



# Supporting social equity by boosting small businesses: What economic history can teach us

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## Insights

- The COVID-19 pandemic has wreaked havoc on many small enterprises. Already vulnerable populations have been hardest hit.
- While the current crisis is quite different from previous economic dislocations in its origin and evolution, observations by economic historians of the root causes of differential effects can offer some lessons.
- The good news is that taking steps to right societal wrongs and to support small businesses can help the economy as a whole recover more quickly and resiliently and truly build back, not only better, but more equitably.

We know that small businesses are integral to our communities and to the economy. We also know that the COVID-19 pandemic has wreaked havoc on many small enterprises. Customer demand has dropped in many sectors, and any forecast of the recovery must consider unknowable factors, such as how governments will react to future waves of the coronavirus. Similarly, early in the pandemic, supply chains were disrupted, leaving business owners challenged to find needed inputs, and making it more difficult for workers to perform their tasks.

Already vulnerable populations have been hardest hit. In the United States, Black-owned businesses experienced larger revenue drops than other businesses; Latinx- and women-owned businesses were also disproportionately affected. Given the importance of small businesses to the economy and the current imperative in the United States to correct the course of systemic social and economic racism, helping Black-owned businesses to survive, recover, and thrive has never been more important. Helping them do so not only makes economic and business sense; it is an opportunity to help to set the country on a better path post-pandemic.

## The impact of demographics on small business

The contributions small businesses make to the community—as well as to the global economy—should not be understated. According to the World Bank, small businesses account for more than 95 percent of registered firms worldwide and 50 to 60 percent of global employment (World Bank, 2020). Small businesses create jobs, supply opportunities to achieve financial independence, and are often seen as driving innovation. Many iconic companies and successful entrepreneurs had their start as small businesses—Microsoft, Starbucks, Etsy, and many others.

In the past year, small businesses overall have been among the worst-hit by COVID-19. While some sectors—travel and tourism, for instance—have been more negatively impacted than others, data also show that certain groups of small business owners, independent of business activity, have been hit harder than others.

A May 2020 paper by Stanford Professor Robert Fairlie assesses the impacts of the pandemic on small businesses in the United States using Bureau of Labor Statistics (BLS) Current Population Survey (CPS) data. Between February and April 2020, nearly all industries experienced the largest drop in business ownership on record, as the number of active business owners in the United States fell by 22 percent (a total of about 3 million business owners). However, it was clear that Black businesses were hit especially hard, with 41 percent going out of business, more than twice the percentage of white-owned businesses, which decreased by 17 percent. The number of Latinx business owners fell by 32 percent and Asian business owners by 26 percent. Women-owned businesses were also disproportionately affected, dropping by 25 percent during this period, 5 percentage points more than male-owned businesses.

This is a worrying continuation of an already concerning trend. Even before the pandemic, Black business owners were under-represented, making up only about 7 percent of the United States' 15 million small business owners, despite making up more than 13 percent of the US population in 2019, according to the US Census Bureau. Black-owned small businesses in the US are highly concentrated in retail, restaurants, and other service industries, which have been among the most affected by shutdowns and social distancing. Black Americans owned 124,004 firms in 2017; 32.0 percent (39,714) of these firms were in the healthcare and social services industry. About half of Black-owned microbusinesses (firms with five or fewer employees) were in three sectors: Other Services, Healthcare and Social Assistance, and Administrative and Support Services.

In the wake of the COVID-19 pandemic, 43 percent of small businesses indicated that they had enough money to last only six months, and less than half of small businesses had any online business, according to a MetLife/US Chamber of Commerce study. A 2020 Visa study of small business owners in eight countries revealed that their greatest concerns were (1) not having the same revenue as they did before COVID-19 (52 percent); (2) attracting new customers (46 percent); and (3) having to reduce wages or salaries (22 percent). These concerns are even more pressing for business owners that have traditionally had even more challenges overcoming these very concerns.

Even before the pandemic, minority- and women-owned businesses were less likely to borrow from banks. A survey by the 12 Federal Reserve banks (2020) shows that only 23 percent of Black-owned businesses, compared with 46 percent of white-owned businesses, have received a bank loan in the last five years. The Federal Reserve Bank of New York (2020) cites structural barriers that influence their Black and Latinx-owned firms' financial health; for example, these firms are more likely to report higher credit risk ratings than white-owned firms. A study by Bone et al (2017) shows that banks were twice as likely to offer white entrepreneurs help with their small business loan applications than Black entrepreneurs. This study found that bankers were three times as likely to invite follow-up appointments with white borrowers than better-qualified Black borrowers.



Why is this important? For one, Black Americans overall are experiencing a disproportionate share of the pandemic's disruption; they have experienced greater levels of morbidity and mortality as well as more unemployment and bankruptcy, making the imperative to seek societal solutions to alleviate their plight ever more urgent. Additionally, these businesses bring important benefits to the community. According to a May 2020 McKinsey study, for example, minority-owned businesses are more likely than the average business to support their community and employees.

## The historical roots of small business inequality

What can economic historians tell us about which measures might help and which might hurt? Although the current crisis is quite different in its origin and evolution than previous economic dislocations, observations by economic historians of the root causes of differential effects can offer some lessons. Looking at the results of these trends can help to advance a roadmap to greater equity.

**Racial infrastructure gap.** Ellora Derenoncourt (2019) studied the impact of the great migration on Black migrants' economic fortunes. She found an initial positive effect as incomes rose, but this positive impact significantly diminished over generations. Growing up in great migration cities now lowers Black children's long-run outcomes. Based on an assessment of 100 years of data on schooling, residential patterns, and local government spending, Derenoncourt attributes these worse outcomes to the increasing separation and inequality of opportunity. As Blacks moved into predominantly white neighborhoods, a separation into distinct tracks for Black and white families developed. This was accompanied by declining urban quality, following a shift out of public investment in education, health, and sanitation and into police protection. As Derenoncourt summarized on Chad Bown and Soumaya Keynes' TradeTalks podcast (2020), "Black people migrated, and racism nationalized."

**Racial wage gap.** Black workers earned 50 cents on the dollar relative to white workers in the 1950s; by the 1970s, this gap had narrowed, and they earned 75 cents for each dollar earned by white workers, according to Derenoncourt and her coauthor Claire Montialoux (2020). They attribute this largely to a 1966 reform to the federal minimum wage act, which expanded minimum wage coverage to agriculture, retail, and services, in which Black workers were overrepresented. Equalizing coverage to sectors more significant to Black workers served to boost the fortunes of Black workers and reduce the racial income gap, with negligible employment effects.

**Skills penalty.** As wages have grown for high-skilled labor, the Black-white wage gap has persisted, and it began to grow again from 2000 to 2020. The gap persists across wage categories. It is smallest at the bottom of the wage distribution, where the minimum wage serves as a floor, then grows along the skills ladder, with the largest gap at the top of the wage distribution. Bayer and Charles (2018) find that the increased wages accruing to higher levels of education outweigh the initial decrease in the wage gap.

## Short- and long-term policy measures

The Census data findings have important policy implications. The disproportionate closure of Black-owned businesses as a result of COVID-19 is a worrying trend. The economic effects of losing business will be a tough blow for already disadvantaged families losing income. Communities will suffer from losing these motors of growth. Even more worrisome are the potential implications for economic inequality. The economic literature suggests several ways to help avoid the longer-term effects. All require an intentional focus on remedying the root cause of inequity. Some will require significant resources. All are important.

**Help small businesses survive.** First, avoid the economic consequences of the current pandemic by helping these small businesses



bridge the crisis. Many companies, including Visa, are taking measures to support small businesses. These measures take the form of helping small businesses digitize and adapt to the new environment; financial assistance; and using data to direct customers to Black-owned businesses. Communities are also pitching in, with neighborhood news boards advertising Black-owned businesses that are open and in need of customers. Financial institutions are working to develop product innovations to help more individuals and small businesses move from credit invisible to credit scorable and reach more unbanked and underbanked Black and Latinx households through customized financial products.

**Invest in equity in education.** It is well known that unequal access to education produces multiplier negative effects on outcomes for Black children (see, for example, Darling-Hammond (1998) and Shores et al. (2019)). The literature mentioned above demonstrates the serious systemic impact of unequal access to quality services. It is imperative that we invest in the early education of Black children and provide access and opportunity for training of youths.

**Invest in targeted opportunities.** Entire communities benefit from targeted training and scholarship programs that help young people succeed. Such programs also benefit businesses that have traditionally been deprived of the skills and talent of these traditionally underrepresented populations. Companies must adopt a multilayered approach that pairs training with networking opportunities and inclusion initiatives that enhance the proportionality of minorities in leadership roles and normalize representation of minorities in decision-making roles.

In addition to being a moral imperative, the economic return on racial equity is significant. A 2014 paper by the USC Program for Environmental and Regional Equity (PERE) estimates that US 2014 GDP would have been 14 percent higher—a \$2.1 trillion increase—with racial equity. This is an awfully large amount of national welfare to leave on the table, especially during a crisis.

Now is the time to act. The business community has recognized the opportunity for a reset. The Business Roundtable, an association of US CEOs, recently released a number of recommendations to advance racial equity and justice and increase economic opportunity in America. Business Roundtable companies have pledged to expand their support for Black-owned small businesses and entrepreneurs, with a Roundtable-wide goal of \$1 billion in support by 2025. The Roundtable has also called for providing technical assistance to Black and Latinx small business owners, including mentorship and support, with a Roundtable-wide goal of reaching 50,000 businesses by 2025 and making financial contributions to funds focused on minority-owned small businesses. Although support to survive this crisis is welcome help to small business owners, it is not sufficient to overcome the insidious gaps that will continue to hold these businesses back from reaching their full potential.

They have also targeted one of the perpetrators of inequity, pledging to boost educational outcomes for Black and African-American students, adding literacy and financial literacy programs. Visa's Black Scholars and Jobs Program sets up a \$10 million fund to assist college-bound Black and African-American students. Upon graduation, recipients who have met their commitments will be guaranteed a full-time job with Visa. At the same time, Visa is increasing its mentoring programs for Black and African-American employees. This recognizes that educational assistance is most effective when it is supplemented with targeted workplace training and recognizes the importance of the power of the network to career success.

Taking these steps will not be easy and will require resources. The good news is that taking steps to right societal wrongs and to support small businesses can help the economy as a whole recover more quickly and resiliently and truly build back, not only better, but more equitably. With concerted efforts from policymakers and the business community, we hope that future economics texts will teach important lessons about economic empowerment for all.



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