Assignment-10

Define Cash Conversion cycle:

The Cash conversion cycle (CCC) is a metric that measures the time (in days) it takes for a Company to convert its investments in inventory and other resources into cash flows from Sales. It reflects the efficiency with which a company manages its working capital. The CCC helps a Company understanding how long each dollar invested in operations is tied up before it is converted into cash.

The formula for the cash conversion cycle is:

CCC = Days Inventory outstanding (DIO) + Days Sales outstanding (DSO) − Days Payables outstanding (DPO).

Key components:

1. Day Inventory outstanding (DIO):

The average number of days the Company takes to turn its inventory into Sales. A lower DIO indicates efficient inventory management.

$$DIO = \frac{\text{Average Inventory}}{\text{Cost of Goods Sold (COGS)}} \times 365$$

2. Days Sales outstanding (DSO):

The average number of days it takes the Company to collect Payment after making a sale. A lower DSO means the company is Collecting Payments from customers quickly.

$$DSO = \frac{\text{Accounts receivable}}{\text{Total credit sale}} \times 365$$

3. Days Payables outstanding (DPO):

The average number of days the Company takes to Pay its suppliers after receiving inventory. A higher DPO is generally better for Cash flow as the Company can hold onto its Cash longer.

$$DPO = \frac{\text{Accounts Payable}}{\text{COGS}} \times 365$$