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.

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.

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					
Credit Card	24% annual interest rate (2% per month); no origination fees	$80,000	24			
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.

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					
Credit Card	24% annual interest rate (2% per month); no origination fees	$20,000	2			
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?