FINANCE NEW MEXICO

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A Score That Matters: What FICO Means to Small Business Borrowers

By Finance New Mexico

When a business applies for a loan, the lender reviews the credit score of the owner or owners and uses that information to assess risk. While the score is only one metric of financial stability, it can determine whether the business gets the loan at all, how much it can borrow and what interest terms it can expect.

For that reason, business owners need to know their scores and maintain the highest possible number by paying bills on time or getting help to correct money-management problems.

The gold standard for credit evaluating is the FICO score, named for the company that developed it, the Fair Isaac Corporation.

FICO measures five elements and assigns each a different percentage of the score. Payment history represents 35 percent, total debt accounts for 30 percent, length of credit history is 15 percent, new credit accounts are 10 percent and types of credit are 10 percent.

About 20 percent of all U.S. consumers score below 579. To lenders, they represent the highest risk of default. People with scores this low are unlikely to get a loan from a traditional lender, but they may qualify for financing from a nonprofit lender such as Accion or WESST.

People in the 580 to 669 range also have below-average credit. The Loan Fund, a community development lender, and most banks require a minimum score of 600. Lenders consider 670 to 739 a decent, average score.

A score between 740 and 799 indicates a dependable borrower; the top 40 percent of U.S. consumers score here. Lenders especially welcome the exceptional borrowers with scores between 800 and 900 — the top 20 percent. Borrowers in these last two groups can expect the lowest interest rates and best terms.

FICO bases its scores on information compiled by the three top consumer reporting bureaus — Experian, TransUnion and Equifax. Business owners don't have to guess what the reports show. Once a year, they can obtain a free credit report from each of the bureaus through the annualcreditreport.com website.

The reports show credit accounts, including car loans and mortgages; the dates accounts opened and closed; the credit limit and balance; and payment history. New credit requests stay on the reports for two years. Overdue debts, including those assigned to collection agencies, and matters of public record —foreclosures, bankruptcies, judgments, liens and garnishments —haunt credit reports for seven to 10 years.

Business owners should monitor their accounts to check for inaccuracies, outdated information or suspicious activity, such as new accounts they didn't open. They can't get their score for free with their credit reports, but some banks and credit card companies offer that information as a customer service.

Credit report inaccuracies and black marks undercut a business's ability to secure the best deal on a loan. They can lower a credit score enough to cost tens of thousands of dollars over the life of a loan or place a loan out of reach. The savvy business owner will use all available tools to monitor and improve credit health.

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