

A GUIDE TO BUILDING SMART BUSINESS CREDIT

Establishing business credit can be the key to growing your company

DID YOU KNOW?

- Business Credit can help grow your business
- Sound payment practices are key to a solid business credit profile
- Separating Business Credit and Personal Credit can greatly mitigate your risk
- There are 4 keys to building business credit
- Credit applications can be made easier by following a few simple steps

INTRODUCTION

You may think that business credit has limited application for your business—that it matters only when you’re trying to secure financing. In reality, business credit is a powerful tool that can help you save money, establish valuable commercial relationships, and, ultimately, *grow* your business.

That said, business credit may not be easy to understand, and establishing it can be difficult. The goal of this guide is to demystify the topic and provide clear, concise advice on how to develop business credit that works harder for your business over the long haul.

BUSINESS CREDIT BASICS

Let’s start with the way you pay.

Do you run your company using a combination of supplier financing and personal credit—maybe adding an equipment lease or commercial loan into the mix? Do you have a few suppliers that extend payment terms, but you buy office supplies on a personal credit card, and have the telephone account listed in your own name?

Being inconsistent in maintaining sound payment practices may result in missing important opportunities to build a solid business credit profile. Whereas having a robust history of steady payments to a variety of creditors boosts the borrowing power of your business and puts other companies at ease about extending credit to your firm, says small business legal and financial expert Barbara Weltman, author of *The Rational Guide to Building Small Business Credit*.

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SEPARATING BUSINESS AND PERSONAL CREDIT

It's important to maintain a business credit profile that is distinctly separate from your personal credit profile.

Building separation between the two can help your business develop the credibility that matters to banks, suppliers, and other creditors, according to Weltman. A business credit profile that includes multiple, positive reports from financial institutions, vendors, utilities, telephone accounts, lessors, and other operational credit accounts in your company's name shows that your business pays its creditors in a timely manner. Maintaining separation can also protect your personal credit profile should a financial mishap occur in the company, and, conversely, can help insulate your business from anything that might have an adverse affect on your personal credit.

UNDERSTANDING CREDIT REPORTING BUREAUS

Your credit bureau report is at the heart of building business credit.

Credit reporting agencies collect credit data from a wide range of sources. This information is used to create a profile that illustrates how your business has historically met its financial obligations, which helps prospective creditors decide whether to take a chance on extending credit to your company.

Most bureaus make it easy to report this data, and standards vary by bureau. In some cases, businesses are able to report information about themselves. But in an effort to maintain data integrity, some bureaus use only information that has been verified by a third party, a practice that ensures unbiased reports and helps level the playing field for all businesses.

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The majority of banks, credit card companies, and other financial institutions report payment patterns to credit bureaus on a regular basis. However, to make sure you're fully covered, it's a good idea to ask suppliers and business partners to do the same, advises Lita Epstein, author of *The Complete Idiot's Guide to Credit Scores*.

Why a business credit profile matters

A good business credit profile serves two primary functions: it helps your company more easily gain access to the credit it needs at better terms, and it can help you understand more about the companies with which you do business.

Lenders, suppliers, and partners often review business credit profiles to help them determine the risk involved with extending credit to your company. This helps them gauge how likely your company will pay in a timely manner. In short, it helps them decide whether or not to do business with you. By the same token, you should examine the credit profiles of other companies in order to evaluate the financial stability of a prospective customer, supplier, manufacturing facility, or other business partner.

Although it's often overlooked, notes Weltman, evaluating a prospective client's commitment and ability to make payments is a critical step to take prior to extending credit.

"Many small business owners are so excited to make a sale that they don't do their homework," she adds. "Remember, it's not a sale until you get paid. Unless you like to work for free, you need to make sure you get the necessary profile information up front."

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ESTABLISHING BUSINESS CREDIT

So what does it take to build your business credit profile?

The following best practice guidelines offer a perspective on the fastest, most efficient way to get it done:

- **Borrow and pay.** Some businesses think that the only way to establish business credit is to open a business credit card. While that makes sense for some companies, securing credit terms from suppliers or taking out a commercial loan can offer similar benefits with fewer downsides. Paying according to agreed-upon terms is the first step in establishing good business credit.
- **Be visible, (i.e., ensure that your good behavior is reported).** Unfortunately, unless your creditors are reporting timely payments to credit bureaus, a good track record won't help your business credit profile. Ask suppliers and other businesses that extend credit or payment terms to your company to consistently report your payment history. Many bureaus have an option to do so through their websites, or the company can contact the bureau's customer service department for assistance. The more positive reports there are in your company's profile, the more comfortable other companies or creditors will be doing business with you.
- **Monitor your company's profile.** It is just as important to consistently monitor your company's credit profile as it is to monitor your personal credit profile, says Weltman. You can order your business credit report from each bureau for a fee, which varies by bureau. It's a modest investment that will help you spot any issues in the file and address or correct them. In addition, active business credit monitoring can alert you to any fraud being perpetrated in the name of your business. Be sure to check your credit profiles well in advance of applying for new credit so that you have time to address any inaccuracies or problems prior to submitting your loan or other credit application.

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- **Act like a business.** Even the smallest operation can benefit from a positive business credit profile. Again, your business accounts (telephone, utilities, leases, loans) should be established in your business' name. In the early stages of a business, you may need to personally guarantee payment, but the more established your business credit history is, the more likely it is you'll be able to negotiate and secure good credit terms without those guarantees.

KEYS TO CREDIT APPLICATIONS

As your business grows, you'll probably need to complete credit applications for your suppliers, vendors, and other creditors.

These applications can be key to securing lower interest rates, higher credit lines, and gaining the financing flexibility you need to grow your business (and continue to build a strong payment history). Consider the following guidelines before you complete a credit application:

Credit applications can be key to securing lower interest rates, higher credit lines, and gaining the financing flexibility you need to grow your business.

- **Evaluate your own business credit.** It's always a good idea to review your business credit profile before applying for new lines of credit. As discussed above, your business credit profile includes a wealth of information that prospective creditors will use to make decisions about the amount and terms of your credit line. Such information may include payment history, tax liens, judgments, collection activity, and inquiries from other prospective creditors. Try looking at your profile through the lens of a creditor, reviewing such information as:
 - **Trade payment history.** Does your company have a history of paying its bills on time, or are you routinely late? Late payments in the past may simply be the result of a temporary cash flow crunch, but if your company regularly lags in paying bills, creditors may not see your business as a good credit risk.

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- **Credit balances.** Is your company using a high percentage of its overall available credit? This may be a reason to seek additional credit, but it may also be a warning sign that your firm is overextended. On the other hand, are balances relatively low compared to credit limits? This may indicate good financial management.
 - **Track record.** How long has your company been in business? Startups may be riskier debtors than companies with long histories of paying bills on time.
 - **Red flags.** Review your firm's credit report for liens or judgments. One or two such reports may not be deal-breakers, but they may require you to explain what happened. If there are items that need explaining, be up front. Perhaps your business had a short-term, cash-flow crunch; or you lost a key employee, which led to some black marks on the report. It's better to address them than to ignore or hide them.
- **Get good references.** Your business will often be asked for credit references. Be sure to contact your references ahead of time to ask for their permission to be included on credit applications. Failing to do so could make the contact less inclined to give you a positive reference. There may also be an issue that you aren't aware of—such as an overlooked invoice or other problem—that, if reported, could reflect poorly on your business. Try to provide three to four references. It's likely that prospective creditors will ask them:
 - How long they have done business with your company?
 - What is the maximum credit line they've extended to your business?
 - How long does your company typically take to pay an invoice?
 - Have there been times when your company hasn't been able to pay on time?
 - **Fill out the form completely.** When completing the application, be sure to provide all of the information requested. Skipping sections could lead to delays or even result in your credit line being denied. If you have questions, contact the creditor to get them answered.

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CONCLUSION: GROWING YOUR BUSINESS WITH GOOD CREDIT PRACTICES

As you've read, good business credit has an impact on more than just a loan application; it can be at the core of fueling the growth of your business.

It provides access to the funding and payment terms you need to expand and, perhaps most important, build trust in any business relationship.

Employing good business credit practices doesn't have to be confusing or challenging. Maintaining a distinctly separate business credit profile, staying current on payments to creditors, ensuring that your good payment history is reported to the credit bureaus, and monitoring your business credit profile to detect issues or fraud can help your business grow. Additionally, when you find yourself in a position to extend credit to your customers, you have the same opportunity to use the commercial credit tools outlined above to limit your risk.

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THINK LIKE A BANKER: THE 4 CS OF BUSINESS CREDIT

To make the most of business credit, it helps to think like a loan officer.

Banks have four key criteria that they typically use when evaluating a business's creditworthiness—the Four Cs of Business Credit (Character, Collateral, Condition, and Capacity). Different banks will weight these factors according to their own

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practices, but it helps to put your best foot forward in each of these areas when presenting your business as a potential borrower.

1. **Character.** Lenders and creditors want to be sure that they're doing business with reputable companies and not putting themselves at risk of fraud or other negative activity. If your business or personal credit profiles show spotty payment history, liens, judgments, or other red flags you will need to be prepared to explain those factors or accumulate a longer period of steady payments before seeking new credit.
2. **Collateral.** A financial institution may need to secure a loan based on something of value to your business. It may take the form of business equipment, inventory, or other assets the business owns. Some lenders will seek personal guarantees and may look for personal assets, such as real estate, to secure the loan. The more collateral your business has, the easier it generally is to get the money or terms you need.
3. **Condition.** A solid business credit profile indicates a strong financial history, (i.e., a business in good condition). To show your business in the best possible light, work with your vendors, suppliers, and other creditors to ensure that they are reporting your timely payments to business credit bureaus. This will help tell the story of your business' robust health. Lenders and other creditors may look at the personal credit scores of owners or partners in the business, so be mindful of those profiles as well.
4. **Capacity.** Before extending credit, lenders want to know that your business generates enough revenue to meet the payment obligations. This will be easier for established businesses with a history of sales than it will be for startups. If your business is new, provide information about projected sales and expenses, along with an explanation of how you arrived at those numbers. Be realistic; lenders may compare your projections to industry standards. If you overestimate your expected sales and underestimate expenses, that can be an indication that you may not have done your financial homework well.

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Give yourself time to prepare in advance of meeting your lender, and be ready to answer questions about each of these four categories. Look at your business with a critical eye, so that you can anticipate potential stumbling blocks, and be prepared to answer tough questions from your lender. Being prepared can mean the difference between approval and rejection.

BUSINESS CREDIT RESOURCES

As creditors increasingly rely on business credit profiles to make real-time decisions about credit terms, it is more important than ever for your business to build a solid credit profile with a robust history of timely payments. By integrating state-of-the-art technology and superior data, Experian's Business Information Services is an important resource in helping you build your business credit.

Experian is a leader in providing data and predictive insights for businesses, helping them mitigate risk and improve profitability. The company's business database provides comprehensive, third-party-verified information on 99.9 percent of all U.S. companies, with the industry's most extensive data on the broad spectrum of small and mid-sized businesses, including yours.

Learn more about your current profile and how to make it a forceful tool in building your business by visiting us at experian.com/mybusinesscredit.

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