



An Uphill Battle: COVID-19's Outsized Toll on Minority-Owned Firms

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Introduction

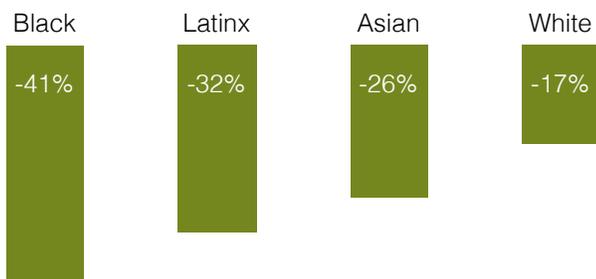
Since COVID-19 sparked state-mandated lockdowns nationwide in March, data suggest that minority-owned small businesses have been disproportionately impacted by the pandemic, facing higher rates of closures and sharper declines in cash balances as compared to nonminority-owned small businesses. Research shows that Black-owned businesses closed at more than twice the rate of white-owned firms and experienced declines in cash balances nine times as steep as nonminority firms in some cases. Black-owned businesses faced the greatest impact of any racial group, though Latinx- and Asian-owned businesses also experienced outsized closures and declines in cash balances. This report collects insight from various sources into the pandemic's effect on minority-owned firms thus far and examines possible explanations for race-level differences in COVID-19's impact on businesses.

What We Know So Far about the Impact on Minority-Owned Firms

As the pandemic has unfolded, data show that COVID-19 sparked either the temporary or permanent closure of minority-owned firms at higher rates than nonminority firms. A National Bureau of Economic Research (NBER) working paper estimates that between February and April, the number of actively working, self-employed Black business owners decreased by 41 percent, the largest change of any racial group included in the study (figure 1)¹. Also facing steep drops in self-employment rates were Latinx and Asian workers, experiencing declines of 32 percent and 26 percent, respectively. In contrast, the study estimates that the number of white self-employed workers saw a 17 percent drop in activity over the same period.

For firms that are still operating, cash balances are a growing concern, with minority-owned firms experiencing a more severe cash crunch than nonminority-owned firms. Research from the JPMorgan Chase Institute shows that as of late March, cash reserves of Black-owned small businesses were down 26 percent from the prior year, while Asian-owned firms' cash reserves bottomed out in early April and were down 20 percent during the same period. Overall, the median small business in the study experienced a 5 percent year-over-year decline in cash reserves, with white-owned firms experiencing a decline closer to 3 percent.² Notably, though the financial performance of Asian-owned firms historically mirrors that of white-owned businesses more closely than other minority-owned businesses, since late March, Asian-owned firms have experienced a decrease in cash reserves around five times as large as that of white-owned businesses and the steepest decline in revenues of other racial or ethnic groups included in the report.³

Figure 1. Change in Number of Business Owners Who Worked in Last Week by Race of Owner, February 2020 to April 2020



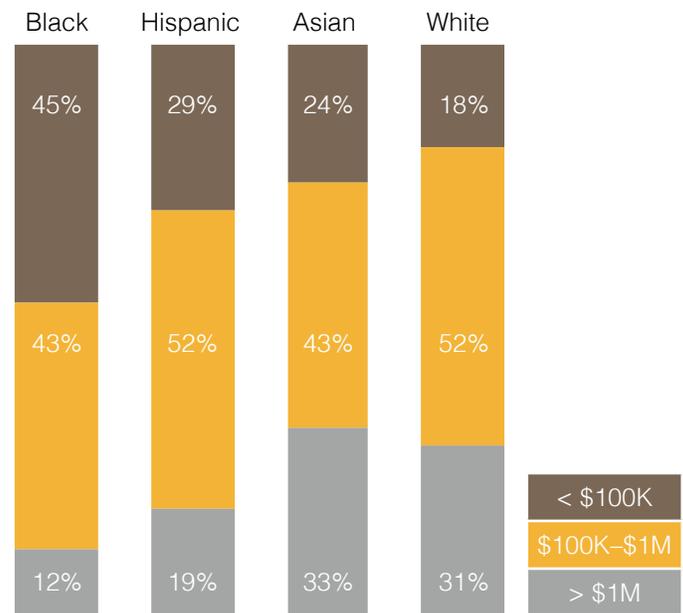
Source: Fairlie, Robert. 2020. "The Impact of COVID-19 on Small Business Owners: Evidence of Early-Stage Losses from the April 2020 Current Population Survey."

Exploring Possible Explanations for Why Minority-Owned Firms Face Greater Impact

Pre-COVID Conditions

Prior to March, there was reason to suspect that minority-owned firms might be ill-equipped to survive a severe economic downturn. Two recent Federal Reserve studies have highlighted the disadvantaged financial position of minority-owned firms. The Federal Reserve Bank of Atlanta's *Small Business Credit Survey 2019 Report on Minority-Owned Firms* indicated that, on average, minority-owned small businesses had lower revenues than nonminority-owned firms.⁴ As figure 2 shows, for Black-owned firms, the disparity is largest. Nearly half (45 percent) of Black-owned firms reported earning \$100,000 or less annually; in contrast, only 18 percent of white-owned firms reported yearly revenues of less than \$100,000.

Figure 2. Annual Revenues of Small Businesses by Race of Owner



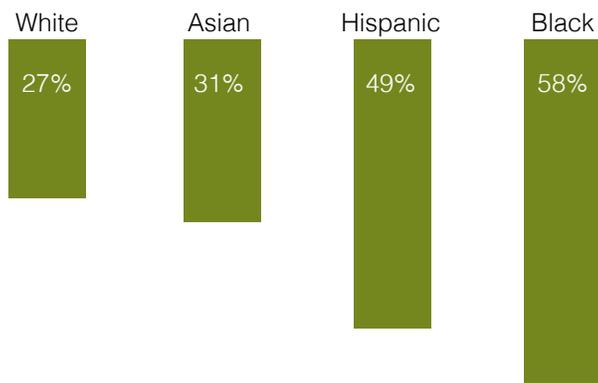
Source: *Small Business Credit Survey 2019 Report on Minority-Owned Firms*, Federal Reserve Bank of Atlanta.

Note: Categories may not sum to 100 percent due to rounding.

A subsequent study from the Federal Reserve Bank of New York showed that minority-owned small businesses were substantially more likely than their nonminority counterparts to report financial distress.⁵ The authors of the study categorized the *2019 Small Business Credit Survey* respondent firms as financially "at risk" or "distressed" using data on the firms' financial challenges,

profitability, and business funding. The authors calculated that, in 2019, despite only 29 percent of all small businesses being either financially at risk or distressed, 58 percent and 49 percent of Black and Hispanic firms, respectively, fell into these categories (figure 3). The firms recorded as being at risk or distressed were significantly more likely to report that they would tap into the owner’s personal funds or have to close their business in response to a two-month revenue loss. These findings also suggest that the financial stresses facing minority-owned business owners might soon extend beyond the firms and into the owners’ personal finances if they use personal funds to keep their businesses open.

Figure 3. Share of Small Businesses Reporting Being Financially “Distressed” or “At Risk” by Race of Business Owner



Source: *Can Small Firms Weather the Economic Effects of COVID-19?* Federal Reserve Bank of New York.

Figure 4. Industries with the Highest Share of Minority-Owned Businesses

Industry	Minority Business Share of Industry	Examples of Subsectors
Other services (except public administration)	44%	Repair and maintenance, personal and laundry services, private households
Transportation and warehousing	44%	Truck transportation, support activities for transportation, warehousing and storage
Health care and social assistance	43%	Hospitals, nursing and residential care facilities, social assistance
Administrative and support and waste management and remediation services	40%	Office administrative services, employment services, travel arrangement and reservation services , services to buildings and dwellings
Accommodation and food services	40%	Traveler accommodation, full-service restaurants, drinking places

Source: US Census Bureau 2012 Survey of Business Owners.

Industry-Level Impact

Business outcomes across industries provide insights on differences in outcomes by race. Many sources do not segment data by race of firm owners, but analyzing industries with traditionally high minority representation can offer some evidence of the pandemic’s outsized impact on minority-owned businesses.

Businesses in sectors of the economy in which workers are required to operate near customers or other workers have been more exposed to state-mandated shutdowns and the health-related consequences of the virus. A study from the Federal Reserve Bank of Philadelphia identifies six of the hardest-hit industries within the US economy; of the six, four are either sectors or subsectors with above-average minority representation.⁶ Figure 4 displays the industries with the most minority representation, with those listed as the hardest-hit in the study bolded. In all, approximately 22 percent of all minority-owned businesses fall into these high-risk industries as opposed to 13 percent of nonminority-owned firms.⁷

Similarly, a study published by the NBER, which analyzed a March survey of small businesses, provided early evidence that industries with high shares of minority firms were facing significant disruptions as a result of the pandemic. The survey asked businesses how long they could survive if COVID-19 disrupted the economy for one, four, or six months, and the authors reported results by industry. The findings indicate a more significant impact in industries that have higher shares of minority business ownership. Figure 5 categorizes the industries into high- and low-minority share industries according to 2012 Survey of Business Owners data. This exercise reveals that firms in sectors with high minority representation are less likely to expect their businesses to survive a prolonged pandemic.⁸

The findings are further supported by data from the US Census Bureau’s Small Business Pulse Survey, which suggests that early concerns among industries with the highest concentration of minority-owned firms have materialized in the form of significant financial strain. On average, these industries have been more likely than the national average to report a “large negative effect” from the pandemic as well as missed payments on loans and operational expenses such as rent and payroll.⁹ The financial impact reported by these firms raises concerns

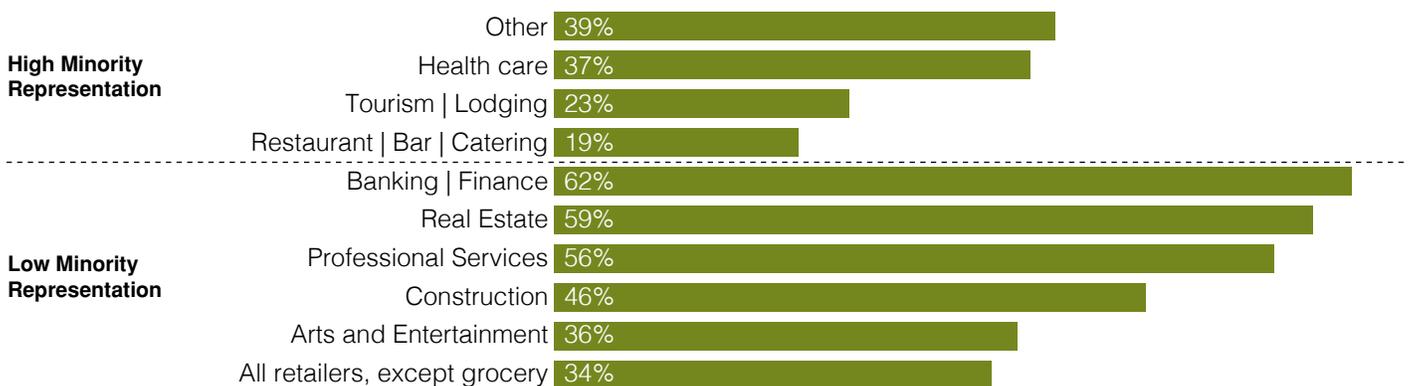
surrounding their ability to weather sustained effects from the crisis.

Limited PPP Access

The early stages of the Paycheck Protection Program (PPP)—the \$650-billion fund intended to help small businesses support their employees and survive the initial financial shock of the pandemic—were addled with confusion and frustration, particularly among minority business owners.^{10,11,12} While these issues weren’t limited to minority-owned firms, data suggest that these firms may have experienced outsized effects.

One reason minority-owned firms may have struggled to access PPP loans is rooted in the relationships these firms have with financial intermediaries. Upon the launch of this program, applications for PPP funds could be submitted only through previously approved SBA lenders—primarily banks. Many banks required PPP seekers to have a deposit account or an outstanding loan with the lender in order to have their applications processed. However, many minority-owned firms lack relationships with traditional banks.^{13,14} Data from the 2016 Small Business Credit Survey and Federal Reserve Banks show that Black-owned businesses

Figure 5. Firms Estimating 6-Month Survival amid Continued COVID-19 Disruptions



Sources: US Census Bureau 2012 Survey of Business Owners; Alexander W. Bartik, et al. “How Are Small Businesses Adjusting to COVID-19? Early Evidence from a Survey.”

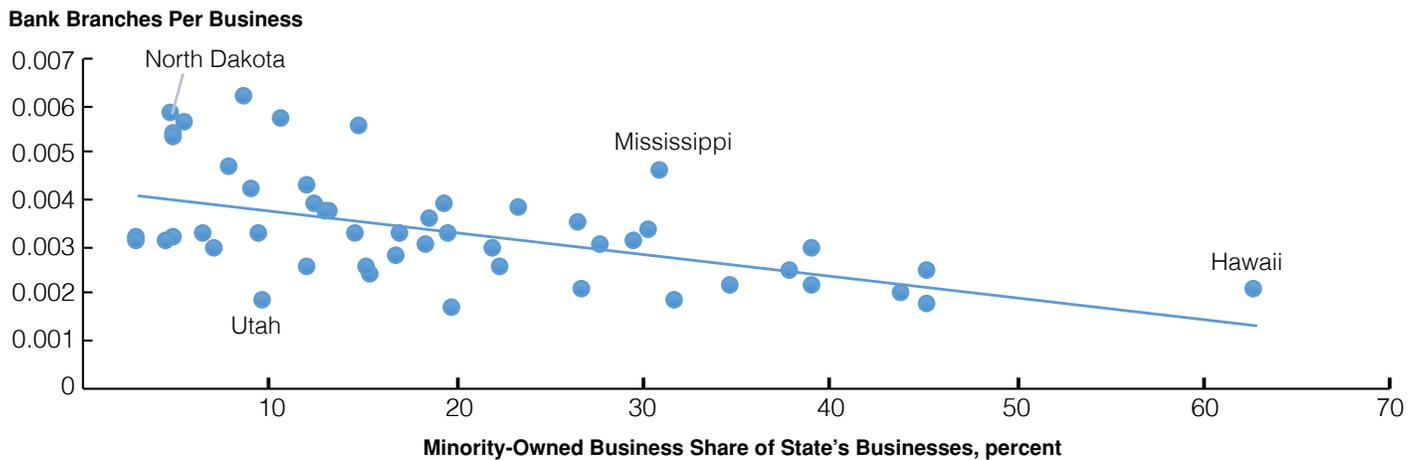
are half as likely as white-owned firms to report borrowing from a bank in the past five years.¹⁵ Overall, minority-owned firms are considerably more likely to use community development financial institutions (CDFIs), credit unions, and nonbank online lenders, many of which were either not certified to be an SBA lender or were low-volume SBA lenders.¹⁶ Through the end of May, CDFIs, minority depository institutions (MDIs), and credit unions collectively accounted for less than 4 percent of PPP loan volume. Though the federal government took steps in the second round of PPP funding to increase access through less traditional credit channels, issues surrounding access to the program early on may have left some minority-owned firms in a disadvantaged position during the critical early days of the crisis.¹⁷

Amid reported confusion surrounding the rollout of the PPP program, limited capacity to serve clients at some bank branches may have contributed to PPP access issues, particularly for minority-owned firms. On average, states with the most bank branches per small business have had the largest number of PPP approvals relative to the small business population. North Dakota is a key example of how an abundance of bank branches translated into more PPP approvals: North Dakota has the second-most bank branches per small business of any state and also

had the most PPP approvals per small business through May 30 (figure 6).¹⁸ A *Washington Post* article explored the state's success in capturing PPP funding, noting that North Dakota firms leveraged close relationships with branches to understand the processes associated with applying for the PPP and achieving loan forgiveness.¹⁹ North Dakota, however, has among the fewest minority-owned firms per business of any state, and most minority firms are located in states with few bank branches relative to the population of small businesses. California and New York, both of which have relatively few bank branches per small business but have high concentrations of minority firms, were among the states with the fewest PPP loan approvals relative to the number of small businesses.²⁰

A combination of several factors may offer an explanation for why the COVID-19 pandemic has impacted minority-owned firms with greater severity than nonminority-owned firms and could continue to do so as concerns around the virus persist. While 2019 Small Business Credit Survey data show minority-owned firms may have been less prepared to weather an economic downturn prior to the pandemic, the concentration of minority-owned firms in industries most impacted by shutdowns and complications surrounding the PPP rollout likely exacerbated issues for those businesses.

Figure 6. State-Level Relationship between Concentration of Bank Branches and Concentration of Minority-Owned Firms



Sources: Federal Deposit Insurance Corporation; Small Business Administration Office of Advocacy; US Census Bureau 2012 Survey of Business Owners

Why the Success of Minority-Owned Firms is Important

Sustained financial impact from COVID-19 on minority-owned firms would not just deeply affect workers and minority households but also the broader US economy. Minority-owned employer firms support almost 9 million jobs across the United States, and their role in the economy continues to grow. Between 2014 and 2016, the number of minority-owned small businesses increased 11 percent. During the same period, the number of nonminority firms increased by only 1 percent.²¹

Business ownership also serves as an important source of wealth for minority households. A study by the Association for Enterprise Opportunity shows that over three different five-year intervals, individuals who opted for self-employment experienced a growth in wealth four times larger than those who did not seek self-employment.²² For Black households, whose median wealth is one-tenth that of the median white household, business ownership may be an important step toward closing the wealth gap.^{23,24}

Lastly, if COVID-19 sparks a swell of permanent minority business closures, starting new firms in communities that lost businesses could prove difficult. Research from the Kauffman Foundation highlights that startup funding is more difficult to obtain for minority-owned firms; more than 70 percent of new Black, Hispanic, and Asian firms rely on personal funds and family savings to start their businesses, but white entrepreneurs are the most likely of any race to secure a business loan from a bank to start their businesses.²⁵

Implications for Policy

The COVID-19 pandemic continues to underscore the importance of detailed data in helping policymakers reach timely decisions in support of minority-owned businesses. Existing data on small businesses offer insights on key differences between minority- and nonminority-owned firms in areas such as business performance and credit access, revealing disparities that suggest that minority-owned firms are less financially secure and more exposed to the effects of an economic downturn than nonminority-owned firms. Unfortunately, many sources of small business data—including some that measure the impact of the pandemic—fail to offer details on differences across race and ethnicity, making it difficult to accurately assess the impact of an event such as the COVID-19 pandemic on some of the country's most vulnerable businesses. Given that minority- and nonminority-owned firms face different sets of challenges and outcomes, better data on small businesses with respect to the owners' demographic characteristics would be an important step in more clearly understanding the needs of these businesses so that policymakers can address them.

The pandemic has also highlighted the importance of nontraditional lenders such as CDFIs, MDIs, and credit unions. To the extent that gaps remain in access to funding through bank channels, policymakers could provide additional support to minority-owned businesses by focusing efforts on institutions that serve those firms. In prepandemic times, nontraditional credit sources distributed a fraction of the financing that traditional banks did, though they serve as an important source of small-dollar loans and often offer technical assistance to help small businesses, which may not have the in-house expertise of larger firms, navigate financial challenges. Providing more funding to organizations that primarily serve minority-owned firms could allow such organizations to scale up their services and build a more resilient network of minority-owned businesses nationwide. These steps would strengthen the foundation of minority-owned businesses, positioning them to recover from the current economic downturn and preparing them to weather future crises.

Notes

- ¹ 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 27309. Cambridge, MA: National Bureau of Economic Research. doi.org/10.3386/w27309.
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- ⁴ Federal Reserve Bank of Atlanta. 2019. *Small Business Credit Survey 2019 Report on Minority-Owned Firms*. December. fedsmallbusiness.org/medialibrary/fedsmallbusiness/files/2019/20191211-ced-minority-owned-firms-report.pdf.
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- ⁸ Bartik, Alexander W., et al. 2020. "How Are Small Businesses Adjusting to COVID-19? Early Evidence from a Survey." Working Paper 26989. Cambridge, MA: National Bureau of Economic Research. doi.org/10.3386/w26989.
- ⁹ The US Census Bureau's Small Business Pulse Survey is a 16-question weekly survey of businesses nationwide. The Census Bureau defines small businesses as firms with a single location, fewer than 500 workers and receipts exceeding \$1,000.
- ¹⁰ Prior, Jon. 2020. "Frustrated by PPP, Many Small Businesses Are Ditching Their Banks." *American Banker*. June. americanbanker.com/news/frustrated-by-ppp-many-small-businesses-are-ditching-their-banks.
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- ¹² In May, the SBA Inspector General released a report outlining the SBA's failure to implement the Paycheck Protection Program in accordance with the Coronavirus Aid, Relief, and Economic Security (CARES) Act. The CARES Act states that the SBA is required to ensure that the loans "[prioritize] small business concerns and entities in underserved and rural markets, including ... socially and economically disadvantaged individuals."
- ¹³ Bhardwaj, Prachi. 2020. "Small Business Loans and the Coronavirus Stimulus: Here's How the Major Banks Are Handling PPP Applications." *Money*. April. money.com/sba-loans-stimulus-ppp-application-requirements/.
- ¹⁴ Hwang, Caroline. 2020. "PPP Loans: Lender List and Requirements." *Yahoo! Finance*. April. finance.yahoo.com/news/ppp-loans-lender-list-requirements-173706601.html.
- ¹⁵ Federal Reserve Banks of Cleveland and Atlanta. 2017. *2016 Small Business Credit Survey: Report on Minority-Owned Firms*. fedsmallbusiness.org/survey/2017/report-on-minority-owned-firms.
- ¹⁶ Through August 8, 5,460 different lenders approved PPP loans. In FY 2018, only 1,810 lenders provided SBA 7(a) loans, according to a Congressional Research Service report. On the SBA's list of the 100 most active 7(a) lenders, only 7 are nonbank institutions.
- ¹⁷ The Federal Reserve System supported PPP lending through its Paycheck Protection Program Liquidity Facility (PPPLF), which supplied money to institutions to facilitate the dispersal of PPP funds. The Federal Reserve Bank of Cleveland supported CDFIs through the PPPLF, while the Federal Reserve Banks of Minneapolis and San Francisco supported other nondepository institutions.
- ¹⁸ Author's calculations. State share of minority-owned businesses is calculated from 2012 Survey of Business Owners data and 2012 US Small Business Administration Office of Advocacy data. The number of bank branches per state is from the Federal Deposit Insurance Corporation. PPP approvals are reported in publicly available SBA reports.
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