Catalyst Research

Achieving The PPP Mission: A Final Prescription and Beyond to Support All of America's Small Businesses

Policy Analysis Memo

April 2021

EXECUTIVE SUMMARY

Congress created the Paycheck Protection Program (PPP) to help small businesses, their employees and communities survive the COVID-19 pandemic. In many ways PPP has succeeded for America's economy and definitely for the largest small businesses. But PPP has failed our smallest small businesses and has largely failed minority-, women- and veteran-owned businesses.

To ensure that PPP helps all of America, including in rural, minority and other vulnerable communities, Congress should immediately refine the program so assistance flows only to the smallest and most vulnerable businesses that have been left out up to this point, and extend it to give these businesses a realistic opportunity to benefit.

- By capping loans at $50,000 and limiting applicants to companies with fewer than 10 employees, PPP will target the businesses that have not yet benefited.
- By replenishing PPP funds (which are likely to run out mid-to-late May) with an additional $75 billion, and extending PPP for an additional six months, the smallest and most vulnerable businesses will have time to apply for a loan.

These simple, inexpensive steps would allow PPP participation by millions of small businesses - primarily from underserved communities - that have been essentially shut out of the program so far. The results would make PPP the most equitable and broadly successful small business support program ever.

Looking forward, Congress should also create a "small business restart" program that helps millions of small businesses, particularly sole proprietors, get back on their feet.

INTRODUCTION/BACKGROUND

The COVID-19 recession has been unusual in many respects. After the initial full-economy seizure, the stock market soared to record highs. Simultaneously, millions of small businesses ceased to exist and millions more continue to suffer. A recent Federal Reserve Bank study found that 3-in-10 small businesses believe they will not survive 2021 without additional government assistance. Facebook recently published data documenting that small business revenue is continuing to slide, and businesses are continuing to close due to the pandemic.

When schools, offices and millions of businesses shut down in March 2020, Congress quickly recognized that small businesses and their employees would be hit particularly hard. The Paycheck Protection Program (PPP) was created to help them weather the storm, and uniquely among small business lending programs was intended to "keep the lights on" and keep employees on payroll. Now in its third round, PPP is scheduled to expire May 31, 2021 or when its funds are depleted.

In April 2021, about a year after PPP loans were first available, Catalyst Research convened four small business finance experts to discuss under Chatham House Rules if PPP has succeeded, should be continued, and how it could be improved. Participants were:

- David Audretsch: Distinguished Professor and the Ameritech Chair of Economic Development at Indiana University; Founding Co-Editor of the journal Small Business Economics.
- Neil Hare: Former Vice President, U.S. Chamber of Commerce; nationally recognized expert on small business lending and policy; Forbes Magazine contributing columnist.
- Scott Stewart: CEO of the Innovative Lending Platform Association, the leading organization representing online lenders and related service providers serving small businesses. Previously Senior Director of FinTech Initiatives at Financial Services Roundtable.
- Jason Tepperman: CEO of PLC Fund Advisors, LLC, which manages IntraFi Local Credit, a lender to small and mid-sized businesses. Previously established and led the $4 billion U.S. Treasury Small Business Lending Fund, and a senior team member managing the Troubled Asset Relief Program (TARP).

PPP OVERVIEW

As of early 2020 there were more than 30 million small businesses in America. Congress and the U.S. Government define small businesses as having fewer than 500 employees, but more than 70 percent are sole proprietorships and millions more are microbusinesses with fewer than 20 employees. Small businesses collectively employ nearly 60 million people, which is more than 47 percent of our workforce.

Congress approved three phases, or rounds, of PPP funding. Each round had different rules, including with regard to borrower criteria, loan limits, lender fees and loan forgiveness. These design choices were heavily influenced by lobbying and media stories, driven especially by banks and sophisticated industry associations.

- Banks wanted to be the preferred loan originators, and claimed to be best positioned to streamline applications and approvals. Banks' legislative success essentially created borrower preferences for their customers, the larger small businesses that have lawyers and accountants, can prepare loan documentation materials more quickly, and need larger loans that generate higher lender fees.

- Influential industries, e.g., restaurants, brilliantly championed the pandemic plight of their smallest industry participants while influencing program design to maximize funding available to large franchisees.
- Low lender fees exacerbated these problems, as for most banks a PPP loan under $50,000 was unprofitable so smaller borrowers were ignored.

As a result of these preferences, during the 1st and 2nd rounds of PPP funding and also the first half of the 3rd round (2021), lenders prioritized bigger, more sophisticated pre-existing small business customers. This group's dominance may have ended after the first two PPP rounds, but when the rules permitted borrowers to get a second loan the lenders again gravitated to the profitable pre-existing customers, effectively blocking smaller companies for a second time.

In December 2020 the SBA recognized that lenders would not process unprofitable small loans, so origination fees were increased for loans under $50,000. This incentivized lenders to process smaller loans, but only after the larger borrowers' 2nd loans were exhausted. Finally, in March 2021, the Biden Administration prioritized the smallest borrowers by creating a 14-day exclusive period during which borrowers were required to be very small businesses with fewer than 20 employees. As a result, millions of additional businesses have become aware that they are eligible and funds are accessible, and PPP is once again a popular program that will soon be oversubscribed.

In total, of the 8.7 million PPP loans approved as of late March:

- Over 6 million loans have been made to 5 million small businesses with employees, representing 60% of the 8.3 million small businesses that have employees
- Over 2 million loans have been made to 1.5 million sole proprietors, representing only 7% of more than 21 million sole proprietors.
- Small businesses with employees have captured 95% of PPP funding (more than $700 billion)
- Sole proprietors have captured only 5% of PPP funds ($35 billion), with the most recent SBA data indicating that sole proprietors increased their capture to 14% of total PPP funds in Round 3.

PPP HAD MANY LARGE SUCCESSES, BUT MILLIONS OF SMALL MISSES MUST BE RECTIFIED

In several ways PPP has been successful. For the first time ever, Congress created - quickly - an emergency aid package specifically designed to help small businesses retain employees during an emergency. The promise and then delivery of more than $750 billion to more than 7.5 million borrowers helped many small businesses weather the initial economic seizure and keep employees on payroll. Keeping employees on payroll meant they were available and eager to assist firms' transitions to pandemic business models such as remote work, online commerce and delivery. Maintaining employment reduced economic upheaval and its ripple effects, as otherwise terminated employees could continue paying rent and buying food, and this stability in turn reduced the burden on unemployment and other social services and mitigated the pandemic's emotional havoc and community devastation that would have been worse.

But the smallest and most vulnerable businesses did not have equal access to PPP. Until very recently, PPP design flaws noted above favored (a) sophisticated applicants with pre-existing banking relationships that could deliver detailed application paperwork quickly, and (b) larger firms needing larger loans that generated more profits to lenders. As a result, PPP Round 1 funds were exhausted in only a few weeks, as millions of smaller businesses were turned away by overwhelmed lenders or never even found a lender who would answer the phone or respond to an email.

PPP Round 2 funds also did not reach the smallest businesses, as lenders focused intensively on addressing the pent-up demand from larger firms that could not access Round 1 funds, and then moved forward to profitable loans requested by the middle tier of small businesses. Even after several months when loan applications slowed substantially, the smallest and least sophisticated small businesses (that needed assistance with qualifying paperwork) were effectively ignored.

As a result, in late 2020 billions of dollars were still available and loan originations slowed to a crawl. The popular opinion among policymakers and casual observers was that PPP had successfully completed its work -- that all small businesses which needed funds had received loans. But nothing could be further from the truth.

ONLY RECENTLY HAS PPP BEGUN HELPING THE SMALLEST BUSINESSES, INCLUDING WOMEN-, MINORITY- AND VETERAN-OWNED BUSINESSES, AND RURAL BUSINESSES.

In December 2020, at the outset of PPP Round 3, the SBA increased loan fees for very small loans and this should have opened the door to the smallest firms. But Round 3 rules also made businesses eligible for a second PPP loan, so once again lenders focused on profitable and easy-to-process larger loans. The largest portion of small businesses – more than 70 percent – are sole proprietors and businesses with fewer than 20 employees. These also represent the vast majority of minority-, women- and veteran-owned businesses – and they were still shut out.

Finally, in February 2021, after ten months of being shunted aside, the smallest and neediest business owners had their shot at much needed PPP assistance. The outcry from sole proprietors and microbusinesses had reached a politically effective volume, so the SBA created a two-week exclusive period during which only sole proprietors and businesses with fewer than twenty employees could apply for loans.

Suddenly there was a huge new wave of applicants seeking funds. PPP was popular again - not because the need for funds was new but because the door was opened to an entirely new and very large class of smaller, less sophisticated borrowers. During the two-week exclusivity period:

- Minority-owned business applications rose 20%, or an additional 1,000 businesses accessing PPP relief each day
- Women-owned businesses applications rose 14%, or an additional 600 businesses accessing relief each day
- Rural small businesses rose 12%, or an additional 1,000 businesses accessing relief each day.

Moreover, the new wave of loans are smaller and more efficient for taxpayers.

- In January 2021 the average PPP loan was $77,000. In April 2021, after word spread that lenders are now welcoming sole proprietors and microbusinesses, the average loan was only $22,000.

EXTEND PPP AND EXTEND A LIFELINE TO AMERICA'S SMALLEST BUSINESSES

The data tells the tale of two small business populations:

- Larger small businesses enjoyed PPP opportunities from April 2020 through February 2021. Applications were overwhelming at first, and then eventually slowed to a trickle after millions of businesses received funds and even a second allotment.
- The smallest small businesses were effectively shut out from PPP until February 2021. The exclusive period sparked an aggressive effort to help minority-, women- and veteran-owned businesses, and the surge in applications demonstrates a previously unrecognized need that should not be ignored.

If PPP closes on May 31st as scheduled, or likely even sooner as funds are running low, these small business owners risk being permanently left on the sidelines without the assistance they need. As this deadline nears, it is urgent that Congress act promptly to extend PPP and replenish funding one more time, with a laser focus on helping the smallest businesses that effectively were not included for the program's first ten months.

To ensure that the continuing program is truly focused on the smallest, hardest-hit businesses, we recommend that February's 20-employee exclusivity cap be reinstated for the program's duration and that it be lowered to a 10-employee maximum. We also recommend that loans be capped at $50,000, that borrowers be limited to one loan, and that lenders continue reporting data about minority-, women- and veteran-owned businesses.

If these limits are incorporated, then a modest funding of $75 billion through the end of 2021 will provide PPP support to an additional 15 million small businesses and make it the most successful and most equitable small business support program ever. We have all read media coverage of PPP abuses by billionaire sports team owners and wealthy restaurant franchisees. Now we have an opportunity to ensure that the smallest small businesses are helped before the program ends.

AFTER PPP - A MICRO-BUSINESS RESTART AND RECOVERY PROGRAM

Following the 2008 recession, the number of small businesses did not regain the 2007 level until 2017. Given the magnitude and gravity of the Covid recession, it is likely that the post-pandemic small business recovery will take even longer.

PPP cannot assist small businesses that closed before help arrived, but Congress can support a revival by creating a targeted "Small Business Renewal and Restart Fund" that will help entrepreneurs re-ignite their passion and revive their businesses. Modest $10,000 grants or $20,000 loans can be paired with virtual or in-person "modernize your business boot camps" that teach digital marketing and other small business skills that will improve entrepreneurs' probability of success. An appropriation of $20 billion will support loans and education programs for more than 5 million business revivals.

CONCLUSIONS AND RECOMMENDATIONS

Our overarching conclusion is that PPP has had a very positive impact on relatively large small businesses, but has provided only negligible assistance to the smallest of small businesses - sole proprietors and microbusinesses that have fewer than 20 employees. Historical data is clear and consistent that during economic downturns sole propreitors and microbusinesses are the first businesses to fail, and the last to revive. We also know from research on small business impacts of the pandemic that minority- and women-owned businesses have suffered disproportionately and have only limited access to financial resources - making PPP especially important to their survival prospects. Finally, for those small businesses that do survive the pandemic, post-recession hangovers are the longest for small businesses.

Based on these findings, we recommend that in order to achieve an equitable outcome for the Paycheck Protection Program program, Congress should immediately refine and extend it in a targeted manner for America's smallest and most vulnerable businesses, as follows:

- Target PPP funds to sole proprietorships and the smallest businesses by capping company size at 10 people and loan amounts at $50,000.

- Extend PPP through the end or 2021, so the smallest businesses that were effectively shut out of PPP until mid-February have time to apply.

These simple changes would allow millions of the smallest and most vulnerable small businesses across America - including millions from underserved communities - to participate in one of the largest and most significant government relief programs ever implemented. Just like vulnerable individuals who have still not received their Covid vaccine, there are millions of vulnerable businesses that need extra time and attention to access PPP funds.