



# DISCUSSION PAPER

## PAYMENT CARDS CENTER

### Small Business Use of Credit Cards in the U.S. Market

Susan Herbst-Murphy

December 2012

**Summary:** *America's small businesses have adopted credit cards as both a payment method and a borrowing vehicle. The segment also uses other payment card products, including debit, charge, and prepaid cards. The dollar volume of spending with cards designed for small businesses increased by 230 percent over the five-year period from 2003-2008. But the recession of 2007-2009 and contemporaneous changes in the regulatory environment had effects on both the supply to and demand of small businesses with respect to credit cards. To obtain an update on these issues, the Payment Cards Center hosted a workshop facilitated by Frank Martien, a partner with First Annapolis Consulting. During the workshop, Martien presented evidence of improved supply and demand conditions for small business credit cards. In addition to these positive post-recession observations, Martien described how the symmetry between a small firm's accounts receivable cycle and the billing cycle for a credit card may help explain why credit card use is so attractive to this segment. This summary also discusses recent developments in the small business debit card market.*

Keywords: Small business credit cards, small business cash flow, small business credit  
JEL Classification Numbers: E42, L14

\* Payment Cards Center, Federal Reserve Bank of Philadelphia, Ten Independence Mall, Philadelphia, PA 19106. E-mail: [susan.herbst-murphy@phil.frb.org](mailto:susan.herbst-murphy@phil.frb.org). The views expressed here are those of the author and do not necessarily reflect the views of the Federal Reserve Bank of Philadelphia or the Federal Reserve System. This paper is available free of charge at [www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/](http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/).

FEDERAL RESERVE BANK OF PHILADELPHIA

Ten Independence Mall, Philadelphia, PA 19106-1574 • (215) 574-7220 • [www.philadelphiafed.org/payment-cards-center/](http://www.philadelphiafed.org/payment-cards-center/)

## **I. Introduction**

Over the past two decades, small businesses have increasingly used credit and debit cards to pay for goods and services. The loan utility of the credit card has also become an important borrowing source for small enterprises. The increasing importance of payment cards to small companies was described in a Payment Cards Center (PCC) paper published in 2011.<sup>1</sup> The paper also identified challenges that small businesses faced during the 2007-2009 recession, including tightened underwriting by lenders and the reduction of existing credit lines.

To obtain an updated outlook on conditions affecting small businesses, the PCC hosted “Credit and Payments in the Small Business Segment,” a workshop facilitated by Frank B. Martien, a partner at First Annapolis Consulting, where he heads the commercial payments practice.

Using information compiled from various sources, including First Annapolis’s own client consultancy, Martien presented an optimistic view of the small business credit card market as 2011 was drawing to a close. His findings indicated an improving credit environment for small enterprises. Cards continue to be important to small enterprises, and with the business of issuing small business credit cards returned to profitability, supply should be sustained. Cash flow requirements are cited as the most common credit need among small businesses. Martien shared insights into how credit cards uniquely meet that specific need, perhaps revealing one reason why over 80 percent of small enterprises acquire a credit card by the fifth year of operation.

---

<sup>1</sup> Susan Herbst-Murphy, “Getting Down to Business: Commercial Cards in Business-to-Business Payments,” Federal Reserve Bank of Philadelphia (March 2011).

The information Martien shared at the workshop also highlighted the role bank branches may play as a channel through which new small business credit cards are acquired. Martien concluded with an update on how and to what extent small businesses rely on mobile devices.

## **II. Promising Post-Recession Indicators**

At the time of the workshop, Martien reported that the trends were indicating improvement in both supply and demand compared to conditions at the peak of the recession.

Information that First Annapolis purchased from Barlow Research found that approvals of applications for credit by small businesses began trending upward in the fourth quarter of 2010, after showing consecutive declines in the previous three quarters. The improvement was sustained through the first half of 2011. In each quarter from the third quarter of 2009 through the second quarter of 2011, about one in three small businesses applied for credit.<sup>2</sup>

Martien also discussed the trends specific to purchase activity on payment cards, an area where the recession had also had a dampening effect. By late 2011, however, increases in spending volume were in evidence.

---

<sup>2</sup> Martien's source was "Small Business and Middle Market Banking Economic Pulse Survey Results," Barlow Research Associates, May 6, 2011. Barlow's Economic Pulse Survey is an invitation-only economic survey administered online or via fax, fielded for two weeks during the first month of each quarter. A stratified sample based on four U.S. regions and nine sales volume categories is used. The results are weighted by regions and sales volume categories using current business population counts. Barlow categorizes small businesses as those with annual sales of \$100,000 to \$10 million.

### **A. Credit Cards: After Some Volatility, Stability Returns**

Martien conveyed an interesting observation from his review of data reported by the National Small Business Association (NSBA). During the recession, there was a change in the most-used form of financing by small businesses. In December 2008, nearly 50 percent of small firms had used credit cards in the previous 12 months, slightly ahead of bank loans. But according to the NSBA, the use of credit cards to meet financing needs declined through the end of 2010 and then proceeded to rise very slightly during the first half of 2011.<sup>3</sup> Risk-mitigating practices on the part of card issuers may have contributed to this trend. A slide from Martien’s presentation (Figure 1; figures can be found at the end of the paper) shows that in early 2009, issuers were aggressively reducing credit line size on both consumer and business credit cards. This activity subsided over the following months, and by the end of 2010, more banks were making “considerable” increases to card-based lines of credit. Martien noted a point that has also been widely reported elsewhere: Much of the credit line reduction occurred on inactive accounts.

While lines extended were being reduced, interest rates on new credit card offers rose. Martien speculated that these changes were influenced by a more challenging economy as well as by changes in the regulatory environment. During 2009, business credit cards were offered at rates between 13 and 13.5 percent. By the end of 2010, the average offer carried a rate of about 14.5 percent. Offer rates then plateaued for some months, with some declines in APRs in evidence by late 2011.

---

<sup>3</sup> “2011 Mid-Year Economic Report,” National Small Business Association (August 1, 2011).

The stability of interest rates appears to have continued into the third quarter of 2012. The *American Banker* provides periodic snapshots of current average credit card offer rates for various product categories and compares that average with the average for the week before, six months before, and one year before. As of August 6, 2012, the average rate on business cards was about 12.5 percent, and it had hovered at that rate for each of the three previous periods. The average rates offered to small businesses were below the average for all credit card offers (15 percent) and well below the near 16 percent average offer rate for business credit cards in January 2009.<sup>4</sup>

According to an NSBA survey of 300 members conducted in May 2012, the average interest rate on the credit cards that respondents considered to be their “primary card” was 15.6 percent. Given that the current average market rates on direct mail offers are 3 percentage points lower than the reported average for *existing* accounts, one might expect to see turnover in card accounts, as small businesses acquire new accounts to replace existing higher rate accounts. But the interest rate may not always be the most relevant attribute that small businesses consider when making decisions about credit cards, a topic that will be covered in Section III.

Of course, an average of all interest rates offered is not a perfect gauge of what any specific borrower might be able to obtain. Credit history and other characteristics of the borrower figure prominently in rate assignment. Fortunately, the NSBA also categorizes reported rates to provide an understanding of the proportion of small businesses falling into low, medium, and high rate categories. For the May 2012 survey, the NSBA found that 13 percent of respondents reported single-digit interest rates for

---

<sup>4</sup> See “Infographic: Credit Card Offers,” *American Banker*, August 6, 2012 and July 16, 2009. Part of the decline in reported interest rates may be due to reductions in short- and intermediate-term interest rates that resulted from FOMC policy decisions.

their primary credit card. One-third fell into each of the mid-rate categories of 10-14 percent and 14-19 percent, and 22 percent reported rates of 20 percent or more.<sup>5</sup>

Martien shared a graph that plotted these data from quarterly NSBA surveys beginning with the fourth quarter of 2009 through the fourth quarter of 2011. Figure 2 is an updated version of that graph. The graph depicts changes in the proportions of small businesses in each category over that time. While some volatility in reported rates can be inferred from the graph, a comparison between data from December 2009 and December 2011, when the workshop was conducted, indicates that, by the end of this two-year period, a higher proportion of primary accounts had rates below 10 percent and a lower proportion of accounts had rates of 20 percent or more.

Martien posited that improvements in small business credit card loan performance may have enabled issuers to relax rates a bit by late 2011, as reflected in Figure 2. His analysis showed increased charge-offs in the small business card portfolios of major issuers from 2007 into 2009. But by the fourth quarter of 2010, charge-off rates were trending downward.<sup>6</sup> Taken as a whole, conditions had improved sufficiently by the end of 2011 that, according to Martien, profitability had been restored to small business credit card issuers. Supply contraction was easing, and there was some evidence that demand was rising. Experian/Moody's Analytics' Small Business Credit Index reported more recent improvements in the health of small businesses in both the first and second quarters of 2012 but noted that the pace of improvement had slowed. The findings for

---

<sup>5</sup> "Small Business Access to Capital Survey," National Small Business Association, July 2012. The NSBA conducts this survey quarterly. Of note, 50 percent of the respondents to the May 2012 survey reported that they paid their credit cards in full each month.

<sup>6</sup> The portfolios reviewed included Advanta, Barclays Bank, Discover Bank, Bank of America, Capital One Bank, and Amex Bank. Advanta ceased operations in 2009 and subsequently went into receivership, but the remaining five issuers all experienced lower charge-off rates at the end of 2010 and the beginning of 2011 after experiencing earlier peaks in credit card losses.

the second quarter index offered a mixed picture, with some sectors and geographic areas faring well and others facing challenges.<sup>7</sup>

## **B. A Review of Card Spending, Including Small Business Debit Cards**

Patterns in spending using small business credit and charge<sup>8</sup> cards were consistent with these other trends. Spending dipped between 2008 and 2009 as the economy experienced a recession. But as Figure 3 indicates, small business credit and charge card spending had increased to pre-recession levels by 2011.<sup>9</sup>

Of note is the unbroken rise in small business debit card spending before, during, and after the recent recession. Business debit card spending may have followed the same pattern observed in consumer debit cards: During the recession, nondiscretionary spending, for which debit cards are commonly used, was less affected than was discretionary spending, for which households are more apt to use credit cards. So consumer debit card spending was essentially flat, while credit card spending declined as households constrained discretionary spending and deferred large-ticket purchases. This may have also been true of small businesses.

It is also likely that changes in the payments marketplace played a role in the rise in small business debit card spending during the period covered in Figure 3. The Oliver Wyman 2011 Debit Issuer Study revealed that both the supply of and the demand for

---

<sup>7</sup> See “Small-business Credit Conditions Improve Slightly as Economy Shows Signs of Stalling,” Experian Information Solutions and Moody’s Analytics, 2012.

<sup>8</sup> Charge cards for small businesses function the same as those for consumers. They do not provide a revolving credit utility. Users may take advantage of a line of credit during a billing cycle but are obliged to pay in full all charges made during that period by the payment due date.

<sup>9</sup> The Amex OPEN portfolio includes both charge cards and credit cards for small businesses. Based on the source data he used, Martien estimated that 30 percent of OPEN spending is done with credit cards and that amount is included in the credit figures. The remaining 70 percent comprises the charge volume shown on the chart.

small business debit cards increased over this period.<sup>10</sup> In 2010, 82 percent of financial institutions were offering small business debit cards, a 12-percentage-point jump from the 70 percent who were doing so in 2009. The percent of small business deposit accounts with co-ownership of debit cards increased from 43 percent to 46 percent during that time.

Given this cumulative penetration rate of only 46 percent of *existing* small business deposit accounts, it is significant that for 2010, a debit card was opened for 56 percent of *new* small business checking accounts opened. Oliver Wyman also found that the proportion of cards with activity increased slightly for business debit cards, 40 percent in 2010 versus 37 percent in 2009, and the number of transactions per active card also rose by one per month. These growth trends are similar to the pattern of awareness, adoption, and activation that precipitated the growth surge in consumer debit that occurred around the turn of the 21<sup>st</sup> century.

It is uncertain, however, that this trend will continue. In late 2011, a ceiling on debit interchange that could be earned by large issuers (those with assets of \$10 billion or more) was established by Regulation II. This rule implements the requirements of the Durbin amendment to the Dodd–Frank Wall Street Reform and Consumer Protection Act.<sup>11</sup> That rule established a cap of 21 cents per transaction, plus 0.05 percent of the transaction value. Issuers with qualifying fraud prevention programs can receive an additional 1 cent per transaction.

---

<sup>10</sup> Oliver Wyman, 2011 Debit Issuer Study, commissioned by PULSE (April 2011).

<sup>11</sup> See Section 1073 of Public Law 111-203. The text of the final rule can be found at §235 Code of Federal Regulations, Title 12.



The survey for the 2012 Debit Issuer Study was fielded after Regulation II was implemented, and its results present some preliminary indications that the new regulation might affect the supply side of small business debit. For large issuers, the interchange earned on a small business debit transaction declined by 85 percent. Some respondents to the 2012 survey reported that their debit programs were now unprofitable.<sup>12</sup> Income deterioration of that magnitude was causing some banks to re-examine the small business debit product. One issuer quoted in the study said, "Post-Durbin we are no longer focusing on growing business debit, but rather we are simply supporting the product."<sup>13</sup> With supply available but perhaps not so actively promoted, is demand strong enough to continue the five-year growth trend seen from 2006-2011?

Continuing development in the small business debit landscape will be interesting to observe. As noted above, the Durbin amendment exempted banks with assets below \$10 billion from the debit interchange fee ceiling. That should mean that smaller banks' incentive to offer debit cards should not be substantially affected and they may continue to be proactive in making debit cards available to small businesses. But these companies have shown some preference for doing business with large banks. Among respondents to a survey of the National Federation of Independent Business (NFIB) Research Foundation, two-thirds of small businesses identified one of less than 20 banks, all with assets of \$80 billion or more, as their primary financial institution.<sup>14</sup>

---

<sup>12</sup> Oliver Wyman, 2012 Debit Issuer Study Executive Summary, commissioned by PULSE (August 2012). The study reports that the post-Regulation II revenue to a large issuer for the signature-authorized transactions that account for over 80 percent of business debit purchases is 26 cents. The comparable consumer debit transaction would yield 24 cents, so gross income to the issuer remains slightly higher on business debit transactions than on consumer debit transactions.

<sup>13</sup> Oliver Wyman, 2012 Debit Issuer Study.

<sup>14</sup> William J. Dennis, Jr., "Small Business, Credit Access, and a Lingering Recession," NFIB Research Foundation (January 2012). These banks included Bank of America, JPMorgan Chase, Wells

### **III. Acquisition and Use of Credit Cards by Small Businesses**

Small businesses of various ages, in various sectors, use credit cards at a rate that exceeds, by a wide margin, their use of business loans or noncard lines of credit. As seen in Figure 4, by their fourth year of operation, about 60 percent of small businesses have obtained a credit card. The rate increases to nearly 80 percent between the fourth and ninth year of operation and stabilizes at that point. Credit card ownership outpaces other forms of credit for small enterprises of all ages. Martien reported that small businesses engaged in construction, manufacturing, retail, and financial and professional services were at least twice as likely to have a credit card as to have a business loan and were much more likely to have a credit card than other types of credit lines.

A contributing factor to the high rate of credit card ownership among small businesses is that many personal credit cards, used for business purposes, are included. Both business and personal (consumer) credit cards characteristically offer a billing cycle of approximately 30 days, with the payment being due about 21 days after the billing date. Because nearly two calendar months pass between the beginning of a billing cycle and the payment due date, an average of 40-45 days elapse between when a purchase is made and the date payment is due for that billing cycle.

Another characteristic available with most revolving credit cards is a “grace period” during which no interest is charged. When the balance is paid in full each month by the payment due date, cardholders can repay without incurring any finance charges.

---

Fargo/Wachovia, Citibank, HSBC, U.S. Bank, SunTrust, RBS Citizens Bank, BB&T, Regions, TD Bank, Key Bank, PNC, Fifth Third, State Street, Union Bank, and Bank of New York/Mellon.

And Martien noted that a substantial percentage of small businesses report that they typically pay their card accounts in full.

Based on analyses that First Annapolis has performed on small business card portfolios, Martien estimates that only about 40 percent of accounts revolve balances from one cycle to the next. The remaining 60 percent are considered “convenience users”—cardholders who do not use the revolving credit function of their cards but rather pay their balances in full each month. This high rate of convenience use among small enterprises reveals a compelling point about the influence of interest rates in card lending to these companies. For many, perhaps the majority, a card’s interest rate may not be the factor considered foremost in the decision to acquire and use a card.

Cardholders who do not revolve balances, and thus do not accrue interest charges, incur an effective interest rate of zero on this short-term borrowing.

So if a large proportion of small businesses are not using the revolving facility of their credit cards, and debit cards have been made available with business checking accounts, what motivates the high rate of adoption and usage of credit cards by young and small companies?

#### **IV. Timing Is (Almost) Everything; Network Effects Matter, Too**

Martien’s analysis revealed that about half of small enterprises require no outside financing over a 12-month period. When credit is needed, however, smoothing cash flow is the most common purpose. For example, among the members of the NFIB who replied in a survey that they had sought credit, 63 percent sought funds to use in managing the company’s cash flow.<sup>15</sup> This was the number one reason for seeking credit.

---

<sup>15</sup> Dennis (January 2012).

Martien used accounts receivable and accounts payable information for companies with less than \$1 million in annual revenue to demonstrate some of the cash flow challenges for these micro-businesses. Citing a 2011 CashEdge survey, Martien indicated that these micro-businesses issued an average of 26 invoices per month, for which they waited an average of 19 days before receiving payment, with 63 percent of those payments received by check. From this information, Martien estimated an average of about 45 days that these firms had receivables outstanding from their customers, with the majority of these payments requiring some additional time for check deposit and clearing before the business had full access to the proceeds.

This estimate of turnaround time is consistent with findings of the Aite Group, which conducted research on accounts receivable (A/R) among larger organizations. That study found that the overall average days sales outstanding (DSO) is 44.5 days, and three-quarters of respondents have an average DSO of greater than 30 days.<sup>16</sup>

This A/R cycle is in near-perfect synchronism with the 40- to 45-day credit card cycle described in the previous section. Martien posits that small businesses recognize that credit cards are ideally suited to help them bridge cash flow until they receive payment from their customers. And given the high rate of convenience use of credit cards by small businesses, many are able to do this without incurring the additional costs of finance charges.

The billing cycle and grace period attributes of credit cards are well complemented by the acceptance network that exists for general-purpose credit cards (GPCCs). A small business can leverage a single credit line, available through a card

---

<sup>16</sup>“Insights into Corporate Receivables,” Aite Group (August 2010); <http://www.aitegroup.com/Reports/ReportDetail.aspx?recordItemID=697>.

issuer, to make purchases with any of its suppliers that have already contracted to accept payments with the affiliated card brand network. The ability to tap into an established acceptance network increases the options available to the entrepreneur who might otherwise have to operate on a cash basis or would be obliged to establish separate credit arrangements with each of these vendors.

The findings of the NFIB survey underscore the importance of this network effect. Almost half (46 percent) of respondents reported that *none of their purchases are financed using vendor-supplied trade credit*. Those businesses that do have the benefit of obtaining credit through their suppliers tend to be larger. For enterprises with 20 to 250 employees, about 35 percent were able to finance half of their expenditures with trade credit, while the same was true for less than 20 percent of businesses employing one to nine people.

This combination of product attributes and acceptance network provides a fairly rich value set that may go a long way in explaining why credit cards are so widely adopted by small companies.

## **V. Personal Credit Card Use by Small Businesses**

The tendency for entrepreneurs to use personal credit for business purposes is widely recognized.<sup>17</sup> Martien's analysis showed an increase in this behavior between 2010 and 2011 in the three smallest business categories. Use of personal credit cards by companies employing 10 to 19 full-time employees (FTEs) and those with 20 to 49 FTEs rose in 2011, while their use of business credit cards declined. In the smallest category,

---

<sup>17</sup> For example, the NFIB survey finds that 36.5 percent of respondents named personal cards as the type of card most important in conducting their business in the previous 12 months. Dennis (January 2012).

those with one to nine FTEs, the percentage that used personal credit cards increased in both 2010 and 2011. Their use of business credit cards also rose slightly in 2011, following a decline in 2010. For larger small businesses, those employing 50 to 250 FTEs, personal card use declined sharply in 2011 and use of business credit cards registered a small increase.

Martien offered some potential explanations as to why small business owners may prefer to use their personal credit cards. First, they are widely available. With nearly 80 percent of American households owning at least one credit card, most business owners are already likely to have a personal credit card.<sup>18</sup> And based on direct mail numbers that Martien reported, there are 100 offers of personal credit cards for every six business credit card offers, making personal cards much easier to obtain.<sup>19</sup>

Maximizing reward programs available on some card products may also have an influence. Small business owners may also want to consolidate both personal and business expenditures on one account to optimize reward earnings. Then there is the benefit of management simplicity. For small business owners who work long hours and wear many hats, having fewer accounts to manage might be a reason to add business expenses to a personal credit card already used by the household.

---

<sup>18</sup> Scott Schuh and Joanna Stavins, "How Consumers Pay: Adoption and Use of Payments," Federal Reserve Bank of Boston (December 2011).

<sup>19</sup> Citing Comperemedia as his information source, Martien reported that only 6 percent of the millions of direct mail credit card solicitations to reach American mailboxes in recent years were for small business cards. Issuers typically scale back direct mail offers during economic downturns. The Comperemedia data indicate that this has been true of small business credit card offers, which peaked at 872 million pieces in 2007 but fell to 251 million pieces in 2010.

## **VI. Other Business and Personal Assets and Liabilities of Small Businesses**

Beyond the use of personal credit cards by small businesses, the Survey of Consumer Finances (SCF) and the NFIB survey provide further insight into the intermingling of personal and commercial finances by entrepreneurs. The SCF found, for example, that 18.2 percent of families with actively managed businesses reported using personal assets as collateral (up slightly from 17.8 percent in 2007).

The SCF asks respondents for occupational status, with 11.4 percent selecting the “self-employed” category in 2010. (Other categories were “working for someone else,” 56.9 percent; “retired,” 24.9 percent; and “other not working,” 6.8 percent.)<sup>20</sup> The self-employed were more likely than those in the other three employment categories to own their primary residence. They were almost twice as likely as retired families (the next highest group) to also own other residential property.

Findings from the NFIB survey suggest a willingness among small business owners to use real estate equity to support their businesses. More than one in five respondents to that survey said they used proceeds from residential mortgages to finance business activities. (The proportion was over 30 percent among small businesses employing 20 to 49 people.) An even higher proportion, 35 percent, used the proceeds of mortgages on business properties to finance business activities, and 24 percent used the real property of the business to collateralize loans, including trade credit.

### **A. Where Do Declines in Creditworthiness First Appear?**

With both personal and business credit being used within the small business segment, Martien examined the interesting question of whether personal or business

---

<sup>20</sup> Jesse Bricker, Arthur B. Kennickell, Kevin B. Moore, and John Sabelhaus, “Changes in U.S. Family Finances from 2007 to 2012: Evidence from the Survey of Consumer Finances,” *Federal Reserve Bulletin* 98:2 (June 2012).

credit information is more useful in credit underwriting. In 2005, Experian Business Information Solutions published a report based on four years of personal and business credit bureau information for small business owners. Over this time, during which the economy was fairly stable, 82 percent of these small business owners had *no major blemishes* on either the personal or the business side. Of the 18 percent with notable credit flaws, the blemishes first appeared on the owner's personal credit file nearly as frequently as when the problem first appeared on the business credit file. But as shown in Figure 5, more substantial differences appear when size and age of the enterprise are considered.

In general, personal credit bureau information is a more reliable early indicator of credit problems among smaller (those employing fewer FTEs) and newer businesses, while among more established businesses and those employing more FTEs, the business credit file is the better bellwether. In Martien's opinion, these findings suggest that for smaller and newer businesses, credit underwriting and portfolio management might emphasize personal credit files. For larger and more tenured businesses, the credit history for the enterprise may offer the preferred credit management data set/tool.

#### **B. Additional Findings from the 2010 Survey of Consumer Finances**

Over 70 percent of the self-employed reported business equity among their assets, more than 10 times that of the other groups, and this ownership was a significant component of their personal wealth.

In 2010, the self-employed were more likely than the "retired" and "other not working" families to carry debt but slightly less likely (82 percent vs. 83.9 percent) than those in the "working for someone else" category. In dollar terms, however, the median



value of debt carried by self-employed families exceeded all other categories. Not only was their debt level 140 percent of other working families' debt level, the amounts were higher for every loan category: residential mortgages, installment loans, credit cards, credit lines not secured by property, and "other" loans.

The average annual incomes of self-employed families in the SCF were significantly higher than those of their counterparts: nearly \$150,000 compared to under \$85,000 for those working for someone else. And the dollar value of their financial assets outpaced that of their counterparts in other employment categories for most types of holdings, including stocks, bonds, and retirement accounts. So while entrepreneurs carry more debt than their counterparts, they also benefit from higher income and greater financial assets, which should help them to withstand some degree of economic shock, as long as that shock does not disturb what, for some, can be an intricate interdependence between personal and business holdings. For example, a downturn in the success of the business could adversely affect both the income the owner derives from the business and the value of the business asset, while a decline in home values could affect the ability to use personal equity to support the business.

Setting aside a worst-case scenario, the metrics identified in the SCF are favorable for small businesses and may help explain the comparative borrowing experience between self-employed families and those in other categories. In the 2010 SCF, 23 percent of the self-employed said they had applied for credit in the preceding five years, compared to 61.7 percent of all families. Only a quarter of the applications by self-employed families were declined, compared to a third for all families. Expectations of

being turned down kept 18.5 percent of all families from even applying for credit, compared to only 7.5 percent of the self-employed.

### **C. Pre-and Post-Recession Comparisons from the SCF**

The timing of the triennial Survey of Consumer Finances provides a window into how families headed by a self-employed individual were affected by recent economic shocks. Field research for the survey was conducted in 2007, when the economy was on the threshold of a recession, and again in 2010, a year after the recession officially ended. Between 2007 and 2010, mean income declined for families in all employment status categories, but the self-employed experienced the most precipitous drop: 25 percent. Despite the declines, mean and median income and net worth for families headed by a self-employed individual surpassed those of their counterparts in all other categories.

During that time, *the average net worth* of the self-employed declined 15 percent, less than the 19 percent drop for those working for someone else and roughly equal to the declines for families headed by a retiree. Families in the “other not working” category actually reported a 5.7 percent increase in net worth between 2007 and 2010.

## **VII. New Account Sourcing**

Despite the scores of millions of credit card offers that small business owners receive in the mail, Martien considers bank branches to be an increasingly important channel for generating new business credit card accounts. He said that small business credit cards fit into banks’ relationship strategies for marketing to small businesses. And since small business owners frequently visit bank branches, applying in the branch can be a convenient way to obtain a credit card.

Approval rates for branch-sourced applications tend to be higher than for other channels. Martien speculates that the positive selection inherent in face-to-face interactions plays a role here. Those with less than perfect credit histories will opt for more anonymous application channels, while those confident of approval are less reluctant to make an application in person.

For similar reasons, the small business banking officer may be disinclined to actively encourage a customer to apply unless there is some certainty that the customer's application would be approved. Since a denial of credit could create a bad customer experience, branch sales staff may promote credit card applications only when they are fairly certain that the client is creditworthy. So Martien speculates that this branch interaction may often be more customer pull than banker push.

Because of this potentially awkward position, banks may prefer to employ pre-screened direct mail to generate leads. By using this form of outreach, banks can encourage those small business clients who have been evaluated and deemed likely to meet credit card underwriting criteria to apply. Martien stated that direct mail offers are typically directed to higher income, older prospects/business principals, a pattern that suggests prospects' credit histories are being reviewed before solicitations are mailed.

Small businesses may also have the opportunity to obtain credit cards from the retailers with which they conduct business. Because these private-label cards can only be used with one retailer, they tend to have the strongest appeal within two different groups. One is the small business that does a great deal of business with, and/or is very loyal to, the retailer offering the private-label credit. Because these programs may offer a discount or other loyalty benefits for shopping with the retailer, they can be worthwhile when a

business spends a lot of money with the sponsoring retailer. These small businesses may also prefer the inherent control of a limited-purpose card when delegating certain category-specific purchase responsibilities within their own organizations.

The other group with prominent ownership of private-label cards is composed of more credit needy borrowers. Because one of the reasons retailers offer credit is to facilitate additional sales, they may be willing to accept a higher threshold of credit risk.<sup>21</sup> So some small businesses that need additional credit may obtain approval more readily from a retailer offering proprietary credit. The fact that use of these cards is typically restricted to a single retailer helps mitigate some risk to the retailer, and the higher interest rates that are commonly found on private-label credit cards help offset the higher credit losses that often accompany more lenient underwriting. Conversely, higher rates may frequently deter small businesses whose credit history qualifies them for other, lower-rate credit.

## **VIII. Opportunity for Mobile Technology**

Business travelers are increasingly relying on mobile devices, and those devices are increasingly “smart” devices. Martien reported that, in 2011, 55 percent of business travelers had a smartphone compared to only 35 percent of U.S. leisure travelers.

Just as in the consumer segment, a convergence between mobile technology and payments is anticipated, but in exactly what form remains uncertain. The majority of

---

<sup>21</sup> In May 2012, the charge-off rate of asset-backed securities associated with private-label credit cards was 6.1 percent, a full 2 percentage points higher than the comparable charge-off rate for bank credit cards. A 12-year review of charge-off rates for private-label and bank card ABS reported by Standard and Poor’s reveals that May 2012 was not an anomaly. From 2000 to 2012, private-label charge-off rates consistently exceeded the charge-off rate for bank credit cards. See Appendix I: CCQI Monthly Summary, Standard and Poor’s, at: <http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245336769124>.

merchants are still not able to accept payments through mobile devices. But smartphone-compatible devices that enable credit card acceptance may create opportunities for card acceptance in new merchant categories and channels. Much remains to be played out.

In the meantime, card issuers are building additional value into the information access and alert tools that cardholders and business travelers have already shown an inclination to use. Similar to what is happening in the consumer segment, many small business credit card holders can check account information and get text alerts about their account via their mobile devices. Issuers are innovating additional features, more specific to small businesses and business travelers, offered through mobile devices. Examples include an alert when an international transaction fee will apply to a transaction conducted in a foreign country and an expense reporting tool that allows purchases to be directed to a specific project or client account by making entries via cell phone.

## **IX. Conclusions**

General-purpose credit cards mediate commerce in the small business segment by enabling entrepreneurs to conduct business within an existing network of qualified merchants without the need to set up separate trade lines with each of those merchants. In *consumer payments*, cards have become such a fixture that, by now, this intermediary function is taken for granted. The practice of consumers asking merchants to “charge it,” while the merchants kept a ledger of what their customers owed, sent bills, and collected those amounts, has been all but forgotten.

But for the small business segment, where vendor credit may (or may not) be

offered, the role of cards in facilitating the exchange of value between buyers and sellers is a reminder of the efficiencies delivered to both sides of this two-sided market. And efficient payments “serve as a lubricant to the economy,” argue Bergman, Guibourg, and Segendorf, who further maintain that “payment mediation is an economic activity in itself [and] efficient means of payment produce direct social benefits that may be substantial.”<sup>22</sup>

In addition, the billing cycle and grace period typically provided by credit cards help small businesses manage cash flow – their primary motivation for applying for credit – while they await payment from their own clients. A high percentage of these card accounts are paid in full each month, so interest charges are never generated. For these small business convenience users, like their consumer-card counterparts, the decision to own and use cards may be less directly correlated with market rates of interest than with some other attributes of the credit card product.

Small business borrowing has contracted since the beginning of the economic downturn, but spending on small business credit cards has resumed. Spending on small business debit cards continued in an unbroken upward path throughout the recession, in part due to the growth of debit in small business payments as more banks offer business debit products and more businesses acquire them and use them more frequently.

After a rise in credit losses, risk to issuers has improved. As a result, issuer profitability is again above water and offer rates, which had risen, have come down and appear to have stabilized. Conditions are again favorable for small businesses to obtain and use credit cards.

---

<sup>22</sup> Mats Bergman, Gabriela Guibourg, and Bjorn Segendorf, “Card and Cash Payments from a Social Perspective,” Sveriges Riksbank *Economic Review* (February 2008).

Companies interested in applying for credit cards may increasingly be doing so in a bank branch. The extremely low response rates of direct mail make it an expensive acquisition technique, although it might be useful in generating leads among pre-screened prospects.

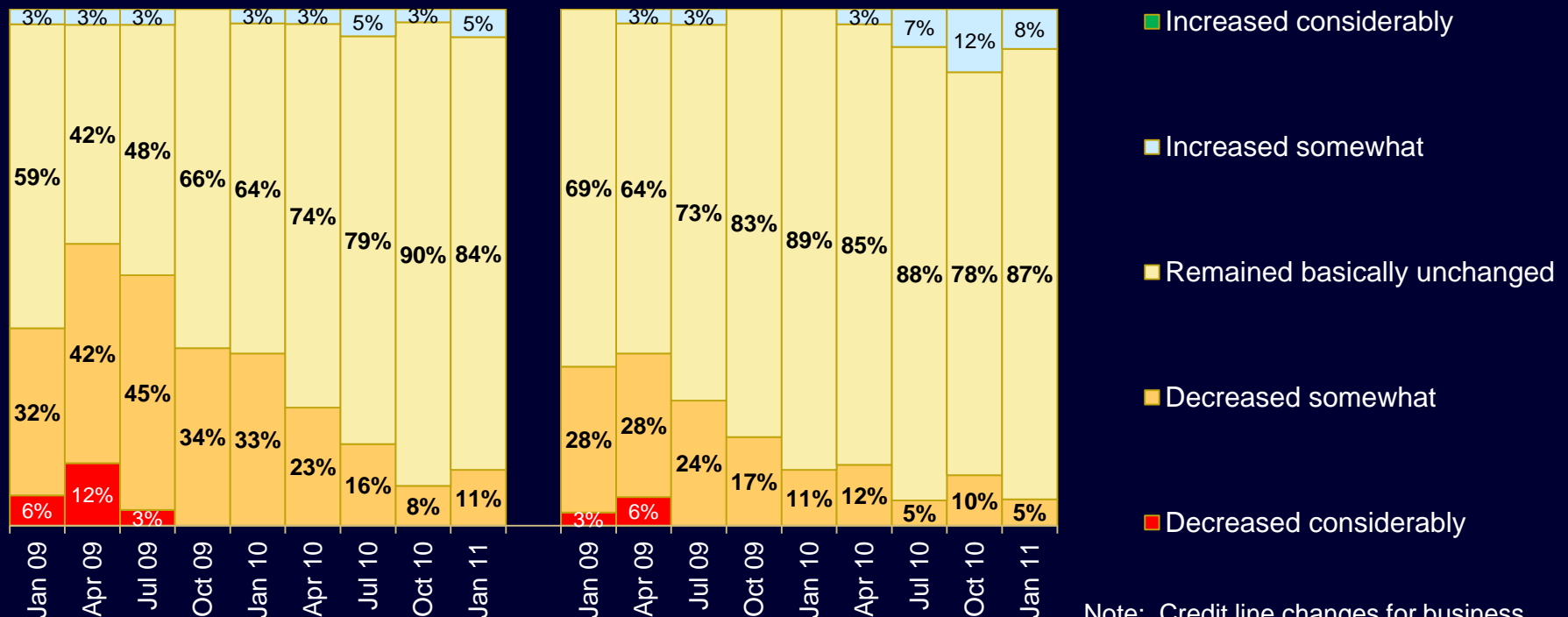
Challenges to small businesses persist in the current environment. Weak demand and the unpredictability of business conditions continue to affect respondents to surveys of the National Federation of Independent Business. But the small business credit card industry appears to have come through the worst of the economic slump, remaining available to meet the borrowing and payment needs of the nation's entrepreneurs.

# Figure 1. Changes in Credit Card Line Amounts

Q. Over the past three months, how has your bank changed the size of credit lines for existing customers?

## Consumer Credit Cards

## Biz Credit Cards

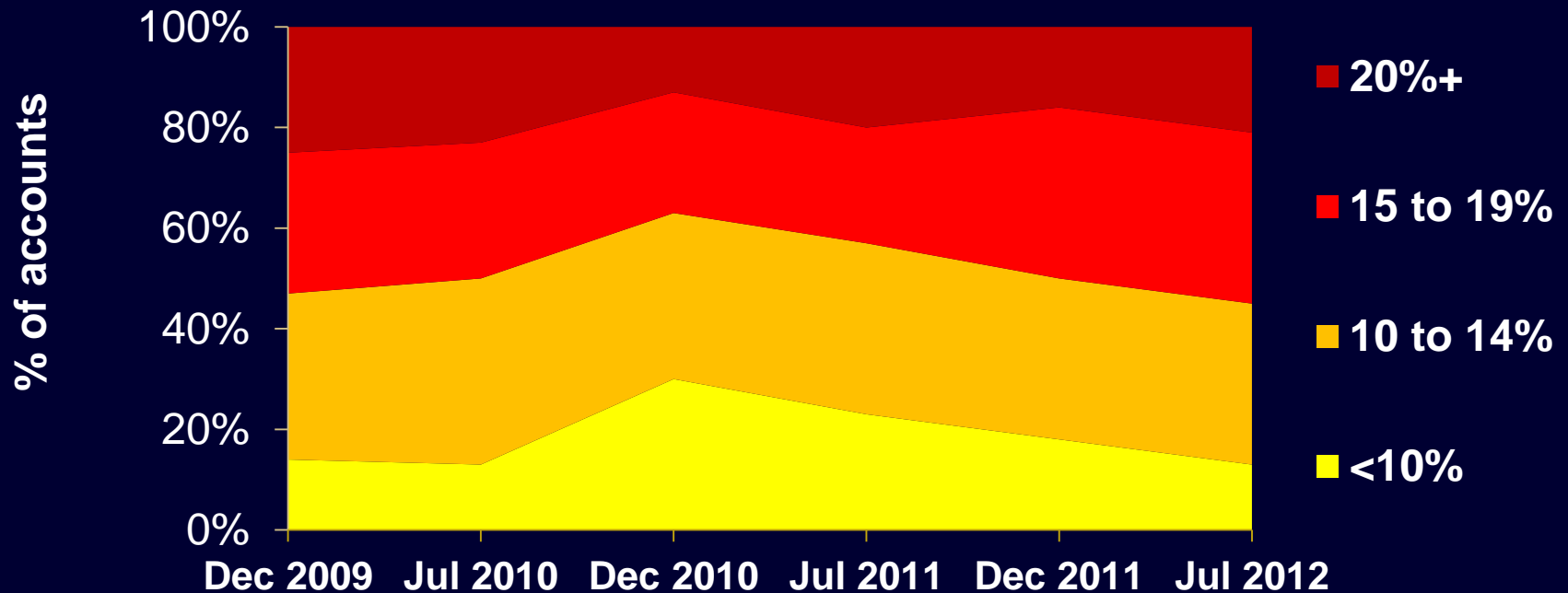


Note: Credit line changes for business cards not reported after January 2011.



# Figure 2. Changes in APRs on In-Wallet Credit Card

## Primary credit card APRs (range)



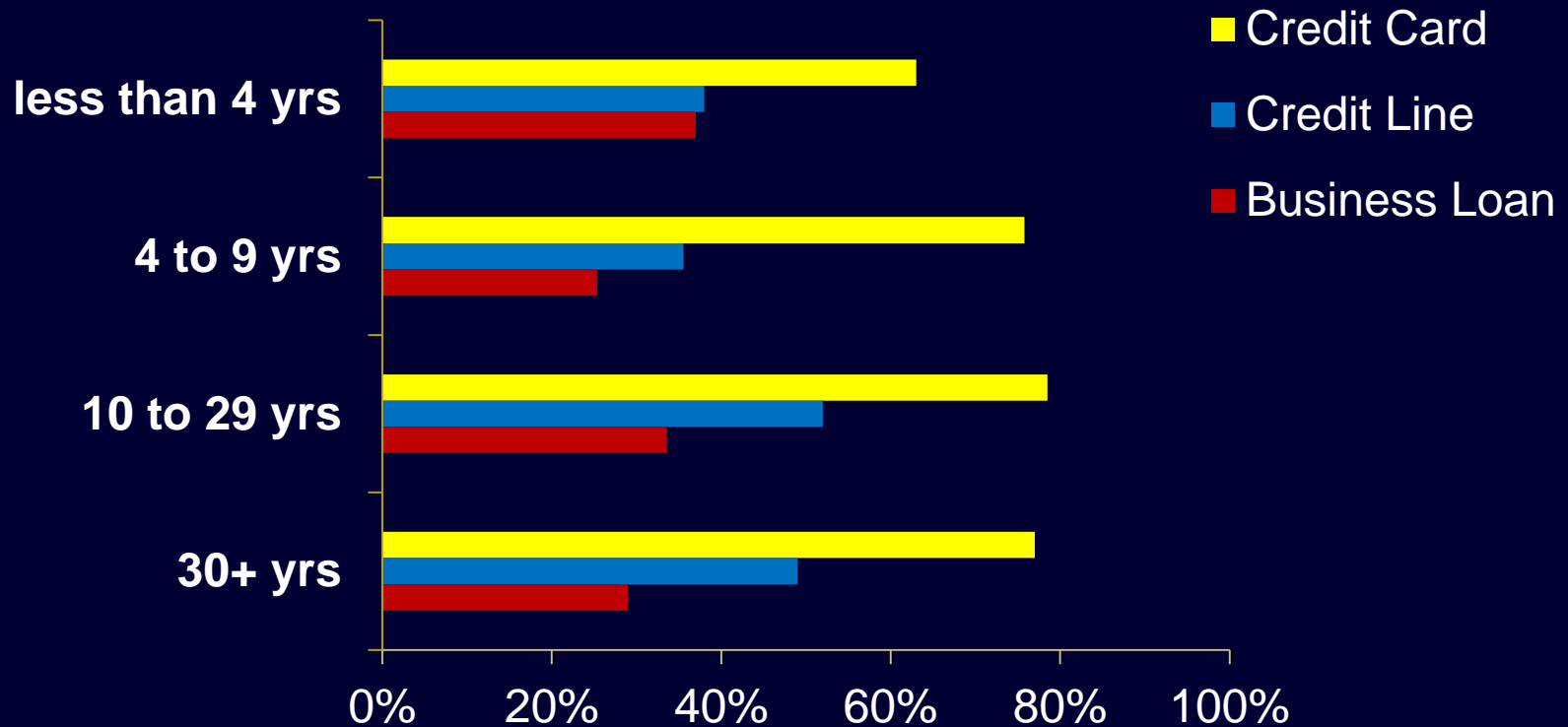
# Figure 3. Spending with Small Business Credit, Charge, and Debit Cards

*U.S. Business Card Spend (in \$ billions)*



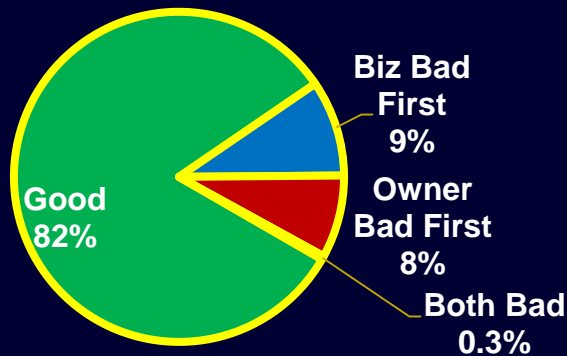
# Figure 4. Card Ownership by Age of Small Business

## Small Biz Credit Used by Years in Biz

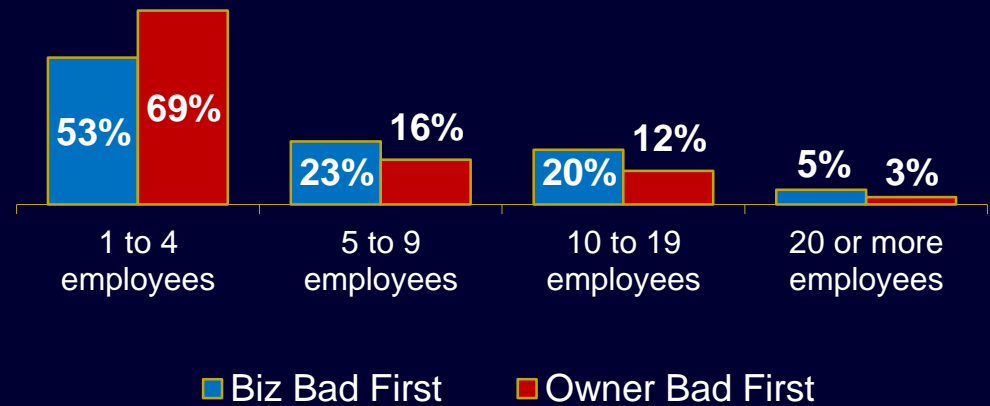


# Figure 5. Do Cracks in Credit First Appear on Personal or Business Side?

Which credit goes bad (i.e., notable blemishes) first? (four-year study period)



by Employee Size



by Years in Biz

