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Five Alternative Sources of Funding

By Diana Ransom

Despite lining up a last-minute, $3 billion reprieve from its bondholders over the weekend, CIT Group (CIT) isn't in the clear yet. To counter its losses, CIT aims to attract more funds through deposits to its bank in Utah. However, the company first needs approval from the Federal Reserve and the Federal Deposit Insurance Corp. to transfer more of its assets to the bank. And more broadly, the firm must find a long-term solution to the increasingly expensive business of finding capital to make loans.

Even if CIT manages to stave off filing for bankruptcy protection, small-business owners would be wise to familiarize themselves with credit alternatives — especially these days, says David S. Waddell, the CEO of investment strategy firm Waddell & Associates in Memphis, Tenn. Owners are now finding that their longtime deposit relationships arent proving as useful, as many lenders restrict loan and credit terms to keep more cash on hand, he says. (According to the Federal Reserve's most recent Senior Loan Officer Opinion Survey in April, 75% of domestic banks said they tightened credit for small firms — up from 70% in the Fed's January survey.) In addition, credit card companies like American Express (AXP) and Advanta (ADVNB) are either tightening their terms or cutting small businesses off entirely.


Bloomberg News

"Hopefully, recent events and those within the last year gave entrepreneurs inspiration to locate alternative forms of capital," says Waddell. But if aligning back-up (or primary) financing sources hasn't been a top priority at your firm, it's not too late.

Here are five small-business funding alternatives to consider:

Government-backed loans

In March, the Small Business Administration began guaranteeing as much as 90% of some loans. Now, preferred SBA lenders such as Bank of America (BAC) and KeyBank (KEY) may be more willing to extend you an SBA-backed loan, says Brian Hamilton, CEO of Sageworks, a Raleigh, N.C., financial research firm, and a former SBA consultant. Since President Obama signed the American Recovery and Reinvestment Act (ARRA) into law in mid-February, the weekly loan dollar volume has risen more than 40% in the 7(a) and 504 programs, compared to the weekly average before passage, according to John J. Miller, a SBA spokesman.

Passage of the ARRA, also permitted the SBA to temporarily waive a fee that it charges to banks, which is passed on to borrowers, says Martha Seidenwand, KeyBank's SBA program and operations manager in Cleveland. (Special SBA programs including the American Recovery Capital (ARC) program and the floor plan financing program, might also prove helpful. For our story on ARC Loans, click here.)

Community banks and credit unions

Having dodged the brunt of the mortgage bullet, community banks and credit unions may be in a better position to lend to small businesses, Hamilton says. A number of community banks are issuing additional loans to small businesses as the outlook for the lending environment improves. In addition, credit unions may soon take on more small-business loans as larger lenders tighten their terms.

Peer-to-Peer networks

After a nine-month registration period with the Securities and Exchange Commission, the San Francisco-based peer-to-peer lending network Prosper is back in the business of brokering loans. At Prosper, borrowers list how much they need and details about their business, while strangers can make loans with as little as $25. Virgin Money specializes in structuring business loans between friends, family members and associates. Lending Club will connect only credit-worthy borrowers with lenders. (Note that there are some pitfalls to going this route. Click here for our story.)

Microlenders

In need of a small cash infusion? Enter: New York-based microlenders Accion USA and Count Me In. Because these organizations rely on donations from charitable organizations and individuals, they’re more willing to lend to entrepreneurs just starting up or to those with checkered credit histories. Although microloans generally carry higher interest rates than bank loans, Accion recently lowered its rates from between 11% and 18% to between 8% and 15%. The SBA also provides microloans and offers rates between 8% and 13%.

Asset-based lenders

Don’t let the near-collapse of CIT, one of the nation’s largest factoring firms, fool you. There are troves of other asset-based lenders willing either to purchase your accounts receivables for 80% to 90% on the dollar or to lend against them. LSQ Funding, an Orlando, Fla., factoring firm, for example, works exclusively with small to midsized businesses across the U.S., and New York’s FGI Finance purchases international receivables. For those who like competition, the New Orleans-based Receivables Exchange allows credit-worthy businesses to auction off their receivables to the highest bidder.