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Food For Thought

Cash Conversion Cycle/ Net Trade Cycle

For the ratios you have in front of you, we have already discussed how to calculate the average collection period for receivables i.e. (Net account receivables)/ (average daily sales where average daily sales equals annual sales divided in turn by 365 days). We also know how to calculate days inventory is held by dividing inventory by average daily cost of sales where average daily cost of sales is cost of goods sold divided by 365 days. And lastly, we know how to calculate days payables are outstanding by dividing accounts payable by average daily cost of sales i.e. exactly the same denominator we used for calculating days inventory.

If we then add the average collection period to days inventory is held and then subtract days payable are outstanding we derive a very important number, the cash conversion cycle or net trade cycle. Assuming no over reliance on the trade, fewer days to achieve cash conversion are better than more days to achieve cash conversion, from the perspective of credit quality.

Applying this to the real world, can you match the companies to the Company lettered net trade cycles?

Name the Company	Days
Choices:	
• Tiffany	
• Saks	
• Target	
• Wal Mart	
• Company X	
Company A	
Average Collection Period	3.51 days
Days Inventory Held	41.28 days
Days Payable Outstanding	56.98 days
Net Trade Cycle	-12.19 days

¹ *Food For Thought* is a periodic publication of JP CONSULTING tailored to address specific issues of interest in the insurance and banking industries. The opinions expressed in this publication are those of its author alone – Professor Herb Jacobs, New York University – School of Continuing Education. If you wish to have your name removed from the distribution list, please respond to our e-mail with the word “Unsubscribe” on the subject line of the e-mail.



Name the Company	Days
Company B	
Average Collection Period	53.09 days
Days Inventory Held	55.42 days
Days Payable Outstanding	60.89 days
Net Trade Cycle	47.62 days
Company C	
Average Collection Period	3.60 days
Days Inventory Held	128.99 days
Days Payable Outstanding	64.74 days
Net Trade Cycle	67.85 days
Company D	
Average Collection Period	22.83 days
Days Inventory Held	480.99 days
Days Payable Outstanding	75.46 days
Net Trade Cycle	428.36 days
Company X	
Average Collection Period	19.13 days
Days Inventory Held	34.28 days
Days Payable Outstanding	114.85 days
Net Trade Cycle	-61.45 days

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