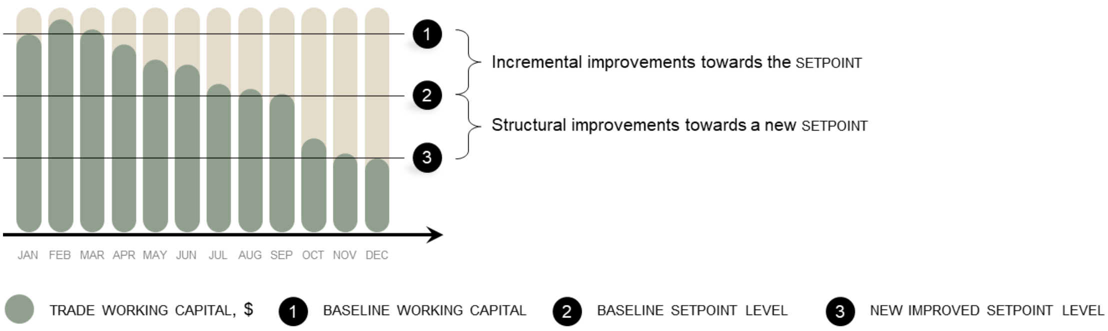
Lean Working Capital – improving your SETPOINT through structural change

In our previous article – **Lean Working Capital; incremental steps towards your SETPOINT** – we explored the reasons why companies often find themselves operating with excess working capital, without fully understanding their setpoint targets in the first place, and why an initial INCREMENTAL approach to improve this situation is advised.

This article will introduce the concept of STRUCTURAL improvements to working capital: where an incremental approach refers to several gradual movements towards reaching an existing setpoint level – often through removal of supply chain bias and its underlying causes – a structural approach seeks to create a new and improved setpoint level (see figure 1).

FIGURE 1. Illustrative example of working capital improvements towards a SETPOINT level



Approaching structural change – structural change is accomplished through few and often-larger activities – and/or through the introduction of structured financial tools. In both cases, the primary objective is to alter a company's underlying inherent supply chain constraints (i.e., capacity, lead-time, complexity and predictability) – with the purpose of optimizing the amount of working capital required to sustain operations.

Even though incremental and structural change can be pursued in parallel to – or even independent of – each other, companies do well in considering the following caveats: (1) avoid implementing structural change without first understanding the underlying supply chain inefficiencies, and (2) avoid using structural change as a means to hide or offset these inefficiencies and their impact on working capital performance.

The implications from supply chain inefficiencies are often not linear to change, but often exponential. The case example below provides a real-life example of how this could go wrong:

Case example

A seemingly well performing multinational FMCG company's effort to ramp up capacity in its largest production facility resulted in profitability loss and a dramatic increase in trade working capital.

Some background: in order to meet a recent uptake in sales and to reduce inventory requirements during peak demand local management decided to add an extra production shift, not realizing the plant's performance very much relied on a handful of experienced individuals – rather than strong processes and system support.

The additional volumes turned out to be pivotal for operations, as the informal and person-dependent mechanisms put in place to offset supply chain inefficiencies under previous circumstances now proved insufficient, resulting in several operational issues, e.g., missing materials at planned production start, deteriorating quality output, as well as incomplete and/or delayed customer shipments.

As a result, the company saw increasing cost for over-night shipments, rework and overtime, delayed customer payments and costly dispute resolution, as well as rapidly increasing inventories.

Structural change activities – Many structural change activities provide a wider effect than just working capital – directly or indirectly – which is why companies are advised to approach structural change as part of a broader scope, with a clear mind on what they want to achieve. This will help avoid conflicting agendas, reduce unwarranted spill-over effects between departments, and provide the opportunity to amplify the outcome through tactical cross functional collaboration. For example:

- An isolated push for longer supplier payment terms often leads to increased prices, reduced discounts and/or a general negative effect on supplier relationships; whereas
- A combination of supplier consolidation and renegotiating payment terms and conditions can lead to a true win-win, where the supplier gives away both terms and price in return for

larger volumes. This could be further enhanced through the implementation of an Approved Payables Finance program.

The SETPOINT Group's Lean Working Capital toolbox includes multiple structural change activities available for organizations to pursue (see figure 2 for reference) and will be discussed individually and more in-depth in coming articles – **stay tuned!**

FIGURE 2. Typical structural change activities (not exhaustive)

STRUCTURAL APPROACH	a	b	c	d
1. CAPACITY	Increase capacity by unlocking unscheduled time	Invest in new, additional, capacity (equipment and/or footprint)	Divest inefficient and/or non-core business areas	
2. LEAD-TIME		Renegotiate supplier and/or customer terms & conditions	Secure VMI and/or consignment stock on relevant materials	Optimize flow and/or footprint of warehouses and plants
3. COMPLEXITY	Rationalize supplier base and/or SKUs	Increase standardization of manufacturing and/or assembly	Install BI tool to increase transparency and allow for hyperscale modelling	
4. PREDICTABILITY			Invest in S&OP processes, including advanced demand planning	Install BI tool to allow for advanced statistical forecasts & AI projections
5. FINANCIAL TOOLS	Install Approved Payables Finance program	Install Receivables Finance program		

In conclusion – Structural improvements seek to find a new and improved SETPOINT level, allowing the company to operate and sustain its operations with less working capital.

Even though structural improvements can be approached as stand-alone activities companies are advised to first understand and control their underlying supply chain inefficiencies – to avoid unwanted and often exponential negative consequences to working capital.

Also, tactical cross-functional collaboration can allow companies to pursue win-win solutions, impacting not only working capital but profitability as well.

More on SETPOINT Group's LEAN WORKING CAPITAL™ in coming articles.