PAYCHEX THRIVE
A BUSINESS PODCAST

Season 4 | Episode 36

Financing Solutions for Businesses

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Speaker 1:
Welcome to Paychex THRIVE, a Business Podcast, where you'll hear timely insights to help you navigate marketplace dynamics and propel your business forward. Here's your host, Gene Marks.

Gene Marks:
Hey, everybody, it's Gene Marks again. Thank you so much for listening and watching here at the Paychex THRIVE Podcast. Today, I'm talking to Solomon Lax. Solomon is the CEO of Revenued, www.revenued.com. Solomon, first of all, thank you for joining me today. I'm very happy that you're here. You're speaking to us from Baltimore, correct?

Solomon Lax:
Yes, Baltimore, Maryland.

Gene Marks:
Very nice. I'm right up the road from you in Philadelphia. We have a lot to talk about. I'm very interested in Revenued. I've been through your site and some materials about the company backwards and forwards, but obviously our listeners and our viewers have not been. Tell us a little bit about the company and also tell us about yourself and how you came to be CEO of the company.

Solomon Lax:
I became CEO of the company partially accidentally and partially intentionally. What I mean by that is that I took over a related company, which was one of the larger merchant cash advanced companies, in 2015 when a private equity fund purchased them, I came in as the CEO. Through that company, we've done about a billion dollars in merchant cash advance, and way back in 2016. This is something everybody faces in their business. This is roughly only a year after we took over the company. I'm a fairly new CEO doing stuff that's pretty new to me, and all of a sudden, we see basically margin compression.

Solomon Lax:
We see margins just fall off a cliff. Tremendous amount of unbridled competition coming into the space. Everybody's doing it, low barriers to entry, and we had to rethink the business from scratch. What is the value of it? At that time, I started thinking about how do you develop business credit scoring, which is not dependent on FICO, which is totally dissimilar from the way banks traditionally look at small businesses. Banks look at small businesses basically as you're either asset-based, so it's real estate or it's factoring, or in the absence of those two or in addition to those two, it's the FICO score of the business owner.

Solomon Lax:
People don't really have the ability or banks don't really have the ability to look past that and decide whether a business is financeable based on the business itself, its metrics. Certainly not at a smaller size. When you get bigger, 10 million plus, probably a little bigger than that, where you have 10 to $50 million in annual revenue, you start having accounting reports. Sometimes you have an audit. You have larger predictable cash flows. You have something that's large enough to have a human underwriter pick it out and take a look at it and say, "Can we do a cash flow based loan to this business in the absence, in the vacuum of knowing anything about the owner?"

Solomon Lax:
And even though I think who the owner is and the relationship with the bank plays a large part in it, it doesn't start to get really just rationalized away from the owners until it gets much larger. Roughly around that time, you had a sea change in this. You had a number of companies, one which Amex has now rebranded. Amex purchased Kabbage. You had Kabbage. You had OnDeck. You had a couple other companies that they came at this with a twofold value proposition, one which largely I think they fulfilled, and then the second one I believe largely not, or at least partially not. One is that the process of getting a loan from a bank is just very friction filled.

Solomon Lax:
It's really cumbersome, bring all your papers and then it's not enough and come back and bring some more papers. It's very paper driven. It's very laborious. It's unpleasant. In addition to that, the second value prop is, well, we're going to do credit scoring in a way, leaving aside all the acronyms, the machine learning buzzwords, we're going to do scoring, and we're going to do underwriting in a way that a human bank as a standalone would not do. We're going to develop new methodologies that are going to be at right angles to FICO that can provide what they call lift. We're going to find those diamonds in the rough.

Solomon Lax:
We're going to find those businesses where your FICO score might not be very good, but your business is really a robust business. Sometimes it's simply because building the business, you did stuff that impacted your personal credit score. It's just how you got there.

Gene Marks:
You were in the merchant advanced business. I mean, I thought some of those companies were looking at advances, looking at, sorry, revenues and cash receipts they were able to tie directly into point of sale systems that a lot of retailers or restaurants might have. And then based on that history turn around and say, "Well, that's actual data rather than assets or waiting for a financial statement, and we're able to loan the money based on that."

Solomon Lax:
That's exactly right. So, where it started was old school, what they called merchant cash advance, which was started by a company called CAN Capital that is not very active today. It morphed into stuff like Shopify or Amazon or some large tech company, Square, Square is a very big player, where they're doing exactly what you said, which is they have a good amount of data flowing through their system already because they have a processing relationship of some type with the merchant.

Solomon Lax:
They look at that data and they say, "Well, based on that data, based on just revenue we see flowing through, we can build those sorts of algorithms and stuff. We can say fairly safely that we can give you X dollars against that revenue stream." That is really what OnDeck and Kabbage and Revenued does, augmented though with something a little different, which is that the point to truth for Square or somebody like that is we have credit card processing. The central data point for most other companies, not that there are so many of us, but the data point is really your bank account. We're getting into your bank account with Platte or similar.

Solomon Lax:
And then everybody has you could think of it as a recipe for a cake where mainly it's flour and water, and then everybody has the secret recipe they got from grandma where they put it in some other stuff to make it really tasty. Everybody bakes in some other stuff. Cabs used to talk about UPS deliveries and things like that, however esoteric you want to make it. But the two main ingredients are really going to come down to your cash fund and your cash flow.

Gene Marks:
You saw an opening then in this market for Revenued, right? I mean, there was something that those guys were not providing. What was that?

Solomon Lax:
Yeah, exactly right. Two things. One is I thought everybody else was doing a really good job on the frictionless process. People were taking out paper from the process. People making it fast. Largely, they were not operating in subprime, meaning there was still a hard cutoff roughly around 660. A lot of near prime activity. If you had a FICO over 660, you would pretty much be able to get an advance or in this case, loan or a line of credit, whatever was being offered. But first of all, below 660, we really saw it still as being a vacuum, because the scores didn't get that much away from the FICO as potential you could.

Gene Marks:
You're saying even people that could have been tied into these systems and even if their revenues were showing a certain level, because their FICO levels were below, they were in a subprime market and those lenders would ignore them. Correct? Still not do business with them.

Solomon Lax:
I can't speak definitively for Shopify or Amazon on that. But from the prism, from the viewpoint of how you're looking at a merchant, again, thinking about baking that cake, if you see their bank account activity, sometimes that's going to largely identify with what Shopify would see and their processing activity, but many, many times it won't. A lot of reasons for that. You have cash coming through your business also. You have a lot of checks. You're in a different type of business than just swiping credit cards. For certain businesses especially, bank account activity is going to be much more powerful than just credit card swiping, that transactional.

Solomon Lax:
We saw that as being a real way to add value subprime. And then finally, we saw the ability to do a business card. There's a lot of reasons why a merchant is going to want a card versus a line of credit, which we do also, or the term loan. There's certain utility to a card. There's certain use cases for a card that you really need a card for. We saw the ability to provide a card as being powerful. From a marketing perspective, we've been pleased. Because when we go to sites like Bankrate and guys like that and we say, look, we got this card and we're just fine with subprime credit, if you're a business owner and you have sub 660, we like that.

Solomon Lax:
That's not something that we reject. We're really the only one of the few offerings for that category. If you go through one of these online sites and you go through there filtering and everything, at the point where you answer, well, I have a FICO score below 660, they're basically showing you a secured card. They're not showing you a business card.

Gene Marks:
Right. A secured card, meaning that you have to guarantee. You put up assets.

Solomon Lax:
You have to put up cash. You have to put up cash. The limits are tight.

Gene Marks:
I've got questions for you. First of all, what industries are usually the ones that would take advantage of this type of card? I mean, is it primarily retail and restaurants or all?

Solomon Lax:
No, it's everybody.

Gene Marks:
It is.

Solomon Lax:
I mean, really when you look at our portfolio, it is as evenly distributed as small businesses. It really looks like a map of small business, both geographically and by industry.

Gene Marks:
I was told particularly by people in the online banking business that capital and financing is always available if you're willing to pay the price. Are you saying that your card is more expensive because you are taking on more risk, but you are providing the capital that people need?

Solomon Lax:
The thing that everybody has to grapple with is, when is the capital worthwhile for you as a business?

Gene Marks:
What's the return on investment, right?

Solomon Lax:
What's the return on the investment? Let me first address this and we'll talk a little bit what we did and what we thought it made sense. But the first thing everybody has to understand is it's really risk-based pricing. At the end of the day, the lender, whether it's us or someone else, what they care about is after their cost of acquisition of acquiring you as a customer and after their cost of default, like how many people don't pay you back, what is the spread? The nominal APR of the thing may look high, but there are certain credit populations where you would just not be able to offer a card to if you couldn't price for your default.

Solomon Lax:
Banks largely will say, "Look, my regulator's going to shove me down if I do that. I can't run a 6% or a 10% default rate. That's eye-popping. An average bank is a 2% or less on business loans. My regulator's going to come in. They'll examine my books. They'll find I have an 8% default rate and I'm charging 36% APR. They'll say, 'What the heck are you doing?' I'll be in trouble." Banks don't go there. The first thing to understand is there really has to be risk-based pricing in order to be able to tolerate a higher default rate.

Gene Marks:
Understood completely. How would a card from Revenued compare to a traditional card that I would get from a, I don't know, Citibank or a Wells or whatever? I mean, how do those compare?

Solomon Lax:
Sure. Citibank and Wells and all those compare favorably for rate. If you have a FICO score of 700 and you have a Wells card with a $20,000 limit, you certainly should use that Wells card before you use the Revenued card. The Revenued card, first of all, does not have 30 days free.

Gene Marks:
You're paying interest right away.

Solomon Lax:
Yeah, yeah. It's not technically interest, but yes. From the user's perspective, it costs from day one. It has good rewards programs. We're doing 3% rewards. It also has, which is right now I think Amex is the only one who is starting for offer it as a matter of fact because they bought Kabbage, it has a flex line attached. From our perspective, the pricing and the utility, we're exhausting to this. You know, could take it as a draw. You can go to your account. You can pull down that same credit capacity. It's in your account the next day. It's highly flexible as far as that goes.

Solomno Lax:
This was the same thing I wanted to get to was what we really wanted to do was something that would be a much better replacement for the traditional revenue-based financing. Because I would say about 25, 30% of small businesses have either taken or have some exposure to the old-fashioned merchant cash advance. The issue with that really is it's pretty rigid, meaning it's like a term loan. You get it for six months. You get it for nine months. It's expensive. Let's say you decide you don't really need all that $30,000. You want to repay it after three days. You used it to cover payroll for a week.

Solomon Lax:
You're stuck. There is no better terms available other than what you managed to negotiate. There's nothing structural that allows you to say, okay, I took it for three days. I took it for 20 days. The fact that it was an APR of let's say 70% doesn't really make a difference because it's really short term, and now here's the money back. Thank you very much. The answer in traditional MCA is, thank you, but no thank you. You're still locked in to the full term. What we have is technically it's really a buyback, but it's a repay feature within the first 30 days, which is extremely inexpensive.

Gene Marks:
What happens if you don't repay within the first 30 days though? Does it get structured as a longer term, or can you pay it down, pay it off whenever?

Solomon Lax:
No, it's structured depending on the terms that are offered originally. There's six month, nine month, but it's meant to pay down so that the balance goes to zero over time.

Gene Marks:
I see.

Solomon Lax:
Unlike a credit card, it's not supposed to revolve forever.

Gene Marks:
Got it. Do you make the same evaluations that these online vendors do that you did when you were doing merchant advances? I mean, are you tying into your customer's point of sales systems or accounting systems or anything like that?

Solomon Lax:
No. We haven't found that accounting systems are particularly useful because the way small businesses set them up, a lot of times...

Gene Marks:
Not great. Not reliable. I mean, a point of sales system obviously makes the most sense because transactions are happening every minute.

Solomon Lax:
We find it all flows into your bank. Ultimately, we think that the bank account is really the most powerful we'll call it the truthful source about how business is doing, especially if you're pulling out cash flows for 12 months, which Platt can get you up to 12 months. You can really see what a business is doing. And then the models we have are built on, at this point, tens and tens of thousands of transactions where you have a ton of data points, you have millions of data points over time, and you can get a good read on what people are doing with cash flow.

Gene Marks:
Sure, sure. I mean, listen, you're talking to a lot of business owners right now. I mean, who is that ideal customer for you? Somebody that comes in your door and you say, "These guys are perfect for this."

Solomon Lax:
It's really a tool because we don't have application fees and we don't charge annual fees. It's really a tool that everybody should have in their back pocket. Because from that perspective, a ton of the usage we see is just rainy day. We used to have this like when it was manual 100 ago in MCA, you always had a story. My insurance company is slow in paying. I'm going to miss payroll. I'm running a home health company. I'm going to lose all my people on Monday if I don't make payroll. That sort of thing. As a tool for rainy day, I think it's a great tool for everybody just to have. But the second point is, is that we are starting to report now.

Solomon Lax:
I mean, we recently started this. We're starting to report to all the business credit reporting places, Dun & Bradstreet and the rest. I don't think business owners appreciate that there's this whole parallel structure of business credit that is parallel to personal credit and that it more and more is coming into play. How do you build that? How do you build those things? How do you become aware of it? How do you become educated on it? We're starting to give people that. We're starting to do the reporting and also give them the reports.

Gene Marks:
That is great. How long has the card been around? When did you start this up?

Solomon Lax:
The card's been around a little bit over 12 months.

Gene Marks:
No kidding. Wow, that's amazing. Where are you finding most of your business coming from right now?

Solomon Lax:
It's mainly online and also a little bit from previous experience during PPP, which is, by the way, its own dramatic story. We were about to start the beta of the card in '20. We actually had two cards out on the street, one to a vegetarian hamburger joint that used it straight through PPP. Never missed a payment. Anyway, we just did not know what was going to happen in March of '20. We really threw a pass to Cross River that we had a relationship with. We ended up doing a million applications for PPP.

Solomon Lax:
We funded off of the same platform, $4 billion in PPP loans. It was crazy, because the system wasn't built for PPP. We had to duct tape it. Basically, my software engineers were doing the equivalent of duct tape around it to make it work. But we at that point were in touch with a ton of small businesses.

Gene Marks:
That's where you created your branding for it, I'm assuming, where people got to know...

Solomon Lax:
Look, hopefully it was a great experience whenever we got funded, but it was pretty crazy.

Gene Marks:
Got it. We'll wrap this up. It's a great form of financing. This is really geared, it seems to me, and stop me if I'm misdirecting in a way, it's for all businesses, but particularly those businesses that are subprime businesses and other ones, ones that might have that credit score that's below what a typical credit card issuer or bank would go to lend you money. To me, whenever I look at financing opportunities like that, it's like you match the financing with the project. It's a short-term thing. I mean, your interest rates are high, but I'm assuming that it's not as if a lot of your customers are really getting this financing on an annual basis. I mean, they need the cash.

Solomon Lax:
You're totally correct. In other words, it's too expensive to tolerate unless you have some huge IRR, whatever you're doing. It's too expensive to tolerate on a long-term basis. You should not put in place this type of financing for three years for a project unless you got got a crazy IRR. But what we see is a couple use cases. One is just short-term coverage for an episodic need that it's hard to envision. The second is, again, a high IRR opportunity that you can trade out of and you either are going to put in lower cost financing. But aside from the low FICO population, what is actually surprising to me, because I thought exactly like you, is we have probably about 30% of our customers have FICO scores over 700.

Solomon Lax:
I think the delta there is, is that someone is underwriting them for a card and not a line of credit and saying, "Here's your $20,000 card," and their business needs $150,000 worth of credit. We're giving them that $150,000. The capacity, the ability to extend a higher credit capacity is prevalent in this type of methodology. But I agree with you totally. I don't think that most businesses can tolerate above 50%, which we go go from the 30s and up. For somebody with a 40% APR alone in place for three years, you can do the math. You just have to have an IRR that's high enough to be able to do it.

Gene Marks:
Make sense.

Solomon Lax:
Mostly, we see the population pulling it, paying it back, pulling it, paying it back, using it episodically. It's self-amortizing. It's not hanging out there forever.

Gene Marks:
Solomon Lax is the CEO of Revenued. The website is Revenued.com, R-E-V-E-N-U-E-D.com. Solomon, thank you. I want to wish you best of success with the card. It sounds like a great short-term financing opportunity for businesses to use. Everybody, check it out. Thank you so much for joining.

Solomon Lax:
Thank you, Gene.

Gene Marks:
Everybody, you've been listening to Gene Marks and the Paychex THRIVE Podcast. I appreciate you listening and watching, I hope, as well. If you've got any tips or guest suggestions, please visit us at our page at payayx.me/thrivetopics. That's payayx.me/thrivetopics. Again, thanks for listening and watching. My name is Gene Marks. We will see you again soon with another episode of THRIVE. Take care.

Gene Marks:
Do you have a topic or a guest that you would like to hear on THRIVE? Please let us know. Visit payayx.me/thrivetopics and send us your ideas or matters of interest. Also, if your business is looking to simplify your HR, payroll, benefits, or insurance services, see how Paychex can help. Visit the resource hub at paychex.com/worx. That's W-O-R-X. Paychex can help manage those complexities while you focus on all the ways you want your business to thrive. I'm your host, Gene Marks, and thanks for joining us. Until next time, take care.

Speaker 1: