DEBT VS. EQUITY: BORROWING VS. SELLING OWNERSHIP

The real cost of each, side by side, and how to decide which fits your business and goals.

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AT A GLANCE

- **Debt:** you borrow and repay with interest. You keep your ownership, but you must make payments, even in slow months.
- **Equity:** you sell part of your business. No monthly payments, but investors share your future profits and value forever.
- Debt often looks expensive today. Equity often turns out more expensive later, **if the business does well**.

Why it matters

Choosing between borrowing and selling ownership is one of the biggest decisions a founder makes. The wrong choice can mean payments your business can't afford, or giving away a large share of a business that becomes valuable.

Side by side

	Debt	Equity
What you give	Repayment plus interest	Part of your ownership
Monthly payments	Yes	No
Control	You keep control (within loan rules)	Investors may get votes or board seats
Cost if the business does great	Fixed: just the interest	Can be very large: investors share all the gains
Cost if the business struggles	Payments still due; you may personally guarantee	Investors share the loss
Who it suits	Businesses with steady cash flow	Fast-growing businesses, or those without cash flow yet

Example: two ways to raise $100,000

> EXAMPLE
>
> **Option A: loan.** $100,000 at 10% interest over 5 years. Monthly payment: about **$2,125**. Total repaid: about **$127,500**. Cost of the money: about **$27,500**, and then it's done.
>
> **Option B: equity.** An investor pays $100,000 for **20%** of the business. No monthly payments. If the business is worth **$2 million** in 5 years, the investor's 20% is worth **$400,000**. If it's worth $5 million, their share is worth $1 million.

If the business can comfortably make the $2,125 monthly payment, the loan is likely far cheaper over time. If it can't, or if fast growth is needed before profits, equity may be the better choice, despite the higher long-term cost.

Questions to decide

1. **Can the business make regular payments from cash flow?** Check your DSCR. See **R-06 Small Business Loans and SBA Loans**.
2. **How fast do you need to grow?** Fast growth with no profits yet often requires equity.
3. **How much control do you want to keep?**
4. **What would investors bring besides money?** Expertise and connections can be worth a lot.
5. **Can you combine them?** Many businesses use some of each.

In between: hybrid options

- **Convertible notes and SAFEs:** start as investment that converts to ownership later. See **R-14 SAFEs and Convertible Notes Explained**.
- **Revenue-based financing:** repaid from sales, no ownership. See **R-08 Revenue-Based Financing**.
- **Revenue-sharing notes:** investors get a share of revenue until a set return is reached.

Common mistakes

- **Giving up equity for something a loan could fund**, like equipment.
- **Taking on debt the business can't repay.**
- **Comparing only the short-term cost.**
- **Ignoring personal guarantees** on business debt.

Your checklist

- ☐ Calculate the monthly payment a loan would need
- ☐ Check whether your cash flow can cover it
- ☐ Estimate what different ownership shares could be worth in 5 years
- ☐ Consider a mix of debt and equity

☐ Talk to an advisor before deciding

Key words, explained

Word	What it means
Debt	Borrowed money repaid with interest.
Equity	Ownership in the business.
Dilution	When your ownership share shrinks because new shares are issued.
Hybrid financing	Funding with features of both debt and equity.

Where to go next

- **R-14 SAFEs and Convertible Notes Explained**
- **R-16 Ownership and Dilution: The Cap Table Explained**
- **R-06 Small Business Loans and SBA Loans**

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