THIRD WAY

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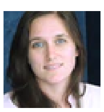
Three Ways to Save Small Businesses



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Takeaways

- American small businesses are being decimated as a result of the coronavirus. With over 90% of small businesses impacted by the COVID-19 crisis we need to do more to keep Main Street afloat. [1]
- While small businesses have been the focus of policymakers' response to the crisis, more help is needed as many firms haven't been able to access existing relief efforts and/or have been impacted more severely than the response had anticipated.
- Helping small businesses is also important for equity, as minority and women-owned businesses have lower survival rates during a recession. [2]
- America won't be the same without our small businesses, we can save them with a

variety of new efforts.

Lavery Brewing Company in Erie, Pennsylvania was founded in 2009 in the city's newly revitalized downtown district. As a result of the coronavirus and stay at home orders, the brewery has had to lay off 27 of its 30 employees and close its recently opened second location. [3] Owners Jason and Nikki Lavery predict that sales will be down between 40% and 50% from this time last year. To maintain its operating costs for the next two months, it will need $120,000. Without government relief, this brewery will have to shutter its doors permanently.

The Laverys aren't alone. The most recent small business survey conducted by the National Federation of Independent Business (NFIB) on March 30th found that 92% of small businesses have been impacted by COVID-19. [4] Four out of 5 survey respondents reported slower sales. Even more alarming, this survey is conducted every ten days and each tenth day, the number of small businesses negatively impacted is ballooning. In the previous survey conducted on March 20th, only 76% of small businesses reported being negatively impacted, and on March 10th only 23% of businesses claimed to be impacted. This problem is getting worse each week that we do not make big and bold efforts to strengthen the lifeline of small businesses

Congress has acted with remarkable speed. From quick advances through the Economic Injury Disaster Loan (EIDL) assistance program to the Paycheck Protection Program, Congress has allocated over $679 billion [5] in small business aid. Unfortunately, the rescue effort has had too many gaps and left too many small businesses without a lifeline. In this memo, we examine small businesses in this economic crisis and offer a series of recommendations for how to ensure every small business gets federal aid.

The Problem

The coronavirus is putting unique pressure on US small businesses and there have been numerous gaps in the rescue effort. To understand this dynamic, it's important to explain a key characteristic of small businesses: most of them have extremely lean profit margins.

Across the United States, the majority of small businesses do not have large cash reserves lying around. Through the course of operation, they generate revenue and typically pump that revenue back into the business. In a report published last fall, the JPMorgan Chase Institute found that 47% of small businesses had two weeks or less of cash liquidity and 29% of small businesses were actually unprofitable. [6] Even more disheartening, small businesses in communities of color, communities with fewer college graduates, and communities with lower home values have lower cash liquidity. So, the majority of small business owners just don't have a financial cushion to maintain operating costs while waiting for quarantine measures to end. And small-business owners in distressed communities will be even more impacted by the economic shutdown.

In response to this, Congress took a series of actions to provide financial relief to small businesses:

- In the initial $8.3 billion government relief package, the federal government appropriated an additional $20 million to the Small Business Administration (SBA) for the EIDL program. EIDL loans are designed to provide quick advances of up to $10,000 and have a broad range of acceptable uses including payroll, mortgage and debt payments, and utilities.

- The Coronavirus Aid, Relief, and Economic Security (CARES) Act dedicated $349 billion to the Paycheck Protection Program (PPP). This program, run by the SBA, gives qualifying businesses low-interest (1.0%) loans to help them continue paying their bills and employing their staff to weather this storm. Businesses that retain or rehire their workforce are not required to repay their loans.

- The Paycheck Protection Program & Healthcare Enhancement Act of 2020, the so-called "Phase 3.5 bill," allocated an additional $320 billion to the PPP, with $60 billion set aside for loans made by small banks, small credit unions, and community financial institutions. This bill also allocated an additional $10 billion to the EIDL program and appropriates an additional $2.1 billion to the SBA to cover increased administrative costs for the management and implementation of SBA loan programs.

While this federal action was essential, there have been too many gaps in the rescue effort, namely the PPP effort. Issues include:

Inadequate funding. The initial PPP funding was dwarfed by the demand. All $349 billion in loans were allocated within 14 days of the program's start. [7] Even with the second infusion of funds for the program, too many small businesses are able to access these resources. Although over four million loans have been processed, thus far, there are 30 million small businesses in the United States and almost all have been negatively impacted by COVID-19. [8]

Inadequate reach. In the first round of PPP funding, limited guidance on what qualifies a business as being able to certify itself as a small business led to self-employed individuals, sole-proprietorships, venture-backed companies, and some franchises being shut out of PPP loans. This is a huge problem. Many of these businesses are as equally vulnerable to the pandemic. Also, these small businesses contribute significant value to our economy. As previously mentioned, the vast majority of women and minority-owned businesses are sole proprietorships. Likewise, franchises and venture-backed companies constitute a gigantic share of America's employers. For instance, a recent Information Technology and Innovation Foundation (ITIF) report found that if America's 83,000 venture-backed companies, with fewer than 500 employees, are excluded from the PPP, one million workers would be laid off over the next decade. [9] The SBA needs to make clear that these businesses qualify as small businesses and have a lifeline to support their workers.

Inadequate process. To get a PPP loan, a small business had to apply through a private lender. Yet, many small businesses did not have a pre-existing lending relationship with a participating SBA lender. Of the 22% of businesses whose loans were not successful, more than two-thirds said they were waiting for their bank to start accepting PPP loans. [10]

Inadequate flexibility. Many small businesses struggle with limitations on how they can spend the PPP funds and qualify for loan forgiveness. The PPP requires that 75% or more of funds must be used for payroll, and all funds must be spent within an eight-week window. While these provisions were set with the intention to keep employees on payroll, the limits have hindered various businesses from using the program, especially those with high rents and other substantial non-payroll costs. Reforms to PPP should include more flexibility on rehiring, use of funds, and other improvements highlighted by the Economic Innovation Group. [11]

Inadequate administration. The SBA has struggled to keep up with the demand for loans. Underfunded and with a limited agency capacity, banks have complained that the SBA web portal frequently crashes, and that it is nearly impossible to get an SBA representative on the phone. Not only has the SBA struggled to maintain the necessary agency capacity to process lenders' loan requests, but many banks are also new to working with the SBA. Before the PPP was launched, only 40% of banks participated in SBA lending programs. [12]

The result? PPP loans provided a critical lifeline for many small businesses, but unfortunately, there were too many gaps—leaving far too many small businesses out in the cold and fighting for their survival.

Of these small businesses shut out from relief, women and minority-owned businesses are finding that receiving PPP loans is especially challenging. A large share of minority-owned businesses is shut out from PPP loans because they are non-employer firms. While minorities make up 40% of our population, they own under 20% of businesses with employees. Women too are underrepresented, owning 33% of firms with employees. [13] Not only are these businesses less likely to receive aid, but recent history has also shown that minority and women-owned businesses are less likely to survive a recession than their white and male counterparts. A Census study showed that following the Great Recession, minority (48.7%) and women-owned businesses (55%) had lower business survival rates than white- (60%) and male-owned businesses (61%). [14] Overall, these findings illustrate the longer and harder road to recovery facing minority and women-owned businesses.

The Solution

Small businesses need a stronger lifeline to weather this storm. The PPP can continue to be a valuable component of the rescue effort, but it needs to be expanded and revised—and additional programs need to be added alongside it. Here are three ways to do that:

1. Expand and revise the Paycheck Protection Program.

We need to patch the holes in the PPP and ensure that it reaches every small business and better meets their needs. *First, Congress should immediately invest $1 trillion in an expanded Payroll Protection Program*. As long as small businesses need financial relief, there should be resources available to them. *Second, Congress must expand eligibility requirements so all afflicted small businesses can participate*. The current Treasury guidelines for the PPP do not clarify how borrowers can certify that they qualify as a small business. Consequently, banks have taken a precautionary approach limiting what types of businesses qualify as small businesses. In the next round of funding, the SBA should expand PPP eligibility by amending the CARES Act so that self-employed workers, sole proprietorships, and venture-backed companies with fewer than 500 employees qualify for the program.

Don't stop there. *Third, Congress should give more flexibility on how small businesses use the funds.* Even businesses that qualify are limited by the SBA's strict guidelines on how funds must be spent to qualify for loan forgiveness. Rep. Abigail Spanberger (D-VA) and several of House colleagues, penned a letter urging the SBA to loosen the restrictions on how small businesses spend PPP funds to ensure that businesses will receive loan forgiveness, keeping with the spirit of the CARES Act language. [15] *Fourth, Congress should extend the eight-week window on spending PPP dollars*. For many businesses in areas where COVID-19 cases are not expected to peak until later this summer, receiving funds now is far less helpful than when their need demands. The current guidelines requiring businesses to spend all funds in eight weeks is punitive to businesses whose operating costs and profit margins are seasonally variable. *Finally, we need to expand the transparency of this program so we can ensure that companies do not abuse the program and help goes to businesses that truly need it.*

One proposal that would drastically move us in this direction is Rep. Derek Kilmer's (D-WA) $900 billion expansion of the PPP. [16] This bill extends the duration of the program through the remainder of the nationwide social distancing measures put in place due to the pandemic. It also defers loan payments for the duration of the pandemic and establishes a provision allowing PPP recipients to qualify for loan renewal/extensions during the last two weeks of the time-window of their loans. By proposing these reforms to the PPP, small businesses will have more time to use PPP funds to maintain their payrolls and keep their doors open.

2. Establish a PPP Supplement for vulnerable businesses.

The JPMorgan Chase Institute found that in "all majority Black or Hispanic communities, most small businesses had fewer than twenty-one cash buffer days," and "margins for small businesses in communities with few college graduates were over 10 percentage points lower than those in communities with many college graduates." [17] Additional resources will be needed to ensure that businesses in these already-vulnerable communities are also helped.

Sen. Cory Booker (D-NJ) and Sen. Steve Daines (R-MT) have proposed establishing a separate $50 billion Small Business Local Relief Fund. [18] Operated by the US Treasury, this program would allocate funding to state, county, and city governments to seed their own small business relief funds. The relief funds would provide support to "small businesses with less than 20 employees and those located in low-income communities (defined as those eligible for the New Markets Tax Credit)." [19] These funds are designed to provide support to local businesses that have been historically excluded from mainstream financial services. Small, minority-owned, and rural businesses would be prioritized. This plan is not designed to replace PPP loans, rather it is meant to "serve as a bridge" to the PPP and other federal lending products.

Sen. Kamala Harris (D-CA) and Rep. Ayanna Pressley (D-MA) have also proposed a bill to provide financial relief to America's most vulnerable businesses, the "Saving our Street (SOS) Act." [20] This bill would provide $124.5 billion to establish a Microbusiness Assistance Fund. Administered by the Treasury and I.R.S., this bill will enable "microbusinesses" to apply for grants of up to $250,000.. Because these grants are designed for businesses with few employees, the funds are not restricted to retaining employees. The funds can be used for all operating costs, including providing PPE and hazard pay to employees. To qualify, the business must have either 10 or fewer employees or have 20 or fewer employees with at least half of its employees living in low-income communities. Businesses with more than $1 million in revenue are not eligible. Further, the bill stipulates that at least 75% must go to historically underrepresented businesses, including minority-owned businesses.

3. Provide direct grants to small businesses.

For many firms, the long lag times between qualifying for government financing and receiving the cash in their bank accounts will mean a death knell to their business. For these businesses, survival is dependent upon quick cash injection to protect solvency, and the PPP comes up short.

Given the need for unrestricted funds to keep the lights on in the smallest businesses that have had limited ability to access PPP, Rep. Madeleine Dean (D-PA) has proposed direct grants of 30% of gross receipts (up to $120,000) to all small businesses with less than 50 employees and under $1.5 million in gross receipts in 2019. [21] This would function as a business version of the $1,200 stimulus checks that are going to individuals and families from the CARES Act. By not restricting the funds, this money can be used to make rent payments, pay vendors, and keep the lights on for struggling small businesses. And by targeting this grant to the smallest of businesses, this effort will reach many diverse small business owners who have limited access to PPP. This is similar to a proposal from before the CARES Act was sponsored by Sens. Ron Wyden (D-OR) and Ben Cardin (D-MD). [22]

In a more expanded version of this idea, investment firm Vanguard has proposed $650 billion in direct payments to small businesses' accounts. [23] Administered by the Treasury, this $650 billion will be disbursed as payments issued to enrolled small businesses through their Employee Identification Numbers (EINs). These payments would be issued for the next three months. The plan provides benefits to all small businesses, including those left out of the PPP. In addition, it also expands eligibility to businesses employing fewer than 2,000 workers, up from the 500 workers threshold of PPP. It also expands eligibility to businesses employing fewer than 2,000 workers. Vanguard estimates that under this plan, 13.8 million businesses, employing two-thirds of the private workforce, would be eligible. They estimate that for a small business with fewer than 500 employees, the Treasury would pay out on average $55,000 per month. Like the PPP, these payments can be used to cover payroll, employee benefits, and other operating costs. In order to enroll, businesses would apply through the IRS using the same processes that they use to file their taxes. All businesses file taxes, making this proposal more readily available to businesses that do not have existing relationships with financial lenders.

Conclusion

As policymakers look to the next legislative package to deal with the economic fallout from the COVID-19 crisis, small business relief must be on that list. Millions of jobs and livelihoods are at stake. Small businesses continue to need a stronger lifeline to weather this storm. Expansions and reforms of PPP can also include new programs to better meet the unique challenges that many small businesses have faced in this crisis. Fortunately, there are many ideas and ways to help.

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