

MANAGING ORGANIZATIONS IN A TIME OF CRISIS

Discrimination in Access to Credit During the Covid-19 Pandemic

Date: August 6, 2020

Authors: Rachel Atkins and Robert Seamans, Department of Management & Organizations,
NYU Stern School of Business

Key Takeaways: The U.S. federal government's Paycheck Protection Program (PPP) resulted in Type I and Type II errors. Type II errors, in which those eligible for loans did not get them, has been particularly challenging for black-owned businesses. These challenges should have been anticipated, given historical evidence on discrimination in access to credit. To remedy these issues, we suggest policy makers collect more data on loan applicants and recipients, and consider how program design may have differential impact on black and under-represented minority business owners.

Overview of Paycheck Protection Program Policy Response to Covid-19 Pandemic

Through the CARES Act, the U.S. federal government has created multiple policy interventions in response to the Covid-19 pandemic. These include increasing amounts and expanding eligibility for unemployment payments and loans to small businesses so they can keep employees on their payroll. The latter, known as the Paycheck Protection Program (PPP), is administered by the U.S. Small Business Administration (SBA). The program allocated \$349 billion in its initial round for loans to firms with 500 or fewer employees. The loans could be used for payroll, mortgage interest or rent, utilities, and other expenses and would be forgiven provided firms retain their employees or quickly rehire furloughed or previously laid-off workers. The SBA did not make loans directly but rather relied on third-party SBA lenders, a group of federally insured depository commercial banks and credit unions. Though loan recipients are not charged fees, SBA lenders can still charge fees associated with the loans which were paid by the federal government. Within days of opening PPP, funding had already run out. Congress acted by allocating an additional \$310 billion in funding for a second round of PPP loans.

During the initial implementation of these programs news media outlets began reporting that publicly held companies such as Shake Shack and large non-profits such as Harvard University were able to access PPP funding (Sobey, 2020). After administration officials made it clear that these were not the types of organizations they had in mind when writing the regulations for the PPP loan program, several of these entities returned the funds even though they were technically eligible to receive them. While there are perhaps some companies that received loans that should not have (Jeschke, 2020), speed was of the essence – it was important to get these loans out and so making such “Type I errors” was understandable.

Other issues with these loan programs occurred when businesses that should have received them didn't – so called “Type II errors.” Media outlets have highlighted the difficulties small business owners faced when attempting to access the funds (Trevizo, 2020). Reports speculate that since lenders were able to extract more in fees from larger businesses more quickly, they were dis-

incentivized from granting loans requested by smaller businesses (Egan, 2020). In addition, many small businesses do not use SBA lenders. As noted by Acharya and Gopal (2020) many small businesses instead rely on smaller banks and even fin-tech lenders for financing.

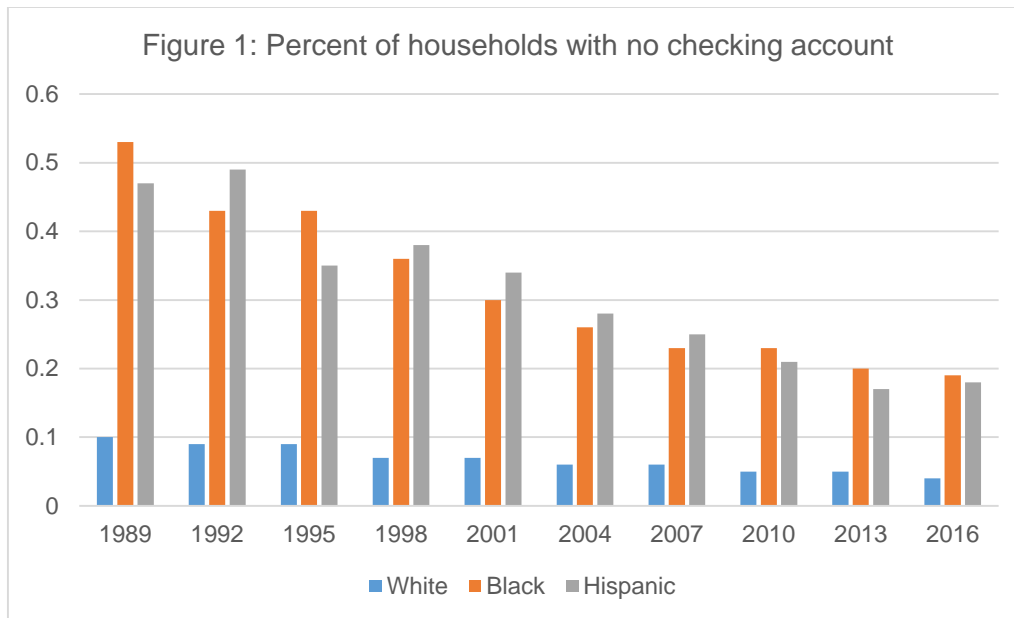
Data from the Census Small Business Pulse Survey (SBPS) highlight the difficulties many small businesses faced when trying to access PPP Loans. While 75% of small businesses applied for PPP loans only 38% received them (Buffington et al, 2020). Furthermore, since the PPP was designed as a “first-come-first-served program” (Granja et al, 2020) small businesses were at a disadvantage given their lag time in knowledge about the program’s eligibility requirements and benefits. Preliminary survey evidence reveals that smaller firms had less access to information about PPP and other programs when compared with large firms, and that this information gap did not close quickly enough over time (Humphries, Neilson, and Ulyssea, 2020).

Unique Challenges for Black-owned Businesses

Minority business owners have faced unique challenges when attempting to access PPP loans (Flitter, 2020; Hunter & Hunter, 2020; Kuryandchick, 2020). While the SBPS does not collect data on firm characteristics that would allow us to identify more vulnerable populations of business owners, a recent study finds evidence that black business owners had an even more difficult time accessing these funds than their white counterparts. The National Community Reinvestment Coalition, in collaboration with researchers from Utah State, Brigham Young, and Rutgers Universities, conducted an audit study of financial institutions in Washington DC (Lederer et al, 2020). Between April 27 and May 29, 2020, they sent 63 matched pairs of black and white testers to 32 bank branches and assessed whether the testers received equal treatment from bank representatives. Black testers were more likely to be discouraged from applying for a loan or were more likely to be steered towards a home equity line of credit product rather than SBA loan products made available by the Cares Act.

This outcome was not unpredictable. Black individuals and black-owned businesses have historically been underbanked. Historically, black households are less likely to have a bank account as compared with white households and black business owners are less likely to be approved for loans from commercial lending institutions (FDIC, 2018; Bates & Robb, 2013; Bates & Robb, 2014; Blanchflower, Levine & Zimmerman, 2003; Cavalluzzo & Wolken 2005; Rob & Robinson, 2018). Figure 1 below depicts the percent of unbanked households by race/ethnicity and year. The percent of unbanked black and Hispanic households has decreased over time, but still greatly outpaces the percent of unbanked white households.

Instead, black owned firms more often rely on community development financial institutions for business loans and many of these organizations did not have access to the SBA system when the PPP loan program was initially implemented. Furthermore, many minority neighborhoods lack access to bank branches. Several studies find negative correlations between the proportion of minority residences and the probability of a commercial bank branch being located there (Wheatly, 2010; Cover, 2011; Hegerty, 2016; Hegerty, 2020). As Rachel Atkins, Provost’s Postdoctoral Fellow at Stern, recently said in an article for Mother Jones “we’re now witnessing the layering effect of these decisions in the midst of a crisis” (Voght, 2020).



Source: Survey of Consumer Finances

Historical Evidence

Chatterji and Seamans (2012) study the effect of the 1977 U.S. Supreme Court's Marquette decision which deregulated credit cards. They find that credit cards had a positive effect on entrepreneurship, particularly black entrepreneurship. They surmise the strong effect for black entrepreneurs is because black entrepreneurs had a harder time accessing capital from traditional sources such as banks, where they faced discrimination in lending. Indeed, Chatterji and Seamans find that the effect on black entrepreneurship was even larger in areas with higher levels of discrimination, providing suggestive evidence in favor of this explanation.

While Chatterji and Seamans provide a historical example of discrimination, there is evidence that discrimination persists. Aside from credit cards, many entrepreneurs utilize equity in their homes as collateral for bank loans to help finance their new ventures. Atkins (2020) examines differences in access to this housing collateral channel between black and white households. By examining the period between 2003 and 2014, Atkins exploits exogenous variation in home equity from the housing bubble and subsequent financial crisis to estimate the relationship between home equity and the probability of starting a business. Conditional on owning a home, an increase in home equity increased the likelihood of a household starting a business. On average, the probability of starting a firm for whites across the study period was 1.69 percent. A 10 percent increase in home equity would increase that probability by 0.05 percentage points to 1.74 percent (or a 3 percent increase in probability). By contrast there is no evidence that an increase in home equity increases the likelihood of starting a business for blacks.

This outcome may reflect differences in the ability of blacks and whites to utilize their home equity as collateral for commercial loans. This conclusion is supported by further analysis of the ways in which changes to state level homestead exemptions altered the effect of home equity on starting a business for white as compared with black households. In states with below median increases in the exemption, the impact of home equity on business starts decreased while the relationship remained steady in states with zero or above median changes. This evidence is consistent with the existence of a housing collateral channel (Cerqueiro and Penas, 2016; Cerqueiro, Penas, and Seamans, 2019). However, this phenomenon only materialized for whites.

Implications for Managers and Policy Makers

This brief highlights the need to better understand and evaluate institutional barriers that prevent similarly resourced blacks and whites from experiencing the same economic outcomes. It also reveals that governments and organizations can create seemingly race neutral policies (some of which are explicitly intended to aid disadvantaged minorities) that ultimately disproportionately aid white individuals or white owned entities. In doing so they exacerbate existing racial inequality.

This is particularly salient with respect to racial differences in acquiring access to debt financing. Lack of data on commercial lending to small businesses which include the race of the applicant has hindered our ability to measure the impact of these institutional barriers. Section 1071 of the Dodd-Frank legislation requires financial institutions to collect data on small business lending to women and minority owned small businesses. Though this bill was signed into law in July of 2010 the Consumer Finance Protection Bureau has yet to issue rules necessary to implement this data collection process. Were the reporting requirements of section 1071 in place prior to the economic crisis brought about by Covid-19, there may have been a mechanism in place to track whether the PPP program was adequately serving black-owned and other disadvantaged businesses. Instead, most of the data collected on PPP loan recipients as reported by SBA are missing information on the race of the loan recipient and there is no available data on loan applicants. Thus, there is a need for better data collection, a point also made by Acharya and Gopal (2020).

Policy makers must also consider how program design may exacerbate existing racial disparities as well. For example, a disproportionate number of black owned firms do not have employees and thus were ineligible for PPP loans. Nevertheless, these firms still must pay rent and other utilities in order to stay in business. Even among employer firms, black-owned businesses are less likely to have established borrowing relationships with existing SBA lender firms and thus were less likely to be approved for these loans in part due to the PPP loan program's design. When government programs and policies are designed in ways that make black-owned businesses less eligible, they exacerbate racial disparities in the likelihood of surviving during the crisis that the program was designed to help businesses weather. Rather than black or other disadvantaged businesses being at a higher risk of closing during the Covid-19 crisis solely due to pre-existing deficits in resources or endowments, poorly designed government policies and policies established by private entities such as commercial banks may disproportionately assist white-owned firms and inadvertently contribute to racial differences in the likelihood of survival.

Finally, this brief uncovers an opportunity for further research by management scholars. There is a plethora of organizational behavior research on the kinds of unconscious biases (Chugh, 2005) that help us understand why bank representatives, like the ones in the audit study described above, may treat black and white loan applicants differently. However, more research from organizational theorists and strategy scholars will deepen our understanding of how racial inequalities are produced and reproduced. For example, organizational theory research may shed light on how organizational decision making, organizational structure, or social networks contribute to the differential ways in which banks or other lending institutions interact with minority owned as compared with white owned businesses. Likewise, research from the strategy field may expand how we think about the distribution of market power and material or knowledge resources as well as the role that institutions play in explaining why racial disparities in outcomes among firms and business owners have persisted over time.

Managing Organizations in a Time of Crisis is a series of research briefs produced by the [Department of Management & Organizations](#) at NYU Stern School of Business.

References

- Acharya, V., & Gopal, M. (2020). Targeting the Paycheck Protection Program to those Most in Need. Available: http://pages.stern.nyu.edu/~sternfin/vacharya/public_html/pdfs/PPP_Comments_Acharya_Gopal_032920_FINAL.pdf?_ga=2.22760123.1049699795.1596719825-252442471.1546878423
- Atkins. R.M.B, (2020). Homeownership, home equity, and black-owned business starts: examining the impact of racial disparities in housing assets on firm creation.
- Bates, T., & Robb, A. (2013). Greater access to capital is needed to unleash the local economic development potential of minority-owned businesses. *Economic Development Quarterly*, 27(3), 250-259.
- Bates, T., & Robb, A. (2015). Has the Community Reinvestment Act increased loan availability among small businesses operating in minority neighbourhoods? *Urban Studies*, 52(9), 1702-1721.
- Blanchflower, D. G., Levine, P. B., & Zimmerman, D. J. (2003). Discrimination in the small-business credit market. *Review of Economics and Statistics*, 85(4), 930-943.
- Buffington, C., Dennis, C., Dinlersoz, E., Foster, L., & Klimek, S. (2020). Measuring the Effect of COVID-19 on US Small Businesses: *The Small Business Pulse Survey* (No. 20-16).
- Cerqueiro, G., & Penas, M. F. (2016). How does personal bankruptcy law affect startups? *The Review of Financial Studies*, 30(7), 2523-2554.
- Cerqueiro, G., Penas, M. F., & Seamans, R. 2019. Debtor Protection and Business Dynamism. *Journal of Law and Economics*, 62 (3): 521-549.
- Cororaton, A., & Rosen, S. (2020). Public firm borrowers of the US Paycheck Protection Program. Available at SSRN 3590913.
- Chatterji, A. K., & Seamans, R. C. (2012). Entrepreneurial finance, credit cards, and race. *Journal of Financial Economics*, 106(1), 182-195.
- Chugh, D. (2004). Societal and managerial implications of implicit social cognition: Why milliseconds matter. *Social Justice Research*, 17(2), 203-222.
- Cover, J., Fuhrman Spring, A., & Garshick Kleit, R. (2011). Minorities on the margins? The spatial organization of fringe banking services. *Journal of Urban Affairs*, 33(3), 317-344.
- FDIC. (2011). FDIC National Survey of Unbanked and Underbanked Households. *Federal Deposit Insurance Corporation*. <https://www.fdic.gov/householdsurvey/2017/2017report.pdf>
- Egan, M. (2020) Big banks accused of favoring more lucrative small business loans in coronavirus program. *CNN.com* April 21, 2020 <https://www.cnn.com/2020/04/21/business/small-business-loans-ppp-lawsuit/index.html>
- Flitter, E. (2020) Black Business Owners Had a Harder Time Getting Federal Aid, a Study Finds. *New York Times*. July 15, 2020. <https://www.nytimes.com/2020/07/15/business/paycheck-protection-program-bias.html>

Granja, J., Makridis, C., Yannelis, C., & Zwick, E. (2020). Did the Paycheck Protection Program Hit the Target? (No. w27095). *National Bureau of Economic Research*.

Hegerty, S. W. (2016). Commercial bank locations and “banking deserts”: A statistical analysis of Milwaukee and Buffalo. *The Annals of Regional Science*, 56(1), 253-271.

Hegerty, S. W. (2020). “Banking Deserts,” Bank Branch Losses, and Neighborhood Socioeconomic Characteristics in the City of Chicago: A Spatial and Statistical Analysis. *The Professional Geographer*, 72(2), 194-205.

Humphries, J. E., Neilson, C., & Ulyseas, G. (2020). The evolving impacts of COVID-19 on small businesses since the CARES Act.

Hunter, J. & Hunter, M.A. (2020). “Few Black – owned businesses get PPP loans”. *Salemnews.com* July 16, 2020 https://www.salemnews.com/news/local_news/few-black-owned-businesses-get-ppp-loans/article_764ff682-9ce9-529f-a94a-9a38ecdda75d.html

Jeschke, M.M. (2020). Ineligible PPP Borrowers Granted Safe Harbor Period to Return Money by May 7. *Holland & Knight*, April 24, 2020 <https://www.hklaw.com/en/insights/publications/2020/04/not-yours-to-keep-ineligible-ppp-borrowers-granted-safe-harbor-period>

Kurlyandchik, M. (2020) 785 Michigan restaurants got \$150K or more in federal loans. Only 1 listed as Black-owned. *Detroit Free Press*, July 16, 2020 <https://www.freep.com/story/entertainment/dining/mark-kurlyandchik/2020/07/16/michigan-restaurants-payroll-protection-program-loans/5391257002/>

Robb, A., & Robinson, D. T. (2018). Testing for racial bias in business credit scores. *Small Business Economics*, 50(3), 429-443.

Sobey, R. (2020). Harvard under fire for accepting more than \$8M in coronavirus relief package. *Boston Herald*, April 20, 2020. <https://www.bostonherald.com/2020/04/20/harvard-under-fire-for-accepting-more-than-8m-in-coronavirus-relief-package/>

Wheatley, W. P. (2010). Economic and regional determinants of the location of payday lenders and banking institutions in Mississippi: Reconsidering the role of race and other factors in firm location. *Review of Regional Studies*, 40(1), 53-69.

Voght, Kara. (2020). “You’re Just Screwed”: Why Black-Owned Businesses Are Struggling to Get Coronavirus Relief Loans. *Mother Jones*, April 24, 2020 <https://www.motherjones.com/politics/2020/04/youre-just-screwed-why-black-owned-businesses-are-struggling-to-get-coronavirus-relief-loans/>