

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 understand how long each dollar invested in operation sits tied up before it is converted into cash.

The formula for the cash conversion cycle is

$$CCC = \text{Days inventory outstanding (DIO)} + \text{Days sales outstanding (DSO)} - \text{Days Payables outstanding (DPO)}$$

Key Components:

Day Inventory outstanding (DIO):

The average number of days the company takes to sell its inventory into sales. A lower

DIO indicates efficient inventory management

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

Day sales outstanding (DSO):-

The average number of days it takes the company to collect payment after making a sales. A lower DSO means the company is collecting payments from customers quickly.

$$DSO = \frac{\text{Accounts Receivable}}{\text{Total credit sales}} \times 365$$

Days Payable 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.

$$DPO = \frac{\text{Account Payable}}{\text{Costs}} \times 365$$

Summary