What does the cash conversion cycle (CCC) mean for businesses during the COVID-19 pandemic? Ian Brenner explains how companies are being affected and share three areas of focus when managing cash conversion during a disrupted global supply chain.

During these unprecedented times of physical distancing and economic distress, the cliched phrase “cash is king” has taken on an even greater meaning.

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The disrupted global supply chain, decreased work mobility, and the rapid shift in consumer spending, towards essential goods and digital services, have forced companies to re-evaluate how nimble their business model is. One of the major ways is to assess operational flexibility and CCC efficiency.

The CCC—also known as the net operating cycle—is a measure of how many days a company takes to convert their raw materials into cash flows from sales. By adding their days inventory on-hand (DIO) with their days receivables outstanding (DRO) then subtracting their days payables outstanding (DPO), a company can assess how quickly cash cycles through their operations and, as a result, how much cash they have available to respond to sudden changes.

You can find our past article that details the CCC as a performance metric in this article.
In the current economic climate, many companies will see their CCC increasing. DIO will increase as operations slows and less raw materials are used. Cash flow limitations will increase both DRO and DPO as businesses are unable to provide quick payment for goods and services, and longer payment terms are requested across the supply chain. Although the $107 billion support package from the Canadian government (as of March 30, 2020) will provide a much needed jolt of cash to struggling businesses through tax credits, wage subsidies, and loans, the overall CCC will be lengthened as long as non-essential businesses are shutdown and people are told to stay in their homes.

How can businesses prepare their CCC for what’s next?

The eventual aftermath of the COVID-19 pandemic will bring about new challenges for businesses as demand develops again (whether slowly or quickly remains to be seen) and supply chains are restored. By assessing and effectively utilizing the three levers of the CCC, this can be an opportunity for businesses to build greater loyalty with their customers and obtain market share in a changed landscape.

1. **Analyze and divest your inventory**

   The resurgence of demand may create a distribution channel phenomenon called the ‘bullwhip effect’ where initial demand from consumers may result in increasing fluctuations in required inventory along the supply chain.
   We can use the hoarding of toilet paper as an example. With the increased demand from consumers experienced by retailers, production is spiking, and soon large volumes of toilet paper will be on its way to stores. However, people are not using any more than normal overall, even if more is being used in the home versus at work. Once people go back to work, households will not buy for weeks and months, leading to surplus inventories all throughout the supply chain. Whereas for other goods, the lack of demand felt now will result in a spike in demand once the crisis abates.
   To mitigate the potential effect of supply disruptions, companies along the supply chain must begin analyzing and divesting their slow-moving or obsolete stock (SLOB) and identify opportunities to purchase critical inventory at low prices. Although there are operational risks to increasing DIO, it is imperative that companies are prepared to provide their goods and services for the levels of demand that will resume once the economy begins its recovery.

2. **Know your customers**

   Increasing your DRO also goes contrary to proper CCC management in the short-term, yet this may pose as an effective long-term strategy for developing a loyal customer base. This starts by knowing your customers and being able to identify which ones pose the greatest upside potential for your business. Whether those criteria are based on demographic or payment history, granting relaxed payment terms and cash flow assistance to your best customers at the start of the economic recovery process may generate loyalty that will be essential

for your business' long-term success. This will only be effective as a short-term strategy as increased DRO decreases flexibility to your business and increases debt.
For example, Pepsi Canada sells mostly through retail channels with very little purchased out of home. Coca Cola however dominates the on-premise market and only a bit over half of their business through retail. With the collapse of 40 percent of their sales channels, Coca Cola has less freedom to offer relaxed terms to their retail partners than Pepsi does, giving Pepsi a momentary edge in this long-running battle.

3. **Leverage trusted partnerships**

   The strength of business relationships is being tested and will continue to be tested in the aftermath of the current situation. These relationships are often what enable favourable payment terms, therefore it's imperative that businesses identify and build their existing partnerships.
   While it's true that it's not the best time to start building a relationship, the human connection—not a form, letter or mass email—can go a long way to establishing a business relationship that may bear fruit down the line.

Although risk-averse behavior may seem practical in a time of such uncertainty, an aggressive approach to CCC management—analyzing existing inventory, understanding your customers, and strengthening existing partnerships—can prepare a business for the bounce back of the Canadian economy.
With clear data and an action plan that tackles all three levers of the CCC simultaneously, proper CCC management may provide the additional market share and customer loyalty a business needs to succeed in this unprecedented landscape.

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