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Fishing for funding options

Small businesses turning to alternative bank sources

by Chad Eric Watt

Lee Richards buys fishing rods by the shipping container. One container shipped from Asia contains 5,000 to 6,000 rods and reels.

Like many small and new business owners, Richards has spent a lot of time and energy figuring ways to pay for those upfront before he sells them via his mail order business, Acadia Sports Inc.

“No bank is going to touch this kind of business,” he said. “They don’t understand the cash flow models.”

With big banks sorting through the implications of unprecedented upheavals and a bailout in the works on Wall Street, small business customers, including Acadia, are looking for alternative ways to access the money they need to make their companies go.

Richards is now trying an option he found on the Internet. On Deck Capital Inc., based in New York City, offers one-year cash advances to small businesses. In exchange for cash upfront, On Deck takes daily payments via debit payment. The interest rates On Deck charges vary by industry, but work out to an annual percentage rate between 18% and 36%.

On Deck bases its lending decisions on a company’s cash flow. Conventional lenders often look at the owner’s personal credit for small- business loans.

“We dig deeper,” said Mitch Jacobs, CEO of On Deck, which was founded in 2006. “We’re able to double the number of businesses that banks can lend to.” That means On Deck can effectively lend to twice as many businesses as banks can, although they tend to be smaller institutions.

On Deck examines automatically generated payment processing information to gauge a company’s stability and ability to pay back loans. It uses a debit system to collect its daily fees.

That daily debit acts as a health monitor for small businesses.

“If a \$100 debit gets declined, we know there’s a problem,” Jacobs said.

Factoring formula

Counting on future cash flow is similar, but different to factoring or merchant cash advances, in which a nonbank lender buys a business's accounts receivable at a discount.

Richards has used factoring and said he prefers On Deck's small fixed payment to factoring's percentage-based payment.

"Factoring worked out OK, but it's very expensive money," he said.

Compared with conventional loans, factoring arrangements often carry a much higher interest rate, which reflects a higher risk associated with the arrangement.

"My costs are higher than a bank, but your banker is the one who sent you to me," said Phil Maloney, an independent broker for factoring deals with Advantage Funding Services, which is based in Plano..

Factoring is a lot like a credit card, Maloney said, in that it gives a customer some breathing room between spending money and settling its accounts.

And while factoring is often associated with very high interest rates, Maloney said it's not in his interest to make deals that would drive a company out of business.

"If I see I'm going to be too costly for them, I'm not going to do the deal," he said.

Maloney's business includes many referrals from conventional bankers, and he says the volume of deals he sees has been on the increase.

"Deal flow right now is pretty good, and one of the reasons that it's pretty good is that bank lending is pretty tight," Maloney said.

He said On Deck's offering requires business history and creditworthy customers, so its offerings wouldn't work for a new or young company.

Outgrowing cash crunch

Richards founded Acadia Sports in 2004 and turned to On Deck at the end of 2007, and paid off that loan by April.

Our business picks up dramatically in February and March," he said. "What I'm trying to do at year-end is stock up inventory."

Richards is hopeful that Acadia Sports will soon grow big enough to escape short-term cash crunches. The company generated \$1.1 million in revenue last year, and Richards projects it will hit \$2.4 million in revenue in 2008.

That's because fishing, as a hobby, picks up when the economy slows down. That's the same as what Richards found as a partner in a prior mail order business, golf gear seller [Mastergrip Inc.](#) (He sold his portion of that business in 2007.)

“When the economy is down, things like golfing and fishing pick up,” he said.