



## 6 Reasons to Use Alternative Financing

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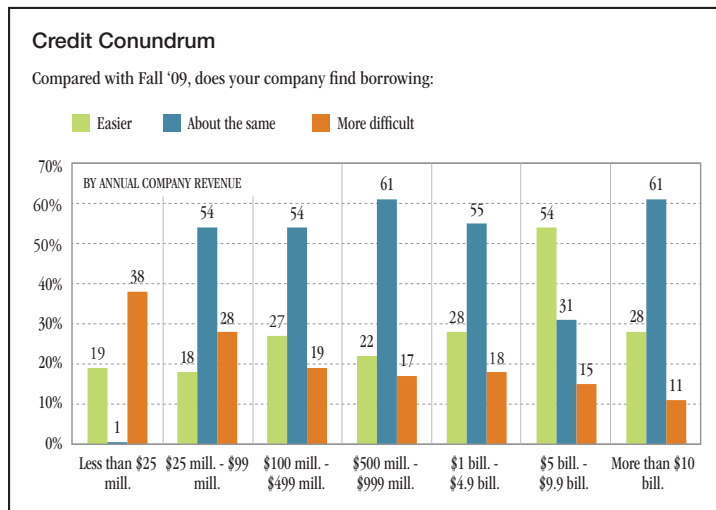
# 6 Reasons to Use Alternative Financing

## Why alternative financing could be the best solution for your company

According to a recent survey by the Pepperdine Private Capital Markets Project, 71 percent of private companies said they believed they could grow their revenues, if only they had access to additional growth capital. But the financial landscape for small and midsize businesses has changed dramatically since the financial crisis, and many are finding it harder than ever to fund their companies on their terms. In today's economy, companies that rely on traditional financing alone are subject to more constraints – and more risk – than ever before. Alternative financing can help your business break free of those constraints to achieve growth and success. Here are six reasons why alternative financing could be the best solution for your company, now and in the future:

### 1. Banks Aren't Lending

Figure 1



Source: CFO Magazine, July/August 2010

One of the enduring effects of the financial crisis is that credit remains scarce for small and midsize businesses, even those with strong financials and cash flow. In 2009, when the crisis was in full swing, bank lending fell \$587 billion, or 7.5%, according to the FDIC. There are some indications that banks are starting to lend to small businesses again, but these increases are modest, and lending is nowhere near pre-recession levels. What's more, many banks – especially community banks that small businesses rely on for financing – are failing. In March of 2011, the number of banks in the U.S. that were in danger of failing hit 985, the highest level since the beginning of the financial crisis. This credit tightening has disproportionately harmed small and midsize businesses, which traditionally have had fewer options than large companies for raising capital (see Fig. 1). Cash-strapped businesses are struggling to fund day-to-day operations and fuel growth, and are missing out on the strategic benefits of having cash on hand. Businesses that can get financing from traditional sources are faced with more restrictions and higher rates, as banks apply stricter lending standards. Asset-lite companies with little tangible collateral are finding it especially difficult to obtain bank financing. It's important in this context to have a financial strategy that is flexible, affordable, and will not saddle you with onerous constraints. Fortunately, there are many innovative alternatives to traditional financing that can help businesses get the cash they need to fund operations and fuel growth.

## **2. Traditional Financing Isn't as Cheap as You Think**

If you own or manage finances for a business, chances are you have bank financing, or you've applied for it in the past. Bank financing is widely regarded as a cheap and simple way to fund a business, but it often comes with hidden charges and penalties that most don't factor into their costs. Some loans require you to put up a down payment and pay sales tax on the loan in advance, which can be a significant upfront cost. You can incur penalties for missing a payment, or for paying early, whether to alleviate your debt or refinance. Add to these the processing fees, documentation fees, third-party fees, and government fees and taxes associated with loans and lines of credit, and the costs could add up to far more than merely "principal plus interest." Additionally, traditional financing can carry heavy restrictions and personal risk. To satisfy bank loan requirements, a business is usually required to put up a mix of collateral, including cash and hard assets such as property or equipment. Since the recession, banks are more likely to ask for a personal guarantee, since the value of most hard assets has fallen. If you can't pay back your loan, you risk losing valuable business assets – and personal ones as well.

The bottom line is that, when all the fees, penalties and risk are added up, traditional financing is not necessarily the most inexpensive or worry-free option. In the changing economy, it's important for small and midsize business owners and finance executives to examine innovative alternatives that in many cases are cheaper than traditional financing, and that carry fewer restrictions.

## **3. There's Nothing Left to Squeeze**

The financial crisis has forced many companies to take drastic steps to squeeze money out of their internal operations, all to avoid the expense and restrictions of external financing. Companies are employing tactics such as cutting unnecessary expenditures, negotiating better terms with suppliers, speeding up collections, and streamlining invoicing processes in order to hold onto cash, according to a 2010 survey from *CFO* magazine. Fifty-eight percent of respondents in the survey considered it likely or very likely that they would hold finance staff more accountable for cash flow control. One CFO surveyed said he learned a simple lesson from the crisis: "If you don't have the cash, don't buy it." This renewed focus on disciplined cost containment may even be a good thing, but it has reached its limit for many companies as the economy comes to life and they begin to take on new business. If there's nothing left to squeeze from internal operations, they're going to need an external source of financing to fund that growth, and they will look to flexible and affordable alternatives.

## **4. Alternatives Offer Flexibility**

A number of innovative financial alternatives have entered the market in recent years. Using cutting-edge technologies that increase efficiency and speed, these financial solutions can free you from many of the constraints of traditional financing. One such alternative is online receivables financing, where your business can sell receivables in a real-time, online auction. Unlike other forms of receivables-based financing, online receivables financing allows you to sell invoices to multiple institutional investors, so you get the most competitive pricing. (Businesses get 99-98 cents on the dollar, on average.) There are

no personal guarantees, all-asset liens, contracts or hidden costs, and there is no obligation to trade. Your customers are never notified that you are selling their invoices, so you control your customer relationship. You can sell one invoice, or multiple, whenever you need an infusion of cash.

Now more than ever, it's important to look beyond traditional financing and consider innovative alternatives to fund your business. Online receivables financing is a flexible and affordable financial solution for small and midsize businesses. Some businesses use it to supplement existing lines of credit, while others use it as their primary source of working capital.

## **5. Avoid Personal Guarantees**

Most business owners and finance executives try strenuously to avoid personal guarantees, which are a staple of traditional financing. Commercial finance websites are filled with advice about how to secure financing without a guarantee, and there's even something called personal guarantee insurance to protect you. If you sign a personal guarantee, not only is your company on the line, but your personal assets are as well. If your business hits a rough patch, you could lose your house, your car, or your savings. Perhaps that's why a recent paper from Dun & Bradstreet says that personal guarantees should be considered a "last resort" for businesses seeking financing. Unfortunately, many kinds of traditional financing require some form of personal guarantee.

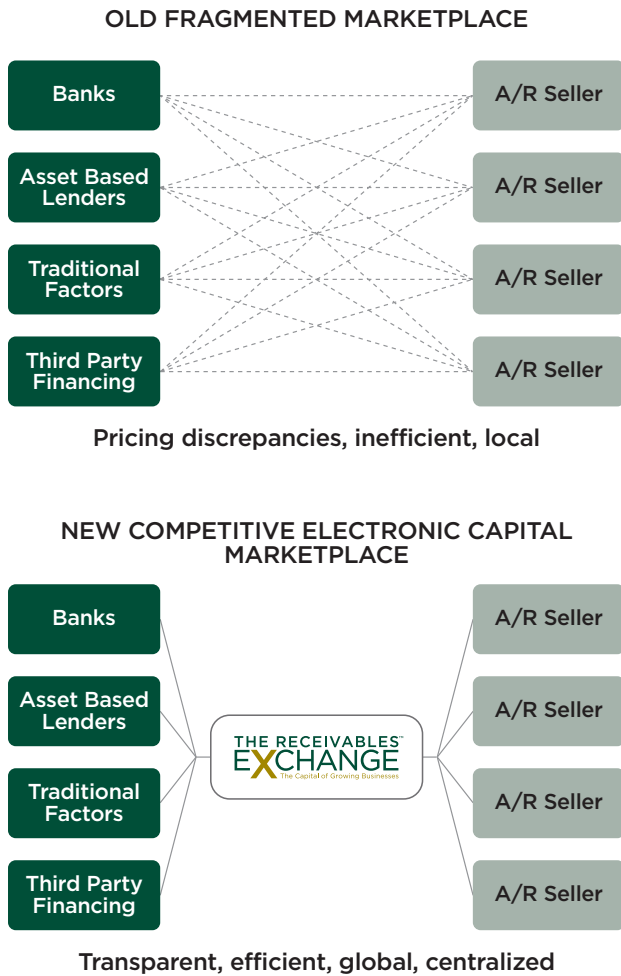
Thankfully, some alternative financial solutions do not require a personal guarantee. Online receivables financing, for example, does not require you to personally guarantee the invoices you sell. That's because the investors who are bidding for your receivables assess their risk based primarily on the credit rating of your customers, not your rating. If your company sells to large companies with good credit, these investors are willing to assume the risk of purchasing those invoices, knowing your customers are likely to pay their bills. Your business does assume some obligations: If your customers do not pay, you have an obligation to repurchase those invoices, for example. Most owners would rather assume this obligation than risk losing their house or savings because of a personal guarantee.

## **6. Diversification Reduces Risk and Lowers Costs**

In a recent paper offering financial management tips, Deloitte recommends that, "In the long term, CFOs will likely need to develop a new mix of capital to finance their companies." Relying on a single source of financing is a risky strategy in the changing economy, and business owners and finance executives should spread out their risk by diversifying their financial portfolios. A sharp increase in bank failures serves as a warning to business owners and finance executives that the bank relationship you relied on today could be gone tomorrow. A diversified portfolio allows you to easily adapt if one of your financial providers disappears, or stops extending credit to your business.

In addition to exposing you to risk, relying on one source can also drive up your costs. Many business owners are too busy to shop around for the best rates from traditional lenders, so they take what is offered to them, and are more inclined to agree to restrictions like personal guarantees. They reluctantly accept

Figure 2



expensive fees and penalties because they don't have the time to seek alternatives. But things are changing, and many are finding alternatives that are flexible, affordable and easy to use. Alternatives such as online receivables financing allow you to diversify your funding in two key ways: First, if you are supplementing existing financing with receivables financing, you are instantly spreading out your risk by relying on two sources of capital instead of one. Second, because online receivable financing is a market-based approach, it brings multiple potential capital providers together into one marketplace, so if any one provider goes away, the others will be there to bid on your receivables (see Fig. 2). And a real-time marketplace also reduces costs, because capital providers are actively competing to purchase your receivables.

## About The Receivables Exchange, an Innovative Working Capital Solution

This report is brought to you by The Receivables Exchange, the real-time online marketplace for working capital. Called the most innovative e-commerce company in the world for 2010 by *The Wall Street Journal*, The Receivables Exchange brings a new dimension to business financing. The Exchange is not factoring, but a flexible market-based solution that opens up the sale of receivables to competition from multiple buyers on a real-time online platform. Competition among buyers means you can get 99-98 cents on the dollar for your receivables, on average. Your customers are not notified that their invoices have been sold. With The Receivables Exchange, you can get cash on your terms, without constraints.

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