Six Cs of Credit

Chapter 25 Unit 6

Performance Objectives:

You will read about and reflect on your current position with respect to character, capacity, capital, credit, condition, and collateral. You will visit an online credit calculator to assess your current creditworthiness.

Evaluation Criteria:

Successful completion of this chapter requires you to:

- Read about the "Six Cs of Credit."
- Go online and use a credit calculator to get a quick assessment of your credit.

Task 1: What Makes Good Credit?

Read the information below.

Banks are businesses and need to make a profit. So they carefully consider each loan application to make sure they are lending their money to people who are capable of paying them back. Banks can't make money when people default on their loans.

Bank officers look for what are called the "Six Cs of Credit" when determining whether or not to approve someone's loan application. Below is a description of each of these six criteria.

1. **Character**
   Even though the loan is for your business, the person responsible for paying back the loan is you. It is your reputation that the bank will be considering.

   If you have missed payments or defaulted on a loan or declared bankruptcy in the past, it doesn't disqualify you from getting a loan. But trying to hide these facts can destroy your character in the eyes of the banks. The best strategy is to be straightforward and honest. Loan officers will see this information anyway.

2. **Capacity**
   The banks will look at your business's balance sheet and cash flow statement to see how much you can afford to borrow. They will also ask for your personal financial statement to see what kind of debt you can handle. Most small business loans tend to be based on the individual's ability to repay the loan, not on the cash flow of the business (Bangs, D., The Start Up Guide. p.116). They may ask about your spouse's employment as well.

   Loan officers tend to consider loan applications more favorably if: (a) you are introducing a new product or service with an obvious demand; (b) there is little competition; (c) your market is composed of small independent businesses; and (d) a lower rate of failure in your type of business.

3. **Capital**
   As mentioned earlier, most banks require that you put up a percentage of the loan (just as you would for car loans or buying a house), usually 20 percent.

4. **Credit**
What is your credit history? Have you repaid your loans regularly and on time? You can easily obtain a credit report by going online. Several credit report sites are listed on best1.org. If you have a bad credit history you may want to consider going to a CDFI (Community Development Financial Institution) which are set up by the federal government to help people in areas underserved by traditional financial institutions. You can ask your business counselor to help connect you to a CDFI in your area. CDFIs are also typically more willing to give loans in smaller amounts than most large banks.

5. **Condition**
The condition and terms of the loan are another factor. How much is needed? Over what period of time? For what will it be used?

6. **Collateral**
Collateral represents a repayment source in the worst case scenario. Most banks require that the loan be 100 percent collateralized. This means that you have to have enough collateral to cover 100 percent of the loan amount. If you want a loan for $100,000, then you will have to have a car, equipment, building, and inventory that add up to $100,000. Be careful when figuring what collateral you have, though. Not everything is calculated at 100 percent. For example, inventory is valued at 50 percent.

Task 2: Online Credit Assessment

Click on the following link for the **Bankrate Credit Calculator**[1]. Go though the quick credit assessment. Reflect on your credit in the space below.

[1]Bankrate Credit Calculator: http://www.bankrate.com/calculators/credit-score-fico-calculator.aspx

Notes: