

# How to Build an Emergency Fund for Your Business





**Financial experts often recommend individuals have an emergency fund to use for unexpected expenses and setbacks. The same advice holds for small businesses—and the importance of emergency funds has been driven home by the coronavirus pandemic.**

Major economic downturns or natural disasters are obvious situations where an emergency fund can help your business survive. But there are smaller emergencies that can prove devastating, too. What would happen if you were injured or ill and couldn't work for months? What if your region or industry suffered an economic slump? How would you survive losing a key customer that accounts for half of your revenue?

Few entrepreneurs are prepared for an emergency. In a [2019 survey](#) by the Federal Reserve Banks, two-thirds of businesses reported having financial challenges in the prior 12 months. When asked how they'd handle two months' loss of revenues, just 14% of businesses said they could rely on emergency funds. Nearly half would have to use the owners' personal funds, 37% would cut salaries, 33% would have to lay off employees, and 17% would go out of business.

Business interruption insurance, emergency loans or FEMA funds can help in many situations, but as COVID-19 has demonstrated, loans can be hard to come by, and insurance policies can take weeks or months to pay out. In the meantime, you need a way to keep your doors open and your employees paid. An emergency fund can help.

In this eGuide, we'll explain

- **How much money to set aside for your emergency fund**
- **The best ways to build up a fund, even in tough times**
- **Where to put your emergency savings and how to manage it**

Learn how to get started saving an emergency fund for your business so you're ready when the next crisis hits.

## How Much to Save in an Emergency Fund

How much money should you set aside for an emergency fund? Three to six months' worth of overhead is a good general rule, says David Worrell, an outsourced CFO and author of [The Entrepreneur's Guide to Financial Statements](#). Focus on saving enough to cover essential expenses. "An emergency means your sales stop—so you don't need the emergency fund to buy inventory," he explains. "You need it to pay things like rent, utilities and administrative costs." Worrell says three to six months' worth of savings should give you enough time to either refocus your business or, in the worst-case scenario, shut down.

How much you should save can vary depending on your business. Some industries are seasonal or more vulnerable to economic ups and downs than others. Others are subject to customer lawsuits or changing government

regulations that can impact their finances. Businesses whose customers are slow to pay may also need a bigger stockpile of cash. If you feel you are at greater risk, consider saving more than six months' worth of overhead.

Your personal financial situation is also a factor. If you have a spouse with a steady job or have enough savings to support yourself, you don't necessarily need to build your paycheck into the monthly overhead. If you rely on your business for your family's sole income, however, you'll have to include your salary in the emergency fund.

Don't plan to rely on your personal savings to keep your business afloat. "The problem with feeding a business out of your personal finances is you may not know where to stop," explains Worrell. You could end up not only losing your business but also losing your home or wiping out your retirement savings.

Still not sure how much you should be putting aside? Talking to your financial professionals or a [SCORE mentor](#) can help you assess the risks your business faces and how much money you might need to get through an emergency.

## Ways to Build Up an Emergency Fund

The best way to build your emergency fund is by saving a percentage of business income each month rather than a flat amount. This ensures that you automatically put more money aside during boom times. "Don't pay yourself based on projections or money in the bank; pay yourself based on the profit from two months ago," advises Worrell. "Deduct 10 to 20 percent from that amount and put it in savings first; then pay yourself."

Worrell says this approach works well because the owner's income is the largest single variable most business owners can control. "If you have a great month and your [profit-and-loss] looks good, it's tempting to take all that money out of the bank," he says. Paying yourself based on profits from two months ago gives your cash flow time to catch up and lessens the effects of bad debt. "If a customer isn't going to pay you, at least you'll find out before you take that money out of the bank," he explains.

Maintaining good [cash flow](#) habits will also help you prepare for an emergency, says Worrell, advising, "Pay slow, collect fast and vet your customers based on creditworthiness." Otherwise, an emergency may be compounded by poor cash flow.

In addition to building a cash emergency fund, it's also wise to have credit available. Get a business credit card and line of credit to be used only in case of emergency. While this shouldn't substitute for cash savings, it can provide an additional layer of emergency cushion.

Want to put even more money in your emergency fund? Try these tips.

- **Cut back on nonessential spending.** Subscriptions, memberships or fees for online services can quickly add up, especially if they automatically renew every year. Meet clients virtually instead of spending money on business lunches or travel. Reduce spending on office supplies by purchasing in bulk.
- **Comparison shop for business services.** You may be able to save money

## WHAT COUNTS AS AN "EMERGENCY"?

In order to build an emergency fund, you must avoid the temptation to use it for non-emergencies. In general, you should only tap into your emergency fund if you're facing severe financial hardship. Typically, this means your sales dry up altogether or decline so steeply that you can't make up the difference simply by cutting costs. Such emergencies are often caused by larger economic forces, such as the 2008 recession or the aftermath of 9/11, or natural disasters that have long-term effects on a community.

A chance to buy inventory at an incredible discount, expand into a new space or take advantage of other opportunity might seem like an "emergency" in the moment. But using an emergency fund to pursue opportunities is generally a mistake, cautions outsourced CFO David Worrell. He advises borrowing to take advantage of the opportunity—assuming the ROI is greater than the interest rate—instead of using your emergency fund. Having the emergency fund on your balance sheet will make it easier to borrow money.

If borrowing isn't possible, you may have to pass up a few opportunities to keep the emergency fund intact. "Fast growth without a fallback fund is part of what gets companies in trouble," Worrell explains. "Furthermore, most new opportunities add to your monthly costs, which means your emergency fund should be growing. If instead you use the reserve fund to pursue the opportunity, you're going in the wrong direction."





by switching banks, payment processors or insurance providers, or choosing free or lower-cost software applications.

- **Be more thoughtful about new investments.** Do you really need that shiny new toy? Assess the ROI of equipment before buying. Consider buying used or refurbished instead of new.
- **Barter with other business owners to reduce expenses.** For example, a marketing company could design another business's website for free in exchange for something they need.
- **Sell equipment you no longer need.**
- **Negotiate with suppliers.** They may be willing to lower their prices if you pay cash or pay early, for example.
- **Increase sales.** Look for ways to motivate your sales team to encourage higher sales. Be sure to reward them financially, too.
- **Raise your prices.** Consider charging new customers slightly more. At the new year, or when existing customers renew their contracts, raise prices.
- **Lower your real estate costs.** Can you move your business to a smaller location or switch to 100% remote work? Subletting part of your space to another business owner, if your landlord allows, could bring in additional money.
- **Go greener.** Save money on your utilities by installing energy-saving features like smart lighting and thermostats. Make it a habit to turn off equipment when it's not in use. Digitize documents instead of printing.

## How to Manage Your Emergency Fund

Put your emergency savings somewhere accessible—but not too accessible. If you can resist the temptation to tap into the money, you can simply keep it in your business checking account and ignore it.

If you feel like that's too tempting, set up a separate savings account, money market fund or short-term certificate of deposit (CD) connected to your primary business account. In a pinch, you'll be able to quickly access the money and transfer it to your business checking account. On a day-to-day basis, however, having separate accounts will remind you not to spend your emergency fund.

Keep in mind your business costs and needs will change over time. At least once a year, assess your emergency fund, your overhead costs and the risks you're exposed to, and make adjustments as necessary.

## Your Business Safety Net

Building a business emergency fund may seem like a daunting task for small business owners who already operate on thin margins. But having some savings in place can mean the difference between surviving an emergency and closing your business.

“When it comes to an emergency fund, doing it is more important than how you do it,” says Worrell. Commit to building a cash reserve, take small steps to save every month, and before you know it, you'll have a safety net you can rely on to keep your business going, no matter what life throws at you. ●

