What type of financing do I need for my business?

The 3 ways for you to get capital for your business are **Debt** or **Equity** and **Crowdfunding**. Debt and Equity are the two most traditional forms with crowdfunding be relatively new.

Debt financing involves borrowing a fixed sum from a lender, which is then paid back with interest. Debt usually requires collateral and/or personal guarantee. Debt typically comes from banks, credit unions and CDFIs (Community Development Finance Institutions).

Debt financing comes in many forms including:

- **Secured lines of credit** from banks or other financial institutions: Though harder to get, this type of financing has low interest rates, and lets you draw down only as much cash as you need, in any given period.
- **Term loans** from banks, Credit Unions or CDFIs: These provide the full amount of capital upfront and require regular payments over a fixed amount of time.
- **Credit cards** from banks or Credit Unions: You borrow money that must be paid back with interest after a grace period. Typically high interest rates.
- **Invoice or receivables financing** from financial companies: When you need cash on hand, this form of financing fronts capital at a discount, for income you would receive later.

Pros of debt financing:

- Can be used by almost any kind and size of business, typically best for first time business owner.
- You retain ownership of your business, which means you will not have to share profits long-term.
- You know when you need to repay.
- There are a range of options (different kinds of loans, credit cards, lines of credit, etc.).
- Interest on the debt can be deducted from the firm's tax return.
- Interest rates on loans are usually lower than the return on equity investments.

Cons of debt financing:

- Requires repayment of both principal and interest whether business is good or bad.
- Debt is an expense and expenses prevent you from reinvesting your revenue in the business.
- There's always a risk. Defaulting will cost you the assets (or personal guarantee) you pledged as collateral.
- Lenders may restrict what you use the money for or whether you can look for more financing elsewhere.

Equity financing is the sale of a percentage of the business to an investor, in exchange for capital. Equity typically comes from friends, family, angel investors and venture capital firms. A typical equity investor is going to be looking for a high rate of return, a strong business plan and management team. An operating agreement should always be put in place.

Sources: Bond Street and Investopedia

Equity financing typically comes from three sources:

- **Friends and family (or other small investors):** These private investors put a relatively small amount of money into your business in exchange for relatively small pieces of the pie.
- **Angel investors:** Generally private individuals or associations, these investors typically put 10s to 100s of thousands of dollars into your company and are sometimes looking for a large ownership percentage.
- **Venture capital firms:** These firms publicly invest millions of dollars into very promising startups.

Pros of equity financing:

- For new businesses with no revenue or those which are yet to attain profitability, equity financing can be your best if not only option.
- Investors take on almost all the risk; they receive their returns only if the business succeeds
- No percentage of your revenues will be diverted to pay loans.

Cons of equity financing:

- You give up a percentage of your business.
- Investors may have control over key decisions and influence the culture of the company.
- Landing investment can be a full-time effort, and reporting to investors regularly can take precious man-hours.
- Investors or "equity partners" usually do not expect a return on their investment for 3-5 years, but they often exit after 5-7 years.

Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business venture. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together, with the potential to increase entrepreneurship by expanding the pool of investors beyond the traditional circle of owners, relatives, friends and venture capitalists.

Pros of crowdfunding:

- It enables you to test the market before fully launching.
- If successful generates customers that are now invested in your success.
- Allows you to maintain full ownership of your business.
- The funds are interest free.

Cons of crowdfunding:

- You need capital in advance in order to successfully market your fundraising campaign.
- You will have to pay for and deliver on whatever goods or services are promised to your funders, i.e. a brewery is fundraising to purchase equipment and with an investment of $50 the funder receives a t-shirt.
- The crowdfunding platform will keep a percentage of what you raise.
- Some platforms only charge the funder and release the funds for the project if the full amount of the campaign is met.

Sources: Bond Street and Investopedia