Why A Credit Line Could Save Your Business

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When a business emergency strikes, a line of credit can be a true lifeline, bridging a cash flow gap so your business can continue to make payroll, cover expansion costs, or buy raw materials. Working capital is the lifeblood of any business. When your business gets stuck, fast access to capital via a credit line can be the difference between survival and bankruptcy. Think of a credit line as an insurance policy. Just because you have the credit line doesn't mean you have to use it. But when you do need it, a credit line is like having access to an untapped cash reserve. That's priceless!

Never considered applying for a business credit line before or not sure if you would qualify? Here's what you need to know.

When a Credit Line Can Save Your Business: Bridging Cash Flow Gaps

Consider this: you run a small fashion startup and your latest designs are flying off the shelves. That's good news, right? Well, not entirely- since most of these purchases were made with credit cards, the money won't instantly appear in your business account. In fact, Fashion Buzzer reports it can take up to a month or longer for money from credit card transactions to appear. That leaves your business without the working capital it needs to purchase additional raw materials and create new merchandise. Your business is left without the means to produce more products and meet customer demand.

That's where a credit line comes into play. A credit line is "a predefined amount of money that the bank is willing to lend you in a rather short period of time." In the case of a fashion business, if you have a credit line open, you can immediately use this credit to purchase the additional raw materials you need to meet customer demand. There's no waiting around for approval.

How to Apply for a Business Credit Line: Secured v. Unsecured

The first rule of thumb with a business credit line is to apply before you need it! Otherwise, you'll be stuck wading through paperwork at the exact moment you need the cash. Next, you'll need to consider which type of credit line to apply for. There are two types: secured (traditional from a bank) and unsecured (business credit cards).

Traditional credit lines are issued by banks and can require substantial documentation, including financial statements, tax returns, and business registration documents, reports the Small Business Administration. With a traditional credit line, your business will have the benefit of direct check writing privileges. The downside? In addition to the lengthy paperwork, these lines can be tricky to obtain. In addition to low approval rates, SBA reports that 29 percent of small business owners have had their credit lines reduced in the last four years. One in 10 businesses have even had their lines called in early by the bank. Yikes!

Another option is an unsecured business credit line through a business credit card. This credit line is tied to your FICO score and doesn't require extensive business documentation or scrutiny. An unsecured business credit line typically caries higher limits and may even offer an introductory 0% APR for the first 12 months. Not sure which one is right for your business? NerdWallet recently published a comprehensive list of the best small business credit cards for 2016 that compares sign-up bonuses, rewards, and payment terms. Shop around to get the best deal!

When a Credit Line Won't Help: Poor Financial Forecasting

If you're stuck in a cash flow pinch, a credit line can be a true business lifesaver. But it can't keep your business afloat forever. As a small business owner, I know just how tricky it can be to juggle competing cash flow demands. I've written before about the importance of coming up with a long-term solution for cash flow problems. Depending on your business, these solutions could include requiring an upfront project deposit from new clients, offering early or on-time payment discount incentives, lowering carrying costs by reducing overhead expenditures like office space, and prioritizing bill payment based on due dates.

Temporary cash flow crunches are inevitable part of doing business, but they shouldn't be a *permanent* state of business. If you find yourself continually struggling to balance the books each month, it's time to go back to the financial forecasting drawing board.

A financials forecast is a simplified financial plan or budget for your business that estimates your projected income and expenses. Financial forecasting will help you forecast revenue and growth by accounting for your current expenses (e.g., fixed overhead costs) and variable costs, along with predicted revenue. In general, most startups create two financial forecasts: a conservative forecast assuming low growth/high expenses and an aggressive forecast assuming high growth/low expenses. Here's where things can go wrong. If you fail to adjust your forecast as your business grows, you could be making financial assumptions off the aggressive forecast even though your business is following a more conservative growth trajectory.

Bottom line:

Don't wait until a cash flow crunch strikes to secure a business credit line. Plan now for unexpected cash flow emergencies. Finally, remember that cash flow emergencies should be a temporary state, not a permanent reality! If your business is bouncing from one cash flow crunch to the next, it may be time to take a hard look at your financial forecasting.

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