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Why Net Working Capital is an Operational System, Not a Finance Target

KRIYA
PARTNERS
Execution-Led Value Creation

For more than a decade, industrial companies operated in an environment of cheap liquidity. Safety stock was inexpensive insurance. Payment discipline was flexible. Inventory buffers were tolerated.

That environment has ended.

Lending remains selective and expensive. Banks and investors now look beyond EBITDA to **cash conversion discipline**. A bloated balance sheet is no longer just inefficient – it signals operational weakness.

Net Working Capital has moved from a finance KPI to an **operational credibility test.**

It represents the last source of interest-free capital and the most reliable engine to **self-fund** the very restructuring and transformation initiatives required to secure a company's future.

When external financing is selective and expensive, liquidity must be reclaimed from the processes, parameters, and habits of the value chain.

The implication is straightforward: You do not improve the balance sheet first. **You improve the processes that cast its shadow.**

€20m of excess inventory at a 7% cost of capital is €1.5m of annual EBITDA leakage.

The Core Thesis: The Balance Sheet is an Operational Shadow

Net working capital is the physical manifestation of **operational friction**.

- If machines take too long to change over or batch sizes are too big, inventory rises.
- If Order-to-Invoice data is inconsistent, receivables rise.
- If Master Data parameters are undisciplined, payables leak.

Targets and benchmarking exercises alone rarely deliver structural cash improvements because they address the symptom, not the cause. To release cash, **the Operating System must change**.

In heavy industry—characterized by long lead times, engineering complexity, and supplier concentration—NWC cannot be treated as a periodic program. It must become a daily operating discipline where cash conversion is

embedded into how plants plan production, how procurement sets parameters, and how commercial teams commit to forecasts.

A bloated balance sheet is not a finance problem. It is an operations problem.

Inventory: Where Cash Meets Reality

Inventory is the hardest NWC component to fix because it is the "relief valve" for every process failure in the company. Unlike payables or receivables, it cannot be optimized purely through policy; it requires operational redesign.

Beyond the structural tensions of "Fear vs. Math," a critical and often neglected lever is the management of the Inventory Tail: Slow-Moving and Obsolete (SLOB) stock.

In industrial settings, SLOB inventory is rarely an "accident." It is the result of three specific process failures:

- **Engineering Change Note (ECN) Friction:** New versions are launched before the "old" components are consumed because engineering and procurement are not synchronized.
- **Portfolio Neglect:** The "Long Tail" of low-volume SKUs is produced in large batches to optimize changeover, creating years of supply that will never be sold.
- **The "Safety" Paradox:** Planners often increase safety stock for volatile items, which eventually stop moving, turning "safety" into "obsolescence."

The HOW of Inventory Execution:

- **Segmented Production Logic:** Treat "High Runners" with a Pull/Kanban system and "Slow Movers" with a strict Make-to-Order logic to prevent the build-up of dead stock.
- **ECN Lifecycle Governance:** Implementing a "Burn-off" discipline where new designs are only released to the floor once the existing component pipeline is cleared.
- **Dynamic Parameter Audits:** Move away from static annual reviews. ERP parameters (Lead Times, Safety Stocks, MOQs) must be updated quarterly

based on *actual* performance, not "theoretical" settings.

A Hard Example: The "Capacity vs. Title" Paradox

Consider this high-stakes industrial reality: Large, precision crankshafts sourced from a global sole-supplier, where 12-month lead times and intense competition for capacity force customers into defensive—and expensive—over-ordering.

The traditional response is to place large forward orders and hold substantial safety stock. The Operational Response is more nuanced:

- **Capacity Booking:** Decouple 'Capacity' from 'Configuration.' By reserving production slots rather than specific SKUs, you secure supply while delaying the final configuration decision until the latest possible moment—minimizing the risk of building the wrong finished goods.
- **Lead Time Decomposition:** ERP lead times often contain "slop." Decomposing order processing, queue time, and transit often reveals "ghost inventory." Resetting parameters to *actual* performance can release months of stock.
- **Moving the Decoupling Point:** Using regional buffer hubs or bonded warehouses allows material to remain off-balance-sheet until the moment of consumption, improving NWC without jeopardizing security.

NWC is the interest-free capital you already own. You just have to go deep into your operations and reclaim it.

Receivables: A Signal of Process Friction

High Accounts Receivable (AR) is rarely just a collections problem; it is a signal of Information Friction. Late payments in industrials frequently originate from:

- Incorrect invoices or delivery discrepancies (contents and timing).
- Engineering changes not reflected in billing.
- Mismatched Master Data between buyer and seller.

The most effective lever is Process Hygiene, not collection pressure. Synchronizing order-to-delivery

data flows ensures that customers have zero operational justification for withholding payment.

Payables: Discipline Over Negotiation

Accounts Payable (AP) optimization is frequently reduced to term negotiation. In practice, cash "leaks" through inconsistent execution: early payments triggered by fragmented systems or decentralized vendor data or worse even lack of standards. Locking payment discipline into the ERP environment and enforcing strict payment-run logic often delivers more sustainable impact than renegotiating terms alone.

The Operating Standard Going Forward

The most common failure in NWC programs is treating them as one-off initiatives. Within two years of a "project," working capital usually rebuilds.

Sustainable results require Structural Embedding:

- Clear ownership of NWC metrics at the Plant Manager and Business Unit level.
- A Weekly Tactical Cash Session where production and procurement explain deviations from the "Frozen Zone" plan.
- Integration of cash metrics into the S&OP (Sales & Operations Planning) rhythm.

Industrial companies that treat working capital as a finance exercise will struggle to sustain liquidity. Those that treat it as an Operational System will unlock the capital required to scale, without the need for external financing.

Cash is created—or destroyed—by daily decisions at the operational level. Master the operations, and the balance sheet will follow.

EBITDA is the promise. Execution is the bridge to Cash.

The NWC Execution Audit: 4 Questions for Leadership

1. Do your Plant Managers have a weekly KPI for Cash, or only for Volume and OEE?
2. When did you last audit your ERP lead-time parameters

against actual supplier performance?

3. Are you launching new engineering versions before the "old" component inventory is physically depleted?
4. Can your Finance system physically prevent an early payment to a vendor, or is it merely a policy?