The Importance of Checking a New Client's Creditworthiness

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It's always good news whenever a small or mid-sized business lands a new client. However, before you break out the party streamers or pop the cork on a bottle of champagne, it might be a good idea to check the creditworthiness of your new client first. This is especially true if you will be selling to the client on terms, such as net-15 or net-30 days, like most small and mid-sized firms do.

Unfortunately, in their excitement over landing a new client, business owners and CEOs sometimes fail to perform this critical step. This can be a big mistake that can cause serious financial harm — especially to small and mid-sized firms that may not have the financial resources to withstand the hit from a large client that doesn't pay its bills.

Dangers of Not Checking Credit

Not checking the creditworthiness of a new client can lead to a number of negative outcomes for a business, including the following:

- Lower revenue and profits if new clients don't pay their bills;
- Slower cash flow if new clients pay their bills late;
- The inability of the company to pay its own bills on time, which can damage relationships with suppliers and vendors; and
- In a worst-case scenario, the outright failure or bankruptcy of the company if unpaid bills are too large.

The best way to check the creditworthiness of a new client is to obtain and analyze credit data on the company before agreeing to grant them payment terms. There are three main credit reporting agencies that provide business credit data:

Dun & Bradstreet — D&B is the most popular and well-known U.S. credit reporting agency. It draws upon its vast business databases in order to assign business credit ratings according to a proprietary multi-tiered system called Paydex. Using past payment history and current payment capabilities, the system assigns every business a Paydex score of between 1 and 100, with 100 representing a perfect payment history. Generally speaking, you should look for a Paydex score of at least 80 before granting credit to a new customer.

D&B also assigns businesses a U.S. Commercial Credit Score of between 101 and 670. These scores are categorized into five credit risk classes that indicate the likelihood of a business paying its bills late (for example, at least 90 days past the due date). Class 1 scores of 580 or higher indicate the lowest probability of delinquency (1.1%) while Class 5 scores below 452 indicate the highest probability of delinquency (53.1%).

Experian — This credit reporting agency uses a credit rating system called Intelliscore that assigns businesses a credit risk score of between 0 and 100. The higher score, the less credit risk posed by a new client. In addition, Experian also offers a number of other types of business credit reports and credit subscription plans.

Equifax — This credit reporting agency analyzes detailed payment data to assign businesses a Credit Information Score of between 0 and 69. Credit Information Score scores over 40 are considered to be the highest risk while scores below 10 represent the lowest risk.

Protect Your Company Financially
You can protect your company financially by ordering a business credit report on your new clients from one or more of these agencies. You can do so by visiting their websites at DNB.com, Experian.com or Equifax.com. All of the agencies consider the timeliness of bill payments to be the number one criteria in a business' credit score. Therefore, obtaining business credit reports is the best way to gauge whether new clients will pay their bills on time — or at all.

Your business could realize a number of benefits by checking the creditworthiness of all new clients before granting them credit, including the following:

- More stable profits due to improved receivables collections;
- Improved cash flow due to more clients paying their bills on time;
- Better relationships with your own suppliers and vendors due to your ability to pay your own bills on time; and
- Less chance of serious financial disruptions, including business bankruptcy, due to non-payment of a large client bill.

Concluding Thoughts
In their excitement over landing new business, owners and CEOs sometimes fail to check their new clients' creditworthiness. This can cause serious financial harm, especially to small and mid-sized firms that may not have the financial resources to withstand the hit from non-payment of a large invoice. The best way to check the creditworthiness of a new client is to analyze their credit data by obtaining a business credit report. An outsourced CFO services provider can help you with this critical exercise.

About CFO Edge
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