

When Banks Won't Lend, There Are Alternatives, Though Often Expensive

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After years of a small-business credit crisis, conditions seem to have improved. But with the economy still struggling and new regulations meant to eliminate bad lending, bank loans continue to lag.

“The days of yesteryear when you could go to your corner bank are over,” said Kenneth Walsleben, who teaches in the entrepreneurship and emerging enterprises department at the Whitman School of Management at Syracuse University. “Small, emerging, growing businesses have few traditional sources to turn to. You have to get a little creative.”

Some creative alternatives have been around forever; others emerged during the crisis. Almost all are substantially more expensive than traditional bank loans, which is why they have been sources of last resort. But as demand for alternative options has increased, some prices have come down. This guide, based on conversations with lenders, brokers and business owners, suggests which products make the most sense for different types of businesses.

Asset-Based Lending

HOW IT WORKS Companies sell their receivables, or invoices, to a factoring company, which gives the companies 80 to 90 percent of the value upfront and the rest when the invoices are paid off. Some lenders offer loans based on a company's purchase orders, contracts or inventory.

WHO USES IT Business-to-business companies that cannot wait for payment and especially troubled companies, because an invoice factor depends on the client's ability to pay, not the borrower's solvency. Purchase-order, contract and inventory loans require more creditworthiness from the borrower. “If you're in the office supplies business and you get an order from Staples, you can use purchase-order financing, and it can level the playing field,” said Neil Seiden, managing director of Asset Enhancement Solutions, a financial adviser in Port Washington, N.Y.

COST Purchase-order financing costs 4 to 5 percent monthly, while the effective annual interest rate charged by factorers is usually 18 to 30 percent, said Mr. Walsleben, who is also a co-owner of the Hamilton Group, a factoring company.

SUPPLIERS Liquid Capital, the Interface Financial Group, Triton Business Solutions, Simplified Leasing, Rosenthal & Rosenthal and scores of other firms offer factoring and other asset-based lending services. Many are members of the International Factoring Association trade group.

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Lease-Back

HOW IT WORKS A company sells its real estate or equipment for cash and simultaneously leases it back.

WHO USES IT Healthy companies with warehouses, manufacturing locations or other properties that hold value that could be put to use elsewhere. The borrower sells at market value, usually the average of several appraisals, and leases the property back at the market rate for 10 to 25 years.

COST The lease-back adds a monthly lease payment where previously there was none. Companies get less value from equipment than real estate because, unlike real estate, equipment depreciates over time, and lenders tend to value it at what is known as forced liquidation value, a lowball price based on what it would fetch at auction. Equipment lease-backs can create tax burdens as well. "If I own a press outright for 10 years and it's worth \$1 million, but it's on the books for \$250,000, and I sell it for \$1 million, I'll have to pay tax on a gain of \$750,000," Mr. Walsleben said.

SUPPLIERS AIC Ventures, W.P. Carey, Calkain Companies and many others. Borrowers can search on the Commercial Finance Association trade group's Web site.

Cash Advances

HOW IT WORKS A business receives a lump sum from a lender, which then takes a percentage of the business's daily card receipts until the loan, plus a predetermined fee, is paid.

WHO USES IT Restaurants and other retailers. Business-to-consumer companies generally have more limited financing options because they do not have wholesale invoices to factor or factories to borrow against.

COST Twenty percent and up, but highly variable.

EXAMPLE When he needed money last year to cover utilities and taxes during the slow winter months, Dennis Sick, owner of the Mohegan Manor restaurant in Baldwinsville, N.Y., took out a \$45,000 advance on credit card receipts. The lender said he would take 13 to 18 percent of Mr. Sick's daily credit card sales until he had received \$64,000, which would take 12 to 15 months and give him an annual rate of 35 to 40 percent. But Mr. Sick ended up paying the \$64,000 in seven months, giving the lender an annual return of some 70 percent.

SUPPLIERS AdvanceMe, RapidAdvance and many others. The North American Merchant Advance Association trade group gathers many providers.

Nonbank Loans

WHO USES IT Seasonal businesses, microbusinesses and other businesses that cannot meet bank requirements.

HOW IT WORKS Lighter Capital, a revenue-based finance company in Seattle, offers loans of \$50,000 to \$500,000 to small businesses with high gross margins. The borrower pays Lighter Capital 2 to 8 percent of its monthly revenue until the repayment amount is reached, and usually gives the lender warrants for 1 to 5 percent of the company. The country's 400 or so nonprofit community development financial institutions, on the other hand, fill the role of small community banks, lending to microbusinesses. "Our clients are supplemental income businesses, like cupcake trucks and Main Street businesses whose lines of credit got called," said Claudia Viek, chief executive of the California Association for Micro Enterprise Opportunity, a network of California C.D.F.I.'s.

COST Lighter Capital's chairman, Andy Sack, said the cost of obtaining financing from his company was around 20 percent annually. Ms. Viek said she expected California C.D.F.I.'s

to make some 2,000 three- to five-year loans of up to \$50,000 this year, at an average interest rate of about 8 percent. The rates can go as high as 14 percent.

EXAMPLE “In the past, we would go to the local bank and get loans on signature,” said Christi Riggs, 40, co-owner of Lone Star Linen laundry service, based in Taylor, Tex. When the bank said no, Ms. Riggs took out a loan from On Deck Capital, a New York-based company that analyzes business performance data — cash flow, credit, even social media information — to review loan applications from small businesses. Once granted, the loans, up to \$150,000, are repaid through automatic daily bank account withdrawals, much as a merchant cash advance works. The short-term loans, typically for three to 18 months, charge an annual rate of 18 to 36 percent, said Noah Breslow, chief executive of On Deck. Ms. Riggs ended up paying \$27,750 on a six-month loan of \$25,500, or an annual rate of about 18 percent.

SUPPLIERS Lighter Capital, On Deck Capital, Kabbage and others. Many C.D.F.I.’s are members of the CDFI Coalition.

Peer-to-Peer Loans

HOW IT WORKS Individual investors combine to lend money to small-business owners through online vetting platforms like Lending Club.

WHO USES IT Small-business owners with good credit scores who need money to expand or to buy equipment.

COST Depending on the owners’ credit ratings, annual rates can run from less than 7 percent to more than 25 percent. The loans are small, however, with a maximum of \$35,000 at Lending Club.

EXAMPLE When Hannah Attwood wanted to raise money to open a cloth diaper supply and cleaning service, she went to four banks. “They just kind of laughed at me,” said Ms. Attwood, 34, founder of Adore Diaper Service, based in Ventura, Calif. She applied to Lending Club on a friend’s suggestion, and within a week, 61 investors had jointly given her a three-year, \$6,000 loan at 11.36 percent. She combined the loan with an equal amount of savings to buy industrial washers and dryers and cloth diapers.

SUPPLIERS Lending Club and Prosper dominate the peer-to-peer market in the United States.