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Opinion

FICO score can make big difference

By Lisa Spiwak

For most small businesses, the toughest aspect of running the operation is managing cash flow. Most small businesses depend on timely payments from their clients to pay their own bills.

However, in difficult times such as these, clients often stretch payment of their invoices to 60 days or longer. In order to be able to pay bills without having collected its receivables, a small business must have access to cash. It is their safety net and lifeline.

For many years, access to cash for small businesses was derived from bank lines of credit. Lines of credit were fairly easy to obtain and they allowed small businesses to weather the tough months and cover monthly shortages.

However, the financial crisis of 2008 forced the banks to pull back or cancel many of the credit lines they had previously issued. The stricter state and federal regulations that the banks have to abide by has caused banks to completely change their lending parameters. Banks are now forced to turn down loans because of collateral or credit scores that they would have happily accepted previously.

Losing access to credit can devastate a small business. Without a line of credit to draw from, a small business owner must rely on personal finances to get the business through the tough times. This is where the importance of your FICO score comes in. A business owner's higher FICO score can be the difference between getting the credit needed to keep the business going and not getting the credit which results in business's failure.

The granting of all credit is based on your FICO score. A FICO score is a credit score developed by Fair Isaac Co. (shortened to FICO), a company that specializes in "predictive analytics." This means that they take information and analyze it to predict what is likely to happen. FICO credit scores are used by lenders to predict behavior such as how likely someone is to pay their bills on time or whether they are able to handle a larger credit line or how likely a person is to end up in bankruptcy.

Viewpoint

Most people do not realize that there are several "tricks" to raising their FICO score. People think that if they cut up their credit cards and close out those accounts, they can raise their score that way. This is huge mistake. Thirty percent of one's credit score is based on the ratio between one's available credit and their debt. Therefore, when a person closes a credit card account, he is lowering his available credit and in turn lowering the ration between his available credit and debt. One is best served to keep credit cards open and not use them. Tear up the card but do not close the account. This increases the available credit to debt ratio and increases your FICO score.

Further, an additional 15 percent of one's FICO score is accounted for by the length of credit history. Therefore, the longer you have a credit account open, the more valuable that account is to your FICO score. If you are insistent on closing out credit accounts, make sure that you close out the youngest ones with the smallest credit limit first to minimize the damage to your FICO score.

Another trick with credit cards is to contact your credit card accounts and ask them to raise your credit limit. Therefore if you do close an account, the addition of more credit from one of your other existing accounts will minimize the impact on your FICO score that closing that account would have.

One other mistake that many people make is to shop for credit too frequently. Every time you apply for credit you invite someone to run your credit and this act results in the lowering of your credit score. Do not over-shop for credit.

You will also raise your FICO score by paying your credit card accounts off every month. Maintaining balances on credit cards will lower your debt-to-credit-limit ratio, which will in turn lower your FICO score.

The higher one's FICO score is, the more credit he can obtain and the bigger safety net he has in the event his business's cash flow tightens up. Until banks start granting small businesses lines of credit again, a strong FICO score may be the most valuable weapon a business can have in its arsenal.

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