



The Difference Between Debt And Equity Financing

There are two main types of financing for a business, debt or equity financing. Debt financing tends to be the type of financing you receive from a traditional bank loan and equity financing tends to be financing you receive from venture capital into your business from outside investors. The benefit of debt financing is that it is finite and you will pay down the debt over time to a zero sum balance without any further obligation to the lender. The down stroke to debt financing is that traditional lenders will take a hard look at your business including how long it has been in existence, income from operation, expenses and will require hard assets for collateral for the loan. Additionally, lenders will most certainly want you (and any other principals of the organization) to personally guarantee repayments of the loan. Another disadvantage of debt financing is that your organization will be burdened with some other type of regular payment (usually a monthly payment) depending on the terms and conditions of the financing and this can absorb critical cash flow, especially with small business.

The benefit of equity financing or venture capital is that you will be receiving money in exchange for equity in your business in the form of stock or some other form of equity like percentage of income or gross/net sales. A primary benefit of this type of financing is that typically there is no monthly payment requirement to investors. Instead, you are giving up ownership interest, most often, permanently.

Traditional lenders, banks for example, will look at your business much differently than venture capitalist. Bankers want a zero-risk or near-zero risk position when they provide financing and will rely almost completely on the operating economics of the business with little regard for “potential future growth”. They want to see strong cash flow backed up by hard assets before they do a deal—the ingredients that most small business lack or they wouldn’t be seeking financing, right? Venture capitalist, on the other hand, tend to consider the management team and the potential future growth of the business more heavily than actual operating numbers, especially for small business with large potential but few sales and little or no operating history. Although these two lender types vary in their approach to analyzing a business for funding, you can be sure that careful scrutiny of you business will be conducted...

Besides the actual operating economics and pro forma analysis, both types of lenders will look closely at two particular documents: 1. Your business plan. 2. Your bank or loan request package. These two documents, if assembled correctly, can make the difference between success and failure when dealing with either lender type.

There are plenty of free SBA related materials that tell you how to create blue-chip, boiler plate business plans but they tend to be written for perfect businesses and not the average Joe who is less than picture perfect. If you are seeking some type of financing for your business I strongly suggest that you visit our site and check out our business e-books. We have several that cover a variety of topics and there are specifically two that will be a real treasure for you to own. One is called Power Planning (a powerful report on writing a wide variety of business plans) and How To Raise Money For Your Business (teaches you how to assemble professional loan requests packages). They are priced at \$5 each and can be worth millions in the hands of the right person. I am not trying to hype product, I am simply giving you a heads up.

The secrets to getting financing from either type of lender is a closely held secret by financial and business brokers for a number of reasons. Chief among them is it forces people like you to do business with them and they earn commissions. The SBA materials, while good, do not have the street savvy to get the job done in most cases. The proof is in the pudding—what has the SBA ever done for you? The SBA is just another government back bureaucratic nightmare for most. We also have some links for venture capital firms in our business links area located on our site on the Smart Link Zone page—it's all-free.

Give it some thought.... Your future may depend on it.

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