The Working Capital in Ecommerce Report

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Healthy cash flow is one of the most critical pieces to the ecommerce puzzle. When a store has access to sufficient funds it can meet its obligations, expand its offerings, and take on the world. Yet capital constraints remain a constant worry for ecommerce entrepreneurs worldwide. In fact, cash flow problems are why ***nearly one-third of businesses fail***[1] and why there's currently €1.2 trillion in excess working capital tied up on company balance sheets.[2]

Whether online or in-store, in the US or India, not even the most successful stores are exempt from cash flow worries. Many stores find themselves short on funds, even when their store is profitable. In its Working Capital Report for 2019/20, PwC discovered that while working capital increased by 9.4% globally from 2017 to 2018, progress improved by a meager 0.1 days when analysed from a day-to-day context.[2]

But there is a silver lining. Brands that address cash flow problems head-on help to clear the way for bigger profits and opportunities.

In our first ***Working Capital in Ecommerce Report,*** we'll review the latest publicly available data on cash flow challenges for high-growth brands. We'll also take an objective look at working capital as a funding source, and review the hard data on the pros and cons of using working capital to fill cash flow gaps.

Working Capital woes: Current challenges for ecommerce businesses

Cash flow shortages are kryptonite to ecommerce businesses, obscuring the path to success and leading online stores operating into a stressful payout-to-payout cycle. An Intuit Quickbooks study found that ***61% of small businesses*** experience cash flow issues, leaving 38% of them unable to meet their financial obligations.[3]

Certain cash flow problems are unique to the ecommerce industry, making them difficult to solve without dedicated tools and solutions. There are various challenges and reasons an ecommerce business would look to working capital, and many of them are still misunderstood by modern lenders.

Traditional funding options can be restrictive, expensive and difficult to secure

The ecommerce landscape continues to develop rapidly, leaving traditional funding providers, like banks, struggling to keep up. This lag in innovation has made getting funding from banks difficult for ecommerce brands, as many banks have stringent rules and processes which simply don't align with the modern ecommerce business model.

For brands fortunate enough to make it through the intense application process, the requirements for a bank loan, Small Business Administration (SBA) loan or other traditional funding, are not for the faint-hearted. Traditional funding providers often stipulate what borrowers can use the capital for, when they must repay it, and for how long they will have access to the funds — characteristics that can quickly cause difficulties if a capital need arises in a business area not within the funding's remit. These issues explain why, according to Goldman Sachs, 80% of entrepreneurs use some variation of personal funding sources to access cash for their growing business, with 31% turning to personal credit cards.[4]

80%

of entrepreneurs use personal funding sources.

Meanwhile, ecommerce growth remains costly

Despite the fact that ecommerce brands do not need to contend with many of the expenses physical stores face, scaling the business still comes at a price. Each item, territory, warehouse, or marketing channel is a burden on a growing brand's resources.

For example, a new product line creates additional inventory, advertising, and storage needs. Without reliable financial reinforcements, a store can experience cash shortages, even when it's reinvested its profits. As a result, a growing ecommerce brand may be forced to delay taking on new opportunities or miss them entirely, leaving space in the market that its competitors with deeper pockets can quickly take advantage of.

Delays and disasters make managing cash flow feel like walking a tightrope

Whether an ecommerce brand sells via a marketplace or its own website, there are many factors that cannot be controlled or predicted, such as delayed payouts or sudden shipping delays that force a brand to halt sales.

When these problems occur, they can have a major impact on the brand's available cash. From this point, it's a race to find the cash to stay afloat, and some brands and marketplace sellers find themselves placing last. Forced to make tough decisions regarding which products to restock and which suppliers to pay first, the cost for these brands is both lost sales and damaged trust with customers and vendors.

In a worst case yet surprisingly common scenario, this could even signal the end of the business altogether with 31% of businesses[5] not being able to secure enough credit to cover operating expenses, and more than 32% of ecommerce businesses[6] citing "running out of cash" as one of the main reasons their business closed.

Working capital funding solutions for ecommerce

Working capital funding solutions range from short to long-term funding options that give ecommerce brands the chance to stabilise their cash flow. With a working capital solution to solve the inevitable cash flow gaps, brands can invest in scaling their growth, while keeping operating expenses covered. Today, there is a growing market of working capital solutions to choose from, including:

- Credit lines
- Business loans
- Cash advances
- Invoice factoring

The benefits and drawbacks of each type of working capital

Whether a store is a freshman or veteran in the online selling world, a working capital solution can help it get ahead. In fact, according to the Goldman Sachs ***10,000 Small Businesses Report,*** 54% of companies use part or all of the funding they secure to improve their operations, working capital, and cash flow.[4]

However, ecommerce funding has its drawbacks too. It's important to assess the pros and cons for each working capital solution objectively in order to make the best choice. Let's explore some key facts on the various types of ecommerce funding and the advantages and disadvantages of each.

Credit lines

With a line of credit, the business is offered a designated credit limit or 'cash pot' to draw from. Typically, account owners can use and repay the funds at their discretion, as long as it is within the assigned time limit. In most cases, only the cash an account holder uses will incur interest.

The advantages of credit lines

Affordable interest rates and fees: Working capital funding sources like credit limits tend to be gentler on the pockets than other funding options, such as credit cards and cash advances. The interest rates are typically lower and are tied to a store's credit and performance history. The account holder will only pay interest on the capital amount used and therefore does incur high interest rates on unused credit.

Flexible repayments and limits: Repayment figures are often flexible, depending on how much of the credit line the account holder has used. This means that in many cases, companies are not locked into a fixed monthly payback plan. Some providers will increase the limit as the store grows as long as the company can provide proof of sales growth.

Fast access to capital: When unforeseen issues arise and threaten cash flow, brands can use a credit line to get back on track quickly. Many modern funding providers understand time is of the essence in ecommerce and can get brands from application to funded in a matter of days.

No need to give up equity: With a line of credit, ecommerce brands do not have to make a decision about which is more important — ownership or funding — as they would in a VC or private equity arrangement.

Interest payments are tax deductible: In many cases, the interest paid on a credit limit is tax deductible. Brands and sellers can essentially receive cash at a heavily reduced rate, as the interest may cancel out certain tax liabilities.

The disadvantages of credit lines

Credit lines can't fix an unhealthy business: A credit limit can offer a great working capital solution for keeping sales and cash flow on track, but it won't fix ingrained cash flow issues, like dead and underperforming stock or slim margins.

Easy to overextend: Like credit cards, knowing the extra funds are available can cause brands to become lax with regard to spending. Without a proper plan and discipline, expenses and repayments could get out of control, putting further strain on a store's cash flow.

Interest can pile up: If a company is unable to make repayments consistently, it may enter a vicious cycle of paying only the interest on the credit line, rather than the initial amount.

Business loans

Business loans work just like personal loans in that the account holder receives cash from a bank or financial institution with principal and interest. The account holder then pays back the funds over a set time period, and may need to make lump sum payments along the way. There are many reasons why business loans may or may not make sense as a working capital solution for an ecommerce business

The advantages of business loans

Short to long-term funding for a variety of needs: Business loan providers often offer a wide range of funding options, covering things like inventory and real estate purchases. With a little effort, ecommerce brands may be able to find a loan to meet their business needs.

Reasonable rates and repayment periods: Since borrowers can access cash with long repayment periods, many business loans come with reasonable fees and interest rates and can tailor monthly obligations during the application process. Some loans also allow borrowers to repay early. SBA loans can have interest rates at 8.5% plus a 2-4% prime rate.[7]

Good credit history and collateral can help borrowers: Borrowers with a solid business reputation, credit history, and savings, can often get better loan terms. These savings can help ecommerce borrowers scale.

The disadvantages of business loans

Long application process: Not only can a business loan application take months to complete, there's no guarantee it will go through. Applying companies may waste precious time and resources in the application process and still walk away empty-handed.

Strict requirements: Many traditional lenders struggle to grasp ecommerce and its modern quirks. For example, most SBA loans require personal collateral, relevant management expertise, good credit, profits, and more. Today, only 13.5% of small businesses[8] secure bank loans with the bulk of successful applicants being brick-and-mortar retail stores.

Must use funding as prescribed: Most business loans come with rules on what borrowers can and can't use the funds for. Ecommerce borrowers must take care to ensure the loan meets both current ***and*** future needs, and may even need to secure access to additional funding sources for unexpected expenses and opportunities.

Strict monthly repayments: There is little flexibility with business loan repayments. This can put additional pressure on business performance, with the US Federal Reserve finding that 47% of small businesses either made payments late or didn't pay at all.[5]

Cash advances

A cash advance, also known as a capital advance, is unsecured cash given by a funding provider to a business based on its future revenue. The cash advance provider buys part of the business' predicted sales at a discounted rate. Each time the store makes a sale, the provider receives a portion as repayment until the cash advance balance clears. This also means capital advances aren't considered debts.

85%

of cash advance applications are accepted versus 73% of business credit line applications and 52% SBA loans.

The advantages of cash advances

Debt-free capital: Since a cash advance isn't a loan, ecommerce brands and sellers can gain access to funds without monthly payments. Instead, repayments will be based on the store's future sales.

'Risk-free' funding: Cash advances are the closest thing to getting 'risk-free' upfront capital from an external source. The funding provider assumes most of the risk if the account holder makes no sales and can't repay.

No collateral required: Cash advances don't typically require collateral. Providers rarely ask for a personal credit score. Instead, the funding amounts are based on a store's performance, health, and age.

No waiting around: Unlike most business loans, applicants for a cash advance won't have to wait months for approval. According to the US Federal Reserve, capital advances have the highest approval rates of any lending source at 85%. Some providers process applications as quickly as 24 hours.[5]

The disadvantages of cash advances

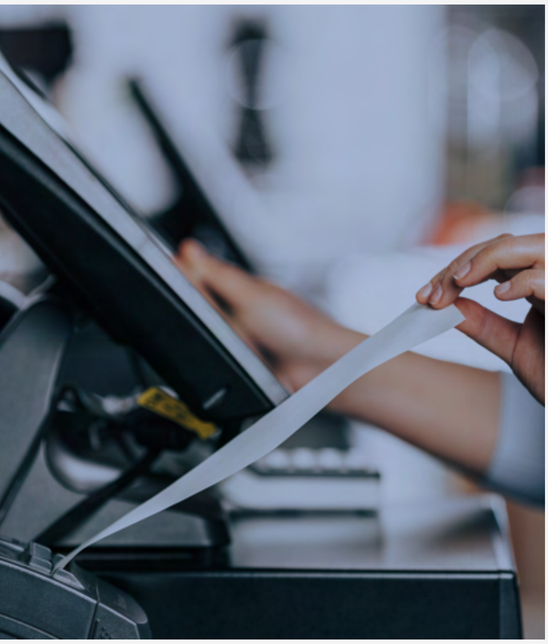
High fees: Cash advances can come with fees considerably higher than those attached to a loan. Also, most cash advances run for a little over a year, so they can't usually be used long-term like a line of credit.

Users must repay quickly: The short-term nature of cash advances means businesses that use this option may have less breathing room to repay. If mismanaged, ecommerce brands and sellers could find themselves in the sticky situation o f having to take out a loan to cover expenses.

Can be a burden to a struggling business: If an ecommerce company takes on a cash advance while it's already facing financial difficulties, it may end up relying on multiple funding sources to get by. These obligations can compound to the point that the company is unable to afford the minimum payments while also maintaining sufficient capital for daily operations.

Invoice factoring

Invoice factoring, also known as debt factoring, involves selling your accounts receivables to a factoring company at a discount. The factoring company will charge a lump sum fee (which varies according to your revenue) and release funds to you.



Pros of invoice factoring

Quick and flexible: Invoice factoring allows a business to unlock capital stuck in unpaid invoices to get immediate cash flow. There are no repayments to make which may also mean no interest fees.

Not dependent on credit history: If a store lacks credit history, the option to use invoice factoring still stands, as most factoring companies don't require it.

No collateral demands: Since factoring companies get their revenue from a store's unpaid invoices and fees they charge, there is no requirement for collateral.

Cons of invoice factoring

Only useful to companies with an accounts receivable arm: Invoice factoring may work well for ecommerce stores that sell wholesale goods, but it does not apply to brands selling via marketplaces or their own sales channels.

Not suitable for business with due invoices small in value or quantity: With invoice factoring, the business' receivables must hold enough value to meet the fees and discounts the factoring company will take.

Not suitable if customers have poor credit: To minimise their risk, factoring companies look at the customers' credit history to decide whether they will take on a company's due invoices.

The path to better working capital in ecommerce

When faced with complex cash flow challenges, scaling an ecommerce store can feel like an uphill climb. However, when backed by the right working capital solution, high-growth brands and marketplace sellers can overcome these challenges to build a profitable store, powered by a cash flow system that runs like clockwork.

Taking on external funding is a big step in any store's journey. It's important to research the various funding options available and seek additional opinions from a certified financial professional to ensure the working capital solution you choose can actually support growth and pave the way for a profitable future.

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About SellersFunding

Ecommerce is thriving, your cash flow should be too. At SellersFunding, we're challenging the funding status quo to bring ecommerce businesses fast, flexible funding options they can count on to grow their business no matter the weather. Reach out today to learn more about how we can help you scale.

Sellers Funding