

Borrowing from Friends, Family Requires Wise Management

Friends and family are an invaluable source of support for the aspiring small business owner. And often, they're an invaluable source of financial assistance as well.

In fact, more small businesses rely on loans from friends and family than any other funding source. Familiarity with the person and his/her business goals, the investment opportunity, and the ability to monitor the venture's progress are among the major reasons why friends and family members willingly contribute to a start-up or expansion.

However, a ready source of cash is not without its potential pitfalls. Business loans from family and friends also can be a disaster if they are not done right. Unstructured or loosely structured financing and payback terms can haunt both sides later on. Research shows that 14 percent of business loans from family and friends go into default, compared to about one percent for bank loans.

To increase the odds of success, approach family and friends with a detailed loan proposal, including financials from your business, just as you would a bank or venture capitalist. Be frank about the risks. If things go badly, they could lose all or some of their money. Consider the consequences of a soured business deal to your relationships.

Pick a financing structure that works best for your business and make certain everyone understands it. Specifically, be clear on whether the deal involves an ownership stake in your business, or whether it is a simple debt you plan to repay. And be clear about repayment terms.

To legally seal the deal, use a document such as a "Promissory Note." Putting the terms of your borrowing agreement into proper legal form is crucial. You can find the downloadable legal documents you need, including many different Promissory Note variations, at www.findforms.com. Self-help legal publisher Nolo also offers loan forms and related information at www.nolo.com.

Another helpful resource is Virgin Money at www.virginmoneyus.com, previously known as CircleLending.com before it was acquired by well-known entrepreneur Richard Branson. Virgin Money helps small business owners avoid the problems that can arise with loans from friends and family by providing loan administration, recordkeeping, payment processing and structural support. The service emphasizes flexibility to meet the needs and concerns of both borrowers and lenders, from terms and interest rates to repayment strategies.