Working Capital Demystified Part 2

Net Working Capital vs Working Capital Requirement

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Net working capital and working capital requirements are closely related concepts in finance and business management – they are interlinked yet distinct.

Net working capital is a metric to determine a company's liquidity cash, cash equivalents and other current assets a business has available less all its current liabilities.[1] Net working capital is analogous to the balance sheet in accounting in that it is a snapshot of the assets and liabilities as of a given day. Net working capital is not the complete balance sheet though, rather it is limited to only those accounts that represent liquid assets e.g., cash, inventory, receivables, etc., and short-term liabilities i.e., those liabilities that will be coming due within twelve months or less.

Whereas net working capital can be compared to the balance sheet, working capital requirement is more analogous to the income statement or "P&L." Working capital requirement (WCR) is the amount of working capital a business needs to cover its short-term operating expenses. The difference between "working capital" and "working capital requirement" is the availability of capital vs. capital needs. Working capital depicts the current ability of the company to pay its short-term liabilities as of a specific day. Whereas the WCR shows how much working capital the company needs based upon how long it takes the company to convert its sales into cash. By comparing the WCR with the actual working capital on hand a company can decide whether it operates with too much, too little, or the right amount of working capital.

[1] https://ecapital.com/blog/what-is-a-working-capital-requirement-a-guide-for-business-owners/