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On Deck Capital Targets Businesses Banks Won't Touch

The online lending service is thriving by making loans to struggling small companies. Its founder wants to turn it into a matchmaking system for business borrowers and lenders

By [John Tozzi](#)

When Mitch Jacobs founded online lending service [On Deck Capital](#) in 2006, his goal was to make loans to small business borrowers who had been rejected by banks as too risky. At the time, the need was hardly obvious. Business owners could borrow against rising home values, and banks stuffed mailboxes with credit-card offers. Those days are gone: \$40 billion in bank credit to small businesses has evaporated since 2008, according to Federal Reserve data.

The crunch has been good news for On Deck, whose short-term loans average \$30,000 and carry annual interest rates of 18 percent to 36 percent, two to three times more expensive than conventional bank credit. The 54-employee New York City company is on track to reach \$15 million in revenue this year, up from \$5 million in 2009, says Jacobs. Since it began lending in 2007, On Deck has disbursed \$80 million to 3,000 companies. The typical borrowers are small retail or local service businesses—restaurants, hair salons, doctor's offices—with average annual sales of \$250,000 to \$2.5 million. "The goal of On Deck is to build the systems and tools that enable a Main Street small business owner to access and manage capital for [her] business and make that a very easy-to-use online service," the 38-year-old Jacobs says.

Three innovations make On Deck's lending possible. First, it simplifies the application process. Instead of businesses sending stacks of paper to a bank, On Deck accesses data from applicants' online banking and credit-card processing accounts, credit scores and other information. Second, On Deck uses that data to evaluate the business's cash flow. Jacobs says the cash-flow analysis gives a more complete picture of the borrower's ability to repay than the personal credit scores that banks typically rely on for small dollar-amount loans. Third, On Deck automatically collects small daily repayments directly from the business's bank account, rather than counting on the borrower to write a check every month. On Deck takes an origination fee of 2 percent and a subscription fee starting at \$500, in addition to the interest income it shares with such investors as hedge funds and private equity groups that provide the capital for its loans. "They're clearly filling a gap that the banking industry has not stepped up to," says Susan Feinberg, senior research director at [TowerGroup](#), a Needham (Mass.) research firm. "When you look at the interest rates that they're charging, clearly these companies are desperate and they can't find a source of borrowing at any reasonable rate."

Matchmaking Ambition

"Desperate" is the word Houston florist Elaine Ousley-Nevarez uses to describe her six-employee shop's situation in the spring of 2009. With her bank unwilling to extend more credit, she took a \$20,000 loan from On Deck at an interest rate of more than 20 percent. She used the money to pay overdue bills to suppliers. When her first loan was nearly repaid, she borrowed another \$7,000 and refinanced the rate to 15 percent. Ousley-Nevarez is now working with a bank on a new loan.

Jacobs wants On Deck to move beyond making loans directly and become a system to match millions of business borrowers with the best sources of capital to meet their needs. In August, the company

launched a free tool to help businesses understand their finances using their online credit and banking data, similar to how personal finance site [Mint.com](#) works for consumers. (Jacobs says the full data profile, printed out, would make a stack of paper four inches thick.) Next, On Deck plans to use that information to connect businesses with lenders offering a menu of funding options, from credit cards to [Small Business Administration](#)-backed loans. Jacobs expects to introduce partnerships with other lenders in the next six months. Eventually, he says, he envisions a time when "five mainstream financial institutions are bidding to make a loan to a pizza place" using the On Deck system.

The challenge will be whether demand for On Deck's services will disappear when the economy recovers and banks ease credit, Feinberg says. "Commercial banks, community banks and credit unions are going to take a fresh look at the small business market, in part because consumer banking is becoming more and more challenging because of the new regulations," she says.

Founder's Success

Jacobs has a record of success as an entrepreneur: Two previous companies he founded were acquired, including a venture he started as a junior at Dartmouth College that allowed off-campus merchants to accept student IDs as payment cards. Jacobs has raised \$18 million in equity for On Deck from investors that include [Contour Venture Partners](#), [First Round Capital](#), [Khosla Ventures](#), [RRE Ventures](#) and [Village Ventures](#). And the company has access to \$60 million from investors to fund loans.

On Deck is part of a small group of innovators using technology to make small business finance more efficient, Jacobs says. He cites others, such as The [Receivables Exchange](#), a marketplace for businesses to sell unpaid invoices to investors at a discount, and [Progreso Financiero](#), which helps underbanked Hispanic customers build credit. Says Jacobs: "We have a relatively small and focused group of entrepreneurs more successfully tackling a problem that all the resources of the U.S. government and financial system have been stumbling trying to solve."

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