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Considering a bank loan? Should you sign a Personal Guarantee? Here is What you Need to Know!

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Many business owners are often hesitant to sign personal guarantees (PGs) which are generally required by banks when applying for a business loan. To avoid this, they decide to raise equity from outside investors to meet their capital needs.

While I don't discourage business owners from raising equity, in this article, I am sharing a few important aspects to consider when making this decision.

It is also worth noting, that PGs are normally provided to banks on an unsecured basis, meaning banks typically don't require you to provide a collateral mortgage on your home or other assets to support the PG.

As an alternative, there are some financing solutions available where lenders either don't require a PG or can accept a limited one (which is typically 25%-35% of the loan).

Stepping back, the primary exercise to be done when contemplating this decision is to compare the risk of the guarantee being called vs. the long-term value of the equity given up. With that in mind, here are some factors to consider when making this decision:

Stage of a business life cycle:

A key driver of the risk of the PG being called is where the business is at in terms of its lifecycle.

If it is still conceptual and/or where the business model is still unproven, then the risk of business setback is greater which would increase the probability of the bank calling on your PG (if the business defaults on the loan).

Conversely, if the business is close to or already generating revenues, and profitability is in sight, then the risk of business failure is likely lower (albeit high growth businesses often need an ongoing capital supply) and as such the probability of a bank calling on the PG is lower.

What is the true economic cost of raising equity?

Another important aspect to consider is the long-term true cost or value of the equity you are giving up today, to avoid providing a PG.

For example, if the owners of Amazon or Google decided in those early years to give up say 10% or 15% of the equity in their businesses to avoid providing a personal guarantee, how much in today's dollars has that decision cost them?

While not every business becomes a Google, Facebook or Amazon, for illustrative purposes,

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consider what the cost would have been in today's dollars if any of these companies had given up equity in their earlier stages of business to avoid providing a PG.

Other aspects to be mindful of when raising equity:

If one's decision is to avoid providing a PG, then there are some other important factors to consider when raising equity. These include, but are not limited to:

- **Decision-making** - Raising equity means you will be accountable to other shareholders. This could impact decisions around how you want to operate the business, its direction or even things like how you scale the business or what you earn!
- **Agreements** - Bringing on shareholders typically requires either shareholder or SAFE agreements to be negotiated and put in place.
- **Dispute resolution** – A surprisingly high number of businesses get into financial difficulty due to shareholder disputes. So having a clear dispute resolution process for this needs to be considered.
- **Valuation** - You also need to reach an agreement with an investor on the current valuation of the business in which they are going to invest. This may require the services of a CPA, CBV (Chartered Business Valuator) to assist.
- **Due diligence** - the prospective investor may want to do a fair amount of due diligence and there is no guarantee after all of it, that they will invest!

Lastly, if one ultimately decides to provide a PG, some banks are also receptive to removing personal guarantees over time, providing the performance of the business supports this removal.

In conclusion and like many financial considerations, the primary issue is around risk vs. return. If you feel your business model is still unproven and inherently risky, then avoiding providing PGs and raising equity may be the right option for you.

Alternatively, if the business is already generating revenue, and profits, and is performing well and the risk of default is lower, then providing a PG will likely be a lot more cost-effective than issuing equity over the long term.

At Isaacs Advisory, we have extensive experience in advising, structuring, and sourcing financing solutions for high-growth businesses.

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