Season 3 | Episode 82

5 Ways to Help Your Business Work Better with Rising Interest Rates

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Hey, everybody, and welcome. I am your host, Gene Marks, and here you are at “On the Mark”. This is the place where I’m sharing with you the top business news of the week, including changes in legislation, business trends, or anything and everything that impacts your business.

By the way, I’m also a small business owner, so, you know, I speak from experience about the effects these things have on just the business, my business, as well as your business, as well. So, you know, listen, if you like what you hear, don’t forget to subscribe to our channel on your preferred listening podcast platform like Spotify.

Let’s move into this week’s news, okay. And the news really this week is all about interest rates. Interest rates are going up. And I want to talk a little bit about the impact that’s going to have on your business and my business over the next year or so.

Just this past week, the Federal Reserve announced its intentions to raise the federal funds rate — that’s the rate that it charges banks for getting money — another 75 bases points, so that’s 0.75%. (75% of 1%). It’s almost a percentage increase in interest. It’s a big one. Right.

Just to give you an idea, the current prime rate as of the end of July, this was like July 28, 2022 is now at 5.5%. That is the rate that the banks charge their best customers for debt — probably ain’t going to be the rate that you and I receive because we’re smaller businesses, so there’s more risks. But, if you were like a Fortune 100 or a Fortune 200 company and you were looking for debt from the bank, a lot of banks would charge you their prime rate and that’s now at 5.50%.

Just to give you some you know, some context here, the prime rate at March 17, 2020, so a little bit over two years ago, was 3.25%. So, the prime rate itself has gone up quite a lot in just the past two years.

Now, how does that translate into, like, regular rates that you and I spend? Well, when we get business loans or we get equipment loans or we get financing, it’s usually a couple of points above prime, which means that if you are — even with the best of credit available — if you get a loan that’s one point above prime, your interest rate for your business is going to be about 6.5%. So, that’s a big deal. That is more interest rates that are being charged for debts.

Now, is that like debilitating? Is that something that's going to stop you from borrowing or stop a lot of other businesses from borrowing? Well, the Fed is hoping that that doesn't happen. They are hoping that people are going to continue to borrow. However, they are hoping that because the cost of it is gone up, people are going to borrow that much less, which means that there will be less of a demand for money, which means that they don't have to supply so much money into the system, and when there is an oversupply of money into the system, that's what causes inflation.

So, these interest rate increases are designed to slow down the demand for that money so that, you know, supply and demand can catch up with each other and therefore lower, you know, the level of interest because it increases the value of the dollars that are in circulation.

So, let's talk about this. Your interest rates are going up. It has an impact on your business in a few ways. No. 1 is what I just talked about. It is going to increase your current debt payments, particularly if you've got variable loans, which means that you've got to start right now, budgeting for the fact that you're going to have higher debt service costs at least over the next 12 months because of these higher interest rates that is going to be impacting your operations. That's No. 1.

No. 2: It is going to increase the interest rates for new loans. So, it's one thing that you can service your existing debt, but the question is whether or not, you know, you want to take on new debt, particularly at higher rates. When the prime rate was 3.5%, that's pretty cheap money. Now, that the prime rate is 5.5%, and you're going to be paying a percentage point or two more than that, now it becomes a little bit more than that, which means that if you're looking for financing to go for inventory or to buy capital equipment or your property or even another business, it's going to cost you that much more. You're going to have to take that into consideration because of those rising rates.

Now, there is a good side to this, as well, and that good side is that rising interest rates could mean higher returns on your savings. Now, for the past, jeez, I don't know, 15 years or so, it's like we really weren't paying that much the money that was in our checking account when it came to interest earnings, because there really was none. I mean, banks are paying like zero interest.

Well, that's changing, right now because the interest rates themselves have gone up. Banks are now paying more interest on cash savings, which means that if you've got excess cash, it is going to become more and more important that you sweep that excess cash into interest bearing accounts.

Now, what kind of interest-bearing accounts? Well, there's you know, there's obviously there's money market accounts. There could be certificates of deposits. There could be long term treasuries or bond accounts, as well, that will return money that you can wrap up. As long as you are allowing it to be somewhat less liquid over a period of time, you can start earning some decent interest.

So, it's really, really important as a business owner that you set up some interest-bearing accounts for your business and make sure that you've got a tool in place to sweep any excess cash into that interest bearing account.

So, let me recap, first of all, what we've talked about, right? Higher costs on your existing debt. You're going to budget for that. Higher costs on new debt, so you have to think twice before investing, buying inventory, property, plant and equipment because there's going to be higher costs on that.

Offsetting that, though, is higher interest rates that you can now get on some of your accounts. Hasn't exactly kicked in yet, but it is something that's going to be, you know, affecting us over the next few months and therefore something that we want to take care of.

One other thing I just want to make sure that you are fully aware of in a higher interest rate environment is credit cards. A lot of us use credit cards for our businesses. Some of us don't pay off the balance every month, and, you know, we're subject to the exorbitant amounts of interest that some of these credit cards do, you know, issuers force us to pay.

Well, those rates are also going to be going up and they will go up at a higher rate than what we've seen the Fed issue because there's more risk involved. So, my strong advice to you is to pay down your credit card debt as quickly as possible to make sure that it is out of the way. That way, you know, if you have any carry a credit card debt that you're carrying, the interest rate increases that are going to happen won't affect your business as much. But they are going to happen, so you really want to be careful with your credit card debt.

All of these things are impacting your business now because of higher interest rates.

Couple other things I want to mention in a higher interest rate environment. It should not put you off of buying capital equipment. Remember, that there is still, in effect, a huge tax deduction if you want to get capital equipment for your business; that's furniture and fixtures, machinery, equipment, a lot of computer-related stuff, technology stuff, even software. If you buy capital equipment, most businesses can deduct over a million dollars of that right off the bat in the first year that you buy.

So, if you were to make these acquisitions now, even if you finance it, you can take the full deduction for it as long as you put it into service by the end of the year, which means you can still get the financing. You can even defer the financing if you can negotiate that and get a big tax deduction. So, I don't want you to think that just because interest rates are going up, you should stop all capital investment. Yeah, it may cost a little more, but don't forget, there really is a big tax incentive for investing, making capital investments. It's called the Section 179 deduction, and you should definitely keep that in mind.

Finally, another thought on interest in my final thought on rising interest rates. If you're able to refinance your debt into something that's longer term, something that's fixed, you might want to talk to the Small Business Administration at sba.org. Talk to an SBA certified lender, maybe convert or get new financing — that's called a Section 7A or 504 loan. If you were to do that again, the interest rates themselves could be variable or could be fixed — there's different options — and that way you might be able to get better market rates of your interest, better market rates for your financing.

And, also again, whatever you can fix longer-term, you might be paying a little bit longer — more in interest — but I don't think this is going to be the end of interest rate increases. I think we are going to be looking at another one or two in the next year or so until the Fed can really get inflation under control. So, if we know now that interest rates are likely to go up even in the next year, kind of makes sense to fix them at whatever rate they are now going forward.

Hope you've enjoyed this, guys. You've been listening to the "On the Mark" podcast for this week. I hope you gain some information to help your business. If you'd like to submit a topic or recommend a guest for our Thrive podcast, just visit payx.me/thrivetopics. That's P-A-Y-X dot M-E/thrivetopics.

My name is Gene Marks. Thanks so much for listening. Take care and we will see you again next week.