

Statement for the Record

By the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Small Business

United States House of Representatives

April 3, 2008



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Madam Chairwoman and members of the Committee, the American Bankers Association (ABA) is pleased to submit this statement for the record regarding the use of credit cards by small businesses. The ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than \$125 million in assets – represent over 95 percent of the industry's \$12.7 trillion in assets and employ over 2 million men and women.

ABA appreciates the opportunity to submit this statement for the record regarding the use of credit cards by small businesses and we would like to thank Chairwoman Velázquez for exploring this issue. Given that credit cards are responsible for more than \$2 trillion in transactions each year in the United States and are accepted at millions of merchant locations and ATMs, there can be little doubt of the significant role they play in our national economy. It is important for this Committee to consider how useful credit cards are to small businesses, particularly start-ups that may have limited access to other sources of funding.

As Congress contemplates intervening in the credit card marketplace, it should consider the potential that such intervention will have substantial negative, unintentional consequences for both

consumers and our nation's small businesses. These are likely to come in the form of higher prices and less access to credit and – with respect to small businesses – will come at a very inopportune time in our economic cycle.

Credit cards are used by small businesses every day. They serve as a source of funding, as a means for handling short-term fluctuations in cash flow, as a tool for tracking purchases and controlling employee spending, and as an instrument for simplifying tax preparation. These benefits are significant and legislation that reduces them will be harmful to small businesses.

The ABA would like to make two points with regard to this issue:

- ▶ Small businesses are significant participants in the credit card market.
- ▶ Policymakers should exercise caution as legislative intervention into the credit card market may have unintended consequences that will harm small businesses.

I. Small Businesses Play a Significant Role in the Credit Card Market

Credit cards are used with such ease and ubiquity today that it is easy to take them for granted. Industry participants spend vast amounts of time, money and resources each year to maintain and improve upon the complex electronic payment system that makes using credit cards so easy and convenient. Thanks to continual innovation and market forces, credit cards have evolved from a simple perk for the wealthy into an everyday financial tool that everyday people can use to make purchases and manage their personal finances.

But credit cards are more than just a convenient purchasing device for consumers; they are also an indispensable source of funding for small businesses.

One of the greatest reasons why small businesses fail is because they lack sufficient capital. Traditional sources of capital generally require that collateral be pledged as a guarantee of repayment. In many cases, funds borrowed may only be used for a pre-approved purpose, such as the purchase of heavy equipment or industrial machinery. Absent sufficient collateral, the risks are too great for banks to loan money based solely on the notion that a business idea is a good one.

Credit cards do not carry the same limitations as traditional loans. Use of a credit card constitutes a loan, but the only security that a card issuer has for the loan is the customer's promise to repay. Moreover, credit cards can be used to purchase goods or services from any vendor that accepts the card. Because of their flexibility and near-universal acceptance, small businesses rely on credit cards to finance many of their operations and manage their monthly expenses.

According to the most recent Survey of Small Business Finances conducted by the Federal Reserve, 77 percent of small businesses used either a business credit card or personal credit card for business expenses in 2003.¹ A more recent survey by SurePayroll, an online payroll service provider, puts the figure at 90 percent.² Significantly, Federal Reserve data indicates that almost 30 percent of small business card users carried a balance from month to month in 2003 – that is, they used credit cards as a funding mechanism to keep their businesses running. Based on 2006 statistics from the Small Business Administration (SBA) indicating that there are nearly 27 million small businesses in the U.S., this means that more than **20 million** small businesses use credit cards in their business operations and that more than **8 million** use credit cards as a source of funding. This figure is likely much higher considering that the Federal Reserve statistics are five years old. Data from the 2007

¹ Traci L. Mach and John D. Wolken, "Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances," *Federal Reserve Bulletin*, October 2006, p. A167.

² News Release, SurePayroll, SurePayroll Insights Survey: Business Owners Share Opinions on Perks and Pitfalls of Business Credit Cards, April 16, 2007, available at <http://www.surepayroll.com/spsite/press/releases/2007/release041607.asp>

SurePayroll survey suggests that nearly 40 percent of small business card users carry a balance, meaning that upwards of **10 million small businesses** use credit cards as a funding mechanism.

The role credit cards play as a financing tool for small businesses is enhanced with commercial cards. Commercial credit cards operate in much the same way as personal credit cards with the main difference being that they are issued to a business or its proprietors rather than to individual consumers. Business credit cards used to be plain vanilla with few perks, but today there is a wide variety of rewards programs that small business owners can choose from. Another difference is that while some business cards carry preset spending limits like personal cards, others do not, although these usually carry annual fees. It is estimated that commercial cards were responsible for nearly \$500 billion in volume from cards issued in the U.S. in 2006.³ These cards are a significant tool for managing cash flow concerns as well as a convenient source of funding when necessary.

Credit cards serve not only as a valuable source of funding for small businesses, they also improve the ability of small business owners to closely monitor and control expenses and they aid in tax preparation. Monthly credit card statements make it easy for small businesses to keep track of capital outlays and they significantly reduce the costs associated with wading through piles of paper receipts and invoices. Commercial credit cards also allow small business owners to avoid commingling their personal finances with those of their business and some commercial cards can be set up to limit how much money employees can charge or where they can use them. This improves efficiency and gives proprietors greater control over their business. Small business owners are also increasingly using their credit cards to pay their quarterly tax bills. According to a recent study by Visa USA, credit card spending on tax payments and preparation by small businesses increased 80

³ “Commercial Cards’ Share of B2B Payments Grows,” *Cards and Payments*, March 2008, p. 20.

percent between February 2006 and February 2007.⁴ Using a credit card for this purpose helps small businesses avoid tax liens and small business owners get the extra benefit of adding points to their rewards programs.

Finally, it is important to recognize that credit cards also generally carry a zero-liability policy. If unauthorized use of a card occurs or a business entity does not receive an expected shipment of goods, the charges can be contested and are usually reversed almost immediately pending resolution of the dispute. This benefit is extremely significant for small businesses, particularly those for which cash flow is a big concern. The ability to avoid an unexpected outflow of funds helps keep afloat those small firms that often have to wait 90 or 120 days to get paid for their goods or services.

II. Intervention in the Credit Card Market Will Negatively Impact Small Businesses

Given the fact that millions of small businesses regularly use credit cards for both funding and day-to-day business management purposes, significant harm could result from legislative intervention that reduces access to credit cards or increases the cost of their use. If legislation contains price control provisions (or the functional equivalent thereof), the cost of borrowing will increase. A recent study by noted economist Jonathan Orszag bears this out.⁵ According to Orszag, price controls that were placed on interchange fees in Australia in 2003 have resulted in an increase in fixed prices for cards. Annual cardholder fees have increased by more than 30 percent and the value of rewards to cardholders has decreased by nearly 20 percent. Similarly, the Office of Fair

⁴ “Small Businesses Pay Taxes With Credit,” *Washington Post*, June 12, 2007.

⁵ Orszag, Jonathan, “An Economic Assessment of Regulating Credit Card Fees and Interest Rates,” Commissioned by the *American Bankers Association*, September 2007.

Trading in the United Kingdom set maximum limits on credit card penalty fees in 2006. According to Orszag, recent reports indicate that several companies have reintroduced annual fees and raised fees in other areas.

Price controls not only run the risk of increasing costs for borrowers, they also threaten to reduce access to credit. If card issuers are limited in their ability to accurately price their products to reflect the risks involved, they will be less likely to extend credit to riskier borrowers.

Higher prices and less access will have a detrimental effect on small businesses – particularly on start-ups. Many entrepreneurs rely solely on their personal savings and credit cards as a source of start-up capital for their fledgling businesses. Consider the case of Home Artisan Authority, a remodeling business in Dallas, Texas. The proprietors of the firm contributed \$5,000 apiece to start the business and the rest was funded with various credit cards. In 2007, sales were just under \$2 million and the Home Builders Association of Greater Dallas named the company the 2007 Remodeler of the Year.

The story of Home Artisan Authority is not unique. Many start-ups rely on credit cards to get their business off the ground. Moreover, the vast majority of small businesses use credit cards. If the cost of doing so increased as an unintended consequence of legislative intervention, or if bootstrapping entrepreneurs could no longer get access to credit cards, the deleterious effect on small businesses and the national economy could be significant. According to the SBA, small businesses accounted for 50.9 percent of the domestic work force and all the net new jobs in 2004.⁶ Arguably, many small businesses and the many people they employ might not exist today if they were not able to rely on credit cards to help them get started.

⁶ Small Business Administration, Office of Advocacy, *The Small Business Economy: A Report to the President 2007*, p. 9.

Finally, it is worth noting that many small businesses continue to use personal credit cards for business expenses. This is particularly true for smaller firms. According to the Federal Reserve, 46.7 percent of small business owners used a personal credit card to pay business expenses in 2003.⁷ Thus, the unintended effect of higher costs and reduced access will be felt not just by consumers who use credit cards for personal expenses, but by many consumers who are also small business proprietors that use credit cards for business reasons.

Conclusion

Small businesses play a significant role in the national credit card market and they receive considerable benefits from using credit cards to manage everyday company affairs. Small businesses are also the backbone of our nation's workforce and a vital part of the economy.

The desire to protect consumers from practices that are deemed harmful is laudable, but policymakers must be wary of the unintended consequences that may result from intervention into the marketplace. If legislative proposals have the unintended consequences of higher credit card costs and reduced credit card access, a significant negative impact on American small businesses could result. Hence, policymakers should exercise caution and carefully consider the full extent of their actions before proceeding.

⁷ See Mach and Wolken, *supra* note 1.