

Social Sector Practice

COVID-19's effect on minority-owned small businesses in the United States

Already vulnerable, minority-owned small businesses brace for disproportionate impact. Here's how to help.

by André Dua, Deepa Mahajan, Ingrid Millan, and Shelley Stewart



Whether by necessity or ingenuity, minority-owned small businesses may be giving us an early sign of how US businesses will adapt in the wake of COVID-19. These businesses are experimenting with new ways of working to ensure their employees' safety, offering monetary relief to employees and community members, and introducing new services such as free delivery to those who need it.

According to our recent poll of more than 1,000 small businesses nationwide,¹ more than 40 percent of minority-owned small businesses have added new services to support their communities and employees, compared with 27 percent of all respondents. A majority of minority entrepreneurs are optimistic about economic recovery in general:

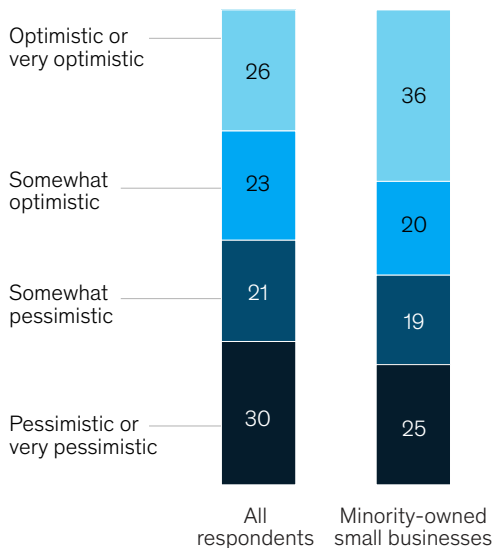
56 percent of minority small-business owners reported that they were optimistic about post-COVID-19 economic conditions, compared with 49 percent of all respondents (Exhibit 1).

Yet minority entrepreneurs, facing myriad challenges, are also concerned about risks to their own businesses. Of all vulnerable small businesses, minority-owned ones may be most at risk. Many were in financially precarious positions even before COVID-19 lockdowns, and minority-owned small businesses often are in industries more susceptible to disruption. Ensuring that these businesses survive in the current circumstances will require fundamental shifts in how private-, public-, and social-sector organizations come together to support them.

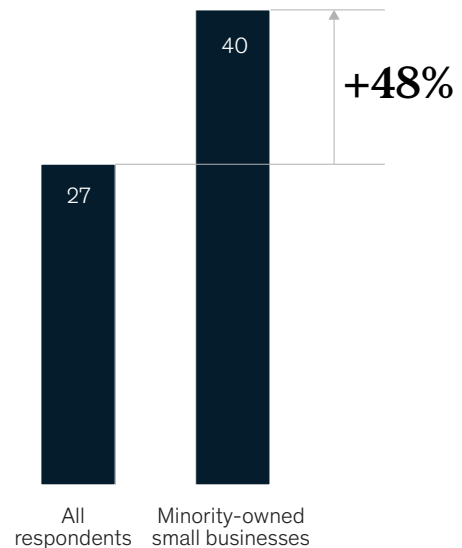
Exhibit 1

Minority-owned small businesses are more optimistic and more likely to offer support to their local community.

Confidence in own country's economic recovery after COVID-19, % of respondents¹



Added new services to support community and employees during crisis, % of respondents²



¹ Question: How is your overall confidence level on economic conditions after the COVID-19 situation? Survey of small and medium-size businesses with <\$500 million in annual revenue, conducted May 8–12, 2020, n = 1,004.

² For example, providing free delivery, adjusted hours for the elderly, and special communications with safety guidelines.

Source: McKinsey COVID-19 US Small and Medium-Size Business Financial Pulse Survey

¹ McKinsey COVID-19 US Small and Midsize Businesses Financial Pulse Survey, conducted May 8 to May 12, 2020, with 1,004 respondents. Sample covers representative range of industries (North American Industry Classification System 2) and states. This article focuses on employer small businesses with at least one but fewer than 500 employees.

What makes minority-owned small businesses vulnerable?

The COVID-19 crisis is affecting small businesses across the board. The 1.1 million minority-owned small businesses with employees in America are an essential job source, employing more than 8.7 million workers and annually generating more than \$1 trillion in economic output. Women own nearly 300,000 of them, employing 2.4 million workers.

The crisis could disproportionately affect minority-owned small businesses for two critical reasons: they tend to face underlying issues that make it harder to run and scale successfully, and they are more likely to be concentrated in the industries most immediately affected by the pandemic.

Financial distress prior to the COVID-19 pandemic

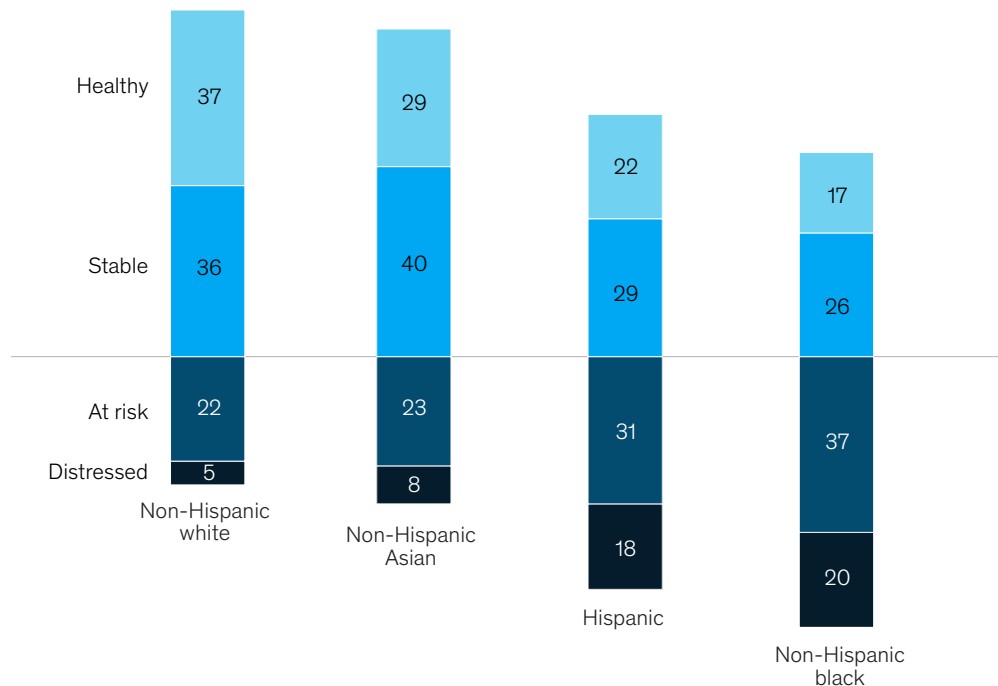
Minority-owned small businesses face structural challenges that underscore the underlying economic fragility of underrepresented groups, including the black and Latinx communities.

These underlying challenges could directly affect the health of minority-owned small businesses. In an assessment of the financial health of companies, the Federal Reserve Banks reported that minority-owned small businesses were significantly more likely to show signs of limited financial health—by factors such as profitability, credit scores, and propensity to use retained earnings as a primary funding source.² These companies were approximately twice as likely to be classified as “at risk” or “distressed” than nonminority-owned small businesses (Exhibit 2). That’s particularly

Exhibit 2

Companies helmed by black or Hispanic owners were more likely to be classified as ‘at risk’ or ‘distressed’ prior to the COVID-19 crisis.

Financial-health spectrum by type of ownership, % of companies¹



¹Financial-health assessment based on profitability, credit risk, and business funding. “Healthy” companies are profitable, have higher credit scores (low credit risk), and use retained business earnings to fund business. Companies that meet 2 of those criteria are “stable,” 1 of those criteria are “at risk,” and 0 of those criteria are “distressed.”

Source: *Small business credit survey: 2019 report on minority-owned firms*, Federal Reserve Bank of Atlanta, December 2019, [fedsmba.com](https://www.fedsmba.com)

² *Small business credit survey: 2019 report on minority-owned firms*, Federal Reserve Bank of Atlanta, December 2019, [fedsmba.com](https://www.fedsmba.com).

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concerning, since the US Federal Reserve also indicates that distressed companies are three times as likely as healthy businesses to close because of a two-month revenue shock.³

Limited access to credit is a compounding factor that hurts the underlying health of minority-owned small businesses. Based on data from the 2018 Small Business Credit Survey, the Brookings Institution found that large banks approve around 60 percent of loans sought by white small-business owners, 50 percent of those sought by Hispanic or Latinx small-business owners, and just 29 percent of those sought by black small-business owners.⁴ Research has found that black small-business owners were significantly more likely to be asked to provide more information about their personal financials—including personal financial statements and personal W-2 forms—when applying for small-business loans than white small-business owners were, even when controlling for credit score and business characteristics.

Black-owned businesses, overall, also tend to start out with far less capital, whether from investments or bank loans, than white-owned businesses do. And only 1 percent of black business owners get a bank loan in their first year of business, compared with 7 percent of white business owners. Twice as many white business owners—30 percent of the total—use business credit cards during their first

year compared with 15 percent of black business owners.⁵ The COVID-19 crisis is likely to compound this issue: 42 percent of minority-owned small businesses responding to McKinsey's US Small Business Pulse Survey reported that obtaining credit was becoming increasingly difficult, compared with 29 percent of all respondents.

As an additional consideration, research suggests that the average minority-owned mature small business is 30 percent smaller than the average nonminority-owned mature small business.⁶ Our own analysis of the data provided by Minority Business Development Agency found that only 11 percent of minority-owned small businesses had employees, compared with 22 percent of nonminority-owned small businesses.⁷ And, when looking exclusively at small businesses that have employees—excluding sole proprietorships—we found that, on average, minority-owned small businesses had 32 percent fewer employees and 47 percent lower receipts than nonminority-owned ones did (Exhibit 3).

Minority-owned businesses in the industries most affected by COVID-19

The concentration of minority-owned small businesses in industries more susceptible to disruption makes a large share of them vulnerable to the pandemic. Service industries, including accommodation and food services, personal and

³ Companies' financial health assessment is based on profitability, credit risk, and business funding. Companies categorized as "healthy" are those that are profitable, have higher credit scores and low credit risk, and use retained business earnings to fund the business. Companies that meet only two of those criteria are "stable," those that meet only one of those criteria are "at risk," and those that meet none of those criteria are "distressed."

⁴ Sifan Liu and Joseph Parilla, *Businesses owned by women and minorities have grown. Will COVID-19 undo that?*, Brookings Institution, April 14, 2020, brookings.edu.

⁵ Robert Fairlie, Alicia Robb, and David T. Robinson, *Black and white: Access to capital among minority-owned startups*, Stanford Institute for Economic Policy Research working paper, number 17-003, February 2017, siepr.stanford.edu.

⁶ *Zero barriers: Three mega trends shaping the future of entrepreneurship, State of Entrepreneurship 2017*, Ewing Marion Kauffman Foundation, February 2017.

⁷ "U.S. business fact sheets," Minority Business Development Agency, May 11, 2020, mbda.gov.

Exhibit 3

Minority-owned small businesses tend to be smaller than nonminority-owned small businesses by employee count and receipts.

Average employees for small businesses by type of ownership, number of employees¹



Average receipts for small businesses by type of ownership, \$ million¹



¹ Analysis based only on small businesses that have employees; excludes nonemployer small businesses.
 Source: "U.S. business fact sheets," Minority Business Development Agency, May 11, 2020 [based on 2012 data], mdba.gov

laundry services, and retail, which have the highest share of minority-owned small businesses, could be the most highly disrupted in the near term. These services often require physical proximity to others and are less likely to be delivered remotely. And although the healthcare and social-assistance sector is less likely to see immediate net job loss and company closures, it is the industry most exposed to contracting the virus (Exhibit 4).

Whether or not a small business is minority owned, 51 percent of small-business jobs performed by minorities could be vulnerable in the near term, compared with 47 percent of small-business jobs performed by white employees. Hispanic employees, for example, compose roughly 25 percent of all small-business jobs in accommodation and food services, the most immediately vulnerable sectors. Of all nursing assistants—a high-contact, essential job with elevated risks of virus contraction—33 percent are black. Both minority-owned small businesses and minority-held jobs are already being disproportionately affected by the COVID-19 crisis. While minorities composed 37 percent of the labor force in February 2020, they

accounted for 58 percent of the newly unemployed on March 14, 2020.⁸

Despite being more optimistic about the recovery of the economy as a whole, minority-owned small businesses appear to be more concerned about the impact the pandemic will have on their own businesses, according to McKinsey’s US Small Business Pulse Survey: 58 percent of minority-owned small businesses are “extremely” or “very concerned” about the financial viability of their business. For Native American-owned firms, the figure is 68 percent, compared with 47 percent for all US-based respondents. Furthermore, minority-owned small businesses in the United States are also more likely to have conducted layoffs or furloughs or to have shut down their business: 55 percent compared with 48 percent for all respondents.

What can help minority-owned small businesses navigate the COVID-19 crisis?

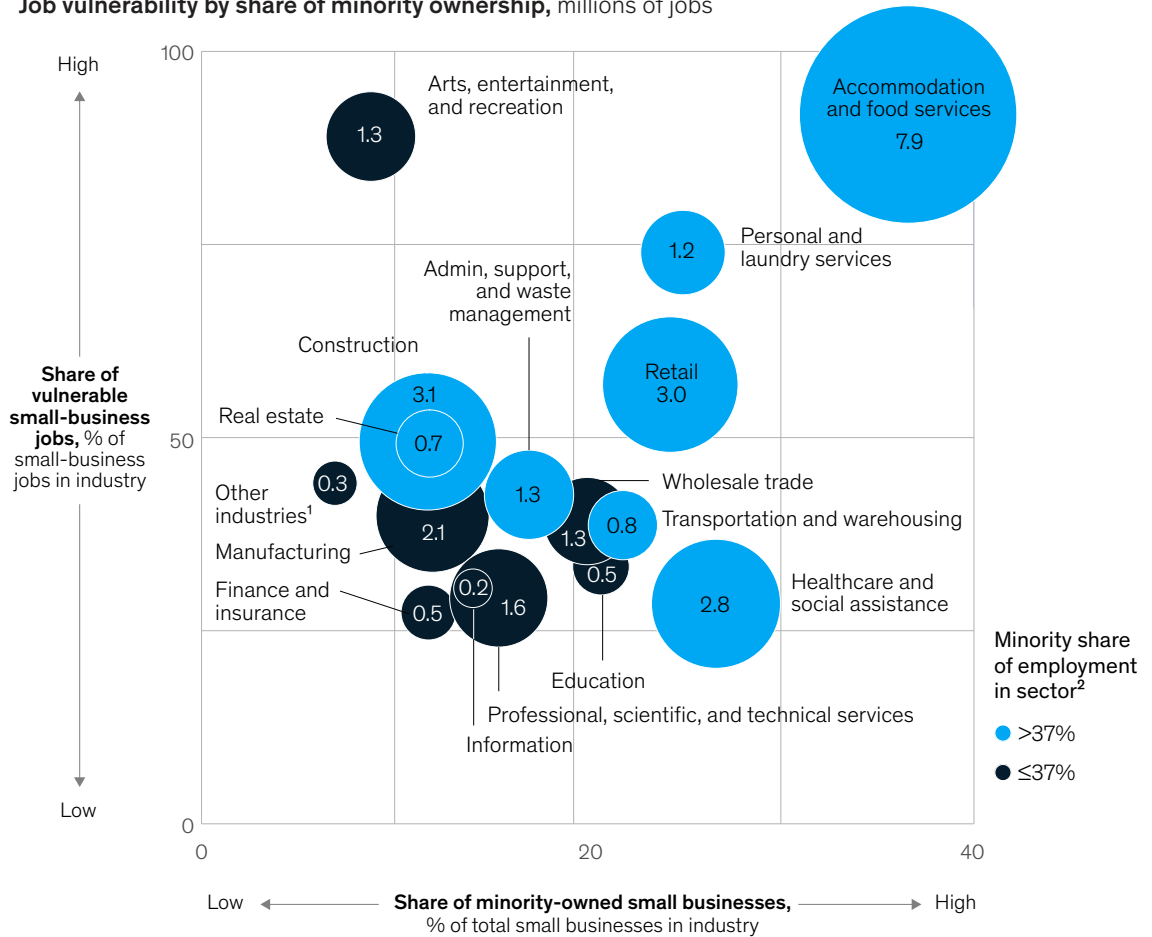
The immediate difficulties facing minority entrepreneurs and their businesses require rapid action from decision makers in the private, public,

⁸ US Bureau of Labor Statistics Household Survey.

Exhibit 4

The share of minority-owned businesses and minority employment is highest in the industries most directly affected by COVID-19.

Job vulnerability by share of minority ownership, millions of jobs



Note: Analysis includes only small businesses that have employees (employer companies); excludes self-employed (nonemployer companies).
¹Includes mining, quarrying, and oil and gas extraction; company and enterprise management; utilities; and agriculture, forestry, fishing, and hunting.
²37% cutoff based on minorities accounting for approximately 37% of the US labor force, as of February 2020.
 Source: Annual Survey of Entrepreneurs, 2016; McKinsey Global Institute analysis

and social sectors. Addressing their long-term needs and ensuring their longevity and success will require further effort and more fundamental shifts.

Providing immediate relief

The public sector has taken steps to support and provide relief to small businesses and their employees. However, the smallest businesses, particularly those with annual revenues less than

\$250,000, were significantly less likely to apply to the US Small Business Administration Paycheck Protection Program, according to our Small Business Pulse Survey. That may be because of lack of clarity around the programs themselves or changing guidance, as small-business advocates aver.⁹ Regardless, the lower application rate is likely to affect many minority-owned small businesses, which tend to be smaller than others, on average.

⁹"AICPA, NFIB, and others say SBA must issue more guidance on PPP loan forgiveness," Association of International Certified Professional Accountants, May 12, 2020, aicpa.org.

Short-term liquidity is paramount for all small businesses, but the challenges could be more acute for the most vulnerable ones. 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. Community-relief funds could provide short-term support to businesses with reduced revenues. Large companies could also offer emergency grants to support small businesses in crisis.

Reach is critical to ensure that the previously mentioned measures deliver impact. In some instances, public institutions may need to improve and tailor their delivery mechanisms so that they reach minority-owned businesses and address their specific needs. Similarly, all actors willing to help, including government agencies, not-for-profit organizations, and private-sector companies, may need to review their outreach programs and educational campaigns to increase awareness around the types of assistance they offer. They may also see opportunities to make their programs and services more user friendly and accessible.

Addressing near-term cash management and improving broader resiliency

Expanded access to funding could dramatically enhance the underlying health of minority-owned

small businesses, improve the odds that they reach scale, and strengthen their financial resilience. Here, the public sector could help by incentivizing lending and addressing banks' concerns about risk of lending to underserved small businesses. Community-development financial institutions could play a significant role, as they are deeply embedded in their local communities and may have a greater understanding than traditional financial institutions of the challenges that minority entrepreneurs face.

On the revenue side, a way to help with cash management would be to accelerate receivables from government or large corporate customers. Businesses that could afford to do so would provide significant relief to their suppliers by paying them early and reducing their cash-conversion cycle. Procurement commitments from government organizations and the private sector could also help level the playing field for minority-owned suppliers. Government agencies, for example, could build on programs such as the US Department of Commerce's Office of Small and Disadvantaged Business Utilization and the US Department of Transportation's Disadvantaged Business Enterprise programs to ensure that minority-owned small businesses are given an opportunity to compete for contracts.

Helping businesses adapt their models and operations could also deliver impact in the near term. In high-risk domains, including

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businesses and workplaces that require physical proximity, it will be necessary to adjust rapidly by redesigning contactless experiences and safer work environments. Access to technology is vital. Throughout the country, not-for-profit organizations and volunteers are helping small businesses in their communities get online, develop apps, and launch pick-up and delivery services. More broadly, technology companies could play a critical role by providing affordable or free access to digital tools and solutions to help the most vulnerable companies upgrade their technology and compete in the digital age.

Beyond supporting the near-term needs of minority-owned companies, decision makers in the private, public, and social sectors should treat the COVID-19 pandemic as an impetus to address the many structural challenges facing these businesses. Longer-term shifts could help ensure the lasting success of minority entrepreneurs and

their businesses. Further research is necessary to help develop a specific set of longer-term recommendations for creating better business ecosystems, increase access to funding, improve the availability of business and financial advice, and develop deeper peer networks for minority entrepreneurs.

The COVID-19 pandemic has exacerbated the many challenges of minority-owned small businesses. Resources are available for all small businesses, but up-to-date and granular data on those owned by minorities remain limited. Such data would help private-, public-, and social-sector actors better understand and address the challenges faced by minority entrepreneurs and their businesses. Doing so will not only improve the overall resilience and long-term prospects of the US economy, it will also help create a more equitable society.

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