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SMALL BUSINESS

As Credit Lines Fade, Credit Cards Step In



Bradley C. Bower for The New York Times

Stephen Strachan, a flower importer, said rate increases on credit cards had forced him to curtail ventures and lay off workers.

By JANE BIRNBAUM
 Published: September 10, 2008

The credit card offers are in the mail.

Just as the slowing economy has made access to cash a higher priority for a lot of small businesses, banks have become more reluctant to extend traditional lines of credit to those businesses, experts say. But banks have been offering "small business" credit cards.

Bank cards and lines of credit both offer money when it is needed, but there is a fundamental difference: lines of credit have low, fixed interest rates or slow-moving, variable ones, while interest rates on credit cards can jump unpredictably.

"Small-business cards have fundamentally replaced lines of credit," said Alan L. Carsrud, executive director of the Global Entrepreneurship Center at Florida International University in Miami.

Bob Seiwert, head of the Center for Commercial Lending and Business Banking at the American Bankers Association, said he had no hard data but appeared to agree with Mr. Carsrud's assessment. "People are driven to cards today because bank credit lines are tougher to get" as banks have tightened credit in the last six months or year, he said. "Lenders may adjust card rates and limits as the perceived risk of lending to the borrower

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increases.”

Entrepreneurs have long used personal credit cards to help bankroll new ventures, said Scott A. Shane, a professor of entrepreneurial studies at Case Western Reserve University.

The small-business cards often differ from personal credit cards in that some offer benefits like product discounts and extended payment terms. But they are identical in critical ways — users are generally liable for revolving balances that grow exponentially as interest rates rise, and lenders may sometimes raise rates and reduce credit limits at any time for any reason.

In a survey in February of 500 owners of small and medium-size businesses, the National Small Business Association, a lobbying group in Washington, found that 28 percent had used bank loans in the previous year, a record low. Forty-four percent said they had used cards to meet capital needs in the previous six months. Fifty-seven percent said their card terms had worsened over the last year.

“I don’t fault banks for charging high interest rates on cards because so many small businesses fail,” said Marilyn Landis, the group’s chairwoman and a 30-year banking veteran. But “small-business owners desperately need the ability to enter contracts with card providers that are predictable, understandable and stable.”

Ms. Landis, who owns a company in Pittsburgh that provides chief financial officer services to growing businesses, spoke from personal experience. She said that her introductory rate on a small-business card had risen to 27.9 percent, from 3.9 percent, after the lender said a mailed payment had arrived one day late.

Stephen Strachan, a flower importer in York, Pa., told members of Congress this spring that rate increases on business and personal cards had forced him to curtail ventures and lay off workers. Mr. Strachan made his remarks at hearings for a bill pending in Congress, the Credit Cardholders’ Bill of Rights.

Beginning in late 2001, Mr. Strachan said, the only new bank credit lines he could find had interest rates higher than those on his personal and business cards. So, he said, he used cards to supplement existing credit lines.

“Card lenders originally offered me very high limits at very attractive rates because of my excellent credit profile,” he said in an interview. “But once I accepted, a couple really turned up the heat.”

In 2003, he said, one bank raised interest rates from as low as 3 percent to as high as 30 percent on four cards with a total balance of about \$150,000. The lender cited Mr. Strachan’s rising total debt, and late and missing payments, as the cause. Mr. Strachan said that whenever he had received statements, he had always mailed payments “well before their due date.”

In May, the Federal Reserve released proposals for limiting the circumstances under which lenders could increase interest rates on existing card balances. The limits would apply to personal cards — including any business expenses charged on them — but not to business cards, a Fed spokeswoman said.

Small-business card lenders generally grant initial terms on the basis of personal credit, with consideration of any business payment scores.

Business card usage is sometimes reported to personal credit bureaus. This can decrease

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a personal credit score, known as a FICO score because it was created by the Fair Isaac Corporation.

Ms. Landis said some of her business card activity had appeared on personal credit reports. And FICO decreases can also result in higher business card rates, she said. "I know because I ran up a balance on a personal card while traveling, which dropped my FICO, and the rate on one of my business cards immediately went from about 18 percent to 23 percent."

Jason Peringer, a certified massage therapist on Martha's Vineyard, said he discovered the connection between personal and business credit after his home burned down.

A construction loan and a houseful of new furnishings that he put on personal cards — purchases required before an insurer would partly reimburse him — increased Mr. Peringer's debt-to-income ratio and lowered his credit score, he said. [American Express](#) cut his business card limit to \$1,000, from \$15,000, and the [Advanta Corporation](#) raised his business rate to 34.99 percent, from 16.99 percent, he said.

"I had never missed or been late on any payments," he said.

There is not much data about card charge-offs — the debt that lenders write off as uncollectible — stemming from small business. The Federal Reserve found that charge-offs for all commercial bank cards rose in the second quarter, reaching 5.47 percent. Neither the central bank nor most large lenders break out business card charge-offs.

But Advanta, which markets MasterCard exclusively to small businesses, reported second-quarter charge-offs of 8.38 percent, up from 3.48 percent a year earlier. Advanta said it was one of the largest small-business card issuers last year.

Entrepreneurs get the most out of cards when they regularly pay off their balances. "Many of my clients use them, but in a limited way in the early stages," said Michael Gonnerman, a financial adviser in Boston to high-tech entrepreneurs.

Timothy Ferriss, author of the best-seller "The 4-Hour Workweek" and a business consultant in San Francisco, began his entrepreneurial career selling a sports nutritional supplement. He said he had already done market testing and secured customer commitments when he put \$10,000 in manufacturing costs on personal cards in 2001.

He said he had charged about 70 percent to an American Express card requiring monthly payment in full. The rest went to zero percent introductory rate cards that he paid off within three months. "I avoided depending on self-discipline, which entrepreneurs often overestimate."

Today, Mr. Ferriss said, he often asks customers to charge their payments. Even if he must accept slightly less, he prefers the immediate payment to managing the cash flow problems of extended payment terms.

Entrepreneurs may pay dearly if they fail to understand their small-business card agreements. Victor Patenaude, a collections lawyer in San Diego, wrote in an e-mail message that he had obtained "thousands of judgments" against entrepreneurs who could not pay their business card debt. "Last week, an attorney called up, guns blazing, and said we will lose at trial if we think her client is personally liable," he wrote. "After I faxed the application and pointed out the small print, she fired her client and suggested he pay us."

Marc Augustine, a consumer electronics exporter in Miami, said he had negotiated a bank credit line and several cards without personal liability by building a solid history of

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borrowing and rapid repayment. He said he was concerned about a friend, already the owner of one business, who has put \$30,000 on personal cards to start a new venture.

"I speak to him, but he says he has to have it now," Mr. Augustine said.

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