SAN DIEGO BUSINESS JOURNAL

Failing to Grasp Loan Terms Can Be Costly to Companies

FINANCE: Online Lenders Offer Fast Cash at a Price

By **SARAH DE CRESCENZO**
Published June 22, 2017

Garret Akerson, who with his wife, Deeanne, founded the Oceanside-based e-commerce company Kindred Bravely, says it's easy for small business owners to get in financial trouble by borrowing money from online lenders promising fast cash at high interest rates.

For the husband-and-wife team behind Kindred Bravely, an Oceanside-based e-commerce retailer of maternity clothing, it was their business success — not their struggles — that prompted them to turn to a well-known online lender.
Garret Akerson, who founded four startups before Kindred, his wife Deeanne's brainchild, said the simplicity of the process was appealing.

"You can get funds within a week, whereas (the U.S. Small Business Administration) is going to take three months," he said.

But as the Akersons discovered, that fast cash comes at a price: high interest rates that can quickly become crippling, threatening the financial stability the business sought in the first place.

Apparently, the couple is not alone.

Chuck Sinks
CDC Small Business Finance

Fast Cash
An increasing number of businesses are getting tripped up, many of them because they don't understand the terms of the loan, especially the annual percentage rate (APR), said Chuck Sinks with CDC Small Business Finance, one of the country's largest Small Business Administration lenders.

"There aren't a lot of finance majors out there that stop and put a calculator to this, and even those who are skilled at it, it's very difficult to suss your way through all the variables to get a general idea what the APR is of that money," he said.

One business owner told him she found it nearly impossible to resist offers of quick cash to tide over her struggling business.

"The money is there the next day, so they'll pay anything to get it, or they don't know what it costs, which I think is more often the case," he said.

Industry Efforts at Transparency

Online lenders, those tech-enabled companies that provide cash to borrowers sight unseen in a fraction of the time it would take to get a conventional loan, grew rapidly in the wake of the recession. Small businesses in need of working capital, their lifeblood, found themselves scrambling when banks retreated.

A number of alternative lenders, including Kabbage Inc., have responded to customer concerns about the loans' lack of transparency. The lender is a founding member of a trade association called the Innovative Lending Platform Association that has developed a set of common pricing metrics and calculations for companies to use in their loans documents. A similar group, the Marketplace Lending Association, requires members to disclose transparent prices, including the APR for loans.

The Cost of Success

The Akersons knew the price they were paying for their online loan, but they needed the cash to scale their business. Shortly after the e-retailer started out in June 2015, it turned to CDC Small Business Finance, borrowing $100,000 to launch two more products, one of which remains the company's best-selling product.

Deeanne Akerson
Kindred Bravely

"From there it was kind of meteoric," Garret Akerson said. "To finance a rapidly growing company causes almost as many cash problems as a company that's in the decline. It just eats up so much cash, especially if you're having to pay for inventory."

To accommodate that growth, they decided to take another $100,000 loan, this time from online lender Kabbage. The lender has provided more than $3 billion in funding to more than 100,000 businesses, according to its website.

"Their (Kabbage's) process is very simple, which I think is what makes it very attractive," Akerson said. "Based on your earnings they submit an offer almost right away."

Payment — either one-sixth or one-twelfth of the loan total, plus a fee — is made monthly, which the lender bills as a method of providing businesses with capital without hidden costs. But as a business makes payments, reducing the principal, the equivalent annual percentage rate rises.

"We had already poured in all our personal savings and didn't have any more to contribute at the time unless we wanted to get external funds, and we didn't want to get an external investor, at least not yet," Akerson said. "In our case we ended up paying an APR over 20 percent. We should never have done it."

Within three months, the Akersons ended up working with CDC to get another $100,000 loan to pay off the one they had taken from the online lender, which they owed nearly $10,000 each month.

This year the company, which employs 16 employees — all stay-at-home mothers — expects to take in about $5 million in revenue.

'Last Resort Type Thing'

For another San Diego business, it was a matter of borrow or bust.

Kid Ventures, founded by Darren and Debbie Solomon about a decade ago, operates three indoor play venues for children in San Diego County.

But when the company's original location in Pacific Beach had to close a few years ago due to unexpected zoning issues, Darren Solomon said conventional lenders weren't interest in lending to Kid Ventures until its revenue returned to previous levels.

"Cash flow became a real challenge," he said.

They turned to Kabbage and got a line of credit for $75,000 for six months.

"It was a last resort type thing," he said.

Darren Solomon
Kid Ventures

He found the qualification process innovative - when underwriting the loan, the lender took into account some untraditional business metrics, such as social media following — but like the Akersons, the monthly payments became onerous.

Eventually, they decided to get a loan from a private lender using their home as collateral to pay off the funds from Kabbage.

"You have high payments in a much shorter time frame than traditional banks or lenders so you get the money, but it's hard to fulfill the payback requirements," he said. "Ultimately, it created a lot more strain than it did benefit."

Terms Clearly Spelled Out

Both the Akersons and the Solomons said the lending platform spells out its terms clearly, but that even experienced business owners, when in a bind, can be susceptible to offers of money they might not be able to pay back.

Sinks said he recommends business owners expend more effort — whether that means meeting with someone in person or filling out additional paperwork — in exchange for lower-cost capital through the SBA or community development financial institutions.

"On the one hand, (online lenders) are filling a need, but on the other hand, you have to almost be an MBA to really figure (the APR) out," he said.

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