

Applied Financial Statement
Analysis
Assignment - 8

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Assignment-8

Explain about negative working capital and in what perspective it will be good. why?

Negative working capital occurs when a company's current liabilities exceed its current assets. In simple terms, it means that a company doesn't have enough short-term assets (like cash, receivables or inventory) to cover its short term obligations (like payables, short-term loans, or accrued expenses). This can sound alarming but in some cases, it can actually be a sign of efficiency, depending on the business model.

When negative working capital can be good.

1. Cash-flow efficient businesses

Companies with strong cash flow and low reliance on inventory can benefit from negative working capital. For example, retail businesses (like supermarkets or online retailers) often receive cash from customers but have time before they need to pay suppliers. This means they don't need a lot of working capital and they may

deliberately run with negative working capital.

Fast Turnover Industries:

Businesses with quick inventory turnover and short sales cycles, such as fast food chains and e-commerce platforms can operate with negative working capital. They receive payments from customers quickly (sometimes before delivering goods) but suppliers are paid on credit terms, creating a situation where liabilities temporarily exceed assets.

Supplier financing:

Companies may intentionally extend their payment terms with suppliers, using this credit as a form of short term financing. This enables them to keep less cash or working capital on hand while still fulfilling operations. Essentially the business is using suppliers to finance operation rather than its own capital.

Why Negative working capital can be beneficial:

→ Lower Financing needs:-

Companies with negative working capital don't need to raise or hold as much cash for operations, reducing borrowing or capital costs.

→ Higher efficiency

It can reflect operational efficiency, especially in industries where goods are sold quickly and payments are delayed to suppliers.

→ Focus on core Activities

Firms can allocate their resources to more productive areas (like expansion or innovation) instead of tying up cash in working capital.

Summary