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Interact With Your Accountant

Memorandum

To: Clients, Associates & Friends of Pro@ctive CPA
Form: Mark L. Wyssbrod, Managing Member
Date: June 25, 2013
Re: June Economic Update: Stop Worrying About Refinancing

In this memorandum you will receive information about:

- Interest rate trends
- What's the catch?
- Why can't small businesses receive lower rates?
- Debt cannot solve debt problems
- How you can reduce debts

Please contact me should you have any questions.

Current Observations

The lower trend of interest rates since the Great Recession, Small Business Depression, began has lead interest rates to 100 year lows. However, many small businesses have not been able to take advantage of the reduced rates. From current and past economic readings it seems apparent the lower rates we are beginning to grow accustom to might not be around much longer. The US Federal Reserve (Central Bank) has very clearly indicated, choreographed and prepared the market for higher interest rates starting 2014, 2015 and beyond.

Many small business owners have been spending a lot of time trying to refinance into lower interest rate loans with minimal success. The material amount of time spending on the refinance is distracting them from running their businesses more effectively and efficiently. At the same time, the duration of the loan application process is several weeks at a minimum and possibly can be stretched out for several months. One of the problems many small business owners have faced over the past few years is after all of the time and energy spend into trying to refinance, they are either denied, the loan closing costs do not make it economical or the down payment required does not make it possible.

What's The Catch?

Banks have interest rate floors which means they will not lend lower than a certain level no matter how low interest rates go. For example, interest rates you hear about might be 3%, but the bank's lending floor is 5%; so you pay 5% on the loan, not the lower 3% you heard about.

This is common practice for banks. Also, small businesses that need loans tend to be riskier. Riskier loans demand higher interest rates.

So who are getting the 3% loans? Large corporations with lots of cash who do not necessarily need the monies which can also go straight to the market place to raise capital are the companies who qualify for the lower rates.

Why Can't Small Businesses Receive The Lower Rates?

Many small businesses have fragile financial position which disqualifies them from receiving beneficial lower rates. The fragile financial position includes minimal cash to support operations, aging equipment, high levels of accounts payable, high levels of credit card and other short-term debt, high levels of long-term debt and minimal equity. Would you lend your own money to a company in this financial position?

Generally speaking, it takes businesses in this financial position two to three or more years to turn around and strengthen their financial position. By the time they fix their financial position and qualify for a new loan interest rates will be back to levels which the loans are already at.

Debt Cannot Solve Debt Problems

Many small business owners seem to have a tendency to believe they can solve a debt problem with more debt or a different kind of debt. Debt problems cannot be simply solved with more debt. Debt problems get solved by sacrifice: reducing debt with after tax-profits or diluting ownership to raise capital to reduce debt.

What Can I Do To Reduce Debt?

First, focus on increasing revenues and margins to boost profitability. Second, use the *after-tax profits* to reduce debt. Position your small business to stand alone without a bank! Instead of your business requesting (feels like begging) the bank for a loan, make it so it's the banks privilege to do business with you!

Another idea is to increase your patience! You may not need the piece of equipment (or item) right now as your feelings are driving you to believe. It may be better financially to rent the item for only the amount of time you need it.

Have a written plan! Having a written plan increases the likelihood of success. A written document will also help list goals and you will be able to better track accomplishments.

Conclusion

Even with the economic recover beginning to trickle down it remains a challenging environment for many small businesses. During the next few years business owners will have to sacrifice current profits (rewards) to reduce high levels of debt (prior year benefits). The business owners will want to rebuild their financial position before the next recession.

Knowledge is power; power is change!