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Let’s review…what is your cash gap?

By Jim Morphey
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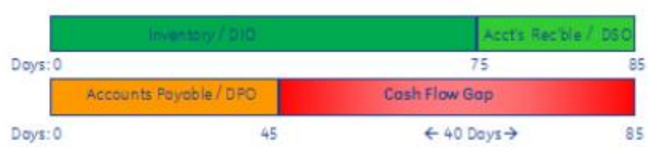
They say a picture tells a story. Here is a picture of the cash gap. It represents a business’ financing requirements after analyzing the average time difference between the largest assets’ turn and when a supplier must be paid. Simply put, the cash gap is the length of time between your cash inflow and outflow.

The bigger the cash gap the more critical for your business. As you can see below, a cash gap exists for 40 days. The picture notes that it takes the business on average 75 days to convert its inventory and another 10 days to convert account receivables into cash. Meanwhile the business must pay suppliers within 45 days.



In this example the business may need to finance the cash gap out of cash reserves, borrow money from a bank, or inject funds from outside the business to cover the shortfall. The example portrays a situation that is observed all too frequently and reiterates an important point - keep a close eye on inventory and accounts receivable trends at all times, and understand your pay requirements. Understanding the relationship between your inventory turn and 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 may often 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 Wells Fargo Commercial Distribution Finance (CDF). Morphey has more than 40 years of management experience in consumer finance, trade credit, and most recently with domestic and international inventory financing, as well as factoring. Morphey's career has been devoted almost entirely to the domestic consumer electronic, appliance, and outdoor power industries. His background includes executive assignments in operations, credit, and relationship management at the national level with Whirlpool, Whirlpool Financial Corporation, Transamerica Distribution Finance, and senior relationship assignments at GE Capital.

Morphey received a Bachelor of Science in Management from Northern Illinois University. He was a member of the Association for Finance Professionals (AFP). He earned professional certifications from The National Association of Credit Management/Credit Research Foundation (NACM/CRF) Graduate School of Credit & Financial Management held at Dartmouth College, and also from The Finance, Credit, and International Business Association (FCIB). Morphey has published many articles on the topics of inventory management as well as cashflow. He also helped produce a six part video series on a variety of cashflow topics which may be found at www.cdf.wf.com/learningcenter. Morphey and his family reside in southwestern Michigan.

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