Raising money for a business is called financing. Sometimes entrepreneurs can raise all the money they need to start and operate their businesses by themselves, through their earnings and savings. However, you may find that, to start your business, you need more money than you have. Or, after your business is up and running, you may need additional cash to expand it. You might want to add new products, or enlarge or remodel your store. At some point, most entrepreneurs are likely to need some type of financing.

How much money will you need to get your business going? Start-up investment is the one-time sum required to start a business and cover the start-up expenditures. The start-up investment is also called seed money or start-up capital. The start-up investment for a new company has two components:

- Start-Up Expenditures
- Cash Reserves (for emergency fund and reserve for fixed expenses)

DEBT FINANCING

You may be able to start a business with little or no start-up investment. You may also be able to fund the start-up investment yourself. However, if you need more money, you will have to find additional sources of capital. One method of obtaining more money is to borrow what you need. When you do that, you will increase your company's debt. This is called debt financing. There are three main sources of debt financing: banks, credit unions, and relatives and friends.

- **Banks.** The major source of debt financing for an entrepreneur is a bank. The money the bank lends you can be used to start or to grow your business. Naturally, the bank expects to be repaid. You will be required to make regular payments. Banks are very careful with their loans - they want to be as certain as possible that they will get their money back, with interest. Entrepreneurs often use bank loans to start a business, but you need to be careful when assuming debt.
- **Credit Unions.** Another source of debt financing is the credit union. A credit union is a nonprofit cooperative organization that offers low-interest loans to members. Many entrepreneurs have financed their businesses through credit-union loans. Credit unions, like banks, will loan you money for growing your business. However, credit unions may offer you lower interest rates than banks. A credit union, just like a bank, may ask for collateral or ask you to provide a co-signer.
- **Relatives and Friends.** The start-up capital for many businesses has come as a loan from the entrepreneur's relatives or friends. A large number of successful small businesses have begun this way. However, the major concern for you, as a new business owner, will be to earn enough revenue to pay back the loans-the hard-earned money of your friends or relatives. What happens if your business does not generate sufficient sales to make a profit, or it fails entirely?

EQUITY FINANCING

The other primary method of financing a start-up business is to sell shares of ownership in the business. If you use this method, called equity financing, you will be giving up some of your company and perhaps some control. The main sources of equity financing are relatives, friends, angels; venture capitalists; and partners.

- **Relatives, Friends, and Angels.** Sometimes start-up capital for a new business is obtained from relatives and friends as equity financing, in which they take a share of the company in payment for their investment. This is much the same as borrowing money from relatives and friends - with the same advantages and disadvantages - but with one big difference. Your friends and relatives now own part of the business. Some equity investors are referred to as "angels." An angel is an investor who is interested in financing start-up ventures. Like any investor, an angel wants to make a profit but may have additional reasons for investing.
- **Venture Capital Companies.** Another source of equity financing, similar to angel investment, is venture capital. Venture capital is money that is invested in a potentially profitable business by a specialized company whose purpose is to invest in start-ups. Venture capitalists are only interested in equity financing. Unlike angel investors, venture capital companies create funds in which many people have invested. Because venture capital investment is a high-risk business, these investors typically seek to earn five to ten times their original investment over five years. Because they see so many business plans, venture capitalists are typically difficult to interest in anything but very promising business start-ups.

- **Partners.** The most common source of equity financing is giving a percentage of the ownership of a business to a partner. When seeking a partner, you should do as much research as possible to be assured that the two of you will have the same basic principles and goals for the business. You will be co-owners of the company. As with other forms of equity financing, adding a partner requires an entrepreneur to give up some ownership. Unlike friends, family, angels, and some venture capitalists, a partner typically wants to play an active role in the operation of the business.

RETAINED EARNINGS

The amount of profit a company keeps to buy new equipment, buildings, and other resources that the company uses to expand and modernize is called retained earnings. When a corporation uses retained earnings, the decision is made internally and implemented by means of an accounting procedure. No outside approvals are required. For these reasons, use of retained earnings is a preferred way of obtaining financing. However, for most start-ups, retained earnings is not an option because the business is too new to have any profits to rely on.

Think Critically

1. What are some of the challenges you might encounter if you get equity financing from friends and/or family members?

2. Why is a secured loan easier to get than an unsecured loan?

Problem Solving

1. Explain the difference between debt capital and equity capital.

2. What are some of the ways entrepreneurs can get equity capital? Debt financing?

3. Do you think it is better for an entrepreneur to finance a business with debt capital or equity capital? Explain your answer.