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5 things to know before you ask family and friends for money

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Before borrowing money from a friend, states a well-worn American proverb, decide which you need most.

Many small-business owners and entrepreneurs may not feel they have the luxury of heeding such advice. Initial startup costs, operating capital and even drawing a salary require a level of funds just beyond reach of many businesses at various stages of their venture.

Family and friends may be willing resources to turn to and interested in helping. But is this route a good idea?

ShopTalk spoke with several local experts about issues to consider before borrowing from family and friends. Here are five tips they shared:

1. Recognize your relationship will change.

"The moment you borrow money from a family member or friend," says Lauren Cantor, a business adviser, coach and owner of the Entrepreneur's Source, "you are changing the dynamics of the relationship. You are now in a business relationship and you must treat it as such."

Terri DeBoo concurred. She is the founder of Ideas@Work, a local firm that assists newcomers and others with assimilating and acclimating into the Charlotte business community.

"People need to be careful and expect their relationship will now shift where people feel license to weigh in," DeBoo cautioned. "It is not uncommon to see a sense of entitlement and even instruction on use of the funds by the lender. Given their investment, some people may feel OK questioning your personal spending habits while you

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  A family member or friend has asked you for money for their business. What do you do? Here are some things to keep in mind:

  • Attorney Steve Hockfield strongly cautions lenders to avoid cosigning on loans, offering personal guarantees or lending more than they can afford to lose. "I've seen many instances where people lost considerable money when loans they've guaranteed were defaulted on," Hockfield said. "Never put your home up as collateral; you may lose it."

  • Insist that your borrower has "skin in the game." If they aren't risking their money, why should you risk yours?

  • Review your borrower's business plan and be sure you fully understand what your money is being used for and how it is going to contribute to the success of the business.

  • It's always OK to say "No." If you're not comfortable, there's no explanation needed.

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still owe them money from a business loan."

2. Clearly define and agree upon expectations, terms and contingencies.

This may seem to be a no-brainer. But failing to clearly define terms regarding payback amounts, schedule, and interest rates – or consider what-if scenarios – has derailed many relationships.

Charlotte entrepreneurs Andy and Robin Ciordia started the popular confectionary, the Secret Chocolatier, together with Robin's parents, Bill and Karen Dietz, in 2008. The business recently expanded to a second location and needed extra capital to upfit the new store and purchase a significant piece of equipment to handle increased sales volume.

"I looked to a member of an advisory board I established for the business when we first launched," Andy Ciordia said, noting his remodel costs for the new store ran about $20,000 and the new piece of equipment needed was $10,000.

"The adviser owns an equipment leasing business. He considered becoming an equity investor when we first opened, knew our business plan well and suggested he purchase the equipment we needed, lease it back to me through his company, and sell it to us for $1 at the end of the lease term. It was a great win-win solution with well-defined terms executed through his business."

Ciordia's experience with prior startups taught him valuable lessons regarding what-if scenarios, and the importance of considering the possibility that things may not turn out as expected.

"I'd rather owe you what's agreed upon on paper than what you think I owe you in your heart," he said.

This leads to Tip No. 3.

3. Get it in writing.

Documentation is crucial for business agreements. Loan documents should be reviewed, if not prepared, by a lawyer well-versed in business law.

"The very act of drafting an agreement signals an irrevocable shift from a personal relationship to a business one," said Steve Hockfield, attorney with Charlotte based law firm of Erdman and Hockfield LLC.

"Putting all terms in writing can help avoid future misunderstandings. If you treasure the relationship, I'd try and avoid this situation (of asking friends for money). But I do recognize people have needs and obtaining funds through friends and family can offer advantages."

Hockfield citied some advantages to borrowing from friends and family, including no credit checks, no loan fees and expedited access to funds.

4. Get independent, expert advice regarding borrowing.

One issue often overlooked is rethinking the decision to take on extra debt at all.

Using borrowed money for expansion plans, owning vs. leasing equipment, research and development expenditures or marketing expenses may not be appropriate or well-timed given the health of your business.

Outside advice can help entrepreneurs critically evaluate whether or not borrowing makes sense or is appropriately timed.

Ciordia seeded his advisory board with those who were comfortable pushing back and challenging him as he weighed alternatives. He also takes advantage of SCORE, a nonprofit organization comprised of retired business people dedicated to educating entrepreneurs and providing advice to small businesses. (Find Charlotte SCORE at http://www.charlottescore.org.)

"I'm always soliciting advice from others who have been in similar situations," Ciordia said. "It's good to get another perspective."

The Small Business Association has a Charlotte office (http://www.sba.gov/offices/district/nc/charlotte) and provides advice, events and workshops on funding sources and government assistance.

5. Use friends and family as a last resort for financing.

One piece of advice on which all our experts agreed was that friends and family should be lenders of last resort.

"It adds an element of stress to the relationship that can make things difficult," Ciordia said.

Consider all other available sources. The landscape for microlending and funding sources is rapidly evolving.

Cantor cited sources such as business credit cards with low introductory fees, crowd-sourcing sites such as Kickstarter and, in the case of some franchise businesses, the franchisor. There are pros and cons for each and she recommended getting input from others who have personal experience.

“Do your homework,” Cantor said. “You may find attractive alternatives to borrowing from your family or friends.”

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