



Cash
Conversion
Cycle

CHECKLIST

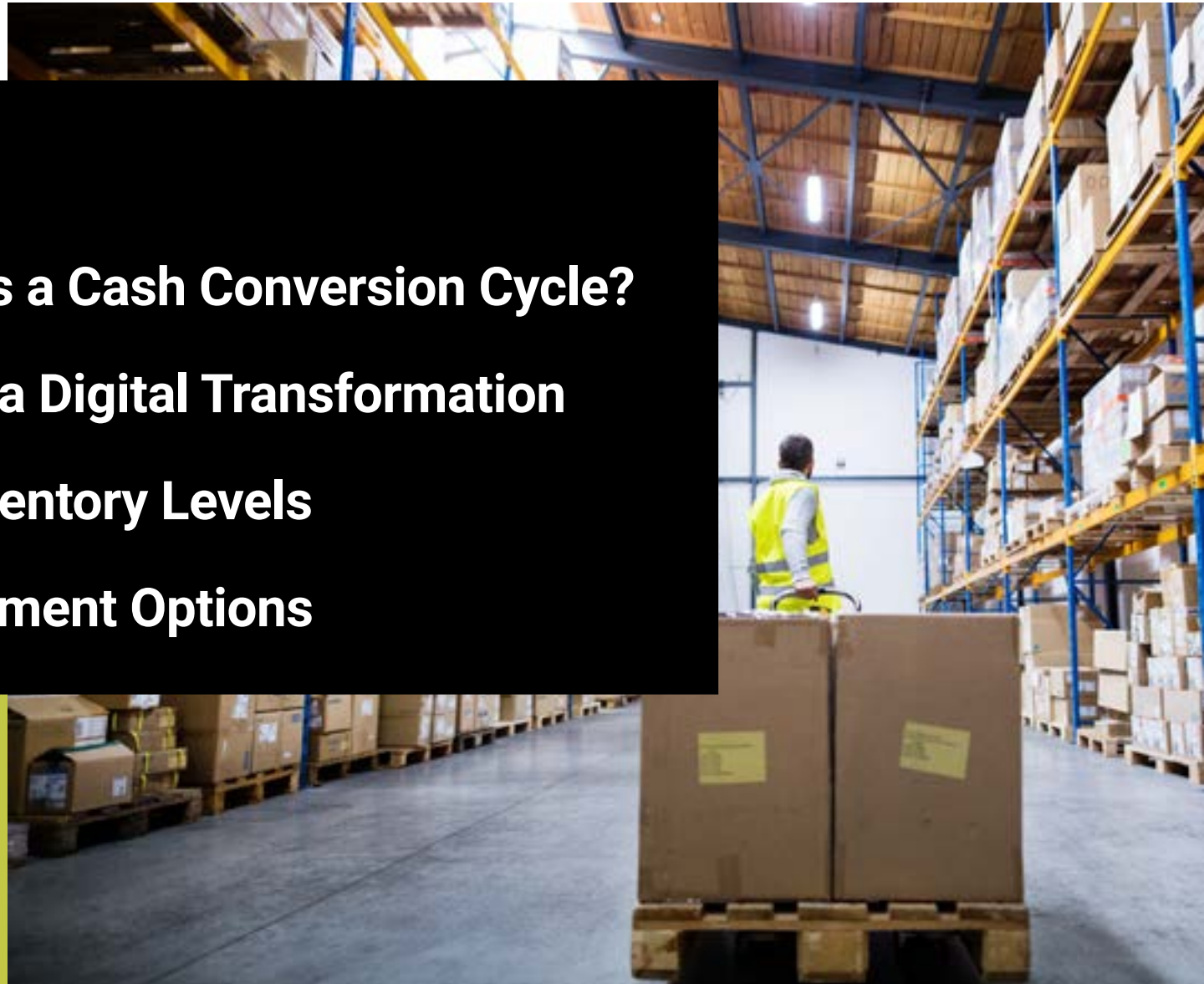
How to Improve Your Company's Cash Conversion Cycle

Practical tips to get started

TranzAct
Technologies Inc.

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INTRODUCTION

At TranzAct, we understand that companies can improve their balance sheet by improving their cash conversion cycle, and that these gains can come through improving their supply chain processes.

We also know that many companies are looking for ways to improve their financials due the growth in supply chain costs. These increases were noted in CSCMP's recently released 2023 State of Logistics Report:

"In spite of a softening in the overall logistics and transportation market over the past year, U.S. business logistics costs continued to rise, due in a large part to the effects of inflation and a hot labor market. In 2022, U.S. business logistics costs (USBLC) reached \$2.3 trillion, a 19.6% rise over 2021. As a result, logistics costs represented 9.1% of U.S. gross domestic product in 2022."

While there is a wealth of information addressing this topic, we want to briefly touch on three supply chain related strategies that can improve a company's cash conversion cycle:

- 1. Implementing a Digital Transformation**
- 2. Optimizing Inventory Levels**
- 3. Improving Payment Options**

First...What exactly is the cash conversion cycle?

Briefly explained, the cash conversion cycle is a formula that calculates the time between incurring expenses and obtaining payment. Across industries, a typical cash conversion cycle lasts about 30 days. In some cases where payment is made in advance, such as drop shipping, the cycle can be negative.

A typical formula for the cash conversion cycle is as follows:

Days Inventory Outstanding (DIO) + Days Sales Outstanding (DSO) – Days Payables Outstanding (DPO)

Here's a visual representation of what a cash conversion cycle looks like:

Cash Conversion Cycle Example



Where do you start with improving your cash conversion cycle?

Start by calculating the average time for cash conversion to gain a benchmark. If it's difficult to do this for the entire organization all at once, start with a certain product and expand from there.

Once you've completed your calculations, you can see how your number compares to industry benchmarks right away, and how it changes over time within your organization.

Implementing a Digital Transformation

Although the concept of digital transformation has been around for a long time, we've found that many companies still have a long way to go before they're able to track key supply chain metrics.

Here are a few items to consider:

- Is there a system for tracking all inventory digitally?
- Are bills and payments tracked effectively?
- Have KPIs been established in these areas?
- How often are KPIs reviewed?
- Are there opportunities to identify improvements?



Optimizing Inventory Levels

Identifying the right amount of inventory to carry is one of the most important and challenging tasks facing supply chain and logistics managers. Due to the shortages during the pandemic, many companies went from a Just In Time (JIT) to a Just In Case (JIC) inventory platform, and have been carrying excess inventory as a result.

To optimize the amount of inventory held, here are a few questions to consider:

- How have sales forecasts and demand planning impacted inventory levels? Are there opportunities for improved forecasts or better communication?
- Is it possible to streamline inventory and reduce variation?
- What fulfillment rates are you seeing from suppliers? Is it possible to reduce lead times or implement a program to provide greater fill rates?
- Are there backup strategies in place for missed deliveries? Are there secondary suppliers that could fill in gaps?
- Have you mapped your supply chain end-to-end to identify weaknesses that could impact inventory timelines?
- Have you conducted a risk assessment to identify parts that are critical for manufacturing operations? Have you calculated the time to recover (TTR) and time to survive (TTS)?
- Would it make sense to explore onshoring or reshoring to shorten inventory cycles?
- Is drop shipping an option for any products?
- Have you explored partnering with external parties to look for areas of improvement?

Remember: The costs of running out of inventory can be indirect and hard to measure, such as customer switching costs, in the case of consumer goods, or damage to a significant customer relationship.

Improving Payment Options

To shorten the cash conversion cycle, when it comes to financials the goals are two-fold: to delay payments to suppliers as much as possible, while receiving payments from customers as early as possible. Different incentives and disincentives can be negotiated on either side.

Making Payments to Suppliers

- Seek extended terms, but understand the overall impact. It's possible that prices could be raised to account for this change.
- Consider narrowing your supplier base for greater leverage in contract negotiations.
- Pay no earlier or later than the agreed upon date. Having a payment system or provider can help to ensure that you're able to delay payments as much as possible without missing due dates and incurring fees.

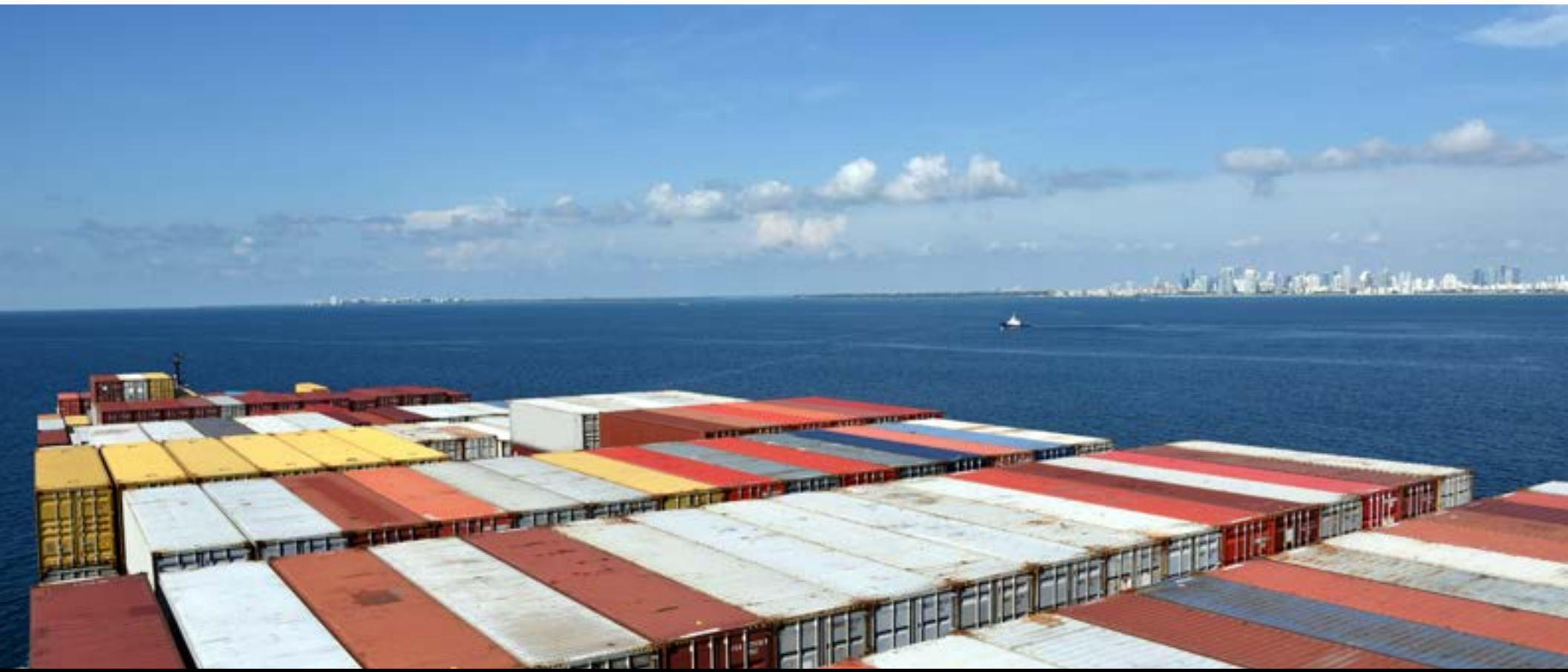
Getting Paid from Customers

- Consider asking customers for advanced deposits if appropriate. In the post-pandemic environment, there may be a greater willingness to guarantee supply in exchange for advance payment.
- Examine the value of offering discounts from early payments and consider testing different options.
- Look into providing incentives to enroll in automatic payments.
- Identify if any issues are causing repeated payment delays. Consider breaking out the costs for regularly disputed items.

What's next?

Keep in mind ...if you find opportunities to implement changes, remember to get alignment from the team involved and support from the top as needed. Making improvements can take time and involve many parties.

If you have questions or are looking for assistance, we encourage you to [get in touch](#).





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