How Startups Can Prepare for Hard Times

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EDITOR'S NOTE: Investment in startups by VCs declined by almost half for the year ending June 30, 2023 over the same period a year earlier. As a result, many startups -- even those that successfully attracted investment in the past -- are closing their doors. This article and others in this special issue explore other ways to finance your venture.

Starting a new business can be exciting, scary, and an opportunity for an entrepreneur to create a tangible version of their dreams. However, it can also be a slippery slope as creators of startups try to manage the business while keeping their personal finances afloat.

"The money is the money. You have to manage your personal finances to manage the business," says David Deeds, Schulze Professor of Entrepreneurship at the University of St. Thomas Opus College of Business (https://business.stthomas.edu/) in Minneapolis. "It's all about the cash flow. Your personal finances must be lessened to make the payments for the business. What you need to do is think about what your monthly outflows are and minimize those without sacrificing the business."

Deeds, who is also editor-in-chief of EIX, the Entrepreneur and Innovation Exchange (https://eiexchange.com/) , which is a funder of Next Avenue, added that people who want to start a business must be "brutally honest" with themselves.

Don't Run Out of Money Before You Start Making It

"If you think it's going to take six months for a new venture to start having cash flow positivity — it could take up to 18 months for that to happen," he says. Noting that entrepreneurs must still pay their rent or mortgage, car note, utilities, grocery bills, etc., Deeds stresses the importance of financial honesty.

"You might have quit your job to put all of your time into the new business. How long can you go with that? Perhaps you have nine to 12 months of cash (available) before you would have to eat into your retirement savings or need to get a new job to supplement the business and your living expenses," says Deeds.

Patricia Wynn, owner of Patricia Services, LLC, in Hillsborough, North Carolina, is acutely aware of the need to balance her personal living expenses with growing her lifestyle-assistant business, which is the focus of this Next Avenue series.

When Wynn began her business in April 2021, she had just one client and continued to work at a home health care agency to pay her bills. "After about six months and adding some more clients," she says, "I was able to quit working at the home health care agency and still have enough income to support the company, but also support myself."

Wynn has purposely built her business incrementally. She currently has about 12 clients that she provides with a variety of services, including, cleaning, cooking and companionship. Wynn has not brought on additional staff yet, with the exception of periodically having her brother provide cleaning services for an Airbnb client that pays an additional $40 above the $150 house cleaning fee for mileage, because the properties are approximately 70 miles away.

Keep Your Spending and Growth Under Control

"I pay myself about $500 a week and depending on how many clients I have during the week, try to put $300 to $400 back into the business," Wynn says. "I have a separate business account with a debit card, rather than a credit card, because I don't want to be tempted to buy things that I don't really need. For example, my clients often provide cleaning supplies, and if I do purchase supplies, they reimburse me."

According to Deeds, Wynn is using the right strategy by developing her business slowly. "It's a long build and not a quick build. She's doing it the way you're supposed to by not getting caught up in the go-big-or-go-home theory. Growth is expensive, and you fund it before you grow."

Daniel Forbes, a professor of entrepreneurship at the University of Minnesota's Carlson School of Management(https://carlsonschool.umn.edu/) and a senior editor for EIX, agrees that anyone with a startup must work to insulate their personal expenses and understand that it takes time to make a profit.

"A new venture often requires up-front investments," says Forbes. "And then there's often a period of uncertainty when additional investments may be needed. During that time, it's especially important to keep your personal finances insulated from the business. Rent, car payments and so on — you don't want your ability to cover those things to be jeopardized by business-related expenses."

In order to maintain a separation between business and personal finances, Kimberly A. Eddleston, the Schulze Distinguished Professor of Entrepreneurship at Northeastern University's D'Amore-McKim School of Business(https://damore-mckim.northeastern.edu/) in Boston, urges owners of startups to sign company bills with not only their name, but add their title in the business. She says company credit cards should also feature the name of the company and the owner's company title. This is to avoid commingling business and personal finances and keep from "piercing the corporate veil" by signing in their capacity within the business and not as an individual.

Forbes stressed that with a new business, "it will take some time before you have a chance of realizing consistent positive returns," so maintaining a budget is key.

He added, "In the early months of any business, be prepared to live at least as frugally as you used to, and maybe more frugally. A new business is like bringing another dependent into your household. Until it's reached a certain level of growth and stability, it's likely to add to your expenses, and sometimes unpredictably."

Adjusting Her Schedule to Reduce Travel Costs

Wynn says that while she does have a monthly car note, she owns her home, and does not pay a mortgage or rent. She has identified additional ways to keep living and business costs lower.

"To compensate for fuel expenses, I'm trying to group customers in the same area together on the same days, to limit gas cost and mileage," she says. "I do have overdraft protection on my business account. I'm not spending on updating my wardrobe — I'm wearing clothes purchased before I began the business. You can't splurge, you have to account for inflation as well."

Now that she has been in business for a year, Wynn says she is raising her rates to $30 an hour from her original rate of $20 an hour.

It is very important for entrepreneurs with new businesses to assess the rates they charge for each service they offer and review which are the most profitable, says Eddleston.

"It's important to understand what's making you money and what's costing you money," she says. "Entrepreneurs need to look at what they are offering. If a service is providing a loss, then you might need to stop offering it. Also, for the business, spread out payment of bills as far as possible to manage your cash flow and get overdraft protection from your bank."

Eddleston, also a senior editor of EIX, further stated, "you must take off the rose-colored glasses as an entrepreneur and put on your pessimistic glasses when it comes to finances. Be prepared for emergency expenses."

Have Cash at Hand to Seize Growth Opportunities

"Very few (new) businesses can handle growth, so they need to look for ways to get an influx of cash," Eddleston adds. "Control the growth, but see if you can get a line of credit from a small local bank or loans from family and friends."

Wynn's business is not particularly capital intensive, which Eddleston says is a good thing. "Businesses that are capital intensive often have more difficulty acquiring

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the capital they need to stay afloat," she notes.

Lastly, Eddleston says that entrepreneurs must ask if they are meeting their goals with a startup. "Some are looking for more money," she says. "Some are looking for a better work/life balance. Some want to have a sense of purpose in their community and build a legacy."

Building on Her Mother's Business Legacy

When the pandemic started, Wynn says she was definitely looking for a way out of her stressful job as a general manager at Wendy's. She was in search of a better life/work balance. As she researched group homes for seniors and the home health care industry, she focused on developing a lifestyle assistant business.

"I realized I was touching on a legacy that my late mother(https://www.nextavenue.org/my-mom-my-first-superstar/) , Alice Alston, established as a home health care worker," Wynn says. "My mother's sister and her niece also went into the same field. In addition to being a home health care worker, my mother provided cleaning and child care services for a few clients.

"By creating Patricia Services, LLC," she adds, "I'm part of that legacy, too. My mom purchased the home where I now live in 1980, with her income as a home health care worker."