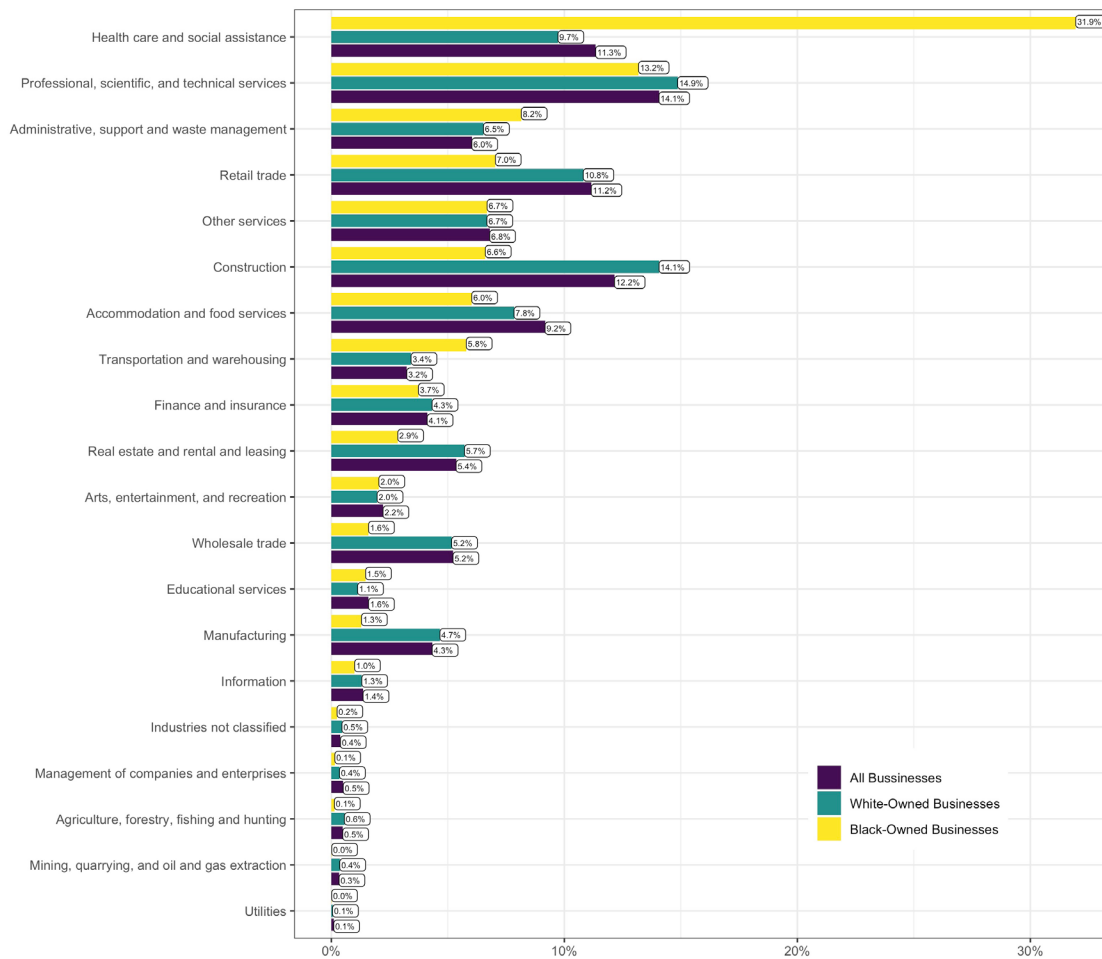


Figure 03: Business Typologies Ranked by % of Total: Black-owned Businesses, White-owned Businesses vs. All Businesses, 2017. Source: U.S. Census Bureau 2018 Annual Business Survey.

For example, within health care and social assistance, Black-owned businesses are overrepresented in Childcare and Home health, and underrepresented in medical, dental and mental health provider facilities.^{viii} Black-owned businesses are also relatively underrepresented in industries such as retail, manufacturing and construction, which are generally higher revenue industries.

WHAT THIS MEANS

The COVID-19 crisis and subsequent social unrest is wreaking havoc on Main Street small businesses across the United States. Millions of small businesses have shuttered for the duration of the crisis. The hardest hit are Main Street enterprises living on the brink — restaurants, bars, coffee shops, barbershops, hair salons, auto repair shops, dry cleaners^{ix} and others that provide face-to-face services. With data showing the strong concentration of Black-owned businesses in these sectors, people of color are among the most impacted by the current pandemic.

We’re already seeing the effects. As was shown recently in a working paper from the National Bureau of Economic Research, Black and Latinx Business owners have been disproportionately impacted by the COVID-19 pandemic. While the underlying survey, the Current Population Survey, includes business owners for both employer and non-employer businesses, the numbers are stark. Comparing February and April, 2020, the author found a 41% decrease in active Black business owners, and a 32% decrease in active Latinx business owners, as compared to a 22% decrease of active business owners overall.^x During the early days of the crisis, many cities enacted local emergency relief funds to give small businesses the capital infusions they needed to survive until larger pools of capital were made available through the federal government. The CARES Act (and subsequent legislation) has deployed several relief vehicles overseen by the Small Business Administration (SBA), most prominently a new Paycheck Protection Program (PPP) as well as the traditional Economic Injury Disaster Loan program.

Despite the extraordinary efforts, it is clear that the federal lending products offered and delivery system used were not aligned with the many small businesses that operate on the periphery of our economy, particularly underserved small businesses that are owned by persons of color and/or located in low- and moderate-income neighborhoods. The nation's starting point on Black-owned businesses is particularly challenging.

Data on Black-owned businesses helps explain three main limitations of federal relief efforts to date:

Black-owned businesses are usually sole proprietorships or businesses with employees that tend to be small in size and primarily situated within non-advanced sectors of the economy with lower pay and benefits. Black-owned businesses do not have close ties to the mainstream banking system, are unlikely to tap the SBA relief programs, and are in dire need of objective technical guidance and support.^{xi} Black-owned businesses' economic performance combined with decades of redlining and structural racism in the financial industry put people of color in a particular vulnerable situation to handle financial imbalances and pressures. Recent research from the Federal Reserve Bank of New York found that over 50% of Black-owned businesses were financially at-risk or distressed prior to the current pandemic, with shutdowns and lower consumer demand making them more likely to close, take out debt, or use the owner's personal wealth to prop-up the business.^{xii}

The structure of PPP has also overwhelmingly disadvantaged Black-owned businesses. Smaller firms, with fewer employees, and less access to the mainstream banking world were less likely to access the program as it was originally designed. Indeed, according to a survey from Goldman Sachs,^{xiii} fewer Black business owners applied for a PPP loan during the initial funding round, and they were approved at a lower rate than businesses overall. With the SBA having not required demographic information on PPP loans, we may not know the extent to which minority business owners were disadvantaged by the program.

The Annual Business Survey also shows that Black-owned businesses are younger than most firms, with nearly 50% of Black-owned businesses being in businesses 5 years or less, compared to 36% of White-owned firms. Younger firms may have more residual debt from the startup phase, less savings to cushion an economic disruption, and a shorter track record to show to lenders if they seek emergency capital during the crisis. A study by the Center for Responsible Lending found that 46% of White-owned business were able to obtain credit from a bank over the last five years, while only 23% of Black-owned businesses were able to do so.^{xiv} Thus, the structural legacy of Black-owned businesses generally being undercapitalized combined with the fact that they skew younger than most firms puts them particularly at risk during the crisis.

We clearly need a different playbook going forward, but there are several pieces of good news. The most recent expansion of the Paycheck Protection Program mandated portions of the capital pool to be distributed through community banks and Community Development Financial Institutions (CDFIs); CDFIs, in particular, are sensitive to and engaged with the Black-owned businesses. In addition, a growing number of states are using CARES funding to create small business relief funds that target diverse business owners. Yet more capital that is fit to purpose needs to flow. The [RELIEF for Main Street Act](#), a bi-partisan bill co-sponsored by Senator Cory Booker deserves particular attention.

The federal government, of course, only plays a partial role in nurturing and growing businesses owned by people of color. There are multiple components to this ecosystem that will be necessary for businesses to truly thrive: creating demand (e.g., supplier diversity, anchor procurement), providing support for new and existing businesses, enhancing access to new forms of capital and regenerating nodes of commerce and community life.

Small business is routinely extolled as the lifeblood of the U.S. economy and the path to prosperity for millions of people. The Annual Business Survey reveals that our soaring rhetoric does not match performance reality. This is just the latest indication of a policy and market failure that is systemic and deeply rooted. Only a well thought-out structural response and a radical surge in public, private and civic investment in all aspects of the small business ecosystem will yield different results.



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- i. <https://www.census.gov/programs-surveys/abs.html>
- ii. <https://www.census.gov/programs-surveys/abs/technical-documentation/methodology0.html>
- iii. The 2018 Annual Business Survey sampled approximately 850,000 employer businesses. The Annual Business Survey does not focus exclusively on small business, therefore including the approximately 20,000 businesses with more than 500 employees, or 0.3% of all employer firms.
- iv. <https://www.census.gov/library/publications/2007/econ/2007-sbo-businesses.html>
- v. For context, according to the 2012 Survey of Business Owners, Black-owned businesses with employees represented ~4% of the total number of Black-owned businesses.
- vi. The 1972 Economic Census did not break out the total number of firms by those with and without employees, and thus the “total growth” number refers to growth of both employer and non-employer businesses, while the growth in Black-owned businesses refers to only employer businesses.
- vii. 95% of firms in the Annual Business Survey are classified by race, sex, ethnicity, and veteran status of the business owner. The other 5% are firms with “no owners with a 10% or greater ownership of the stock or equity in the business,” according to the Census methodology, likely leading to the much larger numbers for firms overall.
- viii. https://aeoworks.org/images/uploads/fact_sheets/AEO_Black_Owned_Business_Report_02_16_17_FOR_WEB.pdf
- ix. [Barbershops, hair salons, auto repair shops, and dry cleaners are all categorized as “other services” within NAICS.](#)
- x. Fairlie, Robert. 2020. “The Impact of Covid-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey.” Working Paper No. 27309. National Bureau of Economic Research. doi.org/10.3386/w27309
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