HORVÁTH

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ESKER

White Paper

Process-driven Optimization of Net Working Capital

The Lever for more Liquidity and Efficiency

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Rising financing costs and economic uncertainties make efficient management of net working capital (NWC) essential. However, traditional measures, such as adjusting payment terms, often reach their limits.

This white paper by Horváth in collaboration with Esker shows how holistic optimization of internal processes, particularly in the order-to-cash (O2C) area, can achieve sustainable effects. Strategic process analyses and the use of modern automation technologies can shorten the cash conversion cycle (CCC), secure liquidity and increase efficiency. To this end, the processes of credit management, dispute management, invoicing and cash allocation are discussed in more detail.

Net working capital: a highly topical issue

According to recent studies, net working capital (NWC) management is once again at the top of the agenda for many corporate decision-makers. The relevance of the NWC has steadily increased over the last few years and the trend is not set to end any time soon.

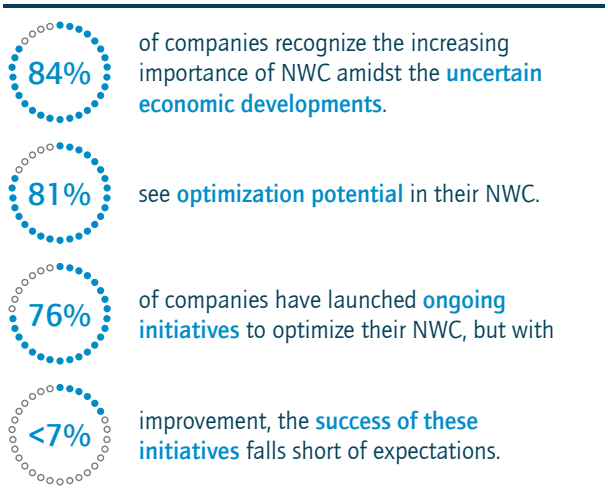

Fig. :1 Horváth-NWC study: The most important findings

This trend is confirmed by current insolvency data: In November 2024, corporate insolvencies surged across major economies. In the United States, 69 public and certain private companies filed for bankruptcy, marking one of the highest monthly totals since early 2021 and contributing to a near 14-year high for the year. Meanwhile, the Eurozone experienced a 19% increase in business insolvencies compared to the previous year, with notable rises in countries like France (+17%) and Italy (+45%). These figures reflect a broader global trend of rising insolvencies, driven by persistent economic pressures such as high interest rates and inflation as well as additional uncertainty driven by geopolitical disruptions.

In addition, refinancing costs for companies have increased significantly over the past three years due to higher interest rates and tighter credit conditions. These developments illustrate how crucial it is for companies to secure their liquidity and use capital efficiently.

The optimization of NWC is therefore becoming increasingly relevant. Net working capital is a key figure that results from the difference between current assets (e.g. receivables, inventories) and current liabilities (e.g. trade payables). It serves as an indicator of a company's liquidity and operational efficiency and shows how much capital is available for day-to-day business operations.

A key factor in this context is the cash conversion cycle (CCC), which illustrates the efficiency of capital utilization in a company's business processes. The CCC measures the time it takes a company to convert capital invested in the production or purchase of goods back into cash. It is made up of three main components: the inventory period, the accounts receivable period and the accounts payable period. The storage period indicates how long inventories remain in the company before they are sold. The debtor term describes how quickly customers pay their invoices. This contrasts with the creditors' credit period, which shows how long the company itself has to settle its liabilities to suppliers. A short CCC indicates a rapid repayment of capital, which strengthens liquidity and reduces financing costs. A longer CCC, on the other hand, indicates a stronger capital commitment, which can lead to increased liquidity risks.

In an environment in which the risk of payment defaults and high financing costs is increasing, companies must therefore pay greater attention to managing these financial flows efficiently. This ensures that they have the required capital available at the right time and in sufficient quantities.

To ensure this, the following three optimization measures for the NWC have proven particularly effective in practice:

1. receivables management (days sales outstanding (DSO)): Classic lever: shortening of payment terms or introduction of early payment discounts.

2. accounts payable management (Days Payables Outstanding (DPO)): Classic lever: extension of payment terms or use of cash discounts.

3. inventory management (Days Inventory Outstanding (DIO)): Classic lever: Introduction of just-in-time principles

or better forecasting methods to avoid overstocks and bottlenecks.

These measures have a direct and major impact on the NWC but also have clear limits in practice: they are already heavily used, are difficult to implement in the long term or fail due to the market environment.

This white paper therefore highlights another way to improve the NWC: The holistic optimization of internal company processes. The focus here is on accounting-related end-to-end processes (E2E) and their role in optimizing the NWC. The general advantages of process-based optimization will be presented and how the debit-side processes (order-to-cash, O2C) in particular can contribute to improving the NWC through optimization, digitalization and the use of AI.

Net working capital: the potential within the processes is known

In our NWC Study 2024, 70% of respondents rated the digitalization and automation potential in the E2E processes Purchase-to-Pay (P2P) and Order-to-Cash (O2C) as "very high" or "rather high".

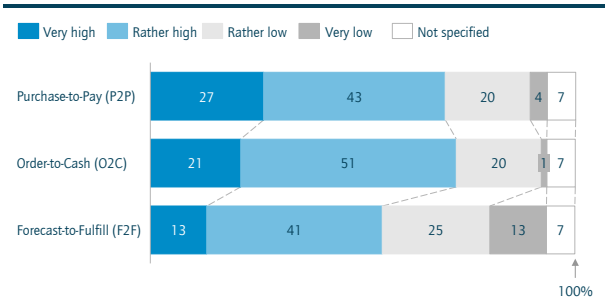

Fig. 2: Horváth NWC study: Digitization/automation potential O2C/P2P

This assessment underlines the fact that companies have recognized the enormous potential of these key areas and appreciate their importance for efficiency, cost reduction and competitiveness. Nevertheless, it is clear that many of these potentials have not yet been fully exploited. The discrepancy between the perception of potential and the actual degree of implementation shows that many organizations are pursuing ambitious goals but frequently encounter practical challenges - often due to organizational or technical obstacles that prevent progress. There are convincing reasons to start with O2C or P2P processes to optimize the cash conversion cycle.

Traditional NWC approaches often start at the end of the process chain and have clear limits and risks

The aforementioned approaches to optimizing net working capital are proven levers for improving cash flows. However, these methods always require the involvement of external players or even involve serious risks for the company:

- **Receivables management:** Shortening payment terms for customers can lead to tough negotiations, especially if the customer is also pursuing an NWC initiative. In the B2C sector, a payment term that is too short can jeopardize customer loyalty and lead to competitive disadvantages if customers prefer alternative providers.
- **Liability management**: Extending payment terms to suppliers can improve liquidity in the short term but often leads to strained relationships. Suppliers who want to optimize their own payment flows may insist on stricter contractual terms or price mark-ups, which reduces the long-term benefits of this measure. In extreme cases, important supplier relationships could be jeopardized.
- **Inventory management:** Reducing inventories to reduce capital commitment can harbor unforeseen risks. Reducing inventory too drastically can affect the ability to deliver and lead to production interruptions in the event of a sudden surge in demand. This not only jeopardizes sales, but also the company's reputation.

Furthermore, these classic levers are all associated with an additional disadvantage: Negotiations for payment terms must be conducted anew with each new supplier or customer or renegotiated with regular suppliers/existing customers at regular intervals. It is therefore clear that the methods mentioned can certainly contribute to the effective improvement of the NWC but should not be regarded as the exclusive solution. In addition to the individual measures mentioned, the focus should therefore also be placed on the entire chain of internal processes.

Process optimizations strengthen from within, are scalable and sustainable

The potential is in your own hands

A decisive advantage of internal end-to-end processes (E2E) is that the potential for optimizing the NWC lies entirely within the company's sphere of influence. Unlike traditional measures, which often involve external stakeholders such as suppliers or customers, internal processes can be designed and improved regardless of their willingness

to cooperate. There are enormous opportunities to achieve improvements, particularly in accounting-related processes. Processes such as automated invoice processing, the optimization of payment plans or the early reconciliation of receivables and payables have a direct impact on the NWC. Efficiently designed processes minimize delays and errors that could affect cash flow and ensure precise control of incoming and outgoing payments.

Sustainability

By anchoring the NWC concept in these processes at an early stage, there is another key advantage: sustainability. While many NWC measures, such as the extension of payment terms, only achieve short-term and one-off effects, the optimization of E2E processes leads to long-term, recurring improvements. An efficiently implemented process prevents disruptions in downstream steps or even eliminates entire work steps through automation.

Scalability

The aspect of scalability also plays an important role: optimized processes can be extended to different business units or regions without great effort, which enables consistent and holistic management of the NWC. Compared to external measures, which are often subject to individual negotiations, E2E processes offer a standardized and repeatable methodology.

Optimization measures: Procedure

As different as the process maturity levels of companies are, the necessary measures must also be designed individually. It is therefore important to systematically identify weaknesses, eliminate them in a targeted manner and manage and ensure compliance with the optimized processes in the long term.

The Horváth framework for effective net working capital management takes a holistic approach to optimizing a company's liquidity and financial management. It is based on four central elements: Analysis & Identification, Process Automation, Control & Governance and Cash Planning & Financing. Data-based analyses and benchmarking are used to identify optimization potential and improve processes in a targeted manner. Automation ensures efficiency gains, while clear governance structures with defined KPIs, dashboards and responsibilities ensure sustainable anchoring within the company. Finally, integration into financial planning enables effective cash flow management and the optimal use of financing options.

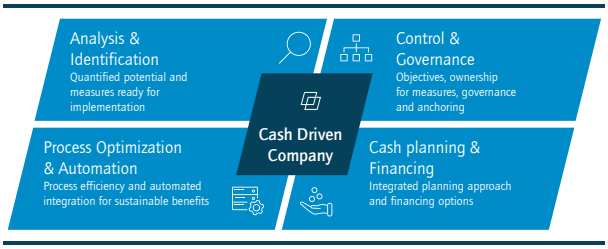

Fig. 3: Approach to effective net working capital management

The focus is also on process automation, which plays a central role in increasing efficiency and sustainably optimizing net working capital management.

Optimization measures: Implementation in the digital process landscape

The benefits of end-to-end optimization and automation of E2E processes can generally only be realized efficiently and completely using digital and technological tools. This is where modern ERP systems or specialized automation solutions come in. The major providers of standard software, such as SAP, offer a solid basis for automating and therefore accelerating processes.

Practice shows that standard solutions are often sufficient to fundamentally improve processes and achieve initial efficiency gains. However, it quickly becomes clear that these approaches usually only mark the beginning and reach their limits when it comes to full automation. Those who rely exclusively on standards hardly stand out from the competition and are unable to realize sustainable process-related competitive advantages.

Tailor-made, innovative solutions are therefore required in order to exploit long-term efficiency potential and differentiate oneself in the market

This is particularly evident in large, heterogeneous system landscapes or in small and medium-sized companies that do not have fully developed standard software in all areas. In such cases, specialized solutions are required to implement automation seamlessly and efficiently

In order to fully and sustainably demonstrate the possibilities of digitalization, we will therefore present concrete solutions from our partner company Esker.

Esker as best practice in source-to-pay and order-to-cash optimization

Esker, an international software company, specializes in the automation and digitalization of business processes, particularly in the areas of finance and customer service. In

the area of order-to-cash (O2C), Esker offers a modern cloud platform that fully digitizes and automates all O2C processes. The centralized platform of the Esker solution promotes internal and external communication and collaboration with uniform, user-friendly user interfaces and flexible integration of a wide range of source and target systems.

Fig. 4: Schematic representation of Esker's solutions for S2P/P2P and O2C

Supported by advanced, high-performance AI technologies, data and departmental silos are broken down and repetitive activities that do not generate (added) value are eliminated. With detailed reports and customizable dashboards, valuable potential can be identified and trends and future developments recognized in good time. This helps companies to react at an early stage to the constant and ever faster changing framework conditions and thus gain decisive competitive advantages.

Esker is system-independent and can therefore be flexibly integrated into any IT landscape. The cloud-based approach enables fast and targeted implementation, which can also be expanded with additional modules if required. The solution is aimed at customers with manual and highly heterogeneous financial systems as well as customers with existing homogeneous ERP systems, such as SAP ERP, SAP S/4HANA or Microsoft Navision. Figure 5 shows that Esker can support companies in various ERP scenarios and lifecycles - from the optimization of individual processes (scenario 1) and the harmonization of heterogeneous ERP landscapes (scenario 2) to the expansion of standardized ERP processes (scenario 3) and step-by-step ERP modernization (scenario 4).

Option 1: The ERP system has process-related weaknesses
- Automation of core processes such as invoice and order processing, to compensate for ERP weaknesses.
- Transparency and workflows are improved, regardless of the limitations of the ERP.
- Esker offers a cloud-based solution that ensures stability and integration.

Option 2: ERP systems are good in terms of processes, but too heterogeneous among themselves
- Esker creates a central platform that standardizes processes independently of the ERP system.
- Standardization of order-to-cash and procure-to-pay processes in a diversified ERP landscape.
- Central dashboards and analyses enable a consolidated process view.

Option 3: Extension of a standard ERP system through highly specialized processes
- Esker automates manual tasks such as document processing and adds workflows.
- Self-service portals improve customer and supplier communication.
- Compliance and audit capability are strengthened by Esker's end-to-end documentation.

Option 4: Transformation bridge – step-by-step ERP modernization
- Esker helps with ERP migrations through simple integration of multi-ERP landscapes.
- Minimize critical disruptions by securing processes.
- Proof of concept for automation to test and validate strategies prior to ERP migration.

Fig. 5: Expansion stages of an ERP system in conjunction with the Esker solution

Optimization measures in practice: the order-to-cash process

In order to illustrate the possibilities and effects of process optimization in connection with NWC, the order-to-cash process is examined in more detail below.

A good O2C process ensures that the time from customer order to receipt and correct allocation of the payment is as short as possible and transparent at all times.

The way to achieve this is to take an E2E view of the entire process chain. All sub-processes, but also the integration between the sub-processes, must be analyzed. Individual measures can then be taken to measurably improve the overall O2C process.

Figure 6 identifies four key areas that can make a significant contribution to reducing throughput times (DSO: Days Sales Outstanding) and increasing process efficiency through targeted optimization:

1. Credit management
2. Invoicing (EDI)
3. Dispute management
4. Payment allocation

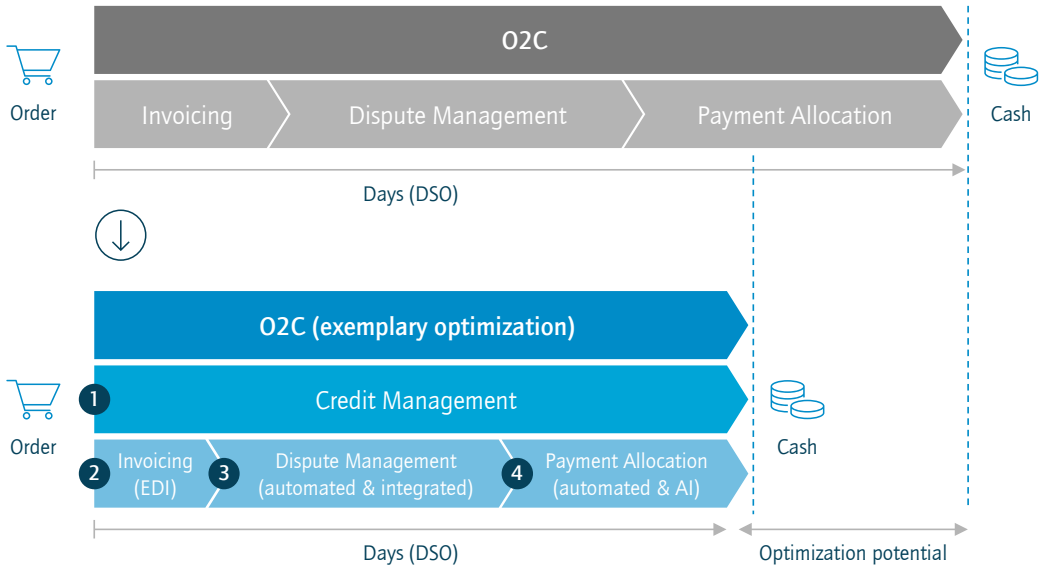

Fig 6: Illustration of an O2C process optimization with exemplary sub-processes

Credit management: Proactivity - controlling risks through credit management

Credit management encompasses all of a company's measures and processes aimed at efficiently managing trade receivables (debtors) and minimizing the risk of payment defaults. It includes checking the creditworthiness of customers, setting credit limits, monitoring outstanding receivables, receivables management and collection processes. The aim of credit management is to ensure the company's liquidity while maximizing profitability through a risk-adjusted customer policy.

Credit management - importance in the context of the NWC

The integration of credit management into operational processes is of central importance in order to proactively prevent bad debt losses. By integrating credit checks into ongoing business operations, companies can identify potential payment defaults at an early stage and adjust the credit or order limits of individual customers in a targeted manner. A customer-specific credit rating based on real-time data enables more precise management and faster response times.

In the further course of the process, the use of automated or AI-supported systems for releasing or blocking orders can optimize payment processing and significantly reduce the risk of payment defaults.

Credit Management - Practical implementation with Esker

A comprehensive solution for credit checks and credit management is characterized by several central functions. New

customers can submit their credit information quickly and securely using a digital application form. The automated check of this data enables a well-founded credit decision and reduces manual entries. Central management of all credit-relevant data ensures transparency across the entire customer portfolio and makes it easier to track credit decisions. Mechanisms for monitoring credit limit overruns, adjusting ratings and automated workflows for credit checks are also integrated. Artificial intelligence supports the management of credit limits and risk assessment so that potential risks can be identified and addressed at an early stage.

Invoicing: Automating the invoice

In the order-to-cash process, electronic and automated invoicing encompasses the digitalization and automation of invoice creation and transmission, from order acceptance to payment processing by the customer. This includes the creation of error-free invoices based on the order information, their digital delivery (e.g. via EDI, PDF or other electronic channels) and linking with payment systems.

Manual work steps, such as entering invoice data or sending by post, are minimized and lead to a seamless connection between ERP systems, customers and banks.

Invoicing - meaning in the context of the NWC

In the O2C process, electronic and automated invoicing is a decisive factor for effective NWC. It means that invoices are created and transmitted correctly more quickly and are therefore paid more quickly by the customer. The effects can be illustrated by the following aspects:

- Faster invoicing: Thanks to automation, invoices are generated directly after order processing and sent electronically. This speeds up the payment request and shortens the time to payment (DSO).
- Reduction of payment errors and queries: Automated invoices are based on the exact order and delivery data. This minimizes errors and prevents queries from customers that could lead to delays in payment.
- Benefit from early payment discounts: Automated invoices (especially EDI formats) enable faster posting to customers, increasing the likelihood that customers will take advantage of cash discounts and pay on time.
- Improved clarity of receivables: Dashboards and reports in the automated invoicing system provide real-time data on outstanding receivables. This enables companies to react specifically to defaulting payers and send payment reminders automatically.
- Optimization of cash flow forecasting: By integrating invoice data in real time with ERP and accounting systems, cash flow can be planned more accurately.

Invoicing - Practical implementation with Esker

In order to ensure efficient and smooth implementation of these requirements in practice, accounting processes must be seamlessly integrated, adapted to the specific company and geared towards maximum automation. Esker offers powerful invoice management solutions that enable fast and effective digitization of invoicing and receivables management. The platform not only optimizes manual processes and heterogeneous financial systems, but also increases the efficiency of existing standard ERP systems.

Particularly noteworthy are the automated invoice generation, electronic invoice transmission via various channels (e.g. EDI, e-mail, PDF) as well as seamless integration into payment processes and real-time reporting for proactive receivables management.

Dispute management: avoiding delays

Dispute management is a central component of the order-to-cash (O2C) process and refers to the systematic handling of disputes and complaints that may arise during the processing of customer orders. Disputes can have various causes, including incorrect invoices, discrepancies in deliveries or deviations from the agreed contractual terms. The process includes identifying, documenting, analyzing and resolving such disputes.

Dispute management - significance in the context of the NWC

Dispute management is an important factor in NWC, as outstanding disputes have a direct impact on incoming payments and therefore on cash flow. Delayed payments due to unresolved disputes increase the days sales outstanding (DSO) and can have a negative impact on a company's financial stability.

How dispute management can speed up the receipt of payments:

- Proactive identification of disputes: Effective dispute management identifies potential disputes at an early stage, often before they reach the customer. This prevents small problems from developing into major delays.
- Structured communication and promotion of the customer relationship: Clear and structured

communication between the company and the customer allows misunderstandings to be clarified quickly and solutions to be worked out efficiently. Satisfied customers are more willing to pay invoices on time.

- Automation and integration of technologies: Modern dispute management tools that are integrated into ERP systems enable open disputes to be tracked and prioritized. Automated workflows help to shorten processing times.
- Transparency and reporting: A transparent process with regular updates and clearly defined responsibilities ensures that all parties involved are on the same page. This increases the likelihood of a quick solution.
- Avoiding repeat errors: Good dispute management not only analyzes the current dispute, but also draws lessons from it to avoid future errors and conflicts. This reduces the number of potential delays in the long term.

Dispute Management - Practical implementation with Esker

The Esker solution for dispute management enables efficient and transparent processing of invoice disputes and disputes. This enables companies to significantly reduce processing time and increase process efficiency. With the integration of intelligent workflows and centralized data management, the entire dispute resolution process is structured and clear. For example, disputes can be processed more efficiently and processes can be documented more comprehensibly and tasks can be processed more flexibly thanks to centralized data management.

Payment allocation - digitalization and AI as drivers of NWC optimization

Payment allocation is the process by which incoming payments are assigned to the corresponding invoices or liabilities of a company. This process is essential to ensure correct accounting, the reconciliation of accounts and an overview of outstanding receivables. Payment allocation becomes particularly challenging when payments are incorrect or incomplete, for example due to typing errors, incorrect references or unclear purposes. However, this process can be significantly optimized with the help of modern technologies such as artificial intelligence (AI). Unstructured or incorrect data is analyzed and precisely assigned.

Payment Allocation - meaning in the context of the NWC

Payment allocation has a direct impact on the NWC, as the quick and precise allocation of payments has a positive effect on a company's liquidity and cash flow. The faster payments can be allocated, the more effectively receivables management can work.

Payment allocation can be significantly optimized through the use of AI and intelligent algorithms, especially for complex or incorrect payments. While conventional reconciliation tools are purely rule-based and therefore only recognize predefined patterns, an AI-supported solution uses machine learning and natural language processing to precisely analyze even unstructured and incorrect payment data.

- Recognition of patterns and deviations: AI can correctly assign data such as customer names, invoice numbers or payment references even if they have been entered incorrectly (e.g. due to typing errors or format deviations). It analyzes similarities and patterns instead of relying on exact matches.
- Self-learning systems: The algorithms are continuously improved through machine learning. With each successfully assigned payment, the system becomes more precise and can independently recognize new patterns that were not previously explicitly defined.
- Context-based allocation: AI can link information from different data sources (e.g. customer history, open invoices, intended use) in order to allocate even incomplete or contradictory payments in a meaningful way.
- Scalability and speed: In contrast to manual or rule-based processes, AI can analyze and allocate a large number of transactions in real time, which is particularly valuable for companies with high transaction volumes.

Payment Allocation - Practical implementation with Esker

Artificial intelligence (AI) plays a central role in the further automation and optimization of payment allocation. Esker's cash application solution uses specially developed AI technology to precisely allocate even complex or incorrect payments to the corresponding invoices. This automated process enables seamless and error-free posting directly in the ERP system.

The high degree of automation ensures a constantly up-to-date and complete overview of cash flow and improves

financial management through greater data accuracy. In addition, the increased transparency in payment allocation increases efficiency in credit and receivables management, as up-to-date and accurate information on customer accounts is available at all times.

Further benefits

Overcoming the shortage of skilled workers through digital solutions

In view of the increasing shortage of skilled workers, digitalization in accounting is becoming more and more relevant. Automation and AI make it possible to efficiently organize routine tasks such as the entire invoicing and receivables process as well as dispute management. This reduces monotonous, manual activities, which reduces employees' workload and increases their satisfaction. By relieving existing specialists of routine tasks, they can concentrate on more demanding and strategically valuable activities such as innovation projects, customer consulting or process optimization. This strengthens their loyalty to the company and helps to reduce staff turnover.

Reporting and control

Effective reporting and management are critical to analyzing historical metrics such as Days Sales Outstanding (DSO), Days Payable Outstanding (DPO) and Days Inventory Outstanding (DIO). These metrics provide valuable insights into a company's financial health and efficiency. Targeted measures for NWC optimization can be derived from this

In addition, the ability to accurately predict future payments plays a key role. A reliable forecast of payment flows enables improved liquidity planning and helps companies to avoid financial bottlenecks. Analysis tools and algorithms allow patterns and trends in companies' cash flows to be identified, on the basis of which well-founded decisions can be made. This leads to optimized capital commitment and increased financial flexibility.

In addition, precise forecasts can help to strengthen the confidence of investors and stakeholders as they provide a clear picture of the company's future financial position. Overall, reporting and management, combined with a robust forecasting capability, are essential for the sustainable optimization of net working capital and the long-term financial stability of a company.

Esker offers companies the opportunity to monitor key financial and process figures in real time. Intelligent dashboards visualize all relevant parameters of the cash conversion cycle (CCC) so that companies can identify bottlenecks or surpluses at an early stage and take targeted measures

Conclusion

The results of our Horváth NWC Study 2024 and the analyses presented here illustrate the central role of net working capital management in a time of increasing economic uncertainty.

The record number of insolvencies in Germany shows that companies are more dependent than ever on the efficient use of their capital in order to ensure financial stability and liquidity.

Effective NWC management requires a holistic approach that goes far beyond traditional methods such as extending payment terms. While these measures remain a proven tool, their reliance on external stakeholders such as customers and suppliers limits their usefulness. Instead, the future of NWC management lies in the optimization of internal end-to-end processes, which are entirely in the hands of the company

It is important to use the existing data in the company and make it available to all interested parties in the desired form in a "single source of truth". By using specialized software such as Esker, standard processes can be further optimized and additionally automated through the targeted use of AI.

This white paper underlines the fact that companies that focus on process digitization and the targeted use of AI not only create short-term liquidity advantages, but also secure long-term financial stability and competitive advantages. The potential is in the hands of the company - it just needs to be used consistently.

> The future of net working capital management is digital, automated, strategically and operationally anchored. Companies that follow this path strengthen their resilience and lay the foundation for sustainable success.

About Horváth

Horváth is an international, independent management consultancy with more than 1,400 employees at locations in Europe, the USA and other global markets. As a top consultancy for transformation, performance management and digitalization, we lead companies and public organizations to sustainable success and long-term value creation. high value creation. Horváth is characterized by well-founded, innovative approaches and solutions - based on our roots and values, shaped by our founder Professor Péter Horváth. Clients, from board level to specialist level, particularly appreciate the focus on efficiency and effectiveness as well as the trusting cooperation. Horváth has received numerous awards for its high level of satisfaction with project results.

About Esker

Esker is the global AI specialist for the smart automation of business processes for the Office of the CFO. By using the latest automation technologies, Esker's source-to-pay and order-to-cash solutions optimize working capital and cash flow. At the same time, they improve decision-making, collaboration and interpersonal relationships with customers, suppliers and employees. Esker has offices in North and Latin America, Europe and Asia-Pacific, with German offices in Feldkirchen/Munich and Ratingen. Based in France, the company generated a turnover of 178.6 million euros in 2023.

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