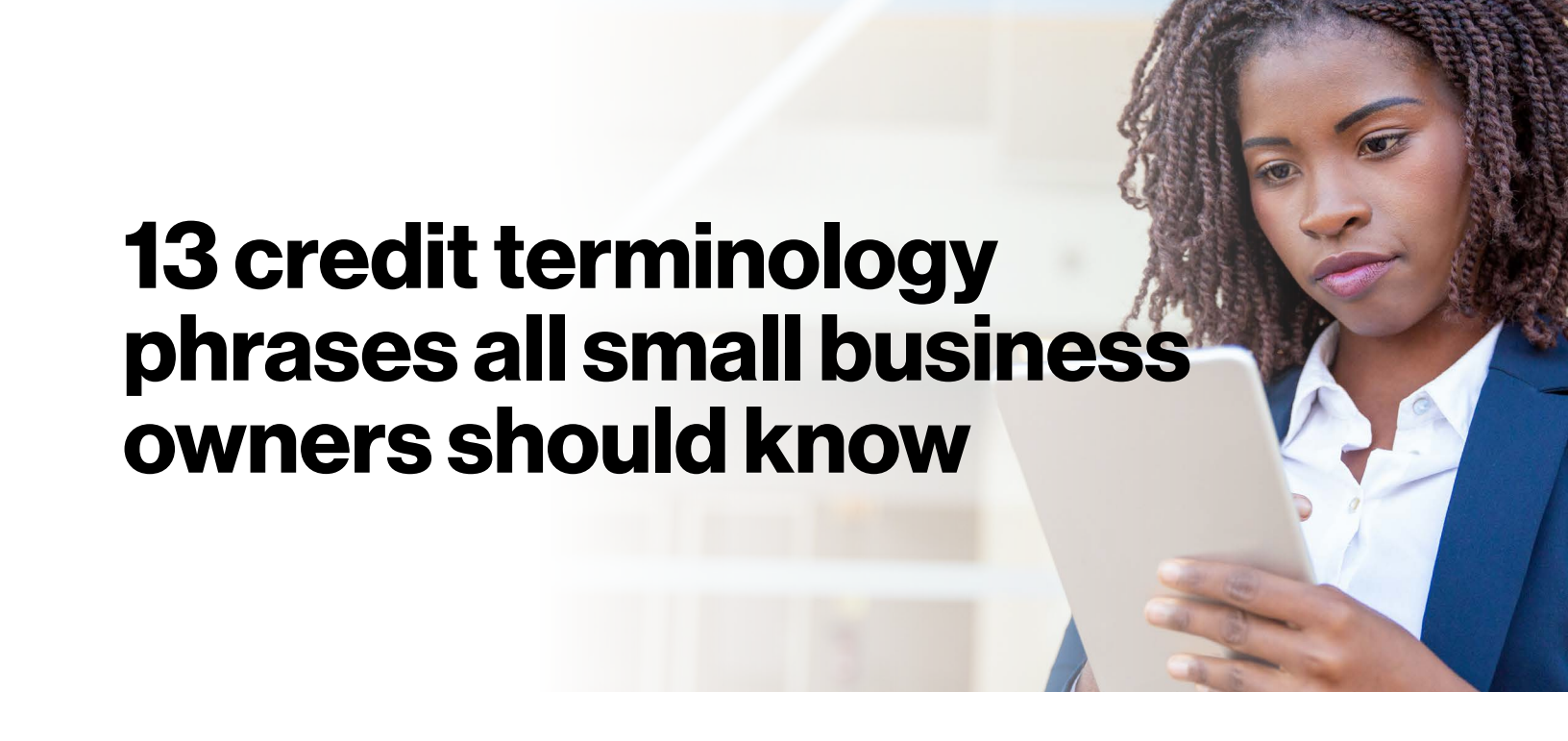




13 credit terminology phrases all small business owners should know

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Running a successful small or medium-sized business (SMB) requires speaking the right lingo—and even for SMB owners or managers who have significant experience in the business world, many of the words and phrases within SMB credit terminology are not exactly easy to master. They're technical terms with meanings that can be challenging to parse.

To provide guidance, we've prepared the following guide to SMB business credit terms. Below, you'll find explanations of many of the key credit-related phrases and concepts that are critical for small business success.

Why credit terminology matters for SMBs

Learning credit terminology can be so important for SMB success because these terms frequently feature in discussions with business partners, customers and lenders. Knowing what key terms mean and understanding the nuances surrounding related, but distinct credit concepts can be essential for navigating business relationships successfully.

In addition, understanding what credit terms mean is important for making informed legal and investment decisions. It could be quite risky—not to mention irresponsible—to commit your small business to a loan that comes with a prepayment penalty without understanding how that condition could affect your repayment plans, for example. Likewise, you'd want to know the difference between interest rates and APR so that you can interpret both of these factors accurately when reviewing terms for a loan.

1. Accounts receivable

Accounts receivable refers to payments that customers owe to your business for goods or products you've provided but which haven't been paid for yet.

For example, if you ship a product to a customer who has not prepaid, the payment for the product would fall under your accounts receivable until the customer completes payment.

Accountants typically treat accounts receivable as a type of asset because it represents revenue. In some cases, it may be possible to use accounts receivable as collateral for obtaining a loan through a process known as invoice financing or factoring. However, because there is a risk that customers won't pay (or will pay late), the interest rates for this type of loan tend to be high and the amount you can borrow against accounts receivable is typically low.

2. APR

APR stands for annual percentage rate and APR contributes, in part, to the total cost of borrowing money on an annualized basis. When comparing financing terms, APR may be a more informative metric than interest rate, since a loan that offers a lower interest rate is not necessarily the best deal if it includes higher fees.

3. Asset

In business, an asset is anything of value that a business owns. Tangible assets can include physical items, such as vehicles or buildings. Assets can also be intangible, like intellectual property or the monetary value tied to a business's brand.

4. Business credit score

A business credit score is a figure that can help lenders determine a company's present and historical financial responsibility. A business credit score is used by lenders to decide whether or not to extend credit and under what terms. Like personal credit scores, business credit scores are arrived at after several factors are considered and quantified and can serve to summarize a company's financial trustworthiness.

Business credit scores are calculated by credit bureaus, and in most cases, they fall between zero and 300. The higher the number, the more financially trustworthy a credit bureau deems your business to be.

5. Business line of credit

A business line of credit is an agreement with a lending company to provide a business with access to funds on an as-needed basis. The lender charges interest based on the amount of money borrowed against the line of credit. Businesses may also pay additional fees, such as an annual cost to keep the line of credit open. In most cases, lenders set a limit ahead of time on how much money a business can borrow through a line of credit.

Compared to term loans, which provide businesses with a fixed sum of money and require interest payments on the total sum, business lines of credit can be attractive because they allow access to credit when needed, without requiring the business to borrow (and pay interest on) money it doesn't need.

6. Collateral

Collateral makes up assets that a borrower can use to secure a loan. If the borrower fails to make loan payments as agreed, the lender can seize the collateral.

For business loans, common examples of collateral include real estate or inventory that the business owns.

Not all loans require collateral; those issued without collateral are called unsecured loans. However, lenders typically charge lower interest rates for loans that are secured by collateral.

7. Microloan

In the business world, a microloan is a small loan. Typically, the purpose of microloans is to help a new business get started or assist a small business in scaling up.

There is no official definition of how large or small a loan can be to qualify as a microloan. However, a common benchmark is to say that microloans cannot exceed \$50,000, the maximum amount that the U.S. Small Business Administration will lend.

8. Net terms

Net terms describe how long a company or customer can wait to issue payment after receiving an invoice without having the payment considered late. For instance, "net 30" means that payments received within 30 days of the arrival of an invoice are considered timely, while "net 60" means that payments can take up to 60 days to arrive without being late.

9. Personal guarantee

A personal guarantee is an agreement on the part of a business owner or executive to repay a business loan personally if the business defaults on it.

Agreeing to make a personal guarantee for a business loan requires individuals to assume personal risk since lenders could seize the person's own assets—like personal vehicles or investments—as repayment of a loan. However, for companies without established credit histories or with low business credit scores, lenders may ask for personal guarantees as a condition for issuing credit.

10. Prepayment penalty

A prepayment penalty is a fee that lenders may assess if a borrower pays off a loan earlier than initially agreed. For instance, if you take out a loan with a repayment term of ten years, but you pay off the principal and interest in only five years, a prepayment penalty may apply. Prepayment fees are equal to a percentage—typically between 1% and 5%—of the amount that the borrower pays off early.

The reason why lenders might charge prepayment penalties is that if loans are paid in full early, lenders collect less interest. This means prepayment penalties incentivize borrowers to stretch out loan payments, which generates more revenue for lenders. But if the prepayment penalty is lower than the sum of future interest payments, or if you simply want to reduce your liabilities in order to strengthen your business credit, it may make sense to pay off a loan early and accept the prepayment penalty.

Not all loans are subject to prepayment penalties. In the case that they are, lenders will define prepayment penalties when issuing a loan.

11. Profit and loss statement

A profit and loss statement—sometimes called an income statement or P&L statement—summarizes a business's income and expenses over a certain period of time. Profit and loss statements show whether your business has generated a net profit or, if not, how much your expenses exceed your revenue.

In the realm of small business credit terminology, profit and loss statements are important because lenders may ask for them when a business applies for a loan. The statements help lenders assess the business's financial health and earning potential.

12. Term loan

A term loan is a type of loan that provides the borrower with a lump sum. Typically, the borrower makes fixed payments on the loan and principal at regular intervals for a set period of time, such as five or 10 years.

These conditions make term loans different from lines of credit, which don't provide a lump sum or come with fixed payments.

13. Working capital

Working capital is the amount of usable capital that a business has on hand. It's equal to the value of the business's total assets minus debts and other liabilities.

Because working capital is necessary for funding ongoing business expenses, such as paying employees, tracking working capital is important for monitoring the financial health of a business.

Learn more about small business success

Learning credit terminology lingo is only one of many steps that small businesses must take to thrive.

To find out more about running a small business, and access other resources tailored for SMBs, visit Verizon's [small business solutions](#) hub.

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