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Strength in Diversity

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The Disproportionate Effect of MCAs and SBFs on Minority-Owned and Small Businesses

Historically, commercial banks targeted minority communities and less capitalized businesses by denying or limiting access to credit, a practice known as "redlining."[1] Over the past several years, two new forms of credit have emerged that are often the only practical alternative for minority-owned and small businesses: merchant cash advances (MCAs) and sales-based financing products (SBFs). These alternative credit sources have become the primary secured creditors of today's distressed minority-owned and small businesses.

The disturbing reality is that these products, aggressively marketed as fast and flexible alternatives to conventional credit, carry effective annual percentage rates that are predatory and perhaps, depending on the interpretation of applicable law, usurious. As discussed below, the rate of default for MCAs and SBFs is extraordinarily high compared to traditional sources of credit.

The structural conditions driving small businesses toward these products have been well-documented by reputable consulting and research firms. According to a January 2025 Boston Consulting Group (BCG) article, they estimated that the global funding gap for small and medium-sized businesses may exceed $5 trillion worldwide, with the gap in the U.S. alone ranging from $350 to $750 billion.[2] The Federal Reserve's Small Business Credit Survey confirms this: Large banks approve 40 percent of small business loan applications, and small banks approve 53 percent.[3] BCG emphasized that with banks pulling back from this segment, "fintechs and other forms of lending (such as MCAs) have stepped in to fill some of the void."[4]

What Are MCAs and Sales-Based Financing?

MCA providers deftly characterize the transaction not as a loan but as a *purchase of future receivables*. The funder purchases a fixed dollar amount of the business's future credit card or sales receipts at a discount. Daily or weekly direct ACH withdrawals from the borrower's bank account, or credit card receipts tied to a percentage of sales, are then used to recoup the funder's advance. That amount is labeled the "holdback" or "remittance rate" and is typically 10-20 percent.

MCAs often are utilized by small retailers and restaurants. Because the product is structured as a purchase rather than a loan, MCA providers have argued that it falls outside state usury laws and federal disclosure requirements.

SBFs are a closely related product, often distinguished only by the source and terms of repayment. Rather than capturing a percentage of card swipes, SBF agreements may draw against total revenue or bank deposits. Platforms such as Shopify Capital, Square Capital, PayPal Working Capital and Stripe Capital all offer variants of this product to their merchant-users. Shopify Capital,

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1 The authors thank summer associates Cassandre Axis, Brandon Licorish and Carolina Mendoza for their meticulous source verification and editorial comments.

2 Ryan Curley, *et al., The Forthcoming Revolution in Small Business Lending*, Bos. Consulting Grp. & Biz2X 1, 1–3 (2025), https://media-publications.bcg.com/The-forthcoming-revolution-in-small-business-lending.pdf?linkId=714147398.

3 Allan Garfinkle, *Federal Reserve Small Business Lending Survey: Key Findings for 2026*, Crestmont Cap. (Mar. 28, 2026), https://www.crestmontcapital.com/blog/federal-reserve-small-business-lending-survey#lender-type-comparison.

4 Curley, *et al., supra* note 1 at 4.

for example, offers both MCAs and short-term loans. Repayment is automated as a percentage of daily Shopify sales, with no credit check and no traditional underwriting. Shopify has disbursed more than $5 billion in such funding since 2016.[5]

The True Cost: Factor Rates vs. APR

MCA and SBF providers do not quote interest rates. Instead, they present a "factor rate" — a simple multiplier applied to the advance. For example, a factor rate of 1.30 on a $100,000 advance means the business repays $130,000 regardless of how quickly repayment occurs. This credit design is deliberately opaque; it obscures the annualized cost of capital, which is the standard metric used to evaluate any type of credit.

Because factor rates are time-insensitive, the effective APR depends entirely on repayment speed. Paradoxically, the faster a business repays — often driven by strong sales that accelerate daily holdback withdrawals — the higher the annualized cost.[6]

A conventional term bank loan at a rate of 7 to 11 percent APR is far less expensive. Compared to an MCA product, a borrower will pay *four to 30 times more* for the same capital. Critically, unlike traditional loans, there is no interest saved by early repayment, which means that the full purchased amount (or "loan") is owed whether or not the business has a strong sales month. Paradoxically, a strong sales month *accelerates* repayment and *increases* the annualized cost. This naturally leads to higher rates of default for users of these products.

Default Rates: The Data Is Alarming

The most telling metric is default frequency when compared to traditional lending. Traditional commercial bank loans carried a delinquency rate of only 1.13 percent as of early 2024.[7] Even the historical peak default rate for bank business loans — 6.75 percent in April 1987 — is lower than the current MCA default rate.[8]

MCAs carry a default rate estimated at 7 to 12 percent.[9] The aggregate dollar figures are staggering: Major MCA providers — including PayPal, Shopify, Citigroup and Square — "reported combined defaults of $2.22 billion in 2024," a 59 percent increase from $1.40 billion in 2023.[10] These figures reflect only the largest, most visible platforms; the total market default volume, including independent funders, is likely substantially higher.

One reason for high default rates is that businesses frequently "stack" MCAs by taking a second or third advance to cover the daily ACH withdrawals from the first advance. Each layer of advance further restricts working capital. This predictably leads to a cash-flow crisis, followed by default, and often bankruptcy or an out-of-court workout or wind-down.

The Surge in Small Business Filings, with MCAs as a Direct Driver

A landmark *Bloomberg Law* analysis directly links the surge in bankruptcy filings to MCA debt. Commercial bankruptcy filings increased 37 percent in Q1 2026, with subchapter V elections increasing 67 percent in Q1 2026.[11] Through the first nine months of 2025, subchapter V elections totaled 1,764, a 6 percent increase over the same period in 2024 and part of a broader 10 percent rise in total bankruptcy filings year-over-year.[12] According to *Bloomberg Law* data, bankruptcy cases listing MCA firms as creditors surged in 2023 and peaked last year, 2025, with over 230 filings.[13]

The *Bloomberg Law* analysis includes several examples. Chapter 11 debtor Rogers Landworks LLC entered 21 separate MCA transactions totaling $3.6 million before filing bankruptcy in December 2025. Other cases identified include Pat McGrath Cosmetics ($3 million in MCA payments before a January 2026 filing) and a 43-location Subway franchise carrying $1.4 million in MCA debt at a 94% annualized return rate.[14]

Legal scholars have focused on MCA issues in general and in bankruptcy courts. One article confirmed that "most small business debtors under Subchapter V of Chapter 11 have at least one merchant cash advance creditor"[15] — making familiarity with these instruments a practical necessity for every small business bankruptcy practitioner. The lack of regulation of these credit instruments provides ample opportunities for abuse.[16]

Minority-Owned and Small Businesses: A Captive Market

This debt conundrum is, in part, a social policy problem. MCAs and SBFs disproportionately serve borrowers who cannot access conventional financing. Taken together, Federal Reserve and Biz2Credit data suggest that only a small fraction of small businesses ultimately secure a traditional bank loan. Fewer than 40 percent apply at all, and of those who apply at large banks, only approximately 13-14 percent are approved. MCA providers, by contrast, approve 70-80 percent of applicants

5 "See How We're $mashing One of the Biggest Barriers to Entrepreneurship," Shopify (Apr. 23, 2024), https://www.shopify.com/news/capital (highlighting that by April 2024 Shopify Capital, issued through WebBank, had disbursed over $5 billion since 2016); *see also Top Merchant Cash Advance Stories: Q2 2024*, Onyx IQ (Feb. 13, 2026), https://onyxiq.com/blog/merchant-cash-advance-stories-q2-2024 (reporting $816 million in Shopify Capital advances in Q4 2023 alone).

6 *A Funder's Guide to Managing MCA Defaults*, Onyx IQ (Feb. 13, 2026), https://onyxiq.com/blog/managing-merchant-cash-advance-defaults.

7 The 7-12% figure reflects industry consensus across multiple sources; a 2023 LendingTree study cited in industry publications reported MCA default rates had reached 21%, up from 12% in 2020. *A Funder's Guide to Managing MCA Defaults*, *supra* note 5.

8 *Id.*

9 "Merchant Cash Advances Defaults Surge 59% to $2.2 Billion as Businesses Turn to Reverse Consolidation," barchart (Jan. 25, 2026), https://www.barchart.com/story/news/37072113/merchant-cash-advance-defaults-surge-59-to-22-billion-as-businesses-turn-to-reverse-consolidation.

10 EPIQ AACER, Monthly Bankruptcy Filing Statistics (2023-2025), epiqglobal.com. EPIQ AACER is the leading provider of U.S. bankruptcy filing data and the official data partner of ABI.

11 "Bankruptcy Filings Increase Across All Chapters in First Quarter 2024," EPIQ AACER (Apr. 2, 2024), www.epiqglobal.com/en-us/resource-center/news/bankruptcy-filings-increase-across-all-chapters-in-first-quarter-2024; "First Quarter Subchapter V Small Business Filings Increase 67% Over Previous Year," EPIQ AACER (Apr. 8, 2026), www.epiqglobal.com/en-us/resource-center/news/first-quarter-subchapter-v-small-business-filings-increase-67-over-previous-year.

12 *Supra* note 10

13 Alex Wolf, "Merchant Cash Advances Piling Up in Small Business Bankruptcies," Bloomberg Law (Feb. 24, 2026), https://news.bloomberglaw.com/bankruptcy-law/merchant-cash-advances-piling-up-in-small-business-bankruptcies.

14 Wolf, *supra* note 13.

15 Caitlyn Coates & Michael Markham, "Merchant Cash Advance Claims in Bankruptcy," Disclosure Statement Newsletter, U.S. Bankruptcy Court for the Northern District of Florida (Apr. 1, 2025), https://www.flnb.uscourts.gov/sites/flnb/files/2025-04_NSL.pdf; *see also* Adam J. Levitin, "Predatory Small-Business Lending: Market and Regulatory Failures," 42 *Yale J. on Reg.* 737, 758,798 (2025).

16 *Ibid.*

meeting minimum revenue thresholds — making them the lender of last resort.[17]

For minority-owned businesses, the disparity is more acute. A 2024 LendingTree analysis found that 39 percent of Black-owned businesses were denied a loan, line of credit or merchant cash advance — the highest rejection rate of any racial or ethnic group. Hispanic-owned businesses were denied at a 29 percent rate, while white-owned businesses were denied only 18 percent of the time.[18] A Goldman Sachs survey conducted in January 2024 found that 37 percent of Black small business owners who had taken loans in the prior year reported experiencing payment terms that felt predatory, compared to 28 percent of all small businesses nationally.[19]

McKinsey & Company's research on the racial wealth gap found that even with strong personal credit, Black business owners are about half as likely as their white counterparts to receive full financing.[20] Black entrepreneurs start businesses with approximately $35,000 in capital, compared to $107,000 for white entrepreneurs — which represents a fundamental disadvantage that drives reliance on high-cost alternative credit. McKinsey estimated that if Black Americans were given loans and coaching at the same rate as other groups, their companies could generate $1.6 trillion in revenue and create 615,000 new firms.[21]

One study found that 39% of Black sole proprietors who did not apply for financing in 2023 were "discouraged borrowers": They anticipated denial, so they did not apply at all.[22] For these entrepreneurs, the MCA funder's promise of fast approval with no credit check is not merely convenient; it is often the *only available path to capital*.

The Regulatory Landscape: A Patchwork in Progress

MCA providers have long argued, with significant judicial success, that their products are not loans and therefore fall outside usury statutes, the Truth in Lending Act and state consumer finance laws. Courts have generally accepted the "purchase of receivables" characterization, although this area of law is evolving. Several states — including California, New York, Virginia, Utah, Connecticut and Kansas — have enacted commercial financing disclosure laws requiring MCA providers to disclose APR equivalents and total repayment amounts.[23] The Consumer Financial Protection Bureau, which supervises financial institutions and monitors compliance with federal consumer finance law, has extended its Section 1071 data-collection rulemaking to MCA transactions, creating for the first time a federal data collection requirement capturing MCA originations by race and geography.

State enforcement has been rare but aggressive where it has occurred. The New York Attorney General's office obtained a $1.065 billion judgment against lender Yellowstone Capital — "the largest single-state consumer restitution in state history" — involving interest rates producing APRs up to 820 percent. This judgment will result in $534 million in cancelled debt for more than 18,000 small businesses.[24] However, absent federal regulation, many MCA and SBF providers continue to operate across state lines with minimal disclosure obligations.

This highlights the importance for bankruptcy practitioners to monitor the evolving judicial treatment of MCAs and SBFs. Courts are increasingly scrutinizing whether MCA agreements are true sales or disguised loans — a determination that affects the automatic stay, preference analysis, the secured status of UCC financing statements filed against receivables, and the dischargeability of obligations in a subchapter V plan.[25]

Implications for Bankruptcy Practitioners

When a small business debtor arrives in chapter 7 or chapter 11 with a stack of MCA obligations, practitioners should:

- consider whether the MCA or SBF is a loan, and if so, whether it is a secured obligation. MCA creditors routinely file UCC financing statements asserting a lien on receivables, requiring debtors to seek cash-collateral authorization in chapter 11 cases;
- consider whether an MCA's daily ACH sweep or pre-petition collection action constitutes a preference or fraudulent conveyance;
- reconstruct the true cost of each advance by converting factor rates to effective APR, which will be relevant both for plan treatment and any fraudulent-transfer or usury-based challenges;
- consider whether stacked MCAs support an evidentiary finding of insolvency at the time of each advance, which would support avoidance actions;
- identify the regulatory framework applicable in the debtor's state, as mandatory APR disclosures may be

17 2025 Report on Employer Firms: Findings from the 2025 Small Business Credit Survey, Fed. Small Business Credit Survey 1, 13 (Mar. 2025), https://www.fedsmallbusiness.org/reports/survey/2025/2025-report-on-employer-firms (37% of firms applied for a loan, line of credit, or merchant cash advance in the prior 12 months, unchanged from 2023); Biz2Credit, "Small Business Loan Approvals Stalled at Big Banks, Rose at Small Banks and Alternative Lenders in November 2023," Biz2Credit Small Business Lending Index (Nov. 2023), https://cdn.biz2credit.com/appfiles/biz2credit/pdf/Small-business-lending-index-November.pdf (large bank approval rates at 13% in November 2023, with small banks at 19.7%); *see also* Boston Consulting Group & Biz2X, *The Forthcoming Revolution in Small Business Lending* (Jan. 2025), https://media-publications.bcg.com/The-forthcoming-revolution-in-small-business-lending.pdf (noting that small businesses receive funding "at least half the rate of larger enter); Fed. Small Business Credit Survey, 2024 Report on Employer Firms: Findings from the 2023 Small Business Credit Survey, Fed. Rsrv. Banks (Mar. 2024), www.fedsmallbusiness.org (large bank approval rate: 14%; small bank 26%; online lender 48%).

18 Maggie Davis, "1 in 5 Loan, Line of Credit or Merchant Cash Advance Applicants Denied in 2024," LendingTree (Sep. 22, 2025), https://www.lendingtree.com/business/small/applications-denied-study/#finding-funding-as-a-small-business-top-expert-tips.

19 Goldman Sachs, "New Survey Data Shows Black Small Business Owners Less Likely to Secure Loans," https://www.goldmansachs.com/pressroom/press-releases/2024/new-survey-data-shows-black-small-business-owners-less-likely-to-secure-loans (Feb. 6, 2024) (survey of 1,459 small business owners conducted Jan. 15-21, 2024).

20 David Baboolall, *et al., Building Supportive Ecosystems for Black-Owned US Businesses*, McKinsey & Company, (Oct. 29, 2020), https://www.mckinsey.com/industries/public-sector/our-insights/building-supportive-ecosystems-for-black-owned-us-businesses#/.

21 McKinsey & Company, "The economic impact of closing the racial wealth gap," Public Sector Practice (Aug. 2019).

22 "Reaping the Unrealized Gains of Black Businesses" Brookings Institution, www.brookings.edu (June 2025).

23 "Commercial Financing Disclosure Laws (by State)," Onyx IQ, https://onyxiq.com/resources/commercial-financing-disclosure-laws/ (last visited June 11, 2026).

24 Steve Rhode, "NY AG Wins $1B Against Predatory Lender Yellowstone Capital," Get Out of Debt Guy (Jan. 15, 2026), https://getoutofdebt.org/230067/ny-ag-wins-1b-against-predatory-lender-yellowstone-capital.

25 *See In re Watchmen Sec. LLC*, No. 24-00087-JMC-11, 2024 WL 4903363, (Bankr. S.D. Ind. Nov. 20, 2024); *In re J.P.R. Mechanical Inc.*, 2025 WL 1550541 (Bankr. S.D.N.Y. May 30, 2025); *In re IVF Orlando Inc.*, No. 6:24-bk-05475-TPG, 2025 WL 2831400 (Bankr. M.D. Fla. Oct. 3, 2025).

relevant to characterizing the debt and challenging its enforceability; and

- understand the social and economic context, as many debtors had no meaningful access to conventional credit and made the best decisions they could under severe constraints. That context is relevant to plan-feasibility arguments, creditor negotiations and the equitable discretion of the court.

Conclusion

MCA and SBF financial products have filled a genuine capital gap for minority and small businesses, which have largely been excluded from conventional credit markets. But their opaque structures and effective APRs make them among the most expensive and dangerous financial instruments available to minority and small business owners.

According to EPIQ AACERS, small business filings continue to surge,[26] and MCAs and SBFs are significant creditors in an overwhelming number of those cases.[27] The default data confirms that these products generate distress at rates that dwarf traditional lending, and they concentrate that distress among the most financially vulnerable borrowers: small firms, minority-owned businesses and first-generation entrepreneurs. abi

26 "February Small Business Subchapter V Elections Increase 91% Over Last Year," EPIQ AACER (Mar. 5, 2026), https://www.epiqglobal.com/en-us/resource-center/news/february-small-business-subchapter-v-elections-increase-91-over-last-year (according to EPIQ AACER, small businesses filings captured as subchapter V elections within chapter 11 increased 91% in February 2026).

27 Wolf, *supra* note 13.

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