FIN 301 Homework Solution Ch19

Chapter 19: Short-term Financial Planning

4. Remember that:

   Cash conversion cycle = inventory period + receivables period – accounts payable period

   Notice from these answers that not all actions that shorten the cash conversion cycle are necessarily good for the firm, nor are all actions that lengthen the cash conversion cycle necessarily bad. The costs or benefits of the actions associated with changes in the cycle must also be considered.

   a. Lower inventory levels will reduce the inventory period and therefore reduce the cash conversion cycle.

   b. The accounts payable period will fall, which will lengthen the cash conversion cycle.

   c. The accounts receivable period will fall, which will shorten the cash conversion cycle.

   d. The accounts receivable period will rise (since customers pay their bills more slowly), which will lengthen the cash conversion cycle.

5. The firm can use its new system to maintain lower inventory levels. This will reduce the inventory period and therefore the cash conversion cycle, and will reduce net working capital as well.

6. Accounts receivable period $= \dfrac{(100+120)/2}{5{,}000/365} = 8.0$ days

   Inventory period $= \dfrac{(500+600)/2}{4{,}200/365} = 47.8$ days

   Accounts payable period $= \dfrac{(250+290)/2}{4{,}200/365} = 23.5$ days

   Cash conversion cycle = 8.0 + 47.8 – 23.5 = 32.3 days

7. cash conversion cycle = inventory period + receivables period – accounts payable period

   a. The discount should induce some customers to pay cash. Accounts receivable, the receivables period, and the cash conversion cycle will fall.

   b. Lower inventory turnover implies more days in inventory. The cash conversion cycle increases.

   c. If the firm produces goods more quickly, inventory levels corresponding to work in process will fall. Therefore, the inventory period and the cash conversion cycle fall.

   d. If the accounts payable period falls, the cash conversion cycle will increase.

   e. Because the goods are already ordered, inventory of finished product will fall relative to sales. Therefore the inventory period and the cash conversion cycle fall.

   f. Inventory increases imply a longer inventory period and longer cash conversion cycle.