By: Matthew Gillman, [SMB Compass Founder]

You've probably heard time and time again that lenders will look at your personal credit profile before approving your business loan application. That is because your credit reflects how diligent you are in paying off your debts. It also gives lenders an idea of how risky it would be to lend you money.

This article will demonstrate why personal credit is essential when looking to get business financing. It will also provide practical tips on building up your personal credit score to prepare you for future loan applications.

What is personal credit?

Personal credit is the creditworthiness of an individual based on their credit history. It is a three-digit summary of your payment history, which shows whether you're paying your bills on time and in full. It tells creditors like banks, credit unions, and alternative

lenders whether you’re a risky borrower or you repay loans on time.

Your personal credit is a record of all your transactions, from the payments you make on your credit cards to your mortgage loans and auto loans.

What measures your personal credit?

Two popular credit score brands determine your credit rating: Fair Isaac Corporation (FICO) and VantageScore. FICO is the oldest credit scoring company that’s already trusted by millions of Americans, while VantageScore—which was established in 2003—is a joint venture between Experian, Equifax, and TransUnion.

These two companies offer the same credit scoring models: FICO and VantageScore use a scoring range between 300 and 850. For this discussion, let’s look at how FICO scores are determined.

There are five elements involved in your FICO score which are your payment history (35%), total debts (30%), length of credit history (15%), credit mix (10%), and new credit (10%).

1. **Overall payment history**
   Your payment history is the record you’ve established by making on-time payments—or missing them—over a certain period. It provides an overview of your payment behaviors, whether you’ve missed any bills or debt payments in the past.

2. **Total debts incurred throughout your payment history**
   Total debts are all the individual loans you acquired over a certain period, such as auto loans, mortgages, or credit cards. The higher your total debts, the lower your FICO score will be.

   By reducing your total debts, you can improve your FICO score and make yourself a more attractive candidate for loans in the future.

3. **Length of credit history**
   Most small business owners don’t get approval on their

loan applications because they lack sufficient credit history. The length of your credit history tells if you have been using credit responsibly throughout the years. The longer your credit history is, the more experienced and credible you become at paying off debts.

Simply put, if you have a long history of using credit responsibly, it will help improve your score. On the other hand, if you have a short credit history, it could lower your score.

To determine the average length of your credit history, simply divide the ages of your oldest and newest accounts by the total number of accounts you have.

4. **Credit mix**
   Credit mix refers to the different types of credit you have on your credit report. Having various types of credit can improve your FICO score because it shows lenders that you can handle different types of debt responsibly. If you're looking to improve your FICO score, one thing you can do is to diversify your credit.

5. **Number of new credit**
   The number of new credit refers to the number of new loans you've been applying for at a certain period. Lenders usually check if you've been shopping around to get as many credit accounts as possible.

What is a good personal credit rating?

Having a solid personal credit history can help you get approved for a loan and get better terms, such as a lower interest rate. If you have bad personal credit, you may still be able to get a loan, but you will likely have to pay a higher interest rate. But how do you know if your current credit rating is good?

We mentioned earlier that credit scores range between 300 and 850. Your credit score must be 580 or higher to have a good personal credit rating. The higher your credit rating is, the higher your

chances of securing a loan with lower interest rates and better terms.

Why do lenders need to know your personal credit rating?

First and foremost, lenders look at your personal credit profile if you don't have an existing business credit. With that absence, lenders need to look at any proof of your payment behavior through your personal credit to get an idea of how risky it would be to lend you money. Small business owners usually don't have enough time to build up a good business credit unless they have been running the business for years. To give you an idea, a business credit score is anywhere between 0 and 100; lenders will require you to have at least a rating of 75 to qualify for loans.

If you have a low personal credit score, it could mean that you will not be approved for a loan or that you will have to pay a high-interest rate. Also, having a low credit score could indicate that you're more likely to default on your new loan, which isn't good for the lender.

Also, personal credit reports show lenders that you have held strong relationships with different types of creditors in the past. For example,if you are applying to get a business credit card, lenders will trace your credit history and see how you've managed your personal credit cards. They want to know how consistent you are in paying your debts and what your credit utilization is.

Lenders are also required to review your credit score when applying for new credit. This helps them determine whether you're eligible for the new credit and, if so, what terms they'll offer you.

That said, it's essential to build up your credit rating before applying for small business financing. Make sure you check your credit report at least once a year to know where you stand. Don't worry; requesting your credit report won't affect your credit score.

How to build personal credit

There are a few things you can do to improve your credit score. Below is a quick list of things you need to check.

- Start paying your bills on time, even ahead of schedule.
- Keep your balances low.
- Keep your credit utilization below 30%.
- Avoid opening new credit cards, especially when you still have existing debts.
- Try not to close old credit because it will affect your credit history.
- Consolidate your debts if you can.
- Dispute errors in your credit report, such as misspelled names or wrong addresses.

Lastly, it helps to work with finance experts and lenders who can help you increase your chances of getting approved for a loan. With some effort, you can improve your credit score and get the lenders on your side.

Know Why Personal Credit is Important When Looking for Business Financing Click To Tweet

About the Author: Matthew Gillman is a business financing expert with more than a decade of experience in commercial lending. He is the founder and CEO of SMB Compass, a specialty finance company providing education and financing options for business owners.