FKS Consulting
FINANCE | KNOWLEDGE | SOLUTIONS

Working Capital Optimization

Why inventory reduction alone can destroy enterprise value

Executive Summary

Working Capital Optimization is a System Challenge

Short-term liquidity improvements can create long-term operational and financial consequences

Sustainable optimization requires balancing four dimensions:

- Cash flow
- Profitability
- Operational resilience
- Market responsiveness

Core conclusion: **Inventory should not be minimized in isolation. It should be optimized within the overall business system.**

Inventory is more than Tied-Up Capital

In industrial value chains, inventory also protects operational stability and supply capability

Inventory is frequently viewed primarily through a financial lens. Operationally, however, it performs additional functions:

- Stabilizes production and material flows
- Absorbs demand and supply fluctuations
- Protects customer service levels
- Maintains market responsiveness

The **question should** therefore **not** be. "*How quickly can inventory be reduced?*"

But rather: "**Which inventory level creates the best balance between liquidity and operational performance?**"

Production Cuts can Improve Cash Flow – and Reduce Profitability

Lower production volumes do not automatically eliminate structural costs

Reducing production may lower inventory and release cash. Fixed and structural costs, however, remain largely unchanged in the short term.

Typical consequences include:

- Underutilization and idle capacity costs
- Higher unit costs
- Lower asset efficiency
- Increasing margin pressure

The paradox: **Cash flow may improve while operational profitability deteriorates.**

Production Networks do not React like Spreadsheets

Operational inertia delays – and sometimes reverses – the intended inventory effect

Complex production networks cannot be stopped immediately. Decisions interact with processes already underway:

- Procurement commitments
- Existing production orders
- Intermediate products
- Multiple production stages
- Global supply chains and long lead times

As a result, inventory may not disappear at all. **It may simply shift within the value chain, creating excess stock at intermediate stages and tying up capital elsewhere**.

Working Capital Decisions are only as Good as the Planning Scenario

Small forecasting errors can create significant operational consequences

Every production adjustment ultimately depends on one assumption: **How will demand develop?**

If production is reduced too aggressively:

- **Underutilization** increases and **Lead times** rise
- **Flexibility decreases** and **Restart and ramp-up costs emerge**

If action comes too late:

- Inventory accumulates
- Cash remains tied up
- Obsolescence risk increases

Working capital optimization therefore requires **scenario-based decision-making** rather than single-point forecasts.

The Greatest Risk may not be Inventory – but Lost Market Share

Short-term cash optimization can undermine the ability to serve a recovering market

If demand recovers faster than expected, reduced production capacity can become a strategic constraint.

Potential consequences include:

- Reduced product availability and Longer customer lead times
- Delayed production ramp-up and Competitors satisfying demand first

Particularly in competitive and oligopolistic markets, lost supply capability can translate directly into **lost market share**. Being unable to deliver may ultimately cost more than carrying additional inventory.

Take Away: The Objective is not Minimum Inventory

Sustainable working capital optimization balances liquidity, profitability, resilience and market responsiveness

Working capital should be understood as the outcome of an interconnected operating system rather than as an isolated finance KPI. The management objective is therefore to balance:

- Cash Flow – release capital where economically reasonable
- Profitability – avoid structural cost disadvantages
- Resilience – preserve operational stability
- Market Responsiveness – maintain the ability to serve demand

The real objective is not minimum inventory. It is maximum enterprise value.

FKS Consulting Perspective

From Reactive Working Capital Management to Predictive Enterprise Steering

FKS Consulting supports finance organizations in:

- connecting working capital decisions with operational consequences
- improving transparency across finance, production and supply chain
- enabling scenario-based decision-making beyond isolated finance KPIs

With a clear focus on:

- Integrated Finance & Operations
- SAP S/4HANA & Group Reporting
- Planning, Simulation & Analytics

Turning complexity into transparency.