

Building and Protecting Business Credit



Responsible credit management is essential to small business success. It can help your business get the money it needs when it needs it **and** at a good rate. Strong credit can also help your company **close deals** since many companies now check credit on vendors before agreeing to a contract.

It is difficult to predict when your business will need to borrow, so **savvy businesses** work toward demonstrating responsible credit management long **before funds are needed**.



Here are some steps you can take to help ensure that your credit profile prepares you for borrowing.

Demonstrate good debt management skills

In order to build a **credit history** you need to use credit. Look for an opportunity to borrow money at a time when your business can use the funds responsibly and **pay them back quickly**. These good borrowing habits and proven ability to repay can help provide a **solid foundation for future borrowing**.

A key part of successful debt management is using borrowed funds for the right purpose. Good

reasons to borrow include covering a temporary cash flow shortage and **financing growth**. In these cases the funds for repaying the debt should be clearly identifiable and could well justify the risk of borrowing. Less ideal is taking on debt to dig out of a financial crisis or to fund payroll. In these cases, unless you have funds earmarked to repay the loan, taking on **debt can be risky**.

Use the right financial tools for the job

Managing your credit is easier when you understand the intended purpose of various financing tools. Use the following list as a guide.

- Use **charge cards** when you can pay off purchases in full by the end of the month so you don't have to pay for access to the capital, e.g. interest.
- If you want to carry a charge over several months, consider using a credit vehicle that lets you pay off interest but keep a **revolving balance**.
- A **line of credit** can help you smooth cash flow, make seasonal purchases or manage short-term cash crunches. Be careful, though, about using it for long-term debt.

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- For more costly purchases such as capital equipment or real estate, a **traditional loan**, with its fixed payment schedule, might be most appropriate.
- Use **business credit cards** for as many purchases as possible. Although you may pay a fee for the card, the purchases you can make with accrued points will likely offset any usage costs.

Understand lenders' guidelines

Like you, lenders want to **minimize risk**. They often use criteria called the **"5C's"** to assess a company's creditworthiness. Consider how your company performs in these areas to help put you in the best light when applying for financing:

- **Character:** What is your company's credit history? How likely are you to repay the loan?
- **Capacity:** Is your company's cash flow sufficient to meet current and prospective loan or lease commitments?
- **Collateral:** What non-cash business assets, such as equipment, real estate and inventory, can be used to secure a loan?
- **Capital:** What's your personal net worth, or the net worth of your business?
- **Conditions:** What outside factors such as economic conditions, competition and the like may affect repayment?

[continued](#)

Overview: A Business Credit Report

Like your personal credit history, your company's credit rating is determined by credit reporting agencies – independent companies that assess your credit "score" based on factors such as payment history and debt load.

Here is how business credit ratings differ from personal credit ratings.

- Your business score is based primarily on the timeliness of payments.
- Unlike personal credit, having multiple active accounts can be a positive, provided that they are in good standing. It demonstrates that your business is savvy about managing its finances.
- Some information in your business profile may be self-reported, which is typically not allowed on personal reports. You do this by establishing a profile with the credit bureau; consult their websites for details.
- Business creditors are not required to report payments to the bureaus, so if you're interested in building a good rating, ask vendors if they are willing to report your payment performance.

As is the case with your personal credit, it is advisable to obtain your company's report from the major reporting agencies (see below). Note that there may be a charge for this; details are available on their websites or by calling them directly.

D&B™ (Dun and Bradstreet) www.dnb.com

Information sources: Business owner and vendor information

Scoring system: PAYDEX™ score based on payment experiences
DUNS Rating™ based on financial statements

Experian Business™ www.experian.com

Information sources: Vendor information only

Scoring system: Intelliscore™ based on payment experiences

Equifax™ Business www.equifax.com

Information sources: Public records, Payment histories, Optional personal data of business principal, Bank and lease data

Scoring system: Small Business Credit Risk Score for Suppliers, Business Failure Risk Score, Risk Class™

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Minimize bad credit risks

Slow-paying customers can impact your ability to access capital. Irresponsible vendors can have a similar impact. Take steps to [protect yourself](#) from the “wrong” kind of business associate by [checking references](#) on prospective partners, customers and vendors. Stay on top of your customers to [encourage on time payments](#) by sending notices when a receivable is due or late. Consider [accepting credit cards](#), which can both [lower your exposure](#) to late payments and increase the timeliness of your receipts. Credit card companies can also [act as intermediaries should a dispute arise](#), and potentially [assist you with fraudulent charges](#).

Separate business and personal credit

While many business owners find their personal and corporate finances linked, it is important to keep these as separate as possible. [Avoid commingling business and personal assets](#). Set up business savings and checking accounts. Have a [dedicated business charge card account](#), as well as separate business loans and credit lines. Separation has two major benefits – it helps your company establish a credit history, and it can reduce the impact that a business problem can have on your personal credit. Be aware, however, that many lenders will closely examine the personal credit history of a company’s owners before approving financing. (See related sidebars.) ■

Understanding Your Company’s Credit Report

What should you look for when reviewing your company’s business credit report? You want to check accuracy while gaining insight into how the credit reporting agencies portray your firm to potential lenders. Remember that business credit uses different parameters than personal credit – the surest way to build business credit may be to make your payments on time, keep your information up to date, and keep your debt financing down.

When you review your credit reports, examine your:

Company profile

- Check details for accuracy: business name and age, address, phone, industry, number of employees and incorporation status. Much of this information is “self-reported,” meaning the onus is on the business owner to ensure that the data is correct and up to date.

Credit rating

- Note if your rating is strong, average or poor. Reporting companies use different scoring methods, so their ratings might not be the same. For example, the D&B PAYDEX score ranges from 1 to 100, with higher scores indicating better payment performance; Equifax’s Small Business Credit Risk Score operates on a scale of 101-992. If the report does not provide context for the score, consult the providers’ websites for details on how to interpret your numbers.

Payment history

- Confirm that your payment history is accurate. Paying within the terms set by your suppliers may be the most direct way to drive a positive business credit rating. Look for trends that lenders might flag, like a change from paying in full each month to making minimum payments.
- Ensure that all supplier relationships are represented. If you’ve been making timely payments to a supplier or lender, it should be reflected in your profile. If it is not, you will need to contact the vendor to report your payment history with them.

Uniform Commercial Code (UCC) filings

- This shows the liens and leases you have in place. View this information from a lender’s eye: Is it accurate? Could your company be perceived as over-extended?



Worksheet: Your Company's Credit Assessment

Maintaining a high business credit score requires ongoing attention. Smart companies actively manage credit ranking as part of regular financial management. As a first step, answer these questions to assess your company's credit fitness. This will provide you with a good overview of how successfully you are managing your company's credit, and where you might begin to make improvements.

1. Monitor my company's credit

It is important to review your company's credit profile regularly for accuracy. A good practice is to request your credit report from the three major credit agencies each year.

How often do you monitor your company's credit score?

- Never
- Once a quarter
- Once a year
- Once every two to five years
- It's been more than five years

2. Take stock of my company's credit needs

Review your current suite of credit tools to make sure they meet your needs – now and going forward. Consider your credit and charge cards, lines of credit, bank loans, trade credit, equipment leases, commercial mortgages and the like.

What types of credit – and how much – is currently available to your company?

Credit Vehicle	Amount	Availability	Targeted Use
Bank Loan	\$10,000	Immediately	Office Furniture
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

Now, consider the needs or opportunities you don't have covered in the above and what new sources you might consider—credit cards, lines of credit, equipment leases, etc.

Credit Vehicle	Amount	Availability	Targeted Use
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____



Worksheet: Your Company's Credit Assessment

3. Review existing/potential relationships

Take a look at your current vendor and customer relationships to see how you might improve them. As you build your credit history, you may need to establish new relationships that can help you take advantage of future opportunities.

In the left column, make a list of your current vendors/suppliers, customers and leasing relationships and indicate whether or not you feel the relationship is working efficiently.

Provider's name

_____	<input type="radio"/> satisfied	<input type="radio"/> unsatisfied	<input type="radio"/> unsure
_____	<input type="radio"/> satisfied	<input type="radio"/> unsatisfied	<input type="radio"/> unsure
_____	<input type="radio"/> satisfied	<input type="radio"/> unsatisfied	<input type="radio"/> unsure
_____	<input type="radio"/> satisfied	<input type="radio"/> unsatisfied	<input type="radio"/> unsure
_____	<input type="radio"/> satisfied	<input type="radio"/> unsatisfied	<input type="radio"/> unsure

Are you negotiating the best payment terms with your vendors?

Interest rates on credit cards and loans may be negotiable, as may be grace periods for payment. If the industry standard is net-60 and you're paying net-30, ask your vendor for new terms; find out about early payment discounts too. If you're not sure about what payment terms to expect, ask other business owners about their terms or research offerings across multiple suppliers.

Vendor	Terms	Renegotiate?
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

Do you review prospective customers' credit before accepting them as clients?

Don't let a slow payer disrupt your cash flow. Use the following checklist to help you determine a payment plan that works in your best interest.

- Review their credit ratings by requesting reports from the 3 major agencies.
- Ask for references
- Create a credit check form in which you gather relevant information such as number of years in business, trade references, business structure and number of employees.

Armed with the answers to these important questions, make an appointment with your financial planner, accountant, bookkeeper or other key financial resource. The only way to improve your credit now and for the future is to make gradual changes in your habits. You and your financial resource can work as a team to create a workable action plan that will support your company's growth and success.

To learn more about our products and services, call 1-800-NOW-OPEN or visit us at www.open.com

Notes



A large, light blue rectangular area with rounded corners, containing numerous horizontal white lines for writing notes.