GroWBiz Media

The Silent Credit Killer

The 4 Biggest Credit Mistakes Small Business Owners Are Making (and How to Fix Them)

By Rieva Lesonsky, CEO of GrowBiz Media

Executive Summary

SITUATION:

Small Business Owners Have Difficulty Getting the Credit They Need to Start and Grow

Getting the financing your small business needs to grow has always been challenging, but never more so than in today's economy. To get the capital they need, more and more small business owners are turning to credit cards as a financing tool. In fact, credit cards are currently the number-one source of small business financing.

PROBLEM:

Using Credit Cards the Wrong Way Makes It Harder to Access Capital

Used properly, credit cards offer many benefits for small business owners. But using credit cards the wrong way can affect a small business owner's ability to get credit and capital in the future. Whether by using a personal credit card for business, using the wrong kind of business credit card, overutilizing the wrong credit cards or failing to maintain adequate available credit, too many small business owners are using credit cards the wrong way without even knowing it...and NOBODY is talking about this!

SOLUTION:

Learn the Right Way to Use Credit Cards for Your Small Business

Understand how to use credit cards the right way. Begin by paying off or reducing your existing credit card debt. Then be vigilant about maintaining or achieving good credit. Increase your available credit strategically and be sure to use the right kind of business credit card(s). Working with a qualified credit and lending expert can help improve your access to credit and capital.

RESULT:

Get the Credit and Capital You Need - Now and in the Future - to Grow Your Business

When you use credit cards the right way, your small business will have a better chance of obtaining the credit and capital you need, when you need it, on the best possible terms. That lets you seize opportunities to service new customers, expand into new markets and achieve your business goals.

Introduction

As a small business owner, you know how important it is to be able to access the capital you need to grow your business. But did you know that the way you're using your business and personal credit cards today could be jeopardizing your ability to get capital for your business tomorrow?

"The challenges of obtaining financing for small business owners are well documented," says Brian Moran, Executive Director, Sales Development at The Wall Street Journal, who has over 20 years of experience in the small business space. "What the owners need are people who understand the different bank and nonbank options that are available. Research shows that basic tools, such as credit cards, are typically not utilized properly, leading to additional funding issues." Like anything else, credit cards can be used the right way or the wrong way.

"Many business owners don't [use credit cards properly]," warns John Ulzheimer, President of Consumer Education at SmartCredit.com and the nation's premier credit expert, "and if you can't articulate the details of exactly how to [use them], then you are probably one of the many."

Small Business Credit Card Trends

Credit cards are by far the most common source of financing for America's small business owners. According to a 2012 report by the National Federation of Independent Business (NFIB), 79% of small business owners use credit cards for business purposes. This is more than any other source of financing, including business earnings. That's up substantially from 1993, according to the National Small Business Association (NSBA), when just 16 percent of small-businesses owners identified credit cards as a source of funding they had used in the preceding 12 months.

A 2010 Keybridge Research study, Quantifying the Impact of Credit Cards on Small Business Growth & U.S. Job Creation, found that each $1,000 in credit card use was associated with an increase in firm revenue of approximately $5,500.

Despite what you may have heard about the dangers of credit card usage, this increase is not in and of itself a bad thing. "Many people are critical about credit card usage," says Kris Roglieri, Founder of Commercial Capital Training Group and President of a commercial finance company since 1998. "However, most of the critics aren't entrepreneurs, haven't built businesses, and don't understand the requirements and pressures that small business owners face."

In fact, increased business credit card use has had many positive results for both small businesses and the U.S. economy. A 2010 Keybridge Research study, Quantifying the Impact of Credit Cards on Small Business Growth & U.S. Job Creation, found that each $1,000 in credit card use was associated

with an increase in firm revenue of approximately $5,500, and each $5,613 increase in credit card use per month created one net new job. During this five-year study, they also found that business credit card lending pumped over $142 billion into the economy on an annual basis and was responsible for the creation of over 1.6 million jobs. (How's that for a stimulus plan?)

However, these positive results don't accrue to all businesses, because while more and more small business owners are using credit cards in their businesses, a growing number of them are using those credit cards the wrong way. Experts—from bankers and other lenders to small business experts—are largely ignoring this issue.

"We need to do an extreme credit and lending makeover in the small business marketplace and increase the level of understanding about these core issues that impact so many millions of business owners and their livelihoods," says Tom Gazaway, founder and President of Hawkeye Management, which specializes in unsecured business loans and unsecured business lines of credit. The company, which has offices in Blackwood, NJ, and Bentonville, AR, has a nationally recognized credit card program among its other offerings.

"There's a reason banks approve less than 10 percent of the applications they get from small business owners. There's also a reason why credit cards are the most popular form of financing for small business owners," says Gazaway. Unfortunately, he says, due to a lack of education and understanding, too many small business owners are using credit cards the wrong way—which can not only damage their credit scores, but also limit their ability to get additional funding and grow their businesses.

"I realize that our database and experiences will be different than people who offer commercial real estate loans or equipment financing, but we focus on working capital and helping people avoid needing collateral and protecting and preserving their credit as they grow their businesses," says Gazaway. "But nobody would deny the importance of having good credit. We talk about treating your credit almost like an asset on the balance sheet. It's that important. We get hundreds of new requests each month, and for us, the number-one reason small businesses can't get credit is that they are using credit cards the wrong way. The problem is especially severe for small businesses seeking $25,000 to $150,000 in financing."

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Are You Putting Your Business's Future at Risk?

What are some of the risks of using credit cards the wrong way?

☑ **It can delay your access to credit.** If you need credit right away to fulfill an order or take advantage of a business opportunity, you may not be able to access it. "Unfortunately, we see many clients who have to spend three to six weeks getting their credit in order before they can even apply to banks or other lenders," says Gazaway.

☑ **It can prevent you from getting the lowest possible interest rate on your loan or line of credit**. If you want access to zero- or low-interest loans, you need to use credit cards correctly. If you don't, your options will be limited to higher-interest loans or lines of credit, requiring higher payments and negatively impacting your business's cash flow.

☑ **It can keep you from getting unsecured loans.**

If you have collateral to pledge, like your stock market investments, the assets in your 401(k) plan or the equity in your home, it's still relatively easy to get a loan from most lenders. But as Gazaway notes, "Part of obtaining capital should be considering the risk perspective. What if you pledge your precious collateral and your business doesn't succeed? It's not fun to think about, but you need to think about what that would look like." With unsecured loans, the worst-case scenario will be some negatives on your credit report, but you don't risk losing your home or your nest egg.

☑ **It can keep you from getting financing altogether.** "The hardest thing for us is when we have to tell the [business owner] who needs $50,000 or $100,000—and sometimes less—to pick up a new contract that would take their business to the next level that they can't get that small amount of capital because they've used their credit cards the wrong way," says Gazaway. "If they had used credit cards the right way and not impacted their personal credit, they would get their financing and be able to move their business forward."

> ***"Unfortunately, we see many clients who have to spend three to six weeks getting their credit in order before they can even apply to banks or other lenders," says Gazaway.***

Now that you know the risks of using your business or personal credit cards incorrectly, let's take a closer look at the four most common mistakes small business owners make when using credit cards.

Mistake #1: *Using a Personal Credit Card for Business*

Using your personal credit card for business purposes is a big mistake—but it's one that many small business owners make. According to a report from the Federal Reserve Board, 41 percent of small business owners use personal credit cards to finance their businesses.

"The challenge for small business owners is that so many of them hurt their chances of growing because they don't protect their personal credit profiles as they build their businesses," says Ulzheimer.

When you use personal credit cards for business purposes, you're not separating your business and personal credit. This hurts you in three ways.

1. You may not (and probably won't) qualify to write off the costs (such as fees and interest rates) of using the funds on your taxes.

2. If your business runs into trouble and becomes delinquent on payments—on any type of personal or business credit card--it will negatively affect your personal credit report. This can impact your ability to achieve the goals you want for yourself, such as buying a new car, remodeling your home or enjoying a family vacation.

3. When you don't separate your personal and business credit, you're not building a strong credit history for your business. This will make it more difficult to obtain capital or even to obtain new business credit in the future, hampering your business's growth.

Mistake #2: *Using the Wrong Kind of Business Credit Card*

Even if you are using a business credit card, it may not be the right one. Did you know that some business credit card issuers report usage information to your personal credit report? That's right. In fact, a 2012 study by CardHub found that six of the top 10 business credit card issuers relay business credit card usage information to their cardholders' personal credit reports.

> ***"One of the most misunderstood elements of credit scoring is how the excessive leveraging of credit cards that report to your personal credit reports will not only hurt your credit scores but, as a result, will also make it difficult to obtain additional funding in the future."***
>
> John Ulzheimer

"From a credit perspective most people know that things like late payments, tax liens, and bankruptcies are bad and can hurt their credit reports and scores," says Ulzheimer. "One of the most misunderstood elements of credit scoring is how the excessive leveraging of credit cards that report to your personal credit reports will not only hurt your credit scores but, as a result, will also make it difficult to obtain additional funding in the future."

Clearly, using this type of business credit card can lead to the same problems you'll face when you use a personal credit card for your business. You're putting your personal credit score at risk, and since you're failing to separate business credit and personal credit, you're not building a strong business credit profile. (If you already have a business credit card, you should check your personal credit report to make

sure the card doesn't show up on that report.) Working with a credit and lending expert can help you choose the right kind of business credit card.

Mistake #3: *Overutilizing Your Business or Personal Credit Card*

If you're using too much of your available credit on a personal credit card or on a business credit card that reports to your personal credit report, you're damaging your credit score. Utilization begins to impact your FICO score when you start using more than 10 percent of available credit on any card that reports to your personal credit report. Although using between 10 and 30 percent of your available credit on these types of credit cards is generally acceptable to most lenders, using more than 30 percent of your available credit will negatively affect your FICO scores and make it much more difficult to obtain additional financing when needed. Thirty percent of your FICO score is determined by your utilization.

"We have scores of people every week and hundreds every month who come to us with excessive utilization on their credit, and they don't realize how problematic that can make it for them to obtain additional financing," says Gazaway.

How does overutilization affect your ability to access capital? "When people have excessive utilization and they can't find a viable strategy to alleviate their problem then one of two things happen," Roglieri says. "They either can't get any financing or they have to get more expensive financing. That expense will come in higher rates and fees and/or collateral requirements."

Overutilization can also prevent you from obtaining larger lines of credit or higher credit card limits. If you're seeking $50,000 to $150,000 in capital, Gazaway explains, you typically need to obtain the money from several places—for example, a $15,000 line of credit from one source, a $20,000 line of credit from another, and a $25,000 line of credit from a third. However, if you've overutilized your available credit, you won't be eligible for credit limits that high. If you qualify at all, you'll likely to be limited to borrowing $1,000, $2,000 or $3,000, which isn't much help to a growing small business. "This is where average approval statistics are deceiving," says Gazaway. "Business owners sometimes think the goal is just to get approved, but did you really succeed if you

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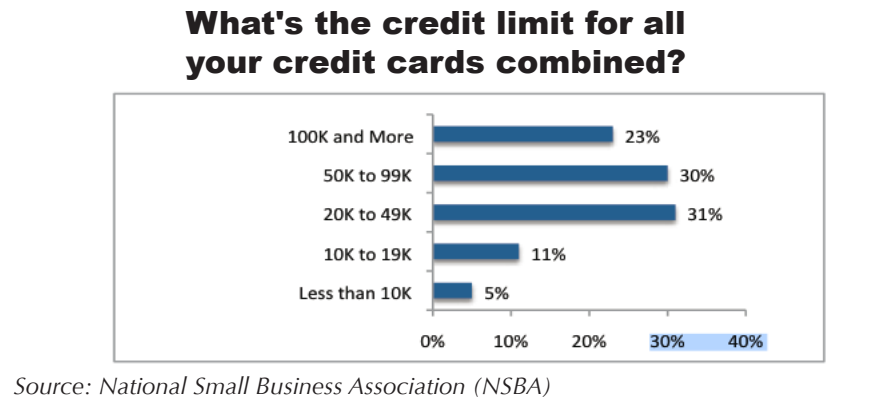


Source: National Small Business Association (NSBA)

only got approved for $2,000 when you could have gotten $15,000 or more from that same lender if your utilization was lower?"

Mistake #4: Not Having Enough Available Credit

Both as consumers and as business owners, we're often told to minimize our use of credit cards, and to keep our credit limits manageable. So how can having lots of available credit be a good thing?

Suppose there are two business owners, both with FICO scores of 800 and outstanding credit card balances of $2,500 on credit cards that report to their personal credit reports. The only difference: One business owner has a total of $100,000 in available credit, and the other has $20,000.

Now suppose each of the two business owners has their line of credit lowered by $15,000. For the small business owners with $100,000 in available credit, this isn't a big deal. He or she still has $85,000 in credit to work with.

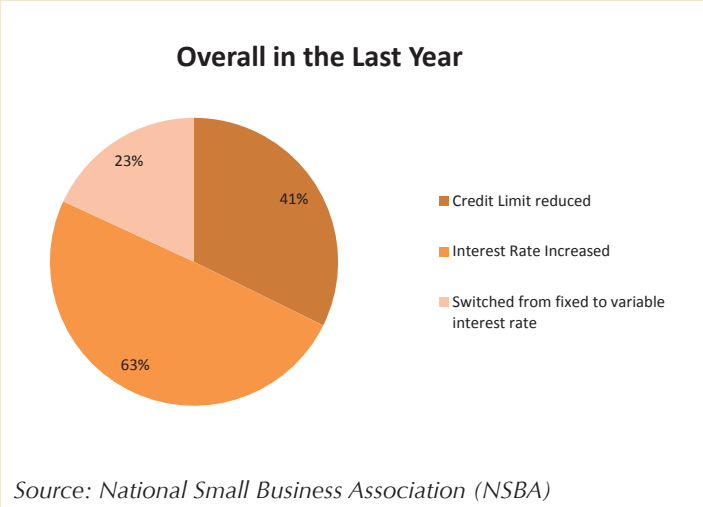
If you're the small business owner with just $20,000 in available credit, however, this is a huge deal. Suddenly you only have $5,000 in available credit. Making matters worse, since you're carrying a balance of $2,500, suddenly your available credit is 50 percent utilized. Because you're using 50 percent of your available credit, your FICO score drops significantly. You have less money available to you, and your options for obtaining more are severely limited—all because you didn't have enough available credit.

In a survey by the National Small Business Association (NSBA), 41 percent of small businesses reported having their credit limit reduced in the past year.

Think this can't happen to you? It very easily can. In a survey by the National Small Business Association (NSBA), 41 percent of small businesses reported having their credit limit reduced in the past year. A recent study by the National

Federation of Independent Business (NFIB) found that the number of small business owners with lines of credit has declined by 10 percent since 2008, and that just 70 percent of small business owners seeking to renew their lines of credit were successful.

Having $100,000 or more in available credit can protect both you and your business, says Gazaway: "A large number of people with FICO scores of 800 have this much available credit." However, a survey by the National Small Business Association (NSBA) found that just 23 percent of small business owners have available credit of $100,000 or more, and 16 percent have under $20,000 in available credit-putting their businesses at risk.



Source: National Small Business Association (NSBA)

How to Protect and Mend Your Credit

and avoid the common mistakes made by millions of small business owners

Ready to stop using credit cards the wrong way and start using them the right way? Experts offer this advice. "First, stop what you're doing so you don't make it any worse," says Gazaway.

Another option is to get a debt consolidation loan to pay off the credit card debt. "You'll still owe the money," explains Gazaway, "but this improves your credit score, and you will not fail to meet loan underwriting criteria because you have the wrong kind of credit card debt." Credit scoring models and lenders prefer to see installment debt over revolving debt.

Where can you get a debt consolidation loan? Gazaway recommends credit unions and smaller banks. If you don't succeed with these lenders, "try peer-to-peer lending networks, such as Prosper.com or Lending Club," he suggests. Be aware, however, you'll pay higher interest rates and

Credit scoring models and lenders prefer to see installment debt over revolving debt.

closing costs than you would at a bank or credit union. Also understand that peer-to-peer networks are inquiry-sensitive, so making too many prior attempts to get loans elsewhere can hurt your chances of getting a peer-to-peer loan.

Once you've paid off or reduced your credit card debt, use this three-step plan to build the best possible credit profile and ensure that you have the best chance of obtaining the business credit you need in the future:

1) Be vigilant about maintaining or achieving good credit. Keep utilization below 30 percent of your total available credit, don't let your busy life cause any late payments that could hurt your credit profile, and minimize excessive inquiries. Don't make the mistake that millions of business owners have made by hurting your credit as you grow your business.

2) Increase your available credit. Seek credit cards or lines of credit from several places to total $100,000, but do it strategically. This means that you want to have plenty of available credit showing up on your personal credit profile. You don't want the business credit to show up on your personal credit profile because you're going to use the business credit, and you want plenty of available credit to show on your report so you look like a better credit risk with healthy capacity to borrow. Remember, banks don't lend to people who are "in trouble"–they lend to people who look like they don't need the money.

> ***"The credit and lending environment for small business owners is much like the legal landscape. If you had a legal matter, you would probably hire a qualified lawyer to represent you. One of the reasons so many people don't get their funding nowadays is that they're not working with a qualified credit and lending expert who understands all the nuances of small business credit and borrowing."***
>
> Cort Christie

3) Use the right kind of business credit card(s). In most cases you'll want to choose cards that don't report activity to your personal credit report.

Working with a credit and lending expert can help ensure you are using credit cards the right way and increase your chances of getting the financing you need to grow your business, both today and in the future. "Nowadays it's different than it was 10 years ago or even before the credit crisis hit a few years ago," says Cort Christie, President of Nevada Corporate Headquarters, which has set up thousands of businesses yearly for 20 years and offers financing solutions.

"Credit cards can be one of the best financing tools for a small business owner when they are acquired and used properly," says Roglieri.

"The credit and lending environment for small business owners is much like the legal landscape. If you had a legal matter, you would probably hire a qualified lawyer to represent you. One of the reasons so many people don't get their funding nowadays is that they're not working with a qualified credit and lending expert who understands all the nuances of small business credit and borrowing."

"On a macro level, it slows our nation's economic growth when we limit the ability of our country's entrepreneurs and small business owners to start, build and grow their businesses and fuel their goals and dreams," says Gazaway. "When you look at the results of the Keybridge Research study, you can see that using credit cards the wrong way is clearly limiting our ability to add thousands of jobs—and that every $25,000 that can't be borrowed by the business owner takes over $125,000 of revenue out of the business owner's pocket."

"Credit cards can be one of the best financing tools for a small business owner when they are acquired and used properly," says Roglieri. "Where else can you get low-cost financing that doesn't require full financials or collateral and that you can use over and over again without repeated requests and applications?"

Concluding Summary

Credit cards are an important tool for small business financing in every economy. However, using your credit cards the wrong way can

☑ delay your access to the credit you need,
☑ hurt your credit profile and damage your FICO scores,
☑ keep you from getting the lowest possible interest rate on your loan or line of credit,
☑ keep you from getting unsecured loans, or
☑ prevent you from getting financing altogether.

Common mistakes small business owners make when using credit cards include

☑ using a personal credit card for business,
☑ using the wrong kind of business credit card,
☑ overutilizing credit cards, or
☑ failing to maintain adequate available credit.

To use credit cards the right way, small business owners should

☑ pay off or reduce existing credit card debt,
☑ be vigilant about maintaining or achieving good credit,
☑ increase available credit strategically,
☑ use the right kind of business credit card(s), and
☑ Consider working with a qualified credit and lending expert.

Create Your Own Stimulus Package:

By understanding (and implementing) the right way to use credit cards and avoiding these common mistakes made by millions of small business owners, you can build and protect a strong credit profile, obtain more funding, and increase your chances of getting the additional capital you'll need to grow your business in the future.

RIEVA LESONSKY

Rieva Lesonsky is CEO of GrowBiz Media, a media and custom content company focusing on small business and entrepreneurship. A nationally known speaker and authority on entrepreneurship, Lesonsky has been covering America's entrepreneurs for nearly 30 years. Before co-founding GrowBiz Media, Lesonsky was Editorial Director of Entrepreneur Magazine.

Lesonsky has appeared on hundreds of radio shows and numerous local and national television programs, including the Today Show, Good Morning America, CNN, Fox Business News, The Martha Stewart show and Oprah, and can regularly be seen on MSNBC's Your Business.

Lesonsky writes about small business for SCORE, Small Business Trends, SBA.gov, Network Solutions, ReadWriteWeb, American Express OPEN Forum, AT&T and The Huffington Post Small Business. In 2009, she was named to Folio Magazine's "Folio 40" list, which honors publishing's top innovators. In 2011 she was named a Small Business Influencer by SmallBusinessTrends.com.

Many organizations have recognized Lesonsky for her tireless devotion to helping entrepreneurs. She served on the Small Business Administration's National Advisory Council for six years, and was honored by the SBA as a Small Business Media Advocate and a Woman in Business Advocate. The Collegiate Entrepreneurs Organization honored her for helping drive "the entrepreneurial revolution in secondary education." The ASBDC awarded her a "Champion of Small Business" award.

Lesonsky is the author or co-author of several books about entrepreneurship. Follow her on Twitter at twitter.com/rieva, and visit her website SmallBizDaily to learn about the latest small business trends and sign up for her free TrendCast newsletter.

RIEVA LESONSKY

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www.growbizmedia.com
4067 Hardwick St., #296, Lakewood, CA 90712
Phone (714) 556-2000