Applied Financial Statement Analysis

Assignment - 6 - 10

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Define Working Capital

Working Capital is the difference between a company-s current assets and current liabilities. It represents the short-term liquidity available to a business for meeting its day-to-day operational needs. The formula for working capital:

WORKING CAPITAL = CURRENT ASSETS - CURRENT LIABILITIES

Key Components:

CURRENT ASSETS: These are assets that are expected to be converted into cash within a year. They include items like cash, accounts receivable (money owed by customers) and inventory.

CURRENT LIABILITIES: These are obligations or debts that the company needs to settle within a year. They include accounts payable (money they company owes to suppliers), Short-term loans, and accrued expenses.

Why It's Important:

Working Capital measures a company's liquidity, efficiency and financial health. Positive working capital indicates that a company has enough short-term assets to cover its short-term liabilities, which helps ensure smooth operations. Negative working capital may signal liquidity issues unless the company has a business model that supports its such as fast inventory turnover and delayed payments to supplies.

It is crucial for ensuring that a company can continue its operations without running into cash flow problems.

EXPLAIN