**Working capital**

The capital of a business which is used in its day-to-day trading operations, calculated as the current assets minus the current liabilities.

**Meaning:**

In an ordinary sense, **working capital** denotes the amount of funds needed for meeting day-to-day operations of a concern. ... Hence it deals with both, assets and liabilities—in the sense of managing **working capital** it is the excess of current assets over current liabilities.

**Concept of Working Capital:**

The funds invested in current assets are termed as working capital. It is the fund that is needed to run the day-to-day operations. It circulates in the business like the blood circulates in a living body. Generally, working capital refers to the current assets of a company that are changed from one form to another in the ordinary course of business, i.e. from cash to inventory, inventory to work in progress (WIP), WIP to finished goods, finished goods to receivables and from receivables to cash.

**FORMULA:**

**WORKING CAPITAL= CURRENT ASSETS – CURRENT LIABILITIES**

**NOTE:**

* **current assets**

Assets that are expected to be converted to cash within a year .

* Cash and equivalents. ( examples of cash at the corporate level typically include bank accounts and [money](https://investinganswers.com/dictionary/m/money) market [funds](https://investinganswers.com/dictionary/f/fund).)
* Short-term investments (marketable securities).
* Accounts receivable.
* Inventory.
* Prepaid expenses.
* **current liabilities**

Amounts due to be paid to creditors within twelve months .

* Accounts payable. These are the trade payables due to suppliers, usually as evidenced by supplier invoices.
* Sales taxes payable. ...
* Payroll taxes payable. ...
* Income taxes payable. ...
* Interest payable. ...
* Bank account overdrafts. ...
* Accrued expenses. ...
* Customer deposits.

**There are two concepts of working capital:**

(i) Gross working capital and

(ii) Networking capital.

**Gross Working Capital:**

The sum total of all current assets of a business concern is termed as gross working capital. So,

Gross working capital = Stock + Debtors + Receivables + Cash.

**Net Working Capital:**

The difference between current assets and current liabilities of a business con­cern is termed as the Net working capital.

Hence,

Net Working Capital = Stock + Debtors + Receivables + Cash – Creditors – Payables.

**The nature of working capital is as discussed below:**

i. It is used for purchase of raw materials, payment of wages and expenses.

ii. It changes form constantly to keep the wheels of business moving.

iii. Working capital enhances liquidity, solvency, creditworthiness and reputation of the enterprise.

iv. It generates the elements of cost namely: Materials, wages and expenses.

v. It enables the enterprise to avail the cash discount facilities offered by its suppliers.

#### Importance of Working Capital:

It is said that working capital is the lifeblood of a business. Every business needs funds in order to run its day-to-day activities.

**The importance of working capital can be better understood by the following:**

i. It helps measure profitability of an enterprise. In its absence, there would be neither production nor profit.

ii. Without adequate working capital an entity cannot meet its short-term liabilities in time.

iii. A firm having a healthy working capital position can get loans easily from the market due to its high reputation or goodwill.

iv. Sufficient working capital helps maintain an uninterrupted flow of production by supplying raw materials and payment of wages.

v. Sound working capital helps maintain optimum level of investment in current assets.

vi. It enhances liquidity, solvency, credit worthiness and reputation of enterprise.

**Classification of Working Capital:**

**Working capital may be of different types as follows:**

**(a) Gross Working Capital:**

Gross working capital refers to the amount of funds invested in vari­ous components of current assets. It consists of raw materials, work in progress, debtors, finished goods, etc.

**(b) Net Working Capital:**

The excess of current assets over current liabilities is known as Net working capital. The principal objective here is to learn the composition and magnitude of current assets required to meet current liabilities.

**(c) Positive Working Capital:**

This refers to the surplus of current assets over current liabilities.

**(d) Negative Working Capital:**

Negative working capital refers to the excess of current liabilities over current assets.

**(e) Permanent Working Capital:**

The minimum amount of working capital which even required dur­ing the dullest season of the year is known as Permanent working capital.

**(f) Temporary or Variable Working Capital:**

It represents the additional current assets required at different times during the operating year to meet additional inventory, extra cash, etc.

**Components of Working Capital:**

**Working capital is composed of various current assets and current liabilities, which are as follows:**

**(A) Current Assets:**

These assets are generally realized within a short period of time, i.e. within one year.

**Current assets include:**

(a) Inventories or Stocks

(i) Raw materials

(ii) Work in progress

(iii) Consumable Stores

(iv) Finished goods

(b) Sundry Debtors

(c) Bills Receivable

(d) Pre-payments

(e) Short-term Investments

(f) Accrued Income and

(g) Cash and Bank Balances

**(B) Current Liabilities:**

Current liabilities are those which are generally paid in the ordinary course of business within a short period of time, i.e. one year.

**Current liabilities include:**

(a) Sundry Creditors

(b) Bills Payable

(c) Accrued Expenses

(d) Bank Overdrafts

(e) Bank Loans (short-term)

(f) Proposed Dividends

(g) Short-term Loans

(h) Tax Payments Due

What is Zero Working Capital ?

What is Zero Working Capital? In financial terms, zero working capital is the state where the total accounts receivable, accounts payable, and inventory is zero.

Working capital is the comparison of current assets to current liabilities. For most organizations, current assets exceed current liabilities and working capital therefore represents the liquid reserves for meeting current obligations. Creditors prefer high levels of working capital since they are concerned about receiving payment. However, management prefers low levels of working capital since working capital earns an extremely low rate of return. Some companies are now driving working capital to record low levels, so-called Zero Working Capital. By keeping working capital at zero, funds are released for many other opportunities.

Zero Working Capital requires major changes in how an organization functions. One way to implement Zero Working Capital is to have a demand-based organization. Demand-based organizations do everything only as they are demanded: Fill customer orders, receive supplies, manufacture products, and other functions are done only as needed. The production facilities run 24 hours a day non-stop according to the demands within the marketplace. There are no inventories; everything is supplied immediately as needed. The end result of this demand driven organization is that little, if any, working capital is necessary to run the business.