SME Economic Opportunity in the Face of Inflation:

Access to Capital

By Paul Disselkoen, Senior Associate, PayPal Public Affairs & Strategic Research

The previous essay in this series explored how SMEs can build resilience in the face of inflationary pressures by adopting an Omnichannel strategy. This essay will explore a key component of the solution that can help SMEs in building resiliency and strength as our economy continues to struggle with inflation, supply chain issues, and global crises: access to capital.

Financing is a key driver of growth and success for small businesses, even under normal economic conditions. Access to capital is consistently listed as a top priority for small businesses and those that can meet their financing needs often experience stronger growth and are better suited to weather unexpected expenses or economic downturns.[i] While financing remains a key priority for small business owners, however it also consistently remains a challenge; a challenge that has been exacerbated by the pandemic, and by inflation.[ii] A recent survey from the National Federation of Independent Businesses found that 62% of small business owners state that inflation will substantially impact their business.[iii]

Unfortunately, economic challenges do not affect all small businesses equally. Minority and women-owned small businesses, traditionally underserved by the financial services industry, are more likely to be adversely impacted by economic downturns. We saw this in the early days of the pandemic when 42% of Black-owned SMBs were closing, twice the rate as their White-owned counterparts.[iv] This can be partially explained by the financial health of the business leading into those challenging times. Going into the crisis, Black and Hispanic-owned businesses had no more than two weeks of cash buffer. Over half (58%) of Black-owned small businesses were classified as "at risk or distressed" before the pandemic, compared to 27% of White-owned businesses.[vi]

Now as we face new economic hardships, researchers find that minority households experience inflation more acutely, making capital access for these communities even more urgent.[vii]

Minority businesses traditionally face barriers to access capital, as compared to their white-owned counterparts.[viii] In a recent survey, nearly half of black-owned SMBs that applied for financing in the last 12 months reported receiving no funding, compared to just 28% of white- owned SMBs.[ix] This, in turn, discourages minority-owned SMBs from even applying. The Fed's recent survey found that, of those that did not apply for financing, 44% felt that they would not qualify or be denied.[x]

Despite the current economic conditions, the demand for capital remains strong. A survey from Hello Alice found 62% of SMBs will seek out financing in 2022 and 84% of those businesses are looking to expand and grow.[xi] The Federal Reserve noted at its August,2022 meeting that it is already beginning to see a decline in capital deployment at some of the biggest banks.[xii] As capital markets naturally contract as a result of difficult economic conditions, looking towards alternative financing channels will be important to fill the gap.

Responsible FinTechs, like PayPal, can have a substantive impact on facilitating lending into underserved communities. **Research** on the PayPal Working Capital product has shown that the loans are typically smaller in nature than loans provided by traditional banks. 70% of PPWC loans went to the 10% of counties that have lost 10 or more bank branches since 2008. Additionally, PPWC loans go to At-Risk or Distressed communities at nearly twice the rate as traditional SMB loans.

It is critical for the public and private sectors to partner on enabling that access to vital funding to help these firms persist during this time of heightened inflation.

We saw in the early days of the pandemic how the Small Business Administration's Paycheck Protection Program (PPP) played a critical role in mitigating the negative effects on small businesses. It was also an excellent example of how the public and private sector can work together to expand funding to underserved communities. As one of the first non-bank participants to be approved, PayPal was able to help facilitate PPP loans to thousands of small businesses, averaging just $26,000 in loan amount, well below the national average. These loans also went to underserved communities such as counties with higher rate of black business activity and areas where many bank branches have closed in the last 10 years.

Building upon success of COVID programs would help to facilitate more capital into traditionally underserved communities. A modernization of the existing programs within the SBA, both in terms of infrastructure and underlying requirements, could make them more accessible to small businesses. It is also essential to consider allowing new entities to participate in these programs. Furthermore, Senators Tim Scott (SC) and John Hickenlooper (CO) recently released a bi-partisan proposal to expand access to the SBA 7(a) lending program. Organizations like the Bipartisan Policy Center have also been engaged in thoughtful deliberation on expanding capital access through a working group with private sector. It is these important bipartisan conversations that can modernize legacy programs and reach more borrowers.

Another critical resource of capital are Community Financial Development Institutions (CDFIs) and Minority Depository Institutions (MDIs). Those institutions have historically been most effective at reaching into their communities to serve businesses that need financing the most. However, these institutions also face their own challenges. Despite an influx of funding following corporate commitments in the summer of 2020, CDFIs and MDIs need technological modernization, additional capacity, and more targeted investments.

Channeling financial investments into these institutions is important, but the public and private sectors must also work together on technical assistance and capacity building. Additionally, finding new ways to work together beyond just funding, could be a way to get more capital flowing into at-need communities. Piloting new funding facilities that integrate FinTech data/technology and a CDFI/MDI's network, could, for example, provide innovative models for further partnership.

As small businesses continue to deal with the economic headwinds of inflation, we have to be intentional about the ways we support their resilience and success. Access to capital is one of the most important factors in accomplishing this.

It requires a whole of ecosystem approach and innovative thinking will be needed to ensure that no entrepreneurs are left behind.

References

i https://www.federalreserve.gov/publications/2019-november-consumer-community-context.htm

ii https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/sbcs-report-on-firms-owned-by-people-of-color

iii https://www.nfib.com/content/analysis/economy/highest-in-40-years-inflation-becomes-top-problem-facing-small-business/

iv https://www.newyorkfed.org/medialibrary/media/smallbusiness/DoubleJeopardy_COVID19andBlackOwnedBusinesses

v https://www.jpmorganchase.com/institute/research/small-business/report-small-business-owner-race-liquidity-survival

vi https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2020/DoubleJeopardy_COVID19andBlackOwnedBusinesses

vii https://www.businessinsider.com/inflation-hurts-black-latino-hispanic-people-of-color-rural-households-2021-11

viii https://www.federalreserve.gov/publications/2019-november-consumer-community-context.htm

ix https://helloalice.com/blog/capital-access-small-businesses-2022-report/

x https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/2022-sbcs-employer-firms-report

xi https://helloalice.com/blog/capital-access-small-businesses-2022-report/

xii https://www.federalreserve.gov/monetarypolicy/fomcminutes20220727.htm

PayPal