Using equity and debt to finance investment opportunities

Finance, Investment

The concept of equity is different from that of debt financing. Although both are sources of capital for investing in new business opportunities, debt financing requires repayment of both principal and interest. The equity infusion of funds means growth capital without servicing a debt (McKeever, 2007). It also means that the venture maintains financial flexibility, which, in turn, enhances the capacity to borrow for funding other opportunities.

Further, the equity alternative to financing investment opportunities permits access to the venture at an earlier date than would be the case in more traditional investment opportunity situations. The added value offered by the investor is also a feature of equity financing. In most cases, investors have broader agendas than just return of investment. They look for deeper involvement – other types of return beyond the financial.

Under equity financing, capital permanently invested by the investors entitles them to share in some form of earnings distribution and therefore to be considered part owners in the business. Furthermore, using equity expands the borrowing power of the business. Finally, there is less market risk, since historically; the cost of equity has remained quite stable (Walter, 2004). However, raising new capital through equity financing would mean giving up a part of the firm’s ownership, and most owners of small firms resist giving up control to outsiders.

They do not want to be accountable in any way to minority owners, much less take the chance of possibly losing control of the business. Out of an aversion to losing control, some businesses choose tofinancenew business opportunities with debt rather than with equity. They realize that debt

increases the risk, but it also permits them to retain full ownership of the firm (Ruppert, 2004). Debt financing may be sourced through commercial banks, finance companies, insurance companies, leasing entities and specialty lenders.

Equity capital, on the other hand, is derived from venture capitalists and immediate circle of relatives, friends or acquaintances of the owner who have spare cash and are willing to invest in the business.

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