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CHAPTER 27 Your Credit and the Law

Credit Cards: Entrepreneurs Are Tapping Them More Than Ever

Despite the glut of financing options for small business, many still don't qualify

by Dennis Berman and Jeremy Quittner in New York

When Paul Baum started his computer hardware company in 1991, he did what new entrepreneurs have long done: He whipped out his credit cards for instant financing.

Seven years later, he's still plunking down plastic—four cards now, down from a high of 15, with credit lines totaling more than $2 million. Says Baum, CEO of Rumarson Technologies Inc. in Kenilworth, N.J.: "I've never had a bank loan." He has a $1.8 million bank credit line, which charges 1/4-percentage point over the prime rate the moment he taps it. Still, he prefers his cards because by paying the balance every month, the financing is free.

Baum's strategy is hard to argue with—for now. But with an economic slowdown expected next year, many entrepreneurs may find themselves caught in a classic credit-card trap—rolling over balances each month and paying 15% or more in interest under onerous terms.

AWAKENING. There's reason to be concerned. Bankruptcies hit an all-time high in the 12 months ended Sept. 30, with more than 1.4 million consumers and businesses filing for credit protection, according to the American Bankruptcy Institute.

Particularly worrisome are recent studies that reveal entrepreneurs are using credit cards more than ever. An Arthur Andersen/National Small Business United survey found that 47% of small-business owners used credit cards to finance their businesses, almost double the percentage of two years ago. Separately, PSI Global, a Tampa (Fla.) bank-research company, shows credit-card use among small businesses has climbed 10% since 1997. The increase in consumer credit-card debt also reflects rising small-business use, as entrepreneurs often tap their personal cards for business. According to the Oxnard (Calif.) *Nilson Report*, outstanding debt on general-purpose credit cards is expected to be $482 billion by yearend. Consumer debt on credit cards has risen 59% since 1994.

The perplexing side of the trend is that young companies have more conventional financing options than ever. Banks and vendors are scrambling to tap this long-neglected and significant piece of the economy as other markets approach saturation. Bank lending to small business has soared 22% since 1995, now totaling $186 billion, an all-time high, according to the Wakefield (Mass.) bank-research company Veribanc Inc. Computer companies such as Compaq and Dell are aggressively pitching leasing deals to small companies. And as part of its larger pitch to small business, American Express is offering entrepreneurs loans for equipment purchases.

CULPRIT. Some experts say the apparent paradox between availability of conventional funds and more credit-card use reflects another problem: Banks' lending policies are stuck in an era when entrepreneurs were shop owners or manufacturers with assets that could be attached as collateral. That's seldom true for the ethereal high-tech and service sectors, the most fertile source of new business today. "Young technology companies are not able to borrow from banks. They don't have any tangible assets, their primary assets are intellectual," says Terrence Hicks, vice-president for entrepreneurial services at Benjamin Franklin Technology Center in Philadelphia.

That's why Jo-Anne Dressendofer uses six personal credit cards with a total line of $100,000 to finance computers, software, and office supplies for her 10-year-old technology marketing business, Imedia in Morristown, N.J. She says banks still spurn her requests for loans, even though she has $10 million in revenue. "All I have is bodies," says Dressendofer. "They cannot collateralize anything." She shops for teaser credit-card rates of around 4.5% and switches when the rates go up. "It is a brilliant strategy," she declares.

The sheer numbers of startups are also fueling the small-business credit-card boom. A record 885,000 new companies (excluding sole proprietorships) were formed from June, 1996, to June, 1997, the Small Business Administration says. The number has increased steadily since 1993 when only 758,000 were created. Business failures have remained steady—around 700,000 a year.

Federal Reserve data from 1993—the most recent available—show that 25% of companies with revenues of less than $10 million carried a monthly balance on credit cards. But for outfits with revenue of more than $10 million, only 4% carried a monthly balance. The reason for the difference: "A business without some track record would generally find it more difficult to get a bank loan," says Joseph M. Scharfenberger, executive vice-president for small-business financial services at Chase Manhattan Bank.

That's why Eric Rosenfeld didn't even bother to hit up the banks when he started Adoptive Consulting Partners in Mount Laurel, N.J., a year and a half ago. He put the $25,000 in startup costs for his company, which specializes in relational databases and multimedia systems, on three credit cards. "My feeling was I needed something quick," he says. "I haven't found many banks that are interested in small-business loans."

And he found that for all their heavy marketing to small businesses, vendors can be just as nervous as banks about extending credit to those with scant borrowing histories. Rosenfeld says Dell turned his business down for a leasing agreement when he needed $5,000 of computer equipment. So he bought it with plastic. "Everyone respects Visa," Rosenfeld says. Dell says startups may not qualify for financing, but the owners have the option of taking the expense on personally.

Heavy credit-card use doesn't cut much ice with seasoned entrepreneurs who've weathered more than a few ephemeral stock-market plunges. Victor Sparber, vice-president for the Hampton (Va.) vinyl-manufacturing company Jay Plastics Inc., which uses a line of bank credit, has been in business since the 1940s. Says Sparber: "It's almost like these young people today, who get a credit card in the mail—next thing you know, they're buying a TV, a couch, they owe $4,000 or $5,000, and they don't realize what they've gotten into."

Entrepreneurs aren't kids, but they are risk-takers. The next twist in the economy will be the test of how far they're overextended.

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