

Diversification Drive: How SMBs Can Limit Financial Risk in 2023

Proposed URL: /diversification-SMBs-limit-financial-risk

Word count: 1100

Content type: Thought leadership

Meta Description: It's a hard time to operate in the market as an SMB, but you can minimize financial risks in business by diversifying finance sources. Read our essential insights here.

Keyword/Query	Search intent
Small business risk	30
Financial risks in business	70
Small business risk management	70
Financial risks for small business	20
How to manage financial risk in business	20

Semantically related keywords:

On June 14th, the Federal Reserve announced it would be keeping the [key interest rate at 5%](#). While many businesses and households may have welcomed this decision, the situation remains difficult for small and medium-sized businesses, for whom credit availability remains poor.

Traditional lending institutions already make it challenging for small and medium-sized businesses (SMBs) to get financial support. To obtain a loan, SMBs face strict eligibility criteria and time-consuming applications, often with a drawn-out approvals process.. On top of this is the risk—despite the time and effort involved in the application—of rejection. Forbes recently reported that [just 18.7%](#) of small business loans were approved in May 2023.

Even with the rate now being maintained at 5%, SMBs continue to face financial challenges associated with raw material price increases, steeper loan prices, supply chain disruption and market volatility. In turn, these factors also often create further barriers to financing, giving large enterprises an unfair advantage, and stifling innovation—which often comes from SMBs—across many industries.

At Setscale, we believe that the right solutions to these challenges come with the right partnerships, because no small business should have to face this landscape alone. In this article, we'll explain how to manage financial risk for those SMBs enduring ongoing economic uncertainty.

<h2>The SMB Market in 2023</h2>

The 2008 financial crisis caused colossal damage to the U.S. and global economies. It also prompted the creation of new ways for growing businesses to access support during difficult market conditions through alternative finance solutions.

Though the fallout was less severe than in 2008, the collapse of Silicon Valley Bank (SVB) in early 2023 came amid a perfect storm of global inflation, recession and the failure of a number of financial services companies this year. SVB's clientele was largely made up of startups and small businesses, and its sudden disintegration had a destabilizing impact on bootstrapped businesses who had banked with it.

Amid the uncertain environment for SMBs, it can be hard to identify how to protect the company against risk. To complicate things further, SMBs have limited resources compared to bigger companies in terms of effective risk management. When the focus of the business is to drive growth, looking at financial risk falls further down on the list of priorities — but it shouldn't.

"The downfall of SVB and other banks, along with other financial service companies, has made it obvious to the small business community—and, candidly, the entire world—that companies and individuals alike need to have various financial resources behind them at all times. Nobody should ever be dependent on a singular provider"

- Daniel Fine, Setscale CEO

<h2>What Are the Top Financial Risks for Small Businesses?</h2>

Starting and growing takes guts. We know this from our own experience of building businesses from scratch, and can safely say that launching a successful company is rarely achieved without outside help. Financial support is something very few SMBs can live without, but this can open them up to different types of risk:

<h3>1. Credit risks</h3>

Paying creditors and suppliers on time can be especially challenging for SMBs who rely on customers' prompt payments. This impacts a business's credit risk. Knowing that every SMB has a different level of credit risk, traditional lenders—e.g. mainstream banks and financial institutions — have strict application criteria to make sure that borrowers are likely to pay them back on time. The more risky a small business is deemed by a bank, the less likely it is to provide a loan.

<h3>2. Operational risks</h3>

All business systems, policies and procedures come with a risk of negative impact and therefore loss, which is called operational loss. Examples of operational risk include technical issues, workplace health and safety, human errors, and fraudulent or criminal activities such as misuse of assets and tax evasion. If these operational risks aren't mitigated against, the result can be serious damage to a business, including reputational damage, outright loss, or regulatory overheads from corporate investigations.

<h3>3. Liquidity risk</h3>

Liquidity measures the level of assets owned by an individual or business that can instantly be turned into cash without resulting in a loss in value. Liquidity risk, therefore, is the chance that a business will not fulfill short-term debts based on its existing liquid assets. When a business has too much liquidity risk, the solution is to bring in additional revenue or find alternative ways to minimize the difference between cash and debt obligations.

<h3>4. Market risks</h3>

The market that any business operates in has its own set of risks. Market volatility, rising material costs, increased interest rates and changes in the exchange rate all continuously reshape a business's playing field.

<h2>Small Business Risk Management and Diversification</h2>

As we've already explored, high interest rates and the lending policies of traditional banks create a tough situation for emerging SMBs to borrow to invest. This is especially painful for businesses that have cash flow problems — Forbes found that as [many as 64%](#) experienced cash flow issues due to late payments and unpaid invoices alone. For this reason, diversification, particularly the use of alternative financing, is more important and valuable than ever before.

<h3>What is Diversification in Business Funding?</h3>

This strategy is often used by investors, who diversify their portfolios by putting money into multiple stocks rather than one to insure against risk and maximize return.

Similarly, businesses can limit risk exposure by developing relationships with multiple sources of capital.. What happened with SVB is a case in point: even though a [government bailout followed](#), by

relying solely on lines of credit from one bank, businesses were left dangerously exposed when it collapsed.

<h3>Alternative Financing</h3>

We mentioned earlier how alternative financing options came about as a result of economic turmoil from the financial crisis of 2008. Today, SMBs (and businesses of any kind) have access to many types of funding beyond banks and mainstream financial institutions.

Alternative financing instruments include purchase order (PO) financing, invoice factoring, peer-to-peer lending, working capital loans, and others. These are designed to help businesses overcome the limitations of traditional bank loans. Instead, alternative financing provides flexibility, for instance by focusing on financing individual stages of the supply chain.

PO financing is one such tool companies can use as part of a diversified finance strategy. This is where a third party gives an advance payment for business suppliers to fill open purchase orders. By paying suppliers, this reduces cash flow pressures, helping companies maintain critical growth instead of forgoing valuable opportunities.

<h2>Diversify with Alternative Financing</h2>

Under Setscale's business model, SMBs get easier access to capital. Unlike traditional banks and other providers, we focus on more than just credit score. Our flexible alternative finance solution helps ambitious businesses scale when they're ready — we pay suppliers directly, so that our partners can focus on driving growth. If you're interested in what we can do for your business, [fill in a form](#) today to get started.