# Cash Conversion Cycle Management in Small Firms: Relationships with Liquidity, Invested Capital, and Firm Performance

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ABSTRACT:

This study investigated the relationship between cash conversion cycle and levels of liquidity, invested capital, and performance in small firms over time. In a sample of 879 small U.S. manufacturing firms and 833 small U.S. retail firms, cash conversion cycle was found to be significantly related to all three of these aspects. Firms with more efficient cash conversion cycles were more liquid, required less debt and equity financing, and had higher returns. The results also indicate that small firm owners/managers may be reactive in managing cash conversion cycle. The study highlights the importance of cash conversion cycle as a proactive management tool for small firm owners.

KEY FINDINGS:

Key finding from this study are:

- Small firms with shorter cash conversion cycles will require lower levels of invested capital.
- Small firms with shorter cash conversion cycles will have higher firm financial performance than other small firms.
- Small firms with shorter cash conversion cycles will be more liquid than other small firms.
- Small firms that are experiencing lower financial performance are more likely than other small firms to decrease their cash conversion cycles over time.
- Small firms that are experiencing liquidity constraints are more likely than other small firms to decrease their cash conversion cycles over time.
- Improving cash conversion cycle reduces the need for invested capital over time.
- Improving cash conversion cycle has a positive impact on firm performance over time.
- Improving cash conversion cycle has a positive impact on firm liquidity over time.

IMPLICATIONS FOR MANAGERS:

- The cash conversion cycle is an important concept for small business owner-managers to understand and monitor.
- Cash flow management is related to the amount of required invested capital and to firm performance and liquidity.
- Small firms tend to be reactive in their approaches to cash flow management.
- Underperforming and illiquid firms may improve their position by addressing their cash conversion cycle and seeking to collect debtor's payments faster.
- Rather than delaying payments to creditors firms might address collection periods and age of inventory.
- During good times it is easy to pay less attention to debtor collection cycles and the accumulation of inventory. However, when times become more difficult and cash flow is squeezed, debtor and inventory control is the most effective mechanism for addressing liquidity.

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