Applied Financial Statement Analysis

Assignment - 7

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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 is:

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 item 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 the 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 it such as fast inventory turnover and delayed payments to suppliers.

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