

# The 4 C's of Credit



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March 2008

Recent economic conditions suggest that the economy has slowed down considerably, and some experts are saying that we have entered a recession. In times like these, banks are more prone to tighten their credit requirements. The inevitable consequence is that credit for businesses can be harder to come by.

Under these conditions, it's even more important that when business owners apply for credit, they understand what banks are looking for. They need to know and understand the four C's of credit:

1. Capacity	3. Conditions
2. Collateral	4. Character

Let's begin with the first C, Capacity – the demonstrated ability to repay. Be clear! Banks are in the business of lending money. That is one of the main ways they make money. So, contrary to how it may appear, a bank wants to loan you money. In fact, banks need you just as much you need them. But that said, a bank also needs to feel confident that the business owner will be able to repay the debt. This is really the "meat and potatoes" of any loan.

A bank will therefore review a business owner's financial statements to see whether you can generate sufficient cash flow to meet both your current expenses and your new obligations.

Collateral is another C that speaks loudly to a bank. In my role as a Business Banker, I am often surprised at how business owners often don't appreciate the importance of collateral. Keep in mind that banks are security conscious; so having collateral helps the bank feel more secure.

In addition, having collateral can substantially reduce your cost of borrowing. Every business has collateral, whether it be accounts receivable, inventory, equipment etc. These are your assets; so use them to your advantage. When you sit down with a banker, make sure you discuss collateral.

The third C is Conditions. Banks also find it prudent to look carefully at current economic conditions when deciding to extend credit. They will look at the industry you are in, and how it is affected by those conditions. A slower economy does not mean a bank won't lend you money; it just means they are more careful in their lending practices.

Another important factor is where your business is in its growth cycle. Generally, banks want to see two years of business data before they consider lending you money. Your business does not yet qualify? There are steps you can take to position yourself to be considered credit-worthy. Talk to your banker and ask him/her to do a thorough review of your business' financial reality. Use your banker as you would your accountant.

The fourth C is Character. J.P. Morgan, one of the most successful business men in the world once said: "I will do business with anyone as long as she/he is honest!" The key is understanding how a bank defines character.

Banks assess your character by your past performances – how you handle your financial affairs, business and personal. Banks want to see that you understand how to manage the business of the business. After all, would you extend credit to some one who has a history of late payments, no payments and defaults?

Please remember that no matter how good your cash flow and cash position, a bank will quickly reject your application, if your credit history is sub par. Clearly, then, the wise business owner will ensure that his/her business dealings are also building good character and integrity.

Finally, given the high cost of doing business in today's global economy, the question is not *if* but *when* will your business need credit. It is crucial, therefore, that business owners understand well what banks require in exchange for their loans.

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