Asking Family or Friends to Invest in Your Business

Entrepreneurs who are starting a new business or expanding an established business are often advised to look to family members or friends when seeking financing for their venture. After all, who is more likely to have confidence in your ability to succeed and in your ability to turn a profit on their investment than the people closest to you? But, mixing business and personal matters can put you in some tight spots, imperiling not only your professional prospects, but also your most significant relationships. To minimize the chances that financing from a friend or relative could lead to future problems, consider carefully how such deals are structured.

If you are raising capital to start a new business, asking family members to contribute from their personal savings is an especially delicate proposition. When attempting to obtain financing from a bank or a venture capital firm, you emphasize all the reasons why you believe your business will succeed, while downplaying any potential downsides. Selling your venture in this way creates no ethical dilemmas because the people you are speaking to are experienced professionals who look for good investments but don't risk their own nest eggs. By contrast, asking your loved ones to contribute their hard-earned savings should be approached differently to avoid feelings of guilt or shame that could arise later if relatives or good friends make contributions they could not afford to lose.

Therefore, when presenting an investment opportunity to a person close to you, protect his or her interests by being honest about the real possibility that the money invested could be lost. Alternatively, consider asking to borrow the money, rather than taking it as an investment, and agree to pay it back with the appropriate amount of interest. Taking a loan from a personal contact only makes sense if you are confident of your ability to repay the debt within a reasonable period of time, regardless of the success of your business.

To avoid potential conflicts, you may want to restrict your fundraising efforts to family or friends who have ample funds and are experienced in business. This can improve the chances that your prospective investor understands the risks involved and is assessing your proposal on appropriate merits. Since the mere act of asking a loved one for money can lead to an uncomfortable situation, reassure your friend or family member that you will understand if he or she rejects your proposal or needs time to think about it. To avoid putting people on the spot, consider preparing a formal pitch, complete with PowerPoint slides and a business plan, to present to a group of family members and friends.

However, keep in mind that the person with the most cash and business experience may not be the person you necessarily want as an investor in your business. In return for his or her investment, your investor may want a level of control in the business that would interfere with your ability to make independent decisions. Especially if you have had conflicts with a relative in the past, avoid asking him or her to take a stake in your business. It is also important to note that, if the friend or relative who has been granted an equity stake in your business should die before the investment has been repaid, the heirs may take a different approach to managing their stake than your initial investor.

Regardless of relationships, potential investors should understand that they could lose their investment and at what stage in the growth of the company they can expect a return on their capital or a repayment of their loan. Ask a legal professional representing the interests of the investor to draw up a formal agreement and outline the potential risks associated with the investment, the level of control in the business that will be granted, and how and when the debt or investment will be repaid. Future misunderstandings can be averted by thoroughly discussing the details of the agreement ahead of time.