deBanked
September/October 2018

GOING NATIONAL: HOW DAVID GILBERT BUILT ONE OF THE LARGEST SMALL BUSINESS LENDERS IN THE COUNTRY

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By Cheryl Winokur Munk

Is Small Business Lending Stuck in the Friend Zone?
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Letter From the Editor

BY
SEAN MURRAY

After an amazing time at deBanked CONNECT San Diego on October 4th, the end of the year is in sight. But we aren't totally done with America's Finest City. San Diego is home to National Funding, a small business lender founded by David Gilbert. In this issue, we delve into how Gilbert bucked the family trend to become an entrepreneur, how the massive company came to be, and what their customers said about the experience of choosing a non-bank for funding. This true story of starting small and going national is one you won't want to skip.

And while non-bank funding is surging, surveys said that friends and family are still a first-stop for working capital. Banks are not as interested in small business lending as they were in the years before the Great Recession. Industry experts see that as a lingering issue. Is small business lending stuck in the friend zone? Or is there opportunity to become something more?

We've got more of course, including excerpts from interviews we conducted with ISOs. Find out what makes them tick!

So until next time, Happy Halloween! And be sure to register for our next half-day networking event taking place at the Eden Roc in Miami on January 24th. **Visit: https://www.debankedmiami.com**

Sean P Murray

–Sean Murray

GOING NATIONAL: HOW DAVID GILBERT BUILT ONE OF THE LARGEST SMALL BUSINESS LENDERS IN THE COUNTRY

By: PAUL SWEENEY

When Ty Austin, who owns a florist shop in West Palm Beach, secured a $5,000 loan from National Funding last year, he was happy to have working capital and could build inventory for mini-gardens and landscaping,

The experience, moreover, was surprisingly pleasant. “The guy I worked with was really cool,” Austin says, referring to the sales representative at the San Diego-based financial technology firm. “It turned out that he was getting married and I ended up giving him and his fiancé advice on floral arrangements.”

The borrowing worked out so well that the Floridian, who is 46 and the sole proprietor of Austintatious Designs, re-upped for a second loan of $12,000 to help purchase a commercial van. The van will be used to transport flowers, plants and tools while doubling as a billboard-on-wheels. “It gives me more ‘street cred,’” he jokes.

To register his approval with National Funding, Austin went online to TrustPilot and posted a rave review of the sales rep: “James Johnson Rocks!”

Pam, a Texas wellness coach who provides clients with an array of holistic health therapies, needed extra money to buy an infrared sauna to add to her portfolio of services. But her credit rating was “poor,” she told *deBanked* in an e-mail interview, “from when I changed careers and lost my health and struggled to make my credit card and student loan payments on time.”

Like Austin, Pam — who asks to be identified by her first name — found National Funding through an online search. And she too secured $5,000, although her transaction was structured as a merchant cash advance, rather than a loan. The terms of the MCA require a daily debit from her bank account. She reckons that the total cost of the MCA to be roughly $1,500.

Pam pronounces herself satisfied with the deal and mightily impressed with the way National Funding treated her. The process took about three days — and would have gone even quicker if she’d located her professional licenses sooner. Best of all, she says, the agent at the company tailored the financing to suit her circumstances. “They were great as far as getting my questions answered, even listening to my past situation, which others may not have cared about,” she says.

“They really wanted to get me an option that they knew I’d be able to repay,” Pam adds. “They said they were in the business of helping small businesses grow rather than putting them in a hard financial situation.”

The positive experiences that Austin and Pam had with National Funding are not isolated instances. Rather, they are representative of clients’ dealings with the company. Witness its online reviews from business borrowers at TrustPilot which go back three years, run for 36 pages, and merit National Funding a 9.4 rating on a scale of 10. That’s a straight-A grade on any report card. Although there’s the occasional naysayer — four percent assert that their experience was “poor” or “bad” (and some negative comments can be blistering) — the weight of the reviews is almost embarrassingly positive.

Typical postings find that National Funding and its agents win kudos for, among other things, being “prompt and professional,” providing service that is “hassle-free and about as friendly as you can be,” and even being “accommodating and gracious.” A man named Al McCullough spoke for many when he declared: “My experience was great. Professional and on time. Couldn’t ask for more.”

All of which helps account for why National Funding — its 230 employees working out of a sleek suburban office building guarded by a tall stand of palm trees in San Diego — is a rising star in the world of alternative business lending and financial technology. In 2017, the company raked in $94.5 million in revenues, a 24.8 percent bounce over the $75.7 million recorded a year earlier and nearly fourfold the $26.7 million posted in 2013.

In recognition of the company’s three-year growth rate of 142%, *Inc.* magazine included National Funding in its current list of the country’s 5,000 fastest-growing companies, the lender’s sixth straight appearance on the coveted roster. Since its inception in 1999, National Funding reports that it has originated more than $2 billion in loans to some 35,000 borrowers.

The company’s impressive performance has similarly merited accolades for David Gilbert, the 43-year-old chief executive who started the company on little more than a shoestring and whom employees regularly describe as “visionary.” Among Gilbert’s trophies: Accounting firm Ernst & Young recently presented him with its “Entrepreneur of the Year 2017 Award” for San Diego finance.

At first glance, the San Diego financier doesn’t look too much different from its cohorts. The company proffers unsecured loans of $5,000 to $500,000 to a mélange of small businesses in all 50 states and across multiple industries, including retail stores, auto repair shops, truckers, construction companies, heating-and-plumbing contractors, spas and beauty salons, cafes

and restaurants, waste management, medical and dental clinics, and insurance agencies.

To qualify for financing, a prospective borrower should have been in business for a year, have at least $100,000 in revenues, and boast a personal credit score of at least 500. While there's no collateral required for loans, National Funding insists on a personal guarantee. The website reviewer NerdWallet cautions borrowers that this "puts your personal assets and credit at risk if you fail to repay the loan."

Along with unsecured loans, National Funding offers equipment leasing – usually for heavy trucks and construction equipment – as well as merchant cash advances. The equipment lease is secured by the machinery. As in the case of Pam, the wellness coach cited above, MCAs are debited daily, the money automatically withdrawn from bank accounts.

There are a number of businesses that National Funding disdains, no matter how stellar their credit. "We won't finance casinos, strip-bars, tobacco, or firearms," Gilbert says. "We're not going to support industries like that."

For CEO Gilbert, doing business ethically is a signature feature of the company. Among other things, National Funding presses its salespeople to steer clear of putting people into dodgy loans that are likely to default. "We're lending capital," Gilbert says, "and one of our core values is the way we support our customers. Are we placing people with the right product to meet their needs or are we being selfish? The best way to be customer-oriented is to get a better understanding of what capital will do for them."

That corporate ethos, coupled with the company's remarkable performance, has raised its profile while earning it a measure of esteem among industry peers. "What I do know about National Funding," says Douglas Rovello, senior managing partner at Fund Simple, a lender and broker in the Tampa area, "is that they have five or six different programs and set their rates high but competitively. They're known for fitting their products to a client's needs," he adds. "And in a business that has its share of bad actors, they have a reputation as a company with a conscience."

A company with a conscience. Customers come first. And yet National Funding turns heads with its sales production of roughly 1,000 financings a month and triple-digit growth rate. So how do they it? A good place to start is with Gilbert, whose leadership skills, business acumen, and second-to-none work ethic "set the tone," says Kevin Bryla, the company's 52-year-old chief marketing officer.

For his part, Gilbert credits his family background and an upbringing in which education and academic achievement were strongly encouraged. The fifth of six children, he's the only one who opted for a business career. "There are three doctors, two lawyers – and me," Gilbert says.

The son of a prominent physician, his mother a homemaker and volunteer docent at the nearby Nixon Library for the past 25 years, Gilbert grew up in Yorba Linda. He attributes his keen interest in business to observing how his father, a pathologist, operated his own laboratory, which employed 60 people. "It was the business side of medicine that fascinated me," he asserts.

Even so, his two closest friends at the University of Southern California — fraternity brothers Marc Newburger and Sean Swerdlow– tell a somewhat different story. They remember Gilbert as someone who found his true calling, his métier, during his college years. Enrolled initially in pre-med courses, he was a diligent student but, his friends assert, manifestly unsuited for a career in medicine.

"*Formative,*" says Swerdlow, the older of the two fraternity brothers and now a management consultant based in Southern California, "would be a very good word" to characterize that period during which Gilbert abandoned medicine in favor of the world of commerce. In 1997, he earned a bachelor's degree in business administration "with an emphasis in entrepreneurship."

But it was fraternity life just as much as the classroom, his friends agree, that shaped him and foreshadowed his future. "It wasn't 'Animal House,'" Swerdlow says of Alpha Epsilon Pi. "We boasted the highest GPA (grade point average) on fraternity row."

Nonetheless, Gilbert took to the social life and camaraderie that the fraternity offered with gusto, and his friendship with the colorful Newburger was especially fateful. A freewheeling entrepreneur today, Newburger takes a measure of credit — Gilbert's disapproving parents might have preferred the word "blame" — for contributing to his fraternity brother's metamorphosis. "Dave hated all of his pre-med classes," Newburger insists. "He had zero stomach for it. He was so much like I was: a natural people person and a born entrepreneur."

Newburger is the quintessential soldier of fortune. After college, he tried his hand as an actor, supporting himself by playing poker and getting paid to be a contestant on TV game shows including "The Dating

Game," "Card Sharks," and "3's A Crowd." He's now the co-president and co-inventor of Drop Stop, a patented device that "minds the gap" between a car's front seat and the console and prevents coins, keys, glasses, and mobile phones from disappearing down that rabbit hole. (Drop Stop really took off after Newburger and his business partner appeared on the television show "Shark Tank" and scored a $300,000 capital injection from celebrity-investor Lori Grenier who took a 30% stake in the company and slapped her name on the brand.)

Back at the frat house, Newburger and Gilbert collaborated on business ventures. The pair once sold T-shirts sporting an off-color message about USC's arch-rival, the University of California at Los Angeles. "The (anti-UCLA) message was pure hatred," Newburger recalls. "But it was just for the day of the football game and it was all in fun."

At first, sales at the stadium were lackluster. USC students kept trying to bid down the price or importune them to throw in an extra tee. As for the game itself, USC's chances for victory looked equally unpromising. As time ran out, however, the Trojan quarterback completed a Hail Mary pass and USC won. The two fraternity brothers grabbed the bundle of shirts and sprang into action. "We got to the exit just in time and sold out in a matter of seconds," Newburger recalls.

Newburger takes credit too for introducing his friend to Las Vegas' gaming tables. Gilbert, his friend says, immediately demonstrated a knack for counting cards, handling money, and taking risks. "It was typically blackjack," recalls Swerdlow, who sometimes accompanied them. "We didn't have much money then. But there were moments when Dave would bet a big pile of chips. He's willing to make a bet and live with the consequences."

Sports are another of Gilbert's enthusiasms. His friends say that, whether he's returning serve at ping-pong or standing over a putt — he plays to an 11 handicap at golf – he wants to win. Remarks Newburger: "He's competitive to the point that — when he beats you — he wants the Goodyear blimp flying overhead to announce his victory."

Gilbert, who is married with two children, is legendarily loyal to friends and family. While most members of a college fraternity might keep up with old companions after graduation by exchanging greeting cards and attending college reunions, Gilbert goes the extra mile.

He once footed the bill for Swerdlow to travel with the USC football team to an away game, arranging it so that his fraternity brother could view the action from field-level. After Newburger had a recent health scare (no worries, he's O.K.), Gilbert rounded up a couple of dozen fraternity brothers and their wives (or companions), and put together a four-day bash in his buddy's honor. The event was held at Cabo, the Mexican beach resort in Baja California, and Gilbert underwrote a fair amount of the cost. "He shares his success with his friends," Newburger says, adding: "I don't know anybody who works harder on friendships."

Many of the personality traits described by friends and colleagues — tenacity and competitiveness, self-confidence and leadership — played a key role in the development and success of National Funding, which Gilbert founded just two years out of college with $10,000 borrowed from his uncle, Howard Kaiman, of Omaha.

He'd worked a couple of quick jobs right after college, including a stint at small-business lender Balboa Capital, but he was always destined to be his own boss. Gilbert's start-up was called Five Point Capital and, at first, it was located in the affluent Chatsworth section of Los Angeles and concentrated on equipment leasing.

"The first two years we were a cold-calling company and then we got into direct mail and saw some success and then we moved to San Diego and started to scale up the company," Gilbert says. The decampment, he explains, was "for the quality of life, but we also felt we could hire from a better talent pool than L.A. We wanted to set ourselves apart."

By 2007, Five Point was cranking up operations, revenues shot to $28 million and its headcount totaled 210 employees. "Then the Great Recession hit" in 2008-2009, Gilbert says. The company was forced to furlough 140 employees, two-thirds of its workforce. Yet even as it retrenched, the company managed to branch out. It began making merchant cash advances, Gilbert says, and, also in 2007, it linked up with CAN Capital to do broker financings. "We were pretty well known and they were looking for partners for factoring and leasing," Gilbert explains.

It took time to recover after the financial crisis. But by 2013 – the year that Gilbert re-branded his company "National Funding" – the company was able to hire back as many as 15% of its laid-off employees (most had found other jobs, in many cases relocating to Silicon Valley, Gilbert reports). By then, the company had secured a $25 million credit facility from Wells Fargo Bank, which allowed it to move up the food chain to

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"become a balance-sheet lender," Gilbert says, and offer a wider selection of financing options.

Key to driving the company's phenomenal growth has been its flood-the-zone marketing and sales strategies. The company spends $16 million annually on marketing using a full panoply of channels and media, both online and offline. These include direct mail and targeted marketing, paid advertising, search-engine optimization or SEO, and sports sponsorships. "We try to build a whole range of marketing mechanisms," explains marketing chief Bryla, "and when you get the mix right, they all help each other."

Gilbert is a big believer in the benefits of sports marketing, the company's website featuring the logos of the San Diego Padres (baseball), and Anaheim Ducks and Los Angeles Kings (hockey). Ever the faithful alumnus, Gilbert and his company back USC football as well. During the 2015-2016 college football season, the company paid for naming rights for what became, for one night, the "National Funding Holiday Bowl" at Qualcomm Stadium.

Janet Fink, department chair at the McCormack School of Sports Management located at the University of Massachusetts-Amherst, told *deBanked* that sponsorship programs can easily cost a million dollars or more. "It's not cheap," she says. "When a company sponsors a team, they get a number of benefits. One is that they get to put the team's logo on their website. The idea is that fans are passionate or have an affinity for the team and that it will rub off on a sponsor.

"Sports enthusiasts," Fink adds, "often make good customers. When you have enough disposable income to go these sporting events, you're probably a good prospect for a loan."

The sponsorships — which include civic involvement such as offering Holiday Bowl tickets to members of San Diego's large military contingent as well as to company employees — also build good will in the community and team spirit among the workforce. (National Funding also makes an effort to hire veterans, says Bryla.)

Gilbert believes in the old adage that you have to spend money to make money. The company spends $14 million rewarding its network of outside brokers. Inside the company, high-performing salespeople are compensated with commissions, bonuses and an assortment of rewards, including resort trips.

But sales representatives' must conform to company guidelines. Justin Thompson, National Funding's sales chief, explains that the "customer comes first" philosophy is not just a slogan but a core value. "We're not a factory spitting out widgets," Thompson says. "We're here to build relationships and sell a repeatable product. We want that customer to come back to us. Every loan is customized. Six of ten customers who pay off their loans come back for a second financing. Whether your business is dog grooming or you're an asphalt company," he adds, "people will do business with people they like and trust."

Using the software program "customer relationship management" (CRM), National Funding expends a lot of effort gathering data on its business customers and extrapolating the information for use in credit evaluations. But the use of technology only goes so far.

Gilbert reckons that the art of the deal involves about "70 percent algorithm and 30 percent people." He adds, "You still need the people component to look at credit profiles. The algorithm spits out a recommendation but we still need the human element."

If there's a fly in the National Funding ointment, it's that the company's fees can be more expensive than a bank loan.

But borrowers who have been denied loans at a bank or other lender are likely to overlook those costs. Austin, the florist in West Palm Beach, for example, came to National Funding when his bank, North Carolina-based BB&T Bank, gave him the cold shoulder despite the $15,000 in deposits that he averages each month. "I've been with them for six years," he fretted, "and they treated me shabbily."

Even more grateful was Jimmy Frisco, of Annapolis, who is co-owner with his wife of Lisa's Luncheonette, a business that includes a food trailer and several cafeterias located in the city's office buildings. They employ about a dozen people.

Frisco had taken a nasty spill and was laid up for seven months. Health insurance covered the $18,000 in medical costs but he and Lisa fell behind in their bills and needed working capital to pay for food purchases and other business expenses. By the time a flyer from National Funding popped up in his mailbox, he and his wife "had been turned down by several other lenders, including banks," he says, adding: "Things happen in life and we don't have the best of credit."

Getting that loan for $25,000 from National Funding took just three days. Frisco's health is much improved and business is back to normal. He won't discuss the terms of the financing, other than to say "it was reasonable."

He adds: "There were no problems with National Funding, no hassle with the paperwork. They're great people to work with."

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IS YOUR FIRM READY FOR MACHINE LEARNING?

By *CHERYL WINOKUR MUNK*

Artificial intelligence such as machine learning has the potential to dramatically shift the alternative lending and funding landscape. But humans still have a lot to learn about this budding field.

Across the industry, firms are at different points in terms of machine learning adoption. Some firms have begun to implement machine learning within underwriting in an attempt to curb fraud, get more complex insights into risk, make sounder funding decisions and achieve lower loss rates. Others are still in the R&D and planning stage, quietly laying the groundwork for future implementation across multiple areas of their business, including fraud prevention, underwriting, lead generation and collections.

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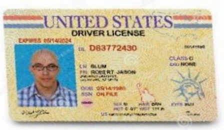

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a little grows a long way

"It's entirely critical to the success of our business," says Paul Gu, co-founder and head of product at Upstart, a consumer lending platform that uses machine learning extensively in its operations. "Done right, it completely changes the possibilities in terms of how accurate underwriting and verification are," he says.

While there's no absolute right way to implement machine learning within a lender's or funder's business, there are many data-related, regulatory and business-specific factors to consider. Because things can go very wrong from a business or regulatory perspective—or both—if machine learning is not implemented properly, firms need to be especially careful. Here are a few pointers that can help lead to a successful machine learning implementation:

CONSIDER THE POSSIBILITIES AI CAN OFFER FOR YOUR SPECIFIC BUSINESS

Tip No. 1

Using machine learning, funders can predict better the likelihood of default versus a rule-based model that looks at factors such as the size of the business, the size of the loan and how old the business is, for example, says Eden Amirav, co-founder and chief executive of Lending Express, a firm that relies heavily on AI to match borrowers and funders.

Machine learning takes hundreds and hundreds of parameters into account which you would never look at with a rule-based model and searches for connections. "You can find much more complex insights using these multiple data points. It's not something a person can do," Amirav says.

He contends that machine learning will optimize the number of small businesses that will have access to funding because it allows funders to be more precise in their risk analyses. This will open doors for some merchants who were previously turned down based on less precise models, he predicts. To help in this effort, Lending Express recently launched a new dashboard that uses AI-driven technology to help convert business loan candidates that have been previously turned down into viable applicants. The new LendingScore™ algorithm gives businesses detailed information about how they can improve different funding factors to help them unlock new funding opportunities, Amirav says.

Lenders and funders always have to be thinking about what's next when it comes to artificial intelligence, even if they aren't quite ready to implement it. While using machine learning for underwriting is currently the primary focus for many firms, there are many other possible use cases for the alternative lenders and funders, according to industry participants.

Lead generation and renewals are two areas that are ripe for machine learning technology, according to Paul Sitruk, chief technology officer and chief revenue officer at 6th Avenue Capital, a small business funder. He predicts that it is only a matter of time before firms are using machine learning in these areas and others. "It can be applied to several areas within our existing processes," he says.

Collection is another area where machine learning could make the process more efficient for firms. Machines can work out, based on real-life patterns, which types of customers might benefit from call reminders and which will be a waste of time for lenders, says Sandeep Bhandari, chief strategy and chief risk officer at Affirm, which uses advanced analytics to make credit decisions.

"There are different business problems that can be solved through machine learning. Lenders sometimes get too fixated on just the approve/decline problem," he says.

QUALITY DATA MATTERS

Tip No. 2

"Most underwriters don't have enough data to effectively incorporate AI, deep learning, or machine learning tools," says Taariq Lewis, chief executive of Aquila, a small business funder. He notes that effective research comes from the use of very large datasets that won't fit in an excel spreadsheet for testing various hypotheses.

Problems, however, can occur when there's too much complexity in the models and the results become too hard to understand in actionable business terms. For example, firms may use models that analyze seasonal lender performance without understanding the input assumptions, like weather impact, on certain


It shouldn’t be this difficult
to prevent backdooring.

geographies. This may lead to final results that do not make sense or are unexpected, he says.

"There's a lot of noise in the data. There are spurious correlations. They make meaningful conclusions hard to get and hard to use," he says.

The more precise firms can be with the data, the more predictive a machine learning model can be, says Bhandari of Affirm. So, for example, instead of looking at credit utilization ratios generally, the model might be more predictive if it includes the utilization rate over recent months in conjunction with debt balance. It's critical to include as targeted and complete data as possible. "That's where some of our competitive advantages come in," Bhandari says.

Underwriters also have to pay particularly close attention that overfitting doesn't occur. This happens when machines can perfectly predict data in your data set, but they don't necessarily reflect real world patterns, says Gu of Upstart.

Keeping close tabs on the computer-driven models over time is also important. The model isn't going to perform the same all along because the competitive environment changes, as do consumer preferences and behaviors. "You have to monitor what's going well and what's not going well all the time," Bhandari says.

KEEP REGULATORY COMPLIANCE TOP OF MIND

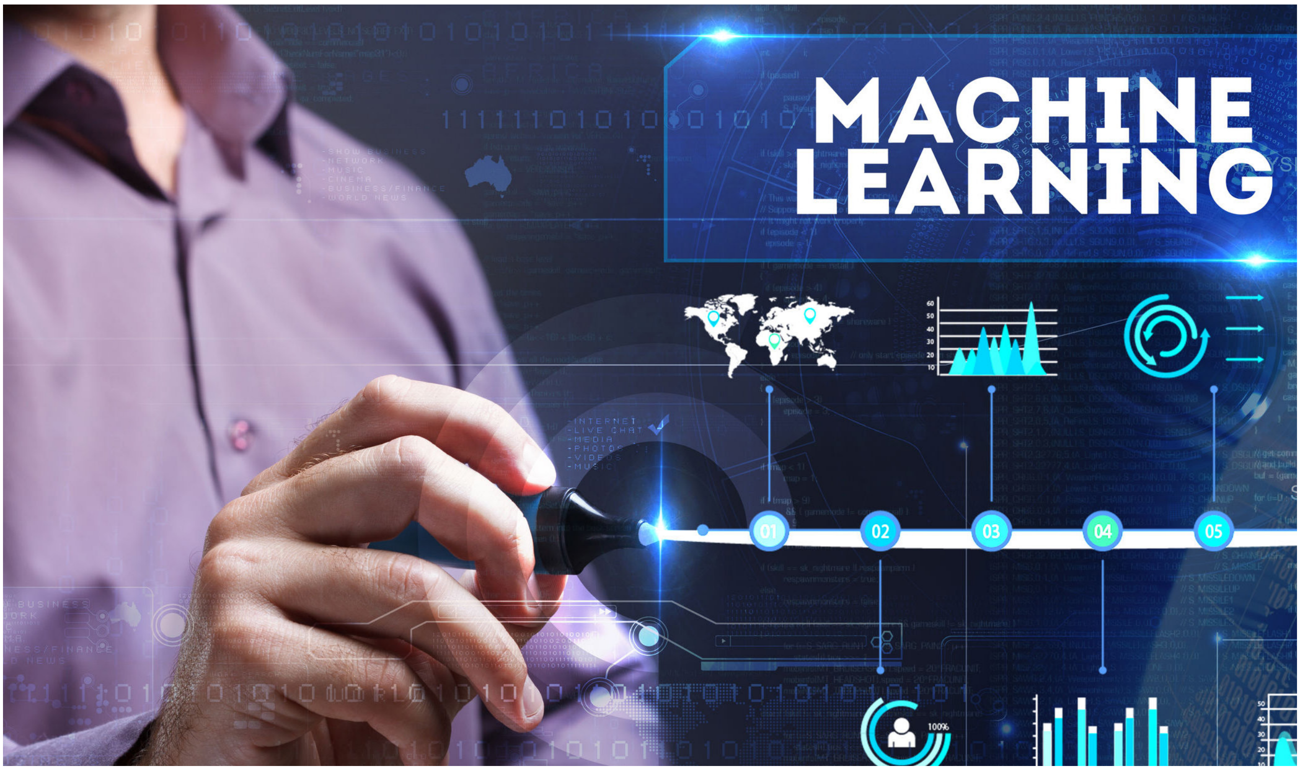
Tip No. 3

Certainly, as AI is integrated into financial services, state and federal regulators that oversee financial services are taking more of an interest. As such, firms dabbling with new technology have to be very careful that any models they are using don't run afoul of federal Fair Lending Laws or state regulations.

"If you don't address it early and you have a model that's treating customers unfairly or differently, it could result in serious consequences," says Tim Wieher, chief compliance officer and general counsel of CAN Capital, which is in the early stages of determining how to use AI within its business.

"AI will be transformative for the financial services industry," he predicts, but says that doing it right takes significant advance planning. For instance, Wieher says it's very important for firms to involve legal and compliance teams early in the process to review potential models, understand how the technology will impact the lending or funding process and identify the challenges and mitigate the risk.

To be sure, regulation around AI is still a very gray area since the technology is so new and it's constantly



evolving. Banking regulators in particular have been looking closely at the issues pertaining to AI such as its possible applications, short-comings, challenges and supervision. Because the waters are so untested, there can be validity in asking for regulatory and compliance advice before moving ahead full steam, some industry watchers say.

Upstart, for example, which uses AI extensively to price credit and automate the borrowing process, wanted buy-in from the Consumer Financial Protection Bureau to help ease the concern of its backers as well as to satisfy its own concerns about the legality of its efforts. So the firm submitted a no-action request to CFPB. The CFPB responded by issuing a no-action letter to Upstart in September 2017, allowing the company to use its model. In return, Upstart shares certain information with the CFPB regarding the loan applications it receives, how it decides which loans to approve, and how it will mitigate risk to consumers, as well as information on how its model expands access to credit for traditionally underserved populations.

The No-Action Letter is in force for three years and Upstart can seek to renew it if it chooses.

LET HUMANS RULE THE MACHINES, NOT THE OTHER WAY AROUND.

Tip No. 4

Theoretically firms could have a computer underwriting model constantly updating itself without having a human oversee what the model is doing—but it's a bad idea, industry participants say. "I believe there are companies doing that, and it's a risky thing to do," says Scott M. Pearson, a partner with the law firm Ballard Spahr LLP in Los Angeles.

During review of the models—and before implementing them—people should carefully review the models and the output to make sure there's nothing that causes intrinsic bias, says Kathryn Petralia, co-founder and president of Kabbage, which is one of the front-runners in using machine learning models to understand and predict business performance.

"If you're not watching the machine, you don't know how the machine is complying with regulatory requirements," she says.

Kabbage has teams of data scientists regularly developing models that the company then reviews internally before deploying. The company is also in frequent contact with regulators about its processes. Petralia says it's very important that firms be able to explain to regulators how their models work. "Machines aren't very good at explaining things," she quips.

As a best practice, Pearson of Ballard Spahr says lenders and funders shouldn't use any machine learning model until it's been signed off on by compliance. "That strikes a pretty good balance between getting the benefits of AI and making sure it doesn't create a compliance problem for you," he says.

RESPECT AI'S LIMITATIONS

Tip No. 5

While AI has many benefits, industry participants say alternative lenders and funders need to be mindful of how it can be applied practically and effectively within their particular business model.

Craig Focardi, senior analyst with consulting firm Celent in San Francisco, contends that the classic FICO score continues to be the gold standard for credit decisions in the U.S. He warns firms not to get overly distracted trying to find the next best thing.

"Many fintech lenders have immature risk management and operations functions. They're better off improving those than dabbling in alternative scoring," he says, noting that data modeling is an entirely separate core competency.

Indeed, Lewis of Aquila cautions underwriters not to view AI as a silver bullet. "AI is just one tool out of many in the lenders' toolbox, and our industry should use it and respect its limitations," he says.

HOW THE BROKERS DO IT

Introduce Yourself

Copelon Kirklin: I'm the President of KPC Group, a one-man broker shop in Kenner, Louisiana. It's 15 minutes outside of New Orleans.

Morning Routine

Kirklin: I wake up at 6. I get a quick breakfast. I check my emails and then on to phone calls.

Biggest Deal Ever Funded

Kirklin: $2.5 million SBA Loan. I had 1 point in it so I made a $25,000 commission.

First Deal Ever

Kirklin: It was in 2014 and I only made $500. But I tell you, it was the best thing that happened to me because it let me know that it was possible.

Biggest Challenge

Kirklin: If I'm dealing directly with a merchant, at the beginning, the way they represent themselves on paper regarding their revenue – everything looks good. And then when the actual bank statements come through, it doesn't match up. I mostly work with construction contractors. It's a niche and it's pretty simple. But it's only simple if [merchants] don't misrepresent their financials, if they're telling the true story. Also, I don't mind working with brokers...it doesn't matter if you're in the deal 50-50 or you're just passing me a deal of a friend...I pay 50% every time, because I want to foster more relationships and get more deals that way. The challenge is when the co-broker can't let go of the client to let me deal with them. It's when they want to be the go-between. When they want to communicate through me to the client and it just doesn't work that way. I haven't closed any deals when another broker tries to work that way.

Introduce Yourself

Zachary Ramirez: I'm the Founder and Managing Director of ZR Consulting, LLC, a brokerage of 10 people in Orange County, California.

Morning Routine

Ramirez: I get up at about 5:45. I have my protein shake – banana, protein, coconut oil and whatever else I can find that seems healthy to me. I get a cup of coffee. I sit down at my desk and the first thing I do is look at all the leads that came in that night. Sometimes there's as many as 80. Sometimes there's as few as 20 or 25. I then distribute the leads to my sales team, so that as soon as they wake up, they have all their leads. After that, I focus on marketing and closing some of the bigger deals.

Biggest Deal Ever Funded

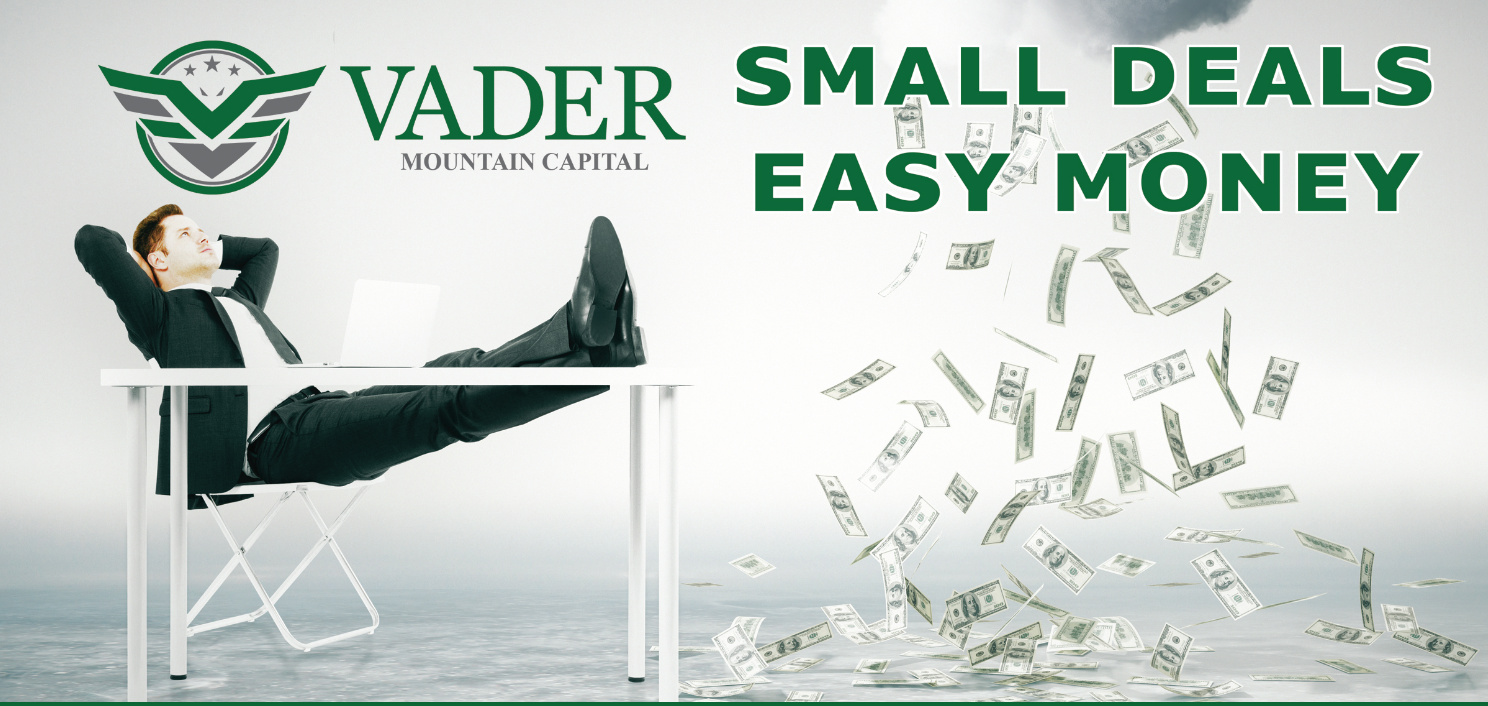
Ramirez: $2 million deal. We had three points in it, so we made $60,000.

First Deal Ever

Ramirez: I was 23 years old and that was the first time I had seen my business capture any revenue. Finally, after a month or two months of straight working, and not finding a single deal, I finally figured out the marketing a little bit and ended up funding one for $75,000. I remember we had 10 points in it, so we had $7,500.

Biggest Challenge

Ramirez: I lost everything on the first broker shop I started. I only funded two or three deals and I ended up spending more money than I made. I was very humbled by this. I realized that being a broker isn't as easy as people think.



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INDUSTRY *NEWS*

7/25 Funding Circle extended their Citibank credit facility to £66M up from £50M.

7/26 PayPal announced in their Q2 earnings report that they had $1.4 billion in outstanding merchant loans, advances, interest and fees receivables. 90.6% of their merchant advances and business loans were performing within the original expected payment period.

Enova, the publicly traded lending company that owns The Business Backer and Headway Capital, reported a 23% year-over-year contraction in business financing originations.

7/27 1 Global Capital LLC and 1 West Capital LLC, DBA 1st Global Capital, filed for Chapter 11 after revealing that their capital raising efforts had been hampered by parallel investigations being conducted by the SEC and FBI.

7/31 The OCC approved the designation of special purpose national bank charters, otherwise known as fintech charters.

Shopify, a Point of Sale solution for small businesses, revealed that they had originated $68.5M in merchant cash advances in Q2, an increase of 84% compared to the same period the previous year.

8/1 B2B Blacklist announced the launch of their business, b2bblacklist.com.

Square revealed that their small business loan division, Square Capital, originated $390M.

Yellowstone Capital announced they had originated $68.5M in the month of July.

8/3 CommonBond, an online student lender, issued another AAA securitization with $292 million of total collateral.

8/6 SoFi is said to have suffered a Q2 EBITDA loss of $200M.

8/7 OnDeck, an online small business lender, reported a Q2 net income of $5.8M and originations of $587M.

Lending Club, an online consumer lender, originated a record high of $2.8B in Q2, up 31% over the same period from the previous year.

8/8 OnDeck added a new $175M asset-backed revolving credit facility consisting of funds provided by Liberty Mutual Insurance Company and certain of its affiliates, as well as funds managed by affiliates of Ares Management L.P.

Q2 Holdings, Inc. Enters agreement to acquire Cloud Lending, a privately held SaaS lending and leasing platform.

Enova hired Jim Granat to be its new Head of Small Business Financing.

8/13 China pledges to ban all new online lending platforms after billions of dollars in scams led to nationwide protests.

8/15 Small business lender StreetShares announced that they were moving to a new 10,300 square foot office after doubling the size of its workforce.

8/16 Credit Karma acquired Approved.

8/20 United Capital Source was selected to service BizBloom's portfolio. BizBloom was a small business financing brokerage that launched in 2015.

8/21 PIRS Capital, an MCA company, secured an increase in their credit facility to $10 million.

8/22 IOU Financial, an online small business lender, announced Q2 originations of $29.2M (US) and net earnings of $852,789 (CAD).

8/23 Upgrade Inc., a consumer credit platform, closed a $62M Series C Round.

8/29 The SEC unsealed a complaint against 1 Global Capital, its owner, and related parties, alleging that the firm fraudulently raised more than $287M from more than 3,400 investors to finance its MCA operations.

8/28 Google partnered with four indian banks to grant consumer loans online through its app Google Pay.

8/31 News broke that Funding Circle, an international small business p2p lender, was planning an IPO in the UK.

SB 1235, the California bill that would require specific disclosures in commercial financing agreements, passed through both chambers of the legislature. Only the governor's signature is needed for it to become law.

9/3 Funding Circle announced plans for an IPO on the London Stock Exchange. They said they were looking to raise around £300 million ($387.4 million).

9/4 Expansion Capital Group, a small business lender, increased their debt capacity to $60M.

Payscape partners, a payments company, partnered with Fora Financial to offer working capital to small businesses.

Varo Money, a banking mobile app, was granted preliminary approval by the OCC to form a new national bank, paving the way for the company to become the first all-mobile bank in the U.S.

9/5 CAN Capital, a small business specialty finance company, expanded its capital capacity with Varadero Capital to $287M.

Business Insider reported that Goldman Sachs was scrapping its plans to open a bitcoin trading desk.

9/7 Goldman Sachs CFO Martin Chavez called the September 5th Business Insider story fake news.

Alcentra, a global asset management firm with $37.7B in assets under management, agreed to buy on behalf of its clients up to $1 billion of Funding Circle's US loans over a period of three years.

9/12 OnDeck surpassed $10B in originations since inception.

The National Equipment Finance Association announced Michael A. Toglia as its new Executive Director/CEO, succeeding Gary Egan.

RDM Capital Funding announced that they had secured a $7.5M credit facility with Drift Credit Opportunities Fund, an affiliate of Charleston Capital Management. RDM is a small business specialty finance company.

9/13 National Bank of Canada partnered with Thinking Capital to use their lending-as-a-service model so that they can offer small business financing to a larger set of the Canadian market.

IS SMALL BUSINESS LENDING STUCK IN THE FRIEND ZONE?

By *ED MCKINLEY*

Small-business owners have lots of places to go for capital, and the alternative small-business funding industry doesn't exactly top the list, recent research shows. In fact, entrepreneurs claim they're more than four times as likely to receive funding from a friend or family member than from an online or non-bank source.

That bit of intelligence comes from the National Small Business Association's 2017 Year End Economic Report, the most recent from the Washington-based trade group. Thirteen percent of the entrepreneurs who responded to the survey received loans from family or friends in the preceding 12 months, while 3 percent obtained funding from online or non-bank lenders, the report says.

But some variables come into play. Shopkeepers and restaurateurs are more likely to rely on friends and family for financing during their first five years in business, says Molly Brogan Day, the NSBA's vice

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FEB '18 BUSINESS CONSULTING

$241,530
funded amount

$29.2k commission	12.08% commission %

JAN '18 BUSINESS OPERATIONS SERVICES

Funded Amount	Factor Rate	Term Length
$324.2k	1.27	11 mo.

FEB '18 DOOR MANUFACTURING

Funded Amount	Commission Amount	Term Length
$360k	$26.7k	7.5 mo.

FEB '18 SAFETY SUPPLY DIST.

$259,389
funded amount

$22.9k commission	9 month term

JAN '18 CONSTRUCTION & RESTORATION CO.

$344,651
funded amount

1.29 factor rate	9 month term

FEB '18 SOLAR ENERGY & ROOFING

Funded Amount	Commission	Commission %
$306.7k	$36.4	11.88%

FEB '18 RESTAURANT

Funded Amount	Term Length	Commission %
$59.2k	9.5 mo.	22.74%

For more deals funded this year and info on what Pearl offers our ISO Partners, check out pearlcapital.com or call 1.800.888.9959 president of public affairs and a 15-year veteran of the survey. The association's members, who account for many – but not all – of the respondents tend to have been in business longer than non-members so the actual percentage of all owners receiving funds from family or friends could well be higher than the survey indicates, she notes.

In fact, the average NSBA member started his or her business 11 years ago – a fairly long time for the sector, Day says. The association attracts well-established merchants partly because the trade group concentrates on advocacy and lobbying in the nation's capital, Day notes. "There's not a lot of networking, there's not a ton of resources or educational offerings," she says of the association. In other words, the organization's emphasis tends to attract prospective members who have been in business long enough to see the results of laws and regulation instead of newcomers still struggling daily to establish themselves, she observes.

Anyway, it's also worth noting that small-business owners appear nearly as likely to approach family or friends for cash as to petition large banks for funding, Day says, noting that 13 percent turn to friends and family, while 15 percent manage to obtain loans from large banks. To her, that indicates that banks just aren't lending to small businesses as frequently as they should – a notion that should sound familiar to anyone in the alternative small-business funding industry.

Unsurprisingly, the association's research indicates bank lending declined as the Great Recession made itself felt in 2007 and 2008. Before that, nearly 50 percent of merchants responding to the survey reported they had recently qualified for loans from big banks, small banks or credit unions, the research shows. "Now it's pretty consistently a percentage in the low 30's," Day says. "People really need these loans."

Lending by banks hit another snag in 2012 when new regulation and legislation, including the Dodd-Frank Wall Street Reform and Consumer Protection Act, made itself felt. "There was such a massive overcorrection in the banking industry that it's still really difficult for small businesses to get loans," Day says.

Moreover, banks were granting fewer "character-based" loans even before the double whammy or recession and regulation, Day observes. Instead of employing the older practice of assessing the intangible virtues of a business owner well-known in the community, bankers began applying a more formulaic approach to evaluating loan applications based on credit scores and other quantifiable variables, she says.

That switch to numbers-oriented decisions proved detrimental for many entrepreneurs. "A lot of small-business owners don't look great on paper," Day admits. Even a great business plan might not convince bankers to loosen their purse strings these days, she notes.

That's where the alternative small-business funding industry comes into the picture. NSBA researchers began including the category of online and non-bank lenders in their surveys in 2013 and have seen the percentage of respondents using them grow each year to its current level of 3 percent.

"It's not huge growth, but it's notable," Day says. Notable enough to achieve importance, she continues. "It's an important opportunity for your readers to fill that void," she says of the shortfall of adequate small-business funding. "They've been doing a pretty good job of doing it."

In fact, the NSBA research indicates that alternative funding and other sources have tended to take up the slack created by the banking industry's decision to exercise extreme caution when evaluating small-business loans. Some 73 percent of small-business owners are obtaining enough financing these days, according to the survey.

Yet hiccups have occurred, like the decline to only 59 percent finding adequate funding in 2010, Day points out. And the fact that two-thirds to three-fourths are generally securing adequate funding means that a fourth to a third aren't, she notes, adding that she urges focusing on the latter group. "It's concerning," she says.

Inadequate funding can prove especially challenging for newer businesses that don't have a track record, haven't stockpiled proceeds from past operations, don't own stock to leverage and aren't savvy enough to finesse placement of debt, Day maintains. More-established businesses have greater access to those resources or have honed those skills, she notes.

And much is at stake. Lack of funds not only hurts

that significant portion of small-business owner but also prevents hiring workers, stymies economic growth and hinders community development, Day maintains. She points to research that shows the nearly direct correlation between availability of capital and increases in hiring. (See Chart A.)

Other NSBA findings include the fact that in July of 2017 merchants reported having debt that averaged $496,000. Some 73 percent of those reported had at least some debt. Some 40 percent of survey respondents, the largest category have debt of $50,000 or less. (See Chart B.)

Chart A*: Correlation between financing and employment

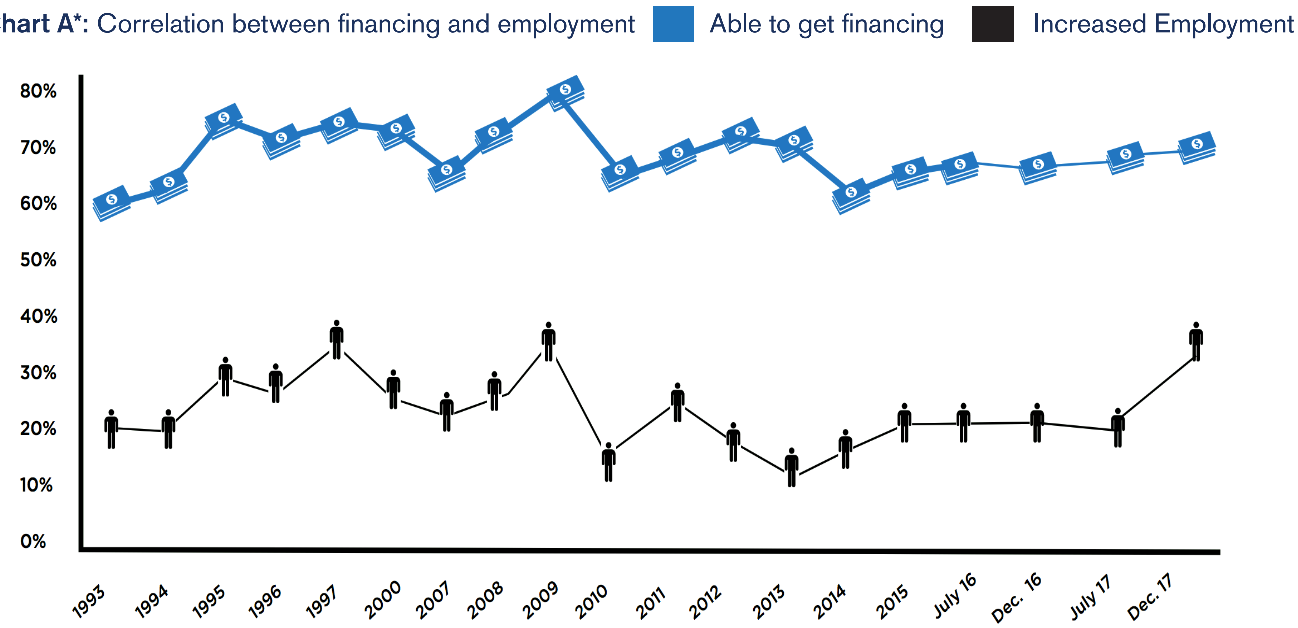

CHART B*: Please estimate your current small businesses total debt, including loans, credit cards, property mortgage, invoices owed, etc.

Percentage of Small Businesses Carrying Any Debt	**73%**
Average debt among those that do have debt	**$496,606.38**
Debt 1 to 50k	**40%**
Debt 51k to 100k	**11%**
101k to 500k	**25%**
501K to 1mil	**10%**
More than 1mil	**14%**

Financing most often comes from funds the business has earned, the trade group says. Some 32 percent of merchants cite that source. Yet simply pulling out a credit card remains a common way to make ends meet, with 31 percent saying they did that to meet capital needs in the last 12 months. (See Chart C.)

While most (57 percent) say that lack of capital hasn't hurt their enterprises recently, 31 percent say a dearth of capital prevented them from expanding their operations, 14 percent report they weren't able to expand their sales because they lacked funding, and 13 percent admit they laid off employees because it was difficult to find the cash to meet the payroll. (See Chart. D)

The availability of credit hadn't changed much in the year leading up to the survey, the association says. About 77 percent reported no change in their lines of credit or credit cards, while 18 percent saw their perceived creditworthiness increase and 5 percent saw it decline.

Those results come with a bit of history. The NSBA has been surveying small-business owners

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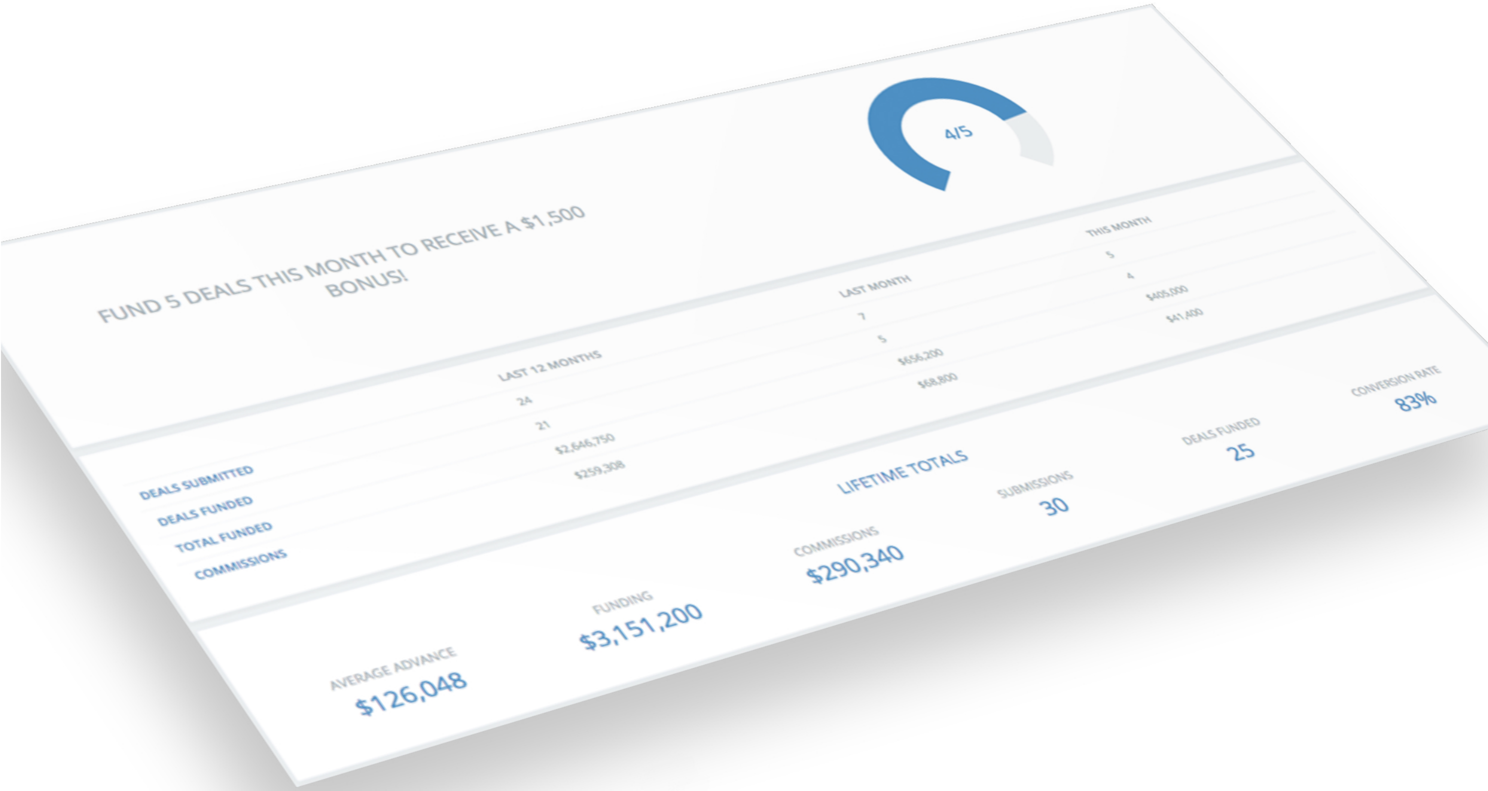

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since 1993. At first, the trade group hired polling companies to perform the task and cooperated on the report with the Arthur Andersen accounting firm. Computerization enabled the association to take the project in-house beginning in 2007. It works on the survey with ZipRecruiter, an online employment marketplace.

Some 1,633 small-business owners participated in the research for the 2017 Year End Economic Report by answering 42 questions online in December 2017 and January 2018. Many of the survey questions have remained the same over the years to facilitate comparisons and tracking.

Small businesses on the list of members and the list of non-members receive two email messages alerting them to the survey and providing an online link to the questions. The surveys take place twice a year.

As mentioned earlier, some survey respondents belong to the association and some don't, but Day was unable to pinpoint the percentages. In response to a question from deBanked, she said she may begin tallying how many respondents are members and non-members because non-members tend to have been in business for a shorter time than members. Non-members also tend to differ from members because political engagement often brings the former to the association's attention.

Participating merchants come from every industry and every state, Day says. Manufacturing and professional services are very slightly overrepresented, while mining is the only category that's scarcely represented, she admits. Not many small businesses operate in the mining sector, she adds.

CHART C*: What types of financing has your company used within the past 12 months to meet your capital needs? (Check all that apply)

	DEC. 2017
Earnings of the business	32%
Credit cards	31%
Large Bank Loan	15%
Community Bank Loan	14%
Private loan (friends or family)	13%
Vendor credit	12%
Leasing	5%
Small Business Administration (SBA) loan	4%
Online or non-bank lender	3%
Venture capital/Angel investors	3%
Private placement of debt	3%
Credit Union Loan	2%
Selling/pledging accounts receivable	2%
State/Regional Loan and Incentive Programs	2%
Private placement of stock	1%
Crowdfunding	1%
Public Issuance of stock	0%
Other	7%
Used no financing	31%

CHART D*: If capital availability is a problem for your business, what is the effect on your operations?

	DEC. 2017
Not a problem / No effects	57%
Unable to grow business or expand operations	31%
Unable to finance increased sales	14%
Reduced the number of employees	13%
Reduced benefits to employees	9%
Unable to increase inventory to meet demand	9%
Other (please specify)	3%
Closed stores or branches	2%

*SOURCE: National Small Business Association. NSBA report: https://nsba.biz/wp-content/uploads/2018/02/Year-End-Economic-Report-2017.pdf

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