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## CLIENT ADVISORY

(September 2004)

### **The Three Cs of Credit**

*A Friendly Reminder of What to Look for in a Credit Customer*

Want an ironclad, one-hundred-percent guarantee that you won't lose money to a credit customer? Don't extend credit. There, wasn't that helpful? Actually, it *is* helpful for creditors to periodically remind themselves that there can be no significant gain without a commensurate level of risk. It keeps you on your toes. It liberates you to take the lending risks that are necessary to grow your business, while simultaneously encouraging you to adhere firmly to your evaluative guidelines.

Of course, every company has its own lending criteria. Many of your criteria depend on the nature of your business. If you're a heavy equipment dealer whose customers are small farmers or landscaping firms, you're probably going to go about determining creditworthiness in a different way than, say, a large bank whose customers are multinational corporations.

But regardless of the size and scope of your clients, your guidelines should be based on what is called the Three Cs of Credit: Character, Capacity, and Capital:

**Character.** For our purposes, character is determined by how a person has handled past debt obligations. Credit history and personal background come into play. So do less tangible qualities like the honesty and reliability of the borrower. Clearly, it's easier for small business owners who regularly see their customers face-to-face to make a character judgment than it is for the bureaucracy-encumbered manager of a large, multi-division corporation. The latter must rely more heavily on the other two Cs.

**Capacity.** This means how much debt a borrower can comfortably handle. You should analyze all of the borrower's income streams and look into any legal obligations that could potentially interfere with repayment.

**Capital.** You must have a firm grasp on the current available assets of the borrower, such as real estate holdings, savings, or investments that could be used to repay debt if income should be unavailable.

You should make certain that your risk assessment protocol takes all three Cs into account. Then, incorporate the spirit of the Three Cs into all of your business practices. This will help you keep your credit people and your salespeople—as well as all other key players in your company—on the same page.

Do this and you can rest easy, secure in the knowledge that you're making the smartest possible lending decisions. If you have any questions about how to go about more firmly entrenching the Three Cs into your credit policies, just call us. We are always happy to help our clients become more confident and knowledgeable in all relevant aspects of the law.

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***Editor's Note:***

- ***We are pleased to announce that attorney Christopher Boback has joined Bernstein Law Firm on our bankruptcy and litigation teams.***

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***Bernstein Law Firm, P.C. is a full-service commercial, creditors' rights and bankruptcy law firm, providing a comprehensive range of services in all aspects of creditor and bankruptcy representation.***