The Paycheck Protection Program: How it Simultaneously Succeeded and Failed

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Abstract

As COVID-19 forced small businesses to temporarily close, owners yearned for financial assistance. Congress responded with The Coronavirus Aid, Relief, and Economic Security (CARES) Act, which included $659 billion of financial aid targeted at retaining small business employees (CARES Act – S. 3548, 2020). Although successful, problems began to emerge as the act's Paycheck Protection Program (PPP) was operationalized. This analysis examines banks' (which include other financial agents who administered PPP funds) and small business owners' confusion regarding PPP, and how profitable and preferred businesses acquired funds while struggling businesses lacked assistance. Recommendations are provided for executing the current PPP program and its emerging problems.

Keywords: paycheck protection program, CARES act, small business

As COVID-19 began to spread in 2020, states enforced different levels of temporary lockdowns. This meant a number of businesses, including small local businesses, were forced to close their doors or reduce their operational capacity. Given the plunging economy and employment crisis, federal policy makers were abruptly faced with how to provide support to small business owners and ameliorate a foundering economy without adequate time to create and evaluate intervening policies and procedures. In order to reduce the impact that the pandemic had on small businesses, Congress passed The Coronavirus Aid, Relief, and Economic Security (CARES) Act, which included an initial total of $349 billion in relief funds, but was later expanded to $669 billion (Humphrier et al., 2020). Ultimately financial institutions were provided funds, made available through the Paycheck Protection Program (PPP); these funds were designed to mitigate the falling economy by minimizing the number of employees in the United States who were losing their jobs and reducing the number of small business owners whose businesses would close.

This analysis will provide an overview of PPP and its efforts to provide economic support to small businesses, discuss the positive and negative outcomes of the program, consider the program's success and failure, and provide recommendations, direction, and future research ideas. An examination of how the program was administered to financial institutions will be reviewed including the operational and application issues related to a quick incremental implementation. For this analysis banks and financial institutions include all federally insured depository institutions, credit unions, and credit systems eligible to participate with PPP. As with any practice, a post-implementation review process is helpful to determine a program's success and how to proceed with any future iterations.

This analysis is relevant for financial practitioners and academicians, as it (a) critically examines current conditions impacting banks and small business owners, (b) allows financial academicians to evaluate a relevant and existing business problem, and (c) provides a comprehensive analysis of PPP legislation impacting small business owners. This article contributes to the existing body of knowledge related to PPP implementation by applying a critical post-analysis to a timely and relevant topic in both banking and small business management.

Over 31 million small businesses operate in the U.S. and employ 47.1% of the U.S. workforce (Office of Advocacy SBA, 2020). In order to qualify for relief funds through the PPP, small businesses generally had to have less than 500 employees, certify that the funds would be used for specific purposes (payroll expenses, interest payments, rent, and utilities), and confirm that the PPP loan was essential in order to maintain daily operations despite uncertainty caused by Covid-19 (Gradisher & Tassell-Getman, 2020). In order to disburse funds efficiently, Congress initially decided that Small Business Administration (SBA) lenders, which include federally insured depository institutions, credit unions, or farm credit system institutions, would be the vehicles for receiving applications and expending funds; PPP lenders were gradually expanded to include other non-bank lenders (Li & Strahan, 2020). Businesses were able to borrow "the lesser of $10 million or an amount equal to 2.5 times the 'average monthly payroll costs'" (Gradisher & Tassell-Getman, 2020, p. 73), with restrictions related to the maximum payroll costs per person.

Businesses also had the opportunity to apply for loan forgiveness if they fulfilled certain criteria set forth by the SBA (Paycheck Protection Program Loans, 2021). The SBA requisites required that businesses maintain employee and compensation levels, and that at least 60% of funds received would be allocated for payroll costs and other eligible employee expenses (SBA PPP Loan Forgiveness, n.d., para 1).

While PPP provided significant relief for businesses, the forgiveness requirements when the PPP was initially implemented caused confusion among business borrowers and financial lenders (Li & Strahan, 2021). This confusion affected small businesses disproportionately as it favored established, profitable, and connected businesses over less sophisticated and financially weaker companies with less resources available to acquire information (Humphries et al., 2020; Hayashi et al., 2020). A review of PPP successes and challenges will follow.

Paycheck Protection Program Success

The $669 billion that was allocated to the PPP to provide economic relief to small businesses was substantial. One reason that the banking system was chosen as the distribution method for PPP loans was because most small businesses already had relationships with banks (Granja et al., 2020). The effects of this decision likely included the strengthening of pre-existing relationships and the formation of new connections for small businesses who were lacking in financial support.

Being able to distribute this money to small businesses throughout the United States undoubtedly had a positive impact on employee retention and consumer spending. Hubbard and Strain (2020) noted that the "PPP has substantially increased the employment, financial health, and survival of small businesses" (p. 1). Many families relied on income from small businesses to survive, either as owners or employees, which the PPP was able to partially replace.

In addition to helping local small business owners to remain in business, PPP funding allowed organizations to continue paying employees despite a reduction in operations, production, and services provided. Furthermore, PPP allowed for the continuance of benefits such as health insurance, which was included in eligible payroll costs (Granja et al., 2020). PPP may have also positively impacted unemployment rates, by keeping employees on the payroll, thus decreasing unemployment costs and encouraging local spending; however, despite the program, unemployment claims still increased sharply during the pandemic (Hubbard & Strain, 2020). Even with all of these successes, PPP failed to reach many of its goals.

Paycheck Protection Program Failure

Risk for banks and other financial intermediaries was mitigated as PPP loans were guaranteed by the government with consistent terms for all businesses (Hubbard & Strain, 2020). However, the speed of PPP rollout, intense small business interest, economic uncertainty during the COVID-19 pandemic, and the large allocation of funding were among some of the reasons for increased program confusion. Despite its great value and intention, PPP revealed many identifiable program issues. As will be discussed within this section, initial PPP policies were confusing, rushed in distribution, and not clearly communicated. Additionally, policies changed as the program progressed and banks and other PPP financial intermediaries were not absolved of all risk as they were not initially provided with comprehensive information.

Lack of information

The initial concerns surrounding the implementation of the PPP were related to the lack of information provided to banks and business owner customers by the government. Since the CARES Act was passed in a rushed fashion, the SBA and IRS did not have enough time to distribute complete information regarding approval or forgiveness guidelines (Hylan, 2020/2021). Cororaton and Rosen (2020) found that this lack of information was not an issue for some business owners, as many owners quickly acquired business funding despite uncertainty and without understanding all of PPP policy guidelines. However, Humphrier et al. (2020) argued that because detailed rules for the forgiveness process were not posted for almost two months following the signing of the CARES Act, "the initial uncertainty, combined with changing guidance, may have distorted small business owners' beliefs about their eligibility" (p. 8).

Small businesses typically have less employees who can focus on gathering technical information surrounding government programs such as the PPP. Because of this, some small business owners may have chosen not to apply out of a fear that it may have resulted in financial issues. One example of this was the initial uncertainty, described by Schreiber (2020), surrounding the inclusion of the PPP loans as taxable income. Business owners who were trying to minimize the impact of COVID-19 may have forgone these funds in the interest of keeping their tax liabilities down. However, the IRS eventually issued clarification, choosing to "exempt forgiven PPP loans from federal income taxation" (Loughead, 2021, para. 1). Walker and Weins (2020) also discussed other complexities of the PPP, such as the types of expenses that are deductible or not deductible. These complications came at a time when business owners were already having trouble with financial planning (Belletsky et al., 2020). Without experienced tax attorneys and financial professionals, small businesses would have had a much more difficult time trying to manage the financial impact of these issues.

Banks and other financial intermediaries also faced uncertainty throughout this process. They were in the unenviable position of trying to minimize their own credit risk, “a loss exposure due to counter parties default on contracts” (Rajendran, 2012, p. 51), while trying to help their small business owner customers avoid bankruptcy. Many businesses applied for PPP loans with the expectation that they would be forgiven instead of having plans in place for repayment. This may have discouraged banks from helping some customers who needed PPP funds due to the concern that they would default in the case that forgiveness was declined.

Lack of targeting

Although the federal government was able to approve $659 billion in funds for small businesses through the PPP, federal policy makers did not have sufficient processes in place to ensure the funds went to the business owners who needed it the most. Instead of providing relief to businesses who had seen the worst effects of COVID-19, Granja et al. (2020) found that resources were allocated to businesses who were less impacted by the virus and subsequent business operation issues. This contradicted the entire purpose of the PPP, and most likely decreased the positive effects of the program.

This lack of targeting was also due to the information frictions discussed above. Since larger businesses have more resources to determine their most favorable course of action, substantial and more viable businesses were able to take advantage of the PPP (Li, 2021). A study by Humphrier et al. (2020), conducted from March 28 to May 16, 2020, found that smaller businesses “applied later, faced longer processing times, and were less likely to have their applications approved” (p. 1). This left smaller less established businesses at a disadvantage in collecting relief funds, even though the funds were designed to keep them afloat. Sacrificing speed for thoroughness and strategic planning, minority owned businesses and disadvantaged businesses failed to access PPP relief early in the process (Cowley, 2021; Quinn, 2021), confirming a target obstacle within this process.

Large, profitable business owners took PPP funds

Following the rules of the PPP, all information related to borrowers and loan amounts were made public. Since a portion of the funds went to large businesses who were profitable during the pandemic, public outrage emerged as this information became known regarding what type of organizations benefited from the funds. Some of these businesses included Shake Shack, Ruth’s Chris Steak House, and the L.A. Lakers (Kukura, 2020), whose organizations were both healthy and lucrative. Overall, Cororaton and Rosen (2020) found that 13.5% of public borrowers returned their loans due to the backlash they faced, and many others resisted applying for funds due to the fear of a decrease in stock prices. Firms who returned PPP funds were more established and stable, with greater financial health and lower liabilities than firms who did not return funds (Cororaton & Rosen, 2020).

Although these firms faced public backlash for their actions, they took advantage of the rules set forward by the government for the PPP. Hubbard and Strain (2020) found that large companies who received negative publicity were eligible for relief funds under the PPP. It could be argued that these companies should have refrained from applying, but not accessing an available benefit may have violated best interest of their stockholders. It is appropriate for a post-policy analysis to question if more reflective, strategic, and scrutinized procedures would have been implemented initially, would relief funds have been suitably targeted to businesses who needed the most help?

Banks favored profitable business owners

Since banks were placed in a position that increased their risk, some of them took counter measures to ensure they could mitigate a certain level of financial threat. Without having complete information regarding the process, many banks focused their efforts on small business customers who were more likely to be approved and those who could continue to operate if they were rejected. Bartik et al. (2020) found that eligible businesses with stronger bank relationships were more likely to have their applications accepted and small businesses who were more adversely impacted by COVID, less connected with banks, and carried less cash-on-hand were less likely to be approved. This shows that without proper regulations or guidance in place, banks supported their larger or more profitable customers first, which resulted in funds being pushed away from at-risk small businesses where they were needed the most.

To support this discovery, Joaquim and Netto (2020) argued that since banks wanted to keep established relationships and not lose clients due to a PPP rejection, "banks have an incentive to distort the allocation towards firms with a higher probability of survival without PPP assistance" (p. 36). This raises the argument that banks may not have been the best vehicle for PPP loan delivery, unless the government was first able to establish regulations that ensure the funds were directed towards those most in need. While banks often have established relationships with small businesses in their community, some studies found that business owners in communities with fewer bank branches, lower income, and greater minority populations failed to access resources provided by PPP (Li, 2021). A post-intervention query could be raised if the federal government should have provided relief to small business owners directly rather than working through the banking system. Did the benefits of intervening through the banking system outweigh the disadvantages of intervening directly with small business owners?

Recommendations, Directions, and Future Research

Recommend improved information

With the effects of COVID-19 being so severe, policy makers may not have had enough time to develop detailed policies and procedures for how each step of the PPP would unfold. However, the obvious failure to deliver critical information in time for business owners to make decisions on whether to apply for the PPP negated some of the positive impact that the program had. Initial program feedback revealed that the smallest most vulnerable businesses were less aware of PPP and less likely to apply (Humphrier et al., 2020). Lack of PPP application was typically a result of eligibility vagueness and loan payback uncertainty (Humphrier et al, 2020). Banks and other financial intermediaries needed to be more customer service oriented, with enough people available to communicate with business owners to answer questions and distribute information. To help small business owners, who may be well versed in their trade but not in finance, understand the details of the PPP better, policy creators should have simplified the language to a point where any confusion was minimized.

Recommend Program Targeting

Since the structure of the PPP allowed larger, more profitable businesses to receive relief funds, the program was less successful than it could have been. Granja et al. (2020) showed "evidence that the PPP had only a small effect on employment in the months following the initial rollout" (p. 39), suggesting that funds may have gone to firms who were not reliant on relief to stay open. A first recommendation would be to limit the cap on employees to a smaller number. Gradisher and Tassell-Getman (2020) stated that businesses with less than 500 employees qualified, as well as some with over 500. If this cap was lowered to the range of 50-100 employees, at least for initial disbursement, larger businesses would have had to wait until small businesses had received relief funds.

A second recommendation would be to increase the percentage decline in revenues that businesses had to show in order to receive funds. This would ensure that small businesses who were more negatively impacted by the pandemic were the first to receive assistance. Further research regarding PPP and future possible iterations should be conducted to determine both the optimum cap for the number of employees and the percentage decline in revenues necessary to qualify.

Recommend policy clarification

As Hubbard and Strain (2020) discussed, large businesses were eligible to apply for relief funds under the rules of the PPP. Since public businesses have a responsibility to maximize shareholder wealth, it can be argued that they were correct in applying for relief funds if they were eligible. This leaves the responsibility for this issue with federal policy creators. As discussed in previous recommendations, policies should have been stricter to ensure that relief funds were targeted where they were most needed. Outside of the number of employees and percentage decline in revenues, further research could be conducted to see if other sustainability limits could be placed, such as total revenues.

Recommend policy criteria

Preferential treatment towards certain small business customers could elucidate why negligible sustained benefits have been observed regarding PPP (Joaquim & Netto, 2020). This raises two questions: should banks have been the vehicle for delivery, and how could the government have prevented this problem? Some of the recommendations presented previously, related to more restrictive criteria, would reduce the opportunity that banks have to distort the funds. However, future research would be required to determine if there were any other delivery methods that could have been more successful.

Limitations and Future Review

This paper analyzed the first round of the Paycheck Protection Program conducted in 2020. A second round of the PPP began early in 2021, which may have addressed some of the issues discussed in this paper. Future review of round two will determine if policy makers were able to address oversites made during PPP initial release. Preliminary reviews show that decreases in stock prices and public backlash towards larger firms "may have eventually dissuaded similar firms from borrowing in the second round" (Cororaton & Rosen, 2020, p. 35).

While this paper lacks empirical research regarding the PPP, this examination uses a critical analysis approach to identify intended, unintended, and observed program delivery, benefits and disadvantages of fund distribution, and reflective considerations which should be contemplated in future iterations. Future research will be necessary to determine the optimal cap on employees, percentage decrease in revenues, maximum gross revenues, and whether there is a more efficient delivery method than banks.

Banks who decided to focus PPP on helping their business customers instead of helping non-customers is also a significant hindrance to consider. Preferred distribution of funds left business owners who lacked access to their primary bank with no way to apply and receive relief funds. Future research should be conducted on how to prevent preference selection from happening, and if the policy makers could mandate that banks and other financial agents must help all applicants, regardless of whether they are already a business customer.

Discussion

Most analysts would agree that PPP funds were essential to help small business owners survive during the pandemic; the CARES Act offered a financial lifeline to sustain struggling businesses during a time of great uncertainty. However, future policy makers and practitioners should consider whether funds should have been targeted more toward businesses who needed "saving" in the short-term or in the long-run. In other words, PPP fund allocation could have been prioritized to smaller businesses who were the most vulnerable or for small businesses who needed funds to protect sustainable jobs. Additionally using funds to help businesses who were directly impacted by closures and who needed technical assistance or business improvements aimed at ensuring their continuity plan could have provided relief where it would do the most good (Perlmeter, 2021; Steward, 2020).

Although the Paycheck Protection Program provided financial and emotional relief to some small business owners and employees, problems in its design and implementation limited its positive effects. Perhaps the chief failure of the program was the inability to provide all necessary information to small businesses, helping them make the sound decision regarding whether to apply and if so, how much funds should be applied to receive. Another substantial problem involved how funds were not sufficiently targeted towards small businesses who needed them most urgently. Large, profitable businesses were able to apply for PPP loans under the criteria set forth. However, some of these companies returned their funds after the public scrutiny that they attracted. Lastly, the question of whether banks were the best vehicle for delivery of PPP loans is raised due to the fact that some were biased towards their more profitable customers. Each of these problems can be addressed by the recommendations provided, but future research must be conducted in order to ensure the new criteria are set at optimal levels. The second round of the PPP is currently underway, so it will soon become clear if federal policy makers learned from the oversights made during round one.

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