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Where to Find Cash in a Crunch

The options may come down to person-to-person loans or receivables financing. Here's what to watch out for

By Lucy Sutherland | July 28, 2006

As Bob Hope once said, a bank is a place that will lend you money - if you can prove that you don't need it.

If you've sunk savings and credit into a new venture and face a cash crunch, these words have a ring of bitter truth: The more you've invested, the less likely you are to have the collateral or the credit score for a bank loan.

And to make matters worse, traditional lenders want to see "a minimum of 24 months of clearly identifiable positive cash flow," says David B. Newton, professor of Entrepreneurial Finance at Westmont College in Santa Barbara, Calif.

Such requirements leave a gaping hole in the credit market, according to Christine Sullivan, Executive Director of the Enterprise Center at Salem State College in Salem, Mass. "I just see a lot of sole proprietors and very tiny businesses who are actually growing and good-sized, but still have this gap in their ability to access this money," Sullivan says.

So how can small companies find quick capital without turning to credit cards or one of the many loan sharks that blanket the Internet? Surprisingly, there are better options.

Person-To-Person Loans

San Francisco-based Prosper, launched in February by E-Loan founder Chris Larsen and backed with $20 million in blue-chip venture money, is a kind of eBay marketplace for small, unsecured loans between private individuals.

At Prosper, what industry watchers have labeled a "person-to-person" loan company, borrowers request from $50 to $25,000 and suggest a maximum interest rate. They also agree to have their credit rating verified. Lenders, who are often looking for better returns than money-market funds or savings accounts, bid to fund borrowers.

Loans can be secured in a matter of days, must be paid in three years, and require no collateral. Prosper says lenders are more willing to fund higher-risk loans, because they can spread money over as many as 100 borrowers.

Newton cautions that such borrowing is still not cheap. "There's nobody out there handing out loans to people who don't really have good credit," he says. But Prosper suggests that high-risk borrowers request interest rates of about 20 percent, a price that may still be lower than a credit card like Capital One or Advanta, which Newton says can charge well beyond that.

Receivables Financing

If person-to-person borrowing feels too much like the Wild West, another growing industry called receivables financing might be for you. Long used by larger companies to improve cash flow, receivables financing is more affordable for smaller companies thanks to the Internet.

Here's how it works: you sell your receivables at a discount to a reputable company such as Advance Me, Business Manager, or Aquent FastCash. After giving you cash, usually in a matter of days, the company collects payments from your clients in an agreed-upon time frame.

Skip Pratt of Oliver Tucker Partners, a Chandler, Ariz., small-business Internet consultancy, advises spending time finding firms that offer the lowest premiums. He also says you should look closely at fees. Opt out, he says, if your business model has thin margins or little price flexibility. Otherwise, the interest and other charges "just hit your cash flow so hard," Pratt says.

If these options still don't fit, Ted Zoller, Executive Director at the Center for Entrepreneurial Studies at the University of North Carolina at Chapel Hill, says small-scale investors in one's community are often overlooked by harried business owners. Not angels in the formal sense, these lenders " friends, family, business associates, or industry veterans " often enjoy helping others get a leg up and may even have valuable advice and industry expertise, Zoller says.

"Make a pitch to them in a structured way and give them performance criteria," he says. Offer a higher return than a bank, say 10 percent, and have a written agreement, he adds. These lenders don't "necessarily have to be friends and family, but those who know you and understand your business and are sympathetic to you," Zoller says.

KEY POINTS

- If your venture is not a proven business model, don't risk personal assets to keep a business going.

- Keep your profit-and-loss statements up to date with software such as QuickBooks. It signals to lenders that you're working hard to manage your finances.

- If you're using credit cards, don't sign up for multiple cards. Doing so can degrade your credit rating.

- Don't mix your business and personal transactions, which creates tax and money management problems.

- When cash flow is good, take out a loan and pay it off in a timely way to build your credit score for a rainy day.