
BLACKTECHSTARTUP EDUCATION

Avoid Predatory Startup Funding and Bad Capital Deals

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Urgency is when bad money becomes most expensive

A business short of payroll or inventory is vulnerable to “money tomorrow” offers. Speed can be valuable, but speed is not a price. Build a one-page funding comparison before signing anything: cash you actually receive; total contractual repayment; expected repayment period; daily/weekly/monthly payment; variable versus fixed remittance; stated interest/factor/fees; prepayment treatment; liens; personal guarantee; default triggers; broker compensation; and effective annualized cost if it can be calculated from the payment schedule.

Do not label every merchant cash advance or revenue-based product “predatory.” The product category and the conduct are different questions. The FTC has documented concerns with some MCA providers involving misleading marketing, triple-digit estimated APRs in some cases, failed reconciliations and abusive collections. Your job is to understand the specific contract and cash-flow burden in front of you.

Factor rate is not an APR

If an offer advances \$100,000 and requires \$130,000 total repayment, the dollar financing cost is \$30,000 before considering other fees. That is a 30% cost relative to the advance, but it is not automatically a 30% APR. If the money is repaid rapidly through daily withdrawals, the annualized effective cost can be much higher because principal is being returned throughout the period. Ask the provider for APR or an annualized-cost disclosure where available and have your accountant or finance professional model the cash flows.

Build the actual payment schedule in a spreadsheet. A financing product can look manageable as a total payback and still crush working capital because cash leaves the bank every business day.

Read the cash-control terms

For sales-based financing, understand whether payments are truly a percentage of receivables/revenue or a fixed daily ACH amount, and how reconciliation/true-up works when sales decline. What proof must you submit? How quickly does payment adjust? Is the adjustment discretionary? What happens if the bank account balance is insufficient? FTC enforcement history shows why promised reconciliation and withdrawal behavior deserve explicit attention.

Also identify who controls payment routing, whether the provider has access to processor receivables, and whether you can switch processors or bank accounts. Financing that interferes with the operating account can create cascading defaults elsewhere.

Map liens, guarantees and default triggers before signing

Ask whether the agreement authorizes a UCC filing or lien, what collateral is covered, whether there is a personal guarantee, and what events trigger default. Review cross-default, additional-financing/stacking restrictions, change-of-control, bank-account changes, material-adverse-change language, confession-of-judgment provisions where relevant, arbitration/venue and collection costs with qualified counsel. State law matters; do not rely on a generic internet interpretation.

Personal guarantees can turn a business financing problem into a personal asset problem. That does not automatically make a loan wrong, but it changes the risk and should change your decision.

Watch the broker and sales process

Ask whether the salesperson is the lender/provider or a broker. Ask how the broker is paid and whether compensation changes based on which product you choose. Get all economics in writing. Red flags include pressure to sign before counsel/accountant review, blank or incomplete documents, promises that a term “isn’t enforced,” unexplained ACH authorization, claims that approval is guaranteed, requests for upfront fees without a verifiable service and discouraging you from comparing offers.

The FTC has repeatedly brought cases involving deceptive small-business financing and abusive collection practices. Verify the legal name of the provider, search enforcement/complaint history, and never let a polished salesperson substitute for reading the agreement.

Run the downside cash-flow test

Model base revenue, a 20% decline and your worst recent month. Layer the proposed payment onto payroll, rent, taxes, vendors and existing debt. If the financing only works when sales remain perfect, it is not resilience capital. Calculate the minimum cash balance each week. If payments cause negative cash before the financed project can generate returns, the structure is wrong even if the headline ROI looks attractive.

For growth financing, match repayment to the time the investment produces cash. Daily-debit capital funding a six-month product build creates a timing mismatch. Longer-duration debt, equity, customer prepayments, grants, purchase-order financing or staged spending may fit better depending on the situation.

Use a funding decision gate

Before signing, require: three alternatives compared when time allows; complete contract; verified provider identity; total-dollar cost; annualized/effective cost analysis where possible; downside cash-flow test; lien/guarantee summary; prepayment/default summary; broker compensation disclosure if relevant; accountant review for economics; attorney review for material legal terms; and a written reason this capital creates more value than it consumes. If the provider will not let you understand the deal, that is information.

For Black founders and small-business owners who may encounter uneven access to conventional capital, the answer is not to accept opaque capital as the price of ambition. Use MBDA, SBA lenders, community banks/CDFI resources where applicable, customers, strategic partners and the broader capital stack in Guide 03 to create alternatives before urgency removes your bargaining power.

Research behind this guide

Use the primary and authoritative sources below to verify current rules, prices, eligibility and program details before acting. Terms can change.

FTC — Small Business Financing Staff Perspective



FTC — Merchant Cash Advance Enforcement



FTC — Protecting Small Businesses Seeking Financing



SBA — Loans



SBA — Lender Match



MBDA — Business Resources



Important: This guide is educational information, not individualized legal, tax, investment, employment, security or compliance advice. For decisions with material legal or financial consequences, use a qualified professional who can review your facts.

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