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Financing Options for Businesses

Credit crunch hampering your business plan? Private lending alternatives may be just the ticket.

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As banks tighten credit, alternative lending systems are poised to grow.

Peer-to-peer lending through Prosper, Loanio, Lending Club and other Web sites should easily top $5 billion a year by 2010, up from $282 million in 2006, according to a study by Celent, a research and advisory firm. About a quarter of such transactions, in which a P2P service matches borrowers with lenders and then services the loan for them, are for business purposes.

Looser standards explain part of the appeal. Private lenders are able to base decisions on broader criteria than banks typically do, relying more heavily on assessments of character and expertise and less on credit scores, for example.

P2P "fills a unique niche," says Edward Woods, a Celent senior analyst. Woods says that while bank lenders often require borrowers to have assets as collateral, for example, that's not always the case for P2P loans.

Both borrowers and lenders find other benefits as well: Less paperwork, more transparency, faster processing and approval and more personal involvement. Plus competitive rates. Because P2P companies make their money on simple fees and not on the interest spread, both borrowers and lenders can negotiate better deals.

At Lending Club, the highest grade loans have a 7.37 percent interest rate while the average interest rate charged by Prosper (for AA borrowers) is 8 percent.

Still, there have been some bumps along the way for P2P lenders. Recently, Zopa, a U.K.-based service, stopped taking new peer-to-peer loans in the United States, citing problems with the consumer credit market, and has changed its business model.

And Prosper hit a regulatory snag in its bid to create a secondary loan market that would allow lenders to resell before the life of the loan runs out. Prosper has been forced to temporarily stop accepting new loan applications until it completes registration with the Securities and Exchange Commission, a process that could take several months.

But Woods chalks up Zopa's change in how it issues loans and Prosper's regulatory hurdle as part of the maturation process for the industry. As for the secondary market, Woods says that in the end, it will attract more customers since it provides additional options for lenders to liquidate.

Microlending, which consists of character-based lending coupled with business training for small and micro enterprises, is going mainstream, too. Borrowers have typically been people with no or poor credit histories, including ex-offenders, welfare recipients and immigrants.

But now, small business owners with good credit are also turning to microfinanciers, which number more than 550 in the U.S.

"We are seeing more of what we consider mainstream or traditional customers because they've been shut out by the banking industry as traditional sources of capital have dried up," says Amy McKenna Luz, president and CEO of the Association for Enterprise Opportunity, a national association representing microlenders.

Laura Kozien, a spokeswoman for microlender Accion USA, concurs. Demand for microloans is driven by "the very strict lending regulations that businesses are operating under these days," she says.

Lenders such as Accion USA and Seedco Financial provide business loans as small as $1000 and as large as a quarter of a million dollars. Interest rates can be steep, but aren't always. For Seedco, they run from 6% to 8%.

Factoring, which involves selling receivables for cash on the spot, is also on the rise. Some services, such as Spokane, Wash.-based Universal Funding, report a 300% increase in business in recent months. Like other factoring services, Universal Funding attributes the sharp spike in demand to the lending freeze.

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