Credit Scores - Do they help or hinder the self employed?

Self employment has its perks, you can wear what you want to the ‘office’, set your own hours and eat lunch at 10am if you so wish but it also has some down sides like an unpredictable income, but does being your own boss impact your credit score?

If you’re thinking about starting up your own business or you’re already self-employed and need to borrow some cash to buy a car or perhaps to become a homeowner here are some things you need to know.

The good news is that being your own boss doesn’t necessarily affect your credit score, but it does mean that some lenders may be a little more wary when it comes to letting you borrow due to that unpredictable income down side we mentioned earlier.

Your personal credit report has all sorts of information about how we have behaved with credit in the past, it also has details about bankruptcies, recent hard searches (for credit applications) and other personal information like your past employers, your address(es) and whether or not you are on the electoral roll.

The reason lenders ask about your present and past employment is to help them determine your income, how long you’ve been in the job to decide if you’re financially stable enough to be creditworthy. So, if you’ve been running your own business for only a few months, lenders may not be able to decide whether you’re a risk or not, because it’s unlikely that you can show a regular monthly income yet. Even if you've been self-employed for quite a while, you might make a lot of sales one month and fewer the next, or your customers may take a long time to pay their invoices. As a result of these ups and downs, your income is likely to be less stable than if you were employed by an established company.

Your credit history is just one of the five things lenders look at when determining your eligibility for credit. The other four are capital (any assets you can use to repay a loan), capacity (your monthly income), collateral (any assets you can use to secure the loan) and conditions (such as the amount and terms of the loan or the current state of the economy).

Lenders will look at your debt-to-income ratio, which compares the total amount you owe every month to your total income. An acceptable debt-to-income ratio depends on the lender's criteria, the type of loan you're seeking and a variety of other factors. In general, if your ratio is 50% or above, lenders may feel you already have too much debt and deny your credit application.

Depending on what your business does, you may also have taken on debt to get it up and running. If you've invested your own money in your business, you might be left with few easy to sell assets you can use to pay off your loans if things get tough. Both can work against you when applying for more debt—but there are steps you can take to improve your situation.

Check your credit report and scores so you know where you stand and can assess what types of loans you may qualify for. Don't try for loans or credit card offers that require a credit score above yours.

You might also boost the likelihood of getting a loan by offering to secure the loan with collateral. If you're applying for a car loan or mortgage, save up to make a bigger deposit which will reduce the cost you have to borrow and may make it easier to get approved.