Section 11. The Advantages & Disadvantages of External Financing

External financing can save your business.

Related Articles

1.Sources of Finance and Their Advantages & Disadvantages

2.What Are Internal Sources of Finance?

3.Examples of External Financing Alternatives

4.The Advantages of Internal Funding

ABSTRACT

External financing is any kind of business funding you acquire from sources outside the company. Bank loans, investments from private individuals or investment firms, grants and selling company shares are all examples of external financing. Before you set out to secure external funding, you need to understand the advantages and disadvantages associated with it.

Preserving Your Resources

One of the advantages of external funding is it allows you to use internal financial resources for other purposes. If you can find an investment that has a higher interest rate than the bank loan your company just secured, it makes sense to preserve your own resources and put your money into that investment, using the external financing for business operations. You can also set aside your internal financial resources for cash payments to vendors, which can help improve your company's credit rating.

Growth

Part of the reason organizations use external funding is it allows them to finance growth projects the company could not fund on its own. For example, if your business is growing to the point that you need additional manufacturing space to keep pace with demand, external financing can help you get the funding you need to build your addition. External funding can also be used for making large capital equipment purchases to facilitate growth that the company cannot afford on its own.

Ownership

Some sources of external financing, such as investors and shareholders, require you to give up a portion of the ownership in your company in exchange for the funding. You may get that large influx of cash you need to launch your new product, but part of the financing agreement is the investor is allowed to vote on company decisions. This can compromise the vision you originally had for your company when you founded it.

Interest

External funding sources require a return on their investment. Banks will add interest to a business loan, and investors will ask for a rate of return in the investment agreement. Interest adds to the overall cost of the investment and can make your external funding more of a financial burden than you had originally planned.

http://smallbusiness.chron.com/advantages-disadvantages-external-financing-10033.html

Section 12. The Advantages and Disadvantages of Debt and Equity Financing

Large investors often seek board membership or an officer position.
Related Articles

1. The Advantages of Using Debt as Capital Structure
2. Sources of Finance and Their Advantages & Disadvantages
3. Advantage & Disadvantage of Equity Capital
4. The Advantages & Disadvantages of External Financing

ABSTRACT

Debt and equity financing are your two basic options to raise money for a start-up company or growing business. Debt financing includes long-term loans you get from the bank. Equity financing is private investor money you get in exchange for a share of ownership in the business.

Debt Advantages

Debt financing allows you to pay for new buildings, equipment and other assets used to grow your business before you earn the necessary funds. This can be a great way to pursue an aggressive growth strategy, especially if you have access to low interest rates. Closely related is the advantage of paying off your debt in installments over a period of time. Relative to equity financing, you also benefit by not relinquishing any ownership or control of the business.

Debt Disadvantages

The most obvious disadvantage of debt financing is that you have to repay the loan, plus interest. Failure to do so exposes your property and assets to repossession by the bank. Debt financing is also borrowing against future earnings. This means that instead of using all future profits to grow the business or to pay owners, you have to allocate a portion to debt payments. Overuse of debt can severely limit future cash flow and stifle growth.

Equity Advantages

Equity financing doesn't have to be repaid. Plus, you share the risks and liabilities of company ownership with the new investors. Since you don't have to make debt payments, you can use the cash flow generated to further grow the company or to diversify into other areas. Maintaining a low debt-to-equity ratio also puts you in a better position to get a loan in the future when needed.

Equity Disadvantages

By taking on equity investment, you give up partial ownership and, in turn, some level of decision-making authority over your business. Large equity investors often insist on placing representatives on company boards or in executive positions. If your business takes off, you have to share a portion of your earnings with the equity investor. Over time, distribution of profits to other owners may exceed what you would have repaid on a loan.

http://smallbusiness.chron.com/advantages-disadvantages-debt-equity-financing-55504.html