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Want a loan for your business? The loan officer is checking your Facebook and Twitter comments

As small businesses continue to have trouble attracting attention from big banks, many have turned to online alternative lenders who charge higher fees – and subject companies to a social-media smell test

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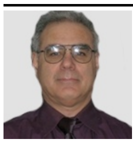

Steve Viuker
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Buttons printed by Fallen Arrows in Atlanta, a small business that sought an online loan when a traditional lender couldn’t help. Photograph: Fallen Arrows

Fallen Arrows in Atlanta is a custom printer that has printed environmentally sustainable t-shirts for artists including Gorillaz. It's a center of the Atlanta arts scene and is so influential that it designates the city's tastemakers. But it can't print money. So when the firm needed financing, founder Tito Sands went to his local bank.

How'd that go? Not so swimmingly.

"When we recently approached a traditional lender for a business loan, it was not a productive experience," says Sands.

As one does, Sands started googling for a savior. Up came a startup called Kabbage.

"Even though the process is online, the fact that I'm in Atlanta – as is Kabbage – jumped out at me", Sands says.

Welcome to the world of alternate lenders for small business. With casual names like AmeriMerchant, Kabbage and Dealstuck, they don't have the mahogany-walled establishment cast of JP Morgan Chase or Bank of America.

But they step in where a traditional bank might not lend to a small business. They exist online, where a nice suit and an open face won't impress them. As a result, their techniques are sometimes unorthodox.

An example: to qualify for a loan from Kabbage and the others, small businesses don't just have to prove decent revenues and good credit. They also have to pass a social-media reputational smell test: what do Facebook and Twitter commenters say about them?

It's a new wrinkle in the previously stiff world of banking. Kabbage is linked to the Facebook and Twitter sites of Sands' Fallen Arrows and other small businesses to which it has loaned money. A firm such as Kabbage can easily see what customers are saying about a business through their social-media sites.

Small business owners can get online loans if they are willing to pay higher fees – and if their social-media reviews come out clean Photograph: Rainier Ehrhardt/Getty Images

But rest easy, Luddite small business-owners: the social-media diagnostics are, for now, mostly cursory.

"Social media is an easy and credible source of information for screening companies," said Charles A Krugel, a Chicago-based labor and employment attorney. "The information is available to anyone, and the person being checked is being evaluated on their behavior. My impression is most screening companies that check social media just want to make sure that they're not giving the OK on someone who may be a terrorist or sexual predator."

According to the FTC's division of privacy and identity protection, companies that use social media in their lending decisions don't have to verify that information since they don't provide it to third parties like a reporting agency does.

"Most small business lenders aren't using social data to make a credit decision. They may use it to confirm the business' identity and validate the length of time they have been in business," said kabbage.com COO and co-founder Kathryn Petralia. "Kabbage uses it to provide incremental access to capital, not as part of an originations model."

Sands came through the process an enthusiast. "The loan process was quick and easy and we've gone back to Kabbage multiple times," he says.

The convenience comes at a cost. While these micro-lenders offer a quicker lending alternative, it is also more expensive, with reliably higher fees. The loan amounts are also much smaller, so they can be paid back in a few months.

For Kabbage, the fees are 1% to 13.5% of the selected loan amount the first two months and 1% for each of the remaining four months.

Every month, for six months, a borrower pays back one sixth of the total loan amount plus the monthly fee. There are no early payment fees.

According to the company, early payoff will shorten the length of the loans and save on future fees.

The company also says technology is what enables it to make small, quick loans.

“The banks’ inability to provide lines of credit under $100,000 has enabled the influx of new business lenders in the market,” says Petralia. “It’s not that the banks don’t want to make those loans, it’s simply that they lack the technology and automation to facilitate them profitably.”

The question is how long these online micro-lenders can avoid being bigfooted by giant banks. Traditional banks have taken notice of the popularity of online lending, even if they haven’t quite mastered the tune.

A recent failed effort, for instance, had Ohio-based Key Bank hooking up with SoMoLend, which employed a social funding platform.

Last year at this time, Ohio’s Division of Securities began investigating SoMoLend (short for Social Mobile Local Lending) for alleged fraudulent practices. The division filed a document last June known as a “notice of intent” to issue a cease and desist order.

That document accused SoMoLend and Candace Klein, the company’s CEO at the time, of a variety of misdeeds. Those included selling unregistered securities, committing securities fraud by overstating SoMoLend’s early success and making fraudulent financial projections by exaggerating revenue projections during public presentations and statements. The firm shut down in February of this year.
Attempts to reach Key Bank were unsuccessful. SoMoLend founder Klein is now chief strategy officer at dealstruck.com in California.

“One of the things I think the Key-SoMoLend story indicates is that some banks that have a strong presence in small-business lending would like very much to capture the small-business working capital market of strictly online lenders but have to balance that with safety and soundness requirements,” said Christine Pratt, a senior analyst with Boston-based Aite Group.

“I would say that they probably hoped to find an IT solution with SoMo that would provide better insight into the borrowers operations”.

The marriage between an established bank – highly regulated – and an online lender highlighted how underscrutinized the business of online lending can be.

“The assumption has been that businesses are simply more sophisticated than consumers, and therefore require less supervision,” Petralia says.

Loan approved. Photograph: Zoonar GmbH / Alamy/Alamy

But bigger banks are coming around to small-business lending, albeit while seeking safety in numbers.

In a report, Pratt points to New York City-based BoeFly.com as a lender of the future. It’s more like a dating service: since 2010, the site has matched small-business customers to lenders willing to finance working capital and other types of commercial loans.

Boefly’s available lenders include 100 US banks with assets of more than $10bn and more than 600 with assets of more than $3bn, as well as a handful of large credit unions. In 2013, the company BoeFly had more than 3,600 lenders on its exchange.

Its initial customers were small businesses with limited access to bank funding due to geography and collateral. The process is uncomplicated: BoeFly alerts a lender that a borrower that fits its profile is looking for a loan. The lender must receive permission from the borrower before it can access the lender’s information.

Connections are made in real time, like Facebook friending. Borrowers fill out just one application online to have their credit request considered by many lenders. Once approved, the goal is to fund these loans quickly.

Small lenders who use the platform well – which means, fast – can level the competitive playing field with larger banks. As many small-business owners who have struggled to find a loan can tell you, the lending business could use a little competition.

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