

5 Tips for Borrowing Start-up Funds from Friends or Family

If you're starting a business that requires significant financial investment up front, finding a source of funding can be a challenge, especially since the average cost of starting a business is \$30,000. This is particularly true for young entrepreneurs who lack a strong credit history or don't want the hassle of dealing with banks or private lenders.

Once these start-up entrepreneurs are done considering their options, it's not unusual for them to ask friends or family for start-up cash. After all, unlike private investors or banks, these people know and trust you. It's possible they can get you quicker access to cash with fewer flaming hoops to jump through. On the flipside, if your business fails or you are tardy in repaying the money, you may be headed for some conflict with the aforementioned family and friends.

So what's the protocol for approaching an informal investor such as a friend, mentor, or even a family member? How do you work with them once you've secured an investment? Here are some key factors to consider:

1. Choose your Financier Carefully – Don't just turn to Dad or your best friend because that's who you know. Select someone with solid business skills who knows the risks and benefits of what they are getting into. Remember, if your business doesn't work out and you can't repay your obligations, relationships will suffer. At the very least, narrow your list down to friends or family who have faith that you will succeed, who understand your plans and are clear about the risks.

2. Demonstrate Passion and Due Diligence – Having an idea is one thing but proving that your idea is viable is another. Be sure you've done your research and due diligence before presenting your idea and asking for money. It's a good idea to write a business plan, even if it's a mini-plan that demonstrates the steps you've taken to research your market and work out your potential profitability. Most important, it should spell out what you need the money for.

3. Be Realistic About How Much Money You Need – Instead of asking for the maximum, consider what you need to get you to a certain point in your business plan. For example, if you need cash to buy inventory, assess your costs and ask for the minimum that you need to get you through three months. Once you have shown your ability to repay that initial investment, you'll be in a better position to ask for more money should you need it. And always remember to show and communicate your business progress along the way, even if it's correcting mistakes you've made with your business strategy.

4. Decide What You Want – A Loan or a Share in the Business? – Think carefully about this one. A loan will require repayment over time (which you'll need to be confident you can do) while a direct investment in your business is usually made in exchange for an active role in how the business is run. The latter can be helpful if you need mentoring guidance or “skin in the game” from someone who knows the business and can help you succeed. However, think hard about whether you want your family or a friend involved in your business operations on a day-to-day basis. Likewise, what are the emotional consequences if you are unable to repay the loan? These are all things to think about.

5. Come up with an Agreement with a Repayment Plan – Even though you may know your lender or investor well, remember that this is a business agreement. Treat it as such. The agreement should detail your business plan, how the funds will be used, how progress will be measured, and how repayment will be made. If the investment is a stake in your company as opposed to a loan, clearly outline the potential risks so your family and friends are 100 percent sure about what they are getting into.

The following is an edited version of the article at:

<http://www.sba.gov/community/blogs/community-blogs/small-business-cents/6-tips-borrowing-startup-funds-friends-or-famil> While the article was written by a US Government agency (The Small Business Administration – SBA) for US businesses, much of the information applies Canadian businesses as well.