PENN WHARTON
UNIVERSITY of PENNSYLVANIA
Budget Model

Small Business and Coronavirus Relief

Summary: In an attempt to prevent and reverse layoffs due to coronavirus, the recently-passed CARES Act established a new lending program targeted at businesses with 500 or fewer employees. These businesses account for 99.7 percent of all firms, 47.3 percent of employment, 40.7 percent of annual payroll, and about one-third of the growth in employment and wages. These businesses also account for 60 percent of employment in the leisure and hospitality sector, which has been disproportionately harmed by the pandemic's effects.

Introduction

The recently-passed Coronavirus Aid, Relief, and Economic Security (CARES) Act established a new $349 billion short-term lending program run by the U.S. Small Business Administration (SBA). Conventional wisdom is that small businesses are the "backbone of the economy," and many small businesses are likely credit-constrained currently. The new coronavirus response program, therefore, is an effort to keep workers employed and small businesses ready to resume activity post-pandemic. This post explores the characteristics of small businesses, their role in employment, and the characteristics of their owners.

Small Businesses and Employment

The new SBA lending program will be available to any business with 500 or fewer employees as well as any business that meets the SBA small business size standards, which vary by industry.[1] Employers with fewer than 100 employees also have expanded eligibility for the CARES Act employee retention credit.[2] Government programs and contracting use the SBA standards to define small businesses, while the research literature on measuring small business activity generally defines a small business as having 500 or fewer employees.

Small businesses represent a declining share of the economy and account for less than half of employment and annual wages paid in terms of both levels and growth. Separate analysis by the Bureau of Economic Analysis (BEA) and the U.S. Treasury Department Office of Tax Analysis (OTA) shed some light on these characteristics of small businesses and their owners.

Table 1 reports the total number of firms, number of employees, and total annual payroll for 2016, along with shares of each variable by firm size. Data comes from BEA, based on the Census Statistics of U.S. Businesses (SUSB) dataset. While 99.7 percent of businesses had fewer than 500 employees, these firms accounted for just 47.3 percent of employment and 40.7 percent of annual payroll. Of these firms, 61.8 percent had 4 or fewer employees (61.6 percent of all firms).

Table 1. Characteristics by Firm Size, 2016

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Number of Employees	Number of Firms	Employment	Annual payroll ($1,000)
500 or more	0.3%	52.7%	59.3%
Fewer than 500	99.7%	47.3%	40.7%
100-499	*1.5%*	*14.0%*	*13.5%*
20-99	*9.0%*	*16.6%*	*14.0%*
5-19	*27.6%*	*11.9%*	*9.0%*
0-4	*61.6%*	*4.7%*	*4.2%*
Total	**5,954,684**	**126,752,238**	**6,435,142,055**

Source: U.S. Census Bureau, Statistics of U.S. Businesses 2016

Table 2 shows that wages among all firms rose by 4.3 percent and employment increased by 2.1 percent between 2012 and 2016. BEA finds that businesses with fewer than 500 employees accounted for 1.5 percentage points of the growth in wages and 0.7 percentage points of the growth in employment, or about one-third of each increase.

Table 2. Average Annual Growth in Wages and Employment by Size Category, 2012-2016

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Firm Size (Number of Employees)	Wages		Employment	
	Percent Change	Contribution to Percent Change	Percent Change	Contribution to Percent Change
Total	**4.3**	**4.3**	**2.1**	**2.1**
500 or more	4.8	2.7	2.6	1.3
100-499	4.5	0.6	2.2	0.3
50-99	3.4	0.2	1.8	0.1
20-49	3.6	0.3	2.3	0.2
0-19	3.0	0.4	0.7	0.1

Reproduced from BEA WP2020-4, "Measuring the Small Business Economy"

Importantly, in 2016, firms with fewer than 500 employees represented 60 percent of leisure and hospitality sector employment, which includes businesses such as food services, arts, and entertainment. These businesses and their workers have been disproportionately harmed by the economic effects of coronavirus. BEA also reports that 38 percent of total employment by firms with fewer than 500 employees is in the health care and social assistance industry (14.8 percent), accommodations and food services (13.4 percent), and other services (9.9 percent).

The OTA takes a slightly different approach, examining tax returns in order to identify businesses and small businesses. Because this data does not include the number of employees per firm, OTA defines a small business as one with total income of $10 million or less and total deductions of $10 million or less. Under this definition, about 55 percent of all filers and 99 percent of businesses qualified as a small business in tax year 2014, accounting for about 17 percent of both gross receipts and net income reported by businesses. Overall, small businesses reported 40 percent of total business losses and 23 percent of total business profits in tax year 2014. OTA classifies 20 percent of these small businesses as "employers," based on their having wage and salary expenses that exceeded $5,000 in tax year 2014.

One important caveat is that OTA's definition of small business includes *some* self-employed individuals but excludes others. OTA notes that self-employed individuals make up most of the smallest businesses. While some of these individuals may not qualify for the new SBA lending program, as self-employed workers they would receive the CARES Act expansion of unemployment insurance. Additionally, some of the individuals that OTA does not count as small businesses may qualify for the CARES Act small business lending program.

Owners of Small Businesses

In addition to identifying small business filers, OTA linked these filings to individual filers' returns in order to identify owners. For tax year 2014, OTA finds that 14 percent of individual returns with income from a small business (as defined above) report an adjusted gross income (AGI) over $200,000, compared to 4 percent of all tax filers. These high-income small business owners accounted for 61 percent of total small business income. About one-third of small business owners have an AGI above $100,000 in tax year 2014, compared to 13 percent of all tax filers.

At the same time, the OTA analysis shows that 5 percent of small business owners reported net losses in tax year 2014, while another 41 percent had AGIs of between $0 and $50,000. Of owners whose small business income represented at least a quarter of their total AGI, 6 percent reported net losses and 55 percent had AGIs of between $0 and $50,000.

To conclude, small businesses make up almost all of the total business count. But by definition they are small —the majority have four or fewer employees and overall small firms account for less than half of all jobs. Providing special relief to small businesses thus is not a comprehensive solution to preserving employment or employer-worker relationships in the economy as a whole. The assistance will certainly improve cash flow, however, helping the many small businesses with thin profit margins and in affected industries to stay afloat while their operations are suspended.

This post was written by Kody Carmody under the supervision of Richard Prisinzano.

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1. For most industries, these standards define a small business as having up to $8 million in average annual revenue or up to 500 employees; for some industries, however, small businesses may have up to

1500 employees or $600 million in average annual income. ↩

2. Specifically, employers with fewer than 100 employees can receive the credit when they experience a significant decline in gross receipts, while those with more than 100 employees can only receive the credit for times when their business is suspended. ↩