

Financing by “Friends, Family & Fools”

A large proportion of all self-employed and newly founded businesses do not take out loans from banks, neither for initial investments, nor for growing the business, nor for covering cash shortages. The financing often comes from a person's direct social environs, especially when the amount of money needed isn't particularly large. However, there are a few things that must be considered so that is a success for all the parties involved and to avoid disputes.

Questions to ask in advance

1. Do you think you know people who have money and would loan it to you?

Is your answer “no”?

2. Have you asked more than ten people?

Our tip: Ask whether or not you expect your inquiry to be successful or not. Be open to every answer, no matter whether the person you are asking answers with yes or no. Even a rejection is valuable, particularly if you find out something about the reasons for their no.

The Project

To be able to ask others for money, the self-employment should have the potential to guarantee your livelihood over the long term and additionally earn enough money to cover the loaned sum. You must be able to convince others of this potential. Check your idea in advance (target group survey), put together a plan, determine how much money you will need, calculate the specific profit expectations. Prepare yourself for questions such as: What is the basis for your profit expectations?

The Financial Backers

You can speak to all the people around you: Family members, friends, acquaintances, potential customers, people you meet in connection with founding the business...

The Attitude

You're not a beggar. You are offering others the possibility to invest in you, in your product or your service, in your company. Consider beforehand what value or benefit these people will get from this investment.

Some examples:

Friend: Wants you to do well, that you be successful

Sister: Wants you to be financially secure

Future customer: Wants your business to get started because they would like to buy the product/the service; would like to participate in the (financial) success of the company (returns)

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The Amounts

Never conceal the potential risks. It may happen that you cannot pay back the money as planned. Therefore only ask for an amount of money the person won't be hurt by if it should be lost. You don't want to be responsible for someone not having money for their retirement because you weren't successful, do you? Ask what the person's absolute limit would be if the money were to be completely lost. It's better to ask more people for smaller sums than fewer people for larger ones.

Repayment

If successful, you will repay the money from the company profits as planned.

If you wish to form a limited liability company as a precautionary measure to limit your liabilities for loan repayment, you should ask yourself the following question: Do you really not want to repay the person who, in complete trust, loaned the money to you? Think hard about whether or not you are really prepared to act in an entrepreneurial manner.

Furthermore: This sort of loan is considered "similar to one's own capital resources" and is not treated like a business loan. That means if your company goes bankrupt, it will not be included in the bankruptcy assets but instead remains your private obligation to repay.

For everyone else, the maxim is: "I'll pay the money back no matter what." Under certain circumstances, that could mean that even without formally declaring a personal bankruptcy, you will be spending only the absolute minimum and use the rest of your money to repay your debts.

The Formalities

Negotiate the modalities in advance with the person giving you the money.

1. When does repayment begin? (Grace period for repayment)
2. How will I repay the money? (Cash, in services, in products)
3. What rate of return does the person loaning the money receive? (Interest on the loan, products, services)
4. What happens if I cannot meet the planned obligations? (Deferment, suspension of payments)

Draw up a contract. Define all the conditions. Get advice about the legal and tax implications.