Sophie knows that $20,000 is not going to be enough money for the business to purchase equipment and supplies necessary to operate the business. She decides to approach her local bank for a 4-year, $80,000 loan. One of the disadvantages of debt financing when compared to equity financing is that debt financing requires that the loan be repaid to the creditor. When companies use debt financing, they typically must make monthly payments, including interest, to the creditor. When companies secure equity financing, there is no required payment to its investors.

Let’s see how obtaining a loan from a bank affects Rose Designs:

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **ASSETS** | **=** | **LIABILITIES** | **+** | **STOCKHOLDERS’ EQUITY** | | | | | | |
|  |  |  |  |  |  |  | **Retained Earnings** | | | | |
|  | Cash | = | Notes Payable | + | Common  Stock | − | Dividends | + | Revenues | − | Expenses |
| Bal. | $ 20,000 | = |  |  | $ 20,000 |  |  |  |  |  |  |
| (2) | +80,000 |  | +80,000 |  |  |  |  |  |  |  |  |
| Bal. | $ 100,000 | = | $ 80,000 | + | $ 20,000 |  |  |  |  |  |  |

Following table illustrates the impact of this transaction on the "Financial Statements" of Rose Designs:

|  |
| --- |
| This table will be replaced by Leonardo item = leo-leonardo-dev-482 |
|  |
|  |
|  |

### Step 1: Identify the accounts and account type.

The two accounts involved are Cash (Asset) and Notes Payable (Liability).

Remember, a Notes Payable involves a liability that is long term or due in more than one year.

### Step 2: Decide if each account increases or decreases.

Cash increases. The business has more cash than it had before. Notes Payable increases. The business now owes more debt than it did before.

### Step 3: Determine the impact on the financial statements.

The balance sheet reflects a $80,000 increase to the asset, Cash, and to the liability, Notes Payable. The statement of cash flows, financing, increases by $80,000.

## Accounting in your business

I only have a small amount of cash to contribute to my new business. How could I obtain financing?

* Consider a bank loan.
* Try crowdfunding. Crowdfunding sites, such as Kickstarter.com, provide an opportunity for small businesses to raise money for a specific project or business idea.
* Investigate SBA loans. SBA (Small Business Administration) loans are guaranteed by the federal government and are designed to help small- and mid-sized businesses obtain financing when they have been turned down by private lenders.
* Ask your friends and family. Consider asking your friends and family for a loan or investment. This can be risky as you might jeopardize your friendship and personal relationships should the business fail. Make sure to provide a business plan and signed loan or equity agreements. Even though this is your friend or family, you should still treat this as a business relationship.

Source: <https://www.inc.com/guides/2010/07/how-to-finance-your-business.html>

## Investing Activities for a Business

Rose Designs has secured sufficient cash from financing. The company is now able to purchase equipment and other long-term assets necessary for the operations of the business. The purchase of long-term assets is a type of investing activity. In purchasing these long-term assets, the business is investing in its future. It will now have the property, building, and equipment needed to provide services to its customers.

## Test your understanding