10,000

WC 20,000. - 10,000

CA - CL

₹10,000.

Applied Financial Statement Analysis

Assignment - 6 - 10

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Why Are We Exclude cash While calculation Working capital?

cash is typically excluded from the calculation of working capital in certain contexts, Particulars in more advanced Financial analysis, because cash is considered a non-operational asset. While cash is indeed a current asset 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 on operational efficiency:-

Working capital measures the 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 operating could distort the actual Working capital requirements of the business

For example, excess cash setting idle 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 a Residual Balance:-

cash can accumulate for various reasons (Profits, financing activities, asset sales) 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 operations.

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 clearer view of the operational liquidity of the company. This means the analysis focuses on how will the company can cover its short-term obligations from sales and operations without relying on excess cash reserves.

cash flow vs working capital

cash is better analysed in terms of cash flow (such as in a cash flow statement) rather than in working capital. The cash conversion cycle (how long it takes to convert working capital into cash) is a better metric for understanding how cash is generated from operations rather than simply including cash in the working capital calculation.

Example:

If a company has \$ 500,000 in current assets (including \$ 100,000 in cash) and \$ 300,000 in current liabilities its working capital (using traditional formula) would be

$$\text{Working capital} = \text{current asset} - \text{current liabilities}$$
$$= \$500,000 - \$300,000$$
$$= \$200,000$$

$$\text{Non-cash working capital} = (\$500,000 - \$100,000) - \$300,000$$
$$= \$100,000$$