How to Meet Today's Small Business Financing Challenges

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Despite low interest rates and an improving economy, many Los Angeles and Southern California small businesses are finding it difficult to obtain financing. An article published late last year in *The Wall Street Journal*[1] pointed out that "the biggest banks in the U.S. are making far fewer loans to small businesses than they did a decade ago."

According to the article, the volume of small business loans made by 10 of the largest banks that make such loans was down 38 percent in 2014 from its peak in 2006, before the recession. As big banks pull out of the small business lending market, this is opening the door to alternative lenders that often have less-stringent underwriting criteria, but also usually charge significantly higher interest rates on small business loans than banks do.

Lending Restrictions by Banking Regulators

One of the main reasons many big banks are pulling back on small business lending is the introduction of many new restrictions federal regulators have placed on them when it comes to making small business loans. Wary of another financial crisis, regulators have taken steps to restrict banks' abilities to make what they view as risky loans. When you consider the fact that it costs a bank approximately the same to fund a $100,000 loan as it does a $1 million loan, you can see why many big banks have decided to make fewer small business loans.

Meanwhile, most of the big banks that are still making small business loans have tightened their underwriting criteria. For example, they may require a five- to 10-year business history as opposed to the three-year business history they used to require. Big banks are also much more likely to require that the small business owner personally guarantee the loan — for example, by pledging his or her personal residence as collateral. And they are going to check the owner's personal credit history just as thoroughly as they check the business' credit history.

Where Can You Turn?

So where can your business turn if you need financing but don't qualify for a loan from a big bank? Here are a few ideas to consider:

- Regional and/or community banks should often be the first choice. These banks are more nimble and they usually work with the Small Business Administration (SBA), which guarantees a portion of the loan. This makes it less risky for the bank to loan to small businesses that might not qualify for financing from a big bank. *(For a detailed look, see our related article: SBA Loans Can Be Great Tools)*

- Asset-based lenders are another option to consider. They lend against accounts receivable, fixed assets, inventory and sometimes purchase orders. Asset-based lenders come in many different types and sizes and they offer a wide range of different types of lending products. If you choose this option, take the time to do careful research in order to find the best fit for your company.

- A company credit card can also serve as a source of business financing. While the interest rate is higher than conventional bank financing, it's lower than many of the alternative lending options. However, the card's credit line might not be high enough to provide the amount of money your business needs.

- There is a growing number of online lenders that specialize in loaning money to small businesses. These include cloud lenders like Kabbage and OnDeck — which has already loaned more than $3 billion to more than 30,000 small businesses — and peer-to-peer lenders like LendingClub.com and Prosper.com. And don't forget about crowdfunding sites like Kickstarter and IndieGoGo, where many inventors and budding entrepreneurs are turning to make their start-up dreams come true.

- Some Silicon Valley-backed lending startups are looking to help new business borrowers who have little or no credit history. Some have even developed apps and algorithms that can evaluate your company's creditworthiness by looking at your smartphone activity. This may be a stretch, but is certainly worth investigating depending on the development stage of your business.

- Finally, you may be able to approach friends and family members about borrowing money for your business. You should be extremely careful if you do, though, as this can be a major source of friction within families if the business venture goes south, significantly jeopardizing close friendships and family relationships over money.

An outsourced CFO services provider can help you wade through what will likely be a very time-consuming search for and evaluation of alternative lending sources like these. Additionally, an outsourced CFO can also help you get your financial house in order so you can present the best possible picture of your company to potential lenders. This way, once you have decided which type of lender you want to approach, your chances of financing success will be much higher.

Concluding Thoughts

Many Los Angeles and Southern California small businesses are still finding it difficult to obtain financing, even though we're seven years past the recession. One reason is that many big banks are pulling back on small business lending due to new lending restrictions from federal regulators who are wary of another financial crisis. In this environment, you may need to consider alternative lending sources other than a big bank. An outsourced CFO services provider can help you evaluate your options and get your financial house in order to maximize your chances of financing success.

1 *Big Banks Cut Back on Loans to Small Business; Ruth Simon; Wall Street Journal; November 26, 2015*
http://www.wsj.com/articles/big-banks-cut-back-on-small-business-1448586637

About CFO Edge

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