



THE STARTUP'S GUIDE TO COMPARING LOAN OFFERS



10 Questions to Ask





INTRODUCTION

Congratulations! Your startup qualified for financing. Like all practical founders, your next step is comparing and contrasting loan offers to find the best deal for your business.

Whether you're considering financing from traditional banks or funding from alternative specialty lenders, you've probably discovered it's difficult to evaluate business loan costs when you have multiple offers with disparate term sheets and complex repayment structures.

We're here to help you navigate the intricacies — and potential pitfalls — of funding your startup using debt.



INTRODUCTION

Loan terms and payment structures are often confusing by design — if you knew what that money was really going to cost, you might not even consider it. It's easier for lenders to ward off competition when you can't fairly compare their offer against others. Similarly, plenty of lenders will do whatever it takes to get the deal done without regard for the long-term success of your business.

All capital providers have costs they pass on to borrowers. Some complicate financing deals to obscure costs, and where there are hidden costs, there are hidden risks.

Lighter Capital has been financing tech startups for more than a decade. Through more than **1,000 rounds** and **\$350 million of financing**, we've seen the savviest entrepreneurs struggle to understand their true cost of borrowing and get lured into bad debt deals because of:

- **Hidden fees**
- **“Discounts” that aren't really discounts**
- **Deceptive APRs and interest rates**
- **Loan misalignment (e.g. incompatible loan structure or term length)**
- **Restrictive debt covenants**
- **Collateral requirements (e.g. personal guarantee)**
- **Warrants**
- **Unreliable lenders**

At best, a miscalculation or misunderstanding can cost you more than you expected; at worst, your venture could run out of money and fail.

The last thing any entrepreneur wants is financing that strains free cash flow and stifles growth. Knowing the tricks some lenders use to win your business will ensure that you don't get duped into debt that can kill your startup and crush your entrepreneurial dreams.


This guide is intended to give you the tools you need to avoid taking on debilitating, costly debt and choose the best financing offer for your startup now and in the future. ■

10 QUESTIONS TO ASK WHEN COMPARING STARTUP BUSINESS LOANS

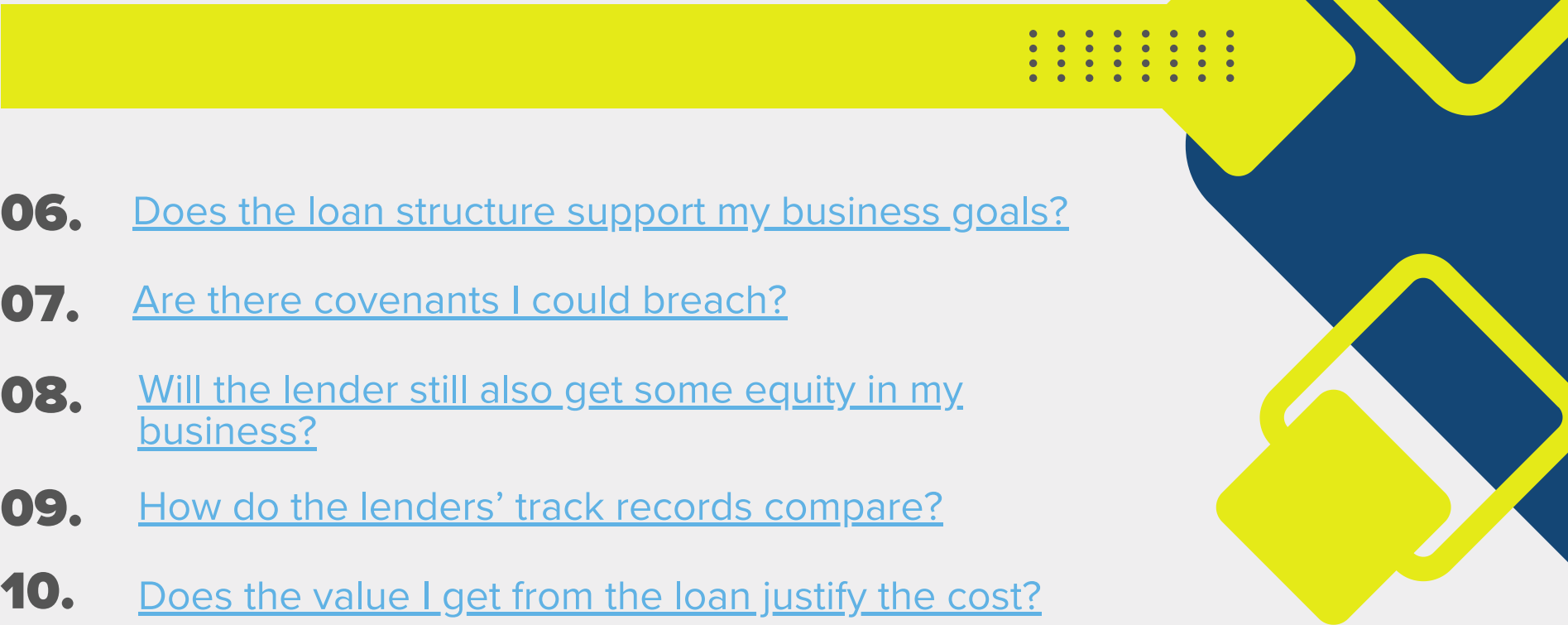
Financing can help your startup expand or weather an unexpected storm. No matter your use case, it's important to understand your costs before you sign a financing agreement with a lender and weigh them against the potential gains for your business. To get the best deal possible, you have to compare more than the interest rate or APR.

Use the following 10 questions to thoroughly evaluate business loan offers. We'll explain how to uncover hidden costs, calculate your true cost of borrowing, and ensure that the value you'll get from the loan will outweigh its costs.

10 QUESTIONS TO ASK WHEN COMPARING STARTUP BUSINESS LOANS

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01. What fees will I be charged in addition to principal and interest payments?
 02. Is the rate I'm being quoted an annual interest rate, quarterly, monthly, or something else?
 03. Is there an interest-only period?
 04. Are my payments fixed or variable?
 05. What is the actual interest rate of my loan?

10 QUESTIONS TO ASK WHEN COMPARING STARTUP BUSINESS LOANS

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- 06.** [Does the loan structure support my business goals?](#)
 - 07.** [Are there covenants I could breach?](#)
 - 08.** [Will the lender still also get some equity in my business?](#)
 - 09.** [How do the lenders' track records compare?](#)
 - 10.** [Does the value I get from the loan justify the cost?](#)

Question 1

WHAT FEES WILL I BE CHARGED IN ADDITION TO PRINCIPAL AND INTEREST PAYMENTS?

Finance charges compensate the lender for providing upfront cash or credit to your business. These can include one-time fees, such as an **origination fee** or **exit fee** on a loan, in addition to interest payments. Ask the lender to identify all fees and finance charges so you can calculate your total cost of borrowing.

Some lenders will be less transparent than others with fees. For example, you may have a \$500,000 loan with a 2% “discount,” which is really a cleverly disguised origination fee. When the loan settles, you’ll have only \$490,000 in the bank because you were charged a fee you weren’t expecting — on top of the \$500,000 you’ll pay back. ➤

Question 1

WHAT FEES WILL I BE CHARGED IN ADDITION TO PRINCIPAL AND INTEREST PAYMENTS?

You can also ask the lender:

What is the net amount I draw down in cash on day one?

If it's less than the full amount of your loan, that constitutes an additional upfront fee, regardless of how it's presented. ■

Question 2

IS THE INTEREST OR DISCOUNT RATE I'M BEING QUOTED AN ANNUAL RATE, A MONTHLY RATE, OR SOMETHING ELSE?

Answers to this question can change your cost of borrowing significantly, especially on a large business loan. It's important that the lender confirms the compounding periods — the more frequent the compounding, the higher the interest — and whether the interest rate is fixed or variable. Below, we guide you through addressing interest rate specifics with a lender and other rates you may encounter.

Compounding

If you're quoted an annual interest rate but the compounding period is monthly, for example, you'll have to account for the effects of monthly compounding on the cost of the loan and how monthly repayments will affect your cash flow. ➤

Question 2

IS THE INTEREST OR DISCOUNT RATE I'M BEING QUOTED AN ANNUAL RATE, A MONTHLY RATE, OR SOMETHING ELSE?

Fixed interest rate: The interest rate remains constant throughout the life of the loan or investment. This provides predictability in monthly payments and total interest costs.

Variable (or floating) interest rate: The interest rate can fluctuate based on market conditions, usually tied to a benchmark rate such as the prime rate. Payments can vary over time, which can affect budgeting and cash flow.

Fixed vs. variable interest rates

A fixed interest rate stays the same over the life of the loan; a variable or adjustable rate can change. A lender offering long-term financing over, say, three years might include a condition that allows them to adjust the interest rate in alignment with changes in the market.

Get specifics on how a new variable interest rate is determined. If the rate adjustment is based on prime rates, you can make assumptions to calculate a range in which your capital costs might land during that period. ➤

Question 2

IS THE INTEREST OR DISCOUNT RATE I'M BEING QUOTED AN ANNUAL RATE, A MONTHLY RATE, OR SOMETHING ELSE?

Discount rate: In a discounted business loan, the lender deducts interest upfront from the loan principal, and the borrower receives less than the full loan amount but still repays the full amount. Because the borrower pays interest on the full loan amount while only receiving part of it, the effective interest rate will be higher than the nominal or simple interest rate.

Discount rate

A “discount rate” as it applies to business loans isn’t an interest rate or a discount on your loan costs, as it might suggest. In practice, a discount rate is the difference (in percentage) between the money you get and the money you pay back to the lender.

For example, a one-year \$100,000 loan with a 15% annual discount rate puts \$85,000 in your bank account. In other words, you get \$85,000 and you pay back \$100,000.

A discount rate on a business loan tends to be misleading, so make sure you fully understand the repayment terms. ➤

Question 2

IS THE INTEREST OR DISCOUNT RATE I'M BEING QUOTED AN ANNUAL RATE, A MONTHLY RATE, OR SOMETHING ELSE?

Repayment cap or factor rate

Some startup financing, such as [revenue-based financing](#), has a fixed borrowing cost and **allows for flexible, variable repayments**. This repayment cap or factor rate determines how much you pay back — it's applied only to the original amount borrowed. Unlike traditional business loans with compounding interest, **you pay a flat fee** for the loan over its lifetime. Even if you pay the loan off early, you'll pay the entire fee.

Here's a simple example. Say you are approved for a \$500K loan with a three-year term and 1.2 repayment cap. The cost of your funding will be \$100K ($\$500,000 \times 0.2$), and you'll pay back a total of \$600K ($\$500K + \$100K$) over three years. ➤

Question 2

IS THE INTEREST OR DISCOUNT RATE I'M BEING QUOTED AN ANNUAL RATE, A MONTHLY RATE, OR SOMETHING ELSE?

Effective APR (EAR)

- Takes into account how often interest is compounded during the year.
- Provides a more accurate reflection of the total cost or return because it factors in the effect of interest compounding over time.
- The more frequently the interest is compounded, the higher the effective APR will be compared to the nominal APR.

Effective annual rate (EAR)

The effective annual rate (EAR), or effective APR, on a loan is the gold standard for identifying and comparing the cost of capital. You can always figure out the effective APR using the quoted interest rate, discount rate, or repayment cap.

More on this in [Question 5](#). ■

Question 3

IS THERE AN INTEREST-ONLY PERIOD?



With an interest-only period, you pay back just the interest during a set term at the beginning of the loan; after that, you pay principal plus interest. This helps you keep more cash in your pocket now. You'll make larger payments later, so you must be confident your capital investments will generate future income that more than covers repayments plus business expenses.

This type of loan is generally more expensive — because you have a higher principal balance over the interest-only period, you will pay more interest on that balance. Though there are cash flow advantages to an interest-only period, it's risky for an early-stage startup. ■

Question 4

ARE MY PAYMENTS FIXED OR VARIABLE?

Though term loans may offer the cheapest capital, repayment terms are also the least flexible, and that can put extra stress on a growing startup. Flexible repayment terms can save the day in a pinch and help you scale.

Fixed or flexible, it's important to look at the impact that repayments will have on your future cash flow, in addition to comparing loan costs. When looking at loan costs, you should also think about the value that variable payments offer versus fixed payments. If your business is seasonal, for example, flexible repayments can provide a lot of value.

More on this in [Question 10](#). ➤

Question 4

ARE MY PAYMENTS FIXED OR VARIABLE?

If loan payments are fixed, it's wise to ask the lender for a schedule of all your expected draw downs and repayments, including interest and fees, so you can calculate the total cost of the loan.

A repayment or amortization schedule not only will ensure you're accurately comparing total loan costs, but also can be used to [forecast cash flow](#) as you pay back the loan. If loan repayments put you in the red, you could find yourself looking for a second loan to pay off your initial loan and keep your business operating smoothly. That's going to cost you a lot more money. ■

WHAT IS THE ACTUAL INTEREST RATE OF MY LOAN, INCLUDING FEES OR ADDITIONAL COSTS?

Question 5

How to calculate EAR

The EAR can be significantly different from a stated annual interest rate, and it's always higher because it factors in compounding.

$$\text{EAR} = (1 + (i \div n))^n - 1$$

i: simple interest rate

n: compounding periods

Lenders often quote a simple interest rate or annual percentage rate (APR) that doesn't account for compounding. The **effective annual rate (EAR) or effective APR**, on the other hand, does. When you know the effective annual rate, with all your fees and costs rolled in, you can evaluate and compare the true interest rate on different loans. ➤

WHAT IS THE ACTUAL INTEREST RATE OF MY LOAN, INCLUDING FEES OR ADDITIONAL COSTS?

Question 5

Example

Say you're approved for a \$100,000 one-year loan with an 18% interest rate. You've confirmed the lender quoted you an APR or the simple annual interest rate and that interest is compounded monthly. Here's how you calculate the EAR:

Stated interest rate: 18%

Number of compounding periods: 12

$EAR = (1 + 0.18/12)^{12} - 1 = (1 + 0.015)^{12} - 1 = 0.196$

Cost of Borrowing: \$100,000 x 0.196 = \$19,600 ➤

WHAT IS THE ACTUAL INTEREST RATE OF MY LOAN, INCLUDING FEES OR ADDITIONAL COSTS?

Question 5

In this example, the *effective* annual rate is 19.6%, and your total cost of borrowing is \$19,600, which is \$1,600 more than what you would have calculated using the simple interest rate you were quoted in the term sheet.

Why do lenders quote the simple interest rate instead of the effective annual interest rate on a loan?

Exactly why you'd expect — to make you think you're paying less. ➤

WHAT IS THE ACTUAL INTEREST RATE OF MY LOAN, INCLUDING FEES OR ADDITIONAL COSTS?

Question 5

Comparing the internal rate of return (IRR)

For simple loans — where you borrow and then progressively repay — with the same term and loan size, you can also compare costs using the **internal rate of return (IRR)**. With IRR, you can look at multiple cash flows and see what they represent as an interest rate. It's useful for comparing financial transactions without an interest rate, which might be understated or unknown.

How does IRR work?

Imagine cash flows going in and out of a bank account where the balance accrues interest at some rate. The account starts with a zero balance and ends with a zero balance. The IRR is the interest rate that results in that ending zero balance. ➤

WHAT IS THE ACTUAL INTEREST RATE OF MY LOAN, INCLUDING FEES OR ADDITIONAL COSTS?

Question 5

Example

You take out a \$100,000 loan today and repay \$110,000 in one year — just a flat contracted dollar amount. The IRR is 10%. Similarly, if you deposit that \$100,000 into a new high-yield savings account and withdraw the full balance, which is \$110,00 after a year, your IRR is again 10%.

Though IRR offers a simple way to compare financing offers, it can be misleading if you're comparing loans of different amounts or term lengths. In that scenario, it's best to focus on whether the overall cash flows support what you want to do as a business and the ROI you expect from the borrowed capital. ■

Question 6

DOES THE LOAN STRUCTURE SUPPORT MY BUSINESS GOALS?

There are many types of business loan products on the market, and they won't all be the right match for your startup or use case.

- Do you simply need cash to keep the business going in a pinch? Then a [short-term loan](#) (12 months or less) might work best for you.
- Is investing in growth initiatives and scaling up a top priority? You'll probably want a longer-term loan with more flexible repayment terms.
- Are you trying to increase your valuation before going into an equity raise? A modest amount of [non-dilutive funding](#) could give you the springboard to get there in a year. ➤

Question 6

DOES THE LOAN STRUCTURE SUPPORT MY BUSINESS GOALS?

Ignore the flashy names that lenders give their various loan products — these, too, can be misleading. What matters is the length of the loan and your repayment terms, and whether they align with your use case.

For example, [merchant cash advance \(MCA\) loans](#), which are sometimes presented as short-term revenue loans, give you upfront cash based on your future sales or revenue. MCA loans, however, have higher fees and aggressive repayments that are meant to support businesses with *immediate* cash flow needs — they should be repaid quickly and aren't meant to fund long-term business growth initiatives. MCA loans are typically quick and easy to get, but they might make it harder to achieve your business goals. ➤

Question 6

DOES THE LOAN STRUCTURE SUPPORT MY BUSINESS GOALS?

Loans that may look less expensive when you compare effective interest rates **could burn up your free cash** and prevent you from deploying borrowed funds effectively if they don't match your use case.

Let's say you need funding to hire a sales lead to build your pipeline and close new business. It's likely to take more than a year to start seeing the gains from those efforts — new customers and revenue — because it will take time to recruit the right person and get them up to speed.

A short-term loan won't be best for your startup in this scenario. ➤

Question 6

DOES THE LOAN STRUCTURE SUPPORT MY BUSINESS GOALS?

You need enough cushion to pay back your debt and keep up with monthly expenses.

Using the previous example, you might have to hire a recruiter to help find your sales lead, and at minimum you'll start paying your new employee before they're up to speed and contributing to growing your revenue stream.

When cash outflows outpace inflows while you're paying back money you borrowed, your business is going to feel squeezed financially. ➤

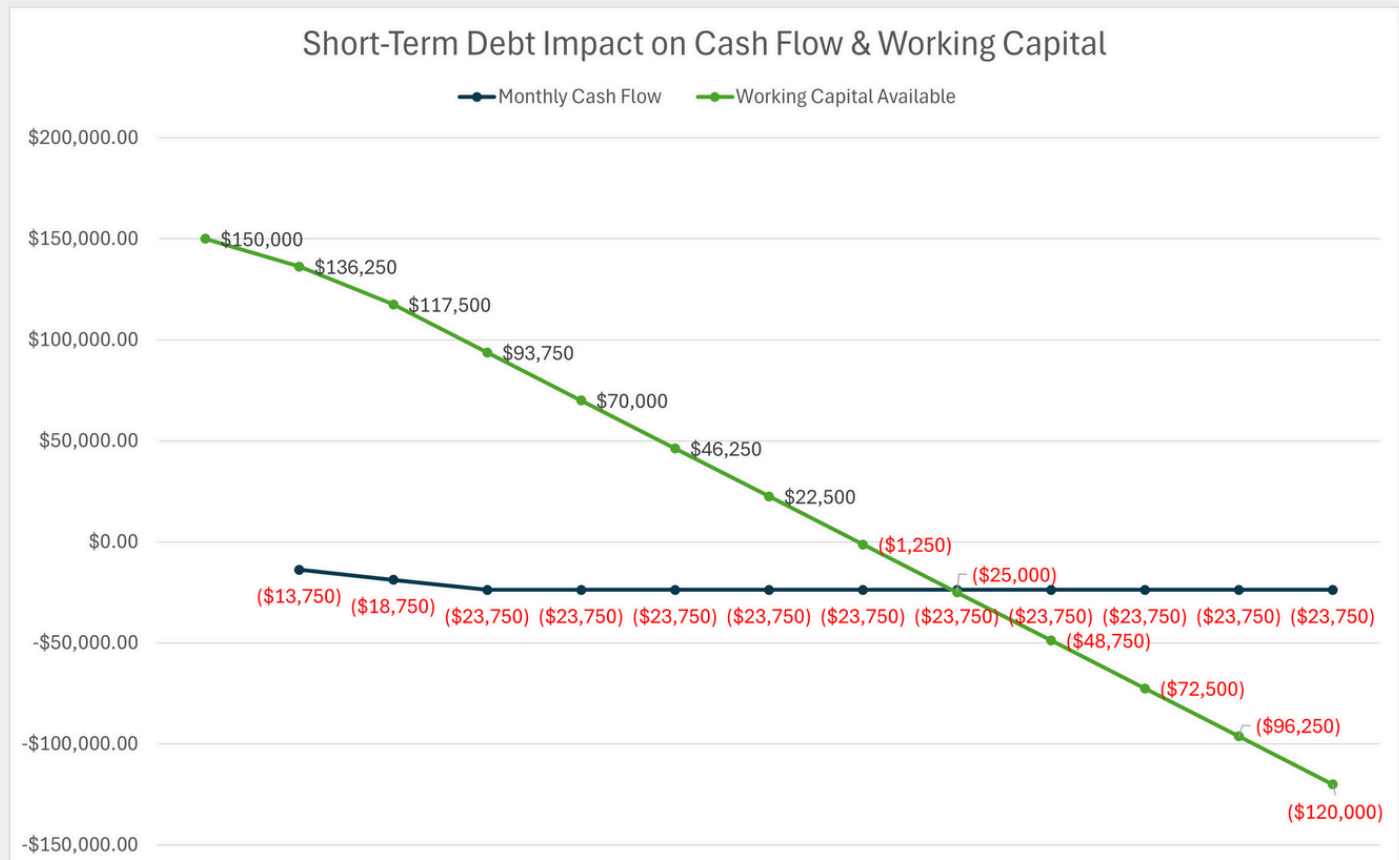
Question 6

DOES THE LOAN STRUCTURE SUPPORT MY BUSINESS GOALS?

In the following example, you can see that a delay in ROI will **drain \$150,000 of working capital**, obtained through a 12-month term loan, by **month 7**. ➤

Here we assume:

- The company is breaking even, making \$40,000 a month.
- A new salesperson can grow sales by 30% by the end of month 6.
- The salesperson starts 6 weeks after the capital was obtained, with a yearly salary of \$120,000.



Question 6

DOES THE LOAN STRUCTURE SUPPORT MY BUSINESS GOALS?

Ideally, the structure of your loan will enable you to re-invest revenue produced from the borrowed money, creating a flywheel effect that will generate more cash flow.

So, look for financing with repayments that provide enough flexibility and ample breathing room for you to keep growing the business. ➤



“Funding from Lighter Capital gave **Rounded** the freedom to immediately execute aggressive acquisition campaigns, which tripled Rounded’s subscriber community over 12 months. No equity, very commercial terms, and a quick no-fuss process.”

Nicholas Beames, Co-Founder and CEO, Rounded

Question 6

DOES THE LOAN STRUCTURE SUPPORT MY BUSINESS GOALS?

Timing

Early-stage startups and bootstrappers typically see the greatest impact from non-dilutive financing when it's used at an inflection point. For example:

- You have a high-performing marketing channel and you want to invest more in it.
- Your pipeline is gushing — you needed to hire a sales team yesterday.
- You closed your largest contract to date and need a bigger team that can effectively service the account.

A small capital injection for investment in an immediate opportunity can help improve metrics and get the business to its next milestone faster, with the potential to garner higher valuations and save millions in equity down the line. ■

Question 7

ARE THERE COVENANTS I COULD BREACH?

Some lenders include covenants, which are conditions within the financial contract that define “guardrails” to keep your business operations within a certain margin of error, increasing the likelihood you’ll repay the loan.

Loan covenants minimize risk for lenders while increasing risk for borrowers, and potentially your capital costs.

Covenants might constrain your business or, if they’re breached, result in penalties. In some cases, the lender may declare default on the loan or call the loan, which requires you pay it in full immediately. This can hurt your creditworthiness, or you could lose control of your startup entirely. ➤

Question 7

ARE THERE COVENANTS I COULD BREACH?

Covenants are usually baked into the loan agreement, so don't sign anything without reading *all* the details. Look for "I shall" or "I agree" in the contract — these words often appear in simple statements that spell out conditions you must fulfill or actions you'll avoid to remain in good standing with the lender.

For example, "I agree to maintain a cash balance of no less than \$100,000 at all times."

Even if the covenant seems insignificant or you breach it unintentionally, it will still put you in violation of your contract. So, be cautious if breaching a covenant seems plausible. ■

Question 8

IF I REPAY THE LOAN IN FULL AND ON TIME, WILL THE LENDER STILL ALSO GET SOME EQUITY IN MY BUSINESS?

Debt financing isn't always non-dilutive. When a lender asks for warrant coverage, they want a stake in your business. A warrant gives a capital provider the right to buy company stock in the future at a price that's established when the warrant is issued. If you agree to a loan with warrant coverage, then the lender might get some equity in your business, and you might get a new business partner.

Warrants deliver a big upside when startups exit successfully. That small slice of equity with upside potential enables investors to offset some risk and provide debt capital at lower interest rates, especially when a startup is backed by other equity investors. ➤

Question 8

IF I REPAY THE LOAN IN FULL AND ON TIME, WILL THE LENDER STILL ALSO GET SOME EQUITY IN MY BUSINESS?

Lenders typically have to act on warrants within a specific time frame, such as 5 years from the end date of the loan. If your company doesn't have a liquidity event that prompts the lender to exercise the warrant within that time frame, the warrant expires. When your startup's stock price rises above the warrant's strike price, the lender is likely to purchase the shares underlying the warrant.

Without the warrant, the equity and its value stays in your pocket.

It's worth doing the math to see what that warrant *could* cost you, in addition to your loan costs. ■

Question 9

HOW DO THE LENDERS' TRACK RECORDS COMPARE?



Reputations matter. Whether it's their ability to follow through on financial commitments, customer service, or a fruitful relationship that's important to you, it's in your best interest to vet lenders just as they vet you.

Recently, there's been a run on the largest tech bank in the U.S., a global health crisis that brought much of the world to a stop, fraud in fintech, and alternative lenders that closed up as quickly as they entered the market.

As a result — and through no fault of their own — startups have lost access to lines of credit and additional loan tranches that were promised, struggled with unresponsive lenders, and felt the crushing weight of expensive debt that put their businesses in peril. ➤

Question 9

HOW DO THE LENDERS' TRACK RECORDS COMPARE?



Look for a lender that:

- Has been in business for more than 10 years,
- Is healthy enough to withstand economic stress,
- Has a track record for being responsive and engaged,
- Will work with you when the going gets tough, and,
- Can provide your startup more than just money.

Also, ask for referrals from clients and consult with other entrepreneurs or trusted advisors in your network. It's worth it to do the extra research. ➤

Question 9

HOW DO THE LENDERS' TRACK RECORDS COMPARE?



Lighter Capital, for example, has been [an innovator and leader](#) in non-dilutive financing since 2010. We've financed over 1,000 rounds of funding. We helped clients persevere through the pandemic, scale efficiently using discounts from our software and service partners, and connect with investors to raise equity rounds. We've even helped founders get their startups back on track after an experience with another lender that didn't go as expected. ■

Qnary CEO, Ray Carbonell, [shares his experience](#) working with Lighter Capital

"Our previous lender didn't have that entrepreneur mentality. They didn't understand the additional capital and liquidity that was required to scale our business quickly. ... Lighter clearly understood our capital needs at this stage of growth, and their people were both responsive and engaged in our business. It was an easy decision to switch."



Question 10

DOES THE VALUE I GET FROM THE LOAN JUSTIFY THE COST?

The features of one loan might tip the scale in its favor, even if your costs are slightly higher, because it minimizes your risk and maximizes your ability to achieve your goals. If you discover the terms and conditions of a loan don't align with your business strategies, then it's not going to give you the best ROI, regardless of its cost. ➤

$$\text{ROI} = (\text{Net return on investment} \div \text{Cost of investment}) \times 100$$

Question 10

DOES THE VALUE I GET FROM THE LOAN JUSTIFY THE COST?

Weighing cost vs. value

Again, the cheapest loan isn't always the best, particularly for startup businesses. You want a good return on your capital costs, though, so consider potential gains, such as:

- Increased revenue
- Expanded market share
- Happy customers
- Higher customer retention
- Competitive advantage

The interest component on debt capital is minuscule compared with the rewards when your startup can achieve any of these outcomes, and it's significantly cheaper than giving up equity. ➤

Question 10

DOES THE VALUE I GET FROM THE LOAN JUSTIFY THE COST?

Risk vs. reward

Today, interest rates for non-dilutive startup financing can exceed 20%, though this depends greatly on the loan provider, the loan terms, and your startup's financial profile. That may seem high, and the cost of borrowing is important, but when financing can spur up to 10x annual growth and you don't have to worry about cash flow for a while — or [equity dilution](#) — that interest rate will look pretty good. ➤



With \$1.1 M in non-dilutive funding from Lighter Capital, **Flip** tripled its e-commerce customer base and increased revenue 10x in just 2 years. It then raised \$6.5M in seed funding.

[Their story >](#)

Question 10

DOES THE VALUE I GET FROM THE LOAN JUSTIFY THE COST?

For example, Lighter Capital's loans don't have [personal guarantees](#), restrictive covenants, or equity requirements. That means you, the borrower, retain complete control over your business, and you can use the capital as you see fit. As a lender, we assume more risk if your business defaults or fails, and we won't see an upside if your business is wildly successful.

Interest rates on our financing reflect the most [founder-friendly](#) loan terms you'll find in today's market, and our customers tend to find our capital is affordable and quite reasonable for what you get overall, including:

- Flexible payment terms
- Longer payback periods
- Product and service discounts
- CEO enrichment and networking ➤

Question 10

DOES THE VALUE I GET FROM THE LOAN JUSTIFY THE COST?

[Lighter Capital's customers](#) frequently come back for additional rounds of funding.

On the [Practical Founders Podcast](#), **Rob Farrow**, co-founder and CEO of [Aisle Planner](#), explained in detail why he kept taking non-dilutive debt from Lighter Capital — 6 rounds in total — instead of angel or VC money. His fundraising ethos eventually led to a lucrative acquisition.

“I took \$150K in the first round,” Rob explained. “To me, it was an invisible employee — our monthly net was the cost of an employee. We were able to use that money to put ourselves at some events we couldn't afford to go to, which helped elevate our relevance in the audience we were targeting.” ➤

Question 10



Listen to the Practical Founders Podcast

Rob Farrow
Co-Founder and CEO
Aisle Planner



“The cost of capital on paper was a little frightening, but...the return on investment was awesome! There’s a lot of money out there. There’s not a lot of good money out there. I wanted good money.”



CONCLUSION

With any startup capital, you should assess offers holistically to identify good money for your business and your goals. Plan ahead, use the [10 questions in this guide](#) to understand your options, and don't let an attractive interest rate seduce you.

Also remember, it's best to borrow money when you *have* money — you'll not only get the best terms, but you'll also be prepared for rainy days.



Get clear, fair, and truthful financing.

Lighter Capital offers the most founder-friendly capital on the market. We get to know you and your business and find you the right financing, so you're set up for success. We also go above and beyond to help you understand and compare capital costs.

To get a quote and see how much your startup could qualify for, complete our quick online application.

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