# Want to get an online business loan?

## 10 questions to ask before committing to one.

**This e-book is interactive.** Click around to easily jump to the sections that interest you.

**What's inside?** Simply put, the purpose of this e-book is to help you fully understand what taking on an online loan truly involves and how it can impact your bottom line.

While many money guides are loaded with jargon and confusing language, we break down everything you need to know into easy-to-grasp terms and examples based on real-life situations.

## Did you know?



## Questions to ask yourself

These questions will guide you on important practices of reviewing your business needs under the microscope and drilling into your financial health.



## Questions to ask your online lender

Use these questions to help you learn what numbers to crunch and to always remember to scrutinize the fine print and vague terms.

# Did you **know?**

The convenience of working with online-only lenders can come with a huge price tag. With the explosion of fast financing over the last decade, it is more important than ever to understand your true costs and what type of loan is the best match for your needs.

# What instant gratification could cost you

In our increasingly on-demand world, you can stream whole seasons of TV shows and expect groceries at your doorstep within two hours of ordering. Millions upon millions have been mesmerized by the sheer ease and convenience of these seemingly lightning-speed services.

The business lending industry over the last decade has followed a similar path to attract more customers, drawing on their desire for ease and instant gratification. Thanks to advances in technology, you can now qualify for a business loan in literally minutes. And the cash usually arrives within a few days or less—ready to be spent on whatever your business needs, whether it's buying inventory, satisfying debts, or simply getting your venture off the ground.

But like anything that comes so easily and quickly, expect some catches. For one, you'll likely have to pay a hefty premium on the money you're getting. **Unaware of the true cost of the loan, borrowers can end up paying upwards of 50 percent to 150 percent APR (Annual Percentage Rate).** Others may get slapped with a heavy penalty for paying their full balance early. Ouch.

## 20% of online-loan customers are unhappy

Issues with e-lenders appear to be wide-spread. One in five customers who took out a nonbank online-only loan said they were dissatisfied with their experience, according to a Federal Reserve study published in 2017. This was the highest rate of customer dissatisfaction among all lender types. That thumbs-down rating was just 5 percent with small banks and 1 percent with community lenders, or CDFIs.

Furthermore, when it came down to **why online-loan clients were unhappy, about one in three respondents said it was due to having to pay high interest rates.** Almost half of these customers attributed their unhappiness with the product to lack of transparency.

That said, online loans do have their specific uses. If leveraged correctly, they can serve as a temporary solution for certain, limited cases.

Regardless of your situation, **failing to do your research can send you into a world of financial hurt.** Fortunately, with expert guidance on what to look out for and critical questions you should ask, you'll be able to effectively decide whether an online loan is the right move for you and your business.




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Did you know?




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# Flashback: How e-lending came to be

Let's first take a quick detour into the backstory of how this once-niche market exploded into a multi-billion dollar industry.

Fueled by toxic loans and renegade-style investing, the Great Recession (circa 2007 to 2009) caused America's financial infrastructure to essentially implode. As troubled banks shuttered and the economy limped along, the volume of small business loans plummeted.

What did this mean for entrepreneurs? Access to capital—a business' lifeblood—was limited or non-existent for most. In other words, traditional banks weren't giving out many loans. And a large void was created in the lightly regulated small business lending market.

For alternative e-lenders, this stormy period signaled a prime opportunity. Unlike the more risk-averse banks, online-only companies were willing to extend credit to mom-and-pop businesses—even those with short, blemished, or sometimes, non-existent credit histories.

And it's easy to see why small-business customers flocked to these emerging firms. Their colorful websites give off an inviting vibe, and they're so simple to use. After blitzing through a few steps and sharing scant details about your business, you're almost instantly approved and funded within a few days.

Quickly, wealthy investors and other financial players took notice of this thriving industry. They poured some serious money into ensuring they thrived, fueling massive marketing campaigns.

And almost overnight, online lenders only grew larger and more ubiquitous. In fact, if you currently own and operate a business, you have probably been on the receiving end of these pervasive promotions.

Did you know?

What instant gratification could cost you

Flashback: How e-lending came to be

Get to know the big alt-lending players

# Get to know the big alt-lending players

To the uninitiated, all businesses in the online-financing marketplace appear to look the same. They do share some common qualities, from their tendency to charge higher rates to the fact they belong to a largely unregulated financial market.

However, they each function in slightly different ways. Here's a quick primer on each type of loan product and how they generally work:

## MERCHANT CASH ADVANCE

**Designed for:**

- Immediate cash

**Major players:**

- Square, PayPal and CAN Capital

**Annual interest:**

- As much as 150% APR

**What to watch out for:**

- This can be the most expensive business financing option, given the short term nature of this product.

This is like the godfather of alternative financing. Companies that issue merchant cash advances, or MCAs, quickly led the pack in the early post-housing crash years and continue to stay strong. MCAs are designed for small businesses who need cash immediately.

As the name clearly states, the financial company will give you an advance, based on credit card sales your business will make in the future. To repay the advance, you'll have a percentage of your daily credit-card receipts deducted every day, based on an agreed-upon rate. The deductions occur daily until the advance is fully repaid with interest. **Oftentimes, MCAs are the most expensive kind of business financing you can get.**

Similar to merchant cash advances, cash-flow loans provide business funding in a pinch. But instead of basing the financing on a company's credit-card sales, cash-flow lenders take into account the average daily balance of your business checking account, or your revenues.

## CASH-FLOW LOANS

**Designed for:**

- Getting small business owners through cash-flow dry spells.

**Major players:**

- OnDeck and Kabbage

**Annual interest:**

- 25% to 70% APR

**What to watch out for:**

- Those with a strong enough cash-flow cycle should consider more traditional financing instead.

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Did you know?



# Get to know the big alt-lending players

To repay the loan, an agreed-upon payment amount is deducted from your business bank account, which is why this type of financing is also called Automated Clearing House, or ACH.

## ACCOUNTS RECEIVABLE FINANCING

**Designed for:**

- Small businesses facing a short-term cash shortage due to unpaid invoices

**Major players:**

- Fundbox and Bluevine

**Annual interest:**

- About 50% APR

**What to watch out for:**

- The interest rate you'll pay is based on your customer's credit and how long your invoice takes to get paid.

If you run a small business, you probably already know that some vendors are quicker to pay than others. And sometimes these unpaid invoices, or receivables, can hold you back from satisfying some important bills to keep your business running smoothly.

Accounts receivable financing allows you to pledge your receivables in exchange for financing at a lower value of the unpaid invoice. With this type of financing, you can have the cash on hand and the unpaid invoices are off your desk.

For example, Joe owns a coffee roaster. A big restaurant who buys his coffee has not paid a $5,000 invoice. With account receivable financing, you can provide the invoice to the lender and get $4,000 in financing immediately, or about 80 percent of the invoice amount.

The finance company will hold the remaining $1,000 as a reserve, and charge Joe a fixed percentage, based on the amount of days it takes for them to receive payment from Joe's restaurant client.

**Beware:** With a vendor who has spotty credit or Net 90+ terms, you may end up paying more. Net refers to the number of days that a client takes to submit payment for an invoice. Net 30 is the standard.

Also, watch out for NSF (Not Sufficient Funds) charges, as they can add up quickly with this type of financing.

Now that you have a firm grasp of the alternative lending industry's origin story and all the big players, let's dive into the questions you should be asking yourself and the lender if you're looking to get an online loan.

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# Questions to ask **yourself**

Take the time to review your business needs under the microscope and drill deep into your financial health. This will go a long way in helping you identify the best loan for your long-term success.

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Q1

# Why do I need this financing?

This is a fairly obvious first question. But the importance of answering this clearly and early on cannot be stressed more. Why? Because it will serve as the foundation for figuring out your best credit option for your specific need.

## Looking to purchase equipment or special one-time expenses?

Equipment is typically pricier than other business costs, so you should actually aim to get long-term financing, anything between three to seven years. That way, you'll have ample time to pay off the loan without straining your business finances. You'll want to steer clear of financing that's meant to be extremely short term and expensive, such as merchant cash advances, which take daily debits from your business's credit-card receipts. One-time expenses can include tenant improvements and office furniture, which also benefit from long-term financing.

## Contemplating a loan to buy inventory?

In this case, your decision will largely depend on the math. If the return on investment, or ROI, you'll see after selling said inventory exceeds how much you'll pay for the cost of the online loan, then it might be a good idea. Another factor in this scenario is, how quickly you're able to sell the inventory. If this part of the equation lags, then you'll likely end up overpaying for the credit.

## What about in an emergency?

Imagine you're running a restaurant and your walk-in fridge goes bust. Your first thought is probably 'How am I going to afford a replacement right away to save my food from spoiling?' In extreme cases like this, a lightning-fast online loan could be the right call. But remember, regardless of how the proceeds are used, expect to pay a premium on the financing. A better solution is a cash reserve, or rainy-day fund, you can build over time that will allow you to handle unexpected expenses.

Questions to ask yourself

Why do I need this financing?

How fast do I need the money?

How much money do I need?

How is my credit?

What's my cash-flow cycle?

Have I tried a traditional or nonprofit community lender?

Q2

# How fast do I need the money?

In Olympic track and field, the fastest runner takes the gold. In business lending, the recipient of the fastest-funded loan could even end up in a losing position. How so? **Generally speaking, the quicker you get online financing, the more you'll probably end up paying for that privilege.**

The risk assessment of the borrower for these types of loans is minimal, so financing companies will end up charging you more than others for the money to make up for their exposure. While you'll suddenly be flush with capital in a matter of days, expect to pay as much as as 150% APR (Annual Percentage Rate). Oftentimes vague terms will prevent you from knowing the true annual interest. We'll go into how to calculate this number in detail in Q7.

## Still think it's worth the convenience?

Now's the time to assess how urgently you need the money. If you can wait a bit longer for the funds, then it might be wiser to go to a traditional or nonprofit community lender, where you'll pay a reasonable rate of about 5% to 18% APR. In addition, it is important to consider the loan term.  By choosing a longer period of time to repay the loan, monthly payments will be much more reasonable.

How much you could pay in annual interest, based on how quick you need the money:

### URGENT:

- Online-only loans: You pay as much as 150%

### 7 BUSINESS DAYS:

- CDC's FastFund product: 15%

### 4-6 WEEKS:

- Traditional or community loans: 5-18%


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Questions to ask yourself

Why do I need this financing?

How fast do I need the money?

How much money do I need?

How is my credit?

What's my cash-flow cycle?

Have I tried a traditional or nonprofit community lender?

Q3

# How much money do I need?

Whether you're working with an online or brick-and-mortar lender, landing on a good, reliable estimate for your loan amount is critical. Knowing your number means you won't end up with too much or too little financing. Ending up in either situation can end up costing you. In other words, **after obtaining the financing, you don't want to run the risk of running out of money or ending up with too much credit that will cost you as it sits waiting to be deployed.**

### THREE TIPS:

1. Be wary of online lenders, as their salespeople will often try to sell you more money than you might need.

2. Show loan officers that you've done your homework. If you were to ultimately decide to approach a non-online lender for financing, having this information down pat will show that you've done your homework, which increases your chances of being funded.

3. Never respond "as much as i can get." If a loan officer asks you how much money you need, never respond "as much as I can get." Loan officers consider this kind of statement an immediate red flag.

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Q4

# How is my credit?

Entrepreneurs often turn to online lenders first for financing because they think their credit scores aren't high enough to qualify for more conventional, affordable loans. But here's a startling statistic: More than 70 percent of small business owners actually don't know their credit scores. Not a good starting point, especially if you're in the market for reasonably priced credit.

**Your credit score, or FICO score, is probably the most important number you should know.** Ranging from 300 to 850, it essentially tells others how financially fit you are. If it's high enough, your score can be your Golden Ticket to affordable financing with excellent terms. And even if your score is far from ideal, understanding what drives it up and down will help you improve it.

**The other part of credit is your history. This will reflect whether you're paying your bills on time or at all.** Lenders consider your credit history a reflection of your character and help them determine whether they can trust you to repay their money. In reviewing your credit you may find an erroneous credit-report blemish, which you can dispute. And if the credit bureau ends up removing the problematic item, you'll end up seeing your credit score increase.

## WHAT'S THE UPSHOT?

1. You don't need a perfect credit score to get an affordable business loan with reasonable terms.
2. For traditional bank financing, you're aiming for a minimum credit score of 680.
3. At some non-profit community lenders, acceptable credit scores can be as low as 620.
4. With a higher score, you'll end up getting a better interest rate, which means you're paying less to borrow the money.
5. Online lenders may not even ask for your credit score. Be aware: The less they assess risk, the more they will charge you for the money.

You can request a free copy of your credit report once each year at AnnualCreditReport.com or call toll-free (877) 322-8228.

Questions to ask yourself

Why do I need this financing?

How fast do I need the money?

How much money do I need?

How is my credit?

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Q5

# What's my cash-flow cycle?

## What is cash flow?

Assuming you're already your own boss, money is probably moving in and out of your business. This is called cash flow. Money coming in includes cash or credit-card sales and customers paying you for your services. Money going out includes things such as rent and paying your employees and vendors. Many small business owners struggle to keep a positive cash flow, or ensuring more is coming in than going out.

## What is a cash-flow cycle?

It's how long it takes you to make or acquire a product, sell it, and receive the payment. This can be easily tracked on a cash-flow projection sheet, a document that will tell you how long a typical cycle is and whether any hurdles are preventing you from maintaining a positive cash flow. If your business is just an idea on paper or very young, you may have to guess, or project, what your cash-flow cycle will look like.

## Why is cash flow important when you're trying to find financing?

Knowing your cash-flow cycle helps you identify what type of financing will be a good business decision.

Say, you're a subcontractor and you've established your cash-flow cycle works on a monthly basis, meaning you're getting paid for work about once a month. Taking on very short-term financing such as a merchant cash advance would be a mismatch. That's because a cash advance take daily debits from your sales. The problem is, you're not making daily sales. You're instead getting paid monthly, which means your debt amount is racking up more quickly than you're making money.

Products like merchant cash advances were initially designed and most appropriate for retail companies, which typically generate daily credit-card receipts.

Q6

# Have I tried a traditional or nonprofit community lender?

Many small business owners avoid going to brick-and-mortar lenders altogether because they think they have zero chance at qualifying for a traditional or government-backed loan. **Getting financing is completely doable with a credit score in the 600s, especially if you work with a nonprofit community lender, which has more flexibility than conventional banks.**

Others avoid going to a more established lender because they may feel intimidated or don't have experience with face-to-face banking. Or maybe you've been told 'no' by a lender in the past. Don't let these reasons prevent you from exploring more mainstream financing.

## Benefits of a nonprofit lender

Nonprofit community lenders have experienced teams on hand who match you with only financing that makes sense for you and your business. Many also have dedicated business advisors to guide you through all of the things mentioned in this guide, from improving your credit score to helping you figure out your cash-flow cycle.

With support from trusted partners like the SBA, SCORE mentors and others, community lenders also focus on providing access to business capital to small business owners who need financing the most, including women, veterans and minorities.

## Looking for an SBA lender?

Find one in your area through the SBA's Lender Match tool, which connects entrepreneurs like you to trusted business lenders across the nation.

## Are you in California, Arizona or Nevada and would like to talk to a nonprofit lender?

Feel free to reach out to CDC Small Business Finance with questions or for help getting started applying for a loan.

CDC Small Business Finance is a leading nonprofit small business lender whose mission is to connect entrepreneurs with affordable, responsible financing. We've paired more than 11,000 small business owners with $13 billion in financing over the last 40 years.




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# Questions to ask your **online lender**

Use these questions to help you learn what numbers to crunch and to always remember to scrutinize the fine print and vague terms.

Q7

# What's my Annual Percentage Rate, or APR?

APR is the amount of interest being charged on top of your total loan amount that you'll pay annually and averaged over the full term of the loan. A lower APR could translate to lower monthly payments. APR is the number that really matters when **determining the true cost of your loan. It also serves as a reliable metric that will tell you if you're getting a good or a bad deal.**

If you're looking into a merchant cash advance, you'll encounter the term "factor rate" or "buy rate." Don't be intimidated by these terms. They represent how much the company advancing you the money will charge you for the credit. And it ranges from 1.1 to 1.5. For businesses with less experience and lower credit-card sales, you'll be charged a higher rate on that spectrum. Here's where people tend to get tripped up: The factor rate doesn't represent your annual percentage rate, or APR.

## So how do you get from the factor rate to the APR:

**Example:** Say you're taking out a $100,000 cash advance and the buy rate is 1.25. By multiplying the cash-advance amount by the buy rate ($100,000 x 1.25), your total pay back will be $125,000 plus the origination fee that online lenders typically charge.

Say you repay that amount over a year. What's your APR? 46 percent.

What if you increase the buy rate to 1.35 and keep everything the same? Your APR increases to 63 percent.

That's pretty pricey capital.

**Here are 2 APR calculators**

Merchant Cash Advance APR Calculator

Term Loan Calculator APR

## DON'T FORGET:

1. If you work with a traditional or nonprofit lender, APRs are usually capped at about 18 percent. An average credit-card rate is also significantly less than what alternative online financing companies charge.

2. Understand your total payback before getting your loan:
   Cash Advance Amount x Buy Rate + Fee = Your Total Payback

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Q8

# Is the financing amortized?

Amortization simply is the process of paying your debt in regular installments over a certain timeframe. At the start of an amortized loan, expect the bulk of your payments to go toward interest. Over time, this amount will shrink and more of the monthly payment will go toward your principal, or the actual loan amount.

### Benefits of an amortized loan:

An amortized loan has a set schedule. It gives you a straightforward breakdown of how much you'll be paying on the loan principal and toward interest, along with the exact due dates. This is a good tool because you can see exactly where you stand on your payments—and how they impact the total amount owed. Best of all, the schedule keeps things predictable, so you won't get hit with any surprises down the line.

**BIZTIP:** Paying down a typical amortized loan over time will result in more money going toward the principal versus interest. And if you make additional payments on an amortized loan every year, then you can even save money by paying less interest.

**BEWARE:** Online-only lenders may position their "Total Cost of Capital" as more affordable than a longer term loan. If you dig deeper this often isn't the case.

### PERKS OF AN AMORTIZED LOAN:

1. Set payment schedule and breakdown of what part of your payment goes toward principal and what part goes toward interest.

2. You won't encounter any surprise payments. Everything is predictable.

3. Clear picture of the effects of your payments over time

### What to know about loans that are not amortized:

Online financing, on the other hand, do not typically amortize. Why does that matter?

Non-amortized financing such as a merchant cash advance, you're essentially paying the same amount in interest even if you make extra payments. And with some online financing, prepaying could end up costing you more. Get the details on prepayment penalties next, in Q9.

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Q9

# Does my financing agreement have a prepayment penalty?

Say you've had a good last few months and you have enough to prepay the balance of your online loan. Great, right? Not so fast. **Many online financial companies will slap you with a hefty prepayment penalty.** This is done to discourage you from leaving them, which means fewer dollars in their pockets.

**BIZTIP:** Always check for a prepayment penalty.

Some online lenders will offer what's called a "prepayment discount," which is a bit of a smoke-and-mirrors tactic. You'll still end up paying a ton in interest, but with a discount, you're just paying a bit less. But there's a big caveat with discounts, too. Say you refinance the online loan through a conventional or nonprofit lender, that "discount" is then no longer on the table because e-lenders don't want you going to a competitor for less expensive capital. **Make sure you understand all the terms of any prepayment penalties so you aren't surprised at a later date.**


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Questions to ask your online lender

What's my Annual Percentage Rate, or APR?

Is the financing amortized?

Does my financing agreement have a prepayment penalty?

Are you a direct lender?

Q10

# Are you a direct lender?

This question can also be rephrased as:
**Do you know who you're working with?**

Most online financing companies issue the loans themselves. But there is a select group that actually just broker the loans. In other words, they aren't the ones giving you the credit. Instead, brokers act on your behalf to apply for online business loans.

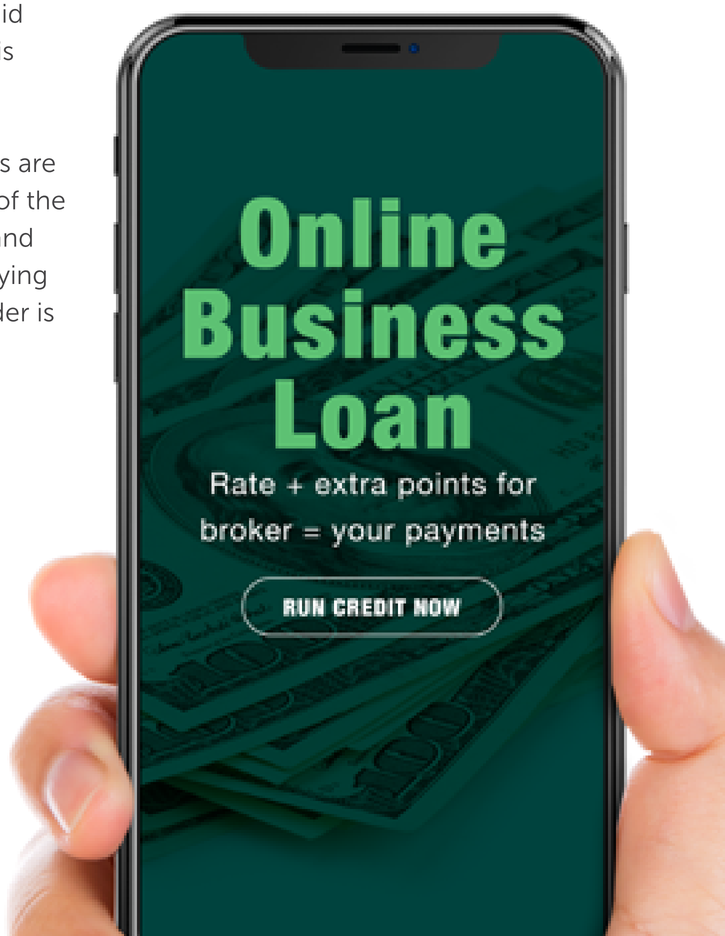
## If you end up with a broker, you can face some significant downsides.

For one, since they'll be shopping around for different rates for you, they'll likely run your credit multiple times. This is bad because it will significantly lower your credit score. Remember what we said earlier about why your credit score is important (Q4)?

What's more, the price these brokers are presenting you is a bloated version of the actual loan deal. They went ahead and tacked on extra points, so you're paying way more than what the online lender is actually charging.

### QUESTIONS TO ASK

- Are you the direct lender or a broker?
- If you are a broker, what extra fees or points are being added for your service?
- How many times will my credit be run?

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# The big takeaways

### Are you looking for fast funding capped at 15% APR?

Check out our very own FastFund product. Apply in minutes. And get funded up to $100K in just a few days.

**Learn more at [cdcloans.com/fastfund](cdcloans.com/fastfund)**

Or ask one of our working-capital experts to call you loaninfo@cdcloans.com

Moving forward, one thing you should know about the online lending world is that it's sales-driven. The idea, for many in this sector, is to simply close the deal.

**Beware:** In fact, many mom-and-pop business owners who end up struggling to pay off their online loan will often get another one to pay off the first, a troubling practice known by the lending industry as stacking. Even though this strategy ends up sinking borrowers into more uncontrollable debt, e-lenders go ahead and issue the new financing anyway.

When you're looking for a small business loan, online or not, you want to work with someone who understands your business and what it needs to succeed in the long run.

So before you embark on your search for business capital, let's recap some of the big ideas we've reviewed in this guide:

- **Be honest with yourself** about why you need the money, what you need it for, and how quickly you need it in your business account.
- **Know and fully understand your credit score,** and if you already run a business, track your cash-flow cycle.
- **Don't rule out traditional or nonprofit banks.** They have teams of knowledgeable financial experts who can help you before, during and after your loan approval. And forget the myth that they're looking for perfect credit scores. Not so.
- **Figure out the true cost of your loan.** Before signing up for an online loan, get over your fear of math and crunch the numbers; there are simple calculators online. If you need help, hire a licensed accountant. They're more affordable than you think.
- **Don't skip the fine print.** It can contain some scary caveats that could hurt you financially.
- **Don't be shy.** Borrowing money is a big responsibility. You are on the hook to repay all of the principal and interest. Ask a lot of questions so you clearly understand all the details of the loan so you don't find any surprises.
- **Get familiar with the Small Business Borrower's Bill of Rights**. The bill, penned by nonprofit and for-profit lenders, lists six basic rights entrepreneurs should be entitled to when seeking business capital.

### Want to learn more about affordable loans with reasonable, transparent terms?

CDC Small Business Finance, an award-winning small business lender and nonprofit, will only match you with financing that makes sense for you and your business. We've provided more than $13 billion in funding to 11,000 small business owners...and counting. And just this year, the SBA named us Microlender of the Year.

Small Business Finance

Let’s talk, we’re here to help.
Call today: 800.611.5170


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