

72.3 An exercise on the significance of working capital

A supermarket, currently selling only food, is considering whether to expand into the sale of household goods. Comment on the possible effects of the change on the firm's working capital requirement.

Response

With food being mostly perishable, supermarkets have been able to achieve very rapid rates of inventory throughput. Since they buy on credit and sell for cash, this means that supermarkets often have no need for working capital – receiving payment for their sales before they have had to pay suppliers for their purchases.

It would be difficult, however, to achieve such high rates of throughput with household goods. As a result, with goods remaining in stock for a longer time, the firm in question might even find it necessary to pay suppliers before it had sold the goods and received payment from its customers. This would increase the firm's working capital requirement, and would have to be planned for if the firm did expand into this new area.