International Journal of Advance and Innovative Research
Volume 12, Issue 4 October - December 2025
ISSN 2394 - 7780

UNDERSTANDING OF COMPARATIVE STUDY OF OPERATING CYCLE & CASH CONVERSION CYCLE TOOL FOR WORKING CAPITAL

Dr. Hitesh G. Suthar
Associate Professor, Thakur College of Engineering and Technology, Mumbai

ABSTRACT
Cash Conversion Cycle is one of the important tools in hands of users of financial statements including investors to measure liquidity performance of the business and ultimately it will also reflect how good the entity being managed with its resources especially in short-term. Working Capital is not only affect due to Manufacturing and business Cycle but other factor also like nature of business, taxation policy, dividend policy, production policy & others. In this study researcher cover only manufacturing cycle and business cycle.

Keyword: *Operating Cycle, Cash Conversion Cycle*

1.0 INTRODUCTION

Micro, Small, Medium and Large Enterprise are required liquidity management for day to day activities. Short term Creditors are primarily interested in liquidity or short term solvency of the enterprise since their claims are to be met in the short-run. Liquidity or Short term solvency means the ability of the enterprise to meet short term obligations as and when they become due. Inability to pay off short term liabilities affects the credibility of the enterprise. Continuous default on part of the enterprises leads to commercial bankruptcy which may lead to its sickness and dissolution.

2.0 OBJECTIVES OF THE STUDY

To understand Operating Cycle

To understand CCC

To understand difference between Operating Cycle & Cash Conversion Cycle

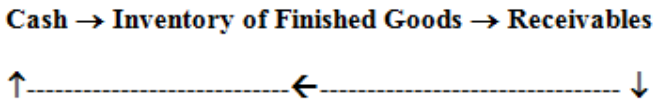
3.0 OPERATING CYCLE

Operating Cycle is the duration of time between acquisition of supplies and the collection of cash from receivables, working capital is required to finance operations during operating cycle for the business to run smoothly.

1.1.2 Operating cycle in a trading firm in the length of time required:

1. to convert cash into inventory of finished goods;
2. to convert inventory of finished goods into receivables;
3. to convert receivables into cash;

Operating Cycle in a Trading Firm is shown below.

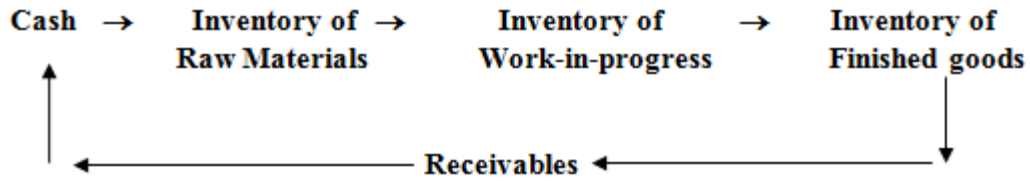


Operating Cycle in a Manufacturing Firm is the length of time required:

1. to convert cash into inventory of raw materials;
2. to convert inventory of raw materials into work-in-progress;
3. to convert inventory of work-in-progress into finished goods;
4. to convert inventory of finished goods into receivables;
5. to convert receivables into cash.

ISSN 2394 - 7780

The Operating Cycle in a Manufacturing Firm is shown below:



Operating Cycle in Manufacturing Firm

4.0 CASH CONVERSION CYCLE

The Cash Conversion Cycle (CCC) is one of the several measures of management effectiveness. Cash conversion cycle is a simple analysis between cash inflows and cash outflows.

CCC = Days to inflows – Days to outflows

Simple cash inflows are mostly generated by selling products and services to customers and outflows happen to make the payments to creditors. In laymen terms slower the cycle of inflows and outflows slower will be entity growth i.e. if entity outflow is fast then inflow, slower will be entity's growth.

On the other hand if the cycle is fast i.e. entity can quickly generate cash i.e. entity can quickly generate cash i.e. entity can quickly generate cash i.e. cash inflows and is also able to quickly pay the liabilities than business can grow at better pace. Cash is generated (cash inflow) by selling goods. But to sell goods you have to buy raw material. So simply the time you take to generate cash inflows. But following is how it happens in detail:

- To be able to sell goods you need raw material and for that you place order and it takes time to receive raw material from the supplier i.e. ordering period.
- Next require time to convert raw materials in to finished goods i.e. conversion time or simply production period.
- In some cases finished goods does not necessarily mean saleable goods. You need to simply wait until your finished goods gets in saleable condition. For example you might have to move the goods from ware house to store (market, retailer, etc). It is called as transition period i.e. when goods are in transition from being finished to saleable.
- Even if goods are ready to be sold they will not be immediately bought by customer so time they remain on shelf i.e. "shelf time" or "shelf period".
- Once the goods are sold every entity wants to have cash immediately but that happens in least cases. Majority of the sales are on credit terms and the time take to make the payment also gets counted i.e. Receivable period.

Therefore total days related to inflows i.e. total time required to generate inflows can be calculated as follows:

Ordering Period + Conversion Period + Transition Period + Shelf Period +z Receivable Period

Other element in the CCC formula is the days to outflows i.e. time by which you can delay the payment to creditors and they are deducted from the days inflows take. The reason we deduct this period is because longer the time creditors allow us to make payment the payment longer the time money will stay with us. In other words by not making the payment to creditors we hold the cash that we might gave paid if creditors are not generous. The credit facility offered by suppliers is considered as indirect source of Finance.

So, basically by delaying the payments to creditors we make up the cash deficiency that is actually caused by delayed inflow. That is the reason why every entity is happy payment period longer than receivables period. Now let's analysis the CCC formula

CCC = Time to inflows – Time to outflows

ISSN 2394 - 7780

The results of this formula can either of the following three:

- Positive Cash Conversion Cycle
- Negative Cash Conversion Cycle
- Zero Cash Conversion Cycle

Each of these three results has impact on the business' ability perform well in terms of liquidity.

2. The CCC is also explained as simply the duration of time it takes a firm to convert its activities requiring cash back in to cash returns. The cycle is composed of the three main working components:

Accounts Receivable Outstanding in days (ARO),

Accounts Payable Outstanding in days (APO),

Inventory Outstanding in days (IOD).

CCC Formula:

CCC = IOD + ARO – APO

IOD = Average Inventory x No. of days in a year / Cost of Goods Sold

ARO = Average Account Receivable x No. of days in a year / Net Credit Sales

APO = Average Account Payable x No. of days in a year / Net credit Purchase

Let's understand with the help of following example:

Particulars	2024 Amount Rs. In 000	2025 Amount Rs. In 000
Revenue	-	18,000
Cost of Goods Sold	-	6,000
Inventory	4,000	2,000
Account Receivable	180	200
Account Payable	1,800	1,600

Average Inventory = 4000 + 2000 = 6,000 / 2 = Rs.3,000

Average Receivable = 180 + 200 = 380 / 2 = Rs.190

Average Payable = 1800 + 1600 = 3,400 / 2 = Rs.1,700

Now, using the above formula is calculated:

IOD = Average Inventory x No. of days in a year / Cost of Goods Sold

3,000 x 365 = 10,95,000 / 6,000 = 182.5 days

ARO = Average Account Receivable x No. of days in a year / Net credit Sales

190 x 365 = 69,350 / 18,000 = 3.9 days

APO = Average Account Payable x No. of days in a year / Net credit Purchase

1,700 x 365 = 6,20,500/4,000 * = 155 days

* Net Credit Purchase = 6,000 + 2,000 – 4,000 = 4,000

Therefore CCC = 182.5 days + 3.9 days – 155 days = 31.4 days

In this example cash converted in to 31 days which shows lesser the period better for the business.

ISSN 2394 - 7780

CONCLUSION

Cash Conversion Cycle is an important tool to judge liquidity of the business. If enterprise made high investment in inventory, it will adversely affect the liquidity of a firm if inventory mainly consists of slow moving and obsolete stock of goods. If enterprise made high investment in receivables, it will adversely affect the liquidity of a firm if receivable mainly consists of slow paying and doubtful debtors. Cash Conversion Cycle is not only affects liquidity but also affects profitability of the business

BIBLIOGRAPHY

1. R. P. Banerjee, Working Capital Management, ISBN-81-760-084-9, 2002.
2. P. C. Tulsian, Financial Management, ISBN-81-219-3225-4, 2011
3. V.K. Bhalla, Working Capital Management, ISBN 81-219-4302-7, 2014