

The 5 Biggest Money Mistakes Small Business Owners Make

The [American dream of starting your own business](#) remains alive and well — the trick is to avoid becoming a statistic. According to the Small Business Administration, approximately one-third of small businesses don't make it past the first two years, and 50 percent of small businesses fail within five years. It comes as no surprise that one of the biggest challenges for these small business owners is money management.

Let's break down the numbers. According to a [2016 survey](#):

- 36 percent of SBOs cited cash flow management as a challenge
- 43 percent mentioned that growing revenue is tough

What are the biggest money mistakes small business owners make and how can you avoid these potential pitfalls to keep your doors open for years to come?

Here are the five most critical missteps to avoid:

Hitting the ground running without a foundational business plan

Your [business plan](#) is the foundation of your small business. It's the blueprint you will use to structure your operations and measure your progress. When the time comes, your business plan is also what will help you convince others that working with or investing in your business is the right decision.

"I don't need a business plan because I don't need to do any fundraising."

This is a huge misconception: Your business plan is not simply a fundraising tool. A solid business plan is a roadmap to help you lay out marketing and operational milestones.

The plan should be telling the financial story from your business: past, present, and future. If you're just starting out, you want to include a prospective financial outlook for the next five years. Set goals for quarterly and even monthly projects to keep yourself accountable in the first year. It's easier to pivot when you have goals to keep you in check versus doing your accounting and forecasting in the dark.

You may not be looking for investors right at the start of launching your business, but you don't want to be scrambling to put together a business plan when the opportunity presents itself. Be prepared from the beginning with a foundation and continue to build on it.

Pro-tip: A business plan could be a good recruiting tool, especially if you're a startup

Not separating your personal and business financial accounts

"I'm not even making a profit. I don't need a separate business account."

"I'm just a freelancer for now. I haven't incorporated. I don't need a business account."

Wrong.

From the second you earn money for your services, you're a small business owner. Freelancer, consultant, entrepreneur, solopreneur: These are just titles that we use to distinguish our roles, but at the end of the day, when you've got income you're declaring on a 1099, you need a separate bank account.

You don't even have to set up a business account to begin with; a checking account that you will only use for transactions involving your business ventures will be enough in the beginning. You want to be able to keep track of every penny coming and going related to your business. When you do finally incorporate, and when tax time rolls around, you'll have a clear ledger without your personal expenses complicating your business finances.

Pro-tip: As soon as you're incorporated, apply for an Employee ID Number (EIN) on the [IRS website](#). The EIN, also known as a Federal Tax Identification Number is provided to you for free from the IRS.

Not planning for tax liability

Ah, taxes. You may have bristled upon seeing the amount of taxes deducted from your paychecks when working a full-time job, but at least those were relatively simple. Once you branch out on your own and start receiving full payments from clients/customers, you're now solely responsible for tax liability. If you're starting a web-based small business, accounting can still feel simple, especially if you have an invoicing system set up for clients. But as your business grows, it's easy to get caught up in the day-to-day management, neglecting tax responsibilities until April rolls around.

The easiest way to stay on top of your tax liability is to pay quarterly taxes on your income. You'll also want to get familiar with state- and industry-specific taxes that'll impact your small business.

Pro-tip: Do things right from the start. Hire a professional to help you set up accounting processes for your business. Remember that business plan you started with? Those financial projections will also come in handy for planning for tax liability.

Being unprepared for a rainy day

Have you ever been caught in a rainstorm without an umbrella? Imagine that for your business — except the downpour impacts your inventory, your vendor payments and, worse, your customers. Most small business owners don't even think about [rainy day funds](#), especially when their business hasn't begun to make a profit. But that's precisely the reason it should be built into your budget from the start.

Don't feel overwhelmed about starting a savings account. Keep it simple and treat it as a regular monthly expense for your business. This way, you can slowly build out a reserve that'll help your business stay afloat. Most experts say six months of operating expenses is ideal for an emergency fund.

Pro-tip: If you have good credit, once your business is incorporated, consider applying for a business credit card or line of credit to use only in case of emergencies.

Not being proactive about taking on debt

Bootstrapping is a great point of pride as an entrepreneur: You've scraped and saved, you've rolled up your sleeves, and you've built a business from the ground up. There's a great deal of satisfaction to be found in pursuing your passion without going into debt.

That's fantastic — as a starting point. However, it's a mistake to rely on bootstrapping as your only strategy for growth.

Bootstrapping helps you hit the ground running but it doesn't necessarily keep the business going or growing. Small business owners obviously underestimate the importance of cash flow: [82 percent of business failures are due to poor cash flow management](#).

Going into debt can be scary, but not as scary as having a bank balance that's so far in the red you're not sure when you'll recover.

[Taking out a loan for your business](#) doesn't have to mean a monumental amount of money. If you've laid out a good budget, with expectations for the expected output (and revenue) for your business, you can take out a loan that's a perfect fit for helping you achieve your business goals.

In fact, taking out a loan to create a solid cash flow cushion for your business is a great way to ensure that you can pay yourself and in turn, reinvest in the business.

Pro-tip: Consult the resources offered by the [Small Business Administration](#), and research other grants available to your business. There are also many flexible options for working capital financing to help you [grow your business in a steady and responsible manner](#).

The American dream of owning your own business is still very much real and attainable. You didn't let your financial fears hold you back from pursuing your dream. Make sure the most common money mistakes of business ownership don't become your downfall. Yes, money management can be stressful, but it doesn't have to be impossible. With the right planning, prospecting and, of course, passion, you can grow a successful operation well beyond the first five years.

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