

# PINE BROOK



## **The Time Is Right for Investing in Alternative Small Business Finance**

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# The Time Is Right for Investing in Alternative Small Business Finance

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In the aftermath of the financial crisis, locally owned businesses have struggled to secure financing. There are over 5.7 million companies in the United States with fewer than 100 employees. These companies generate 25% of total U.S. business revenue and employ 35% of the U.S. workforce, and their lack of access to financing has been an important factor in the muted U.S. economic recovery. The alternative small business finance (“ASBF”) market is responding as a rapidly expanding source of capital for locally owned businesses. Industry sources estimate that 2014 will see \$4 billion in ASBF fundings, up 33% from \$3 billion last year and 700% from \$0.5 billion in 2010. While historically financed as a cottage industry with one-off capital pursuing short-term returns, the sector is now ready to utilize institutional risk capital to establish long-duration specialty finance franchises and to become an increasingly important part of the small business financing environment.

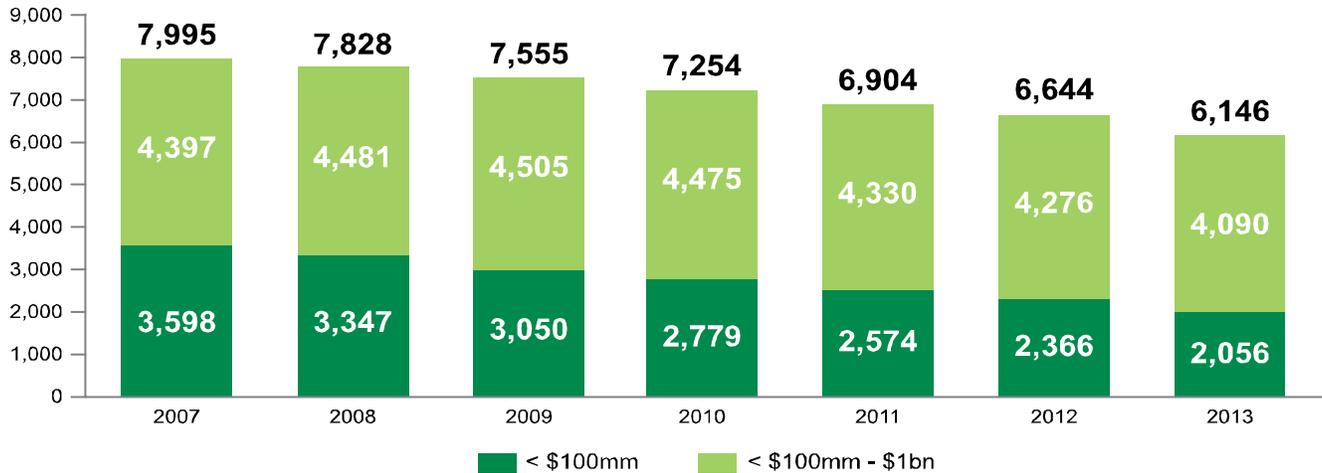
Alternative small business finance involves providing advances to small businesses against future expected receivables. An expected receivable is typically based on daily revenue, whether it is a credit card swipe at a local restaurant or daily receipts for a wholesale auto parts supplier. Historically, ASBF focused on retail establishments and collections were effected via the credit card process. This product was known as Merchant Cash Advance (or “MCA”) financing. Over the past few years, the ASBF product has expanded across the broad spectrum of small businesses via collections drawn from the business’ checking account, or Automated Clearing House (“ACH”) financing. ASBF provides funding to businesses that are unable to secure financing from traditional sources. These businesses may already have a bank loan, have an outstanding tax lien or just require speedier capital without red tape. Regardless, these businesses have a driving need for the capital. Often they’re looking to expand by purchasing new machinery or opening a new location and put the capital to good use.

## What is Alternative Small Business Finance (“ASBF”)?

- Target Market: 5.7 million companies have fewer than 100 employees
  - Generate 25% of total U.S. business revenue
  - Employ 35% of the U.S. workforce
- ASBF funds small businesses that are unable to secure financing from traditional sources
  - Advances to small businesses are provided against future expected receivables

Historically, small businesses have had a number of options to secure financing. Small community banks were willing to underwrite commercial loans (including government-sponsored SBA loans). Alternatively, small business owners could turn to personal credit cards or real estate (home equity loans or second lien mortgages). However, given the impact of the financial crisis, the environment for small business finance has changed significantly. Local banks are disappearing with almost 1,700

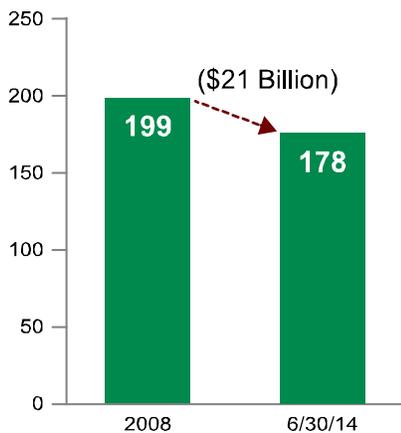
## Number of “Community” FDIC Insured Institutions by Asset Size



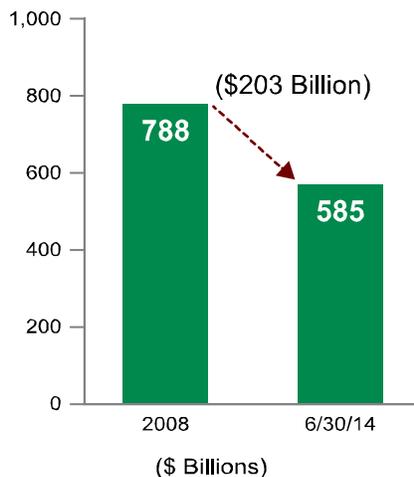
fewer community banks<sup>1</sup> today than in 2006, a 40% decline. Bank small business lending<sup>2</sup> has dropped 12% since 2008, a \$16.5 billion reduction in available business credit. Home equity lines have dropped by \$203 billion since 2008 and consumer revolving credit has declined \$124 billion over the same time period. Lending to small businesses is not a priority for banks in their post-crisis efforts to reduce risk and lend to safer borrowers. In short, small businesses are starved for capital in today's

A number of key ingredients have combined to enable the ASBF market to accelerate its growth. Substantial institutional risk capital is being provided to the sector, capital that is focused on creating franchise value. Debt capacity for the ASBF providers is expanding, leading to broader access to capital markets. Institutional capital is

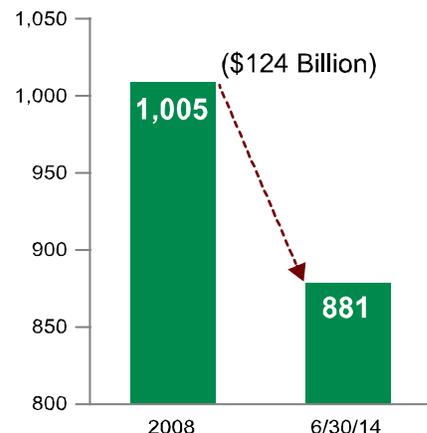
### Bank Commercial & Industrial Low Balance <\$250K



### Reduced Availability of Home Equity Lines



### Reduced Availability of Consumer/Personal Credit



economic and regulatory environment.

<sup>1</sup> Defined as assets less than \$100 million

<sup>2</sup> For lending amounts below \$100,000

flowing as ASBF providers can show an attractive underwriting performance history through a significant recession. Technology is enabling providers to better understand and underwrite their small business customers. Daily ACH payments provide a real-time window into each borrower's health, helping lenders collect more valuable data on their borrowers. Finally, experienced management teams are building institutional-quality platforms, providing comfort to institutional capital that these ASBF providers are ready to participate meaningfully in the expansion of small business financing via ASBF.

Alternative small business finance is beginning to fill the void left by reduced small business bank lending and by the impact of the financial crisis on alternative sources of financing for small businesses. ASBF-like funding to small businesses in 2014 has grown eight-fold since 2010. Pine Brook believes the time is right to marry its financial services growth equity experience and institutional

capital with well-managed ASBF platforms to create long-term value. An ASBF provider that delivers capital to small business in a repeatable, well-underwritten and serviced manner will generate strong and consistent operating returns over the macroeconomic cycle, and the market will value that capability highly.

In August 2014, Pine Brook made an investment in the sector by providing Strategic



Funding Source ("SFS") a top 5 ASBF lender, with a \$110 million line of equity commitment to support its continued growth as an institutional-quality ASBF provider. SFS represents a compelling combination of hands-on ASBF expertise and well-established underwriting, funding and servicing systems. While there will be different approaches to ASBF, Pine Brook believes that SFS's technology-enabled model will allow it to manage its growth while sustaining and increasing its profitability.

Rob Glanville is a managing director and Ethan Wang is a vice president at Pine Brook, a New York-based investment firm with more than \$5.0 billion of assets under management. Pine Brook makes "business building" and other equity investments, primarily in energy and financial services. Its team of investment professionals collectively has more than 300 years of experience financing the growth of businesses with equity, working alongside talented entrepreneurs and experienced management teams to build businesses of scale without relying on acquisition leverage. To learn more about the alternative small business financing sector and SFS, please access Pine Brook's website at [pinebrookpartners.com](http://pinebrookpartners.com).



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