Long-Term Vs. Short-Term Loans

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Whether you're in the early stages of launching a new business or needing to acquire more stock, materials, or employees, an infusion of capital is necessary to maintain business continuity. A traditional method of accomplishing that involves taking out a loan. That's when you're faced with the question: do I need a short-term or long-term loan for my business?

How Long-Term and Short-Term Business Loans Differ

The length of your loan term should be one of the biggest factors you consider when shopping for a business loan. Short-term loans for businesses provide quick access to capital, sometimes within a day or two. A long-term business loan involves multi-year repayment terms following a much more detailed application process. Choosing a short-term loan or long-term loan can affect everything from how much money you can borrow to how much interest you'll pay.

In addition, the lender will want to understand the purpose of the loan. Understanding its purpose will also dictate whether it needs to be short-term or long-term.

The Case for Short-Term Business Loans

A shorter loan term allows you to get the money you need quickly. You often need to ask for a sizable amount of money to receive a long-term loan. The lower amounts of a short-term loan make it easier to pay back the loan and get out of debt faster. Essentially, short-term loans are an easier way for business owners to get liquidity and overcome financial setbacks, as opposed to taking on larger, more long-term debt.

While short-term loans may have higher interest rates at first, business owners who take on long-term financing typically end up paying more in interest. The longer your loan has a balance, the longer you're paying interest on the money you borrowed.

Short-term financing is intended to fund short-term capital requirements, such as labor or materials for a business while the business awaits payment for products or services sold. For example, a small business owner may have a contract to pour the concrete foundation of a large commercial property that spans over a nine-month period. The small business owner may not have enough working capital on hand to fund entire operating expenses during the period between the work being completed and the period of getting paid. A short-term loan to fund payroll and materials may be a good solution for the borrower assuming it is secured correctly, the borrower has a good reputation, and the company demonstrates its capacity to pay.

It's also generally more difficult to be approved for long-term loans. The lender will want to make sure they're lending money to someone who can pay it back. Many long-term loans are also for larger amounts than short-term loans. This makes it riskier for the lender to give you the money.

The Case for Long-Term Business Loans

On the other hand, long-term loans may be necessary for some businesses. This type of financing involves multiyear repayment terms. However, with a long-term loan, you will generally find a more favorable (i.e., lower) interest rate. It is important to compare the two (short- and long-term) to see if a higher interest rate but shorter term will result in having to pay less interest overall.

A long-term loan is usually best for business owners looking to make a significant investment. For example, you would probably need a long-term loan to launch a new office or business or acquire materials and equipment.

With long-term financing, traditionally the repayment of the loan is dictated by the useful life of the asset being financed. For example, the financing of a medical building addition to a doctor's office would not be required to be paid within 12 months, but better suited to be paid over a period of 15 – 20 years. Similarly, for a piece of specialized medical equipment, this type of loan may be better suited to be paid over 36-48 months. Understanding the useful life of an asset is very important because if the bank finances an asset with a short-term, the borrower may have a cash flow shortfall that may doom the business.

Is One Better than the Other?

Ultimately, deciding between a short-term or long-term loan comes down to the specific needs of your business. Regardless of the length of your loan, it's important to work with a lender who understands the needs and challenges of your business. To learn more about how PlainsCapital Bank can help you decide which type of loan is right for you, or to find a lender who can answer any of your loan questions, call us at 866.762.8392 or visit your local bank branch today.