

# Financing Basics for Entrepreneurs: Borrowing for Working Capital and Long-Term Capital Needs

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Working capital is the lifeblood of a successful business. When running a startup, entrepreneurs sometimes rely on their own personal resources to fund the business. An alternative may be to borrow funds through a short-term or long-term loan. These loans offer flexibility to cover day-to-day expenses and support company growth. However, choosing the right option will depend on your specific business needs. In this post, we provide an overview of short-term and long-term loans and key advantages for each.

## **Meeting Short-Term Business Needs**

### **What is a working capital loan?**

As the name suggests, working capital is the money available to operate the immediate and short-term needs of your company. A working capital loan is a short-term (one year or less) line of credit from a bank, credit union, or other alternative lender. This type of loan is intended to finance everyday expenses involving the daily operation of a business.

A working capital loan has a variable rate of interest that is tied to short-term interest rates (APR, LIBOR), and the lender makes a certain amount of money available to the business to draw (*i.e.*, borrow) as necessary. The borrower only pays interest on what is borrowed.

### **Why establish a working capital loan?**

Because aligning monthly revenue and expenses is hard to achieve, a working capital loan provides ready access to capital to keep a business operating. For example, a working capital loan allows a business to borrow money to pay routine expenses, such as rent, payroll, invoices, taxes, insurance, etc. It also allows a business to borrow money to do things like purchase inventory or equipment or invest in advertising. The business repays the loan over time. This type of loan can help a business owner establish good credit history and good business practices, which can be particularly important for an entrepreneur or first-time business owner.

Short-term loans can be unsecured or secured. For secured loans, lenders will likely require a

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personal guarantee and/or need to pledge “all assets” (*i.e.*, revenues, receipts, intellectual property rights, contracts, equipment, inventory, etc.). If a default occurs, the lender has the right to these assets.

### **Key advantages of working capital loans**

- The loan provides an infusion of capital when needed to cover expenses.
- You maintain control of the business.
- Often, collateral is not required to secure the loan, although in these circumstances excellent credit history is needed.
- Borrowers can access money quickly.

## **Meeting Long-Term Business Needs**

### **What is a long-term capital loan?**

A long-term commercial loan is money borrowed for more than one year from a bank, credit union, or other alternative lender. This type of loan has a fixed interest rate that is usually tied to longer-term interest rates (*i.e.*, 3, 5, or 10-year Treasury Rate plus a spread). The borrower pays principal and interest in equal installments over time .

Long-term loans are typically secured. Lenders will likely require a personal guarantee, a pledge of the asset that you acquire with the loan, and/or a pledge of “all assets” (*i.e.*, revenues, receipts, intellectual property rights, contracts, equipment, inventory, etc.). If a default occurs, the lender has the right to these assets.

### **Why establish a long-term capital loan?**

If a business needs to buy capital equipment, buildings, other businesses, or undertake construction projects, a long-term loan may be a better option. All the money is disbursed up front except for construction loans, which are disbursed during the construction period.

### **Key advantages of long-term capital loans**

- These commercial loans can be made in very large sums, allowing you to cover the cost of larger projects with a single loan.
- You maintain control of the business.
- You can get access to funds quickly.
- You can avoid large payments up front, which can be attractive to most startups.

## **Summary**

Whether you are borrowing to cover daily expenses or to purchase equipment, it may be worth exploring short- and long-term commercial loan options. Regardless of the loan you choose, there are benefits to be had from working capital that supports business growth.

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