Selling to the Small Business (SB): Banks Cutting Back on Lending Means Increase in Credit Card Payments to Suppliers (and Further Conflicts With the Supplier's Expense Tied to This Payment Form)

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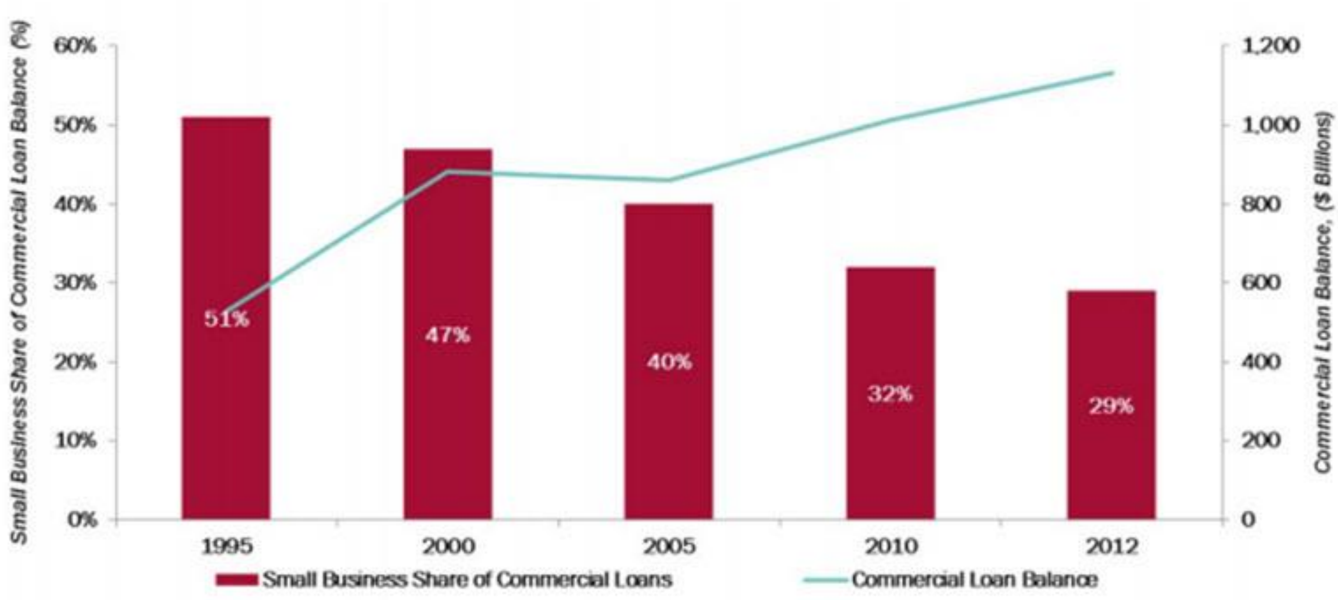
Selling to the small businesses (SBs) carries a number of unique issues for suppliers, including the SB's borrowing needs to meet its operating expenses, which in turn impacts their payment of suppliers selling on open account. The Wall Street Journal reports that large banks are cutting back on loans to small and medium businesses, concluding that loan origination to the SB and maintenance of the loan is unprofitable. As a result, many SBs are turning to credit cards to pay suppliers as the card networks in effect offer the cardholder/customer up to 60 days to pay the card statement from the date the cardholder used the card to pay the supplier's invoice.

The card payment's channel ability to improve both cash flow and working capital for small businesses is crucial given banks' cutting back on their financing. However, credit cards are the most expensive payment channel for the supplier. Indeed, for some suppliers, customer credit card charges are their largest operating expense, other than payroll. What can the supplier do to manage the card cost as more customers turn to cards to pay supplier invoices?

Big Banks Cut Back on Loans to SBs

Figure 14: Small Business Loans as a Share of Total Loans Are in Secular Decline

Small Business Share of Loans at Banks (%) vs. Total Outstanding Commercial Loans ($ Billions)



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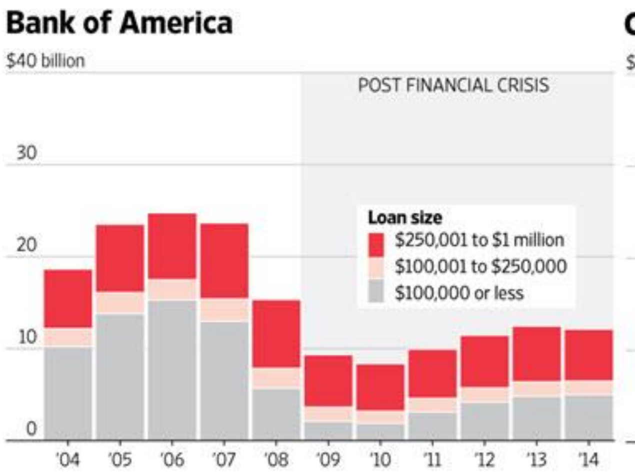
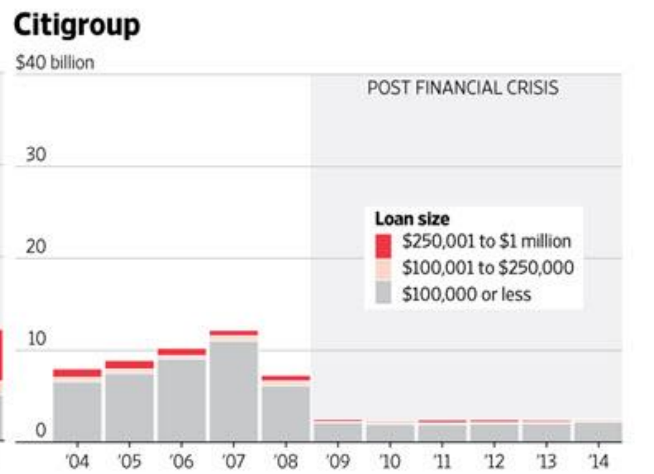
The largest banks have created stricter requirements for SBs to obtain loans. As a result, many SBs are forced to resort to non-bank lenders or, now, credit cards to finance their operations. Many banks are not interested in lending to SBs because it is complicated and administratively expensive as compared with larger loans. J.P. Morgan states that it cost banks the same to originate a $100,000 loan to a SB as for a $1 million loan.

Non-bank lenders have increased their market share from 10% to 26%, as the largest banks have pulled back. The WSJ notes that credit cards are much more expensive if the SB does not pay off the monthly balance, with the average credit card rate of 12.85%. The credit team may flag certain SBs paying by credit card as an increased credit risk.



Source: Analysis of FFIEC data by Rebel Cole, DePaul Univ. THE WALL STREET JOURNAL.



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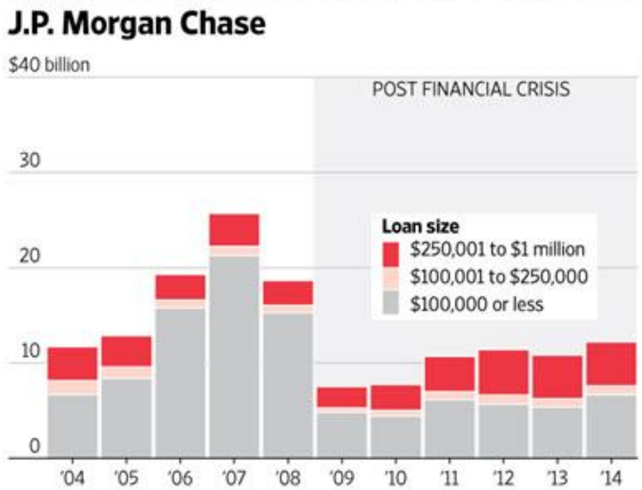

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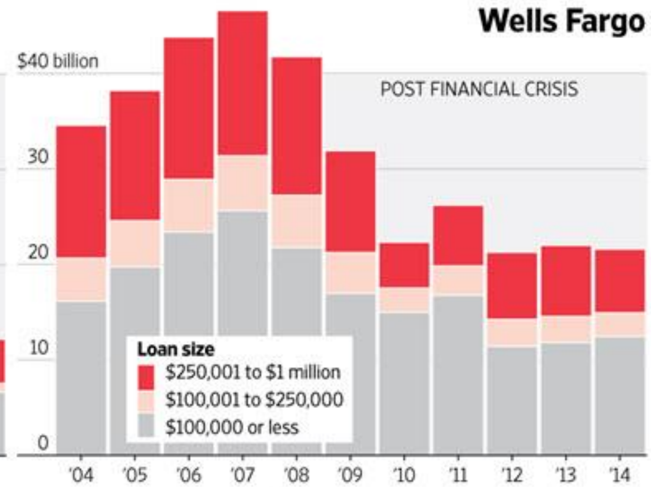

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Card Issuers Offer Added Incentives, Further Moving SBs Away From Bank Financing
The share of customers that pay suppliers by credit card has doubled in the past two years. Card issuers continue to increase the rewards offered to cardholders, including travel points, miles and cash back. Suppliers recognize that no other payment channel offers these rewards, and as such, that card use will continue based on this factor alone.

Making Cards a Price Competitive Payment Channel in Light of the Extraordinary Increase in Demand
Credit cards are the most expensive payment channel for suppliers. And for the reasons noted, card use continues to increase in the B2B space. Given this, it's increasingly common for the supplier's finance team to mandate the credit and sales team to solve the growing expense of this payment form.

One option for the supplier is to refuse to accept cards, but this may result in the customer threatening to pull the business, as it conflicts with customer preference. Another option is for the supplier to offer an early pay discount if the customer pays by say, ACH. Still another option is for the supplier continue to accept - even *encourage* card use (recognizing customer preference) - but add a surcharge to cover the interchange fee. Surcharging allows the supplier to offset a majority of card costs and may also result in the customer electing to use another (cheaper) payment form, again ACH.

Scott Blakeley, Esq., is a founder of BlakeleyLLP, where he advises companies around the United States and Canada regarding creditors' rights, commercial law, e-commerce and bankruptcy law. He can be reached at seb@blakeleyllp.com.