Working Capital Management

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WHAT'S COVERED

In this lesson, you will learn about . Specifically, this lesson will cover:

1. Working Capital Management

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Working capital is important for businesses of any size in order to properly manage liquidity. Recall that we calculate working capital as the difference between current assets and current liabilities. Because of this, businesses need to carefully manage:

- Cash and cash equivalents
- Accounts receivable owed by customers
- Inventory
- Short term debt, such as trade credit

Working Capital Management	Description
Cash	In establishing the appropriate level of cash, a business needs to make sure that it has cash on hand for daily operations in the delivery of products and services. It also needs to have cash on hand to service any short term debt that is due to be paid. There also needs to be an additional level of cash on hand to meet critical expenses, like payroll. Finally, there is also a need to keep cash on hand to take advantage of any unforeseen investment opportunities that might present themselves. It would be easy to say that a business should just keep as much cash as possible on hand to meet these needs, but that would lead to idle cash not being properly invested in other assets to meet income goals.
Accounts Receivable	This involves the development and delivery of an appropriate credit policy that optimizes sales to customers while minimizing bad debt expense. It is important to have appropriate processes in place to make credit decisions. It is also important for businesses to know their customers!

Inventory	Working capital management involves identifying the appropriate level of inventory that ensures businesses who deliver products have the raw materials and finished inventory on hand to meet the demands of their customers. They also must avoid overproduction, which increases inventory storage costs.
Short-Term Financing	A business needs to be sure that it has the credit available to purchase raw materials needed to manufacture products or the inventory of supplies needed to support the delivery of services. Most often businesses can take advantage of credit terms, where suppliers will offer terms for payment which may include the delivery of discounts. In the absence of trade credit, a business will want to have a working capital line of credit from a financial institution.

SUMMARY

In this lesson, you learned that **working capital management** involves an appropriate level of cash management policies to make sure that enough cash is kept on hand for daily operations, payroll, critical expenses, and unforeseen investment opportunities. It also involves managing the credit policy as it relates to accounts receivable. This should be set at a level that optimizes sales but minimizes bad debt expense. Inventory management involves making sure that raw materials are available for the manufacturing of products and that finished goods are held in sufficient quantity for customer purchases. Finally, businesses must have short-term credit, including trade credit available to them, to finance the acquisition of raw materials and supplies.

Best of luck in learning!