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A person in a blue shirt and dark pants is cleaning a large auditorium with a backpack sprayer. The auditorium is filled with rows of red seats, and the person is walking through the aisle, spraying the seats. The background is a vast expanse of red seats stretching into the distance.

# The Impact of Credit Card Policies on Small Business

*Even in a good economy, some small businesses have difficulty accessing bank loans. They may be a service business without collateral or a start-up without a track record. Perhaps they have not been profitable in the first year or two and can't yet show the ability to repay a loan. Many then turn to credit cards.*

## True Stories

Numerous small firms have found their credit card works well as an unsecured line of credit. But sometimes, even if payments are made on time, the approach backfires. Fees are unpredictable. Interest rates may go up. The businesses' credit limit may be reduced, and that can lead to a lower credit score. Several New England cases are illustrative.

### Commercial Cleaning Firm

Since 1991, Anna has run a family-owned, commercial cleaning firm with 11 part-time cleaners. While waiting to receive customer payments, she would manage cash flow by drawing on personal and business credit cards for cleaning materials, equipment, and payroll. In 2008, she had a very good credit score, 715. She carefully paid all bills

on time, including credit cards, home mortgage, and business and personal expenses.

Anna typically drew down about \$10,000 in total on a credit limit of \$25,000. But when the recession hit, the credit card landscape changed. Congress began to prepare for rules reforming card companies' policies. And in the interim, without reviewing the history of individual small businesses, many banks cut the limits for thousands of such borrowers.<sup>1</sup> Anna's credit limit was dropped to the amount of her outstanding debt, \$10,000. She suddenly appeared to have borrowed 100 percent of her credit limit, and lost her borrowing flexibility.<sup>2</sup> That caused her credit score to decline to 620. Her cards, formerly with 2 percent to 5 percent interest rates, now had rates of up to 30 percent. Her monthly cost of doing business skyrocketed; cash flow

was negative. Nevertheless, to this day her credit reports show no late payments.

Anna's attorney advised her to file for bankruptcy. She subsequently restarted the business, and her credit score is improving. Today she is working hard to get beyond the stigma and financial setbacks of bankruptcy.

### Framing and Fine Art Shop

Barbara and Mike bought a framing and art store in 1993. The business developed a strong following among local artists seeking a showcase and customers buying local artwork or framing services. The owners worked long hours but enjoyed the work.

Barbara and Mike maintained an excellent credit score, in the 800s. But in 2004, Mike died suddenly, and Barbara had to take over. She used a merchant account, allowing her to accept customers' payments

by credit or debit card. She paid her bank \$500 for a credit-card swipe machine. Over time, despite her good payment history, the number and amounts of fees and charges increased. The unpredictability made it challenging to know how much cash was available to manage the business.

Merchant accounts typically charge a monthly management fee and two charges per card transaction—a fee and a percentage of each transaction. The frame store's credit card statements from April through June 2010 showed numerous additional charges including a monthly service charge, a swipe-machine charge (though she owned her machine), settlement statement fees, interchange transaction fees, and batch fees. Barbara asked a bank employee for an explanation of the charges, but he said he could not explain them all.

Barbara had signed up for store debit card services when the bank explained that payment would go instantly to her business bank account, with no fees. She purchased a debit card machine outright but was still billed monthly for it. Over time, the bank began to take longer to credit transactions to her account and started adding charges for each debit.

The recession made cash flow even tighter, so in June 2010, she cancelled her merchant accounts. Nevertheless, the bank continued to charge her the monthly merchant account fee and said she owed \$150 for the swipe machine she had already purchased. The errors took months to straighten out. Ultimately, like many other small businesses, Barbara began accepting only checks and cash.

### Regional Magazine

An experienced journalist, Scott decided to start a regional magazine in 2006. Revenues came from advertising, subscriptions, single-copy sales, reprints, and design services. Although he was unable to obtain bank financing, his excellent credit score and his \$250,000 card limit enabled him to use credit cards to finance operations. He eventually charged more than \$200,000, supplemented by \$100,000 in loans from family and friends. Sales grew from \$220,000 in 2007 to \$385,000 in 2008 to \$400,000 in 2009—and as of this writing, an estimated \$450,000 in 2010.

The improving outlook did not come without pain. In 2009, most of Scott's credit card rates jumped to more than 30 percent. The minimum due on his monthly

payments went from \$300 to \$1,200. The sharp and unanticipated increase threw the company off balance. Scott's rising costs hampered his cash flow and credit score, slowing improvement in his company's financial position. Ultimately he was unable to make payments, and on the advice of legal counsel, he stopped them. He began a Chapter 11 filing for bankruptcy reorganization. Because the credit cards had been personally guaranteed, a personal bankruptcy was unavoidable.

## Credit-scoring companies should not drop a reliable business's credit score just because a credit card company changed its policy and cut credit limits.

The business reorganized primarily by cutting staff, with the remaining employees taking on a double workload. The reorganization plus the slowed economy remained a constraint on growth. But in late 2010, growth stabilized, and the company became profitable and emerged from bankruptcy.

### What Can Work

In 2010, President Obama and Congress worked with credit card companies to review and reform credit card policies. In spring 2010, new legislation was passed. Key elements will improve the situation for businesses using their personal credit cards for business.

The May 2010 credit card reform provides guidelines and limits on increases and changes in interest rates, charges, and fees. A 2010 stimulus package expanded access to capital for thousands of small companies. Congress is also expected to address issues with business credit cards.

More should be done to protect the 90 percent of U.S. businesses that come under the Small Business Administration's definition of a small business.<sup>3</sup> Issues needing attention include both merchant accounts and small companies' use of credit cards to pay bills. Banks and credit card companies could help—and in turn, protect local economies—by making case-by-case decisions based on users' payment histories. Sweeping

changes based on regional or industry trends have damaged many good companies. Also, credit-scoring companies could reconsider dropping a reliable business's credit score just because a credit card company changed its policy and cut credit limits.

At the same time, small businesses need to maintain a good credit rating, maintain clear financial statements (including reporting profitability), and seek a long-term banking relationship. At that point, they can refinance credit card debt with a lower rate and a more predictable bank loan. Small retailers, such as convenience stores, might provide an automatic teller machine so customers can pay in cash. Store owners concerned about the quality of check payments might use a scanner to deposit the check into their account and thus know instantly if the check is valid.

Companies can work with an accountant and a credit-counseling organization to develop a new strategy for managing cash, paying down debt, and building a clear business financial history. It is usually beneficial for a business to maintain a merchant account with the same bank that handles their business accounts.

The 90 percent of American companies with fewer than 10 employees provide jobs, tax revenue, and goods and services for communities. Affordable financing is critical to their survival and growth. Continuing to reform credit card policy can make a meaningful difference.

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### Endnotes

<sup>1</sup> Eileen A.J. Connelly, "Mixed Blessing: Credit Card Reform May Shock Some," Associated Press, February 22, 2010, <http://abcnews.go.com/Business/wireStory?id=9906985>.

<sup>2</sup> When borrowers use all of their available credit, it lowers their score and raises their interest rates.

<sup>3</sup> See [www.census.gov/epcd/www/smallbus.html](http://www.census.gov/epcd/www/smallbus.html).

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