

What Is Working Capital Management?

Worksheet

Working capital management is the strategy of managing current assets (cash, inventory, receivables) and current liabilities (payables, short-term debt) to optimize liquidity and operational efficiency.

Questions

- Working capital management focuses on
 - Long-term assets like equipment
 - Short-term assets and liabilities
 - Shareholder dividends
 - Bond issuance
- A company's cash conversion cycle is 40 days. What does this mean?
 - Takes 40 days to sell inventory
 - Takes 40 days from paying for inventory to collecting from customers
 - Pays suppliers in 40 days
 - Must hold 40 days of inventory
- Which strategy shortens the cash conversion cycle?
 - Buy more inventory
 - Pay suppliers faster
 - Collect from customers faster
 - Offer longer payment terms
- A retail store needs working capital mainly for
 - Building new stores
 - Buying inventory before selling
 - Hiring executives
 - Research and development
- Company A buys inventory for \$40,000 on 30-day credit. Sells it for \$60,000 on 20-day credit. How long is the cash conversion cycle?
- A retailer has \$50,000 in inventory and \$30,000 in accounts payable. Current cash is \$10,000. Is this healthy?
- Company collects from customers in 45 days but pays suppliers in 15 days. What's the impact?
- Define: What is working capital?
- Define: Why manage working capital?
- Define: What is the cash conversion cycle?

Answer Key

1. B) Short-term assets and liabilities - Working capital deals with current assets (cash, receivables, inventory) and current liabilities.
2. B) Takes 40 days from paying for inventory to collecting from customers - The cycle is the gap between paying suppliers and collecting from customers.
3. C) Collect from customers faster - Collecting faster reduces the gap between cash outflow (to suppliers) and inflow (from customers).
4. B) Buying inventory before selling - Inventory must be purchased before it generates sales revenue.
5. Inventory holding: 30 days Sales to collection: 20 days Payment timing: 30 days Cash gap = $30 + 20 - 30 = 20$ days (need cash for 20 days)
6. Working capital = \$50,000 - \$30,000 = \$20,000 But only \$10,000 cash available Need to reduce inventory or extend payment terms
7. Negative cash flow period = $45 - 15 = 30$ days Must finance operations for 30 days Needs credit line or higher cash reserves
8. Current assets minus current liabilities - the cash available for day-to-day operations.
9. To ensure the company has enough liquidity to pay obligations and operate smoothly without cash shortages.
10. The time from when cash leaves the company (buying inventory) until it returns (collecting from customers).

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