BUSINESS

Merchant cash advances provide quick funds, but come with risks

The financing deals, usually considered stop-gap measures to get a business through a cash flow crunch, often involve high interest rates and fees, experts say.

Merchant cash advances traditionally give companies a lump sum in exchange for a percentage of their future credit/debit card sales. Photo Credit: Getty Images/iStockphoto/bymuratdeniz

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So you need quick capital and are considering a merchant cash advance (MCA).

This is a financing scenario where traditionally you'd get a lump sum in exchange for a percentage of your future credit/debit card sales, although over the years it has expanded beyond that to sometimes include repayment through daily or weekly bank account debits, say experts.

While such cash advances can provide much needed capital for certain businesses that can't qualify for traditional financing, the risks and costs should be carefully weighed.

"I've used it as rescue financing [for clients] to keep a company afloat while we look for other options," says Neil Seiden, managing director of Asset Enhancement Solutions, a consulting firm in Uniondale.

He uses it selectively because it can carry annual interest rates ranging from 60 percent to triple digits due to the short-term nature of the financing. A typical repayment period is less than 12 months, he says.

Specifically, these advances carry a "factor rate" ranging typically from 1.15 to 1.5, says Seiden. To calculate total cost, multiply the factor rate by the amount being borrowed (so borrowing $10,000 with a factor rate of 1.4 would amount to a financing fee of $4,000 with a total repayment of $14,000). There could be other

Some benefits of these advances: Since they're not technically loans, you don't need collateral or a personal guarantee as you would with traditional financing, and funds are usually available within 48 hours, says Seiden.

Companies often use these advances if they "need to buy time in anticipation of a future event," he says, adding over the years this type of financing has evolved and isn't strictly for companies that take credit cards. In these cases, repayment occurs through daily or weekly debits from their bank accounts.

Jeffrey Wurst, a senior law partner at Uniondale-

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based Ruskin Moscou Faltischek, also has seen this kind of repayment mechanism in more recent merchant cash advances and says they often have "abusive terms."

If terms seem exorbitant, shop around, says Wurst, noting MCAs charging exorbitant rates paint "reputable MCAs in a bad light."

Businesses must consider that high interest rates mean their income is considerably reduced until the financing is paid off, and the typical daily repayment requirement puts "an enormous amount of stress on a company's cash flow," says Leslie H. Tayne, principal of Tayne Law Group, a Melville-based debt solutions law firm.

"Most merchants use these as a stop-gap hoping it's a temporary solution to what they perceive to be a short-term cash flow problem," she says.

But she's seen companies get into trouble when they're counting on a "triggering event" to occur and it doesn't and they're still responsible for repayment.

"I see more cases of business owners defaulting or close to defaulting on these type of advances," says Tayne.

MCAs are usually more expensive than traditional financing due to the risk factor.

“It can be expensive when the borrower’s risk profile is high,” says Nathan Abadi, president of Manhattan-based Excel Capital Management, which offers financing solutions for small businesses that can’t obtain working capital through traditional lending channels.

The average default rate on MCAs is upwards of 8 percent, compared to less than 2 percent in traditional financing, he says.

Excel offers merchant cash advances in the traditional model by purchasing a percentage of a company’s future credit and debit card sales, and it also offers receivables-based financing repaid by daily or weekly debits from a business' bank account, says Abadi.

It works with affiliate credit card processors that divert a percentage of the business’ credit card sales to Excel.

Excel’s average factor rate is 1.30, and processing fees are about 2 percent of the total amount funded, says Abadi.

Since the cash advance is paid back through credit card sales, payments fluctuate based on sales volume.

For some businesses, it offers flexibility, he says, noting it doesn’t fit every scenario and there must be a “clear-cut utilization of the capital” for it to make sense.

Fast Fact:

A CEO survey conducted by Bryant Park Capital and deBanked showed growing confidence in the SMB lending/MCA industry. Confidence had a hit a low of 73.8% in Q1 2017, the lowest point since the survey started in 2015. In Q3, the number jumped up to 81.3%.

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