ASSIGNMENT-9

Why are we exclude Cash while Calculating Working Capital?

Cash is typically excluded from the Calculating of Working Capital in Certain Contexts, Particularly in Core advanced financial analysis, because Cash is Considered a non-operational assets while Cash is indeed a Current assets it doesn't directly Contribute to a Company's operational efficiency or its ability to generate revenue from Core business activities Here's a more detailed explanation.

Focus operational Effeciency

Working Capital Measure that efficiency with which a Company manages its short term assets and Liabilities tied to its day to day operations Including Cash. especially excess Cash that is not immediately needed for operational Could distort the actual working Capital requirement of the business

For example - excess Cash setting in a bank account doesn't reflect how well the Company is managing receivables, inventory or Payables which are more closely tied to operational Performance.

Cash is often Residual Balances.

Cash Can accumulate for Various reason (Profit, financing activities, assets) and it May not be related to how well the Company is Managing its Working Capital Cycle as such including Cash may give an inflated View of Liquidity without showing how efficiently the Company is running its Core operation.

Excluding Cash helps focus the analysis on receivables, Payables and inventory which directly reflect the Working Capital needed to support the business.

Better understanding of operating Liquidity

When we exclude Cash, the resulting Calculation (Called non-Cash working Capital) Provides a clear View of the operational Liquidity of the Company - this Means the analysis focuses on how well the Company Can Cover it short term obligations from sales and operational without relying on excess Cash reserves.

Cash flow Vs Working Capital

Cash is better analyzed in terms of Cash flow (such as in a Cash flow statement) rather than in working Capital. The Cash Conversion Cycle (CCC) (how long it takes to Convert working Capital into Cash) is a better metric for understanding how Cash is generated from operation rather than simply including Cash in the working Capital.

Example

If a Company has \$5,00,000 in Current assets (including \$1,00,000 in Cash) and \$3,00,000 in Current Liabilities its working Capital (using traditional formula) would be

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