Small Business
Usage Report

Credit Cards

Notice to Abusive Credit Card Companies

NOW WE'RE COMING AFTER YOU

SMALL BUSINESS CREDIT CARD USAGE REPORT

THE ISSUE

- Chase Card Services has imposed an unfair and unprecedented change in terms notice on account holders who were promised 2.99% to 4.99% "fixed APR Until the balance is paid in full" long-term loans in a series of ongoing and aggressively promoted offers, some of which have been used by small businesses.
- Chase account holders who received the low rate offers were told that the promotion was a "Rate Reduction for our most Valued Cardmembers."
- The new terms constitute "payment-jacking" by radically increasing the minimum monthly payment that must be made by account holders.
- Chase planned its own set of "alternatives" in advance to deal with account holders by herding most of them into a few options, all of which were very bad for consumers and/or small businesses:
    - 1) get account holders to give up their previously promised promotional rates, by agreeing to a new higher, limited duration rate, typically doubling the previously touted promotional rate (a tactic otherwise known as "bait and switch"; also see class action lawsuits, below);
    - 2) force account holders to pay their entire balance with Chase and close their accounts (essentially this means that the loans became "demand notes");
    - 3) perhaps drive some account holders into default and far more usurious (e.g., 30-something percent) rates, given that new minimum monthly payments would be dramatically increased (the new payment would be *two and one half times* the original payment amount). For example, at 2% of the balance, the monthly payment on a $12,000.00 loan would be $240.00, whereas the new payment would increase to $600.00.
- Chase imposed the change in terms on account holders who were fulfilling their payment obligations (given that account holders would have already been "rate-jacked" into paying the aforementioned far more usurious rates).
- Chase has and is continuing to obstruct account holders and disseminate misleading information in the media and in other venues, in an attempt to deflect scrutiny or otherwise justify its actions.

SMALL BUSINESSES AND CREDIT CARDS: INTRODUCTION

Some basic numbers relative to small businesses and the use of credit cards. In order to accomplish this task and provide you with the freshest data and analysis available, this information will be provided in two contexts: 1) preceding academic papers published by Dr. Robert Lahm (including some with co-authors) along with recent testimony before Congress; and 2) current data. This report will start with the current data.

MOST RECENT DATA

According to the Federal Reserve Board's most recent report (dated 2007; these reports are published at five year intervals, and the previous report was dated 2002) on the availability of credit to small businesses, data (as of 2003) show that 77.3 percent of small businesses used either a personal or a business credit card. Of these small businesses, 70.7 percent paid their balance on these credit cards each month. The inverse of this percentage of businesses that paid their balances in full each month suggests that approximately 3 out of 10 carried a balance forward as a revolving charge (unfortunately, in this present economy, we fear this percentage may have increased as overall credit card debt levels have tended to rise over the years).

Relative to the type of credit card that may be used, either "personal" or "business," 46.7 percent used personal cards, and 48.1 percent used business credit cards. The Federal Reserve Board's previous report (2002, but based on 1998 and 1993 data) found that 46 percent used personal cards, and 34.1 percent used business credit cards. The changes between 1998 and 2003 demonstrate a marked increase in the use of "business credit cards," which is presumably associated with stepped-up efforts on the part of the credit card industry to aggressively market business credit cards.

However, the 2002 report also included data on small business credit card usage as of 1993. At that time, 40.7 percent used personal cards, and percent used 28.8 business credit cards. Thus, in the 10 year period between 1993 and 2003, the use of personal credit cards by small firms rose by 6 percent (i.e., from 40.7 percent in 1993 to 46.7 in 2003), while the use of business credit cards rose by almost 20 percent (i.e., from 28.8 percent in 1993 to 48.1 in 2003, a difference of 19.3 percent). In 1993, 75.1 percent paid balances in full, suggesting that the inverse number of small businesses, approximately 25 percent, carried a revolving balance.

Probing a bit deeper into the most recent data (again, 2003 data as reported in 2007), among firms with 0-1 employees, we find a similar rate (relative to the aggregate number discussed above for all small businesses): 48.1 percent of firms with 0-1 employees, using personal cards. But a lesser number, 32 percent, using business credit cards. 69.6 percent paid their balance off each month, leaving the inverse, those small businesses that carried a balance, at approximately 30 percent.

With respect to the use of personal credit cards, businesses that are organized as sole proprietorships (in terms of their legal form) were identified as the heaviest users of personal credit cards at 52.3 percent, and among the lightest users, relatively speaking, of business cards at 35.1 percent (for the sake of comparison, among C corporations, 39.6 percent used personal credit cards, but 58.9 percent used business cards). Thus, we can observe that generally, as a firm matures relative to its organizational form, it may gradually migrate away from personal credit cards to business credit cards. According to the 2002 Federal Reserve report, "This difference may indicate that small firms have more difficulty than larger firms in obtaining business credit cards and therefore use personal cards as a substitute." We can also note that reliance on personal cards is heavier prior to incorporating, and incorporating usually comes as a natural evolutionary step when businesses mature and grow in size, complexity, number of employees, and the number of years that they have been in business. Hence, fledgling entrepreneurs tend to rely on personal credit cards, the most.

The Small Business Administration (SBA) defines small businesses as those that have less than 500 employees, and according to its most recent data (SBA Office of Advocacy 2008 FAQs), small firms represent 99.7 percent of all employer firms. In 2007 there were 27.2 million businesses in the United States. The SBA also reports that "Credit cards account for much of the growth in small business lending over the past few years." To add further perspective, it also reported that of the 27.2 million businesses, 20.4 million had no employees (based on 2005 data used in the 2008 FAQ publication).

As noted below, based on earlier work (which contributed to testimony by Dr. Robert Lahm before Congress in April 2008), an effort was made to extrapolate the meaning of some of the data in terms of the actual number of businesses that may be associated with personal or business credit card usage. According to the U.S. Census Bureau, (as of 2006) there were 20,768,555 nonemployer firms across all industry sectors. Accordingly, if we multiply "46.7" percent as an overall small business credit card usage rate percentage (personal credit cards only) times the number of very small firms (those that have no employees), 20,768,555, we can estimate that approximately 9.7 million (9,698,915.18) very small businesses are likely to have used personal credit cards.

This is a "best estimate," because if one uses the various data sets that are the most recent from various reporting agencies, years do not match up, and categories do not necessarily match up either. However, we are comfortable that in light of the stability of personal card usage rate percentages based on 1998 (46 percent) and then again on 2003 (46.7 percent) data, the statement, "roughly half" of small businesses use personal credit cards, is supported.

It should be noted that it is not easy to distinguish the purpose or circumstances that may be associated with such usage of personal credit cards. For instance, some purchases might be for shopping convenience, whereas cash advances, balance transfers, and other transactions might be associated with a genuine need for start-up capital, of funds for ongoing operations.

Focusing on one small example, supposing that a small business owner purchased an Internet domain name for $10, and charged that to a personal credit card, the question becomes: "Was that because he or she found that it was convenient to charge an online purchase, or because the funds available on a personal credit card were actually needed to support start-up costs?" To define and discern the true intentions and circumstances behind every purchase decision, therefore, would be a daunting task, even for credit card companies that obviously are in a position to track every single transaction relative to their dollar amounts and the parties thereto. Despite such a robust capacity to track transactions themselves, knowing the actual rationale behind such transactions would require something akin to "mind reading."

The 1998 report stated "survey evidence suggests that credit cards are used primarily for convenience and that, despite a large increase in the use of credit cards between 1993 and 1998, small businesses have not substantially increased their use of credit cards as an alternative to traditional forms of credit," and the 2007 report made a similar observation. However, the 2007 report added, "Such behavior [that "they paid their credit card balance in full each month"] suggests that most firms used credit cards for convenience and not as a substitute for traditional credit products." We might add that credit cards could, on the other hand, be used as a cash flow management tool from month to month, i.e., as a means to supplement cash flow, even if balances are paid in full. Further, "Smaller and younger firms, which are most likely to have difficulty obtaining traditional forms of credit, were more likely to carry balances on their credit cards" (2007 report).

Another interesting caveat is that functionally speaking, so-called "business" credit cards and "personal" credit cards may not differ at all relative to liability. In other words, many business credit card applications still hold a business owner or officer personally liable, even if the name on the card that is issued is associated with a business or profession.

See:

Lahm, R. J., Jr. & Geho, P.R. (2007). Holes in the corporate veil: Confronting the "myth" of reduced liability for small businesses and entrepreneurs under corporate forms. *Entrepreneurial Executive*.

ENTREPRENEURIAL "BOOTSTRAPPING"

Entrepreneurial bootstrapping has traditionally meant starting a business from scratch, with little or no capital. However, that definition has been expanding, because it is intertwined with other ideas (some of which Dr. Lahm has advanced in his own research and papers).

See: http://bootstrappingstories.com/about-us.html

Let us give you an example. Suppose that a business decides to use a "bootstrap marketing" technique, and therefore introduces a "viral marketing" campaign. One means of viral marketing could be executed by releasing a humorous YouTube video, that spreads a message, or a company name at the end or within the presentation itself. Now, as far as the entrepreneur is concerned, did he or she release this video that spreads wildly to save money, or did he or she employ a clever method to spread a message, period? From the entrepreneur's perspective, maybe the answer is both.

See:

Lahm, R. J., Jr. (2007) Bootstrap marketing: an analysis of constructs and implications. *Proceedings of the Association for Small Business and Entrepreneurship (ASBE) 2007 Annual Conference, Austin, Texas,* October 10-13, 2007.

From a research perspective, it is difficult to identify the exact number of businesses that are "bootstrapped," because they are often started in a garage or on a kitchen table, part-time, and may not even be registered as a sole proprietorship or other more complex form (e.g., a corporation). Nevertheless, we are aware of estimates that suggest that 75 to 85 percent of all businesses are "bootstrapped." According to an SBA Office of Advocacy report (Home-Based Business and Government Regulation, 2004), "Home-based businesses are the predominant form of small business. Over two-thirds of all sole proprietorships, partnerships, and S corporations are home-based."

Now, do the estimates associated with the percentage of businesses that are bootstrapped necessarily directly correlate with established data such as the number of people who work from home, or nonemployer firms? No. But, is it likely that a many bootstrappers may start out with a home-based approach, and have no employees? Yes. Hence, even though having no employees or working from home does not necessarily mean that a business is bootstrapped, it is very likely that businesses that are operating with no employees and/or from home are indeed bootstrapping (it is also common advice given to bootstrappers, that they should reduce expenses to a bare minimum, staying lean by not taking on expenses for office facilities or overhead, including employees).

Relative to bootstrapping and historic views, the notion that the entrepreneur "can't get traditional financing," is indeed often a problem. However, bootstrapping has many nuances, which again, is consistent with a research agenda that has sought to explore and advance these views. To illustrate, let's suppose a would-be entrepreneur has a family member (known as an "angel," but do not be confused with the notion that such an individual must be related), who is willing to lend money, or a bank is willing to lend money. In either instance, there may be strings attached.

Perhaps in the case of a family member, those "strings attached" are a guilt trip, or simply putting that person in a position such that he or she might meddle or otherwise interfere with the business. In the instance of a traditional bank loan, an entrepreneur would probably have to sign over his or her house or something else of value as collateral, and may not be willing to do that. So, the entrepreneur, feeling confident in his or her ability to grow a business from scratch, elects to avoid accepting capital (when the "strings attached" are for whatever reason, unacceptable).

Ultimately, bootstrappers are often very creative people, and it can be the case that the adage, "necessity is the mother of invention" comes into play. Many bootstrappers, whose journeys lead them to success, promote that the constraint of having to "make-do" led to the development of a work-around that would have otherwise not been pursued, and yet constituted a true innovation in terms of business processes.

Because bootstrappers use a variety of approaches, such as bartering, trading, negotiating with suppliers, co-locating, and other "do-it-yourself" methods, credit cards are often simply part of a larger mix of strategies. Accordingly, it would be a gross oversimplification to suggest that there was not a whole spectrum of methods used by bootstrappers, or to conclude that the use of credit cards was all there was to it. After all, even though it may have been in a military context, the founding of this nation was the result of committed citizens who were determined to declare their own independence, against seemingly impossible odds. We would expect modern-day American entrepreneurs, to exhibit an analogous type of fortitude.

BOOTSTRAPPING WITH CREDIT CARDS

Here are some links:

http://www.bootstrapme.com/50226711/college_students_used_credit_card_bootstrap.php

http://www.bloggingstocks.com/2007/10/27/entrepreneurs-journal-bootstrap-it-like-google/

http://seattlepi.nwsource.com/business/97603_startup28.shtml

http://www.inc.com/magazine/20040101/gettingstarted.html (good article, with several examples and a headline: about half started with credit cards)

http://app.businessweek.com/UserComments/combo_review?action=getComment&productId=27266&reviewId=326277#326277

http://www.abcarticledirectory.com/Article/Bootstrapping-Is-Valuable-While-Seeking-Funds/68843

See left side of this page, iRobot, Helen Greiner:

http://www.w3w3.com/2007_STORIES/0607/06-25/index_06-25.htm

CREDIT CARDS AND SMALL BUSINESS ISSUES

- SBA reports indicate that approximately half of small businesses use personal credit cards as a source of capital (as discussed in greater detail above):
    - Even if personal versus business credit card account types are separate, from the point of view of actual practice, if a small business owner does not produce enough cash flow through his or her business in a given month, then obviously, he or she might charge tires, or dental work, or other personal expenses on a credit card. Money may come out of an entrepreneur's "left pocket," or his or her "right pocket," but it's still the same pair of pants.
    - Small businesses are vital to the economy, as they "represent 99.7 percent of all employer firms" and "employ about half of all private sector employees" (SBA, 2008).

PREVIOUS PAPERS BY DR. ROBERT LAHM (Some with Co-Authors)

PAPER:

Lahm, R. J., Jr. (2008). Testimony for a hearing of the U.S. House of Representatives, Committee on Small Business, Nydia M. Velázquez, Chairwoman, entitled, "The Role of Credit Cards in Small Business Financing." 1539 Longworth House Office Building, Washington, DC, April 3, 2008.

Lahm, R. J., Jr. & Little, H.T., Jr. (2005). Bootstrapping business start-ups: Entrepreneurship literature, textbooks, and teaching practices versus current business practices? *Journal of Entrepreneurship Education, 8,* 61-73.

QUOTE:

"We submit the instance of industry sponsored research commissioned by MasterCard (de Paula, 2003), which has indicated the increasing popularity of credit cards: 'Of the 64 percent of small business owners who use plastic for business expenses, 57 percent use personal cards, with 33 percent using those personal cards exclusively and 24 percent using them in addition to small-business cards' (p.54)."

PAPER:

Lahm, R. J., Jr. (2005). Just say "charge it": The use of credit cards in entrepreneurial start-ups. *Proceedings of the Association for Small Business and Entrepreneurship (ASBE) Conference, Albuquerque, NM,* October 7, 2005.

QUOTE:

One estimate suggested that approximately 75 to 85 percent of startup businesses use some form of bootstrapping (McCune, 1999, p. 1).

QUOTE:

The SBA's data set distinguished very small businesses with no employees, and its report emphasized that these businesses are an important source of new business startups. According to the U.S. Census Bureau (Economic Census, 2002) most nonemployers "are self-employed individuals operating very small unincorporated businesses, which may or may not be the owner's principal source of income."

Lahm, R. J., Jr. (2005). Bootstrapping: Methods entrepreneurs really use to start a business; A holistic view. *Proceedings of the Annual Eastern Small Business Institute (SBI) Conference, Pittsburgh, PA,* September 16, 2005.

Cole, J.D., Lahm, R.J., Jr., Little, H.T., Jr. & Siepel, S. (2005) Credit cards as a source of start-up capital and ongoing capital management. *Proceedings of the International Council for Small Business (ICSB) 2005 50th World Conference, Washington, DC,* June 17, 2005.

CLASS ACTION SUITS*

- Michael E. Moore and Diane M. Rooney, Plaintiffs, v. Chase Bank USA, N.A., Defendant, as filed by Lieff, Cabraser, Heimann & Bernstein, LLP.
- Brian Woods and Kain Macy, on behalf of themselves and all others similarly situated, Plaintiffs, v. JP Morgan Chase & Co. and Chase Manhattan Bank USA, N.A., and DOES 1 through 100, inclusive, Defendants, as filed by Kiesel Boucher Larson, LLP and additional counsel, Giskan Solotaroff Anderson & Stewart, LLP.
- Alfred D. Morris v. Chase
- Cuyahoga County Court of Common Pleas
- Margaret A. Foshe v. Chase
- Peter G. Knapp v. Chase
- Stockton v. Chase
- Under investigation by Girard Gibbs, LLP.

***** We are tracking numerous class action lawsuits against Chase. For an up-to-date list at any given time, please consult the **CHANGEINTERMS.COM** site; see the links on the right hand side under the category, "**Chase Class Action Lawsuits**."

WHY IT MATTERS

- Credit card companies have indeed gone to war. But is it against losses, or against the very customers whose relationships, if they were managed "fairly," ethically and responsibly, would prevent those losses from occurring in the first place?

- Destroying relationships that are associated with "good-paying" account holders is no way to run a bank (or any business!); nevertheless, financial institutions need to be well-run if American taxpayers' are ever to receive their bail out money back (or rebound in terms of the economy at large).
- People who run financial institutions should always rise to take the moral high ground, not sink to the lowest level possible in terms of playing "dirty" with customers.
- With home values falling, and higher prices for food, health care, gas (it will rise again – oil companies have already reported record profits, along with a willingness to "stick it to consumers"), and other expenses, consumers may turn to credit cards (not that they should, but should they be squeezed so mercilessly, as Chase is doing?). Of course, small business owners may be similarly affected as well.
- Following the "mortgage meltdown," if financial institutions fail to properly (e.g., ethically and fairly) manage account "relationships," we may well be headed to the next crisis, this time, a "plastic meltdown."
- Given that Chase is the recipient of $25 billion in taxpayers' bail out money (the use of which it refuses to explain), every American should be concerned by a lack of sound management or ethical practice with respect to Chase, as well as all financial institutions. After all, mismanagement and abhorrent behavior are how we arrived where we today, with an economy in turmoil:
    - If you are one of the lucky individuals in this life who happens to carry no credit card balances, keep in mind that this is an economic issue.
    - This is a justice, due process, and fairness issue.
    - As the "mortgage meltdown" has already demonstrated, when foreclosure signs "spring up in your neighbors' yards," like weeds, they are likely to spread; credit card issues will spread, and they will eventually impact you, or your children, or someone else you may love and care about.
    - If you have no mercy, empathy or understanding, or ability to grasp the long-term implications associated with this issue, but are in need of employment, we might suggest the credit card industry (where you should surely "fit in").
- Consumers have been abused by credit card companies for years, and with a fragile economy, new Regulation Z rules are not going to be enough, soon enough.
- This issue is all about fairness, or the lack thereof when it comes to the way that credit card companies treat account holders. Banks have enjoyed an unfettered ability to "do as they please" in an environment that is entirely too comfy and cozy with regulators and lawmakers. For example, correspondence between a Chase attorney, Andrew T. Semmelman, and the Federal Reserve Board, negotiating Chase's position and sentiments prior to the passage of new rules under Regulation Z, indicated that even though Chase wanted (and

received) 18 months to comply with new FED rules, it argued that customers should only need 15 days to comply with Chase's new rules (some "compromise," consumers will get 45 days notice once the new rules kick in).

- According to a Government Accounting Office (GOA) report (page 14), as of "2005, consumers held more than 691 million credit cards," as compared to Chase's 159 million cards issued (in 2008):
    - Therefore, as a leading card issuer, the entire credit card industry is watching Chase, and if Chase is successful in imposing its change in terms with no repercussions, other credit card companies may very well follow Chase's lead. This could be a devastating blow to small businesses and therefore the economy, keeping in mind that affected account holders (including small business owners) have been meeting their obligations, and such changes would simply push families and struggling entrepreneurs "off a cliff" at a time when this is absolutely (and especially) the wrong thing to do.

RESOURCES

- Note that we have compiled a significant list of resources on the **CHANGEINTERMS.COM** site, and below is merely a sampling:
    - Credit card statistics and industry facts (compilation)
    - AnnualCreditReport.com
    - CreditSlips.org
    - Delinquency Rates
    - Maxed Out Preview
    - Never Never Never
    - Secret History of the Credit Card
    - Worst Credit Card Practices

FOR CONSUMERS AND SMALL BUSINESSES: WHAT YOU CAN DO?

- WRITE YOUR LOCAL NEWSPAPER(S).
- Contact other members of the media (especially in your local area, or those whose primary focus is consumer/small business issues, the economy, and other related topics).
- Write ANY congressman/congresswoman (HOUSE and SENATE).
- Write your State's congressman/congresswoman.
- File an official OCC complaint (even if we prove that the OCC doesn't really help, that could be a pivotal argument for changing the terms under which the OCC operates, or expanding the powers of other agencies, such as the FTC).
- Write to Chase Card Services CEO Gordon Smith, or JP Morgan Chase (the parent company) CEO Jamie Dimon.
- Write to Chase affinity partners, and let them know that their own brands could be tarnished as a result of their association with Chase.
- When you see fair and in-depth coverage in the news about this issue, call, write, email, or post a comment that thanks the responsible journalist.

- Call "any/all of the above."
- If you can write informed, well composed (spelling and grammar-checked), "PG or G-rated" research-based posts, articles, press releases, or other content for the **CHANGEINTERMS.COM** site, as either a regular author, or a guest author, contact us.
- Use the images we provide to signify you support the cause of ending credit card company customer abuse.
- Link to us, or as some have done, include our RSS feed on your site.
- Buy a T-Shirt or other merchandise such as a bumper sticker to help "spread the word" at http://www.cafepress.com/ChangeInTerms (proceeds are used to support the site and its advocacy efforts).
- Utilize our "*Tired of Credit Card Company Abuse? Make Your Own T-Shirt — Complete Kit With Templates*" free downloadable product (that way, if you don't want to or can't really afford to use the CafePress store, you can make your own); the kit can also be used to send customizable messages to anyone you like: credit card companies, Congressional representatives, journalists, you name it!
- Produce your own YouTube "protest" videos (or help us, we're working on them, too).
- Create a Podcast about the issue, us, or your own insights.
- **CHANGEINTERMS.COM** is on Twitter: http://twitter.com/ChangeInTerms (follow us).
- Keep visiting and commenting on our site (especially, share your own story, if you are willing to tell it), as our site's founder has done.
- If you like what we're doing, trying to fight abusive treatment from credit card companies by attacking this problem at a grassroots level, tell people about us the "old-fashioned way," with word-of-mouth.
- Forward this document (but please, do not SPAM!).

ABOUT CHANGEINTERMS.COM

CHANGEINTERMS.COM is a consumer protest and advocacy site, created by Dr. Robert Lahm, Jr. (a university entrepreneurship professor), in response to credit card companies and their mistreatment of many account holders (including himself). Dr. Lahm's research agenda includes entrepreneurial bootstrapping (which often involves the use of credit cards as a source of start-up capital), about which he has also addressed in previous testimony before Congress. The site provides vibrant discussion and analysis, links to government, regulatory, and advocacy organizations, and sometimes more than a little sarcasm — along with serious critique — about the activities of credit card companies both individually, and as an industry.

While the site laments that it can't actually change terms from a legal perspective, it submits terms and conditions can be changed with credit card companies *from a consumer perspective*. Even with little help from current laws or regulators, consumers can still fight back. The site declares in a message to credit card companies:

NOW WE'RE COMING AFTER YOU