Manage Your Gap and Reap the Benefits!!

By Eugene E. Valdez

The business coaching & consultants of the world like to use the term "KPIs" in their interaction with clients. KPI is an abbreviation for "Key Performance Indicators" which are essentially important business numbers and ratios that entrepreneurs should track. The basic premise of KPIs is the business mantra, "what you measure, you can manage".

In my world of executive coaching, one of my favorite KPIs is what I call the "Gap". My suggestion to CEOs is to know what your gap is, why it is important and strategize ways to shorten your company's gap.

Definition of the Gap

The Gap is most applicable to manufacturers, wholesalers and distributors. (Service companies, professionals firms, retailers or contractors will also have gaps but their gap calculation is slightly different due the nature of their assets, who they sell to and how they get paid.)

The number of days it takes a business to turn its inventory, collects its accounts receivable and when it wants to (or has to) pay its vendors, (accounts payable) are the inputs used in calculating the gap. The gap is a simple math equation equal to: inventory turn days plus AR turn days minus the **"targeted"** AP turn days.

Using hypothetical numbers, it might look like this for a manufacturer/distributor:

Inventory Turn Days	31
Plus: AR Turn Days:	39
Total Cash Collection Days	70
Minus: Targeted AP Turn Days	(30)
"The Gap "	**40**

In this example, this manufacturer/distributor is converting its current assets into cash in 70 days but **wants to or has to pay its vendors/AP in 30 days.** The 40 day difference represents the company's working capital financing gap or gap for short. The challenge from entrepreneurs is reduce or finance this gap or else there could be negative repercussions with their vendors, such as lower credit limits and decreased credit rating.

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Many CEOs finance their gaps with a commercial revolving line of credit be it from a bank, commercial finance company or factoring company. They borrow money from their lines of credit to pay their vendors within targeted terms and then pay the back the line of credit advances when they ultimately collect their account receivables. However, financing the gap with borrowed money results in interest expense which has a direct impact on a company's profits. If a CEO can figure out ways to shorten the gap, they will need to borrow less money which will result in lower levels of interest expense and less of an impact on profits.

Suggested Ways to Shorten Your Gap

A few simple things CEOs can to do shorten their gap is turn their inventory faster, collect their accounts receivables faster and persuasively ask vendors for credit terms beyond 30 days.

Let's say you manage to implement the above three suggestions resulting in a gap of 20 days as opposed to 40 days. Financing a 20 day gap is obviously less daunting and less of an impact on profitability. It is possible that a 20 day gap could be financed with business profits and or accruing certain expenses rather than borrowing under a line of credit.

In summary, now that you know what a "Gap" is make it one of your KPIs that you focus on monthly. Constantly strive to shrink your gap so your company can enjoy better cash flow & profitability

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