

# Capital Corner

## Let's Review... What is your Cash Gap?

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*In previous versions of Capital Corner, we've covered the importance of Cash Flow to understand how to effectively make your business more profitable. We previously covered how to calculate the three essential factors to monitor your cash flow on a regular basis: 1) your average inventory turn, 2) accounts receivable turn and 3) accounts payable turn*

They say a picture tells a story; well here is a picture of the "Cash Gap." The Cash Gap represents the financing requirements of your business after analyzing the average time difference between the turn of your largest assets and when you are required to pay your suppliers. Simply said another way, the Cash Gap is the length of time between your cash inflows and outflows. The bigger the Cash Gap the more critical for you business. As you can see from the picture below, a Cash Gap exists of 40 days which means that it takes this business on average 75 days to convert its inventory and another 10 days on average to convert its account receivables to cash. Meanwhile this business must pay its suppliers for its inventory within 45 days.

In this example the business may need to "finance" the Cash Gap out of the owner's cash reserves, borrow the money from a bank, or inject funds from outside the business to cover the shortfall.

The example portrays an example that we see all too frequently and it underscores the importance of keeping a close eye on inventory/accounts receivable trends at all times while understanding your payable requirements. Understanding the relationship between your inventory turn versus your payables turn can also help you calculate the optimal inventory levels for your business, given your sales volume. The closer your inventory turns are to your payable terms the lower the Cash Gap. The smaller the Cash Gap the smaller the amount of working capital your business may require. Funding the Cash Gap often may require bank lines of credit or other forms of credit, like revolving credit

card debt. Know your Cash Gap, know how it is funded, and know what the Cash Gap is costing your business.



Jim Morphey is the Vice President of Corporate Development for GE Capital, Commercial Distribution Finance. Jim has 37 years of management experience in Trade Credit as well as the floor plan, factoring, and consumer finance business devoted almost entirely to the domestic consumer electronic, appliance, and outdoor power industries. His background includes assignments in Operations, Credit, Sales Management at the national level with Whirlpool, Whirlpool Financial Corporation, Transamerica Distribution Finance, and GE Capital.

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