How I Avoided the 7 Most Common Money Traps for Founders

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Key Takeaways

- It’s possible for a company to be profitable on paper and still fail due to a lack of cash.
- Avoiding financial planning is like flying a plane without a dashboard.

You’ve built a business from the ground up — congrats!

But even the most innovative founders can make mistakes when it comes to finances. After all, every aspect of your business is supported by financial discipline. When mistakes are made early on, they can snowball into significant problems.

Based on my experiences and those of other founders, the same mistakes seem to be repeated. Thankfully, with awareness and discipline, these flaws in financial strategy can be avoided. Here are seven financial mistakes even smart founders make, and how to avoid them.

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1. Mixing personal and business

accounts

Failing to separate your business and personal finances is the most common and dangerous mistake founders make. Innocently enough, it starts as a personal card for a business lunch, but soon spirals out of control.

The problem: By mixing funds, you blur the legal line between you and your company. Your assets (such as your home and savings) could be at risk in a lawsuit. Moreover, it creates a tax nightmare which could result in audits and penalties. Also, it's hard to make wise decisions on profitability and cash flow because of an inaccurate financial picture.

The fix:

- **Open separate accounts.** Get a credit card, savings account and checking account dedicated to your business right away.
- **Pay yourself a salary.** Rather than withdrawing money from the business account, pay yourself a predictable salary. By doing so, a clear financial boundary is established.
- **Use software.** To keep your records clean, use tools like QuickBooks or Xero.

2. Not taking care of your credit score

The majority of small businesses are bootstrapped, with 78% using their own funds to get started. Although self-reliance is admirable, it often means your company has no business credit score at the start, which severely restricts your financing options.

The problem: Due to your startup's limited resources, you may need to seek outside funding for equipment or inventory. If

you don’t have a credit history for your business, you may be unable to secure loans or lines of credit, which can halt your company’s growth.

The fix:

- **Maintain an excellent personal score.** In the early stages of your business, your credit score becomes your company’s credit score. Be sure to pay all your personal bills on time, maintain a low credit utilization ratio, and keep an eye out for errors in your credit report.
- **Build business credit early.** As soon as your company is legally formed, open a business credit card and pay it off every month to establish a credit history.

3. Underestimating the importance of cash flow

It’s possible for a company to be profitable on paper and still fail due to a lack of cash. Many startup founders are so focused on revenue that they forget cash flow is their business’s lifeblood.

The problem: You land a big client and hire staff to do the work. Unfortunately, you won’t receive your payment for 90 days. Due to a cash flow gap, you’re unable to pay your bills. It’s the classic “grow-or-go” trap, where rapid growth outpaces your ability to manage cash flow. In fact, due to cash flow issues, 82% of small businesses fail.

The fix:

- **Create a cash flow forecast.** Keep track of projected cash inflows and outflows with a dynamic tool. By spotting potential gaps in advance, you can avoid crises.
- **Negotiate favorable terms.** Consider shortening your clients’ payment cycles (e.g., 30 days) and extending

your vendor’s terms.

- **Build a cash reserve.** Keep three to six months’ worth of expenses in a separate account. If revenue dips, this reserve can be a lifesaver.

Related: Smart Business Owners Know the Difference Between Profit and Cash Flow. If You Want to Make Money, You Should, Too.

4. Ignoring the tax implications of your decisions

Taxes are more than just a year-end problem; they’re a fundamental part of a company’s strategy. As such, ignoring them is a costly mistake.

The problem: You could face a massive, unexpected tax bill that wipes out all your cash reserves without proper planning. An incorrect legal structure, such as an LLC versus an S-Corp, can also result in overpayments. You’ll miss out on thousands of dollars’ worth of legitimate business deductions without proper bookkeeping.

The fix:

- **Hire an accountant early.** Don’t wait. To help you with corporate structure, quarterly taxes and deductions, find a CPA who specializes in businesses like yours.
- **Educate yourself.** As a founder, you don’t have to be an expert on taxes, but you need to know what constitutes a business expense.
- **Pay on time.** Set aside money for estimated quarterly taxes to prevent a huge, unpleasant surprise.

5. Under-pricing your product or

service

Passionate founders often hesitate to charge what their products are really worth. In addition to leading to burnout, this is not a sustainable business model. As McKinsey points out, overcharging isn't the most common reason for improper pricing. Instead, up to 90% of improper pricing issues are caused by underpriced products.

The problem: When you underprice, you may not be covering your actual costs, such as overhead, marketing and your own time. In addition, you attract the wrong kind of customers – those who are demanding and quick to leave for an even cheaper alternative.

The fix:

- **Know your value.** Know what makes you unique and don't be afraid to charge for it.
- **Calculate your costs.** Don't guess. Be sure to include all direct and indirect costs, as well as a healthy profit margin.
- **Consider value-based pricing.** You should price your product based on the value it provides to your customers. Depending on the benefit you provide, your price may be increased if your solution saves a company significant time or money.

6. Avoiding financial planning and record-keeping

Founders are often visionaries, not accountants. However, avoiding financial planning is like flying a plane without a dashboard.

The problem: When you make hiring or expansion decisions without a solid financial plan, you're flying blind. As a

result, you miss out on opportunities, such as determining which products are most profitable. Also, if your financial records are messy, no investor will invest in you.

The fix:

- **Treat finances like a partner.** Regularly review your finances. For example, a weekly cash flow review could be scheduled.
- **Automate everything.** Record-keeping can be automated with accounting software. Sync your bank accounts and credit cards for a complete record of your transactions.
- **Create a budget and plan.** Even the simplest budget can give you a sense of direction. But, since it's a living document, you should revisit and adjust regularly.

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7. Rushing to hire new employees

As crucial as delegation is, founders also need to take the hiring process into account. Overhiring can hurt a company's burn rate, or the rate at which it loses money.

The problem:

Your early employees shape the culture and mission of your startup. A rush to hire can result in poor fits, higher turnover rates and a significant drain on your finances. If you hire people who aren't the right fit, you'll spend much more than the average cost of hiring someone new, which is around $4,700.

The fix:

- **Outsource first, hire second.** Consider hiring a freelancer or virtual assistant before hiring a full-time employee. With this option, you can manage cash

flow and test needs without committing long-term.

- **Vet thoroughly.** You should ensure potential hires are not only skilled but also a good cultural fit. Early employees are investments, not expenses.

The Bottom Line

Innovators are masters of innovation, but a solid financial foundation must support their innovation. The thing is, there's no reason for these mistakes to occur. When you approach your finances with the same passion and attention you devote to your product, you can ensure that your business not only survives but thrives.

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