# Debt financing versus equity financing essay sample

Business, Company

Debt Financing is borrowing money from a source outside the organization with a promise to repay it along with a certain amount of interest. Debt financing carries a burden of interest on the borrower. It also carries the burden of repayment of the principal amount after a certain period of time. Debt financing is by bank, private companies or borrowings from friends and family. Borrowing an amount from bank or borrowing money from a friend are examples of debt financing. The benefits of debt financing are that the rate of interest is lower and the borrower is able to get a tax deduction on the same. The borrower also has the benefits of maintaining ownership of the business and the assets. He is only obliged to repay the principal amount after a certain duration and to pay interest regularly. Other than that, the lender has no interest in the borrowers business.

Equity Financing is raising funds for the business by partial or complete trading of ownership of the company’s equity. The funds are raised in the form of money for the business use. This is usually done by selling the stock of the company. Companies usually prefer to increase their equity financing because it helps them borrow additional funds at a low rate of interest. It also means that there are a large number of shareholders and the profit of the company is to be distributed among them. It also gives voting rights to the shareholders, hence they can participate in the business.

If the company raises adequate amount from equity financing, it will not have to raise much money from debt. This will ensure that there is no burden of interest payment or principal repayment on the company. Choosing to raise finance from both the methods will diversify the risk and also ensure adequate availability of funds.

It is advantageous for a company to raise money through equity funding because it will reduce the risk as well as there will be no obligation for the company to repay the amount. The shares issued by the company could be non-voting and hence it will ensure that the shareholders do not gain any voting rights. For a company which has just been incorporated or not earning enough profits, equity financing is the best option. There will no repayment requirements and the company may raise additional finance at a low rate of interest from other sources. Having equity financing as an option ensures that the shareholders have faith in the company and are willing to invest their money. Though for a startup it is necessary to raise money through debts because it will be difficult to convince shareholders to invest. Once the company is incorporated and established, equity financing is the way to go. Most companies always prefer equity financing as compared to debt financing. There are various reasons for the choice. One of the basic and important reason is no repayment burden on the company for a long time. The decision may depend on the various situations a company maybe facing.

## Bibliography

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