Financial analysis for managers dq4

Profession, Manager

Financial Analysis for Managers DQ4 The purpose of Working Capital When we talk about the working capital of a particular company, we simply mean the amount which is left after the deduction of current liabilities from current assets.

Working capital plays a vital role in accomplishing the necessary obligations of a firm. It is also important in providing a safer side for the creditors of a company. The essential purpose of the working capital is to control and look after the firm's cash inflows and outflows. Here we cannot deny the fact that at times the company has to face the threats and challenges from the external environment, especially from the competitors and rivals in the market. In that scenario, working capital in the form of cash, which is the most liquid asset, helps in protecting the company's image in front of the public, shareholders and other stakeholders.

In organizations, for the investors' interest, abundance in the company's working capital depicts a positive sign in making financial amendments and integrations internally and also in the market to compete other companies. After globalization, a number of companies are comparing their positions in the market by considering their past and current records and predicting their futures associated with liquidity and solvency of firm's assets (Bernstein et al, 1997).

Today the policy makers, especially the governments, deeply observe the trends in variations of the working capital of organizations to impose rules and regulations on them. Even the investment decisions from giant companies are also based on the extent of working capital that a company possesses.

The Costs associated with Inventory

Inventories act as the important assets for various businesses and they also influence the revenue generation of different companies. Inventory costs are essential to determine because it affects the income and asset levels.

The net income of an organization is dependent on the inventory costs, except for the service organizations, as the net income is directly linked with the costs of goods sold. Inventory costs can be categorized in two ways. The Expensing Inventory Costs in which the time period is considered for a particular product and the other one is The Capitalizing Inventory Costs that deals with the costs of goods and are not charged for specific time duration. In addition to it, we have Includable Costs. This term is related to the cost exclusively used for inventory management. For instance, an organization in a developed country like Japan, imports used machinery to other countries. So the costs for acquiring the machinery, first from the market and then the costs incurred in its repair and advancement for its resale, all collectively are a part of Includable Costs (Bernstein et al, 1998).

Depending on the type of firm, whether it is a service organization, or a merchandising unit or simply a goods' company the costs related to inventory varies because if we consider a manufacturing firm then again we have to consider the elements like purchasing of raw material, labor etc. So the inventory costs are vital in decision making processes for organizations.

References

Bernstein, Leopold A., Wild, John J., 1998. Financial Statement Analysis: Theory, Application and Interpretation. McGraw- Hill Singapore.