Lesson #1:

Business Credit – Is it really worth it? What type is right for me?

"No man's credit is as good as his money." Ed Howe

We don't need to actually experience it personally to know that the *number one* reason new companies fail is due to lack of sufficient cash flow and access to credit lines. Credit is absolutely essential to see your business through slow seasons, crucial periods of growth or to expand and take it to the next level. For the wise Entrepreneur, corporate credit building is a priority from Day One.

Our society is becoming increasingly dependent on using credit to make purchases and decisions. These days, good credit is no longer for just getting a credit card or a loan. Thanks to FICO, more and more businesses are making it imperative that your credit score be used to make decisions about extending goods or services to you. Now you can have your credit pulled for any of the following reasons:

- Renting an apartment or buying a home
- Leasing or buying a car
- Utility services
- Applying for those 'Bill Me Later" offers
- Cell phones, computer equipment, etc.
- Some job applications require credit checks (especially financial institutions)
- Starting your own business

And the business aspect of your credit is what we want to discuss today.

Since your credit is defined by how you've paid (or not paid) your bills in the past, many businesses – landlords, mortgage lenders, utility providers, and even employers – use your credit to predict your future financial responsibility. Anytime you need to borrow money, or even services, your credit is called into question. This is why maintaining good credit is so important.

But why worry about Business Credit when you have good personal credit? Why have to start all over from scratch when you already have a positive history built up and a good line of credit (or multiple credit cards) in your own name? Because I said so. Just kidding. Seriously, though – the number one rule in starting or running your own business is "Do not use your personal credit for business – ever!"

Why? Multiple reasons!!! Where do I even begin?

One very important reason is that by using your personal credit (including credit cards, mortgages, home equity, banks loans, etc.), you are personally guaranteeing that funding source. YOUR name is on it – not your business – leaving you unprotected and completely responsible for the repayment of the funds if the business fails for any reason! And heaven forbid, if you have to file bankruptcy due to an unsuccessful business venture, you - and you alone - will have that mark for a minimum of *7 years* on your *personal* credit record! This will make it extremely difficult for you to buy a car or home, get additional future lines of credit, and may even keep you from getting a job in many fields! And if you have a family, you've just brought them into your living nightmare with you!

It also muddies the water for the IRS and the government when it comes to you and your business being separate entities. This means that most likely you are a sole proprietor (as many new, small and/or home-based businesses are) and instead of being incorporated or having a separate Tax ID or federal EIN number for your business, you use your own personal social security number. And therefore you and your business are one and the same. And by using your personal credit to fund and run your business, you are only proving it even more!

Other reasons to create an entire line of credit devoted solely to your business are:

- You may seem overextended**.** Because businesses require more cash to operate than a typical consumer does on their own, your personal credit will not be accurately portrayed if you are using it to run your business. You can and usually will be turned down because you look like to have too much debt compared to your income and credit lines (especially if any of your credit lines are maxed out or nearly so.)

- To prevent people from becoming overextended, consumer credit reporting agencies (like Experian, Equifax, and TransUnion) keep track of how many credit or loan applications you make, most of which count against your consumer credit score (especially if you've been denied more than once in a 6 month period**.)** Even just one credit inquiry can drop your overall score 1 – 5 points! On the other hand, business credit does not count numerous applications for financing against you, since businesses usually seek financing on a regular basis as a way to run and grow the business.

- Business owners who use personal credit cards to prop up or keep afloat a failing business are at a great risk for one or more of the credit card lenders objecting to the discharge of some, or all, of the debt owed to that particular lender (according to Section 523 of the Bankruptcy Code.) This means that one or more of your vendors may say you accepted the credit knowing you could not afford to pay it back as agreed, and in turn, this could leave you walking away from your bankruptcy still owing thousands of dollars!

- Using your personal credit card for business transactions makes it difficult to track and write off at the end of the year (or quarterly) for your taxes. It's time-consuming and confusing to have to separate all receipts, purchases and interest fees and also means you could easily miss something important – like a deduction – or forget/mix up something that could bring on an audit!

Pretty scary, right?

But what if your personal credit is bad – really bad, or you have none at all? Well then Business Credit is perfect, right?! I don't even need to fix my personal credit now! Wrong! Business Credit is *not* the way to escape bad personal credit! In fact, many would argue that if your personal credit is in a state of disrepair, then you are seeing a clear snapshot of what your business credit will look like down the road.

Credit, in general, is a privilege – not a right. It has to be earned. You have to be trusted. You have to prove yourself. That said, if you have poor personal credit, you may actually have trouble getting Business Credit!

You see, there are two types of bad personal credit. One can be fixed by getting business credit and one can actually keep you from getting the business credit you really need!

1.) *Overextended* - your debt ratio is too high compared to your income and amount of your monthly payments. This also includes the ratio of credit used based on your credit limit. You should never use more than 46% of your available credit – and *never* max out your credit or go even $1 over the limit! The good news is that this credit problem can be usually be fixed when you apply for business credit, since you can transfer business balances and expenses to your business credit, and finally leave your personal credit for just you!

2.) *Negative Marks* – this includes liens, judgments, defaults, bankruptcy, late payments, no payments, charge-offs and collections. If you have any negative marks on your personal credit, it will be a roadblock (although a temporary one) in getting *unsecured* business credit, since you will most likely start off with small lines of business credit and many of those lenders will require a personal guarantee. This is because you currently have no business credit, but soon you'll work your way up to the higher limit unsecured lines you dream of!

We'll give you more on how to fix these problems later, but for now, just remember that business credit is not expendable and to use it wisely!

Sweet Benefits of Business Credit

Now we've gone over why it's important to have business credit separate from your personal credit, but what other advantages are there?

A lot, actually!

Having Good Business Credit means you will be able to:

- be offered lower interest rates
- improve your credibility with lenders and vendors
- enjoy the ability to run your business on credit instead of out-of-pocket cash
- improve your cash flow
- expand your business
- increase marketing and advertising (better product/service recognition)
- manage seasonal changes to the normal business flow
- limit your personal liability for business debts
- jump on a good business opportunity when it arises
- upgrade your equipment, car, home, etc.
- improve your business image (which will increase your chances of loan approvals and even government contracts)
- survive and even thrive during slow or lean times
- hire and train more employees (and offer better benefits)
- invest more money into improving your product or service (thus increasing business and profits!)

Sound good to you? Business Credit is one of the many perks of running your own business! It can be a life-saver and it's good to know it's there when you need it – now if you could just get your hands on it, right?! But before we go into that, let's quickly go over what types of Business Credit are available to you and what they mean.

The Buzz on Business Credit

There are so many ways to go about getting business credit – you just have to know where to look. But be aware that most of these sources are reserved for those who have been in business for 2 or more years, are incorporated, have a good strong business credit history (and sometimes even personal credit applies), and require a lot of research, planning and work before applying! We'll go into detail later on what to do before applying for a loan, but for now we just want to get you familiar with some of the many different types of business financing available to you.

Trade Credit – This is the term for the line of credit you're extended when you buy supplies or goods from a supplier or vendor, delaying the date at which the amount is due or allowing installment payments. Usually the terms are 'Net 15' or 'Net 30', meaning you have 15 or 30 days, respectively, to pay the balance in full.

Trade Accounts – Business credit (either a line of credit or a credit card) linked to specific stores or companies, such as Staples, Home Depot, Office Depot, Chevron, etc. These are a great way to start building a positive business credit profile and purchase supplies at the same time!

Equipment Leasing – A great way to obtain financing for your equipment needs (instead of having to buy it all upfront) and get tax benefits at the same time.

Equipment Sale Lease Back – Usually easier to get than other types of credit since the equipment you purchase is also the collateral. If you default on the lease, they just take back the equipment and leave a nice big black mark on your credit record in return!

Business Credit Cards – Backed by Visa, MasterCard, American Express and Discover, business credit cards are a good source for working capital. Revolving credit cards offer a hassle-free, quick source for limited funds. But this convenience can cost you an arm and a leg with an interest rate slightly less than the rate on individual consumer cards and they typically have lending limits that average just over $15,000. Fees for cash advances from these cards can be outrageous and some cards charge an additional monthly or yearly fee just to keep them. Many will still require a personal guarantee unless you have a solid business credit history with Dun & Bradstreet.

Merchant Account Cash Advance - If you have been accepting VISA/MasterCard through a merchant account (not including PayPal) for at least 6 months, you might qualify for a cash advance based on your monthly volume of charges. Though this type of loan does not usually require that you have great credit, you do however need to have a positive processing record (with few or no chargebacks) and no bankruptcy in the last 3 years. The limit is usually around $50k for this type of loan.

Equity Financing – This requires that you sell an ownership interest in the business in exchange for capital. The problem is usually finding investors willing to buy into your company! This also means you will have to share control of our business with another party.

Loans – there are so many different types of loans that it can make your head spin! Here are just a few:

- *Lines of Credit* – These are designed for temporary cash shortages, so don't use them for major purchases or long term investments. Instead of getting a check for the full amount of the loan, the lender will allow you to borrow up to a certain amount per year (in increments as you need it.) It's usually based on the amount of existing inventory or accounts receivable and tends to stay below $200k. But be careful, if you don't pay the loan balances off promptly they will start compounding and end up being more expensive than any other type of loan!
- *Secured Working Capital Loans* – When you need to convert company or personal assets into working capital. You are putting up asset(s) in exchange for cash.
- *Unsecured Working Capital Loans* – Loans for working capital based solely on the credit-worthiness of the applicant.
- *Franchise Start-Up Loans* – This is specialized financing reserved for the franchisees of recognized, typically nationally known, franchises.
- *Professional Loans* – These are reserved for Doctors, Dentists, Lawyers, CPAs, etc.
- *Business Acquisition Loans* – For when you want to purchase an already existing and established business.
- *Start-Up Loans* – For new businesses
- *SBA Loans* - Loans to small businesses from private-sector lenders (banks, etc.) which are guaranteed by the Small Business Association. These are not easy to qualify for!
- *Debt Financing* – This type of loan is typically limited by the amount of personal assets that the entrepreneur has available to pledge as security for a loan. Usually given through a bank or traditional lender.
- *Long Term Loans* – These are commonly used to purchase, improve, or expand fixed assets such as your plant, facilities, major equipment, and real estate.
- *Short Term Loans* - Often used to raise cash for revolving inventory needs, accounts payable, and working capital. They usually have lower interest rates than Long Term loans and require less collateral.
- *Revolving Check Credit* - A type of open-end credit extended by banks. It's a prearranged loan for a specific amount that you can use by writing a special check. Repayment is made in installments over a set period, and the finance charges are based on the amount of credit used during the month and on the outstanding balance.
- *Microloans* – Loans under $35k (though usually around $13k) administered through responsible nonprofit groups (and approved by the SBA) that are intended for the purchase of machinery and equipment, furniture and fixtures, inventory, supplies and working capital. The funds and the recipient are closely monitored and a self-employment training program may accompany the loan. It cannot be used to pay existing debts and is usually only termed for 6 years.

There are many other ways of financing your business (i.e. borrowing against your 401k or insurance policy, asking friends and family, finding an 'angel' investor or venture capitalist, purchasing a shelf corporation, employee stock ownership plans, going public with an IPO, business alliances or joint ventures, using accounts receivable factoring, applying for state and federal grants, borrowing against the equity in your home or property, etc.) but most of these are only going to put you in the wrong kind of debt (the kind that does not help your credit profile), can be very time-consuming and can cause you a lot of frustration, grief and unneeded stress – so only consider them as a last resort when all else fails!

In Summary

Congratulations on taking the first step in a brand new direction – the Right direction! How do you feel? You should feel excited, proud – and empowered! Now you have a basic but solid understanding of what Business Credit is *(and isn't)* and what it can do for you!

STAY TUNED for the invaluable information-packed inside the 2nd installment of our Business Credit E-Course - together we can help you take your new-found knowledge and use it as a guideline to take the first steps in creating the great business credit that will fund your Entrepreneurial Dream and make it your Reality!

Thank You & Best Wishes!

Your Personal Business Credit Insider,

Connor Mathews

www.Small-Business-Credit.org

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