TARGET FUNDING BONUS CHAPTER

DEBT FUNDING

The ultimate goal of target funding is to secure the capital and resources you need for your business at the lowest cost and least risk to you. That's why I always advise clients to identify and investigate whatever free or low-cost and low-risk funding opportunities are available to and appropriate for them—including loans.

That's not how it usually goes. Instead, many entrepreneurs just walk into their local bank, expecting to walk out with a business loan. And more than 75 percent of them walk away empty handed. Those who can't get a bank loan often just grab the low-hanging fruit—loans that are easier to get but may be wormy with high interest, hidden fees, and unwieldy terms. Or they just get a personal loan, putting their home or other personal assets in hock, or borrow from family and friends.

Had they instead taken a strategic approach to finding the best business loan accessible to them, they might have discovered that they qualified for a zero-interest, lower-interest, or unsecured loan or a loan in the amount and with terms more favorable to them.

The good news is that the world of small business lending has become bigger and more diverse. Today, small businesses have multiple loan options at their disposal. With target funding, you can hone in on the loan opportunities that are both accessible and suitable for you.

Conventional Lenders

Conventional lenders include banks, credit unions, and other bank-rated financial institutions. These traditional types of lenders usually offer lower interest rates and longer payment terms than do other types of business lenders. However, they typically require better credit scores and stronger company financials than do nontraditional lenders, and usually loan only to businesses that have been in operation at least two years and have annual revenues of at least $100,000. They also have lower approval rates. By way of example, here is an example of the small business loans offered by a local community credit union.

OnPoint Community Credit Union

Membership is open to anyone working and/or living in the greater metropolitan areas of Portland, Bend, and Eugene, Oregon, and Vancouver, Washington. OnPoint provides the following small business loan products—for which the loan/line amounts are "customizable."

- Small business term loan: Up to 60 months for small businesses. Fixed or variable interest, 10–16%. For expansion capital, large purchases, new or replacement equipment and machinery. Collateral, equipment/machinery or business assets.
- Small business line of credit: Monthly payment, 2% of balance or $25, whichever greater. Variable interest, 9–11% APR. Collateral, business assets.
- Business auto: Up to 84 months. Fixed interest rate, 3.5–9.5%, based on borrower and year of vehicle. Collateral, vehicle purchased.

- <u>Commercial real estate</u>: Up to 25 years, amortizations. Interest rate based on lending situation. Collateral, real property purchased.

How Lenders Assess the Creditworthiness of a Small Business

Lenders use a set of key assessments known as *the Five Cs of Credit* to analyze an applicant's credit worthiness. How each assessment is measured and how much weight each is given varies somewhat with the type of lender, type of loan, and lending situation. For small business loan applications, the general guidelines for gauging the Five Cs of Credit are as follows.

Character Assessment of the borrower's likelihood of repaying the loan based on indicators of the business owner's integrity and stability—starting with the borrower's business *and* personal credit histories. May also consider length of time in business, work experience, professional references, reputation in industry and community, performance of other/previous businesses owned, legal issues.

Capacity: Assessment of borrower's ability to repay the loan based on indicators of the business's financials—outstanding debt, debt-to-income ratio, cash flow, net profit margin, and other financial benchmarks.

Capital: Assessment of the borrower's capital investment in the business—how much of the owner's money has gone into the business so far, down payment for the loan in question, net worth

Collateral:	Assessment of the borrower's ability to secure the loan based on availability of collateral—equipment, machinery, inventory, accounts receivable, real estate, vehicles, or other liquid assets
Conditions:	Assessment of circumstances affecting the borrower's ability to repay and to effectively use the loan—including intended purpose of loan as well as outside influences, such as economic, regulatory, industry, and market environments

SBA Loans

The U.S. Small Business Administration (SBA) guarantees business loans and funds microloans that are provided by SBA-approved lenders. With their low interest rates and longer repayment terms, SBA loans can be a great financing source for borrowers who meet the tough qualification criteria and can wait a few months for funding. The reality is, SBA loans are a long shot for many businesses and out of reach for those in operation less than two years. Part of the reason SBA loans are so hard to get is because the participating lender has to agree to make the loan, and sometimes their standards are even higher than the SBA's. I have seen many situations in which the borrower qualified for the SBA guarantee but the lender denied the loan because the client didn't meet the lender's requirements.

Following are current SBA loan programs and the SBA guidelines for each.

SBA 7(a) Loan

An SBA 7(a) term loan can be used for almost any business expenditure—equipment, inventory, working capital, commercial fixed assets, leasehold improvements, etc. It can also be used to refinance business debt or to buy a franchise or small business.

Loan Amount	Up to $5 million
Terms	Equipment/working capital: up to 10 years. Large assets/real estate: up to 25 years.
Interest Rate	2.25–4.75% above prime
Down Payment	10–20%
Credit Scores	At least 680 FICO + equivalent small business credit score
Collateral	Some collateral required; does not require full collateralization
SBA Guarantee	50–90%
Loan Fees	0.5–3.75% origination; $2,000–$4,000 loan packaging; 2–3.5% SBA guarantee
Time to Funding	30–90+ days

SBA CAPlines

For small businesses with short-term cyclical capital needs, the SBA offers four lines of credit: Contract, Seasonal, Builder, and Working Capital (assets-based). CAPlines are usually available only to SBA 7(a) loan recipients. The loan amount, interest rates, required credit score, SBA guarantee amount, and loan fees for CAPlines are the same as those for 7(a) loans.

Terms	Builder: up to 5 years. Contract, Seasonal, Working Capital: up to 10 years.
Collateral	Short-term collateral, such as invoices and project contracts
Down Payment	10%+
Personal Guarantee	20%+ guaranteed by business owner

SBA Express Loans

The Express Loan program is an expedited version of SBA 7(a) loan and CAPlines, wherein select SBA lenders are authorized to make the credit decision on behalf of the SBA. SBAExpress loans and revolving lines of credit have a lower maximum loan amount, higher interest rates, lower maximum SBA guarantee, and shorter processing time than standard SBA 7(a) loans and CAPlines. The credit scores, loan fees, and other specifications for SBAExpress loans are the same as those for standard 7(a) loans and CAPlines.

Loan Amount	Up to $350,000
Interest Rate	Up to 6.5% above prime, < $50,000. Up to 4.75% above prime, $50,000+
SBA Guarantee	Up to 50%
Time to Funding	Guaranteed loan determination within three business days. Usually takes a few weeks for lender to process loan and release funds.

Community Advantage Loans

These loans are for diversity borrowers who don’t qualify for a standard SBA 7(a) loan due to low revenues, low collateral, and/or low assets, s but who otherwise meet SBA eligibility criteria. These modified versions of SBA 7(a) loans are provided by SBA-authorized community-based lenders that focus on startup and early-stage businesses owned by women, veterans, minorities, people with disabilities, and/or low-income entrepreneurs. Community Advantage loans follow the same expedited application process as SBAExpress loans, but the loan amount, interest rate, and SBA guarantee are different.

Loan Amount	Up to $250,000
Interest Rate	Up to 6% above prime
SBA Guarantee	75–90%

SBA 504 Loans

The SBA Certified Development Company 504 Loan program is for borrowers who do not qualify for traditional financing to purchase fixed assets, or to buy land and construct a building, or to buy/renovate real estate for their businesses. With the SBA 504 loan program, an approved borrower actually receives two loans—one from an SBA lender and another from a certified development company. The credit score, loan fees, and timeline for SBA 504 loans are the same as those of standard SBA 7(a) loans.

Loan Amount	50% SBA lender; 40% CDC. Up to $14–$20 million (combined).
Terms	Up to 10 years, equipment/machinery. Up to 20 years, large assets/real estate.
Interest Rate	Below market fixed rate.
Down Payment	10% minimum

Collateral	Purchased real property or fixed assets
Other Requirements	Real property 51% owner-occupied. Tangible net worth $15+ million.
SBA Guarantee	0% senior lien position (SBA lender); 50–90% junior lien position (CDC)

SBA Export Loans

The SBA guarantees three types of export loans, which are provided through authorized SBA lenders. The credit scores, terms, down payment, personal guarantee, SBA guarantee, and loan fees for SBA export loans are the same as those of SBA 7(a) loans and CAPlines. The other features of the SBA export loans are as follows.

SBA Export Express Loans

Loan Amount	Up to $500,000
Terms	Term loan, up to 10 years (equipment), up to 25 years (real estate). Line of credit, up to 7 years.
Interest Rate	Up to 6.5% above prime, fixed or variable
Time to Funding	Varies with lender, but faster turnaround than 7(a) loans and CAPlines.

SBA Export Working Capital Loans

Loan Amount	Up to $5 million
Terms	Up to 3 years; typical is 12 months
Interest Rate	Up to 2.75% above prime, fixed or variable

SBA International Trade Loans

Loan Amount	Up to $5 million

Terms	Up to 10 years, general equipment/machinery. Up to 25 years, large fixed assets/real estate.
Interest Rate	Up to 2.75% above prime, fixed or variable

SBA Microloans

SBA microloans are provided by nonprofit lenders that are funded by SBA, but SBA does not guarantee any portion of microloans. These intermediary microlenders set their own interest rates, loan fees, collateral, down payment, and personal guarantee requirements. SBA-funded microloans can be used for expenditures to start or expand a small business; they cannot be used to refinance debt or buy real estate. Some SBA-funded microlenders lend only or primarily to entrepreneurs belonging to one or more diversity groups, such as women, minorities, and veterans. The SBA website features a database of SBA microlenders, searchable by state.

Loan Amount	$500 to $50,000
Terms	Up to 6 years
Interest Rate	6.5–13%. Varies from lender to lender; average is about 8%. Under $10,000, 8% above lender cost. Over $10,000,7.75% above lender cost.
Down Payment	10–20%
Personal Guarantee	Required; varies by lender
Credit Scores	640+ Cosigner may be required if credit not strong enough.
Collateral	Some collateral required; does not require full collateralization.
Loan Fees	Vary with lender
Time to Funding	30–90+ days

SBA Disaster Loans

The SBA provides three types of financing for damages caused by a federally declared disaster: Business Physical Disaster Loans (BPDL), Business Economic Injury Loans (EIDL), and Military Reservist Economic Injury Loans (MREIDL). These disaster loans, which come directly from SBA, are limited to losses not fully covered by insurance and other means (including traditional lenders).

Loan Amount	Up to $2 million
Terms	Up to 30 years (BPDL); shorter terms available for EIDL and MREIDL
Interest Rate	4–8%, BPDL and MREIDL; 4%, EIDL
Credit Scores	660+
Collateral	Required for loans > $25,000 (BPDL & EIDL) or > $50,000 (MREIDL)

Let SBA guide or refer you to an SBA lender near you. The U.S. Small Business Administration publishes an annual *Small Business Resource Guide* for each state, which includes a list of SBA offices and a list of SBA lenders in that state. For a lender referral, visit or contact your local SBA or SBDC (Small Business Development Center) office, or use Lender Match, an online referral tool on the SBA website. The SBA website also features a list of the previous year's most active SBA lenders throughout the country, with a link to each lender's website.

Forgivable Loans

With a forgivable loan, the borrower typically makes no payments and pays no interest for the life of the loan (usually short-term), during which the borrower is expected to reach a specified goal. If that goal is met, the loan is forgiven at the end of the loan period. If the goal is not met, the loan must be repaid according to the agreed-upon terms and conditions.

Local government economic development agencies and nonprofit community development organizations sometimes offer community-based forgivable loans to small businesses. Forgivable loan programs are usually business-incentive programs for revitalizing or creating/retaining jobs in an economically distressed community or district. Some are also aimed at a specific industry, such as restaurants or healthy food businesses, or at disadvantaged entrepreneurs, such as women, minorities, people with disabilities, and/or immigrants.

Following is a representative example of a forgivable loan program for small businesses.

Muscatine (Iowa) Small Business Forgivable Loan Program

The City of Muscatine offers forgivable loans to a limited number of small businesses each year.

Eligibility	New and existing businesses located in targeted areas
Loans	Term loan, \$10,000–\$25,000

Terms 5 years, with 20% of original loan forgiven annually upon the anniversary of origination of loan. Borrower must match 1:1 (owner investment = loan funds).

Uses Building improvements or expenditures related to growing/expanding the business

Interest-Free Loans

Like forgivable loans, interest-free loans are offered by some local and state economic development agencies and community-based nonprofit lenders. Most interest-free loans are microloans, although some lenders offer larger interest-free loans. Following are two examples of interest-free loan programs for small businesses.

State of Minnesota Angel Loan Fund

The Angel Loan Fund (ALF), an initiative of the Minnesota Department of Employment and Economic Development (DEED), was created to provide an additional funding option and incentive for businesses to participate in the State's Angel Tax Credit Program. ALF is an innovative and somewhat complicated business financing opportunity.

Eligibility Early-stage businesses with fewer than 500 employees, certified to participate in the Angel Tax Credit Program for any of the program's years. Business must have received at least one equity investment from an investor certified by the MN Angel Tax Credit Program and accredited by the U.S. Securities and Exchange Commission. However, the total equity investment attained for the round is not exclusive to investments made to meet the requirements of the Angel Tax Credit Program.

Loans Term loan, \$20,000–\$250,000. 10% of total amount of equity investment(s) received in the business's approved funding round subsequent to ALF approval.

Terms 7 years, non-recourse, deferred, with a balloon. If the business is sold during the term, the business must remit a risk-mitigation fee equal to 30% of the original loan principal.

Uses Start-up costs, working capital, buy or expand business, buy a franchise, purchase equipment, purchase inventory, commercial owner-occupied real estate acquisition or construction

Microlenders

Microloans are term loans of up to \$50,000 with fairly flexible repayment terms, more relaxed qualification standards than conventional financing, and interest rates ranging from low to steep. If you're considering a microloan, you have multiple options.

The primary providers of microloans for small businesses are nonprofit lenders, such as community development organizations and local or state economic development agencies. Some nonprofit microlenders belong to the network of intermediary partners that administer the SBA microloan program. In addition, a growing number of online lenders and community-based lenders (small banks, credit unions, CDFIs) have also joined the small business microlending scene. Keep in mind, too, that some microloan programs are aimed at a specific diversity group, geographic location, industry sector, and/or social-impact focus.

Following is representative example of a non-SBA, nonprofit microlender.

Detroit Community Loan Fund

A program of Detroit Development Fund and Invest Detroit, the Detroit Community Loan Fund (DCLF), more commonly known as *BizLoan Fund*, is a community development financial institution and low-profit limited liability company (L3C). BizFund offers microloans and technical assistance to "neighborhood-based" startups and small businesses in the City.

Eligibility	Small enterprises located in the City of Detroit, founded/owned by entrepreneurs that have been traditionally excluded from conventional business development and funding opportunities. These include people of color, immigrants, women, veterans, LGBTQ, low-income/low-wealth, with disabilities, and with less than a college degree.
Loans	Term loan, $5,000–$50,000
Terms	Fixed interest rate, 7%. Flexible, with option of interest-only period
Uses	Working capital; purchase of materials, supplies, fixtures, equipment; business expansion; property improvements
Fees	$100 application fee. No origination and closing fees

How a Small Loan and Entrepreneurial Savvy Grew a Global Company

Founded in 2004 by Maurice Brewster, RM Executive Transportation, Inc., today doing business as Mosaic Global Transportation, is an award-winning, minority-owned ground-transportation company providing executive limousine, corporate charter, and event transportation services. But the Great Recession hit the Northern California-based company hard. Although Mosaic had 44 employees and operated in more than 450 cities, Maurice had bootstrapped his business and had been putting all the profits back into the company. In 2013, Mosaic started turning a profit again.

By late 2015, Maurice was confident that with sufficient funding he could double the size of the company and increase profitability. He applied for a $250,000 loan, which the bank rejected, citing insufficient collateral and no profits for several years. He turned to Opportunity Fund, which looks at lending—and looked at Maurice Brewster specifically—a little differently. From Opportunity Fund's perspective, Maurice had already established a profitable business that had collateral "on wheels" for a loan. They started him out with a $15,000 loan to establish a credit history for and jumpstart the expansion of his business. Maurice did the rest. During Super Bowl 50, his company was named the Official Transportation Provider for the Host Committee. He also expanded his employee shuttle service at Google.

Today, Mosaic Global Transportation is a multi-million-dollar, international company with more than 1,500 vehicles in our network across the globe. Mosaic has been the official charter of the World Series, The Emmys, ESPN's ESPY Award Show, and CBS Interactive. Currently, Mosaic is the transportation option for companies like IBM, Hilton Hotels, Goldman Sachs, Google, and other Fortune 1000 companies. The bootstrapped small business that Maurice Brewster built into a global enterprise has also been named one of Inc. Magazine's 5,000 fast-growing companies in America and one of DiversityBusiness.com's top 100 businesses in California.

Online Small Business Lending Platforms

Before the banking crisis of 2007–2008, online business lenders were virtually unheard of and limited in scope. Today, online lending is a booming industry with an overwhelming number of lenders offering a range of business loans. Most online lenders are fintech companies that utilize web-based artificial intelligence and accounting technology to accelerate the credit analysis and loan approval, disbursement, and payment processes. A growing trend among some of the leading online lenders is to partner with major banks (for example, Funding Circle and Santander; OnDeck and JP Morgan Chase), providing those online lenders with greater access to capital with which to lend.

Business loans from online lenders are typically easier and faster to get than from banks, CDFIs, and other financial institutions. The trade-off is that the borrowing costs are often higher and often include origination fees and early-payment penalties. The loan amounts tend to be smaller and the repayment terms shorter than traditional business loans, and some online lenders require weekly or even daily automatic debit payments.

Loan specifications and requirements vary from lender to lender, but the following are general guidelines for the online lending market.

Eligibility	1–2 years in business. \$100,000–\$250,000 annual revenues; \$50,000 in some cases. 500–650 minimum personal credit score.
Loans	Term loans, \$5,000–\$250,000. Higher maximum loan amounts for online SBA loans.
Terms	Short-term: 3–24 months. Long-term: 12–60 months. Interest rates, 6–15% APR, with great credit score. Up to 30% with good

credit score. Potential for higher double-digit APRs with low credit score.

Collateral	Most online loans must be secured with business assets and/or personal guarantees, though not necessarily full collateralization.
Purpose	Short-term: equipment purchases, inventory purchases, working capital. Long-term: Leasehold improvements, expansion expenditures

As an example, let's look at Fundera, a top-rated online small business marketplace that also features reviews of the country's most reputable online business lenders.

Fundera

Fundera is an online business lending marketplace that partners with dozens of select online business lenders with demonstrated competence and solid reputations. Through its network of online lenders, Fundera offers SBA loans, terms loans, short-term loans, business lines of credit, equipment loans, and startup loans as well as invoice financing and business credit cards.

Here's how it works:

1. Fill out a short online questionnaire. Within minutes receive a list of loans for which you might qualify. This prequalification does not affect your credit score.
2. Review your prequalified loan options with guidance from a Fundera loan counselor to narrow down the list to the best potential loans for you.

3. Apply to the loans you're interested in with a single application, submitted to each lender in one fell swoop.
4. Vet your loan offers with the guidance of a Fundera loan counselor to identify the best deal for you.
5. Accept the loan offer of your choice.
6. Get your money within days, if not hours.

This loan-matching service is provided at no cost to the borrower. Lenders pay Fundera 2–5 percent of the loan amount, once loan funds are dispersed.

> **Know your business credit score.** A 2015 study found that small business owners who understood their business credit scores were 41 percent more likely to be approved for a business loan. Lenders obtain small business credit scores from FICO® Small Business Scoring System® (SBSS), Dunn & Bradstreet® PAYDEX®, Experian® Intelliscore Plus℠, and/or Equifax®. The most popular business credit score is FICO SBSS, which is used by the SBA and over 7,500 financial institutions.

Revenue-Based Loans

Revenue-based lenders typically give more weight to the borrower's revenues (sales), customer churn rate (retention), and growth rate than to the borrower's credit and collateral. There are three types of revenue-based loans: revenue-based financing (RBF), monthly recurring revenue (MRR) lines of credit, and revenue-based term loans. For RBFs and MRR lines of credit, the "interest" is actually a cut of revenues that is commonly referred to as a *royalty*. For revenue-based term loans, interest or a flat fee is charged.

Revenue-based financing is an upfront, lump-sum capital advance, for which the lender's royalty (interest) is based on the company's most recent gross annual revenues. An MRR-based loan is a revolving line of capital, also called an *MRR line*, for which the lender's royalty (interest) is based on the company's average monthly recurring revenue (MRR).

With revenue-based financing, the payment amount, called a *repayment cap*, is a multiple of the principal loan amount. For example, if the loan principal is $25,000 and the prepayment cap is 1.5 times the principal amount, the business would repay $37,500 over the duration of the term. The loan term is defined as a range, such as four to six years. The monthly payments (royalties) are a fixed percentage of monthly revenues, on average 8 percent. Consequently, the dollar amount of the monthly payment increases or decreases according to monthly revenues. Monthly prepayments are made until the cap is reached or the term ends. If the term ends before the cap is reached, the unpaid amount is paid as a balloon payment.

The particulars of revenue-based financing vary from one deal to the next, but the following features are fairly standard.

<u>Prior Revenues</u>	$15,000+ per month, over previous 12 months
<u>Principal Amount</u>	Up to 33% of annual sales, up to $1 million
<u>Terms</u>	3–6 years
<u>Repayment Cap</u>	1.5–3.0x principal amount
<u>Monthly Payment</u>	3–8% of monthly sales

Revenue-based financing is reserved for high-revenue, high-growth ventures that (usually) have secured investment capital. RBFs may be provided by investor, non-bank finance companies, or banks that specialize in providing RBFs to certain industries.

With MRR-based loans, the principal amount of the line of credit is a multiple of the company's average monthly recurring revenues, and the available capital grows as the company grows. This type of debt financing was designed primarily for subscription businesses that are paid in advance and carry little or no accounts receivables, such as SaaS (software as a service) companies, and for other businesses with recurring monthly revenues and low customer-churn rates. The borrower draws down the capital as needed over a two-year period, and then makes monthly payments over an additional three-year period. The monthly payment amount (interest) is a multiple of the MRR and is fixed for the life of the line.

MRR lines are typically used in lieu of a small equity round. MRR lines are provided by tech banks and specialty non-bank lenders. Tech banks offer lower interest but smaller advance lines (2x–4x MRR) than non-bank lenders; they also require financial covenants, and favor VC-backed companies. Alternative lenders offering MRR lines typically have higher interest rates and more warrants than tech banks but offer larger line amounts (4x–6x MRR).

Revenue-based term loans are essentially cash advances that are based on prior or forthcoming sales. These work much like merchant cash advances (based on credit/debit card receipts) and consumer payday loans (based on forthcoming earnings)—with similarly low credit and collateral requirements and often similarly high interest rates and fees. Loan amounts can be a percentage of annual or monthly sales. Payment schedules can range from daily (most common) to weekly, monthly, or quarterly. Eligibility requirements, terms, interest rates, fees, and other specs vary from lender to lender.

Following are representative examples of revenue-based financing (Lighter Capital) and MRR lines of credit (SaaS Capital).

Lighter Capital

The only loan product offered by Lighter Capital, Inc., a specialty finance company, is its trademark RevenueLoan®, a revenue-based financing solution. This revenue-based financing solution is available only to high-growth, high-margin, U.S.-based software, SaaS, tech services, and similar technology companies that are providing products and/or services to at least ten business, government, and/or institutional clients.

Eligibility	\$200,000+ annual. \$15,000 average monthly recurring revenues (MRR) over last three months, with gross margins of 50%+.
Line Amount	Up to 33% annualized revenue run rate. \$50,000–\$500,000 first round. Up to \$2 million per follow-up round (for qualified companies)
Term	3–5 years
Payment	2–8% (never more than 10%) of monthly revenue (cash receipts); paid monthly
Cap	1.35x to 2.0x line amount

SaaS Capital

Self-described as an “alternative growth-financing” entity, SaaS Capital provides “long term credit facilities”—that is, monthly recurring revenue (MRR) lines of credit—exclusively for companies in the United States, Canada, and United Kingdom that sell SaaS-based solutions.

Eligibility	\$200,000+ MRR. Renewables greater than 85%. Revenue growth 15%+ per year. Business does *not* need to be venture backed, profitable, or billing customers monthly.
Amount	5x–7x MRR, as low as 4x
Terms	Drawn down over 2 years. Repaid over 3 years or renewed and amortized over 3–4 years. Interest rate, 10–13% of line amount +1.5% commitment fee + at-the-money warrants. No balance sheet covenants or cash reserve requirements.
Timeline	After initial application and conversation, a yes/no answer usually can be given within a few days. If approved, a term sheet usually can be drawn up within one or two weeks.

Invoice Financing

Invoice financing is a form of financing that is secured with a business’s unpaid invoices (accounts receivable). It is designed for companies that sell to businesses and/or government agencies, which typically purchase goods and services on net terms (usually 30-day, 60-day, or 90-day).

With invoice financing, the business sells its outstanding invoices to a specialty finance company (the *factor*), at which time the finance company advances a *fraction* (percentage) of the invoice value. The remaining value of the invoice is held in *reserve*. When the invoices are paid, the finance company remits the remaining invoice value to the business—minus the finance companies service fees (*rebate*). The initial *advance rate* varies with the finance company and business, and can be as low as 60 percent and as high as 90 percent, although 80 percent is the average.

Typically, the finance company's fees are comprised of two key elements: the *factoring period* and the *factor rate*. The *factor rate* (or discount rate) is based on the finance company's cost of providing the invoice financing services. Depending on the factoring period and the finance company, the factor/discount rate can run anywhere from 2 percent to 10 percent of the total invoice value. The factoring period is the length of time your customer has to pay the invoice (usually up to 90 days). Finance companies charge their factor/discount rates on a weekly or monthly basis. The longer your customers net payment terms, the higher your total cost of invoice financing.

The two most common types of invoice financing are *invoice factoring* and *invoice discounting*. With invoice factoring, the finance company collects payments directly from your customers. This means the factoring company becomes the customers' point of contact with regard to paying your invoice—which may or may not be amenable to customers. With invoice discounting, your customers submit their payments to you. To qualify for invoice discounting, the finance company typically requires evidence that your customer credit-checking, invoicing, and collection processes are up to par—as reassurance that you're capable of collecting the money owed you and minimizing delinquencies and defaults.

Most factoring companies today have fast and easy online application and approval processes. Eligibility is based largely on the volume and quality of the invoices, but the borrower's credit scores and business financials may be considered as well. If you have an outstanding loan with a blanket lien on your business assets, you probably won't qualify for invoice financing because most factoring companies require that their invoice financing facilities take first position.

Invoice financing can be structured in many different ways, and it can get complicated and costly. The factor/discount rates, factoring periods, and initial advance rates vary with the finance company and the financing situation, and some factoring companies charge any of a slew of additional fees—such as origination, transaction, inactivity, and early payment fees. Eligibility requirements, terms, and conditions also vary. So it is critical to do your due diligence in checking out any factoring company you're considering and to only consider factoring companies that reveal exactly how their invoice financing products work and all the caveats and costs involved. If you don't fully understand or feel comfortable with a term sheet, consult with a business financial consultant or attorney before entering into an invoice financing agreement.

Some contemporary fintech-driven factoring companies have more straightforward invoice financing models and more streamlined application processes than some old-school factoring companies. Many of this new breed of factoring companies—such as Blue Vine, Fundbox, PayPal Working Capital, and Triumph—are also more transparent about their fees, advance rates, terms, and conditions. As an example, here is the approach Fundbox takes with invoice financing.

Fundbox

Fundbox invoice financing is essentially a credit line that enables small businesses to borrow against their receivables rather than sell their unpaid invoices. Fundbox finances the full value of the business's invoices, charges a flat fee, and requires weekly payment. You choose which invoices you want to *clear* (finance), within your credit limit, and the funds are transferred to your account within a few business days. Customers pay you directly, and you retain responsibility for collecting your receivables.

To qualify for Fundbox invoice financing, your business must be located in the United States or one of its territories and must also have:

- A business checking account
- Accounting software this is compatible with Fundbox, such as Quickbooks
- At least $50,000 in annual revenue
- At least 6 months invoicing history in a Fundbox-supported accounting software or 9 months of transactions in a business bank account

To apply, you connect your accounting software to Fundbox, and Fundbox evaluates your receivables data. If approved for invoice financing, Fundbox will establish your credit line—which is the full value of your receivables, up to $100,000—and set your flat financing fee. You choose between a 12-week or a 24-week payment plan, and your repayment amounts are based on the balance owing on your credit line. Financing fees start at 4.66 percent, and the fee for 12-week terms are slightly higher than for 24-week terms.

For example, if you drew $1,000 at a 4.66% fee on 12-week payment plan, your weekly repayment would be $87.22 and you'd pay a total of $1046.60 (principal + fees). If you drew $1,000 at an 8.99% fee on a 24-week payment plan, your weekly repayment would be $45.41 and you'd pay a total of $1,089.90. You can plug the amount you owe and your fee into the rate calculator on the Fundbox site to estimate your weekly repayment.

If you owe nothing on your Fundbox credit line, you make no payment and pay no inactive credit fees (as many factoring companies charge). In addition, you pay no early payment penalty. In fact, if you repay early, Fundbox waives all remaining fees.

Invoice Financing Helps Stabilize and Grow a Graphic Print Shop

After years of working his way up the ranks at graphic design and print shops, Asher Collins opened his own business in 2010. Big Guy Signs makes signs, banners, and other graphic print items for businesses in Indianapolis, Indiana.

An early customer favorite was vehicle wraps—which transform a truck or van into a moving billboard. But few of Asher' small-business customers could afford to pay upfront for a wrap, and Asher didn't have sufficient cash flow to extend terms to every client that wanted one. In fact, he said he often had to "rob Peter to pay Paul" to cover operating costs. Asher needed to borrow money, but although sales were strong, his credit score wasn't high enough for a business loan.

So, instead, Asher secured invoice financing from Fundbox, which greatly improved cash flow. He also directed his customers to Fundbox Pay, a credit network for business-to-business transactions that includes the option of opening a line of credit to pay for purchases made through the network. Several customers went with that option and began using their lines of credit to pay for their Big Guy Signs purchases—including the coveted vehicle wraps.

Vehicle wraps quickly became a major part of Asher's business, and some customers also use Fundbox Pay to purchase additional Big Guy Signs merchandise, such as graphic T-shirts. Asher credits much of his company's 60 percent growth to his customers' increased purchasing power and to having the working capital to keep up with increased sales.

Adapted from the original story, by Irene Malatesta and posted on Fundbox.com.

Purchase Order Financing

Like invoice financing, purchase order financing is a line of credit secured by future receivables, for which you pay a percentage of the funds you've been advanced. The amount of your credit line is based primarily on the volume and quality of your purchase orders. It is available only to companies with business and/or government customers.

While invoice financing is based on goods or services you've already delivered, purchase order financing is available only to companies selling tangible goods and is based on customer orders not yet fulfilled. Eligibility is based largely on the creditworthiness of both your customer and your supplier. Another major difference is that the advance is paid to your suppliers, rather than to you. With invoice financing, the advance can be used for any business purpose; with PO financing, the advance can only be used to pay your supplier.

Typically, the supplier delivers the goods to and bills the customer, and the customer pays the PO financing company. The PO financing company deducts their fee and remits the balance to you, and you pay the supplier. With some PO financing companies, the customer pays the supplier; the supplier deducts their charges and pays the PO financing company; then the PO financing company deducts their fees and remits the remaining balance to you.

Although some PO financing companies will advance 100 percent of your supplier's purchase order, most cap out at 80 to 90 percent. PO financing fees range from 1.8 to 6 percent per month—which translates to an annual percentage rate (APR) of 20 to 75 percent. Repayment terms are usually 30 or 60 days.

Purchase order financing is easier to qualify for than regular business lines of credit and business loans, and eligibility depends more on the customer's and supplier's creditworthiness than yours. In addition to the customer's and supplier's creditworthiness, however, eligibility usually requires purchase order amounts of $50,000 or more and transaction profit margins (your cut after supplier charges and financing costs) of 15 to 30 percent. Credit approval (or denial) usually takes a few days; if approved, the supplier is usually paid within one or two weeks.

Purchase order financing can be a viable, if pricey, funding solution for small businesses with insufficient cash flow to fill orders from large corporate and/or government customers and for seasonal businesses with sales spikes and valleys. Shop around for the best deal from a reputable PO financing provider, such as Capital Source Group, King Trade Capital, Paragon Financial, and Purchase Order Financing, all of which are online lenders. Make sure to read the fine print so you'll know all the fees, terms, and conditions upfront—before you sign up for purchase order financing.

Paragon Financial

Founded in 1994, Paragon offers purchase order financing as well as invoice financing to businesses in need of working capital. The specification's for Paragon's PO financing solutions are as follows:

- Advances up to 100% of purchase orders
- Finances $50,000 to $10 million in total purchase orders
- Requires 15% profit margin per purchase order
- 60–90 days repayment terms
- Monthly payments
- Fee: 3–4% of purchase order, first 30 days; 1.25% every 30 days thereafter

After reading about all the loan options available to small businesses, you may feel a bit overwhelmed. Sometimes having many options can be as challenging as having too few. Keep in mind that not all of these options will be appropriate for your business.

Sometimes, business advisors or lenders discourage small business owners from choosing a particular funding strategy. For example, I have heard lenders recommend not using invoice factoring. In my opinion, it really comes down to the individual entrepreneur’s funding strategy, business variables, and timing. In some cases, invoice financing is the right option.

While each debt financing option has its strengths and weaknesses, my favorite by far is microloans. Clients sometimes shy away from micro lenders because they believe it’s not enough money to scale their business. I can’t even count how many companies were able to reach $1 million or more in revenue with a small infusion of capital, sometimes less than $10,000. There is nothing more rewarding than seeing a micro-business start with a small loan and build into a small business that any lender would love to have as a customer.

Personally, I really enjoy working with community-based lenders, such as local government economic development agencies, CDFIs, and small local banks and credit unions. They tend to be tuned into and responsive to the lending needs of their local small business community. With regards to SBA loans, working with an experienced SBA lender will help sort out the correct funding product for your business.

Targeting your debt funding to the loan opportunities that most closely align with your business needs and variables is one of the best things you can do on behalf of your business.