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Economic Commentary

Access to Credit for Small and Minority-Owned Businesses

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Equal access to small-business credit is a critical underpinning to equity in economic opportunity; however, it is difficult to regularly assess the fairness of credit provision. Prior research has focused on the Federal Reserve Board's Survey of Small Business Finance, but the most recent data from this source is from 2003. This article provides preliminary results on new credit access questions added to the Census Bureau's 2021 Annual Business Survey. We find that minority-owned businesses generally were just as likely to apply for credit in 2020, but Black-, Asian-, and Hispanic-owned businesses were less likely than white-owned businesses to report receiving all of the credit that they sought. Also, Black-, Asian-, and Hispanic-owned businesses more frequently reported seeking credit in order to cover operating expenses rather than for financing capital expenditures or expansion. Heading into 2022, minority-owned businesses report weaker ongoing viability.

Equal access to small-business credit is a critical underpinning to equity in economic opportunity; however, it is difficult to regularly assess the fairness of credit provision. Fair credit access depends on credit conditions that are typically unobserved beyond the borrower and the lender. That said, economists have relied on large datasets with information on small-business borrowers that include race and ethnicity to identify patterns of differences in business lending that suggest potential inequities. Idiosyncratic differences in individual borrowers' credit conditions tend to average out in samples that are this large, leaving shared patterns by race and ethnicity. These shared patterns represent preliminary evidence of credit inequities.

Cavalluzzo and Cavalluzzo (1998), Bostic and Lampani (1999), and Blanchflower, Levine, and Zimmerman (2003) examine credit access differences for minority-owned businesses using data from the Federal Reserve Board's Survey of Small Business Finance (SSBF). These papers find unequal access to credit by race and ethnicity of the business owner before and after accounting for observed differences in creditworthiness. Unfortunately, it is difficult to assess whether progress has been made since the early 2000s on credit equity because the SSBF was last conducted in 2003.

Since it became a nationwide survey in 2016, the Federal Reserve's Small Business Credit Survey (SBCS) has stepped in to provide data on a large number of small businesses. This high-quality resource has indicated that minority-owned businesses experience differences in accessing credit, as shown in annual reports on businesses owned by people of color.[1] The SBCS is weighted to be representative of US small businesses, but the survey is collected using a convenience sample that might result in subtle, unknown differences from those of a representative sample.[2] Other recent work has focused on the Kauffman Survey of

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Entrepreneurs (Fairlie et al., 2021), a panel of businesses that started in 2004. While startups are interesting in their own right, the Kauffman survey is relatively small and not representative of the population of small businesses in any given year.

In this *Economic Commentary*, we leverage the Census Bureau's Annual Business Survey (ABS), a survey designed to be fully representative of US employer businesses. It is the gold standard for data on the ownership characteristics of US businesses. The Federal Reserve's SBCS is weighted to match the ABS business size and ownership characteristics. While the ABS does not typically include questions on businesses' credit decisions every year, Federal Reserve staff worked with the Census Bureau to add credit access questions to the 2021 ABS. In this *Commentary*, we use the results from these questions to examine average differences in credit access in 2020 by the race and ethnicity of the business owners.[3] The Census Bureau released preliminary results on these questions concurrent with the release of this *Commentary*. Additional data that include information by employment size or other characteristics of the businesses will be released at a later date.

Annual Business Survey (ABS): The Gold Standard for Data on Business Ownership

The ABS provides the most complete estimate of the demographic characteristics of the ownership of US businesses on an annual basis.[4] Completing the ABS is mandatory for nonfarm employer businesses, and roughly 300,000 employer businesses were electronically surveyed in the fall of 2021.[5] The module Federal Reserve staff included on credit access and performance focuses on the prior calendar year (2020).

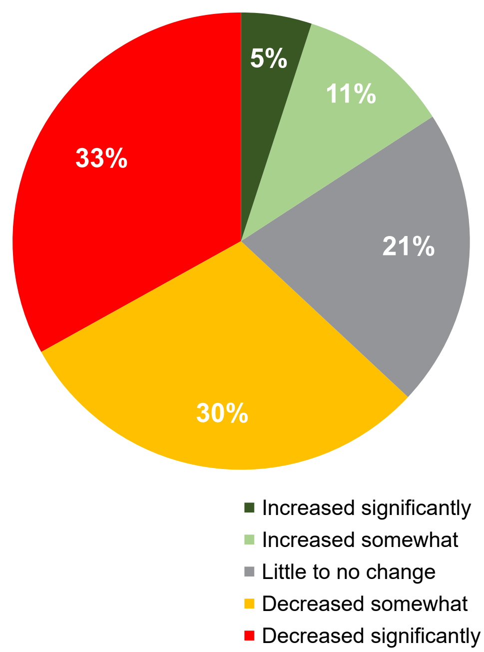
The ABS's coverage of businesses of all sizes makes it attractive for questions on credit access. Surveys focused on credit access are typically limited to small businesses because larger businesses presumably have broad access to credit markets. While the ABS is representative of *all* employer businesses, that is, businesses with one or more employees, most businesses are small. There are nearly 6 million employer businesses in the United States, but only 20,256 businesses (or 0.4 percent of employer businesses) had more than 500 employees.[6] These "large" businesses (those with 500 employees or more) employ 54 percent of the US workforce and earn roughly two-thirds of total business revenue. As such, even without size cutoffs, ABS unweighted averages will largely reflect small businesses.

The ABS determines the ownership of businesses based on having more than 50 percent of the stock or equity in the business. Businesses equally minority- and nonminority-owned are tabulated as separate categories. We focus our analysis on majority-ownership cases.[7] Less than 20 percent of businesses in the United States are minority owned. These businesses typically have fewer employees and earn less revenue.[8] Both employment and revenue are potentially indicators of credit risk, so subsequent analyses should further account for the size of the business when these data become available.

The Pandemic Shrank Businesses and Altered Credit Requests

Most businesses, regardless of ownership status, struggled during the pandemic, leading many businesses to alter their credit needs and resultant credit applications. The ABS asked businesses to categorize how the pandemic impacted their businesses' sales using the following response options: "increased significantly," "increased somewhat," "unchanged," "decreased somewhat," and "decreased significantly." Sixty-three percent of businesses saw revenues decline in 2020, with the largest share (33 percent) choosing "decreased significantly."

Figure 1: The Pandemic Reduced Revenues for Most Businesses



Note: The specific question is "How would you assess the overall effect of the coronavirus pandemic on this business's sales in 2020?"

Source: US Census Bureau and National Center for Science and Engineering Statistics, 2021 Annual Business Survey

In our companion piece (available at https://www.atlantafed.org/research/publications/policy-hub/2022/03/22/03--impact-of-pandemic-on-us-businesses--new-results-from-annual-business-survey.aspx), we show that minority-owned businesses more frequently reported experiencing significant declines as a result of the pandemic than white-owned businesses. Black-owned businesses were 8.8 percentage points more likely to report that their business revenues decreased significantly, while Asian-owned and Hispanic-owned businesses were, respectively, 11.3 and 3.6 percentage points more likely to report significant decreases. These differences (relative to white-owned businesses) are statistically significant.

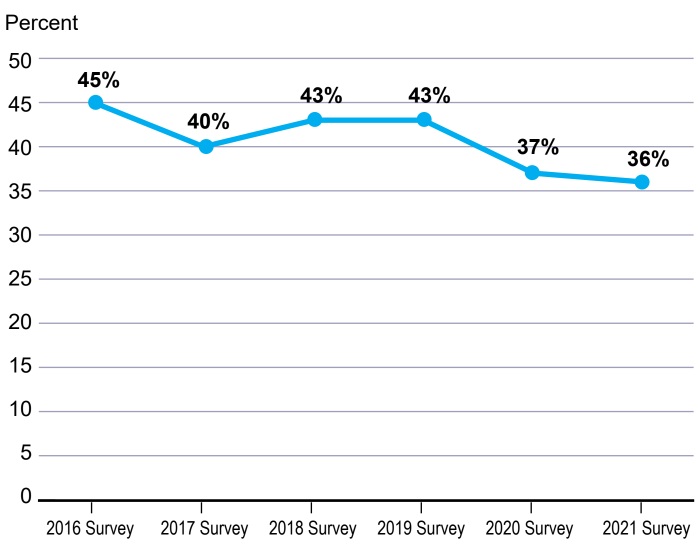
In this difficult environment, all businesses were somewhat less likely to apply for traditional credit. Importantly, businesses were very active in their pursuit of the more generous government lending programs (particularly, Paycheck Protection Program loans), with the ABS showing that nearly three-quarters of businesses reported applying for some form of government assistance during the pandemic. Just 14.3 percent of businesses applied for traditional credit during the first year of the pandemic, according to the 2021 ABS. One open question is whether the relative attractiveness of government sponsored aid, some of which, such as loans through the Paycheck Protection Program, was offered with the potential of loan forgiveness, led businesses to substitute away from traditional sources.

With only one year's data, we cannot define a trend for the ABS set of businesses; having said that, the SBCS has shown lower shares of businesses submitting applications for traditional credit in the 2020 and 2021 surveys. There are some sizeable differences in level of the shares of businesses applying for traditional credit between the ABS and SBCS. However, the framing of the relevant SBCS survey question includes more credit products than the ABS survey question, and the ABS asks businesses to recall decisions after a longer delay.[9]

Minority-Owned Businesses' Credit Experiences

Minority-owned businesses generally were at least as likely as white-owned business to apply for credit in 2020. The ABS revealed that a moderately larger (and statistically significant) share of businesses that were Black-, American Indian and Alaska Native-, or Hispanic-owned applied for new credit. Asian-owned businesses were less likely to have applied for credit. This difference is also statistically significant. Of course, there may have been additional businesses that did not apply for credit because of discouragement. The 2021 SBCS identified about 14 percent of nonapplicants for credit as being "discouraged": businesses that wanted credit but did not apply because they believed that they would be turned down.[10]

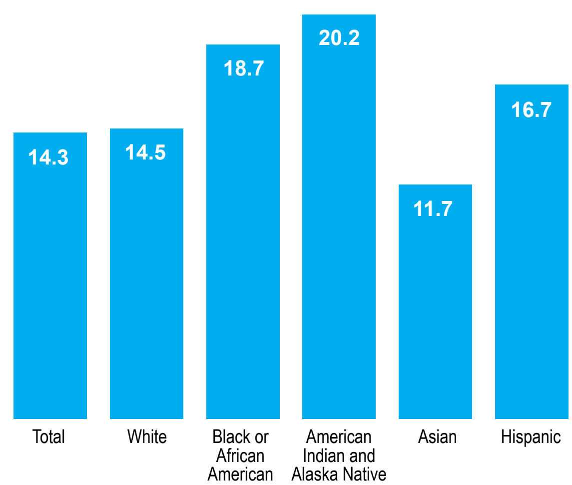
Figure 2: Share of Businesses Applying for Credit



Note: The specific question is "Did your business apply for any financing in the past 12 months?" accompanied by the following 2021 guidance: "Borrowing, leasing, or requesting equity investments, excluding financing provided by owner(s) of business and applications for PPP, EIDL, and other pandemic-related government loans/grants."

Source: Federal Reserve *2022 Report on Employer Firms*

Figure 3: Share of Businesses Seeking New Credit in 2020



Note: The specific question is "For the 12 months ending December 31, 2020, did this business submit an application for new credit (e.g., a credit card, loan, line of credit, trade financing, etc.)?"

Source: US Census Bureau and National Center for Science and Engineering Statistics, 2021 Annual Business Survey

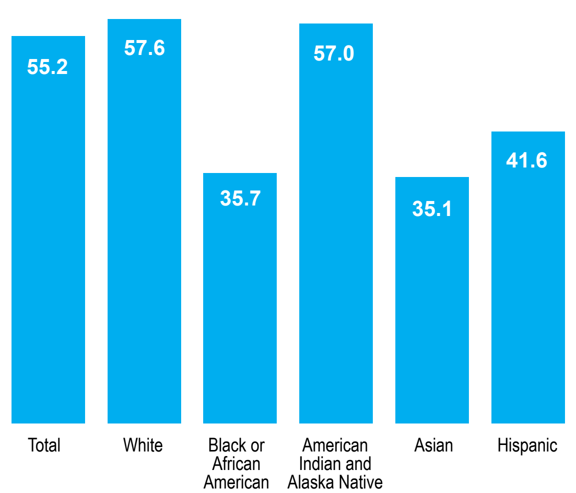
While minority-owned businesses were generally as likely as white-owned businesses to apply for credit, they were significantly less likely to receive all of the credit they sought. In the ABS, businesses were given a choice of four options to capture the amount of requested credit that was received: “none,” “some,” “all,” and “don’t know.” The question is kept in this general form to reduce the response burden so that businesses can answer without need to refer to their records. Most businesses, regardless of ownership, were able to provide the outcome of their credit applications in these general terms. Figure 4 shows that 57.6 percent of white-owned businesses reported receiving all of the credit they requested compared to just 35.7 percent of Black-owned businesses and 35.1 percent of Asian-owned businesses. These differences are statistically significant and potentially economically meaningful given how stark the disparity is. American Indian- and Alaska Native-owned businesses reported receiving credit at a level similar to that for white-owned business.

We do not know the exact scale of the shortfall for Black-, Asian-, and Hispanic-owned businesses because of the simple form of the question. Moreover, assessing whether these difference are solely because of minority or nonminority ownership status requires more detailed information than we currently have, such as potential underlying differences in the size and credit worthiness of applying businesses. Still, raw differences for these groups of business owners are significant enough to be worthy of further research.

Limited credit access can hurt the viability of businesses or limit expansion opportunities. In the 2021 ABS, businesses were asked for what purpose financing was sought. Businesses were given options for meeting operating expenses, business expansions, replacing capital assets, refinancing, and other reasons. The choices were nonexclusive, meaning that a given business could report both refinancing and business expansion credit needs. Overall, in 2020, the most frequent use of credit, regardless of ownership status, was to meet operating expenses.

Unfortunately, we do not have prior ABS information with which to compare these findings. That said, it seems plausible that the large share of businesses that reported needing financing to support operating expenses could reflect the challenging business landscape raised by the pandemic in 2020. As our companion article reveals, the impact of the pandemic was larger for minority-owned businesses than for white-owned businesses. Figure 5 shows that Black-, Asian-, and Hispanic-owned businesses were particularly likely to cite meeting operating expenses as the purpose of borrowing. We interpret this result as a relatively defensive use of credit for these businesses (that is, trying to keep operations afloat rather than focused on expansion opportunities). While not shown in Figure 5, the frequencies of the other motivations for credit applications were more similar by race and ethnicity.

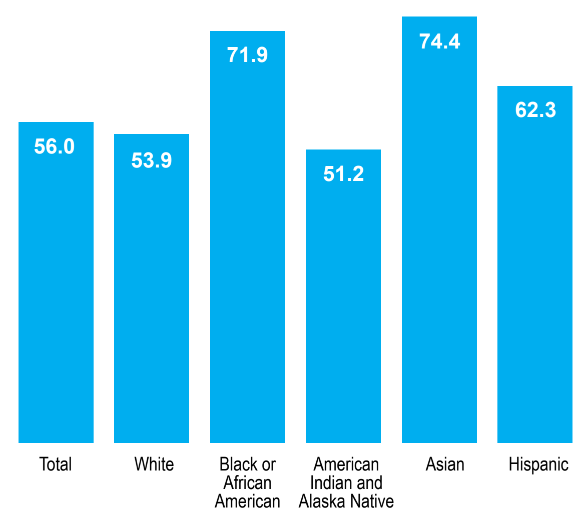
Figure 4: Share of Credit-Seeking Businesses Receiving All of Their Request



Note: The specific question is “For the 12 months ending December 31, 2020, how much of the total amount of credit requested did this business receive?”

Source: US Census Bureau and National Center for Science and Engineering Statistics, 2021 Annual Business Survey

Figure 5: Share Reporting that Financing Was Intended to Meet Operating Expenses

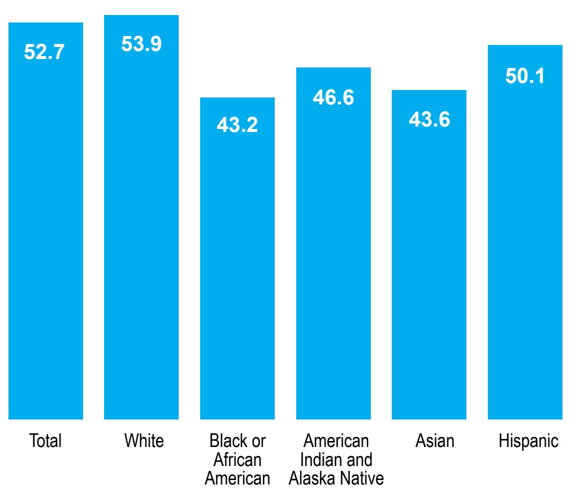


Note: The specific question is “For the 12 months ending December 31, 2020, for what purpose did this business seek financing?”

Source: US Census Bureau and National Center for Science and Engineering Statistics, 2021 Annual Business Survey

Given the financing challenges and differences in government aid received (https://www.atlantafed.org/research/publications/policy-hub/2022/03/22/03--impact-of-pandemic-on-us-businesses--new-results-from-annual-business-survey.aspx), it is not surprising to see weaker expectations for business operations among minority-owned businesses, particularly for Black- and Asian-owned businesses, in Figure 6. These results are, again, statistically significant. Reduced expectations for growth could be an outcome of less access to credit, but less access to credit could also be the product of weaker business opportunities recognized by lenders. Causality is inherently difficult to identify in credit access, but these preliminary ABS results support the potential for credit inequities that deserve further analysis.

Figure 6: Expectation for Business Operations at or above Current Levels into 2022



Note: Results tabulated by Census staff to the question "Will this business be able to maintain operations into the next year (2022)." Available responses are "Yes, at or above current level of operations," "Yes, at or below current level of operations," "No; Don't Know."

Source: US Census Bureau and National Center for Science and Engineering Statistics, 2021 Annual Business Survey

Conclusion

Minority-owned businesses (with the exception of Asian-owned businesses) were at least as likely as white-owned businesses to apply for credit. However, the preliminary release of data from the ABS points to significant differences in the receipt of credit for minority-owned businesses in 2020. Some of these differences likely reflect underlying differences among small businesses, so when more detailed ABS data are released, we intend to follow up this report with an analysis that includes more controls for business size and industry. Nonetheless, the fact that these differences are evident in fully representative ABS data adds to existing evidence from the SBCS and further supports focusing greater attention on rectifying credit inequity.

Banks report small-business loans under the Community Reinvestment Act (CRA), so the CRA is one policy tool that might influence equity in small-business lending. One potential drawback of the CRA is its geographical focus on low- and moderate-income (LMI) communities rather than on minority- or nonminority-ownership status of businesses. Interestingly, an Urban Institute review of CRA credit reveals that reported small-business loans are not well targeted at LMI areas, so the CRA's current impact may be limited.[11]

The preliminary evidence from the 2021 ABS continues to show substantial differences in credit access and use. While a more fulsome examination of these observed inequities awaits the availability of observed business characteristics, these raw results suggest the need to carefully examine credit outcomes. Such analysis will be important as the Federal Reserve Board of Governors' Advanced Notice of Proposed Rulemaking notes that "The Board is considering ways to provide incentives for economic development activity with the smallest businesses and farms, as well as minority-owned small businesses."

Endnotes

1. For the most recent year's report, see the Federal Reserve's *2021 Report on Firms Owned by People of Color*.

2. SBCS data are weighted so that the weighted distribution of firms in the SBCS matches the distribution of the small-firm (1 to 499 employees) population in the United States by number of employees, age, industry, geographic location (census division and urban or rural location), sex of owner(s), and race or ethnicity of owner(s). The weighting methodology was developed in collaboration with the National Opinion Research Center (NORC) at the University of Chicago.

3. In this report, we focus on the Census categories of white-, Black- or African American-, American Indian or Alaska Native-, Asian-, and Hispanic-owned businesses. The Census Bureau also released data on Native Hawaiian and other Pacific Islander-owned businesses. For our purposes, the standard errors for estimates on this population were often too large to yield meaningful comparisons, so we did not include this group in our comparisons of minority-owned businesses.

4. The ABS is conducted jointly by the US Census Bureau and the National Center for Science and Engineering Statistics within the National Science Foundation. More information on the program can be found here: https://www.census.gov/programs-surveys/abs.html

5. The Annual Business Survey is a mandatory survey covering nonfarm employer businesses. Coverage applies to all firms reporting with IRS forms 941, 944, or 1120.

6. Source: ABS 2019. These estimates are from 2019. The 2021 ABS estimates have not been released yet.

7. Equal ownership between minority and nonminority owners is much less common than outright ownership by one demographic group, a situation which makes for larger standard errors and less clear analysis than for single-ethnicity-group ownership.

8. https://www.census.gov/content/dam/Census/library/visualizations/2021/comm/employer-firms.pdf

9. The SBCS lists leasing and requests for equity investments in addition to "borrowing," while the ABS cites examples of "a credit card, loan, line of credit, trade financing." We intend to complete a more detailed comparison of the two sources when the full ABS dataset becomes available.

10. 2022-sbcs-employer-firms-report (fedsmallbusiness.org)

11. https://www.urban.org/urban-wire/small-business-and-community-development-lending-are-key-cra-compliance-most-banks

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