The Impact of Alternative Finance on the Equipment Leasing and Finance Industry:

Maximizing Opportunities and Managing Threats

EQUIPMENT LEASING & FINANCE FOUNDATION
Your Eye on the Future

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The Foundation is the only research organization dedicated solely to the equipment finance industry.

The Foundation accomplishes its mission through development of future-focused studies and reports identifying critical issues that could impact the industry.

The Foundation research is independent, predictive and peer-reviewed by industry experts. The Foundation is funded solely through contributions. Contributions to the Foundation are tax deductible.

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Purpose of the Study

The purpose of this study is to help legacy equipment finance companies and other lenders understand what and who composes the alternative finance marketplace and the environment in which it operates. Because of the rapid growth of alternative finance, traditional lenders now require a perspective that will allow them to determine whether and how they should respond to these new players. These lenders will also want to protect their established positions with borrowers and, more proactively, take advantage of opportunities that alternative finance, and the companies offering it, may provide.

Readers of this report should evaluate the markets alternative lenders focus on, consider their various operating models (including the leveragability of the technology platforms they have developed), and determine how best to take advantage of this emerging growth area. Of course, staying on the sidelines is an option, but it could result in lost revenues and lost market share as alternative finance continues to gain steam.

In many ways, leasing and alternative finance share the same entrepreneurial spirit. As the study underscores, the alternative finance industry is vital and dynamic. It is also likely to enjoy continued growth for the foreseeable future. Alternative finance offers challenges to established equipment finance players, but also growth opportunities for those that can become comfortable with the unique qualities of this industry and determine how to align their current business approach with this group of upstarts. In summary, alternative finance businesses has now become part of the permanent lending and leasing landscape. Traditional competitors should consider the potential impact of these new players, using this study to consider whether and how to participate.

Executive Summary

Alternative finance offers a new frontier in business lending, born from the banks' failure to meet the needs of a large section of small businesses. Leasing, similarly, grew in part from the failure of banks to provide what they perceived as riskier financing for equipment users.

The ground rules of alternative finance remain to be fully formed, and competitors continue to enter the space. At the same time traditional lenders are debating whether and how to engage with these new players. Some even seem unaware of alternative lenders' existence.

A look at early numbers helps explain. One analyst estimated that as of late 2014, alternative finance firms generated just 1.4% of all loans outstanding at banks and other lending firms. If this is true, one might wonder why equipment finance firms should concern themselves with a trend that has generated such small market share.

Information provided by Oxxford Information Technology (OIT), a data analytics firm specializing in the small business space, offers an answer. OIT studied potential opportunities for lending to small businesses and found that traditional players lend to only 10% of borrowers in this sector. Alternative lenders focus on the other 90%, who represent 75% of the total loan volume potential of companies generating up to $10 million in annual revenues. More borrowers now see traditional lenders as reactive to their needs at best, increasingly viewing alternative finance firms as eager and willing to make loans or advances, albeit at higher rates than banks. Among the reasons why:

Customer knowledge of borrowing options has increased. Reputation risk remains a major factor causing some established lenders to avoid the high-yield lending in which alternatives specialize. But more customers are open to alternative lending in light of their needs for convenient and fast funding.

A shift has occurred in how the media describes alternative-finance companies. Just two years ago, business stories focused on the high interest rates alternative players demanded. Today's stories highlight how alternative funding sources provide a reasonable alternative to banks. Thus, a lending option once considered anathema is now seen as attractive.

Deep-pocketed, sophisticated investors are homing in. During the preparation of this study, two major alternative finance firms announced IPOs, valuing these companies at roughly $9 billion and $1.3 billion, respectively. Private-equity and venture groups are committing to such companies because they see an improving economy with a funding gap that these players can fill.

Technology changes the game. At alternative lending firms, market strategy goes hand-in-hand with technology. This powerful combination, known as "FinTech," is used to design loan products and originate, underwrite, and maintain them. Many banks, meanwhile, still struggle with legacy systems that can't incorporate new technology and depend on third-party software providers who may be slow to respond to their needs.

They're not going away. Alternative-lending activity may plummet during an economic downturn, but this industry is past the tipping point. Investors and borrowers required for sustainable success are in place, and to many borrowers, alternative finance firms are now seen as reasonable choices offering speedy turnaround and reliable funding.

What Is Alternative Finance?

The complexity of alternative finance, along with the fact that participants are still designing parts of it, makes a simple definition difficult. Standard & Poor's portrays a larger finance category called "shadow banking" as non-bank financial intermediaries providing services similar to those of commercial banks. Shadow bankers include investment bankers, venture capitalists, insurance companies, and other institutional investors that do business with less regulatory oversight than commercial banks. As this study will illustrate, shadow banking also now includes alternative finance.

Alternative finance has existed as long as borrowers have needed lenders, in that loan transactions often occur outside traditional banking channels. Within the equipment finance arena, others have at times viewed independent finance companies in the industry as alternative players because they seek to complete transactions more easily and quicker than banks, albeit at a higher cost. The alternative-finance label has also variously been applied to business-to-consumer transactions and to transactions marketed to low-income individuals, such as payday loans.

But requirements for loan origination, underwriting, and regulation differ substantially between consumer and commercial lending segments. Lenders in these areas operate in very different competitive environments and have diverse requirements for success. To our knowledge, no alternative players except crowdfunding entities focus on both consumer and commercial spaces. Even within these two distinct areas, lenders tend to focus on specific sub-segments, developing targeted operating models to exploit distinct competitive advantages.

A Short History of Modern Alternative Finance

The Great Recession of 2007-2009 produced a significant pullback in lending activity by traditional players. Banks reined in their internal equipment-finance businesses, in many cases focusing instead on strengthening current portfolios and emphasizing direct-to-borrower transactions. Supporting other lenders was de-emphasized, with the result that many independent lessors and lenders unaffiliated with banks or captives struggled to find funding to maintain their portfolios.

During the Recession, lenders across the financial services industry suffered from overly aggressive past lending practices in multiple areas, notably home mortgage, commercial real estate and small business. In the small-business space, many lenders felt self-inflicted pain, caused by poorly managed internal small-business credit-scoring processes and a dramatic falloff in the value of collateral (real estate in particular) that supported both small- and mid-ticket deals. As credit problems worsened, banks retreated even further from lending. At one point, the chairman of a top 50 U.S. bank made this suggestion: "Maybe we should stop all lending to small businesses."

Since 2009, the economy has undergone a slow but substantial recovery. But many lenders still operate within a greatly narrowed "credit box," severely limiting the types of companies they will lend to. These banks say publicly that they want to lend, but do so only within certain parameters that are actually stricter than even a few years ago. Generally, traditional lenders today see little reason to stretch credit guidelines to allow them to make more difficult loans. At the same time, they cite multiple reasons for remaining conservative. These include increased capital requirements for higher-risk loans and greater regulatory scrutiny that can cause even new loans to be immediately classified as substandard. Indeed, the increased fixed costs of lending due to heightened regulation work to erode the attractiveness of small and/or "B-rated" credits.

Concerns about individual job preservation also play a role. Both for the bank and the individual lender promoting a deal, the cost of making a bad decision far exceeds the upside of any additional loan revenue.

Thus many businesses, especially small ones, lack access to traditional lending sources. These companies may be credit-worthy and able to repay their loans, but they are not considered bankable because they have one or more of the following issues:

- Being in business for less than two, or sometimes three, years
- Operating in what some perceive as a volatile industry
- Generating losses and credit deterioration during the Great Recession.

Each of these factors has contributed to the emergence of alternative finance since the Great Recession.

Today, the improving economy, the need for working capital and term loans by potential borrowers viewed as non-bankable, and other conditions have resulted in an explosion in alternative lending. At least three additional elements have also been critical to its growth.

First involves the emergence of a vibrant "FinTech" group aimed at exploiting lending opportunities. FinTech is the term used to describe financial market strategy combined with the use of technology.

Second entails the increasing role of social media. Social media dramatically increases available information about a business or an individual. It also levels the playing field to an extent for different types of lenders, since borrowers and lessees are able to offer instant feedback to lenders and also communicate easily among themselves.

Third depends on the overall generational shift from Baby Boomers to Gen X-ers and Millennials, which is driving a new competitive environment in both personal and business banking. For example, a recent Viacom survey[i] found that 73% of Millennials "would be more excited about a new offering in financial services from Google, Amazon, Apple, PayPal or Square than from their own nationwide bank."

Indeed, most of the afore-named companies—along with other name-brand firms—have entered the alternative finance market, and their strategy is targeted and perhaps even brilliant: each leverages its unique ability to apply sophisticated data analytics and knowledge of customer cash flow to meet their customers' near-term financing needs.

As of early 2015, Baby Boomers continued to inhabit the C-suites of most traditional lenders, while younger leaders headed the majority of alternative lending firms. This may indicate younger executives' greater sensitivity to the needs and concerns of borrowers from their age group.

This study's focus centers on commercial lending. Much current commercial alternative finance focuses on micro- and small-business companies that range in revenue from near zero to $20 million annually. A Harvard Business School "Working Paper" published in mid-2014[ii] suggests the reason: there are a lot of these businesses. "Of America's 28.7 million small businesses, half are home-based and 23 million are sole proprietorships," the study reports. "The remaining 5.7 million small firms have employees and can be divided into Main Street mom-and-pop businesses, small- and medium-sized suppliers to large corporations, and high-growth startups."

Given the broad range of company sizes and requirements in the small-business category, amounts loaned via alternative finance can be as low as $1,000 and as high as $1 million or more. In fact, the loan sizes for many smaller businesses create issues for traditional lenders—in particular, banks.

One important reason results from the high cost of loan origination, whereby, an individual loan officer may screen, market to, and solicit a potential customer. The solicitation process alone can take months and must then be followed by document collection and analysis, performed by underwriters. Even if a bank uses credit-scoring for some loans, the customer usually has personal contact with a banker at least once in the loan- decision process. After approval, the loan must be closed and then monitored on a regular basis.

As a result, many banks have concluded that to cover the cost of this work, especially as it concerns new compliance and capital requirements, loans need to be in excess of $100,000. Some analysts argue that required loan amounts should be closer to $250,000, depending upon the degree to which internal bank processes are streamlined. If these numbers are correct, it should come as no surprise that increasingly, banks wish only to pursue small loans that are A-rated credits, cookie-cutter in nature, and able to be processed internally with as little customization as possible.

Yet, most of the 30 million or so small businesses with potential financing opportunities are “story credits,” requiring some degree of personal consideration. To date, alternative finance firms have tended to focus on these companies. But opportunities exist to move up market, and if alternative players seize this opportunity, the competitive threat will spread to traditional players now focusing on mid-sized borrowers. And mid-size borrowers typically come with multi-million dollar loan requirements and numerous fee-generating opportunities.

In interviews with one alternative finance firm currently offering small loans, the firm’s executive said it would be “easy” to move up in loan size. The amount and quality of middle-market borrower information and bureau data far surpasses what small businesses can provide, the executive said, allowing greater confidence in underwriting decisions. As a result, this player appears to be evaluating how to move into a space that traditional lenders want most to protect.

Six Key Characteristics

When considering how best to describe the alternative financing now occurring in commercial lending (which includes equipment finance), six key characteristics emerge. These are:

1. Dependence on Financial Technology (FinTech)
2. Emphasis on segmentation
3. Introduction of “new” operating models
4. Use of risk-based pricing
5. Emphasis on ease and convenience
6. Use of FinTech (not bank) culture

Dependence on Financial Technology: FinTech permeates alternative finance companies, driving their ability to compete. FinTech players combine sophisticated analytics, applied to origination, risk management and monitoring, with a technology-dependent origination and customer-service model.

In contrast, banks and other traditional players seem to be playing catch-up with technology. Many respond reactively instead of proactively to new initiatives, whether these involve the Remote Data Capture (RDC) trend of a few years ago, the push to mobile banking, or, currently, the use of Apple Pay.

Most alternative finance companies, on the other hand, develop their business concept and use of supportive and developmental technology at the same time. Technology, strategy, and execution are viewed as one. Consequently, the use of technology is neither an afterthought nor the main driver; it is part of the mechanism of the idea. As sidebars in this study and the comments of those interviewed make clear, traditional lenders—banks, in particular—have created an opening for new lenders to penetrate and gain market share due to traditional lenders’ withdrawal from the smaller loan market and in some cases, public perception of poor service. New entrants, meanwhile, say they’ve found that banks have alienated some customers due to lack of speed and poor overall responsiveness. These are all areas that a FinTech market strategy can address.

Alternative finance companies market extensively through the Internet, buying ads and using cookies and other technology that allows them to stay in front of potential borrowers. FinTech plays an even greater role in allowing these lenders to differentiate themselves by the speed and types of loan decisions they make.

Some powerful examples of alternative lenders' use of FinTech include the following:

- Kabbage: Seven-minute decision-making; accesses bank checking account and reviews years of checking history as part of the loan decision
- OnDeck: Assesses company cash flows in bank accounts; obtains daily principal repayments provided through direct bank-account access of the borrower's account
- Rapid Advance: Bases loan decisions on analysis of past credit-card receivables; receives payment from the merchant services company that handles the credit-card receivables
- Fundera: Screens loan applications and provides multiple loan options within minutes for borrowers to evaluate

Clearly, alternative finance would not exist or make a profit without FinTech.

Emphasis on Segmentation: While preparing a report for a previous Foundation study ("Rise of the Banks in Equipment Finance"), the authors of the current study found that the best-performing banks and independents operated with a clear segmentation strategy. Whether based on an industry focus (such as health care), a specific financing structure or other factors, we found that top performers limited their marketing activities, in effect choosing their customer targets. Such segmentation lowered the cost of origination, improved risk performance, reduced operating expenses, and often allowed for a rate premium based on the perceived value of expertise offered by the lender.

Alternative lenders also focus on segmentation. Rather than segment according to industry populations, however, alternative lenders segment according to needs. They might design websites targeted at specific dollar requirements, for example. Rigorous segmentation also occurs in business crowdfunding, a specific form of alternative finance. At least 10 of the crowdfunding sites discussed below focus on real estate lending. These crowdfunders might make direct real-estate investments, buy mortgages, or make peer-to-peer loans.

Other alternative lenders operate with credit underwriting manuals detailing specific criteria required for a loan. Criteria may include minimum revenues, time in business and type of industry. Exceptions to the rules are made infrequently, due to operating discipline and cost concerns. Alternative finance firms determine target markets based on their risk preferences and perceived opportunities, and they continue to operate in what is often a narrow but lucrative band.

Introduction of "new" operating models: The Small Business Administration provides a list of items a typical bank may require when considering a small business loan. These include information on the business owner's personal background, business plan, personal credit report and score, a business credit report and score, two or three years of financial statements and tax returns, bank statements, corporate legal documents, and information on collateral, as appropriate. The review process can take weeks or even months, with significant interaction between credit, documentation, the originating banker, and the potential borrower. In some cases, the process for a small business loan resembles that of a much more complex middle-market transaction.

To understand one of the main differences between alternative-finance firms and traditional lenders, contrast the time-consuming process described above with Kabbage's marketing pitch as summarized on its website: "Banks take weeks to decide if you qualify. Kabbage delivers funds in as few as seven minutes." The Kabbage site also features a video explaining how the loan process works and why it is so fast.[iii]

Clearly, the approach Kabbage uses to evaluate a loan request differs greatly from a typical bank's analysis. Instead of emphasizing tax returns and financial statements, Kabbage uses real-time analysis of a potential borrower's cash flow and transaction history from one or more of a number of services that small businesses use. These services include business checking accounts, Square, PayPal, QuickBooks, and other financial applications. In addition, Kabbage uses commercial bureaus, such as PayNet. Based on these and other analytics, Kabbage provides a working-capital line of credit of up to $100,000. Customer companies can then draw down on a daily basis and pay down the loan at any time without prepayment costs. Kabbage stresses these conveniences, since drawdowns can occur online and even via mobile applications.

While many banks suffer from product proliferation that overloads bankers with multiple loan products, Kabbage started as a one-trick pony. The firm offered working capital loans from $500 to $100,000 for a period not to exceed six months. Costs were and still are transparent, and are fully explained on the company's website: "no hidden fees, no weeks spent collecting documents, and no hassles."

Exhibit One

Kabbage vs. Traditional Bank

The Kabbage Difference

Kabbage	vs.	Traditional Business Loan*
100% online & automated; link existing business accounts and you are done	Application Requirements	Multi page loan documents, income statements, tax records and collateral
7 minutes	Time to Apply	Hours
Instant decision on the spot	Time to Decision	2 weeks or longer
Take as much as you want, when you want	Flexibility	One lump sum
Dedicated local Kabbage team provides live, personalized service 7 days a week	Customer Service	Call Center based Customer Service team, often outsourced

* Comparison is to a traditional installment loan, not a line of credit.

Comparisons have been obtained through publicly available sources. Individual response time or terms with another provider could be different than stated above.

Source: Kabbage, Inc.

Use of above-market and risk-based pricing: Along the spectrum of implementing risk-based pricing, independents and captives are well ahead of most banks. Particularly in this low-rate and relative slow-growth environment, banks find that other segments of the finance industry are cutting interest rates and fees to buy business. We see this tendency in a range of areas, including equipment finance, Commercial and Industrial, and SBA lending. While the risk models may point to certain higher spread rates, market realities push elsewhere, and usually those realities win.

Consider the dramatically different pricing approach now used by alternative lenders. An August 1, 2012 article by Ian Mount in *The New York Times* noted some of the rates charged by various alternative providers: "Purchase-order financing costs 4 to 5 percent monthly," the article said. Peer-to-peer loans, Mount said, can run "from less than 7 percent to more than 25 percent," depending on the borrower's credit.

The same article went on to discuss the experience of a Texas-based laundry service that took out a loan from On-Deck Capital, described in the piece as "a New York-based company that analyzes business performance data—cash flow, credit, even social media information—to review loan applications from small businesses." Once OnDeck grants a loan up to $150,000, "[it] is repaid through daily account withdrawals, much as a merchant cash advance works," the article continued. "The short-term loans, typically for three to 18 months, charge an annual rate of 18-26 percent."

Some merchant cash advance rates can be even higher, reaching 100 percent or more on a per annum basis. But most of these loans are paid off in a significantly shorter time with a much lower actual interest percentage. The MCA industry views applying an annual rate to a loan that pays off in a few months as being inaccurate, distorting the actual cost.

This simple, straightforward approach, akin to that used by an MCA, allows for speed and simplicity. It also results in higher-than-bank interest costs for the borrower. Kabbage provides a six-month line of credit based upon its analysis of company cash flow. Its website presents a $10,000 loan example, based on average Kabbage score and credit history. For a six-month loan, the total fee charged is $1,200 with Kabbage charging loan fees instead of calculating interest. Web site videos explain each aspect of the transaction, and the borrower has the option of emailing or calling with questions related to costs or other items.

The scarcity of bank funds for certain types of borrowers, the need for immediate cash to finance operating expenses or capital requirements, and the willingness of borrowers to go outside established channels all result in higher interest rates for alternative lenders. But alternative lenders need higher rates to pay their own costs of funding and origination. As one bank competitor commented, "[Alternative lenders] lend where the bank won't, and get paid to do so."

Sophisticated private equity groups or other institutional investors, investors in alternative finance tend to set high hurdles for returns, limiting their ability to cut rates even if they wanted to. But as alternative finance matures and more competitors enter the market, yields are likely to decline—and yet, probably not to the level of bank spreads.

Emphasis on ease and convenience: Years ago, a retail consultant completed an analysis in which he found that pedestrians actually speed up when they pass a bank. Most bank windows are uninviting and hung with closed blinds, making them appear less than welcoming. Add to this situation the Great Recession of 2008-2009 and the federal bailout of several very large banks, and it's clear that banks have an image problem yet to be reversed.

Alternative finance companies are taking advantage in several ways. Many are designing processes from the ground up that make the application process easy, limit application requirements, streamline approval time, and get funds to customers in a timeframe that most banks would envy. A growing number of customers are willing to pay a premium for such conveniences. In reviewing one merchant advance company's portfolio for a client engagement, we found that a significant number of the firm's borrowers were bank credit-worthy and could have lowered their costs by switching to a traditional lender. But the certainty of being able to obtain funds quickly and with what one borrower described as "no headaches" compensated for the higher costs.

Non-bank culture: Most floors of a bank building, whether occupied by relationship managers, product managers, or executives, resemble libraries. Carpeting and acoustic ceiling tiles cushion the noise, and employees often speak in hushed tones. The dress code is business formal, men suited up and women in dresses or pantsuits. Bankers sit in their offices, sometimes with doors closed, limiting group communication. Bank executives often claim corner spaces, obtaining the best views at the expense of separation from their employees.

Some banks even have strict rules linking office type and size to one's job title e.g., the more ceiling tiles in your office, the more successful you are. In these cases, senior executives are often grouped together on a floor, with limited access to other employees and a guard barring the way. Compensation is largely salary-based, with an upside tied to yearly performance and, often, the long-term stock performance of the bank.

Compare the above scenario with one found at the offices of almost any alternative lender. In these spaces, suits and ties have usually given way to shirttails and rolled sleeves. Employees work in open spaces, usually facing each other without barriers between them, except computers. Communication is constant and easy. Private rooms exist but are used sparingly, for conferences and group meetings. Baby Boomers are conspicuously absent and anyone over 40 seems old, since in this group, 20- and 30-year-olds dominate.

At traditional institutions, most bankers have had experience at other banks. At alternative finance firms employees have usually worked at various jobs, including those at banks, before shifting to the alternative world. One 35 year-old at a prominent alternative lender worked a few years at Wells Fargo, a year or two at Google, and another year at a startup before joining his present employer. He said his focus was on job quality and working in a continually challenging environment rather than job continuity. For employees like these, the real excitement and economic upside occurs when the company they work for becomes the next Square or PayPal and provides an opportunity to acquire serious wealth in a short period of time.

These sketches paint a relatively accurate picture of the outward contrasts between traditional bank lenders and alternative players. Bu external contrasts can also reveal internal mindsets. In part, as a result of the recent Recession, the intensified regulatory environment, and an older, more conservative employee base, bankers have little enthusiasm for challenging their set ways and taking on additional risk. Employees at alternative finance firms, in comparison, are younger and have little to lose in challenging established approaches. If anything, these men and women are inspired by such non-financial service challengers as Uber and Amazon—companies that have redefined entire industries and left competitors dead in their wake.

Clearly, the financial services industry operates with greater regulatory constraints than most retail businesses. Yet, employees at alternative finance firms say they feel energized by the opportunity to redefine a business they believe has lost touch with its customers and even its younger employees. Indeed, a "brain drain" may be underway at banks and other traditional lenders in which a significant group of younger, more aggressive, and creative employees make the shift to newer alternative finance companies.

How Big Is the Opportunity?

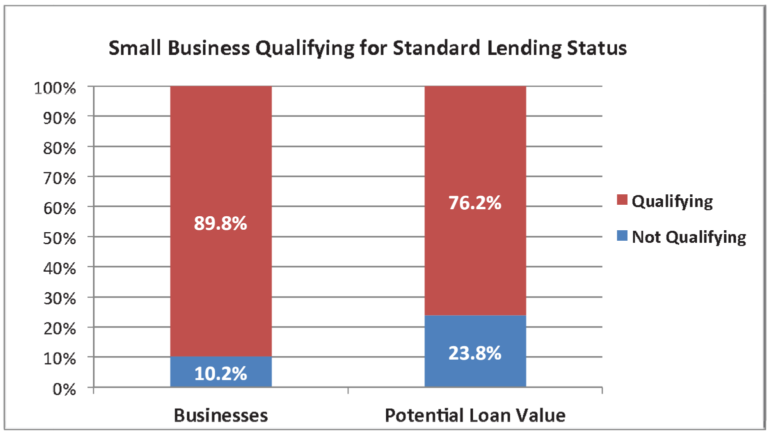
Quantifying the current market for alternative finance requires a fair amount of guesswork, estimation and adding various pieces together. Looking at specific business lines and businesses, we found that Merchant Cash Advance (MCA) executives indicate that they lend a total of $3 billion to $4 billion per year. Funding Circle, which describes itself as a peer-to-peer lender, expects to lend $100 million this year, while its competitor, Lending Club, says it has facilitated a total of $5 billion in loans, most of them to consumers. Since its inception, OnDeck, which operates with characteristics similar to an MCA, reports generating over $1.5 billion in business loans.

A recent Harvard Business School (HBS) working paper generally supports these figures, estimating that less than $10 billion in outstanding loan capital is traceable to alternative funding, "compared to a bank credit market that is 70 times that size." Certainly the potential alternative-funding market is worth billions of dollars and is growing each year. But as of early 2015, a historic analysis may not be feasible since at this stage alternative lending has reached only a fraction of its potential.

Examining the small-business space lending opportunity in general, however, we noted that Oxxford Information Management (Oxxford) has analyzed this space for almost 30 years, providing data analytics and market intelligence to a large number of top-tier financial services companies. When we asked to access Oxxford's database of over 200 sources as a way to glean their view of the size of the available market, Oxxford delivered some startling information. Exhibit Three, courtesy of Oxxford, estimates the number of small businesses that are bankable, as well as the likely dollar amount of potential loans.

Exhibit Two

Market Potential



Source: Oxxford Information Technology

Oxxford calculates that 36.1 million active businesses operate in the U.S. Most of them are home-based businesses with only one employee and little revenue. (Note that approximately six million firms have multiple employees.) Oxxford screened this group, using three criteria that many banks also apply to their lending: companies with sales volume of $250,000 to $10 million, companies in operation at least three years, and companies with an average or above-average credit score. Based on these criteria, Oxxford found that only 10.2% of U.S. businesses would qualify for what they term "standard lending status" from a bank or non-bank entity. That 10% translates into less than 24% of the available loan volume from the universe of customers.

The following chart (Exhibit Three) summarizes the loan opportunity.

Exhibit Three

Bank Approvable and Non-Approvable Business

Category	Number of Businesses (Millions)	Potential Dollar Loan Value (Billions)	Percentage of Businesses	Percentage of Value
Qualified for bank lending	3.7	$544	10.2%	23.8%
Non Qualified	32.4	$1,745	89.8%	76.2%
Total	36.1	$2,289	100.0%	100.0%

Source: Oxxford Information Technology

The vast majority of businesses, close to 90%, fail to make the initial bank screen. The reasons include the very small size of some companies, their often-volatile credit history, and the cost structure of lending to them. But consider the loan potential that these firms offer. Oxxford estimates that the firms, banks and other traditional lenders would consider "unqualified for standard lending" have a potential loan value of $1.7 trillion dollars. This compares to $544 billion of bank-qualified lending, a portion of which involves equipment financing. The upshot: Banks choose to ignore more than three times the loan potential that they focus on. Although there are credit, regulatory, and capital reasons for doing so, this approach nonetheless lowers bank returns (too many banks fishing in the same pond) and to some degree, even limits economic expansion as creditworthy but unbankable customers fail to receive funding.

In 2013, the FDIC listed about 13 million businesses with outstanding small-business loans. But most of these businesses had credit card debt and not standard bank loans. The value of the traditional small business loans shown by the FDIC was about $500 million.

In order to identify, sell to, underwrite, and close transactions with some portion of the 32.4 million "unqualified" borrowers, lenders have to develop non-traditional marketing means and operate with highly efficient processes. They also must underwrite loans with approaches that might make banks and similar players uncomfortable, due to a combination of internal culture, lack of knowledge, and skepticism.

Thus, traditional commercial lenders give much of their growth potential and earning opportunity to others, most of them startup companies that leverage technology across their business systems. Few other industries would be satisfied to sell their most profitable product to only 10% of the market. But banks, encumbered by tradition and regulation, may be unable to move beyond that number. The situation opens an enormous, long-term, and sustainable opportunity for new market entrants.

Crowdfunding: The Birth of a Movement

To the extent that the man on the street thinks about alternative funding, he is likely focused on what is commonly termed "crowdfunding." Crowdfunding is a way for an average individual to support both not-for-profit and entrepreneurial endeavors. As defined in a 2013 World Bank study[iv], "Crowdfunding is an Internet-enabled way for businesses to raise money in the form of either donations or investments from multiple individuals [or institutions]."

This new form of capital formation emerged in an organized way in the wake of the Great Recession, largely because of the difficulties faced by artisans, entrepreneurs and early-stage enterprises in raising funds. With traditional banks less willing to lend, entrepreneurs began looking elsewhere for capital. The World Bank study notes that crowdfunding has quickly transitioned from a reliance on friends and family to "take advantage of crowd-based decision-making." In that same vein, a 2014 *Economist* essay[v] suggested the growing competitive pressure on traditional players from peer-to-peer lending: "By offering both borrowers and lenders a better deal, websites that put the two together are challenging retail banks."

Because of the dollars involved and the sophistication required, however, crowdfunding may now be less significant in commercial lending than in the consumer space. Even so, some changes that affect commercial lending activities are now in process. In addition, the proliferation of crowdfunding sites and the relative ease of setting them up means that many will fail to find sufficient interest and disappear. Nonetheless, crowdfunding serves as a foundation step for alternative finance and as an appropriate starting place for understanding the development of alternative finance in general.

Reliable statistics are always difficult to find for a new and unregulated market like crowdfunding, but there is no doubt that this activity represents a large and growing business. *Forbes*[vi] estimates that worldwide crowdfunding grew to over $5.1 billion in 2013. And while the number of crowdfunding platforms has probably increased since 2012, at that time, the U.S. reportedly had 191 such platforms, well ahead of the UK's 44.

Crowdfunding is not homogeneous. Different businesses vary significantly in their purpose, the type of investors they attract, and the platform that brings investors and projects together. Four major types of crowdfunding websites operate today, ranging from the not-for-profit and unsophisticated to highly sophisticated, profit-focused endeavors backed by detailed analytics. These four types are as follows:

1. **Reward-based crowdfunding.** Typical reward-based crowdfunding involves an individual who makes a donation to support an artistic project or a charitable cause. Kickstarter (**www.kickstarter.com**), formed in 2009, is the most popular and best-known donation-based crowdfunding site, funding almost 20,000 projects in 2013. Roughly 40% of these loans requested averaged of $5,000. Kickstarter focuses on funding creative and project-based campaigns over a 30-60 day period with an all-or-nothing funding approach. Its projects must fit into one of the following categories, as listed on its website: art, comics, crafts, dance, design, fashion, film and video, food, games, journalism, music, photography, publishing, technology, or theater. Kickstarter charges a 5% fee for successful projects.

   An example: A "staff pick" in the technology section of Kickstarter's website features "elemoon: wearable technology that expresses your unique style … elemoon [a bracelet] changes color to match your outfit, alerts important calls/texts & helps you find your phone. Fashion + wearables!"

   As of late September, this project, seeking $100,000, was oversubscribed and fully funded. Pledges ranged from $1 to more than $10,000. The 41 backers who pledged $1 receive a "BIG thank you" on the company's website. The three backers who provided in excess of $10,000 each are to receive, among other items, according to the website, a "One-Of-A-Kind customer bracelet special with precious gems and stones, along with a custom jewelry box to store it in."

   The wide range of monetary amounts and rewards typifies Kickstarter and similar sites. A small donation for a movie project may merit being listed in the credits, while a major payment could land the donor a role in the movie. Money provided typically results in some kind of thank you, not in a financial return.

2. **Donation-based crowdfunding.** These businesses, such as Indiegogo, operate with less restrictive guidelines and allow requests for charities, personal trips, and just about anything else. Unlike Kickstarter, no application or screening process exists, and Indiegogo allows both reward-based and donation-based funding. On its site, projects can vary from funding a new wireless speaker (one of which a high-dollar contributor will receive) to funding a campaign to "Elect Robert-Falcon Ouillette Mayor of Winnipeg." In the latter case, the only benefit may be the funding of campaign signage.

   Community crowdfunding programs tend to involve charities that, for example, provide solar power to an orphanage in India. A $10,000 contribution results in an original song being sung to the donor by children who reside at the orphanage. In fact, much donation-based financing focuses on third-world and infrastructure projects. Beyond charity, for example, the World Bank and others promote crowdfunding as an approach that can support entrepreneurialism in the third-world and potentially allow nations to overcome reliance on the legacy funding systems of the established world.

3. **Lending-based crowdfunding.** This type of crowdfunding matches lenders with borrowers who are looking to fund projects or refinance debt. Initially, much of the focus was on paying back high-interest credit-card debt with reduced-rate, peer-to-peer debt. The borrower's cost savings on a credit card could be 10% or more per annum, while the lender received an interest rate multiple times above what banks offer. Of course, such investments carry much greater risk, with the lender receiving a specific return for making a loan whose timeframe may range from several months to several years. The crowdfunders Prosper (**www.prosper.com**) and Lending Club (**www.lendingclub.com**) have established themselves as leaders in this area. Prosper remains focused on the consumer space, while Lending Club has expanded its focus to small-business lending. Even within Lending Club's consumer site, borrowers sometimes mention that they are funding a business equipment purchase with their loan.

More recently, Lending Club has begun offering a formal platform for small-business lending that allows businesses to disintermediate traditional lenders by directly linking borrowers and lenders. The company screens both individual and business borrowers for their creditworthiness and prices their loan offerings, based on an assigned risk rating. Lending Club states that it bases rates and fees on five elements:

- Creditworthiness of the business
- Creditworthiness of the guarantor
- Chosen loan term length
- Time in business, and
- Analysis of the company's financial strength.

For business loans up to $100,000, Lending Club's rates range from 5.9% to 29.9%, with origination fees of from 1% to 6%. Borrowers can choose to apply for loan terms of from one year to five years, with fixed monthly payments.

In the real-estate arena, at least 10 crowdfunding sites now operate with loans above $1 million. Realty Mogul (**www.realtymogul.com**) describes itself as "a marketplace for accredited investors to pool money online and buy shares of pre-vetted investment properties." Investors can browse and screen real-estate investments, view details of an investment and sign legal documents online, according to information on the entity's website. The minimum investment required is $5,000, with investors becoming part of a passive investor pool. But investors must be "accredited," or have sufficient net worth to participate in a higher-risk venture.

Among recently closed transactions listed on Realty Mogul's website are a $1.6-million loan for the equity purchase of a Hard Rock Hotel in Palm Springs, California (15-17% IRR), and a $1.1-million equity purchase of an office building in Washington, D.C. (15-16% IRR). An illustration of how crowdfunding has matured in size is the minimum investment for one project at $40,000. While structured as loans, these transactions involve equity risks and generate equity-like returns.

4. **Equity-based crowdfunding.** Equity-based crowdfunding is an area of emerging interest. In exchange for their money put at risk, investors receive a stake in the company being funded. In 2012, Congress passed the Jumpstart Our Business Startups Act, or JOBS Act, which contains a provision increasing the number of investors allowed in a private company from 500 to 2,000. But another long-delayed provision that could go into effect in 2015 could have even more impact. Currently, private companies can solicit only accredited individuals, or those investors with considerable income and net worth. But under this provision of the JOBS Act, small companies will be able to raise up to $1 million online in crowdfunding from average investors and provide them with an equity piece of the company.

One recent event indirectly promoting equity crowdfunding involves a Kickstarter-financed company, Oculus Rift. Oculus Rift makes virtual-reality headsets for 3D gaming (**https://www.kickstarter.com/projects/1523379957/oculus-rift-step-into-the-game**). Using crowdfunding, Oculus Rift raised over $2 million from 9,500 investors. Those who pledged $15 or more received a limited-edition poster, while the seven contributors who gave $5,000 or more each received various items plus a trip to the company for "a day hanging out with the team and checking out all of our latest work." What they did not receive was equity in the company.

On March 25, 2014, *Business Insider* reported that Facebook was buying Oculus in a deal whose price could exceed $2 billion. Apparently, Facebook's valuation of Oculus extends beyond gaming to include other uses, including educational and medical. Some Kickstarter contributors used social media to express their displeasure, both at the swallowing up of the company by Facebook, and at their own lack of equity upside, despite their early support.

The JOBS Act passed two years ago. But an April 30, 2014 article by Ruth Simon and Angus Loten in *The Wall Street Journal* reports that the SEC is still "hashing out final rules allowing companies to sell equity stakes in businesses to everyday investors through social media and the Internet." The law gave the SEC just 270 days to finalize its crowdfunding rules (by January 3, 2013). But over 1,000 days have already elapsed without more explicit regulation. Some view the SEC as dragging its feet because of concerns about protecting small and perhaps unsophisticated investors from unscrupulous schemes. Final rules have yet to be published.

SEC rules notwithstanding, several states have moved ahead with their own laws and regulations to allow crowdfunding. This approach is favored by the North American Securities Administrators Association (NYSSA)[vii]. Nearly 10 states have enacted or are in the process of enacting rules, while two more have abandoned legislation. As reported in *Deal.com*, the NYSAA "called for crowdfunding portals to be required to pre-screen each investor; for investors making up to $100,000 a year to [be allowed to] invest up to $4,000; and for investors making more than $100,000 to [be allowed to] invest up to 8% of their income." Concerns exist that the SEC's rules will be too restrictive, with costly requirements related to the use of broker-dealers, lawyers, and accountants. One analyst es- timated that a $1-million transaction could require up to $250,000 in fees and related expenses—a very high cost indeed for raising capital.

While smaller investors await rules to guide their activities, new crowdfunding websites are moving ahead, offering equity interests in companies for accredited investors who commit as little as $1,000. As of late 2014, a crowdfunding site called Circleup (**www.circleup.com**) was offering investment opportunities in almost 60 companies, ranging from apparel firms to sporting goods manufacturers, with transactions that included equipment financing. Many of the companies featured were start-ups, with several generating revenues above $1 million.

One example: Pilates ProWorks, with 2013 revenues of almost $2 million, and headed by a team of self-described "serial successful entrepreneurs." Company information says it wants to raise $1 million, but the ultimate goal seems clear in that the offering write-up lists potential acquirers, including Equinox and LA Fitness, among others. A link on the summary transaction description page provides access to a deal room that offers financial details about the company, as well as a recorded conference call and a term sheet.

Circleup seems to be trying to make the investment process as convenient and transparent as possible. It removes the middleman from equity investments for those with the sophistication and/or self-confidence to move forward without a costly intermediary.

Crowdfunding and Equipment Finance: Recent years have seen crowdfunding move from an emphasis on funding personal projects to funding major commercial projects, including those in high tech. Multi-million dollar projects are now being funded through crowdfunding, and more sophisticated transactions are available, albeit primarily only to accredited lenders. To our knowledge, no equipment finance-targeted crowdfunding site operates today. But loans made by Lending Club and others may be used to finance equipment purchases.

Bank-owned equipment finance companies and captives seem unlikely candidates to use crowdfunding. Banks already have a funding advantage, and captives often receive subsidized funding to fulfill their mission supporting equipment sales. But independent equipment finance companies, whether established players or startups, might find crowdfunding attractive for two reasons. In some cases, setting up a crowdfunding platform to offer borrowers working capital could be an attractive and more flexible approach than the cost and time required to obtain bank debt. And as with certain other business websites, loans could be provided for specific transactions, with the lender secured by the asset being financed. The crowdfunding operating model might then shift to one that is fee-based and does not rely on net interest margins.

Whether under the JOBS Act or by attracting accredited investors, independent firms may be able to attract equity investors to crowdfunding based on their past performance, market strategy, and leadership teams. And, depending on structure, the resulting cost of capital could be competitive. While the focus of accredited crowdfunding investors currently appears to center primarily on commercial real estate and lifestyle companies, there is no reason a FinTech-based equipment finance firm or other lender could not exploit this platform.

As with other types of alternative finance, crowdfunding remains dynamic and under development. Going forward, the four types of crowdfunding will probably combine and adapt to provide borrowers added flexibility and lenders varied risk and return structures.

At this reading, crowdfunding may still seem largely irrelevant to the equipment finance industry. But it could be an opportunity for new entrants to partially redefine the equipment finance operating model, and for current players to experiment with new approaches to funding and investor awareness. Since financial services firms usually find that relationship profitability and account retention increase with multiple product sales, crowdfunding might play a role in increasing customer wallet share still further.

Ten Factors Fueling Alternative Finance

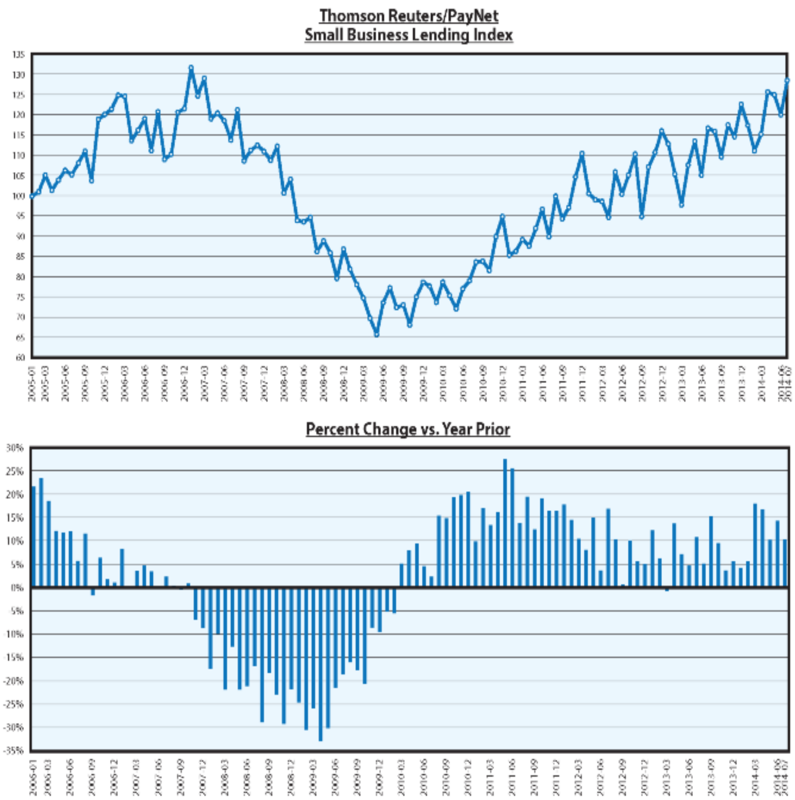
Nearly a dozen factors have fed the development of alternative finance and, while not quite a “perfect storm,” many of them have combined to create a major growth opportunity for new lenders. The factors are discussed below:

1. Limited bank appetite for small-business lending despite these borrowers’ immediate needs
2. Alienation of customers
3. Poor image of traditional lenders
4. Strong non-bank brands
5. A low interest rate environment causing investors to look for higher returns
6. The shift in demographics from Baby Boomers to Millennials
7. Role of social media
8. Stable-/slow-growth economy
9. The value of data analytics
10. The rise of Financial Technology (FinTech)

1. **Limited bank appetite for small business lending:** Recent PayNet data[viii] suggest that levels of small business lending have nearly returned to their highs of 2006-2007 (Exhibit 5). Greater lending activity significantly contributes to the success of small businesses, since these firms may need immediate funds to manage cash-flow requirements or take advantage of expansion opportunities. Often operating with limited capital to begin with, small businesses need lender support to survive rough times and expand during growth periods. But some banks are downplaying this segment, partly due to the high cost of managing small loans throughout the life cycle, from origination to underwriting, closing and monitoring. Compliance costs have also substantially increased.

Exhibit Four

Thomson Reuters/PayNet Small Business Lending Index



While overall loan numbers may be up, approval rates from various lenders differ dramatically. Many banks advertise that they want to lend and, in particular, that small businesses are a high priority. But in reality, lending profitably to this segment is increasingly difficult, with some bankers putting greater emphasis on the middle market in light of poor returns stemming from loans to the small-business segment.

As noted earlier, banks have found that loans of less than $100,000 require such a high level of fixed costs that these loans usually lose money. To that end, one prominent Midwestern bank markets to small businesses primarily for their deposit business, avoiding the offering of loans as much as possible. This bank sees small businesses as a source of funds for middle-market loans. Conversations with executives at the bank indicate that management finds the $250,000-and-above loan levels to be a more attractive area of focus. Ironically, increasing numbers of banks are seeking out alternative lenders and evaluating the applicability of their efficient operating platforms to address small-loan requirements.

This is because acceptable-return small-business lending relies significantly on high technology for origination as well as underwriting. To maximize returns, applications are shortened and internal approval processes are streamlined, with exceptions to policies and procedures kept to a minimum. To achieve acceptable returns in this arena, banks need to create a “loan factory” that operates with as little friction as possible to generate strong returns. In truth, low-dollar commercial lending is often a loss leader for banks, with deposits and other products subsidizing lending activity. In a low interest-rate environment and one in which growth is slow at best, this practice is rarely efficient enough to pass required hurdle rates.

Biz2Credit is a small-business marketplace that primarily works with bank lenders. The company publishes a monthly index summarizing approval rates for its borrowers, versus approval rates for other lenders. For the month of August 2014, the company analyzed a total of 1,000 Biz2Credit customer applications. The applications approved by bigger banks reached their highest level over the prior year, but represented only 20.4% of customers. That percentage contrasts with a 62.7% approval rating for Biz2Credit customers by alternative lenders, a slightly lower percentage from one year previously.

Given the type of companies applying on Biz2Credit's website and others that are similar, the percentage of loans approved by big banks is unlikely to rise much higher. Even in our client work, we frequently see bank approval rates no higher than 40%, indicating high origination costs as banks sift through multiple leads to close a single deal. Many traditional lenders continue to operate within a credit box narrowed and confined as a result of the events of 2007 and later.

2. **Alienated customers:** During the recession, news stories seemed to appear daily recounting how one big bank or another recalled a small-business loan and abandoned a struggling owner. Years later, news stories continue to highlight the unwillingness of banks to lend to small businesses. One 2012 *Forbes* article bore this title: "The 5 Big Banks that Reject the Most Small Business Loans." As late as August 2014, an Associated Press story carried this headline: "Rejected and dejected: woman small business owners still struggle to get loans from banks."

   Bank rejections and accompanying bad publicity has made some customers negative about the reliability of banks and opened them to alternative lenders. This is particularly true of women, Hispanics, and younger business owners. One senior banker expressed a concern that perhaps more in the traditional lending industry should consider: "Once these customers leave us," the banker said, "they are never coming back."

3. **Poor bank image:** The title of an article published August 28, 2013 in *The Los Angeles Times* summarizes a major challenge banks face as they compete against new market entrants and try to retain the loyalty of their customer base. "Banking industry's reputation is nearly as bad as that of Congress," the headline announced. The article, written by E. Scott Reckard, summarized results of a 2013 survey by the Reputation Institute, commenting, "banking has a worse reputation than Big Pharma, news outlets, oil companies, and telecommunications firms—though not as bad as Congress."

   In recent years, banks have been treated as piñatas, both by the press and by regulators. The federal bail-out, the much-publicized limitation on small-business lending at many banks, and continued fines meted out to the biggest banks have harmed not only the reputation of the banks in question, but other, high-profile competitors. Even community banks, operating far away from Wall Street, are often lumped together in customers' minds with major-bracket investment banks.

4. **Strong non-bank brands:** While many banks suffer from poor PR, high tech-oriented lending firms enjoy positive reputations. Amazon, PayPal, and Square have all demonstrated their ability to innovate while providing excellent customer service. Their "insider" knowledge of their customers' cash flow and funding requirements provides them with a strong competitive advantage. This, when combined with a positive image and customer loyalty, results in these companies and others like them exploiting the opportunity to finance their customers, in effect disintermediating and preempting the banking industry. In short, these new lenders solicit funding opportunities before banks have an opportunity to do so.

Case example: Amazon

CFO Magazine summarized the Amazon offer in a September 2013 article (http://ww2.cfo.com/credit/2013/10/else-lending-try-amazon-com/): "For the past year, under a program from Amazon Lending/Amazon Capital Services, Amazon has sent letters to its biggest and best merchant partners to offer them pre-qualified loans to boost working capital," the piece reported. "Amazon's interest rates are lower than what credit cards offer, and the funds clear faster than a bank's. The monthly loan payment is automatically deducted from the merchant's Amazon Seller Account and the merchant is required to use the capital to increase sales through Amazon, not other online channels," the article continued.

The article went on to discuss ways Amazon leverages its unique knowledge about its merchants: "Since Amazon moves merchandise for these e-commerce vendors, it has information about what products are being bought, shipped and even returned, as well as stats on payment trends," *CFO Magazine* said. "These analytic insights are beyond what traditional lenders can obtain. In addition, Amazon controls the payment flow: in effect, they get paid before the merchant, further limiting their risk. Importantly, Amazon requires that the funds offered must be used to increase Amazon's *own* business. Thus, merchants concerned about meeting the needs of "Black Friday" and the Holiday season may view obtaining funding from Amazon as a hassle-free cash-flow tool.

Case example: PayPal

Unlike Amazon, PayPal is not a sales site. Owned by eBay, it is an Internet-based payment-processing service, charging a fee for payments made. Wikipedia reports that PayPal now operates in 203 markets and has 148 million active accounts.

According to its own website (https://www.paypal.com/webapps/workingcapital/tour), PayPal charges a "single, fixed fee" rather than an interest rate. As with Amazon, PayPal takes payments directly from the merchant's account. "Repayment is simply a share of your PayPal sales that you choose," the website says. "There are no due dates. You pay only when you have sales, and payments happen automatically."

While Amazon and PayPal both have access to their merchants' accounts, they can still lose money if sales dry up. PayPal limits that risk by lending no more than 8% of a vendor's annual PayPal sales. The example on PayPal's website shows a vendor with $100,000 in annual sales borrowing $8,000. The vendor choses the portion of daily sales (ranging from 10% to 30%) that will be paid to PayPal to cover principal and fees. A 10% portion results in loan fees of $949, while a 30% daily payment portion costs just $294. Exhibit Six presents PayPal's comparative chart of their service versus more traditional offers. Note that no cost comparison exists, but that the page stresses convenience and speed. The APR for the PayPal offer is difficult to determine unless one knows how long the loan will be outstanding.

Exhibit Five

PayPal's Comparison of PPWC to Other Choices

PayPal | Working Capital | Tour | Case Study | FAQs | Contact Us

Working Capital Tour

1. Overview | 2. Pricing | 3. On Your Side | **4. Compare** | 5. Get My Offer

The PayPal difference

PayPal Working Capital is different from other kinds of lending — here's how.

PayPal already knows your business, so applying is easy:

- No long forms to complete
- No personal guarantee (PG)
- No credit check, so using PayPal Working Capital won't affect your personal or your business credit scores

	PayPal Working Capital	Credit Card	Traditional Bank Loan
Application time:	5 minutes	20 minutes	Hours
Total funding time:	< 1 minute	1 week	1 week
Payments only after you have sales:	✓	✕ Monthly billing	✕ Monthly billing
Single, fixed fee:	✓	✕ Financing fees Annual fees Late fees	✕ Origination fees Utilization fees Late fees
Periodic interest:	None	Yes	Yes
Credit check:	No	Yes	Yes
Personal Guarantee (PG):	No	Yes	Yes
Pre-payment penalty:	No	No	Yes

Source: PayPal competitive analysis, based on common industry practices

Source: PayPal, https://www.paypal.com/webapps/workingcapital/tour#4

Two other big-name players are also worth mentioning.

Square Capital: Square, Inc. operates primarily as a mobile payment company. It is best known for "Square Reader," a plastic device that attaches to a smartphone and reads a card's magnetic stripe, easing the payments process. Square Capital (**www.squareup.com**), its financing business, lends money to customers based on their processing volume and history. Eligible customers automatically see a funding option on their dashboards and receive an invitation to borrow. The Square Capital website provides several borrowing options. One is a $4,000 loan, whereby the borrower repays $4,500 at the rate of 4% of card sales. The largest option is a loan of up to $10,000, which requires an $11,000 repayment and 10% of card sales until the loan is repaid. No other fees apply, allowing the company to stress its streamlined and simple process.

First Data Merchant Cash Advance Program: A more recent entrant now ramping up is First Data, a credit-card processor. This company works with millions of merchant customers both in the U.S. and worldwide, and is now selectively offering merchant cash advances (MCAs)[ix].

First Data's merchant knowledge allows the company to require only a one-page application and to fund some accounts within hours. Trying to differentiate itself from other MCAs, First Data emphasizes the value of its existing customer relationships. "Only First Data can access your existing processing history documentation, streamlining the application process considerably," information on the firm's website says. "We value the overall relationship with our merchants, providing a much more convenient, user-friendly experience."

Amazon, PayPal, Square, and First Data are all exploiting unique knowledge of their customers and the relationships they have developed with them. At these firms, financing complements core activities, with management perceiving lending as a value-added that will increase loyalty and drive more income to the bottom line.

5. **Low interest-rate environment causing investors to look for higher returns:** As the proliferation of new market entrants indicates, investment dollars are readily available for alternative finance concepts. One interviewee at an alternative lender explained: “Investors are looking at spreads, at margins. There are not a lot of strong returns available out there. Alternative finance generates great yields. Investors are going where the returns are. With interest rate levels likely to remain low for as long as the next few years, additional investment dollars will continue to be available. Said another insider interviewed for this report, “Banks and investors want to be involved in this space.” And while banks won’t lend directly to the alternative finance customer base, they will lend to merchant advance companies and others that serve this segment. Doing so allows them to capture some of the attractive return that MCAs generate, in their view, with lower risk.

6. **The shift in demographics from Baby Boomers to Millennials:** Those of a certain age may remember entering a bank branch and being impressed by its high ceilings and the hushed tones of those working there. The grandness was meant to convey the dignity and strength of the banking institution and impress and perhaps intimidate those who entered. Today, many of those magnificent buildings have been turned into catering halls or condominiums. Bank design today emphasizes functionality and accessibility, with many trying to emulate Apple stores. Unlike Apple stores, however, many bank branches remain quiet—not due to intimidation, but due to reduced traffic.

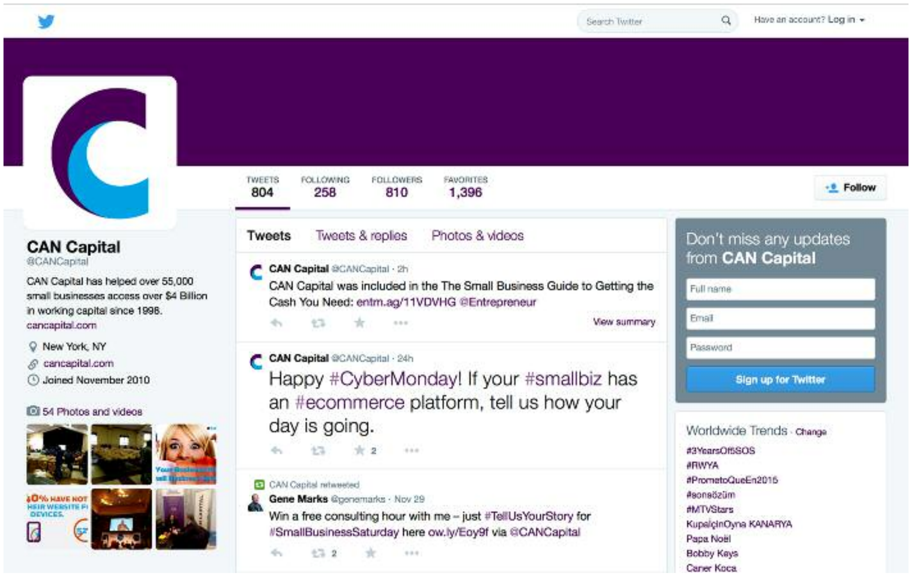
   In the U.S., the banking industry grew with the Baby Boomers and banks’ willingness to meet the borrowing needs of that group. Now, however, as Baby Boomers retire and become less active, Gen X and Millennial customers are becoming critical to banks and other traditional lenders. Many of these customers have left the banking grid or view banking as just one choice for making payments, getting loans, or investing funds. Yet, many banks continue to be managed by Baby Boomers, many of whom seem more focused on job security than innovation. Operating in a risk management culture for decades, these Boomers have little appreciation for what drives younger and more independent customers. This attitude creates an opening for alternative players, many of which are led by younger personnel who have more in common with the Millennial business owners they are trying to entice. Many equipment leasing groups are also headed by Baby Boomers. But equipment finance companies have long operated in an environment in which they must adapt to change or die. These companies and their leaders may therefore be better positioned than other traditional lenders to address the needs of this demographic shift.

7. **Role of social media:** “Social Networks are Driving More Online Sales and Influencing Offline Purchases,” a headline in the September, 2014 *Business Insider* announced. What the article terms “social commerce” impacts not only the purchase of a product but, more basically, the research and investigation activity related to a product’s purchase and value. At its core, alternative finance relies on transparency of communication and the ability to trade opinions about the quality of service provided, which social media strongly encourages.

   For alternative finance companies, sites like LinkedIn and Twitter are essential. They provide ways to describe companies and make them appealing to potential borrowers. Social media sites can position companies as caring and effective, instead of distant and difficult to deal with. Can Capital, a major merchant advance company (see Exhibit Seven), has a Twitter page that may not have many followers (just 720 as of mid-September), but which fosters an image of professionalism and active involvement in meeting the needs of diverse borrowers—including the restaurant industry, which is often excluded by conventional lenders.

Exhibit Six:

Can Capital on Twitter



Source: CAN Capital, https://twitter.com/CANCapital.

Online users can express their opinions about companies on sites like Yelp. As of mid-September last year OnDeck had seven comments on Yelp. The three most recent reviews for OnDeck were five-stars. Reviews from May and January, 2014 have only one star, or, in one case, three stars.

In several instances Noah Breslow, CEO of OnDeck, personally addressed customer concerns while highlighting the statistic that 93% of his customers would recommend the company. “We’re sorry to hear you were disappointed with your experience with us,” he wrote to one customer. “Are you available to discuss your experience with us further offline? We will send you a private message with our contact details.”

CEOs of banks seldom send private messages to their complaining customers, distinguishing OnDeck from traditional competitors. OnDeck also publishes a blog and presents reviews of its services on its own website. As of this writing, OnDeck’s website listed 96 reviews and an overall rating of 9.6 on a 10-point scale. The reviewscome through TrustPilot, an independent website and comment aggregator.

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8. **Stable-/slow-growth economy:** While many observers express concern about the speed and trajectory of our nation’s recovery from the Great Recession, no doubt exists that we have returned to a stable and, at minimum, slow-growth environment. This has resulted in increased investment by small businesses as well as other companies.

   Specifically, the Thomson Reuters/PayNet Small Business Lending Index shows strong increases in 2014, suggesting that to some degree companies are going beyond equipment replacement to invest in expansion. In addition, delinquencies have remained low, and at many banks continue to improve. This further encourages new lenders and investors to enter a market that they see as growing and underserved. Improving delinquency numbers and the loss-provision reversals by many banks further bolsters the view of private equity investors, as well as crowdfunders, that their acting as bank lenders is prudent and likely to result in strong returns. Time will tell.

9. **The value of data analytics:** "The Economic Value of Data," a 2013 report published by the Bank Administration Institute (BAI), discusses requirements for the retail banking head of today and the future. Historically, such a leader was required to possess strong sales management capabilities. Today, however, the report says the focus is greater on one's ability to manage data and evaluate it to generate priorities for bank action. Alas, financial services firms are awash in data, but relatively few lenders apply it to commercial lending in effective and targeted ways.

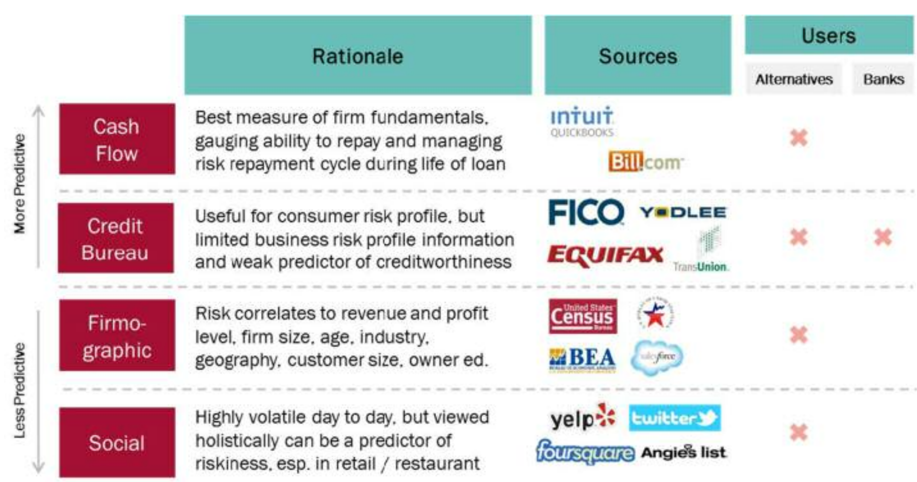
   In contrast, alternative finance companies depend on their ability to collect, absorb, analyze, and develop the implications of data they capture from various sources. Multiple examples of the critical importance of data and related analytics to alternative players exist, such as these:

   - Lending Club has developed a proprietary model to assess and assign risk ratings to its borrowers
   - Funding Circle emphasizes that it has combined "cutting-edge technology with industry-leading risk management models"
   - One private equity-owned direct lender says it has built interfaces to a dozen data sources and developed an automated decision engine that assigns risk-based pricing

   Obviously, banks, particularly those in the retail space, collect and evaluate data. But at alternative finance firms, analytics are a basic part of the playbook. In their *Harvard Business School* working paper, "The State of Small Business Lending," as Exhibit Seven illustrates, Karen Gordon Mills and Braden McCarthy effectively summarize the traditional and nontraditional, and the quantitative and non-quantitative, information that online lenders are accessing as part of their analytic process.

Exhibit Seven

Multiple Data Sources for Online Lending



Source: Harvard Business School

10. **The rise of Financial Technology (FinTech):** Although we have saved it for last, this factor could well become the most important stimulator of growth in alternative finance. *Hot Topics*[x], a technology-focused website, defines FinTech as a term "usually applied to the segment of the technology start-up scene that is disrupting [other] sectors, such as mobile payments, money transfers, loans, fundraising and even asset management." The power of FinTech rests in part on the fact that "FinTech firms can pass on huge savings, as they are far more agile than traditional banks," Hot Topics says. FinTech firms" do not have the same overheads and commitment banks are blessed (and burdened) with," the website continues. "Their relative lack of size also allows them to innovate and adapt in a way bigger corporations can only dream of." The article goes on to cite an Accenture report estimating that global FinTech investment hit $3 billion in 2013, up from $930 million in 2008.

    FinTech enables providers to compete while raising the expectations of an increasingly smart-phone-addicted customer base. Alternative lending products could not exist without FinTech due to their reliance on technology for originating and underwriting cost effectively. At the same time, alternative-lending customers would not exist without FinTech, due to their access to product offerings, leveraged by technology.

    This report discusses challenges that alternative finance companies face, but the factors contributing to the growth of this industry make increased expansion highly likely. Alternative finance, in one form or another, is here to stay.

Characterizing Alternative-Finance Segments

Consultants prefer to provide business descriptions that they consider "MECE" (mutually exclusive and collectively exhaustive), with all characteristics fitting into discrete boxes. But alternative finance doesn't allow for such neatness, since overlap occurs between categories, and lenders, investors, and perhaps even borrowers can operate in more than one space.

Allowing for these flexibilities, however, we can say that alternative finance operates in four major segments, based on points on the risk spectrum at which lenders wish to play and on a relationship and retention focus. These four segments are as follows:

Near Prime: Near prime is almost but not quite "bankable." SBA loans, for example, are just a step away from being fully bankable, with many banks relying on the federal government's guarantee to make a loan that would not survive banks' usual underwriting process. SmartBiz aims to work with banks to improve their productivity and returns for SBA loans, a product many banks view as complex and onerous. Live Oak specializes in SBA lending to targeted industry segments.

Equipment finance-oriented firms like Funding Circle are part of the near-prime space, with customer groups such as medical practitioners, which banks would lend to. But speed and convenience allow Funding Circle to compete—and to charge rates of from 7.99% to 24.99%.

Mid Prime: Mid Prime can be interpreted as heading toward bankability. Mid-Prime loans might be made to service companies without sufficient collateral for security, or to firms with a sketchy past-profits history. Peer-to-peer lenders may work in this space as well as in the Near-Prime arena. A firm like OnDeck, with its emphasis on evaluating company cash flow, would also have a focus in this credit tier.

Sub Prime: The Sub-Prime segment depends fully on risk-taking lenders. MCA lending orients itself toward subprime borrowers, but some bankable borrowers and even prime credits choose to use an MCA because of convenience and speed. Invoice financing firms, or those that buy a specific receivable at a discounted rate, also operate in this space.

"Insider" Knowledge: This category connotes relationship and retention. It's a new category that can cut across the risk criteria discussed in the other three segments. As noted elsewhere, brand-name firms like Amazon and First Data are leveraging their unique knowledge of customer activities and revenue streams to offer loans directly to their customers. Building loyalty and locking in a customer are major motivating factors behind this initiative. What is less clear is where on the risk spectrum these companies will play.

Although it does not include lenders from the "insider" group, Fundera is a loan marketplace that works with alternative lenders, having selected more than 20 lenders across the risk spectrum. Fundera's partner group, shown in Exhibit Nine, provides a good perspective on the breadth of lending capabilities that alternative finance firms provide.

Exhibit Eight

Fundera Lenders Range across the Risk and Term Spectrum

Source: Fundera Bank Partners

Karen Gordon Mills and Brayden McCarthy present another perspective on the industry in their previously mentioned paper. Rather than focus on risk types, they highlight three lending models: on-balance sheet, peer-to-peer lending, and the marketplace approach, whereby an intermediary brings multiple lenders together with the goal of allowing borrowers greater choice and flexibility.

Exhibit Nine

Emerging Models in Online Small Business Lending

	Online Balance Sheet	Marketplaces	P2P Platforms
	OnDeck, Kabbage	fundera, Biz2Credit	LendingClub, Funding Circle
Model	Use balance sheet capital to decision loans via new risk scoring algorithms that include non-trad'l data	Connect borrowers with range of traditional and alternative lenders, incl. big banks, SBA, new players	Connect prime and super-prime quality borrowers with capital from consumers, inst'l investors
Loans to Date	Est. $1.5B as of 4Q13	N/A	Est. $4.7B as of 4Q13
APR	20 – 50 percent	Wide variation given range of products and lenders	9 – 12 percent
Terms	6 – 12 months on average; focused on new loans	Wide variation given range of products and lenders	3 year or 5 year; largely focused on refinancing of credit card debt
VCs	Google Ventures, First Round, Tiger, SAP Capital	Khosla Ventures, First Round Capital, Square 1	Khosla Ventures, Kleiner Perkins, General Atlantic

Source: Harvard Business School

Some alternative finance firms, such as Fundation, OnDeck, and Kabbage, are primarily balance-sheet lenders, although OnDeck has already completed its first securitization, creating a hybrid model. Another group of firms, known as Marketplace Companies, plays the role of broker while participants in peer-lending platforms risk their personal funds. Lending Club, mentioned earlier, is one of several firms enhancing the peer model by moving to institutional investors as well. Lines between these models will likely continue to disappear.

Hurdles Facing Alternative-Finance Companies

At this point the future looks bright for alternative finance firms, compared to just a few years ago. As recently as 2009, these companies were fewer in number and largely unknown. Lenders to the industry were unenthusiastic, and the press was beating up on alternative providers generally. One insider told us that currently, investor and lender interest in this business continues to be strong. “Lots of capital is being thrown at the industry,” the insider observed.

Perhaps more important is that many borrowers now know alternative finance exists and is a viable and often attractive option to banks and others lenders. To that end, more positive stories appear in the media, focusing on the convenience and quick availability of funds that alternatives provide (A *New York Times* headline in March 2014: “Can’t Get a Bank Loan? The Alternatives Are Expanding”).

Yet, with so much suddenly going right for the industry, a number of issues are emerging that could hurt returns and limit growth. At a minimum, these are challenges that individual players and, in at least one instance, the entire alternative lending industry will need to address. These items are as follows:

Internal competition: New competitors appear to be entering the market almost daily. The CEO observing the large amount of capital entering the industry also said that many of the new players in his space were focusing on top-tier credits. “Everyone wants higher quality credits,” he said, adding that he saw margin compression occurring in his deals. In turn, reduced margins also impact brokers and other referral sources.

No one’s position in alternative finance is unassailable. Elsewhere in this report, we discuss Lending Club and its pioneering efforts in peer-to-peer lending, its more recent moves into small business lending, and its stellar Board. Yet, now comes Funding Circle (**www.fundingcircle.com**), a UK-based company making inroads in the U.S. A July, 2014 Fox Business headline summarized the company’s most recent focus: “Funding Circle Raises $65M to take on Lending Club.” While Lending Club focuses on bringing institutional investors to small business, Funding Circle specializes in this area, facilitating qualified investors in investments of at least $25,000. Funding Circle’s website states that the company expected to lend about $100 million to U.S. small businesses (median size of $750,000 in revenues) in 2014. An executive team and investment core as impressive as Lending Club’s backs the company. Robert Steele, former CEO of Wachovia and former board member at Wells Fargo and Barclays, is a non-executive Board member at Funding Circle. Investors include Accel Partners and Ribbit Capital.

In the MCA space (those companies based upon merchant receivables), players like Rapid Advance and CAN face competition from branded, self-financed companies such as Amazon, American Express, First Data, PayPal, and Square, among others. Google recently announced a partnership with Lending Club aimed at “Google partners.” This branded list is expanding as more companies consider how to leverage their customer relationships. These “name” companies have easier access to potential borrowers, already-established reputations, and can offer convenience and lower-cost transactions. Some independent and higher cost MCAs will likely lose business to them. But branded players appear to be more focused on using lending not as a primary product, but as a tool for retaining good customers. It is unlikely that branded players have the risk appetite or the expertise to underwrite the more difficult types of deals that experienced MCAs transact regularly.

Nonetheless, it is clear that more players and more capital will enter alternative finance in the near future. More competition will result, with lower margins all around. The winner will likely be the end customer, who'll receive lower rates and fewer fees.

Too many lenders chasing too few deals: History suggests that a proliferation of new entrants results in clear winners and clear losers. Often, late investors bring "dumb" money with them, putting it in deals that cannot sustain the debt provided. While in the case of alternative finance the lending opportunity is large and likely growing as the business becomes better known and more acceptable, lending is still largely an execution game. Even in interviews conducted for this report, we found some players struggling to find an effective approach to originating deals, with little to offer other than a generic loan product. Without good execution and a coherent segmentation strategy, many new entrants to alternative finance will suffer mediocre returns and ultimately disappear from a competitive environment that some describe as resembling The Wild West.

A 2011 article on crowdfunding provides valuable perspective on the challenges of operating in the alternative space. "13 Crowdfunding Websites to Fund Your Business," published in *Practical eCommerce Magazine*, outlines funding options available to small businesses. By late 2014, three of those 13 companies had disappeared, another had merged, and a fifth company had changed its operating model. One big remaining winner was Kickstarter. We expect similar industry consolidation to occur in the near future as some companies struggle to originate sufficient revenues and double-digit returns for their private equity owners.

Credit issue: All boats rise with the tide and recently, all lenders have seen improved delinquencies and lower losses. But if any credit problems occur, they will likely impact the enthusiasm of peer-to-peer lenders, who've been enjoying above-market returns. More hands-on lenders, such as MCAs, appear to operate with strong monitoring and controls, while institutional investors usually have strong monitoring on staff. More casual peer-to-peer lenders, equipped with neither, could face unpleasant surprises in a credit downturn.

Many alternative-finance lenders mitigate risk by providing only short-term loans of less than one year, allowing them to respond quickly to changing economic circumstances. These lenders track cash flow closely, with some being paid back on a daily basis. Such immediate payback uncovers problems quickly and permits quick action. In comparison, longer-term lenders may be at greater risk, since their ability to react to deteriorating performance is limited.

Banks and traditional lenders jump in: Alternative finance is thriving because banks and other traditional lenders either refuse or are unable to lend to most U.S. companies. Yet, banks have strong relationships with many of their customers and tremendous amounts of data that could be used to design loan products that meet diverse needs and levels of credit quality. Even so, virtually all alternative finance executives we asked said they thought it highly unlikely that banks would get into this business anytime soon. They said further that if any banks do enter alternative finance, these would be mid-sized regionals rather than large banks. Moreover, interviewees said, smaller banks lack the required skill base and sophistication to function in the alternative finance arena, while larger banks seem incapacitated due to internal compliance staff and external regulators. Both regulatory risk and reputation risk are expected to keep major banks out of this business, forcing them to miss a significant opportunity for growth while and keeping this field open for alternative players. We know two banks that are now analyzing opportunities in the alternative space, both with less than $10B in assets.

CFPB and other regulators: So far, the Consumer Financial Protection Bureau has largely kept away from commercial lending. The Board's focus on alternative players has centered on the consumer side, with actions taken against payday lenders and mortgage companies, among others. But one bank considering a relationship with an alternative lender raised the CFPB as a potential problem, stating: "[The CFPB] can go wherever they want, and these guys [alternative lenders] could make a nice target." A senior executive at an alternative finance firm echoed this concern, saying the industry must be vigilant in policing itself to keep out "bad players" and thus prevent regulators from focusing on their business. Beyond the CFPB, however, the SEC will play a critical role in implementing later sections of the JOBS Act, once rules are announced, and FINRA will oversee broker-dealer-related activities.

Meanwhile, competitive threats from new and increasingly well-funded market entrants are already surfacing in the alternative space. However, the ability of existing players to focus on specific market segments and potential growth opportunities as the business becomes more mainstream, suggests that the upside for alternative finance far surpasses near-term threats to the industry's sustainability.

Up Close and Personal: Seven Alternative Finance Firms

Lending Club and its Board of Directors: Investor Interest in Alternative Finance

No company better demonstrates the attractiveness of alternative finance to investors and industry leaders than does Lending Club (**www.lendingclub.com**). Founded in 2007, this San Francisco-based company has generated over $5 billion in loans. Most of its early focus centered on peer-to-peer lending, with borrowers using Lending Club funds provided by individuals to repay higher cost credit-card debt. But Lending Club now offers a platform allowing borrowers to obtain loans and investors to buy notes backed by payments made on specific loans. In short, borrowers benefit from reduced interest rates while investors generate above-market returns. Lending Club applies a proprietary database to each loan, rating it on a letter scale and offering rates based upon the perceived risk of the borrower.

In March, 2014 the company announced that it was entering the small-business market, saying it would facilitate business loans from $15,000 to $1 million at rates from 5.9% to 29.9%—below the rates of many other alternative lenders. But as reported by Patricia Clark in the March 20, 2014 edition of *Bloomberg Business*, "Ordinary investors can't fund small business loans on Lending Club. The program is limited to institutional investors such as hedge funds, insurance companies, and family offices that manage money for the very rich."

Lending Club is the 800-pound gorilla in the peer-to-peer lending world. It is also a company with a very impressive Board of Directors and ownership group. In 2013, Google purchased a stake in the company valued at three times the level of a year earlier. As Lending Club prepared to go public, it has assembled an all-star Board of political, investment, and business heavyweights, including former Secretary of the Treasury Larry Summers; former Chairman of Morgan Stanley John Mack; and Mary Meeker, partner at Kleiner, Perkins, and Hans Morris, and formerly co-President of Visa, Inc. It is worth noting that other alternative finance players also have formidable investors and Boards. OnDeck has Peter Thiel and Google Venture as investors, and James Robinson, former CEO of American Express, as a Board member.

Involvement of high-profile investors and Board members does not simply indicate enthusiasm for crowdfunding. The strength of the Lending Club model may be its flexibility and the extent to which it morphs into new business opportunities, rather than its original focus on one individual lending to another. In the past year, Lending Club has moved into a number of new alternative finance arrangements. It made an agreement with two community banks in 2013 to leverage Lending Club's technology and operating model as a way to increase the banks' efficiency and make low-cost loans to consumers. Lending Club appears to be in the business of pursuing opportunities to disintermediate traditional lenders, whether that involves crowdfunding, linkages to institutional investors, or enabling lenders who previously lacked the technology or knowledge base required to efficiently make small loans. In summary, reinvention, along with regular reassessment and refocusing of its strategy, appear to be part of Lending Club's DNA, attracting investors who wish to remain ahead of the pack.

RapidAdvance: A Disciplined Approach to Alternative Small Business Financing

The website **www.business.com** describes an MCA as a "viable alternative if a business has a cash flow problem and an immediate need for cash." It goes on to outline what is viewed as a typical transaction: "When a company gets a merchant cash advance, the deal is the purchase and sale of future credit-card income. No regular fixed payments are required by the company."

In these types of transactions, the finance provider receives a fixed percentage of the company's daily credit-card receipts. The collection continues until the finance provider receives the funds advanced, along with a fixed fee. The typical term for an MCA transaction is six to eight months.

Attractive features of an MCA to a small business are the flexibility of repayment amounts and the timing. When a company suffers slow sales, the repayment amounts drop, since the MCA provider receives a percentage of the company's receivables rather than a fixed payment as in traditional bank financing. Obviously, if the company discontinues its operation, the revenues and credit card receivable payments end, necessitating an MCA's careful selection of the companies it deals with and close monitoring of portfolios.

MCAs are alternative-financing options possessing both positive and negative characteristics. On the positive side, an MCA's decision-making is usually fast, made within a few days, versus the weeks a bank would likely take. Moreover, because alternative funders are more focused on a company's cash flow rather than its collateral, they are willing to engage with many types of businesses that banks avoid. Major industries using MCAs include restaurants (long anathema to banks for lending), auto repair companies and other retailers, as well as some professional services firms lacking the physical assets that banks like to see. The funds provided are often used by customers to purchase equipment, invest in inventory, or expand a business.

An MCA's greatest negative may be its cost. Rates charged can range from 30% to 100% or more on an annualized basis. There is no concept of "interest rate" in an MCA transaction, because the financing is a purchase and sale of a future revenue stream at a discount. MCA deals are usually short-term transactions, many in the three-to-six month timeframe. Wikipedia, in its definition of MCAs, provides one transaction example: "A business sells $25,000 of its future credit-card sales for an immediate $20,000 lump sum payment from a finance company. The finance company then collects its portion (generally 5-10%) from every credit card and/or debit card sale until the entire $25,000 is collected."

Another alternative lender doing MCAs is RapidAdvance (RA) (**www.rapidadvance.com**). Based in suburban Washington, D.C., RA began operating in 2005, its initial emphasis on MCAs usually averaging less than six months. More recently, however, RA has expanded its product focus to include three other areas: small business term loans, SBA bridge loans, and SBA lending. The bridge loans are provided to assist companies until the SBA transaction closes. The SBA loans are handled by bank partners rather than provided by the company itself.

RA tries to partner with traditional players in various ways. The company is one of a few in the industry to advertise heavily on TV. Customers result from this type of marketing, from the Internet, and from ISO referrals and others. While the company seems to have led the way in using media such as television, its greatest strength may result from the longtime discipline of its credit process. Since its founding about 10 years ago, RA has developed a detailed database that includes information about every loan and advance it has issued. Its foundation in strong analytics allows it to select certain segments to focus on and to underwrite current applications guided by strong experiential data. At the same time, RA uses past experience to evaluate its current portfolio, establishing an early warning system aimed at identifying any emerging issues in its current business mix.

Beyond assessing merchant activity and bank statements, RA also focuses on additional areas of analysis, including social media. RA accesses third-party data from sources like Yodlee and Yelp, and considers a business's social media presence when making its funding decisions. A consistently bad Yelp score for a restaurant, for example, would indicate a potentially volatile business.

While a typical MCA's repayments result from card receivables being turned into cash, RA's underwriting activity goes beyond reviewing card history to include analyzing bank statements and FICO scores. RA will usually not provide financing to companies less than one year in business, and it excludes a number of industries from consideration, based upon their risk profile. Although the company benefits from an automated workflow process that creates cost efficiencies, it does not depend upon automated decision-making. An experienced underwriter reviews each application prior to funding.

RA has developed a strong partnership program with commercial finance companies, ISOs, and commercial banks in order to generate leads. Its website stresses multiple benefits for banks that work with the company, including increased customer relationships and higher non-fee income.

According to RA's website, the Rapidaction Program enables community banks to:

- Say "YES"! – Offer alternative finance solutions that help fund your small business customers' growth and day-to-day operations – in just 5 to 7 days.
- Protect your customers – This program provides the immediate assistance customers need, and positions them to graduate into your traditional credit products.
- Attract new small business customers – You now have a great way to strengthen your portfolio and deposit base.
- Add non-interest fee income – While we handle all the work, you gain additional revenue.

RA's operating model typifies that of stronger alternative-finance companies. The firm began with a clear focus on MCAs, then expanded to provide more solutions to its customer base, ensuring that as the customers' needs changed and their financing options increased, RA would have a greater chance of retention.

As with other alternative players, RA is also trying to work with a variety of partners, to increase both their stream of origination opportunities and the financing options they provide customers. RA focuses particularly on community banks of $1billion or less that lack the analytical abilities RA has developed. RA also works with asset-based lenders and commercial factors on what Jeremy Brown, RA's CEO, terms "situational opportunities." These include partnering with players to provide interim capital to their customers with no minimum amount of collateral required. RA is willing to do this because of its approach to underwriting and monitoring.

In other areas of this report, we've noted the interest of prominent investors and board members. This is also true for RapidAdvance, which received an investment from Steve Mandis, a former Goldman Sachs partner before the company was purchased by Rock Ventures. Rock Ventures is a private equity company owned by Dan Gilbert, owner of the Cleveland Cavaliers and Quicken Loans, Inc.

OnDeck: Leveraging "Bank" Information and Technology

Unlike MCAs that primarily focus on advances against credit-card receivables, OnDeck (**www.ondeck.com**) offers what some call an "ACH loan." ACH lenders advance funds based on the cash flow available in a merchant's bank account. These loans are available to companies without card receivables. OnDeck evaluates transaction account information available to a bank and then enhances it with additional data and analytics. Like Lending Club, OnDeck is increasingly working with institutional lenders that can buy the loans OnDeck originates.

Since its beginnings in 2007, OnDeck has underwritten over $1.5 billion in loans to more than 20,000 companies. Writing in *The New York Times* on March 5, 2014, Amy Cortese describes OnDeck as "one of the first wave of tech-based alternative lenders," applying strong and nontraditional analytics to small business lending. Similarly, Holly Slade, writing in the March 6, 2014 edition of *Forbes Magazine*, described OnDeck as a "small business algorithm lender" and "part of a new financial lending ecosystem that offers an alternative to big banks, which approved less than a fifth of all requests for small-business loans they received in January [2014]."

Applicants upload 90 days' worth of cash flow data, and from there, OnDeck grabs personal and business credit history from bureaus like Experian. It also scans publically available records for past lawsuits. OnDeck further considers the health of an applicant's industry and geographic region, and checks online reviews from sites like Yelp and Google Places.

While OnDeck largely relies on its proprietary methodologies for credit decisions, it understands that the sales process requires some handholding, and it provides loan specialists for online consultations regarding loan needs and options.

Zhengyuan Lu, who runs the capital markets area at OnDeck, underscores the company's technology-reliant approach: "We have a 10-minute, online application process (vs. days or months of bank paperwork), and we evaluate small businesses using thousands of data points (vs. relying heavily on business owners' FICO scores)…the tech aspect makes OnDeck extremely unique. There is a tremendous amount of electronic data about small businesses that traditional lenders are ignoring or unable to process. Through our technology platform, we are able to digest and analyze a significant amount of data in real time, which allows us to make better credit decisions faster." Starting with bank-account data, OnDeck and similar lenders constantly look for additional sources of information, particularly as they relate to the impact of largely uncharted areas like social media.

OnDeck provides several lessons for traditional lenders. Emulating OnDeck, banks and others lenders possessing a great deal of proprietary data could put it to use structuring loans that meet the needs of nontraditional customers.

Traditional lenders would also do well to study OnDeck's solution for an effective operations and risk platform that handle small loans. The company does this by offering what it calls a "Platform Solution" (**https://www.ondeck.com/partner/#vendor-programs**). The company provides its processing and underwriting platform to lenders that want to offer working-capital loans. Banks using the platform receive the following benefits related to growth and the building of customer relationships:

- Leverage of OnDeck's streamlined underwriting and OnDeck™ Score
- Instant pre-approval of customers
- Bulk pre-approvals within the bank's account base
- 24-hour turnaround, offered to new and existing bank customers
- Generation of increased approval, along with flexible borrower terms
- Provision of hassle-free, automated, daily loan repayment.

OnDeck not only builds "bank" information and enhances it; it also uses a self-developed processing capability and underwriting knowledge base that it now provides to other lenders. In addition, OnDeck has applied its technology and analytic capabilities to broadening its funding. In 2014 the company announced its first securitization, which was also the first in the non-SBA direct business-lending industry. In its press release, Lu said, "This transaction will ultimately allow OnDeck to deliver lower cost solutions to Main Street." The September 2014 IPO filing valued the company at more than $5 billion. Funds are to be used in part for acquisition, suggesting some consolidation of weaker players is in the cards.

The FinTech focus may initially be on front-end origination processes or underwriting, but as alternative finance companies mature, their owners continue to apply the power of analytics to additional parts of their firms' business systems. Unencumbered by legacy systems, alternative finance firms are often able to lever their capabilities quickly to enter new business areas. This in turn can result in their cooperation with traditional lenders in one area, while competing with them in others.

SmartBiz: The Power of Teaming

SmartBiz (**www.smartbiz.com**) is a California-based technology venture that appears to provide an excellent example of a FinTech company teaming with traditional lenders to provide a cost-efficient and technologically savvy offering. Neither type of firm could provide this product to an end-customer without the other.

The FinTech in this case is Better Finance, which has established what SmartBiz describes as a "joint effort," initially with two banks, to offer the SmartBiz application. The app is an SBA 7(a) application process that aims to greatly shorten what some bankers have viewed as an onerous and complex process. While the Small Business Administration does not provide loans, it does offer loan-guarantee programs to encourage lenders to fund small businesses. One of the SBA's most popular programs, SBA Express, aims at this market, providing lenders with 50% loan guarantees for loans up to $350,000. Banks frequently place great faith in the enforceability of the guaranty in order to view a small loan favorably.

While the guaranty program has value to banks, SBA-related lending often suffers from a checkered reputation. In the past, bank managers have expressed concern about the complexity of the underwriting process and the specialized personnel required to "cross the t's" to ensure that the guaranty stands up under SBA scrutiny. In fact, some banks have found that offering an SBA guaranty product requires significant fixed investment in specialized personnel and technology. To generate profits from a historically labor-intensive business, banks may need to build volume and develop streamlined internal processes, a chore that is admittedly difficult for many traditional lenders.

SmartBiz says it offer a solution for this problem. Its website summarizes: "The SmartBiz technology automates the entire application, underwriting, and loan origination process for SBA loans, while our PLP [Preferred Lender Program] partners fund the approved 7(a) Program loans." SmartBiz may have the technology, but it needs bank partners to implement its benefits.

One such partner is Golden Pacific Bancorp. Golden Pacific operates two small community banks and is headquartered in Sacramento, California. Another partner is Celtic Bank, of Salt Lake City. Celtic Bank is the nation's sixth largest SBA lender. Both banks have member status in the SBA's Preferred Lenders Program (PLP). As described on the SBA website, it developed SBA Express to streamline the approval process for a 7(a) guaranteed loan: "Under this program, SBA delegates the final credit decision and most servicing and liquidation authority and responsibility to carefully selected PLP lenders." SmartBiz applies its technology to further facilitate the SBA Express process.

SmartBiz provides an excellent example of the marriage of FinTech with traditional lenders in a strong codependent relationship. Better Finance shows banks reaching outside the organization to gain expertise and a turnkey capability that they would be unable to develop for themselves either cost effectively or in a timely manner.

An article by Mark Calvey appearing May 14, 2014 in *The San Francisco Business Times* suggests that the SBA itself supports the SmartBiz concept. The article quotes Mark Quinn, San Francisco district director of the U.S. Small Business Administration touting the value of this platform capability: "SmartBiz offers affordable monthly payments and fills a significant void in the marketplace, offering an enormous opportunity to better serve small business owners with easy on-line access to a low-interest-rate-SBA loan."

Better Finance (**www.betterfinance.me**) describes itself as a "financial technology company providing innovative leasing and credit solutions online, in-store and via mobile." Adaptability appears to be one of the trademark characteristics of FinTechs, including Better Finance. The company's former name was BillFloat, Inc., and its first major product was SmartPay, a lease-to-own payment plan that "spreads the payments over an extended term to make them more affordable." BillFloat provided wireless carriers and retailers with online or mobile applications for instant decisioning.

The same *San Francisco Business Times* article states that SmartBiz changed its name from BillFloat to underscore its commitment to SBA lending. However, that switch to SBA may have occurred in part from a lackluster first effort. Its SmartPay product viewed payday lenders as a main competitor, and the company "hoped banks would become partners in offering the service. But regulators have frowned on financial institutions becoming involved in short-term lending, "resulting in banks dropping products in that area." The article goes on to quote Ryan Gilbert, CEO of *Better Finance*, underscoring the need for the company to be flexible: "We can't control the way the winds blow, but we do control our sails."

In our section on OnDeck an alternative finance executive expressed doubt that traditional players could work with outsiders to change processes and look at internal date more effectively. SmartBiz offer a potential path concerning how alternative players might work with more traditional companies not only in SBA lending but also in other areas.

Biz2Credit and Fundera: Creating a Loan Marketplace

Wishing to give borrowers more choices, several alternative finance firms have developed what are in effect loan marketplaces or virtual kiosks, aimed at assisting borrowers in choosing the best lender, given their borrowing requirements and credit history, versus a lender's credit and risk appetite.

New York-based Biz2Credit (**www.biz2credit.com**) says it has arranged more than $1 billion in financing and offers access to over 1,300 lenders nationwide, many of them banks. Biz2Credit focuses on startup loans, expansion loans and lines of credit. The process begins with a phone call which results in an application and assignment of a case manager who leads the borrower through the process, ideally identifying one or more attractive borrowing opportunities.

Also based in New York is Fundera (**www.fundera.com**), a 2014 startup that provides a marketplace, but differs its approach from Biz2Credit in several ways. Fundera refers loans to a network of about 20 alternative lenders that it selected based on multiple criteria. Currently, none of these lenders is a traditional bank.

Fundera says it pre-screens potential lenders based on the transparency of their process, customer responsiveness and other factors. While some direct end-customer business comes from the Internet and other marketing activities, Fundera currently focuses on building financing relationships with companies that work with small businesses. The company provides alternative finance choices to FTD franchisees, for example. Fundera also works with banks to assess their credit turndowns and thereby provide alternative finance options to potential borrowers, with the banks maintaining control over deposits and other aspects of the customer relationship.

Initiatives such as these increase the choices available to borrowers. In some cases, they may also undermine the traditional relationship between a lender and its customers. In other instances, these firms can serve to broaden a bank or equipment finance company's usual offer, generating a fee for making a referral while allowing the lender to maintain the customer relationship and build user loyalty. Like Priceline, Kayak, and other online travel services vendors, loan kiosks may become a standard option in the future.

Live Oak: What is a Bank, Anyway?

Live Oak Bank (**www.liveoakbank.com**), headquartered in Wilmington, North Carolina, is an FDIC-insured and regulated bank formed in 2008, with assets now over $500 million. While it operates under a bank structure, that is where Live Oak's similarity to other community banks ends. In its intense market focus, its concentration on exploiting one key product capability, and its leverage of technology, Live Oak more closely follows the path of a tech-savvy alternative finance company than a bank.

Live Oak has a very narrow focus, concentrating on offering small business loans to a number of specialized industries, including pharmacies, veterinarians, and funeral homes. The company emphasizes the power of expertise, saying on its website that it is the largest lender to independent pharmacies in the U.S. Live Oak not only specializes in a handful of industries; it also specializes in offering a specific loan, using the SBA 7(a) guarantee program. Live Oak's initial market analysis, presented in its 2007 bank-charter application, quantified the substantial size of this loan opportunity, estimating that the four industry segments initially under consideration generated a loan potential of almost $900 million in SBA 7(a) loans alone.

According to information on its website, Live Oak was formed "for the limited purpose of making high-quality commercial loans, on a nationwide a basis, to targeted business segments that banks traditionally lend to at a premium, but actually have a very low rate of default when properly underwritten." Given the high level of market liquidity, funding has been available from multiple sources, Live Oaks says, including deposit brokers as well as advances from the Federal Home Loan Bank Board.

Live Oak has no branches and operates out of a specially designed building in Wilmington. It sells to and services clients nationwide through its use of high tech, the Internet, and high touch, with bankers using the phone and some in cases, personal contacts, to manage specific relationships. The firm has also established Live Oak U, intended to assist business owners (initially veterinarians) in better understanding the business side of their operation. This allows Live Oak to provide a value-added differentiator to clients and prospects.

How does a branchless company in the eighth biggest city in North Carolina manage to develop a nationwide portfolio of specialized loans, competing against more established players? Live Oak's operating model leverages FinTech in both its back and front offices. In the back office, the firm outsources its IT requirements, working with major players that serve hundreds of other banks. In the front office, the company uses the Internet extensively for marketing and to target specific interest groups. Live Oak bankers also attend industry conferences and join associations. The company has developed a strong publicity machine aimed at inclusion in targeted publications. But management also knows borrowers often view lending as a complex and personal decision, one that requires a certain degree of touch. Further, SBA loans must be underwritten following a set of specific guidelines to meet guarantee requirements. Consequently, Live Oak begins the loan process with a one-on-one phone conversation between an industry expert who can assist in structuring the right type of loan for a particular situation and industry. The loan originator is part of a team that includes an underwriter and a loan closer.

While smaller loans are often unprofitable for many banks, Live Oak's results demonstrate that it has created an efficient and high-quality loan factory. At mid-year its efficiency ratio was 58%, net charge-offs were 25 basis points, and ROAA exceeded an impressive 6.2%.

Live Oak's success suggests that banks and other traditional players can emulate the principles of the best alternative finance companies: to operate with a "limited purpose," that is, focus on limited segments with limited products; to emphasize lower cost origination rather than a traditional high-priced sales force; and, to insist on streamlined processes rather than the hangover of old systems that haunt many banks. This approach is not dissimilar from that being followed today by a number of independent equipment finance companies and even bank-owned companies such as First American Equipment Finance, part of City National Bank.

In summary, Live Oak is a study in contrasts. The company leverages the strengths of FinTech while also using the telephone and personal connections. Live Oak also maintains a traditional player's focus on relationship banking, albeit with relationships defined in narrower terms.

Three Possible Scenarios

Predicting the future is always dangerous, and perhaps more so when a business with many moving parts is involved. Alternative finance is certainly this, with new entrants, new investors, a growing number of customers, potential for increased regulatory involvement, and a stable-but-unsettled economy. One or more of these elements could stop, reverse, or grease the fortunes of companies and individuals in this business.

Nonetheless, it is worth evaluating three scenarios that could occur, along with their relative likelihood and the circumstances that could result:

1. **Dominant small-business lenders move into the middle market:** Since small-business lending has become less attractive at many banks, a portion of banks' customer base is now more willing to work with other brand and non-brand name lenders. As we saw earlier, data from Oxxford and others quantified the lending opportunities available outside traditional channels.

Barring major regulatory interference or a credit hiccup, alternative finance firms will continue to build market share by taking business away from traditional lenders and reaching out to those previously unable to find funding. Perhaps of even greater concern to the finance industry, including equipment finance, however, is growing interest on the part of alternative finance firms in middle-market loans. Some crowdfunding and direct-lending sites are already inching their way into loans greater than $1 million, and more than one insider we spoke with said that moving up in size would be easy and attractive to alternative companies for some of the same reasons the middle market is attractive to current equipment-finance lenders.

Alternative finance companies can play where banks can't or don't want to, and increasingly, they can compete head-to-head. The threat to traditional lenders from alternative players is likely only to intensify, particularly in the current economic and business environment.

2. **Continued niche playing on the fringes:** When we asked one executive to comment on what he considered the greatest competitive threat to the alternative finance industry, he answered immediately, and in one word: "Visibility." For his company and his industry as a whole, the extent to which potential borrowers view alternative companies as viable and attractive options is paramount. To address that issue, alternative finance firms are using every outlet available: mass media, direct mail, the Internet, industry conferences, affinity relationships with various special interest groups, and aggressive public-relations efforts. Nonetheless, the scalability of individual lenders and the likely market share potential of the industry could actually limit growth. We know of at least one investment group that decided not to pursue a deal due to these very issues.

   This is not to say being a niche player is a bad thing. Exploiting niches can result in strong returns in areas that often provide barriers to entry. But this is not where alternative finance leaders are heading. Examples provided by Lending Club and OnDeck, both of which are pursuing IPOs for expansion capital, suggest a desire to move into new market segments and additional lines of business, such as providing processing platforms instead of only direct loans.

   Smaller players may face increased consolidation as the best-funded companies sweep up competitors to build share and head into new segments. For the major alternative players, niche-playing is not a long-term option.

3. **A crisis ensues as rates rise, credit quality dips, and regulators discover the industry:** While the worst-case scenario may be one that established competitors hope for, it seems the unlikeliest, because:

   – It is likely that rising rates will increase borrowers' costs and some lending risks, and at the same time, competitive forces will push down spreads on borrowers in the alterative space. However,, any rate increases are likely to be modest, given the still-fragile economy. Indeed, it is unlikely that rates will rise enough to deteriorate the performance of a substantial number of alternative finance borrowers or the lenders themselves.

   – As for credit quality, most alternative lenders fiercely monitor their portfolios to anticipate any deterioration and take fast remedial action. If a downturn occurs, some falloff will probably occur in peer-to-peer activity but, as noted, alternative lenders are increasingly focusing on institutional lenders.

   – Groups like the CFPB could tie up the industry if they see alternative lenders as the commercial reincarnation of payday lenders. But this is unlikely to happen for several reasons. Small-business borrowers are more sophisticated than individual borrowers, and as competition increases, rates and fees are becoming more transparent. Increased competition is also expected to reduce for many the high rates for which the industry has been known. More regulations will probably be levied on the industry, but we believe regulatory spotlights will continue to shine more intensely elsewhere. Even so, alternative lenders see the need for their industry to maintain high standards of conduct, to avoid both negative publicity and regulatory concerns.

We expect the future to reveal a reality significantly different from any of these scenarios. But continued loan growth by alternative players seems highly likely. Many of them operate with strong management and capital strength, more borrowers are willing to work with them, traditional lenders have absented themselves from many of the segments in which alternatives compete, and the current economic environment is stable. Expect alternative finance companies to become more prominent in the business space.

Recommendations for Equipment Leasing and Finance Companies

The goal of this study has been to provide readers from equipment finance a clear overview of the alternative finance market, including why it exists, what factors are causing it to grow, and what the future holds for this industry and its emerging business models. In summary, the alternative finance industry offers opportunities for the equipment finance industry that its leaders need to evaluate and prioritize. Traditional lessors and lenders can choose to participate in more than one of the opportunities listed below, or they can develop another path—but taking action of one kind or another is highly recommended.

1. **Enter the alternative finance industry directly.** An example: Balboa Capital has entered this space with an MCA product. Another MCA player commented that leasing companies should develop alternative finance capabilities as, in his view, independents “talk to the same customers we do.” Equipment finance firms could also develop a crowdfunding offer. Companies like Cloud Funding provide turnkey solutions to equipment lenders, allowing them to establish a new lending capability with limited upfront investment of dollars and time.

2. **Provide referrals or join syndications.** Equipment finance companies that do not wish to participate directly can form a referral relationship with one or more alternative companies and receive referral fees. They can also participate in loans with an alternative finance company, taking advantage of that company’s specialty lending experience.

3. **Lend to or invest in alternative finance companies.** Wells Fargo is an acknowledged leader in providing funds for this industry. Wells participates in the industry indirectly, thereby avoiding regulatory and reputation issues.

4. **Join loan marketplaces.** Fundera, Biz2Credit, and others might provide equipment finance companies with attractive lending opportunities. Working with such firms requires fast turnaround, significant transparency, and clarity about acceptable transaction types. Yet, given that equipment lending relies in part on residual values and knowledge of the underlying asset, cash-flow lending and equipment-finance lending complement each other. This is particularly true, given the need of many small and mid-sized businesses for working capital to support their equipment purchases.

Other ways to engage with the alternative finance industry may also exist, including taking advantage of the highly efficient operating and risk-management platforms that some of these companies have developed.

Doing nothing, on the other hand, or hoping alternative finance is a flash in the pan that will burn itself out, is a mistake. After all, the best alternative finance firms have much in common with the best equipment-leasing firms: both are innovative, always looking at new ways of conducting business. Both also evaluate new growth opportunities, invest heavily in technology, and are eager and restless about their futures. The culture at both types of firms is one of excellence, innovation and continuous improvement. Such conditions call for cooperation and interplay between these two industries. Indeed, working together could bring about a zenith of efficiency, customer service and prosperity that so far, leaders in equipment finance have only imagined.

Appendices

Research Methodology

FIC's approach for researching and writing this report involved several components. We began by conducting "desk" research of available reports, research, and articles accessible over the Internet. Virtually daily, new articles or commentaries on this topic are published, many discussing the increasing role of alternative finance on customers and traditional competitors. Social media groups such as LinkedIn also provided the opportunity to gain more insights into this emerging business.

We also conducted interviews with a number of ELFA members involved in this space. Critical were our interviews with a cross-section of industry players, including the leaders of alternative- finance companies, investors in those companies, and some borrowers.

FIC has worked in the alternative finance space for several years in several capacities, conducting due diligence for investors and assisting end players in the execution of their strategies.

Interviewees

In preparing this report FIC was able to access an extraordinary group of industry stakeholders, including company executives both from banks and independents, industry experts, and regulators. This report has benefited from their involvement and frank comments.

Our interviewees included:

Jeremy Brown, CEO, RapidAdvance

Chris Corinaldi, Chief Credit Officer, Fundation, Inc.

Mark Doman, Executive Vice President, Business Development, eBureau

Ray Greenhill, President, Oxxford Information Technology

Jared Hecht, CEO and Co-Founder, Fundera, Inc.

Lowell Isaacs, Eastern Bank - Labs, Product Development

Martin Klotzman, Analyst, Ivory Consulting Corporation

Mukul Mittal, EVP Product Development, Cloud Lending

Robert Neagle, Senior Vice President, Global Products Group Leader, First Data Global Leasing

Dan O'Malley, Eastern Bank - Labs

Bill Phelan, President, PayNet

Rick Remicker, Senior Executive Vice President, Director of Commercial Banking, Huntington National Bank

Spenser R. Robinson, Vice President of Data and Risk Operations at Kabbage, Inc.

Scott Thacker, CEO, Ivory Consulting Corporation

Tom Ware, Senior Vice President, PayNet

Interview Topics

We developed several interview guides, each aimed at a slightly different audience: one for investors in this industry, another for the alternative finance company itself, and a third aimed at equipment-finance executives.

Alternative Finance: Investor Perspective

1. Please explain the elements that cause your firm to view the alternative finance space as an attractive investment opportunity.
2. The alternative finance world is not homogeneous. In your view what are the major categories or sub-groups of alternative finance?
3. Which are attractive to you and why?
4. How would you size the opportunity, both the overall alternative space and your priority focus?
5. In many, if not most, cases alternative finance competes with traditional lenders, in particular, banks. Why is that an attractive group to compete against?
6. If you were a traditional lender, what steps would you take to counteract alternative finance companies?
7. This report is being written for equipment finance companies. Do you see any particular challenges or opportunities for these companies in competing or working with alternative finance?
8. Where do you see the alternative space in ten years? What happens if there is a credit downturn?

Alternative Finance: Company Perspective

1. What factors resulted in the creation of your company? Why now?
2. Why did management select the sub-segment in which you operate?
3. What is your target market and why?
4. Can you quantify the size of your target market?
5. How would you categorize the challenges and opportunities in competing against banks and other traditional lenders?
6. What has been your experience in trying to develop cooperative relationships with traditional lenders? Banks? Equipment finance companies?
7. What have been the greatest positive and negative surprises with your business so far?
8. How could traditional lenders best defend themselves against your firm and its capabilities?
9. Where do you see the alternative space in ten years? What happens if there is a credit downturn?

Alternative Finance: Equipment Finance Industry Perspective

1. What threats does the alternative finance space pose to equipment finance companies?
2. What opportunities does alternative finance offer the industry?
3. Where do you see the alternative space in ten years? What happens if there is a credit downturn?
4. How can firms like your best defend themselves against alternative players?

FIC Industry Experience. In preparing this report, we took advantage of our prior experience in preparing the ELFF's *State of the Equipment Finance Industry* report over multiple years and our extensive client experience over the past 20 years in the equipment and commercial finance segments as well as, in recent years, our work in the alternative finance space.

Acknowledgements

A Steering Committee of industry volunteers and subject matter experts provided thoughtful review and targeted suggestions throughout the development of this report. Their participation is appreciated and was critical to the study's success. They are: Scott Thacker – Foundation Research Committee Co-Chair, Jack Albers, Martin Klotzman and Tom Ware.

About FIC Advisors, Inc. (FIC)

For 20 years FIC, a New York-based management consulting firm, has provided fact-based advice and counsel on issues related to growth and profitability to banks and financial services clients around the world. FIC emphasizes practical, bottom-line results. We not only provide targeted recommendations but also work with our clients to ensure successful implementation of our recommendations.
In recent years we have worked in the alternative finance space in several capacities, conducting due diligence for potential investors by focusing on various aspects of a potential acquisition, including its operational effectiveness, risk management processes, and market strategy. We also work directly with alternative finance companies on issues related to developing and executing their growth strategies, including channel management.

Our equipment finance related consulting work includes:

- Evaluating expansion opportunities in new segments, markets, and geographies
- Recommending and implementing process redesign changes to increase lessor and commercial banker productivity
- Assessing acquisition opportunities
- Providing insights on adopting industry best practices
- Developing strategic plans with detailed implementation plans

FIC has also completed projects in commercial finance, inventory finance, franchise finance, timeshare finance, factoring, among other areas. We tailor how we work with our clients to their needs; our approach may involve a formal engagement, targeted workshops, and/or ongoing retainer-based counseling to clients.

We have a long history in the equipment finance space, both as a consultant and researcher, having written the ELFF's State of the Industry Report in recent years. Visit our website at: **www.ficinc.com** for more information about our consulting and advisory services.

For additional information about research presented in this report or to discuss FIC consulting capabilities, contact:

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Equipment Leasing & Finance U.S. Economic Outlook
This comprehensive report analyzes global and domestic trends impacting capital spending and economic growth in the coming year. It identifies key signposts specific to the equipment finance industry and features Momentum Monitors that identify turning points for 12 verticals in their respective investment cycles. The outlooks are updated quarterly.
www.leasefoundation.org/IndRsrcs/EO

Monthly Confidence Index
Through a monthly survey of the industry's executive leadership, we've established a confidence index related to the equipment finance sector and the U.S. economy. The results provide greater understanding of prevailing business conditions and expectations for the future.
www.leasefoundation.org/IndRsrcs/MCI

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