**Regional Micro-Enterprise Credential: Cost of Credit Worksheet**

(Updated: June 12, 2017)

The table below compares the different type of credit (or debt) that small businesses use.

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| --- | --- | --- | --- | --- | --- |
| **Type of Debt** | **Typical 2016 Interest Rates** | **Origination Fee\*** | **Available to Small Businesses?** | **Effort to Complete an Application** | **Best Use** |
| Secured Line of Credit | 6 – 15% | 0 – 3% | Sometimes | Substantial | To purchase equipment the business will use for a long time |
| Unsecured Line of Credit (Credit Card) | 18 – 30% | No | Usually | Easy | Make a quick purchase the business needs urgently when cash is not available; to help a small business maintain operations during a period of slow sales |
| Online Credit | 24 – 60% | 0 – 12% | Almost Always | Minimal |

\* - an origination fee is the percentage of a loan a bank charges when a small business receives a loan. Origination fees add to the cost of the loan.

**Scenarios**

Scenario 1: Your small business wants to borrow $80,000 for a truck and equipment necessary to expand your company.

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| **Type of Debt** | **“Interest Only” Loan Terms** | **Amount Borrowed** | **Months Loan Outstanding** | **Origination Fee Paid** | **Monthly Interest Payment** | **Total Fees, Interest and Principal Paid** |
| Secured Line of Credit | 6% annual interest rate (0.5% per month);  3% origination fee | $80,000 | 24 |  |  |  |
| Credit Card | 24% annual interest rate (2% per month);  no origination fees |  |  |  |
| Online Credit | 30% annual interest rate (2.5% per month);  5% origination fee |  |  |  |

Scenario 2: Your small business must borrow $20,000 for 2 months until your sales pick up during the Holiday season.

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| **Type of Debt** | **Loan Terms** | **Amount Borrowed** | **Months Loan Outstanding** | **Origination Fee Paid** | **Monthly Interest Payment** | **Total Fees, Interest and Principal Paid** |
| Secured Line of Credit | 6% annual interest rate (0.5% per month);  3% origination fee | $20,000 | 2 |  |  |  |
| Credit Card | 24% annual interest rate (2% per month);  no origination fees |  |  |  |
| Online Credit | 30% annual interest rate (2.5% per month);  3% origination fee |  |  |  |

**Discussion Questions**

1) Which is the most expensive form of credit in each scenario?

2) An online credit company says: “We don’t charge interest on your funds – we only charge a monthly fee.” Does this mean that they’re lending you the funds “interest free?”

3) Which is the “best” form of credit in each scenario?

4) Why do small businesses use more expensive forms of credit?

5) What can a small business do to lower its cost of credit?

6) When might it be better to seek equity capital instead of using debt?