



VARZA SCHOOL · THE FOUNDATIONAL 100

The Business Operating Cycle: From Funding and Purchasing to Sales and Collection

Chapter 16 · Track 2 — Starting and Understanding a Business

THE QUESTION IT ANSWERS

How does cash travel through a business, and why can growth increase financing need before it increases available money?

CONCEPTS DEFINED

Operating cycle · Working capital · Cash conversion cycle · Inventory · Accounts receivable · Accounts payable · Cash flow · Trade credit

Edition 2026.1 · Reviewed through 2026-08-31

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Varza promise: clear enough for a first-time learner, exact enough for a professional conversation, and practical enough to support a real decision.

Why this chapter matters

This track moves from personal decisions to an operating business. A business is examined as a repeatable system that creates value, coordinates people and resources, accepts risk, collects evidence, and converts activity into cash and durable capability.

Central question: How does cash travel through a business, and why can growth increase financing need before it increases available money?

The operating cycle converts funding into inputs, inventory or work, customer delivery, receivables, and finally cash. Time held in each stage determines working-capital need and exposes the business to demand, quality, credit, and liquidity risk.

Varza approaches the subject from life to ledger and from ledger to decision. We begin with what actually happened, identify the rights, obligations, resources, timing, and uncertainty, and only then choose the correct term, calculation, document, or account. This order protects the learner from a common error: learning a label without understanding the economic reality that the label is supposed to describe.

Learning outcomes

- Define and distinguish operating cycle in plain and professional language.
- Define and distinguish working capital in plain and professional language.
- Define and distinguish cash conversion cycle in plain and professional language.
- Define and distinguish inventory in plain and professional language.
- Apply the concepts to a numerical case and explain the result rather than only calculate it.
- Identify evidence, workflow, controls, and Varza entities required for reliable use.
- Recognize when jurisdiction-specific or licensed professional advice is required.

The Varza mental model

A financial concept becomes decision-ready when six questions have answers: **what, who, when, how much, based on what evidence**, and **under which assumption or rule**. A seventh question—**what should happen next**—turns knowledge into management.

This chapter uses internationally recognized terminology, but it remains jurisdiction-neutral unless explicitly stated. Accounting standards, tax rules, contract law, consumer protection, labor requirements, and investment regulation can produce different legal outcomes in different countries. The global foundation gives the learner a stable map; local collections must add the binding rules.

Core concepts

1. Operating cycle

Working definition. Operating cycle is the sequence and time required to acquire resources, produce or prepare an offer, sell it, and collect the resulting cash.

Map both activities and elapsed days. The longer the cycle, the more working capital and risk the business normally carries. The number alone is not enough; its definition determines whether comparisons are valid.

Simple example. A wholesaler buys inventory, stores it, sells on credit, and collects sixty days after delivery.

Decision test. Which document or observation would allow another person to verify it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

2. Working capital

Working definition. Working capital is the short-term resources and obligations used to sustain ordinary operations, often analyzed through current assets, current liabilities, and the cash conversion cycle.

A growing business can consume cash as receivables and inventory grow faster than supplier credit. Working capital is therefore an operating design issue, not only a ratio. This is where operational activity and financial reporting meet.

Simple example. A profitable distributor requires additional cash when sales growth increases inventory and customer credit.

Decision test. How would a different assumption change the result? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

3. Cash conversion cycle

Working definition. Cash conversion cycle is the approximate number of days between paying for operating inputs and collecting cash from customers, commonly derived from inventory, receivable, and payable days.

Use it diagnostically, not mechanically. Industry structure, seasonality, advance payments, and measurement definitions can change interpretation. In Varza language, the concept becomes useful when it changes a decision.

Simple example. Fifty inventory days plus forty receivable days minus thirty payable days gives a sixty-day cash conversion cycle.

Decision test. Who can influence the result, and who only reports it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

4. Inventory

Working definition. Inventory is assets held for sale, in production for sale, or in the form of materials or supplies to be consumed in production or service delivery under the applicable framework.

Inventory combines quantity, ownership, condition, location, cost, and expected recoverability. Physical presence alone does not prove ownership. The professional term matters because it prevents two different realities from being recorded as though they were the same.

Simple example. Goods held on consignment may be physically present but owned by another party.

Decision test. Does the item affect cash now, later, or not at all? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

5. Accounts receivable

Working definition. Accounts receivable is amounts due from customers for goods or services supplied in the ordinary course of business.

Receivables require customer-level settlement, aging, dispute status, credit monitoring, expected-loss analysis, and reconciliation to the ledger. A non-specialist can understand this by separating the object, the timing, and the consequence.

Simple example. An issued and earned invoice remains open until paid, credited, written off, or otherwise settled.

Decision test. What is being measured, and what has been left outside the boundary? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

6. Accounts payable

Working definition. Accounts payable is amounts owed to suppliers for goods and services received in the ordinary course of business.

Payables require supplier-level detail, due dates, disputes, approvals, credit terms, foreign currency, tax, and reconciliation. The concept should be measured at the smallest level that still supports a real action.

Simple example. A posted supplier invoice remains open until payment, credit, offset, or other settlement.

Decision test. When did the underlying right, obligation, benefit, or sacrifice arise? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

7. Cash flow

Working definition. Cash flow is the movement of cash and cash equivalents into and out of a person, project, or organization.

Profit measures performance under accounting rules; cash flow measures liquidity movement. The number alone is not enough; its definition determines whether comparisons are valid.

Simple example. Collecting an old invoice creates cash inflow without creating current-period revenue.

Decision test. Which document or observation would allow another person to verify it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

8. Trade credit

Working definition. Trade credit is permission from a supplier to pay after goods or services are received, or from a seller allowing a customer to pay after delivery.

Trade credit finances operations but creates pricing, collection, concentration, and default risk. The stated due date is part of the commercial offer. This is where operational activity and financial reporting meet.

Simple example. A supplier ships inventory on net-30 terms rather than requiring immediate payment.

Decision test. How would a different assumption change the result? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

How the concepts connect

The concepts in this chapter are a system, not a vocabulary list. Operating cycle, Working capital, Cash conversion cycle, Inventory, Accounts receivable, Accounts payable, Cash flow, and Trade credit describe different parts of the same decision. Confusing them usually creates one of three failures: the wrong amount is measured, the right amount is assigned to the wrong period or person, or a correct report is used for a decision it was never designed to support.

A useful analysis therefore preserves both **classification** and **relationship**. Classification tells us what an item is. Relationship tells us what caused it, what it affects, and what could change it. Varza should store both. A report that shows only totals may be suitable for orientation; a controlled decision requires traceability to the underlying relationships.

Formulas and quantitative relationships

Cash conversion cycle

$$\text{CCC} = \text{Inventory days} + \text{Receivable days} - \text{Payable days}$$

The metric approximates the time operating cash remains committed before collection.

Boundary: Definitions, averages, seasonality, advance payments, and industry structure affect comparability.

Approximate growth working capital

$$\text{Additional working capital} \approx \text{Growth in receivables} + \text{Growth in inventory} - \text{Growth in operating payables}$$

The relationship estimates cash absorbed by operating-balance growth.

Boundary: Include tax, deposits, deferred revenue, and other operating balances where material.

Worked case — Growth consumes the bank balance

A distributor increases monthly sales from CU 200,000 to CU 300,000 while preserving its operating pattern.

Item	Amount or observation
Receivable days	45 days
Inventory days	60 days of cost
Payable days	30 days of purchases
Gross margin	30%
Monthly sales increase	CU 100,000

Calculation and reasoning

1. Approximate incremental receivables are $1.5 \text{ months} \times \text{CU } 100,000 = \text{CU } 150,000$.
2. Incremental monthly cost of sales is CU 70,000; two months of inventory is approximately CU 140,000.
3. One month of supplier credit finances approximately CU 70,000.
4. Approximate additional working-capital need is $\text{CU } 150,000 + \text{CU } 140,000 - \text{CU } 70,000 = \text{CU } 220,000$ before tax and other balances.

What the result means

The growth is commercially attractive but financially impossible without funding, better terms, faster collection, lower inventory, advance payments, or a staged plan. Profit margin alone does not pay the timing gap.

The case is deliberately compact. In practice, Varza would preserve the supporting documents, currency, dates, counterparty, project or cost center, approvals, and links to the resulting records. The lesson is not merely to reach a number; it is to make the path to that number reviewable.

Practical workflow

- 1. Define the decision, responsible person, economic unit, period, and acceptable uncertainty.**
Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
- 2. Map each operating stage and the date at which cash, custody, obligation, and ownership change.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
- 3. Measure inventory days, customer collection days, and supplier payment days using consistent definitions.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
- 4. Forecast growth effects on stock, receivables, payables, and minimum cash.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
- 5. Redesign terms, replenishment, billing, and collection without damaging customer or supplier value.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
- 6. Reconcile the result to source evidence and investigate exceptions rather than forcing agreement.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
- 7. Approve the decision or record at the authority level required by value, risk, and legal consequence.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
- 8. Monitor the outcome, compare it with the original assumption, and retain the learning for the next cycle.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.

How this concept should appear in Varza

The minimum Varza data model for this chapter includes cash_account, purchase_order, inventory, sales_order, delivery, receivable, payable, collection, cycle_metric. These names are not

merely interface labels. Each entity should have a stable identifier, status history, responsible owner, applicable currency or unit, effective dates, evidence links, and access controls.

A useful Varza screen should answer four questions without forcing the user to reconstruct the story manually:

1. **What happened or is expected to happen?** Show the operational event, obligation, or decision in plain language.
2. **What changed financially?** Show cash, asset, liability, equity, income, expense, commitment, or risk effects.
3. **Why should the user trust it?** Show source documents, calculations, approvals, and revision history.
4. **What requires attention now?** Show exceptions, due dates, thresholds, and the next responsible action.

The Varza design principles most relevant here are:

- Use automation to strengthen evidence and consistency, never to remove accountability.
- Turn information into a decision, a control, or a question; otherwise it is only decoration.
- Begin with the real event, not the accounting label.

Varza AI may explain, classify, compare, simulate, and prepare a proposed action. It should not silently change a legal record, post a material transaction, close a period, release a payment, or make an investment decision on the user's behalf. Material actions require visible evidence, permissions, validation rules, and an accountable human approval path.

Controls and professional boundaries

1. **Daily exception visibility for overdue receivables and stockouts.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
2. **Reconciliation of operational subledgers to accounting control accounts.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
3. **Working-capital forecast before approving rapid growth or large contracts.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
4. **Stable definitions, versioned assumptions, and consistent units across plans, records, and reports.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
5. **Traceability from every material total to evidence, calculation, owner, and change history.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.

6. Access and approval rights aligned with responsibility and the possible consequence of error or misuse. The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.

A control is effective only when it operates in practice. A policy that everyone can bypass is a statement of hope, not a control. Likewise, a control that blocks ordinary work without distinguishing low-risk and high-risk cases encourages hidden workarounds.

Common mistakes and better responses

Mistake 1: Assuming higher sales automatically release cash

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 2: Paying suppliers early while customers pay late without valuing the gap

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 3: Reducing inventory without measuring service and supply variability

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 4: Using end-of-month balances that hide seasonal peaks

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 5: Using a technically correct number outside the period, entity, currency, or decision boundary for which it was calculated

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 6: Accepting an automated result without reviewing the evidence, assumptions, exceptions, and required professional judgment

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the

current number so the same error does not become routine.

Decision checklist

- ☐ Can I explain operating cycle in plain language and in professional terms?
- ☐ Can I explain working capital in plain language and in professional terms?
- ☐ Can I explain cash conversion cycle in plain language and in professional terms?
- ☐ Can I explain inventory in plain language and in professional terms?
- ☐ Have I stated the entity, currency or unit, date or period, and decision boundary?
- ☐ Can another person reproduce the number from retained evidence?
- ☐ Have I separated actuals, estimates, commitments, and scenarios?
- ☐ Have I tested timing, liquidity, risk, and at least one adverse outcome?
- ☐ Is the required approval proportional to the possible loss or legal consequence?
- ☐ Does the final output lead to a specific action, owner, and review date?

Practice lab

1. **Explain it.** Describe Operating cycle to a person who has never studied finance. Then add the professional definition and identify one boundary your simple explanation omitted.
2. **Classify it.** Create five examples from your household or a small business and classify each using Working capital. State any assumptions.
3. **Calculate it.** Rebuild the worked case with amounts 20% higher. Identify which conclusions change and which remain structurally true.
4. **Challenge it.** Describe a situation in which Cash conversion cycle could be measured correctly but still lead to a poor decision because timing, risk, or incentives were ignored.
5. **Design it.** Sketch a Varza screen or report for this chapter. Include fields, evidence links, status, owner, exceptions, and one AI-assisted action.

Answer guidance

A strong answer uses consistent definitions, reveals assumptions, distinguishes fact from estimate, and connects the result to an action. More than one conclusion may be reasonable when the learner clearly states the decision objective and uncertainty. The worked-case recalculation should preserve the method even when the numbers change.

Varza AI knowledge capsule

This capsule is intentionally explicit so that a retrieval system can distinguish canonical teaching points from examples and commentary.

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    "Cash conversion cycle: the approximate number of days between paying for operating inputs and collecting cash from customers, commonly derived from inventory, receivable, and payable days.",
    "Inventory: assets held for sale, in production for sale, or in the form of materials or supplies to be consumed in production or service delivery under the applicable framework.",
    "Accounts receivable: amounts due from customers for goods or services supplied in the ordinary course of business.",
    "Accounts payable: amounts owed to suppliers for goods and services received in the ordinary course of business.",
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Suggested questions for Varza AI

- Explain this chapter using an example from a household, a shop, and a service business.
- Ask me five diagnostic questions before applying this concept to my situation.
- Show the difference between cash effect, accounting effect, and decision effect.
- Recalculate the worked case using my currency and assumptions, but preserve the original definitions.
- Identify which parts require local accounting, tax, legal, labor, or investment rules.

Sources and standards horizon

This chapter is original Varza educational content. It paraphrases and synthesizes concepts; it does not reproduce a standard or third-party article. The following sources were used to establish terminology, scope, and current professional context:

- **S003 — OECD-INFE, *Core Competencies Framework on Financial Literacy for MSMEs*.** 2018; accessed 2026-08-31. Financial capability for entrepreneurs and small-business managers. Source: https://www.oecd.org/en/publications/oecd-infe-core-competencies-framework-on-financial-literacy-for-msmes_220101c9-en.html
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- **S021 — U.S. Securities and Exchange Commission, *Beginners' Guide to Financial Statements*.** accessed 2026-08-31. Four primary financial statements and their purposes. Source: <https://www.sec.gov/about/reports-publications/investorpubsbegfinstmtguide>

Standards horizon. Reviewed through 2026-08-31. IFRS 18 and the third edition of the IFRS for SMEs Accounting Standard are included as transition knowledge where relevant; both have mandatory effective dates beginning in 2027, with early application permitted under their respective requirements.

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