Cash for Growth
Working Capital in the Nordics
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Executive summary

Working capital can deliver cash today, for growth tomorrow

In the Nordics, the largest sectors have experienced contracting revenues over the past year. The challenging trading environment has put pressure on companies to proactively manage cash and working capital.

The general perception in the Nordic countries is that performance is strong when it comes to working capital management. In reality, this is no longer the case. The average performance is worse than corporates based outside of the Nordics.

Over the past year, working capital performance has deteriorated by 4%. This development is mainly driven by worse receivables management which has been partly off-set by a slight improvement in payables management.

Inventory management, which is crucial for the largest sectors in the Nordics, has not improved. This has resulted in companies in the Nordics continuing to have the highest days working capital across the world, apart from the Middle East and India.

The findings in this study closely align to realities experienced by our clients, working capital performance in the Nordics is lagging behind that of companies in other parts of the world.

Whilst the timing and sources of future growth are uncertain, to reach those sources, Nordic companies need to improve working capital performance to fund their growth and match increasingly globalised competition.

Our survey shows that if companies were to move to the top performance quartile within their industry, a total of €60bn of cash could be released from working capital across the region. Cash is at your finger-tips.
Working capital performance has deteriorated in the past year...

Whilst working capital performance is steadily improving, across the world, in the Nordic countries, performance has fluctuated with no consistent signs of improvement.

Performance in 2013 is in line with 2009, when the companies were still challenged by the global recession. Over the last year there has been a 3.7% decline in performance.

This shows that sustainable improvements in the Nordics remain a significant challenge.
… which has been driven by a deterioration in receivables performance

Receivables performance has remained relatively consistent since 2009, with the exception of 2012. Over the past year, a worsening in receivables performance has driven an overall working capital deterioration.

Between 2009 and 2012, there has been a negative correlation between inventory and payables performance over the period. Over the past year, both inventory and payables performance have improved slightly, however this did not offset the deterioration in receivables management.
The Nordics have the highest days working capital across Europe...

Although the Nordics had amongst the highest days working capital across Europe in 2012, their performance has further deteriorated in the year. In 2013, the region had the highest days working capital in the region.

In 2013, six regions in Europe managed to improve performance, whilst in the Nordics, performance deteriorated by 4%.

Globally, only India and the Middle East performed worse than the Nordics, suggesting there is significant room for improvement across the region.
... however, performance varies widely across countries

Working capital performance varies widely across the Nordic countries, with Sweden experiencing the highest level of working capital where performance is primarily driven by receivables and inventory management.

Denmark and Finland improved performance since 2012, whilst Norway and Sweden showed a three day deterioration.

The trend in Finland and Denmark could be driven by the fact that there has been a significant year-on-year drop in revenues which has led companies to focus on cash flow management as a source of future growth.

In Sweden, revenues remained more stable despite deteriorating working capital performance, whilst in Norway the working capital trend has been primarily driven by the Oil & Gas sector.
Of the largest sectors within the Nordics...

The majority of the largest sectors in the Nordics have contracted in size over the past year, with 8 of 12 experiencing a revenue decline.
For some of the largest industries, declining revenues have shifted focus towards cash management and working capital. This has resulted in a working capital improvement across three of the six largest industries.
Sustainable working capital performance continues to be a challenge

Companies that have improved working capital performance for three consecutive years

<table>
<thead>
<tr>
<th>Region</th>
<th>Improvement Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Benelux</td>
<td>19%</td>
</tr>
<tr>
<td>Central Europe</td>
<td>13%</td>
</tr>
<tr>
<td>France</td>
<td>10%</td>
</tr>
<tr>
<td>Germany, Switzerland, Austria</td>
<td>8%</td>
</tr>
<tr>
<td>Russia, Ukraine</td>
<td>11%</td>
</tr>
<tr>
<td>Spain, Portugal</td>
<td>16%</td>
</tr>
<tr>
<td>UK, Ireland</td>
<td>14%</td>
</tr>
</tbody>
</table>

Only 12% of European companies have managed to sustain three consecutive years of performance improvement. This shows that sustaining performance across the globe is a challenge. In the Nordics, less companies have shown a consistent year on year improvement over the last three years.
Globally, working capital is a key indicator of good management, as top working capital performers have outperformed across indicators.

**Top working capital performers in 2013**
- 3X Net leverage
- 51 DPO
- 31 DSO
- 17% EBITDA
- Top working capital performers:
  - continue to make larger working capital improvements to stay ahead
  - improve working capital while also generating higher EBITDA
  - invest more in their business and need less leverage to do so, and
  - are better at generating cash from operations.

**Average working capital performers in 2013**
- 3.5X Net leverage
- 34 DPO
- 33 DIO
- 66% CCE
- 1 DWC improvement (year on year)
- Average working capital performers:
  - EBITDA
  - DSO
  - DPO
  - DIO
  - CCE
  - DWC improvement (year on year)
In the Nordics, €36bn to €60bn of cash could be released from working capital.

Our survey shows that if companies improve their working capital performance to the next quartile within their industry, they could generate €36bn of cash, whilst an improvement to the industry upper quartile could release €60bn of cash.
Our approach to sustainable working capital

Case study: Operational working capital improvement programme for a wind turbine group

The key issue
The company was struggling to cope with lower demand and increased competition in their industry. They were facing mounting debts and a profit warning saw the company’s share price drop sharply. As a consequence, the company were facing severe liquidity problems.

How we helped
After a restructure, we identified that cash targets were missing. Our team worked with the company to assess their working capital improvement potential and to investigate how the introduction of a cash-focused culture could be elevated on the agenda.

We performed a total working capital diagnostic review, including procure to pay (creditors), forecast to fulfil (inventories) and order to cash (debtors). This identified €1bn of benefit potential.

Our fast pace approach was essential to raise organisational awareness to poor cash performance and raise receptiveness to change behaviours.

This comprehensive six month programme was sponsored by the executive board, with a focus on the core markets across Europe and North America, with the objective to realise €1bn of working capital improvement and deliver the cash benefits over a period of three to six months.

The result
We identified and delivered net working capital cash benefits close to €1bn.

Over a 6 months period the benefits were realised by improving procure-to-pay (creditors), improving order-to-cash (debtors) and reducing inventories.

Financial results for Q2 2013, as a consequence of the project, delivered negative working capital, and the announcement coincided with the company’s share price rising sharply over six months.

We supplement our working capital and cash management methodologies with core consulting approaches to make sure that improvements are tangible and sustainable.

Change management – Establish a more cash focused culture that is able to sustain the higher levels of performance and drive continuous improvement.

Stakeholder management – Ensure that key stakeholders remain engaged during the project.

Benefits realisation – Ensure that cash generation objectives are achieved and maintained.

Cash management – Ensure effective utilisation and forecasting of cash.
How can we support you?

1. Complete a working capital benchmarking exercise to compare performance against peers and identify potential improvement opportunities.

2. Perform a diagnostic review to identify ‘quick wins’ and longer-term working capital improvement opportunities.

3. Develop detailed action plans for implementation to generate cash and make sustainable improvements.

4. Assist the realisation of sustainable working capital reduction by implementing robust, efficient and collaborative processes.

Addressing the key levers:

- Identification, harmonisation and improvement of commercial terms.
- Process optimisation throughout the end-to-end working capital cycles.
- Process compliance and monitoring.
- Creating and embedding a ‘cash culture’ within the organisation, optimising the trade-offs between cash, cost and service.
Examples of areas where PwC could help you to release cash from working capital:

**Accounts receivable**
- Credit risk policies
- Aligned and optimised customer terms
- Billing timeliness and quality
- Contract and milestone management
- Prioritised and proactive collection procedures
- Systems-based dispute resolution
- Dispute root cause elimination

**Accounts payable**
- “Centre Led” procurement
- Consolidated spending
- Aligned and optimised supplier terms
- Supply Chain Finance
- Purchasing channels (to avoid contract leakage)
- Payment method and frequency
- Early payment prevention

**Inventory**
- Lean and agile supply chain strategies
- Global coordination
- Forecasting techniques
- Production planning
- Accurate tracking of inventory quantities
- Differentiated inventory levels for different goods
- Balanced cash, cost and service
Questions for companies in the Nordics to consider:

Supply chain and inventory management are two of the largest challenges that Nordic companies face. This is also the area where we haven’t seen any sustainable improvements over the last few years.

Q. Do lead times increase more than sales when sales pick up?

Q. Do you have transparency of slow or non-moving inventory?

When it comes to receivables, Nordic businesses often have an ingrained trust in timely payments from national suppliers. But international exposure often requires a broader approach.

Q. Is your collection procedure built around risk avoidance?

Q. How disciplined and structured are collections and escalation processes?

Q. Does every salesperson know exactly what terms they can commit to?

Extending supplier payments is a common first action in a cash shortage.

Q. Do you have transparency of spend and payments?

Q. Are there minimum terms requirements per spend category?
Basis of calculations and limitations

Basis of calculations
This study provides a view of working capital performance across the Nordics and is based on the research of the largest companies in the region. The Financial Services, Real Estate and Insurance sectors are excluded. For consistency reasons and to be able to add the individual ratios together we have calculated DSO, DPO and DIO based on sales.

DSO (Days Sales Outstanding) is a measure of the average number of days that a company takes to collect cash after the sale of goods or services have been delivered.
= (trade receivables/sales * 365).

DPO (Days Payables Outstanding) is an indicator of how long a company takes to pay its trade creditors.
= (trade payables/sales * 365).

DIO (Days Inventories On-hand) gives an idea of how long it takes for a company to convert its inventory into sales. Generally, the lower (shorter) the DIO, the better.
= (total inventories/sales * 365).

DWC (Days Working Capital) = DSO + DIO – DPO.

NWC as % of Sales = (receivables + inventories – payables)/sales.

Calculation of improvement potential
The potential improvement opportunity is calculated using the performance of the upper quartile performers (i.e. the top 25%) as a benchmark, and moving, on a sector basis, all companies outside upper quartile performers to the performance of the upper quartile.

ROCE (Return on Capital Employed)
Establishes the relationship between the profit and the capital employed. It indicates the percentage of return on capital employed in the business and it can be used to show the overall profitability and efficiency of the business.
= (operating profit – tax)/(total assets – current liabilities).

Limitations of this study
Companies have been assigned to countries based on the location of their headquarters. Although a significant part of sales and purchases might be realised in that country, it does not necessarily reflect typical payment terms or behaviour in that country.

As the research is based on publicly available information, all figures are financial year-end figures. Due to disproportionate management efforts to improve working capital performance towards year-end (also referred to as ‘window dressing’) the real underlying working capital requirement within reporting periods might be higher. Also off-balance-sheet financing or the effects of asset securitisation (e.g. receivables) have not been taken into account.
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