12.1 How Does Lending Work (TL;DR)?

Governments raise money by selling securities (defined by contract law) called bonds. Corporations raise money by some combination of selling bonds or selling equity stakes in the company. A company's capital structure represents the many different ways a company has acquired the capital it has. A growth company typically doesn't have much revenue to pay dividends to investors, so it might be required to utilize its equity that captures all future value increases. A mature company with strong cash flows will be able to raise more capital through debt issuances without necessarily diluting the future claims to the company's profits. For a corporation, cash flow determines creditworthiness, and in the absence of cash flow, it falls to levers like equity stakes or restrictive covenants that cede governing control of the company.

For individuals and corporations alike, creditworthiness is also based on cash flow. A healthy W2 salary from a steady job is very creditworthy; however, as the individual borrows more and more, that cash flow begins to look thin to lenders, and they begin to look for other forms of creditworthiness before lending additional money. These can take several forms. A high-quality guarantor can be a powerful tool. This would entail getting your rich uncle to cosign your loans. When you start to lose your creditworthiness, it is possible to use another's superior creditworthiness to back your loans.