

Strategies for Success—Billings Business News

Credit Management in times of Economic Downturn

Joe Michels, PhD, P.E., C.P.L.
Solomon Bruce Consulting LLC
Billings, Montana 59106
406-672-6387
www.solomonbruce.com

During times of economic uncertainty, the ability of a business owner to get a loan increased or just get a new loan for your banker are sometimes decreased significantly. The decrease in business sales, lack of product demand as well as customers who elect not to purchase causes significant cash flow problems for many business owners.

Many business owners, after having an unsuccessful time attempting to get additional loans or operating capital from the bank turn to their personal credit cards as a source of increased business capital. This action is fraught with challenges. Although using a personal credit card or business credit card PROPERLY MAY help short term cash flow issues, the opportunity to cause significant problems is overwhelming!

Let's explore some of these challenges and see how we may be able to use a credit card in a manner which is productive and beneficial to a business.

First, you should never charge more on the credit card than you pay off effectively each month. If indeed you need more money than you will be able to pay off at the end of the month, you will begin accruing an interest charge for the use of the money. The interest rate can be as low as 7-8%; however, it can be as high as 36% as well. Here is where you really need to read all of the small print in your credit card contract. You might be surprised how much interest you are being charged.

Being late on the payment may also trigger the bank to raise your interest rate on the unpaid balance remaining on the credit card. This may happen if you have had a spotless credit record for several years, then make one error and are 3-4 days late with the payment. Credit cards should ALWAYS be paid before the due date—that insures that you will not incur any late charges.

Exceeding the credit limit on your card is another way in which to incur significant fees and or increased interest rates. Again, here is where a full and complete understanding of all of the small print contained within your contract comes into full view. Although each of these fees, individually, may not appear to be much, in the aggregate, these fees can become quite substantial. This is true if you go back over a full year or more.

Your credit report is comprised of all the credit sources that you have open. It is better to NOT close an account than it is to close the account if you are not using it. I don't understand the logic, nobody else does either, and however, that is how the credit reporting bureaus work. If you have a card that you have minimal activity on, use it occasionally, then pay it off at the end of the month—it will remain the currency of the card and will not impact your credit rating.

If you need to use your credit card for interim business financing, you should first develop a written plan on how fast you will pay off the balance. If you need to “borrow” \$10,000 right now, and you have adequate and sufficient credit limit, the card company will give you the \$10,000 worth of credit. However, you should have developed a game plan on getting this amount paid to 0 in the least amount of time possible before you take the credit. In this case, you may elect to pay \$2,000/month for 5 months and then have the card fully paid off. You will have paid interest for the 5 months that you “borrowed” the money, however, by that time, your business should have successfully operated in such a fashion that you will not need to use the credit card again for a business loan.

If you have a large credit card balance—now is the time to develop a game plan to get the balance to 0 as soon as possible. This is HARD—however, not impossible. Making the minimum monthly payment will NOT get you there. You are going to have to make payments significantly larger than the minimum monthly payment if you wish to decrease the balance to zero. The reason is easy—the minimum monthly payment normally insures that you only pay the interest due on the principal. This is why you must make substantial payments so that you can cover both the interest as well as the principal. This will allow the principal to be reduced as well as the interest.

I would make a graph or timeline depicting the size of the credit card bill on the Y axis, followed by time period on the X axis. See figure 1 below:

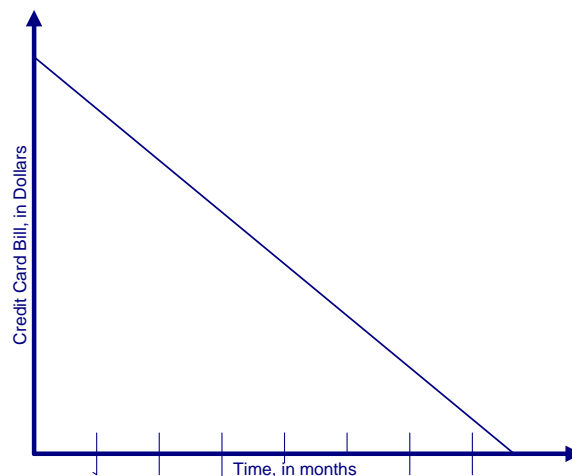


Figure 1

Each month, you then pay down the fractional part of the bill. In the case in figure 1, we have determined that it will take 7.5 months to pay the outstanding credit card bill down to zero. The length of the pay down period is determined by your cash flow projections. In this case, we determined that 7.5 months was the proper period. However, if sales projections are larger, you would be able to pay off the bill earlier.

If you are in significant credit card payment difficulty, contact the bank or insurer of your credit card. The bank may be willing to work with you to get the balance paid off. The bank is interested in receiving their money back, with interest. The bank is not interested in your business failing, precluding their loan from being repaid. However, this conversation should be done early in the time period. It makes no sense to be in substantially over your head and then decide to have a chat with the banker. This chat, however painful it might be, is best suited for as soon as you realize that you are going to experience difficulty in paying the loan or credit card bill as originally agreed upon.

Credit cards are not free money. They are a great tool for proper cash management, however, are not designed to be used to aid in the cash flow of a business. Some people try and use them as cash flow devices—in most cases, at the end of the day, that decision is fraught with peril because of the difficulty of paying off the credit card balance in a timely fashion.

Cash flow is the heart line of any business. However, having maxed out all credit lines and not having the ability to access additional credit is problematic at best. Careful management of your credit cards will insure that you are not placed in a position where the credit card becomes a bigger challenge than you can handle.