MEMORANDUM

FROM: Brent Beshore, Founder and CEO of Permanent Equity
RE: The Economic Impact of Covid-19: Issues Facing Small Businesses
DATE: March 19, 2020

We are in the midst of a public health crisis that is causing massive economic disruption. While corporate consequences may be seen in the stock exchanges, the small businesses (less than 500 employees) that employ 59 million Americans are suffering. Demand is collapsing, production is nearing a standstill, and the credit needed to survive is in dwindling supply. Without immediate intervention, this suffering could manifest itself in record levels of unemployment, untenable levels of default in the credit markets, abandoned commercial real estate, and a resulting market of extreme concentration and limited products and services.

America's small businesses entrepreneurs are uniquely ill-equipped to survive this public health crisis without support, due not to unwise risk-taking, but to features that are unique to the structure of a smaller enterprise.

1. For many small business owners, the finances of their business are co-mingled with their personal finances. A business loss is a direct personal loss -- there is only so much financial pain and loss an owner can endure before the only fiscally responsible decision for themselves and their families is to fold the business.
2. Unlike large businesses, hiring employees is an uphill battle for small business owners. They do not have the recruiting budget nor the name recognition to compete with larger firms for the same talent post-crisis. Laying people off, or materially reducing compensation or hours is often not a short-term solution, but rather, a significant blow to their long-term ability to survive.
3. Small businesses do not have access to sophisticated financial resources, support, or guidance. A small business will typically have one person, or a handful of people, responsible for all accounting, finance, and taxation.
4. Most small businesses are the "small fish" when it comes to their business relationships. They do not have the leverage necessary to dictate outcomes to their vendors, suppliers, creditors, and lenders, and this inequality is only exacerbated by this economic disruption. Any delay or stoppage in payment or performance can mean the end of a partnership that, in many cases, took years to develop, nurture, and grow.
5. Small businesses typically do not have extensive reserves. Current revenues matter a great deal to their survival as do current expenses.

In recognition of those facts, and to combat what we expect to be a demand and liquidity crisis, our recommendations are to temporarily backstop payroll, temporarily suspend the payroll tax, and temporarily provide a large amount of working capital liquidity available in the form of a low-interest, long-duration loan or an asset swap program. Specifically here are our recommendations:

1. Government co-pays 80% of small business payroll expense for salaries up to $100,000/year for the next three months. Qualifying employees must have been on payroll as of March 1st and must be back on payroll by April 15th. This gives employers who have already done layoffs the ability to hire back immediately and provides the businesses with the people they need to survive this crisis.

2. Temporarily suspend the payroll tax on small businesses on the first $100,000 of annualized income, giving both owners and employees more take-home pay and liquidity.

3. Create a “Small Business Bond” program which will provide temporary financial security and a long payback period. Specifically, this would permit any lender who originates conforming credit to qualifying small businesses to receive a government guarantee of 98% of the principal, provided the following structure is met:
    a. 10-year loan term or longer
    b. No principal or interest payments for the first year
    c. 3% or less interest
    d. Personally guaranteed by the borrower
    e. $5M maximum per borrower

4. Create or give banks wider latitude to create temporary loans with inventory or accounts receivable as collateral, giving owners the liquidity needed to make payroll and cover other expenses. Alternatively, create a swap or factoring program that allows companies to sell inventory or accounts receivable to the government at a discount.

With regards to these last two recommendations, speed is important, so the traditional SBA process isn’t viable. Government should widen qualifying lenders and could encourage the effort through a small, standard loan origination fee shared by the government and borrower.

This package of relief would keep payrolls intact, but not free, incentivizing owners to rightsize their businesses for anticipated medium-term demand and not for the temporary drop in revenues. It would provide increased take-home pay with reduced taxation and provide a meaningful mechanism for long-term, low-interest debt available to the owner to meet their short-term obligations, as well as expand the business post-crisis. Additionally, it would give small businesses and their employees time to innovate and adapt to the new reality, which they will.