

The Cash Cycle: How Many Days Cash Does Your Company Need To Keep Operating?

It may help to think of the cash flow process in terms of the cash cycle, which is the amount of money your company needs in terms of days to keep operating. Assume your business had the following financial statistics at the end of its most recent fiscal year:

Annual sales	\$3,600,000
Annual cost of sales	\$3,285,000
Billed accounts receivables	\$600,000
Unbilled accounts receivables	\$400,000
Accounts payable and accrued expenses	\$450,000

The first step in calculating the cash cycle is to determine the amount of average daily sales and the cost of sales. Divide sales and cost of sales by 365 days to give you average daily sales of nearly \$10,000 and average daily cost of sales of \$9,000. Then, calculate the number of days' investment in billed and unbilled accounts receivable:

Billed accounts receivables	\$600,000
Plus unbilled accounts receivables	<u>\$400,000</u>
Subtotal	\$1,000,000
Divided by average daily sales	<u>\$10,000</u>
Number of days investment	100

So it takes 100 days on average between production of a product or service and payment. Similarly, using the daily cost of sales average, you can determine the number of days financed by vendors and employees:

Accounts payable/accrued expenses	\$360,000
Divided by daily average cost of sales	<u>\$9,000</u>
Number of days financed	40

The 60-day difference between the investment and the financing is your company's **cash cycle**, or the length of business activity your enterprise must finance to stay in business. Convert the figure to dollars by multiplying the cash cycle (60) by the average daily cost of doing business (\$9,000) and you see that you need to invest \$540,000 to support your company's operations.