COVID-19 RECOVERY OUTLOOK:
MINORITY-OWNED BUSINESSES

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By Stephen Roblin

The COVID-19 pandemic and economic recession have induced the largest recorded decline in the number of active small businesses owners in United States history.[1] From February to April 2020, the number of active business owners across the country declined by 3.3 million or 22%, according to a recent National Bureau of Economic Research study.[2] As with workers, the severity of economic pain to business owners is strongly correlated with race, ethnicity, gender, as well as immigration status. Indeed, the same study found that closure rates were especially high for Black-owned and Latinx-owned businesses, with declines of 41% and 32% respectively.[3] The study also found closure rates of 26% for Asian-owned businesses, 25% for female-owned businesses, and 36% for immigrant-owned businesses.[4]

The extent to which these national trends apply to Montgomery County is difficult to assess. Nevertheless, it is clear that minority-owned businesses are vital to the County's economy and well-being of residents. The vast majority of self-employed County residents (70%) are either non-white, Latinx, or female.[5] Their businesses employ thousands of residents, provide valuable goods and services, and contribute to local economic growth and innovation.[6] In addition, for minority entrepreneurs, owning a business provides a viable alternative to discriminatory labor markets and promotes upward socioeconomic mobility.[7] Minority-owned businesses in the County confront many of the same conditions that contribute to high rates of minority-owned business closures nationally. For this reason, the County will likely experience—if it has not already—closure of a large number of minority-owned businesses.

Although the current outlook for local minority-owned businesses is alarming, policymakers can help these businesses survive the public health and economic crises. Doing so will require developing and implementing policies in a manner that address the specific challenges minority-owned businesses face.

SUMMARY OF KEY TAKEAWAYS

- Structural and institutional barriers to accessing capital have affected the growth, financial health, and survivability of Black- and Latinx-owned businesses prior to the crisis.
- Current rates of business closure and vulnerability are likely higher for Black- and Latinx-owned businesses operating in the County due to their pre-crisis financial distress, industry composition, and/or challenges accessing private and public sources of capital.
- To promote minority-owned business survival, policymakers should ensure that these businesses have full access to current assistance programs. In addition, policymakers could provide these businesses with targeted financial and technical support, and help private and non-profit institutions better support these businesses.

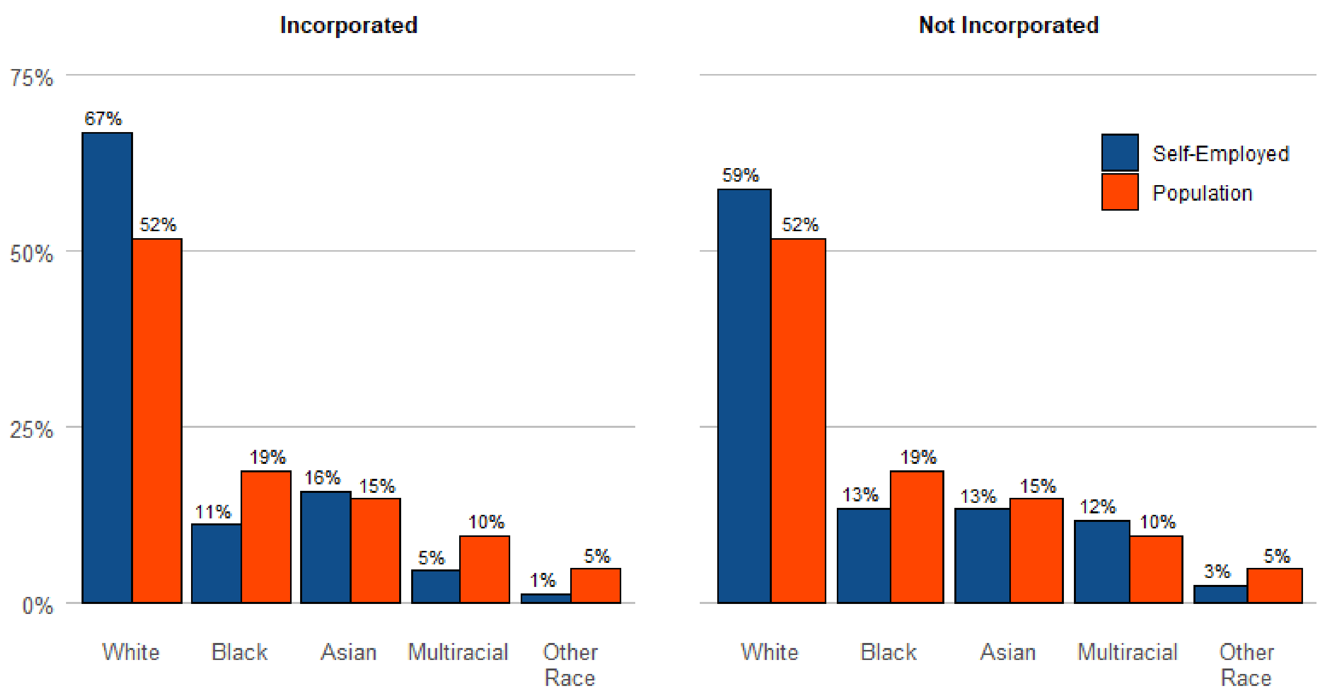
Additional OLO research on COVID-19 recovery is available here: www.montgomerycountymd.gov/olo

LOCAL MINORITY-OWNED BUSINESS BEFORE THE PANDEMIC

State of Maryland and Montgomery County laws define minority-owned business as any business that is at least 51% owned, managed, and the daily business operations controlled by one or more individuals in any of the following minority groups: African American, American Indian/Native American, Asian, Hispanic, physically or mentally disabled, or women.[8] This report, however, concentrates on County businesses owned by Black and Latinx entrepreneurs for two reasons. First, current research strongly indicates that Black- and Latinx-owned businesses have been disproportionately impacted by the public health and economic crises relative to other minority-owned businesses. Second, Black- and Latinx-owned businesses confront similar structural and institutional impediments, which other minority entrepreneurs may not face.

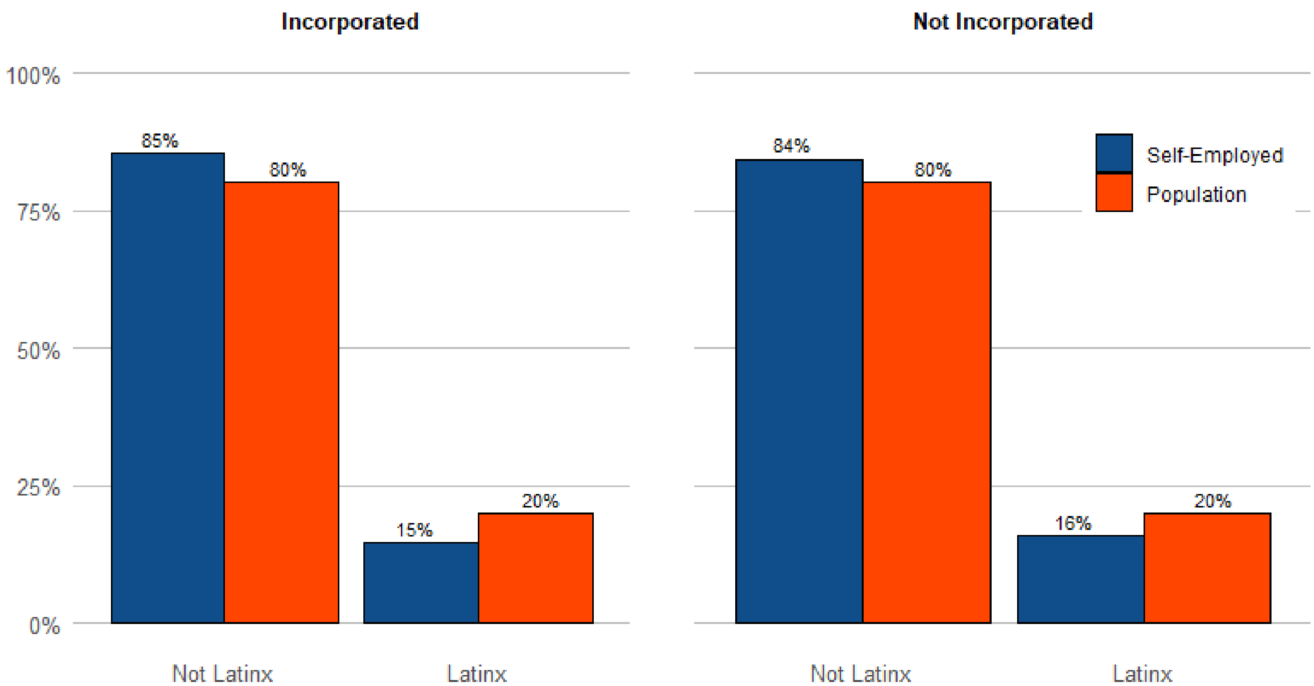
Prior to the COVID-19 pandemic, there were more than 27,000 employer businesses operating in the County, 97% of which had fewer than 100 employees.[9] Because there is no recent data on the demographic characteristics of business owners, the number of employer businesses with at least 51% ownership by Black and Latinx entrepreneurs is unknown. Without this data, the best indicator of the diversity of local businesses is 2018 Census data on self-employed residents. The data includes resident self-employed in their own incorporated or unincorporated business, professional practice, or farm. For all self-employed residents, 44% were non-white or Latinx. As shown in the figures below, Black and Latinx self-employed residents, especially those with incorporated businesses, were under-represented relative to their population levels prior to the pandemic and recession.

Figure 1. Representation of Self-Employed County Residents by Race



Data Source: American Community Survey, 2018

Figure 2. Representation of Self-Employed County Residents by Ethnicity



Data Source: American Community Survey, 2018

The under-representation of Black and Latinx entrepreneurs in the County is likely related to one of the primary structural and institutional obstacles that entrepreneurs of color across the country have faced: access to capital. A study released by the U.S. Small Business Administration this July found that, compared to White-owned business, Black- and Latinx-owned businesses are more likely to have been denied credit, to receive only a portion of the funding requested when their applications are accepted, or to refrain from applying for needed funding out of fear that their applications will be rejected.[10] Researchers have identified several factors that explain the disparity in access to capital:

- discriminatory lending practices,
- less wealth to leverage (e.g. home equity),
- recent financial challenges, and
- lower credit scores.[11]

Importantly, because these impediments are primarily structural and institutional, they do not reflect inherent differences in entrepreneurial abilities. For this reason, the under-representation of minority-owned business in the County represents a potential market failure, in which capital markets have inefficiently allocated financing to local entrepreneurs.

The inability to receive business loans at rates and amounts of White entrepreneurs has serious consequences for the growth and survivability of minority-owned businesses. Structural and institutional impediments to capital markets cause entrepreneurs of color to rely more heavily on alternative funding sources, such as their personal/family savings and assets, personal and business credit cards, Community Development Financial Institutions (CDFIs), and credit unions.[12] These alternative sources, however, are imperfect substitutes.[13] Compared to their White counterparts, Black- and Latinx-owned businesses start with less capital and often remain under-capitalized. Under-capitalization stifles business growth by preventing businesses from making the investments required to achieve scale-based competitive advantages. Under-capitalization also increases the risk of business closure.[14] Indeed, a study published JP Morgan Chase Institute this July found that Black- and Latinx-owned businesses were more likely to experience lower revenues, profit margins, cash liquidity, and long-term survivability as compared to White-owned businesses.[15] As a result, when the COVID-19 pandemic and recession hit, Black- and Latinx-owned businesses were more likely to enter the crisis with insufficient capital and in a state of financial distress.[16]

IMPACT OF CRISES

In late March, state and local government leaders in the Washington D.C. metropolitan region restricted economic activity to contain the spread of the COVID-19 virus. Through the end of May, the region was under lockdown, with residents under stay-at-home orders and non-essential businesses closed. These public health measures shuttered the regional economy, triggering mass layoffs and temporary closures of small businesses in the County. In mid-June, the County authorized the Phase 2 reopening by partially lifting restrictions on economic activity. The County remains in "Phase 2." Given the uncertainty surrounding the containment of the virus, it remains uncertain when the economy will fully reopen.

As reviewed in the OLO COVID-19 Recovery Outlook paper on Small Businesses, the economic contraction triggered a liquidity crisis in which businesses have been starved of desperately needed revenue.[17] Though conditions have somewhat improved, many small businesses in the Washington D.C. region remain financially fragile. The Census Small Business Pulse Survey provides a weekly snapshot of business conditions for small businesses in major metropolitan areas.[18] In the first week of the survey (April 26 – May 2), 73% of small businesses in the Washington D.C. region did not have enough cash on hand to cover more than two months of business operations, with 29% unable to cover more than two weeks of expenses, and 7% having no cash available. Since then, conditions have improved somewhat. The most recent data (August 30 – September 5) indicates that 69% of small businesses lack the available cash to cover more than two months of business operates, with 11% unable to cover two or more weeks and 1% have no cash.

The Census survey does not indicate whether Black- and Latinx-owned businesses in the Washington D.C. region have closed at higher rates than other businesses or whether those that remain open are especially vulnerable. (The available data are not disaggregated by race or ethnicity.) Like their White counterparts, local Black- and Latinx-owned businesses have grappled with the conditions that have caused the mass closure of small businesses across the country—loss of revenue, depleted savings, and disrupted business operations. But unlike their counterparts, Back- and Latinx-owned businesses were more likely to confront these conditions in a pre-existing financially distressed state, as explained above.

There are two other factors that bode poorly for Black- and Latinx-owned businesses in the County. First, several nationwide studies have shown that minority-owned businesses are heavily concentrated in industries that have experienced the most disruptions caused by the public health and economic crises, such as retail, food service, and accommodation.[19] Data limitations make it impossible to determine whether the industry composition of Black- and Latinx-owned businesses in the County reflects the national trends. To the extent that County Black- and Latinx-owned businesses are in more exposed industries, the liquidity crisis would be more acute.

Second, local Black- and Latinx-owned businesses may have had greater difficulty attaining financial relief from private and public sources during the crisis than White-owned businesses. Findings from a nationwide survey of business owners conducted in July indicate that minority entrepreneurs were more likely to report trying and failing to secure a loan.[20] Moreover, Black- and Latinx-owned businesses may be less likely to have received support from the federal Paycheck Protection Program (PPP). A study by the New York Federal Reserve found that businesses that lack existing relationships with banks have been less likely to receive PPP funding.[21] Because of relatively weaker ties to the formal banking system prior to the crisis, Black- and Latinx-owned businesses may not have received their fair share of PPP funding.

Overall, the evidence strongly suggests that Black- and Latinx-owned businesses are closing at a higher rate than White-owned businesses in the County. To be sure, the loss of minority-owned businesses inflicts immediate harm that will have enduring effects on the County economy. At present, the loss of jobs, goods and services, growth, and innovation from business collapse is increasing poverty, homelessness, and other social ills. These impacts are felt most in sections of the County with high concentrations of minority-owned businesses. The uneven geographic and demographic distribution of economic harm from the COVID-19 pandemic and recession could generate a higher degree of inequality for years to come.

TAKEAWAYS

Surveys of small business owners make clear that they would benefit from: (1) financial assistance, preferably in the form of government grants, and (2) a range of business support services, particularly guidance on how to protect employees and customers from COVID-19; technical training on website development, e-commerce, and social media; and guidance on how to modify business models.[22] Several actions could be taken to help Black-, Latinx-, and other minority-owned businesses receive these forms of support.

Ensure Access to Existing Programs. The County has provided small businesses with financial and other forms of support, for example, through the Public Health Emergency Grant (PHEG) program. Policymakers should recognize that "[s]mall business programs and policies based on firm size, payroll, or industry may miss … many Black- and Hispanic-owned firms."[23] To ensure that the County's current relief programs are targeting businesses on the basis of equity and need, these programs could be reviewed to determine whether they sufficiently reach minority-owned businesses. If gaps in outreach exist, these programs could be amended to address them.[24]

Provide Targeted Relief. In addition to improving the performance of existing programs, policymakers could consider directly targeting minority-owned businesses with financial relief and other forms of support.[25] As stated in a recent McKinsey & Company report, "Immediate relief in the form of grants, loans, subsidized access to legal advice, professional assistance to negotiate with creditors or landlords, and free-advertising credits could help minority-owned small businesses respond to the pandemic and protect their employees."[26]

Assist in Accessing Outside Support. As discussed above, local minority-owned businesses have been less likely to receive private and public liquidity. Local government should acknowledge the challenges minority-owned businesses encounter in trying to access credit. The County could promote credit and other services provided by federal and state governments, private lenders, as well as non-profit institutions with a history of supporting minority-owned businesses, such as Community Development Financial Institutions and credit unions. [27]

Endnotes

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