UNIVERSITY OF THE PEOPLE

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Learning Journal unit 2

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The cash realization cycle measures how long cash is tied up in inventory and accounts receivable before a company converts it to cash from sales. Inventory turnover and receivable collection directly feed into cash realization. Inventory turns and accounts receivable are finished faster when cash cycles are shorter. “The cash conversion cycle (CCC), also called the net operating cycle or cash cycle, is a metric that expresses, in days, how long it takes a company to convert the cash spent on inventory back into cash from selling its product or service. The shorter the cash cycle, the better, as it indicates less time that cash is bound in accounts receivable or inventory” (Hayes, 2024).

Inventory turnover measures how rapidly a company sells goods and replenishes stock. Purchasing inventory requires upfront cash that is not recovered until the item is ultimately vended. To free up cash for continuing operations, a business aims to eliminate its inventory as soon as possible.

Receivables tie up cash differently than inventory. Inventory is purchased outright in cash. Sales that have occurred but have not yet been paid for in cash are represented by receivables. Cash inflows back into the business are immediately accelerated by quicker accounts receivable collection.

The cash realization cycle connects inventory and receivables cycles. It starts by tracking average days in inventory. Next accounts receivable days are added. This sums the total average days cash is trapped in production and outstanding sales. The company must finance working capital needs over this cycle time before generating cash income.

A detailed example shows how inventory, receivables, and cash cycles interact. A company has an average 50-day inventory turnover. It sells product to customers with 30-day average payment terms. Adding the 50-day average inventory period and 30-day average receivables together give an 80-day cash realization cycle.

Faster inventory turnover and receivable collection directly improve cash flow. If the company could tighten inventory management to lower average days held to 30, and improve collections to get paid in 15 days, the combined cash cycle drops to 45 days. Accelerating both cycles frees up capital 35 days faster to fund operations.

Each business monitors inventory turns and receivables metrics to minimize cash conversion cycle time. Inventory represents how efficiently a company acquires materials, manufactures products, and sells output. Receivables indicate how well credit and collections secure payment from clients. As these core operations improve, cash is freed up faster to power better financial performance.

Reference:

Hayes, A. (2024, February 6). Cash Conversion Cycle (CCC): What is it, and how is it calculated? Investopedia. https://www.investopedia.com/terms/c/cashconversioncycle.asp

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