NewCastle FINANCE

5 Critical Financial Mistakes Business Owners Make

5 Critical Financial Mistakes That Are Stopping Your Business In Its Tracks

You started your business because you had an idea - a vision - and you wanted to share it with the world.

You didn't start your business to look at numbers.

Early on, you got by without digging deep into your finances. The money came in, and after everything was paid, you still had some leftover - and that's all you needed to know.

But now you've reached a point where your business became more complex. And you are starting to worry that not understanding the intricacies of your business' finances will impact your future.

Many small business owners struggle to understand their financials and how to use them to plan for the future. Unfortunately, as a result, they can make critical oversights that can set back or even ruin their business.

Here are the 5 most common mistakes and how to avoid them:

01

Confusing Profits With Cash

You can make a lot of sales and show decent profits yet still go out of business due to poor cash management.

The root cause for this is an insufficient understanding of the difference between revenue, profit, and cash. These terms are related, but the differences are vital.

Let’s define the terms first:

Revenue

Earnings received from sales.

Profit

Earnings remaining after all expenses (and taxes) have been paid.

Cash

Actual money that is moving in and out of the business.

Now, let's look at an example:

Imagine you record $120,000 in revenue and $80,000 in expenses paid in cash for the current month.

Your profit? $40,000 ($120,000-$80,000).

However, If you don't immediately get paid when you sell your product or service, it can take some time for those sales to reflect in your bank account.

Let's say that in this situation, you were only able to collect $60,000 in cash for the current month. This leaves the other $60,000 still outstanding in invoices.

What does this mean for your cash balance?

It means that you are actually going to be $20,000 **short on cash** for the current month ($60,000 cash collected - $80,000 expense paid with cash)

You'll be $20,000 in the red with cash - despite a $40,000 profit!

As you can see, not managing cash flow can easily destroy your business.

However, excessive cash can create its own issues as well.

For example, if you avoid investing in projects with strong potential returns to keep cash high, business growth will stagnate.

The optimal solution lies somewhere in the middle, and it differs for every business. **The key is to plan for and carefully track your cash flow.**

Many companies opt for expert help in this area as striking that delicate balance between too much and too little takes a fair bit of analysis.

02

Growth Without a Proper Plan

Most business owners want to increase sales and will look for any possible method to do so.

However, you should think hard about **why** you want to increase sales before you take action to do so.

Relentlessly pursuing sales and growth without having a clear answer for "why" and a plan in place to support it can often backfire.

Let’s look at a few examples where you might think that you should increase your sales because...

...you need to cover your costs.

That may lead to more revenue, but all your costs associated with making and supporting those sales could also increase.

Pursuing sales to avoid underlying financial issues can backfire and, in most cases, will make the problem worse.

Instead of more sales, look for areas where you can find better, more efficient, or more cost effective solutions.

Monitor your cash flow closely as well. If done well, you could lower your expenses, keep more profit, and keep more cash - without increasing sales.

...you want to grow your business.

Growing too fast can create problems if you don’t have the infrastructure and processes to support growth.

Make sure you have a plan to handle the “growing pains,” such as hiring enough qualified employees, maintaining your ideal company culture, and ensuring your overall product or service delivery infrastructure can support the growth.

It's essential to understand your “why” for making more sales before you address the “how.”

Sometimes other changes can accomplish your goals or improve your business without a single extra sale.

03

Not Seeing Debt as Just a Tool

Now, you may be hesitant to add debt to your business, which is understandable. Debt can lead to negative consequences if not used wisely.

But debt is nothing but a financial tool. You can use it for good or bad.

Imagine a hammer. You can use it to harm and destroy. Or, when used correctly, you can build or fix things.

Similarly, debt used unwisely can cause financial ruin in your business.

But when you put it towards legitimate purposes, you can build your business faster and be better prepared for the unexpected.

A line of credit (LOC) in particular is one of the best tools your business can have.

LOC is essentially a flexible loan that you can draw on when needed, then pay back immediately or over time. It operates as a mix between a credit card (in terms of flexibility) and a loan (in terms of interest charged).

LOC is handy when you need immediate short-term financing.

For example, perhaps a great opportunity presents itself, such as inventory at a discount. If this inventory contributes directly to your sales, extending your buying power with your LOC to take advantage of the discount can make great financial sense and save you money.

Using your LOC also builds your business' credit score. Doing this early on can pay off in spades when you're shopping for other forms of business loans in the future.

You can use LOC to mitigate adverse events, too.

If cash is temporarily low, for example, your LOC can provide you the capital needed to hold you over until more cash comes in.

Similarly, if you're in a seasonal business, LOC can keep you going during the slower months. Then, when your season arrives, the sales you make will offset the credit you've drawn.

Some businesses even keep LOC in case of emergencies or if they can't save up an emergency fund fast enough.

If your business is affected by an economic slowdown or a disaster, that LOC can bolster your emergency funds.

Overall, it's better to have it and not need it than to need it and not have it.

A reminder: you must use your line of credit wisely.

Spending it frivolously and not properly analyzing each purchase's costs and benefits could put your business in serious debt.

Create a plan for when you'll use it to avoid such a situation.

04

Not Unlocking Hidden Profitability

It can be tempting to take on any clients or product lines that bring you revenue - especially when your business is relatively small.

However, this can hurt your profit, as you might take on clients or maintain product lines that aren't profitable.

They may be a huge drain on your time or financial resources.

One of the easiest ways to increase your profits (and ultimately cash) is to evaluate each of your offerings in terms of profitability, drop those that aren't profitable, and redirect your newfound resources into the remainder of your offerings.

For example:

Say you have two clients, Client X, and Client Y.

You earn $50,000 per year from Client X, while Client Y only provides $30,000 in revenue each year.

But Client X occupies 50% of your time and costs you $55,000 in expenses. However, Client Y only takes up 25% of your time and causes you to incur $25,000 in expenses.

Client X leaves you $5,000 in the red while occupying half of your time - despite providing substantially more revenue.

Meanwhile, Client Y provides substantially less revenue, but they leave you with $5,000 in profit - and occupy only a quarter of your time.

The solution? In this case, it would be best to drop Client X and reinvest time and resources into finding projects similar to Client Y. That would increase your profit and, ultimately, increase your cash as well.

However, when you make decisions like this, you can't rely on your gut feeling. You must look at things from a rational and detached perspective.

Doing so can be challenging when you don't have time or energy to sift through the numbers, which is why many companies will bring in an expert to take a look and advise on what to do.

05

Expecting Strategic Advice from Accountants

Bookkeepers and accountants are excellent resources for recording your business' financial history, ensuring your books are correct, and getting your taxes done accurately.

When your business is still in the early stages, they can even stand in to provide some basic financial advice.

However...

Bookkeepers and accountants look at your past (financial performance) and your present (financial position). They aren't the source for strategic financial advice and planning.

Once your business reaches a threshold of about $1M in annual revenue, it's time to move beyond the “day-to-day” thinking about finances and become more strategic.

Doing so helps you create a plan for how you will get to your goals from your current financial position and establish proper financial processes in place.

This is where Fractional CFOs can come on board and help you manage your business.

A Fractional CFO will sit down with you and help you with strategic financial planning.

They will analyze your current financial situation, make sure that you have proper financial safeguards and processes in place, and help you figure out how to get to where you want to be.

You deserve a partner who helps you use your financial information, not just report it.

Fractional CFO Services for Women-Owned Businesses

01 Schedule a Consultation

02 Get a custom strategy for your finances

03 Make confident decisions and watch your business thrive

SCHEDULE A CONSULTATION

Thank you for reading this guide!

I know you are working hard to run your business.

But I also know that finances can be the difference between success and failure - even if you have a brilliant product.

I grew up surrounded by entrepreneurs and I love the energy of business owners. But I also saw, firsthand, how finances can be a stumbling block for a business - with problems ranging from cash flow, to fraud, to incorrect pricing.

It seemed wrong.

You shouldn't have to add "expert in finance" on your already too long to-do list.

After nearly 14 years of senior finance roles in large companies, I started NewCastle Finance so that I can take that burden off your shoulders.

My goal: help women-owned businesses thrive.

Kathy Svetina