Assignment - 1

why are we exclude cash while calculating working capital?

Cash is typically excluded from the calculating of working capital in certain contexts Particulary in more advanced Financial analysis because cash is considered an non-operational assets. while cash is indeed a current assets it doesn't directly contribute to a Company's operational efficiency or it's ability to generate revenue from core business activities. Here's a more detailed explenation.

Focus on operational Efficiency

working capital Measure that Efficiency with which a Company Manages it's short term assets and Liabilities tied to its day-to-day operations including cash, especially Excess cash that is not immediately needed for operations could.. the actual working capital requirements of the business.

Cash is often a Residual Balance:

Cash Can accumulate for various reason (Profits, financing activities, assets. Sales) and it may not be related to how well the Company is managed its working capital cycle such as including cash may give an inflated view of Liquidity without showing efficiency the Company is running it's core operations.

Excluding Cash helps focus the analysis on receivable, Payables and inventory.

Cash flow vs working capital:

Cash is better analysis in terms of cash flow rather than in working capital. The cash conversation cycle (ccc) [how long it takes to convert working capital into cash] is a better metric for understanding how ~~much~~ cash is generated from operations rather than simply including cash in the working capital.

Ex:

If a company has $ 5,00,000 in current assets (including $ 1,00,000 in cash). and $ 3,00,000 in current liabilities (using traditional formula) would be of working capital

=> working capital = current assets - Current Liabilities

= $ 5,00,000 - $ 3,00,000

= $ 2,00,000.

=> Non-cash working capital = ($ 5,00,000 - $ 1,00,000) - $ 3,00,000

= $ 1,00,000.