

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:

$$\text{Working capital} = \text{Current assets} - \text{Current liabilities}$$

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 debt 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, where the company has a business model that delays payment to suppliers.

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

[Handwritten signature]

Conclusion

Companies with strong cash flow can survive on investment and benefit from positive returns. For example, retail business (like supermarkets or online retailers) often have cash flow from customers in advance before they need to pay suppliers. This means they don't need a lot of working capital and they may be able to pay suppliers with negative working capital.

Further information

Further information can be found on the company's website or by contacting the company directly.