

Reducing risk through blended credit profiles

When attempting to determine a small business's credit risk, which is more useful, the company's credit history or its owner's? For decades, conventional wisdom has held that a business owner's personal credit history alone can be used to judge his or her company's creditworthiness. Many lenders have tended to see small businesses and small-business owners as one and the same, their funds so frequently commingled as to make the two entities virtually indistinguishable.

However, this strategy is not always successful. A business owner with good personal credit still can have a failing company, and someone whose personal credit is messy still can own a successful business.

Since a bad call can cost a creditor thousands — perhaps tens of thousands — of dollars, Experian® decided to test the conventional wisdom for itself.

Methodology

So our conclusions could be as predictive as possible in the current economy, Experian decided to look only at businesses that endured — and survived — the Great Recession. It took a random sampling of 80,000 small businesses and their owners who were in good financial health as of March 2010 and then tracked their credit behavior through September 2013. Experian pulled the required data using its Entity Linkage Service, which makes the connection between business owners and their business.

First, Experian had to establish a common definition for what constituted a bad credit risk for companies and for individuals, acknowledging that the definition would not necessarily be the same for both. After reviewing numerous credit industry analyses, it arrived at these standards.

- **For businesses:** Payments on 50 percent of outstanding balances are more than 91 days delinquent
- **For business owners:** Payments on 35 percent of outstanding balances on trades are more than 90 days delinquent

Additional key attributes such as the number of tradelines, credit utilization, balance and collection count also were observed for four quarters prior to a business or an individual crossing the bad threshold and for an additional four quarters thereafter for both good and bad populations.

Lastly, Experian examined the impacts to the owner's consumer and business risk score that reflect creditworthiness. It used its Intelliscore PlusSM and VantageScore® services for this segment of the study.

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