Only 0.07% of business receive VC, a highly publicized form of equity financing. So, how do the other 99.93% of businesses obtain the capital they need to grow? According to data from the U.S. Small Business Administration (SBA), in 2013, small business owners borrowed an estimated $1 trillion—$585 billion in business loan outstanding, $422 billion in credit from financial institutions, and the rest from a mix of sources. This makes debt among the most popular forms of financing; however, accessibility is just one of the many advantages of debt financing.

Keep in mind that there are several forms of debt financing, including lines of credit, small business credit cards, merchant cash advances and term loans. Make sure to explore all of your options for debt financing and select the one that best matches the unique needs of your project. While a term loan is appropriate for long-term growth investments, such as hiring more full-time employees or opening a new office or retail space, a line of credit is best suited for businesses looking to cover expenses that can be repaid within 12 months.

Whether you choose a term loan or line of credit, debt financing offers several benefits. From maintaining control of your company to receiving tax breaks, let’s review the six advantages of debt financing.

**Advantages of Debt Financing**

**Ownership Stays With You**

If you have followed the TV show Shark Tank, then you’re familiar with the haggling process after the business owner’s pitch, in which investors offer (and adjust their offers) for upfront capital in exchange for equity (check out a sample deal negotiation with inflatable pad manufacturer, Windcatcher).

While the Windcatcher owner was lucky enough to receive a deal with a lower equity stake than he was willing to give up, he still has to part ways with 5% ownership in his company. When seeking equity financing, other business owners may not be as lucky and have to give up a 10%, 15%, or even 20% stake of their company for an investor to be willing to fork out cash.

With debt financing, you don’t have to give out a stake in your company. Under certain circumstances, you may have to use a piece of machinery, vehicle, or very liquid accounts receivable as a collateral for a loan, but you only would have to give up ownership of that collateral if you were to default on the loan. Ownership of your company stays with you.
Current Management Retains Full Control
With company ownership comes control over management decisions. Depending on how much ownership you give up to third parties in exchange of equity financing, you’ll find yourself being less nimble to make decisions on your own. You often will have to seek approval for a mutually agreed list of items, ranging from hiring new personnel to selecting vendors. Virtually all equity investors seek some level of authority in the decision making process of companies that they invest in.

On the other hand, a lender has no say in how you run your small business. They may still want to take a look at your financial statements to perform a cash flow analysis, but they won’t have to approve on your purchases of supplies or hiring decisions. As long as you meet your scheduled payment plan on time, they’ll be happy to let you run your business as you wish.

Interest Payments Are Tax Deductible
Regardless of whether they’re charges from a term loan, line of credit or working capital account, any interest paid on money that you borrowed for business activities is tax deductible.

On Chapter 4 of Publication 535, the IRS indicates that you can “generally deduct as a business expense all interest you pay or accrue during the tax year on debts related to your trade or business” as long as the loan proceeds are used for business expenses and:

- You are legally liable for that debt;
- Both you and the lender intend that the debt be repaid; and
- You and the lender have a true debtor-creditor relationship.

This deduction is available for all types of small businesses. Here are some examples:

- Sole proprietors can deduct interest as a business expense on line 16 of Schedule C – Form 1040 and owners of partnerships.
- Owners of partnerships can claim this deduction on line 15 of Form 1065.
- Owners of S Corporations can claim this deduction on line 13 of Form 1120S.

Many types of charges from your lender for financing or refinancing a loan—including origination fees, maximum loan charges, discount points, or premium charges—can also help you to lower your business tax liability. Certain limitations may apply, so consult IRS Publication 535 or contact your accountant for more details.
Taxes Lower Interest Rate
Due to the tax advantages of debt financing, you’ll need to adjust your interest rate when comparing debt financing to alternative financing options.

Let’s imagine that you were evaluating whether or not to take a loan with an interest rate of 14%. Assuming that your business tax rate was 25%, your after-tax interest rate is 10.5% (14% – (1 – 25%)). When bringing taxes into the picture, 10.5% would be the actual interest rate that you would need to use in forecasts about your business. This is one of those times in which taxes can actually help you improve your bottom line.

Accessible To Businesses Of Any (And Every) Size
While there are alternative ways to raise funds, many of them aren’t accessible to small business owners. Here are two examples that speak to the advantages of debt financing.

First, in 2012, only 2% of small businesses listed venture capital as a source of funding, according to data from the U.S. SBA. On the other hand, 87% of small businesses listed debt financing as a source of funding. One key reason is that venture capitalists are looking for the next “unicorn” (companies with an estimated valuation north of $1 billion) and that disqualifies a majority of small businesses, even those with a positive cash flow history.

Second, while sole proprietorships aren’t prohibited from issuing bonds, very few can comply with the mandatory federal regulations and cover the associated expenses with the process of issuing bonds. If you think meeting the necessary requirements for an asset-based collateral loan can be hard, then complying with the more stringent collateral requirements for issuing bonds is virtually impossible.

On the other hand, even the smallest of small business can shop around for some form of debt financing.

Builds (Or Improves) Business Credit Score
Making timely payments to your lender of choice serves as a way to improve your personal and business credit score, another example of the advantages of debt financing.

It’s a great practice to separate your personal from your business finances, but it’s an even better one to separate your personal credit score from your business credit score. A great business credit score demonstrates vendors and lenders alike that you are responsible business owner, and that your business’s cash flow is sufficient to meet its obligations. Even when a lender doesn’t report to a business credit bureau, having a financing contract and a record of payments may lead to better financing opportunities.
Being responsible with debt financing can help you boost the creditworthiness of your business. As your business credit score increases, so will your business credit offers. Having access to better debt financing, can help you cover any future cash crunches more efficiently.

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- [Common Use-Cases for Term Loans](#)
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