

# ▶ FINANCING OPTIONS FOR SMALL BUSINESSES NAVIGATING TODAY'S MARKET



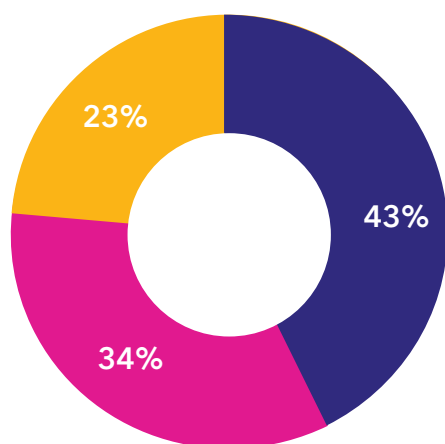
## ▶ Diversifying Credit Sources Can Be Key To Small Business Success

Pathward®, N.A. completed a Small Business Credit Needs & Habits survey of 1,000 small business owners and executive decision makers to understand the state of small businesses and their financing habits and awareness. Financing is often a critical input of small business success and when this input is under pressure the inability to meet business goals can be significant. Recent strong consumer demand, supply-chain disruptions, raised interest rates, wars, etc. have combined to create the biggest spike in inflation in more than four decades. In addition to profit pressures, in a 2023 Goldman Sachs report "small business owners are facing a credit crunch, with 77% of respondents reporting they are concerned about their ability to access capital, a stunning shift from one year ago when 77% said they were confident in their ability to access capital."<sup>1</sup> Good news, small business owners remain focused on growth - 70% of Pathward's survey respondents reported their businesses are in growth mode<sup>2</sup> - and there may be more options for accessing cash than small business owners realize.

## ▶ State of Small Business

**1 in 3 Small Businesses Struggled with Cash Flow in this changing economy.**

Months US Small Businesses Reporting Cash Flow Challenges



■ 1-6 months ■ 1-2 months ■ No cashflow issues

Question: Over the last 12 months, How many of those months have you felt you had just enough cash on hand to remain operational?

According to this Pathward survey of small businesses, 77% had just enough cash to remain operational; 56% anticipate needing funding in the coming year.

Businesses can only go so far as their cash flow will take them, and unfortunately for many, that's not very far. In fact, for 7 to 12 months of the last year, 34% of small and midsize businesses (SMBs) had just enough cash on hand to stay operational. This was most often the experience for companies with annual revenues of \$10M+ (48%) and 50+ employees (46%).

As expected, the lack of funds can lead to several problems that put a business at risk. Four in five

SMBs (81%) have experienced the consequences of a cash flow issue, including delaying a planned expansion or project launch (27%); inability to capitalize on an opportunity (25%) and reduced staffing (22%). A startling 92% of those who anticipate the need for financing within the next year have faced some impact on the business.

### ► **Cashflow Crunches Amidst Growth**

Despite these obstacles, a majority (70%) describe the current state of their company as growing. This is driven by SMBs with annual revenues of \$10M+ (83%), 50 or more employees (79%). Three of four SMBs in the manufacturing sector (75%) and 4 of 5 SMBs in the insurance sector say they are growing (80%)

Being on solid financial footing is vital for sustaining growth. A majority (56%) of SMBs anticipate they will need financing within the next year, including 23% that will need it in the next six months. Those that expect to seek funding in the next year are characterized as being in a stage of growth (58%) and have annual revenues of less than \$1M (63%).

Financing can help make businesses more competitive and perhaps position them for long-term success. SMBs report they may need to seek financing to expand operations (48%), purchase equipment (37%), another 34% would use the funding to invest in sales and marketing, and 27% would use it for customer acquisition.

### ► **Credit Awareness**

Utilizing financing is a virtual inevitability for SMBs. Nine in 10 SMBs (90%) have used some type of financing, especially a line of credit (42%), an SBA loan (40%), personal loan (30%), and equity financing (23%). Only about 1 in 5 (19%) chose an asset-based loan.

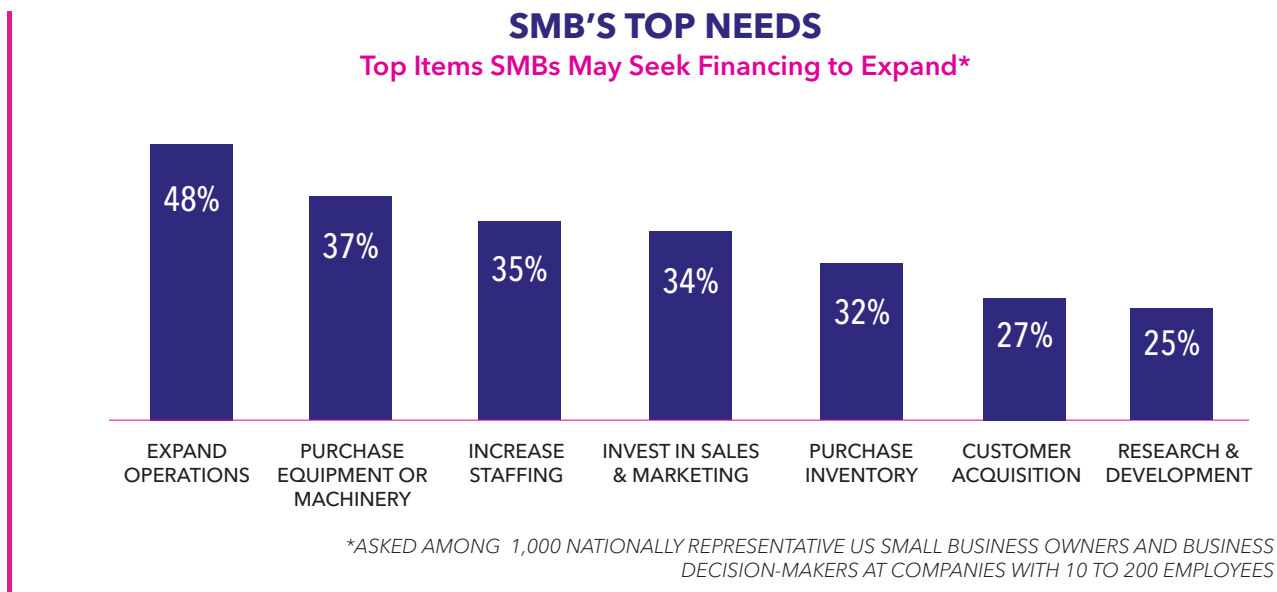
While many SMBs have utilized financing in the past, their understanding of the various funding options varies widely. SBA loans rank the highest in terms of SMBs knowledge at 60%, followed closely by a line of credit (57%). Understanding dips for options like asset-based loans (32%) and commercial real estate loans (27%).

47% of the general business population expresses regret around various loans they have taken in the past. For the insurance and manufacturing industries there are much higher reports of loan regret, particularly in the arena of equity financing.

## ► Creating A Portfolio of Funding Options

It's critical in the current economy that small businesses are nimble and seek multiple funding sources so if one funding source dries up, the business isn't in a desperate search to secure funding. Planning needs to be part of the business strategy. As unsecured sources of funding become more competitive, small businesses may want to evaluate other potential options including secured sources of credit. Examples of these types of lending sources are the lesser-known commercial real estate loans and asset-based loans.

As an example, asset-based lending is a more flexible approach to financing a business's current operations and needs for future growth secured by a range of potential assets, not only real estate. Businesses can secure the loan based on receivables for example.



Lack of familiarity may be one of the factors limiting the use of funding options like asset-based loans. Only 32% feel knowledgeable enough about asset-based loans to explain them to another person, compared to SBA loans (60%), business line of credit (57%), and equity financing (39%). This lack of understanding means small businesses are more likely to consider taking loans they understand like equity financing (26%) versus only 3% considering asset-based loans. However, when businesses were educated on this loan category, consideration for asset-based loans jumped to 62% amongst survey respondents.

Knowledge gaps may lead to misperceptions about asset-based loans. Less than half (41%) of owners and decision-makers understand that an asset-based loan allows a company to finance off their assets even if they have a cash flow issue.

## ▶ True or False?

There are other misunderstood aspects of asset-based lending.

### **These loans maximize the use of assets.**

- ✔ TRUE, because advances are predicated on asset values, unlike conventional loans which are based on a company's cash flow\*.

### **Asset-based loans are an efficient way to gain access to working capital.**

- ✔ TRUE, because it doesn't pull value from the business equity and also doesn't tie up other available funds that are earmarked for other operational needs\*.

### **Companies of any size are eligible.**

- ✔ TRUE, if assets are of sufficient value to collateralize the loan\*.

### **Closing is faster than other types of loans.**

- ✔ TRUE, it can be faster than a traditional bank loan where historical financial statements and documents are required.

### **These loans are only available to established companies.**

- ✘ FALSE, open to startups if the business owner can provide assets available to fund against.

### **They are more expensive than conventional bank loans.**

- NEITHER, they are different. There can be a sense of higher interest rates and fees, but this is offset by greater flexibility in uses of funds advanced and greater access to funds than in a conventional structure.

### **ABL loans only accommodate certain business needs.**

- ✘ FALSE, it provides available cash which can be used for functions and operations as designated by the owner.

*\*All loans are subject to eligibility and underwriting requirements.*

As with any loan, understanding the pros and cons is critical to decision making. However, gaining that education proactively and defining a mix of credit options before a business hits a severe cash flow crunch is a smart strategy particularly in this tight credit market. Ideally, small businesses find a lender who is more than a source of credit. Partnering with a financing source that will evaluate the unique attributes of each small business' circumstances and educate them on opportunities is optimal.

## Survey Methodology:

- Respondents - 1,000 Nationally Representative US Small Business Owners with 10-200 employees. Qualifying titles included: SBOs, CEOs, CFOs, Partners, Owners and for companies of 51+ VP+ of Accounting or Finance qualified.
- Online survey, approximately 15 minutes
- 95% confidence level

<sup>1</sup>Goldman Sachs, 2023 <https://www.goldmansachs.com/citizenship/10000-small-businesses/US/voices/news/may-04-2023-press-release.html>

<sup>2</sup>Pathward®, N.A. 2023 Small Business Credit Needs & Habits Survey