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How to Tame the Wild West of Marketplace Lending

By Claudia Viek
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Online alternative lenders offer a variety of advantages from their use of automation, big data and crowdfunding to reach small businesses. They offer quick loan decisions with a stripped-down application process. These firms assess risk immediately with efficient use of algorithms and technology. Money can be distributed in days, not months.

But for too many small businesses, getting financing from one of these lenders is like the Wild West.

Advertisements for quick cash — once the domain of those lending to individual consumers — are more and more promising the same to small businesses. Internet searches for "small business loan" find sites offering "Up to $500,000 in 24 Hours," "10-minute application," and "get approved and funded instantly."

But data shows the process is anything but easy and affordable for many small businesses. Right before the end of 2015, California's Department of Business Oversight (DBO) sent "an online survey to 14 marketplace lenders requesting five-year trend data about their loan and investor funding programs." The DBO aggregated the findings. Nationally, from 2010-14, the dollar amount of these 14 companies' small-business financing transactions increased by 630% — from $400 million to $3 billion. Through the first half of 2015, transactions totaled $2.26 billion. The majority of their loans carried higher APRs, ranging from 41% to 101% or higher.

Another recent study by Opportunity Fund, a mission-driven lender, analyzed the type of financing that is offered to their small-business clients by competing merchant cash advance companies, alternative lenders that provide financing to small businesses. The study, the first of its kind, looked at 104 small businesses that were involved in 150 financing transactions from 54 different alternative lenders. Many of the borrowers in the study had been stuck with loans they just couldn't afford. The average alternative financing carried an annual percentage rate of 94%, with one loan reaching 358%. The average monthly loan was almost double the net income available to the small-business owners.

Not all online financing fits into the "borrower beware" category. Some online players, such as Lending Club and Funding Circle, have adopted responsible lending practices and can be a source of affordable capital. Square offers an easily understood cash advance, and Intuit directs its customers into vetted, honest products. Online alternative financing can be an efficient source of capital.

But it can also be predatory, especially to the unaware, inexperienced borrower.

Some lenders have tried to hide their true costs by making their offerings appear inexpensive and easy to obtain, but they often have short repayment terms (less than a year) coupled with daily or weekly payment cycles. As we've seen with small-dollar consumer financing, those types of structures can lead to financial ruin. Some particularly unappealing products have double-dipping clauses (meaning you pay twice on the same loan) and don't consider a borrower's ability to pay back in the financing decision. Some obfuscate the true interest rate costs by charging fees and prepayment penalties, and some have confidentiality clauses that won't let borrowers disclose terms to a third party.

Despite some initial movements by policymakers to explore regulating marketplace lenders, this sector is still falling through the regulatory cracks.

Here are three steps to taming the Wild West of online small-business financing:

1. Educate small businesses. Every small business that seeks capital needs to understand easy online cash. Every small business needs to know what "honest" capital looks like, i.e. transparent and affordable money that is essential to healthy local businesses and economic growth. They should know about the Small Business Borrower's Bill of Rights, which focuses on transparency, fairness and the interest of the borrowers. Additionally, those who can should endorse the Borrower's Bill of Rights to promote best practices in lending.

2. Demand a comprehensive study into the characteristics and effects of short-term, high-cost alternative financing on small business. We need more than one study of 150 transactions.

3. And I hate to say it, but we need some rules. Oversight of this industry essentially is nonexistent. Many of the merchant cash advance businesses are not regulated as lenders because they do not technically provide loans — and fall through the cracks of the law.

Claudia Viek is the chief executive officer of the California Association for Micro Enterprise Opportunity. She is the former executive director of the Renaissance Entrepreneurship Center.

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The small business case to designate California Desert monuments

By Claudia Viek

California's rural economies depend on very small businesses – 95 percent of companies in these areas have fewer than five employees. Many of them depend upon our state's unique and spectacular natural resources for their success. The California Desert region is no exception.

That's why we're making the business case that President Obama heed Sen. Feinstein's (D-Calif.) request that he designate three new national monuments in this region - Castle Mountains, Mojave Trails, and Sand to Snow - and protect one of the richest landscapes in North America.

Many businesses in this region depend on tourists, outdoor adventure seekers, and travelers for their livelihood. One such place is the Ludlow Café, a funky diner on Route 66 known for their fluffy, homemade biscuits. Drawing new attention to the desert supports and strengthens businesses like the Ludlow Café and helps bolster a strong and diversified infrastructure of small, locally owned businesses that are major job creators for rural areas.

While 'nearby' cities – as in 80-plus miles from Ludlow – have a couple dozen large employers or lots of bright lights, the towns throughout the California desert are small and unlikely to lure big business. Plus large businesses aren't in business to create jobs, but rather to maximize profits for shareholders. If we look to the federal, state and local governments to provide jobs, we'll just find dramatic cuts in public sector employment.

So who creates the jobs? The DIYers who are starting their own small businesses. National monument designations will attract new attention and enhance tourism and recreation in the region, thus increasing the dependability of customer flow, a must-have ingredient for these businesses. With customers come other economic benefits, like jobs and community investment.

Preserving the California desert will also preserve the painted mountains, archaeological treasures, renowned wildflower displays, diverse recreational opportunities, and western history that includes Native Americans, General Patton's World War II training sites, and Route 66. Each of the three proposed monuments has their own special features.

Castle Mountain is home to Joshua tree, pinon pine, and juniper forests, rich Native American archaeological sites, several unique wildlife habitats, and the historic gold mining ghost town of Hart.

In Mojave Trails – which links the Mojave National Preserve to Joshua Tree National Park – one finds sensitive wildlife, unspoiled desert vistas, sacred Native American trails, and hundreds of miles of alluring backroads, along with lava flows, trilobite fossil beds and the longest undeveloped stretch of Route 66.

Sand to Snow is one of the most important wildlife corridors in Southern California, one of the most botanically diverse mountain areas in the contiguous U.S., and includes highly accessible recreational assets such as 25 miles of the Pacific Crest Trail. Its Black Lava Butte and Flat Top Mesa are home to stunning cultural sites and rare plant species.

Visitors come to this area because of these natural resources and recreational possibilities. Already, visitors to the region's three national parks-Joshua Tree, Death Valley, and the Mojave National Preserve attract over 3.2 million visitors who spent $194 million and supported over 2,700 jobs in 2014. Add to this the nearly 4.2 million visitors who visited California desert lands managed by the Bureau of Land Management in 2013.

Protecting additional recreational opportunities for local and area residents as well as visitors from around the world helps sustain and grow local communities. America's public lands attract baby-boomers and entrepreneurial types, who value quality of life factors and outdoor recreation.

For example, more than 500,000 seniors relocated to Western states in search of protected public lands between 2000 and 2010, creating nearly 300,000 jobs, and seniors-focused micro-businesses are capitalizing off the wave of baby-boomer retirement. Even my hairdresser intends on retiring to the Mojave Desert to open a café and curio shop. Research shows that from 1970 to 2010, western non-metro counties with more than 30 percent of their land base in federal protected status increased jobs four times more than Western non-metro counties with no protected federal land.

We have the opportunity to protect some of the most spectacular and diverse stretches of intact desert while helping to sustain and grow the local economy. Senator Feinstein has repeatedly introduced legislation to protect these areas dating back six years but the prospect for its passage continues to be bleak. It is time for this region to gain the protection it deserves and secure its economic future. I join Senator Feinstein in urging President Obama to designate Sand to Snow, Mojave Trails, and Castle Mountains as national monuments.

Viek is CEO of CAMEO (California Association for Micro Enterprise Opportunity), a non-profit with the mission of creating economic opportunity for all California entrepreneurs to build wealth and strong communities.

THE SACRAMENTO BEE

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New state law gives microlenders a more even playing field

Shoneji Robison, left, and Catarah Hampshire, owners of Southern Girl Desserts in Los Angeles, took out six loans and were in a financial mess until going to a nonprofit microlender. Nick Ut The Associated Press

By Claudia Viek
and Eric Weaver
Special to The Bee

Since traditional banks have largely stopped making small business loans, an influx of companies are stepping in to fill the gap. While some are lending to small businesses in a responsible way, many are not.

By signing Senate Bill 197, Gov. Jerry Brown took one small step to making sure that small business lending is not predatory for California's entrepreneurs.

To illustrate the problem, look to Catarah Hampshire and Shoneji Robison. They quickly grew Southern Girl Desserts, a cupcake business in Los Angeles. To keep up with demand and to expand, they needed fast cash to purchase equipment. A loan broker quickly got the "dessert divas" a cash advance and additional financing from an alternative lender.

Because both loans had very short terms and very high interest rates, Hampshire and Robison were unable to keep up with the large daily loan payments. Short of cash, they soon took out two more cash advances. The advances are not loans, are not regulated and can carry effective annual interest rates of 15 percent to 80 percent. Added up, their financing costs were eating up 40 percent of sales.

Then Hampshire received a flier in the mail from Opportunity Fund, a nonprofit microlender that offered a chance to refinance predatory loans with affordable capital. Her business cut their monthly payments by 90 percent with a longer term and lower interest rate. This loan also helps them build their credit, since it is a regulated business loan, not a cash advance unreported to the credit bureaus.

Opportunity Fund and other responsible lenders make sure that businesses have the ability to repay before making loans – an old-fashioned process called underwriting. Responsible lenders also do not make a second, third or fourth loan to a business already drowning in debt. SB 197 will help responsible lenders become more competitive with other financiers, such as cash-advance firms.

The measure is crucial to California's 3.6 million small businesses and microbusinesses, which need better information about the most appropriate financing available to them. Word of mouth is key to reaching business owners, especially in immigrant and minority communities.

Referral fees for successful loans encourage word of mouth, but before SB 197, state law prohibited licensed lenders from paying such fees to individuals or small businesses that do not have a state broker's license. Most referrers – including tax preparers, nonprofits and others – are not licensed because of high costs.

Meanwhile, alternative lenders and banks commonly use brokers to reach potential customers. Also, since they structure their products so they are not loans, they can pay referral fees to anyone.

Because of this uneven playing field, California businesses were not always getting the best financing available. With SB 197, Opportunity Fund and other lenders can now compete against predatory lenders. It is still a bit like David vs. Goliath trying to reach small-business owners with the affordable credit, but SB 197 provides responsible lenders with a new slingshot.

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