Working Capital

Working capital is defined as current assets minus current liabilities. Adequate working capital allows a firm to meets its obligations on time and to take advantage of discounts for paying early (which can be quite significant). The adequacy of a firm's working capital can usually be determined by comparing a firm's working capital to its sales (and studying this ratio over time).

Working capital is made up of items that are usually liquid or can be converted to cash relatively easily. However, a firm can go without working capital only as easily as an engine can go without oil.

A firm always needs working capital. Despite its liquid nature, working capital is as permanent part of the balance sheet as plant and equipment. For this reason, when calculating return-on-invested-capital (ROIC) an investor can add working capital to fixed assets to determine a firms invested capital (and subtract cash). To learn how to calculate the ROIC, read the **Financial Ratio Analysis** section on the **How-to-Invest-in-Stocks** page.