How Cash Flow Problems Start and How to Fix Them

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"It was a lot of things. Got too big too fast."

That's Sydney in Episode 5 of the hit TV show, *The Bear*, talking to a coworker about why her catering business failed.

"Wasn't exactly liquid enough for a brick and mortar. And so running it out of my garage was…stupid. My credit got destroyed."

Sydney goes on to describe how a botched job with an important customer sent her financially fragile business into a tailspin from which it never recovered.

While her story may be fictional, the scenario she describes is all too common among small businesses.

"Many first time business owners don't understand the importance of cash flow in their business," warns Georgina Cranston, Business Consultant with **Shippensburg University (SBDC (https://www.ship.edu/community/sbdc/))**. "They often fail to have enough cash reserves to carry through their lean months.

How Cash Flow Problems Begin

When you're taking a trip, you plan how to get there, and probably do some research to avoid potential problems along the way. When you're starting a business, anticipating potential cash flow issues can mean the difference between failure and success.

Here are some common cash flow obstacles your business should prepare for:

Rapid business growth without enough working capital

When you're starting a business, you may think that growth is good. It can be.

But it can also be dangerous.

Rapid growth can leave your business struggling to hire employees or contractors and pay them on time, and you can find your business facing unexpected cash flow issues if customers pay slowly, or if expenses need to be paid before the money comes in.

Poor financial management & planning

Business owners often know cash flow is important, but unless they have backgrounds in finance or accounting, they don't understand how to prioritize it.

Small business owners "appear to adopt a minimum standard rather than attempting to achieve a level of best practice when it comes to cash flow management," say researchers Isle, Freudenberg, and Sarker, in a research paper titled, "**Is the literacy of small business owners important for cash flow management?: The experts' perspective (https://search.informit.org/doi/abs/10.3316/INFORMIT.271823489531208)**."

The researchers go on to state that, "Previous research suggests that SBOs lack the required level of financial literacy to make important decisions for the business."

This may seem discouraging, but there are many ways business owners can improve their financial literacy to make better decisions. We'll cover those in a moment.

First, let's cover some of the common causes of cash flow problems.

Seasonal business revenue cycles

Most businesses experience some element of seasonality. Retail businesses may find the holiday season makes it or breaks their year. Restaurants may pick up in the summer and slow down in the winter—or vice versa if they are located in places like Florida and Arizona where tourists and snowbirds go to escape the cold.

B2B businesses may experience a sales spike near the end of the year when clients want to spend money to take advantage of tax deductions.

When there's a busy season, there's often a slow season when sales die down. Without cash flow to survive the slow season, the business may fail.

Poor billing/collection processes

For businesses that don't get paid in full when a sale is made, it's essential to collect payments as quickly as possible. The older accounts become, the more likely you'll have trouble collecting.

"Businesses that are not in retail, who usually get paid for a service when the sale is made, may have an outlay of cash early in a project but not get paid for months," Cranston warns. "This can create havoc if there is not enough cash on hand to cover monthly expenses."

Unexpected expenses

Poor cash flow occurs when cash inflows don't keep up with cash outflows. Unexpected expenses lead to shortfalls that create stress if the business owner doesn't have access to capital like lines of credit or even **business credit cards (https://www.nav.com/business-credit-cards/)** to help tide them through.

Fail to track business finances

One big problem Ednethia Thomas, VP Community Outreach and Client Services with **SCORE Charlotte (http://score.org/charlotte)** sees with clients is a lack of clear awareness around their business finances. "All of the money (is) going in and out of the same account," she says. Clients may not be tracking their money or their accounts payable. "When asked what they need or what their numbers are, there isn't a lot of clarity," she warns.

"It's surprising how many small business owners do not have a handle on their financial situation," agrees Cranston.

Expansion decisions without cash flow context

Just like Sydney's catering business, it's entirely possible for a business to get too big too fast. Before expanding, create a cash flow forecast to help you understand what resources your business needs to grow successfully.

Ways Cash Flow Difficulties Negatively Impact Small Businesses

Small cash flow problems can quickly escalate and cause bigger problems if you're not careful.

Can't cover regular operating expenses like payroll, rent

Essential bills must be paid or the business shuts down. The Department of Labor does not look kindly on businesses that don't pay payroll in a timely manner, and failing to pay essential bills like rent for a bricks and mortar business, or website hosting for an online business, can result in the lights being shut off for the business.

Difficulties repaying lines of credit or other financing

Paying **small business loans (https://www.nav.com/small-business-loans/)** and financing on time is critical both to maintaining the financial health of your business, as well as **establishing good business credit scores (https://www.nav.com/resource/how-to-establish-business-credit/)** and keeping them strong.

Fall behind and you'll likely incur late fees. You may even find your business stuck with higher interest rates in the future if your business credit takes a hit.

Need to cut staff or operating budgets

Laying off workers is never easy, and it's even harder when you're left with no choice because your business simply can't afford to make payroll. Similarly, abruptly cutting expenses can lead to lower morale or productivity as employees wonder if their job is safe.

Hinders growth plans

Customers may be clamoring for your products or services, but without capital you may simply not be able to expand. If you move forward anyway you may find your business saddled with complaints if product or service quality suffers.

Creates tension with vendors waiting for payment

One of my friends worked in the accounting department of a medium-sized business where a managers was notorious for stashing checks to vendors in his desk drawer. When a vendor complained loudly enough (or long enough), he'd pull out the check and pay them.

That's not a great way to do business. After all, if you want your business to be paid on time, it's common courtesy to do that for others. (Plus paying on time can protect your business credit scores.)

Solutions for Fixing Cash Flow Problems

Small business owners often have "no systematic or accurate method for monitoring cash (finances) for the business," warns Darryl Horton, CPA, senior business consultant with **Michigan SBDC Capital Region (https://michigansbdc.org/)**. As a result, they're unable to effectively or accurately monitor cash inflows (and) outflows."

So the very first thing you should do is to set up a budget and make sure you are tracking your finances either with accounting software or with the help of a bookkeeper or accounting professional.

Knowing where your business stands financially is critical.

Here are additional steps you can take to help protect against common cash flow problems.

Invoice clients immediately after work completed

Don't wait to bill your clients. The sooner you invoice, the faster you get paid.

When you bring on a new client, set up clear payment terms, with incentives (offer discounts) to get clients to pay faster, or penalties (like late payments) if they pay slowly.

Some clients, especially large customers, may require longer payment terms. In those cases invoice factoring or invoice financing may be necessary to maintain positive cash flow.

Build an emergency fund and reserve capital

"Planning for cash flow fluctuations from the start is key!" Cranston emphasizes. "Also, having a healthy (prudent) cash reserve on hand can also save a business when things get tough."

Create and adhere to an expense budget

"Develop a monthly budget, accurately identifying projected revenue/sales and expenses," advises Horton. "You should also do this on an annual basis."

Institute a purchase order system and approval workflows

As your business grows, you may delegate spending decisions to employees. If you're not careful, you may wind up incurring expenses your business can't afford or doesn't need. Create workflows to approve expenses, without making the system so cumbersome that employees don't get what they need.

Manage inventory carefully

Whether it's too much inventory, or too little inventory, you need to continually strive to get inventory management right. This is true for bricks and mortar retail businesses, but especially for e-commerce businesses where "going viral" can deplete inventory quickly or fickle tastes can leave you with unsold inventory that racks up storage costs.

Consider adjusting payment terms with vendors/clients

Pay attention to your accounts receivables so you'll know right away if customers or clients aren't paying on time. "Review your accounts receivables policies to improve timely payments by customers," Horton recommends. "This could include adjusting payment terms, or implementing incentives for early payment."

Only take on new expenses or growth within the context of cash availability

Before you agree to that big project or bring on that new client, review how that will impact your cash flow. As said before, growth isn't good if you can't handle the extra costs of new business, whether that's labor, supplies, inventory or other costs.

Look into working capital loans or lines of credit

The time to line up a **line of credit (https://www.nav.com/blog/how-is-a-line-of-credit-different-from-a-credit-card-688238/)** or loan is often before you need it so it is available when you do.

"Sometimes, clients tell me that they can self-finance their business with savings, which can be good," says Cranston, "but I often advise them to secure a line of credit at least while their cash balances and assets are strong since they may need it later on and it's harder to secure a loan or line of credit when the balance sheet looks unhealthy."

"(Business owners) actually need capital," Thomas concurs. "The only caveat to that is once they have it, they really aren't sure what to do with it. This leads to the cycle continuing."

ⓘ A **0% APR small business credit card (https://www.nav.com/business-credit-cards/0-apr/)** can give your business 6-12 months or more interest-free financing.

If you have outstanding debt, review terms periodically to find out whether refinancing your business loans or consolidating debt can save your business money, or help you get better repayment terms. "Consolidate high-interest commercial loans into a lower interest loan, freeing up available cash and increasing reserves," Horton suggests.

Prioritize payments of essential expenses first

Clearly understanding what business expenses are most essential can help you prioritize them if money gets tight. "Paying for things that are unnecessary," is a red flag, Cranston warns.

Horton recommends entrepreneurs "review expenses to determine those that can be adjusted or eliminated."

Review pricing and sales

Sales are key, but if you're not charging enough, no amount of finagling the budget will solve your problem. Make sure you understand your cost of goods sold, and whether you're pricing high enough to maintain sustainable profit margins.

"Review methods for increasing sales," Horton suggests, "which could include adjusting pricing or marketing strategies, or identifying additional revenue streams."

Outsource Accounting Help

If finances aren't your forte, consider working with professionals who can help. There are a number of resources that can help you identify and address business cash flow problems.

Hire a CFO of (fractional CFO) consultant for high-level fixes

You may not need a full-time CFO. A fractional CFO can help your business on a short-term or part-time basis. Many startups use fractional CFOs until they have the budget to hire someone full-time. But experienced businesses may benefit from this expertise as well.

Work with bookkeepers to improve financial processes

If you don't have the time or expertise to handle your own bookkeeping (and not just once a year when taxes are due), consider using a bookkeeping service to keep your finances up to date.

Not only will this make tax time easier, they can also help you run cash flow statements, profit-and-loss statements, accounts receivable aging reports, and more.

If you aren't ready to hire a bookkeeper, consider hiring one to help you set up your chart of accounts in your accounting software. Get familiar with the basics so your books don't require a do-over at tax time.

Employ collection agencies to resolve chronic client payment issues

If you have clients who are falling further and further behind on payment, talk to a collection agency to find out whether it makes sense to let them take over this task. Going forward, you'll want to make sure you build the cost of collections into your contracts, should it become necessary.

Meet with a mentor

Even experienced business owners often meet with business mentors for advice and a sounding board. Organizations like **Small Business Development Centers (SBDC) (https://americassbdc.org/)** and **SCORE (https://www.score.org/)** provide free mentoring to business owners. You can find these and other SBA Resource partners on the **SBA website (https://www.sba.gov/local-assistance)**.

Bottom Line: Common Causes of and Solutions for Cash Flow Issues

Knowing your numbers, managing your cash flow and planning ahead are all key to building a financially healthy business.

“Small business owners usually go into business because they have a passion or talent for something, and think they can make money at it. What they often fail to take into account is that owning a small business means you are responsible for all aspects of it—HR, marketing, finance, customer relations, etc.”, Cranston observes. “What sinks most small businesses are cash flow problems. Planning for this sink hole can alleviate the failure rate.”

Track Your Cash Flow With Nav

Get visibility into where your financial profile stands and what actions you can take to improve. **Nav Prime (https://nav.com/nav-prime)** gives you cash flow insights, detailed credit reports, multiple tradelines, and tools that may improve your financial health so you can access the best financing options for your business when you need it.

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