The Real Cost of a Merchant Cash Advance

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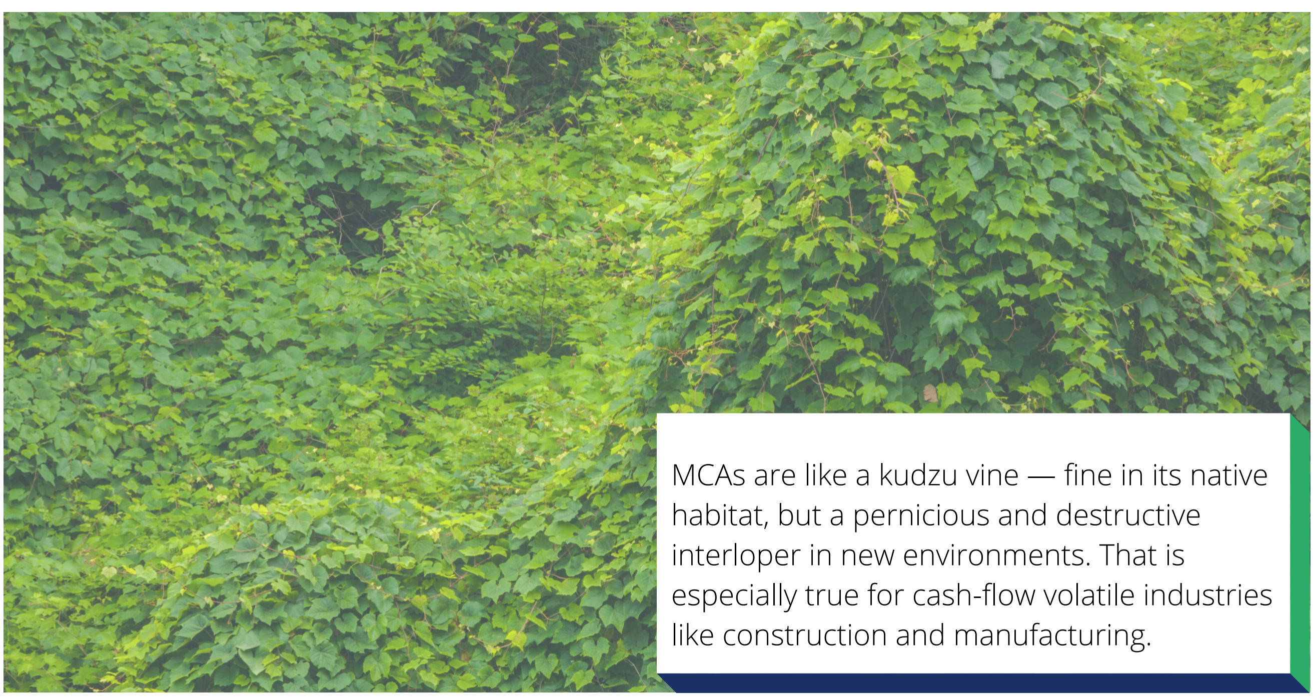
What is a Merchant Cash Advance?

Merchant Cash Advances, or MCAs, are a funding option for all types of businesses who need quick cash. They are sometimes referred to as “daily debit loans,” and are basically the business equivalent of a payday advance.

Once a relatively obscure funding option reserved for businesses with no other options, MCAs are now offered by alternative financing industry giants like OnDeck, Kabbage and Fundera. The MCA industry represents about $19.2 billion in small business funding (1). That’s a lot of cash being offered to entrepreneurs and small businesses. Even e-commerce platform Shopify has gotten in on the MCA action (2).

A Merchant Cash Advance is basically an advance on a company’s future sales. The funding received is based on the average amount of cash flowing through a business’ bank account on a monthly basis and the business owner’s personal credit score.

It is NOT a loan. That’s an important distinction. Turn the page to see why.



MCAs are like a kudzu vine — fine in its native habitat, but a pernicious and destructive interloper in new environments. That is especially true for cash-flow volatile industries like construction and manufacturing.

How is an MCA different from a loan?

MCAs may try to blend in with the flock of alternative financing options, but there are a few stark differences.

MCAs can hurt your PERSONAL credit.
When you apply for an MCA, the lender will pull your personal credit score. If you are working with a broker, then your application is farmed out to several lenders, often who will ALL pull your personal credit. Those multiple inquiries in a period of days will negatively impact and lower the business owners credit score. Ouch.

The costs can be savage.
Even a business credit card, with an APR anywhere between 12% and 29%, is a deal compared to the "interest rates" typical with MCAs. That’s because MCAs don’t have a simple interest rate; they have what is called a factor rate. A factor rate is a percentage of the borrowed amount. They can vary widely from high single digits to as much as 50% or more.

Beware the broker.
MCAs are rarely sold by the actual lender. They are instead pushed through brokers. When a broker sells an MCA to a business owner, they add their own markup to the loan. Their commission can be upward of 10% of the loan's value. (3) This is how MCAs end up with those monster interest rates.

Are some of these folks on the level, trying to help business owners finance growth? Sure, but too many of them are pounding the phone trying to get their next quick win with no regard for the wake of destroyed businesses, and business owners, they leave behind. Here's how it often goes:

You need cash and can't get it through traditional funding. The broker sells you the first MCA with a script that sounds too good to be true. "All the money you need." "Super-fast turnaround." "So easy to apply." Then, when you realize you can't keep up with the payments, your broker has vanished. Or worse, he's on the phone selling you another one.

Did you know one of the best ways for a broker to find a new MCA buyer is to call the list of everyone who currently has one. Brokers know MCAs are high-risk for most industries and absolutely devastating to some (like construction). Unfortunately, many of them simply don't care enough to stop selling them.

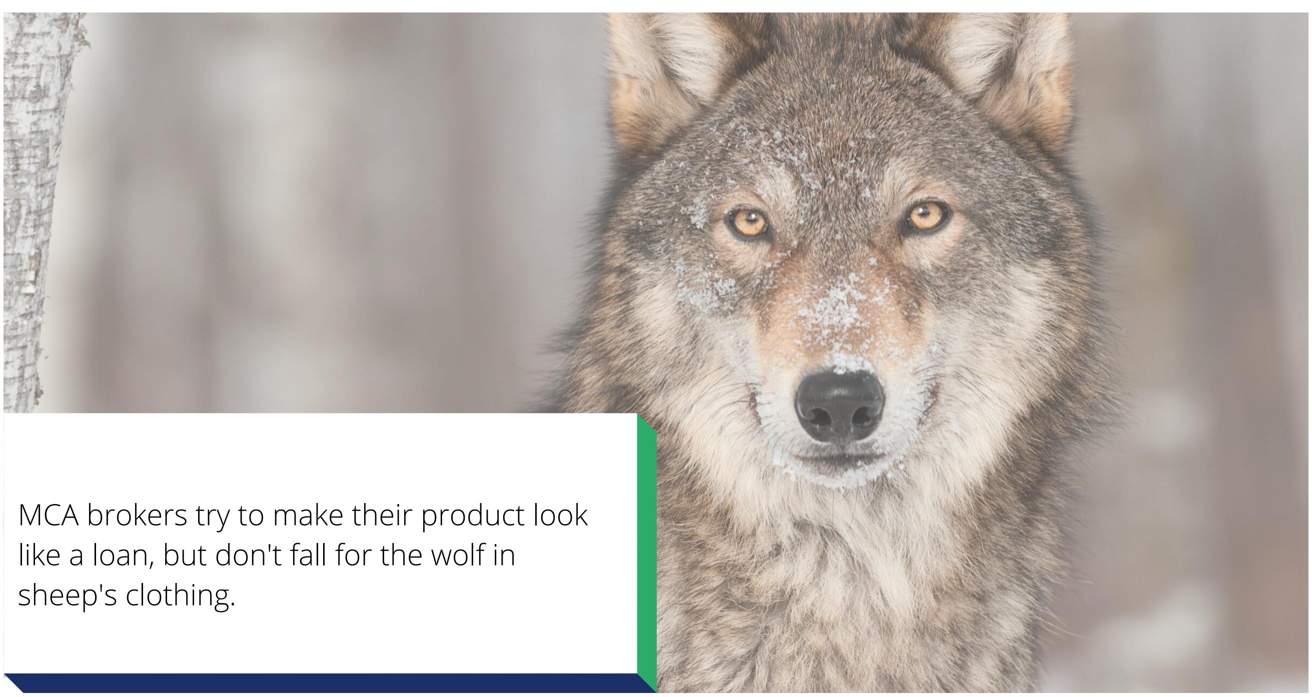
How is an MCA different from a loan?

There's little benefit to paying them off quickly.
Here's where an MCA shows its teeth. With a traditional loan, you can save money by paying off the loan early, thereby saving you interest payments. That is rarely an option with an MCA. You have to repay the total cost no matter how quickly you pay off the loan.

You rarely control the payment schedule.
MCAs will set out a payment schedule — somewhere between 6 and 12 months, but remember, MCAs are tied to your future sales. In the example above, if the borrower's sales are booming then the MCA will be repaid faster, at a higher APR. At twelve months, the APR would be 30%, but at six months the APR is actually 60%.

MCAs have no federal oversight.
Private lenders are not held to the same rigorous federal regulations as traditional business loans. Instead, they are regulated on the state level by the Uniform Commercial Code. That's not necessarily a bad thing, except that it has allowed the wolves of the MCA industry to prey on unsuspecting business owners with little consequence.

It all adds up to a "quick cash" fix that can pack a nasty bite.



MCA brokers try to make their product look like a loan, but don't fall for the wolf in sheep's clothing.

MCA dark secrets revealed!

The scariest part of an MCA is what happens if you don't pay it back on time. If you miss even one payment the MCA company can consider you in default.

First, you will be charged additional fees and penalties. These can be astronomical. Second, your credit rating will tank. If your loan goes into default, the MCA lender will enforce their UCC lien, which means they can take legal action against your business. (4)

Once you are in trouble with an MCA, other lenders consider you too high-risk. Most will not provide the funding you need to get out of the MCA debt. Now you're sinking fast, and no one is throwing you a lifeline.

It doesn't stop there. Because the "loan" is personally guaranteed, they can go after assets you never dreamed might be in jeopardy. Your personal bank accounts can be frozen, even your personal retirement fund is fair play.

In fact, MCA collectors have a reputation for getting personal ... and it is not a good one.

Defaulting on an MCA is really bad.
Like, "swimming with sharks with an open wound" bad.

MCA dark secrets revealed!

The personal guarantee you signed means the lender will come after YOU. Your personal bank accounts can be frozen. Your personal credit score will plummet.

If your loan amount was small, they may simply harass you by phone and email. But, if your loan was sizable, the tactics can get considerably more severe.

Some MCA collectors are ruthless. A 2018 article series from Bloomberg, "Sign Here to Lose Everything," detailed debt collectors harassing borrowers, using expletives and threats in conversations with them, and even telling one borrower that he would pursue the debt until the man died and then send flowers to his wife. (5) The man attempted suicide. Thankfully, he survived, but he lost his business, his savings, even his father's retirement money.

Pretty scary, right? So, what is a business owner to do? Your broker has an idea. Take out another MCA.

Does that sound insane? It should, but desperate business owners do it all the time.

Trying to pay off one MCA with another is like trying to put out a house fire by pouring gasoline on the flames.

Will an MCA work for my business?

Merchant Cash Advances can work for some business types. Industries that have a daily cash flow, like retail stores and restaurants, may have daily profits that cover the MCA's scheduled debit.

Of course, the MCA is still risky and there are dozens of articles about restaurants, real estate companies, and retail shops that were driven out of business by predatory MCA practices. So while yes an MCA might work for some businesses, it's probably still not your best option. And they absolutely DO NOT work for construction and manufacturing companies.

The problem is simple: cash flow.

In industries like construction and manufacturing, businesses wait between 30 and 90 days (and usually skewing towards the latter) after they invoice to be paid. And they don't invoice until at least 30 days of work has been completed. That means that businesses in these industries are perpetually in need of cash to mobilize on each new project, but won't be paid for the work for at least another 60 days.

That is not a cash flow cycle that can support a daily, or even weekly, draw on your bank account.

There are alternatives to MCAs. Small business loans, lines of credit, invoice factoring, purchase order financing, and of course mobilization loans like the ones we provide. The trouble is not the lack of alternatives, but the lack of awareness business owners have regarding those options.

Let's fix that problem right now, by reviewing a few common funding options for construction subcontractors and manufacturing companies.

Alternatives to a Merchant Cash Advance

Every funding option has advantages and drawbacks. It is important to do your research and choose the one that best works for your company and your business goal.

Small Business Loans are one of the most traditional form of small business funding. Most small business loans have competitive interest rates — fixed or variable — and a set repayment schedule. They require a strong credit score and collateral to back up the loan
in order to qualify.

SBA Loans are small business loans of which up to 80% of the principal of the loan is guaranteed by the Small Business Administration. The requirements for an SBA loan are similar to a small business loan, with the addition of your business qualifying as a small business according to the SBA. These loans also will rely on your personal credit.

Commercial Credit is a pre-approved amount issued by the bank or lending partner that your company can access at any time. Commercial credit is often used to cover unexpected costs or to take advantage of a sudden business opportunity.

Working Capital Loans cover a company's routine operational expenses such as payroll, rent, or debt payments. This type of loan is good for companies that experience uneven or cyclical cash flow cycles. For example, many manufacturing companies need short-term funding during the fourth quarter, when their customers are focused on selling the goods already made. The manufacturing companies repay the debt in the spring and summer, when orders pick back up.

Invoice Factoring is commonly used in commercial construction and manufacturing. The factoring company works directly with your GC or customer to verify an invoice is accurate and owed to you, then you are advanced up to 80% of the invoice amount. When the factoring company receives payment for the invoice, it repays itself the amount advanced to you, plus a fee. Any remaining balance is sent to you.

Purchase Order Financing is like invoice factoring. The PO financing company will pay your supplier to fulfill the order. The customer pays the PO financing company directly. It deducts its fees and sends any remaining balance to you.

Say NO WAY to an MCA

Merchant Cash Advances are very easy to get and offer “quick cash.” This makes them extremely tempting for business owners in a pinch.

However, like most things that are easy, there is always a catch. In the majority of cases, it is better to simply avoid the trouble of a Merchant Cash Advance.

That’s why we say,” Say No Way to an MCA!”

Questions? We love questions!

We are always happy to help. Give us a call at 866-442-7759, send an email to info@mobilizationfunding.com, tweet or DM us, or use the chat function on our site. However you send us your question, we will answer it to the best of our ability.

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