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Please see Maxon's comments on page 3 "Insurance"

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Small Business Owners Deal with the Financial Crisis

Experts offer guidance for business owners on banks, credit unions, business loans, labor, pricing, insurance, and equity investments

by Karen E. Klein

When Smart Answers asked several experts to weigh in on the short- and long-term impact of this week's financial free fall on small business owners, we got an earful. Here, organized by areas of concern, are some thoughts and predictions:

Banks. There were no bank failures in 2005 or 2006 and three bank failures in 2007, according to the Federal Deposit Insurance Corporation (FDIC). But so far in 2008, 11 banks have failed, and a number of additional banks are said to be teetering. What happens if your business bank fails outright or is taken over by another?

If you have $100,000 or less in deposits (per taxpayer ID or Social Security number) the money is insured through the FDIC. Check out the agency's Web site for information on how deposit insurance works and what happens if your bank fails.

How do you know if your bank is struggling? While the FDIC does not release its internal bank ratings, a section on its Web site lists a number of private firms that do. Sam Thacker, finance and credit expert for AllBusiness.com, points out that you can ask your banker for the institution's latest "condition report" or look it up online at the FFIEC Central Data Repository Public Data Distribution Web site, which posts financial data on FDIC-insured institutions.

Click on "Call Reports and Thrift Financial Reports," enter the name and location of your bank's headquarters, and you'll get a .pdf file on that institution. "Look at the section of the call report called schedule RC-R, Regulatory Capital. Look at line 33, 'total risk-based capital ratio.' The higher the ratio, the stronger the bank and the less likely it will have difficulties meeting its obligations," Thacker says. But if the ratio is less than .10, the bank is minimally capitalized and (unless it's a new bank) you would be wise to move assets of more than $100,000 to an institution with a better ratio.

Credit Unions. In the past decade, credit unions have become the financial institution of choice for increasing numbers of individuals and small businesses. They're also making more small business loans than ever before. Thacker says he's concerned that credit unions in California and Florida have made numerous home equity loans in recent years and do not have the capital to support major losses if additional defaults occur. "If you're a small business owner banking with a credit union, look carefully at its strength and if you have concerns, move your money," he says.

But Bill Cheney, president and CEO of the California Credit Union League, which represents 400 credit unions and 9 million members in California, disputes the idea that credit unions are at risk of failure. "There have been a couple of credit unions in California that have had some difficulty, but those have been addressed, and they've merged with healthy financial institutions," he says. "Overall, the great majority are well-capitalized, in excess of government guidelines on capitalization, and most are doing well considering today's financial situation."

He says credit unions continue to make loans to members they judge to be creditworthy. "We're getting a lot of calls and interest from our members. They're asking about the availability of their credit lines and about deposit insurance. I encourage members to call if they're concerned; they'll likely find that local institutions are doing much better than the larger ones," Cheney says. Like bank deposits, credit unions deposits are also insured up to $100,000, not through the FDIC but through the National Credit Union Administration.

Business Loans. What if you have a loan with a bank that is taken over by the FDIC or is acquired by a competitor? The FDIC or the new owner will assume your loan and you'll deal directly with them. "If your company is very strong financially, consider moving the loan to another bank that's not in trouble and where you know you'll be able to get personalized banking service," Thacker suggests.

What if you're applying for a small business loan? Even before the financial crisis deepened this week, loans for small business startup and expansion were already drying up. Because of the fears of the banking community about home mortgage defaults, new loans are likely to be even more problematic.

"Many small businesses are not eligible for loans because of their credit standings," says Paul Rauseo, managing director of George S. May International in Chicago. "About 20% of our clients are having their notes called. Out of the blue, they're receiving a letter either reducing their credit lines or calling in their notes."

If you are an established loan customer with an excellent repayment record, you shouldn't have a problem with your loan. "Money will always be available to the very best small business credit customers, so if you're in the top 10% you'll still be able to borrow money," Thacker says. "But if you're a startup, a restaurant, a consumer-goods company, a wholesale supplier to the retail market, or just marginally profitable, access to capital may get tighter yet."

Why are certain small businesses likely to be credit-squeezed? Several large retailers are poised to fail if they don't turn around longstanding revenue declines this holiday season, Thacker says. And small vendors whose business model is based on selling to those retailers are likely to go down with them.

Labor. The demographic most affected by major stock market and housing price downturns are Baby Boomers, Rauseo says: "Inflated stock prices allowed a lot of people to retire at age 55 or 60. Now many will have to keep working longer." This could help small companies whose longtime senior managers were walking out the door early, only to be replaced by less-experienced younger employees, but it also may negatively affect college graduates just trying to get into the workforce.

Pricing. Large corporations know they must pass on this year's increased fuel costs to their customers in the form of price increases. Small companies, often notoriously reluctant to raise prices, simply must learn to do the same, Rauseo says. "We worked with a landscaper who sees 200 clients a month. His cost for fuel increased by $6 a job, but he didn't do anything about it. We encouraged him to take the square footage of each job and tack on a fuel increase. He did it, and not one person complained," he says.

Small business owners also need to focus more keenly on their balance sheets, their business models, and on how much credit they're extending to their customers: "People must pay attention to their profit models and not wait for their accountant to bring them a statement 15 days after the month closes. Small business owners will have to be smarter about their key performance indicators, or they won't be around long," Rauseo says.

Insurance. Worried about the financial stability of your insurance carrier? Ask your broker to provide you with the corporation's most recent financial statements or check its credit rating with an insurance rating organization like A.M. Best, says Hana Rubin, chief operating officer of Maxon, a third-party insurance administrator based in New York City.

"In this uncertain financial environment, it's important to discover if your insurance consulting firm has any ties to financial institutions" and work with a vendor-neutral company if you can, Rubin says. "If you're nervous about your insurance coverage, diversify your policies so you don't have all your coverage placed with one carrier. There's often certain coverage that you have to buy in conjunction with other policies, but in general try not to put all your eggs in one basket."

Private Investment Capital. Despite the tight credit situation, there's still plenty of money available from private equity investors, says Joe Trustey, managing director of private equity firm Summit Partners, which has offices in Boston, Palo Alto, Ca, and London. "Given that growth private equity involves little to no leverage, these investments can go forward even if credit remains tight. Moreover, some private equity firms have their own subordinated debt funds, so they can offer debt financing to entrepreneurs even when banks and other lenders will not." Thacker agrees: "Venture capitalists and angel investors see this environment as the best time to find good deals."

The Big Picture. While the financial crisis doesn't necessarily affect the small business sector directly, economic pessimism and fears about winter fuel costs are likely to sap consumer confidence for some time. "Entrepreneurs should be mentally and financially prepared to hunker down in this economy for a couple of years," Thacker says. "The downturn that started a year ago could last another two Christmas seasons. I'm hoping its going to be less time than that, but people are worried."

Karen E. Klein is a Los Angeles-based writer who covers entrepreneurship and small-business issues.