

# Nordea

Transaction Banking

## Nordea Working Capital Study 2020

Nordea Working Capital Advisory has analysed 9,300 publicly traded companies' working capital performance between 2016-2019.

Working Capital Management affects a company's daily operations and its long-term ability to sustain competitiveness and value creation. The study shows Return on Capital Employed has decreased over the analysed period however the level of working capital has somewhat mitigated this decrease.



# Foreword

Working capital has always been a key focus area for us, with its direct impact on performance and its potential for unlocking opportunities for growth. It goes without saying that regardless of similarities in industry or size, every company operates with its own unique situation and position in the market. As operating models and business approaches are individual for each company, there is clearly no 'one size fits all' solution for optimising working capital. Our latest Working Capital Report takes these differences into account by studying a range of indicators that show the development of working capital over a five year period 2015–2019, using the performance data of 9,300 companies worldwide. We hope that by casting the net wide in our analysis, customers will be able to gain insights on aspects of working capital that are relevant to them.

In this updated edition one of the key findings of our research is that in contrast to the previous period of study margins have decreased, but Working Capital in relation to sales has continued to improve, though at a slower pace. Return on Capital Employed here: With sales, margin and capital being the drivers for value creation (measured as ROCE – Return on Capital Employed), the improvement in Working capital has somewhat mitigated the fall in ROCE. However, large deviations were uncovered below the surface and there is a clear link between optimising net working capital and improving value creation.

The data confirms a clear link between size and working capital, with the larger the company, the smaller the ratio of working capital and the smaller the company, the larger the ratio of working capital. Also, companies improved on average Days Payables Outstanding (DPO) to a higher extent than Days Sales Outstanding (DSO) over the period of study. This conclusion holds true, if we look at data by industry, size or region. The findings suggest that it is easier for a company to extend payment terms towards suppliers rather than customers.

The report also highlights that companies operating with a low level of net working capital manage to create a higher return on capital employed, and thereby supporting value creation within the company. By operating with a low or negative level of net working capital, less capital is allocated to finance the net of outstanding receivables, inventories and liabilities to suppliers. The surplus of capital can then be channelled to other initiatives supporting both financial and strategic targets and ultimately a company's long-term value creation.

The ongoing pandemic creates a very challenging and fluid environment for companies. This is accentuated by significant uncertainty about the anticipated economic recovery including if and when a rebound will occur and the 'shape' of the rebound (U, V, W etc). With this in mind we argue that working capital management is more important than ever as economic recovery requires cash and a sound balance sheet in order to grow sales and secure long-term competitiveness and value creation.

For these reasons Working Capital Management should be high on the strategic agenda for all companies and decision makers. Through our discussions with companies we have found that this is not always the case and so this report helps position the importance of working capital and how it can support the strategic objectives of a company whilst offering a cost efficient source of financing.

**Richard Hayes**

Head of Working Capital at Nordea



# Executive summary

## Value creation is decreasing...

Return on Capital Employed decreased with 1.2% percentage -points, from 8% to 6.8%. The decrease in Return on Capital Employed is mainly explained by lower EBIT margins despite an overall growth in net sales during the analysed period.

## ...but lower working capital levels mitigate the decrease

When looking further into working capital performances, it is evident that low levels of net working capital support a higher Return on Capital Employed. Over the analysed period 2016–2019, with decreasing EBIT margins, on an aggregated level companies have been able to improve working capital which has mitigated the decrease in ROCE. Within the sample there are major differences between the performances and the study will elaborate on best and worst performers as the average working capital level is 6 percentage points lower for companies improving working capital for each year over the analysed period from 2016 to 2019.

## The level of net working capital to sales are lowest for the large companies

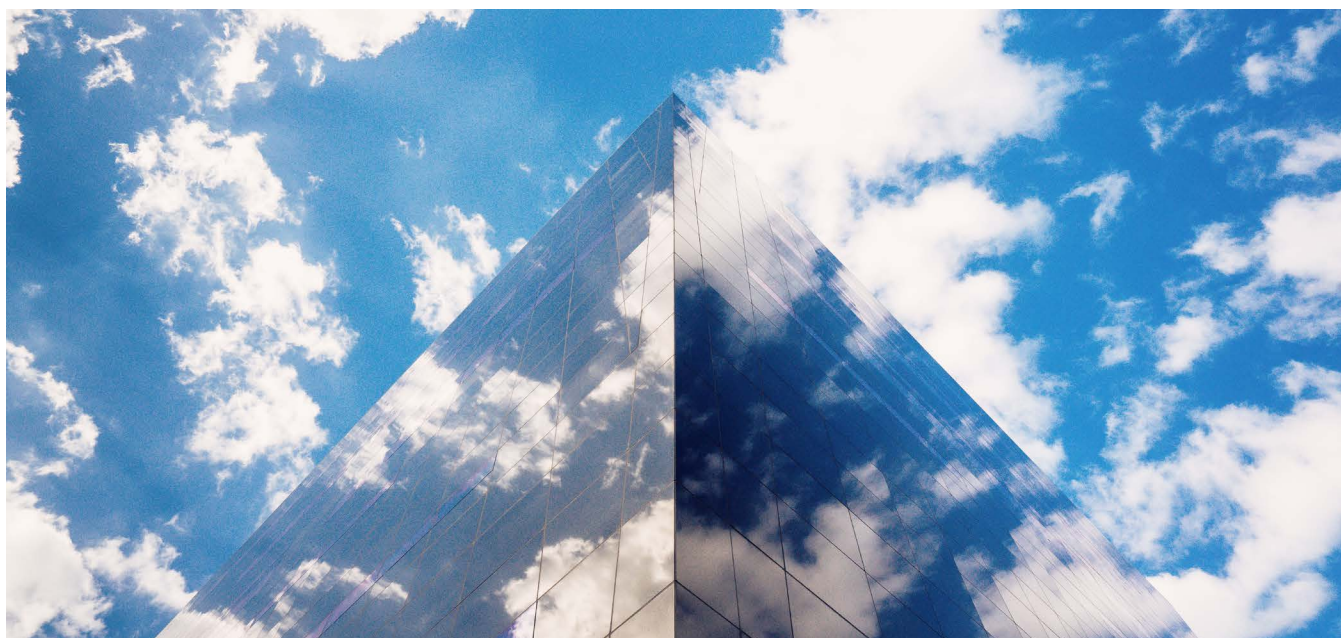
The study shows that large companies have a lower level of working capital compared to smaller companies. This might be explained by overall better conditions, such as size, bargaining power and perhaps by more focus on working capital in order to maintain a low level of working capital. The study shows that also smaller companies can perform just as good as the large ones and succeed to continuously improve the working capital levels.

## Nordic companies heavily affected by covid-19

When comparing 2020 second quarter results to 2019 second quarter the study finds that Nordic companies' revenues have decreased with 7%. In addition to revenues operating profits are struggling as well, while net working capital levels are increasing. The increasing level of working capital is mainly caused by higher inventory levels in relation to sales.

# 7%

of Nordic companies' revenues decreased. Heavily affected by covid-19.



# Nordea Working Capital Study 2020

## Findings and development

The Working Capital study shows an improved level of working capital which has mitigated the decrease in Return on Capital Employed.

The main reason behind the decreased return was a lower operating margin which saw a 1 percentage-point decrease over the period. The level of Working Capital improved with an aggregated amount of 1,080 billion Euros or 1% in relation to sales, and thereby being able to mitigate some of the impact of lower margins.

2016-2019 development in key figures

**-1.2 ppt**

Return on Capital  
Employed

**-1.0 ppt**

Working Capital / Sales

**+3.50%**

Net sales

**-1.0 ppt**

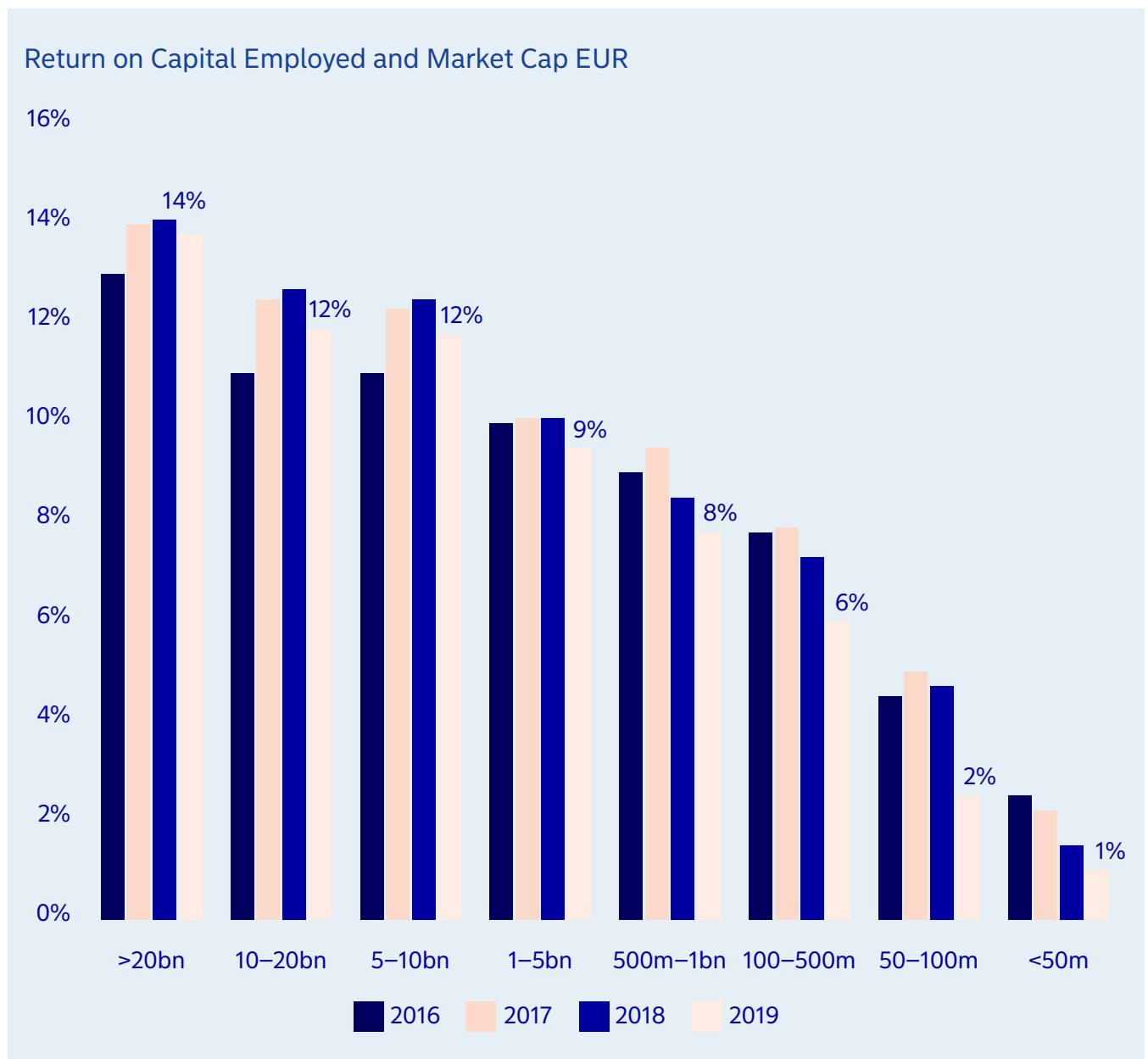
EBIT margin

# Return on Capital Employed & Working Capital

The study evidences a connection between Return on Capital Employed and the level of NWC/Sales.

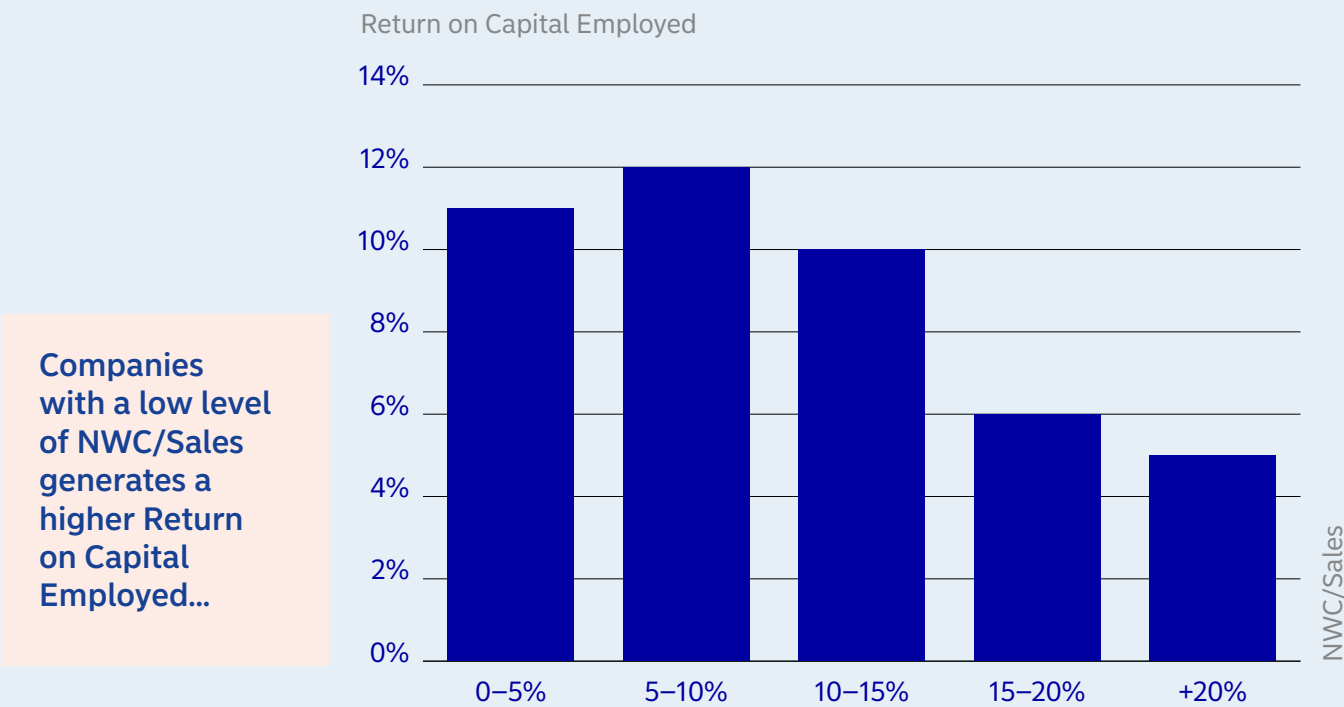
## NWC/Sales and Value Creation

The study brings to light that larger companies generate a higher Return on Capital Employed while smaller companies are struggling with just 1–2% in return. It is also worth noticing that the overall return has decreased quite significantly from 2018 to 2019.

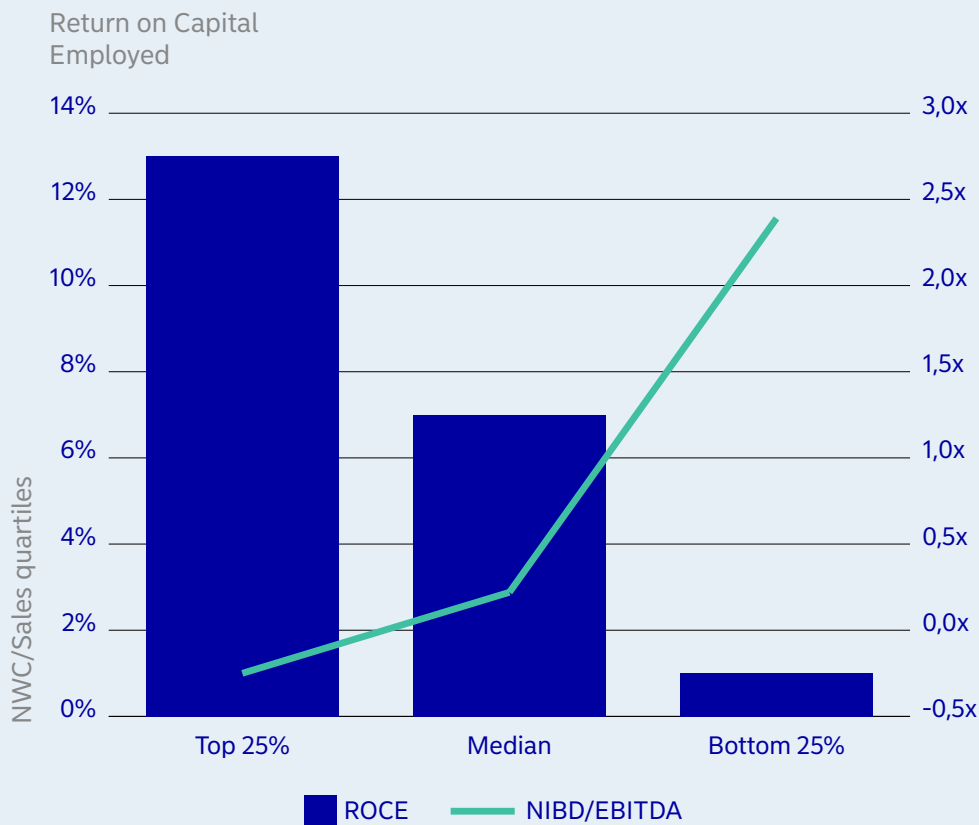


With decreasing returns, especially for small companies, it is important to look for ways to improve.

Displayed in the graph below there is a connection between Return on Capital Employed and the level of NWC/Sales. Companies with a low level of NWC/Sales are more capital efficient in terms of financing daily operations. Below/displayed graph evidences that companies with a NWC/Sales level of 0–5% manages to generate a 11% return, while companies with a NWC/Sales level of more than 20% generates 5% in return.



The below graph displays Return on Capital Employed and Leverage, expressed as NIBD/EBIDTA, for companies in the top 25%, middle and bottom 25% measured on working capital to sales.



...while maintaining a lower need for external financing

Companies with the lowest level of NWC/Sales generates a 13% Return on Capital Employed while companies with a high level of NWC/sales generates just 1%. Furthermore the study reveals that top performing companies have a lower leverage. The NIBD/EBIDTA ratio for the top 25% companies are -0.22x being +2.39x for the bottom 25%.

## Suppliers seem to be an easy target when improving Working Capital

When looking at all 9,300 companies during the analysed period the study shows that suppliers seem to be an easy target when improving Working Capital. The improvement is measured as percentage change in NWC/Sales over the analysed period.

More than half of all the companies have improved their working capital by increasing the amount of trade payables on the balance sheet, meaning pushing payment terms towards suppliers. It seems to be more of a challenge to shorten payment terms towards customers as 'the customer is always right'.

44% of the companies have improved in trade receivables evidencing that it is possible.

It is worth noticing just 8% managed to improve on all three parameters – Receivables, Inventories and Payables.

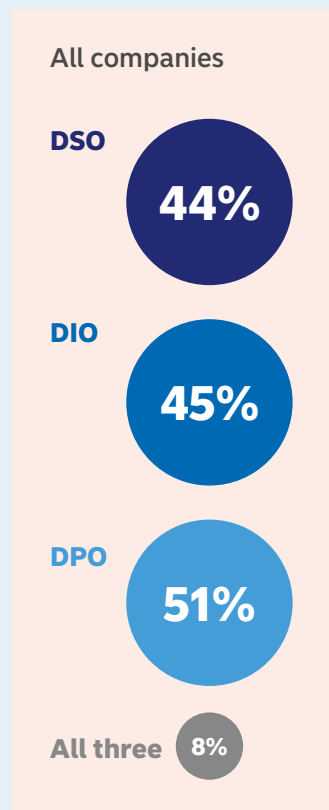
# 44%

of the companies have improved trade receivables.

# 8%

managed to improve on all three parameters – Receivables, Inventories and Payables.

Parameters improved during 2016–2019





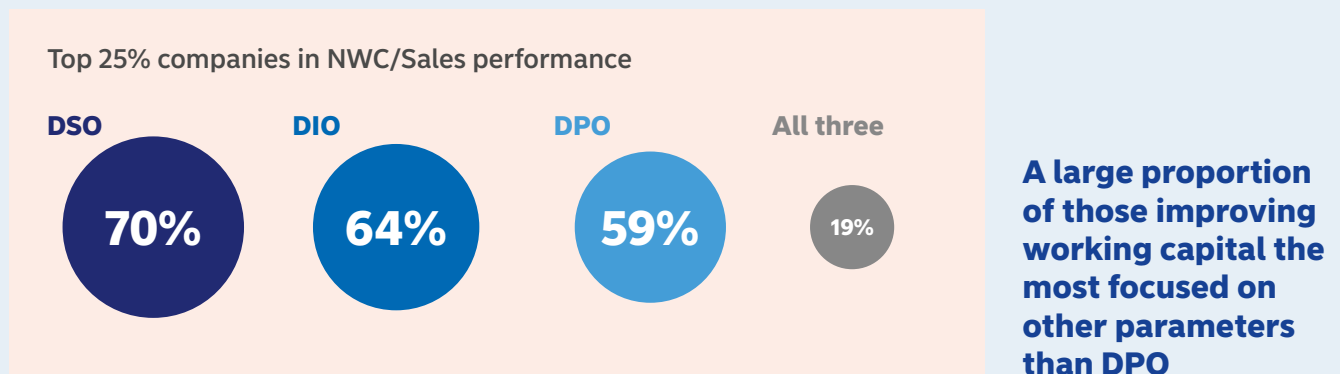
## Best versus worst performers

In order to be best in class you should focus on receivables as well as payables.

A large fraction of those improving working capital the most have worked on other parameters than solely Days Payables Outstanding. The study shows that in order to be best in class, top 25% in this case, you have to work on the receivables as well.

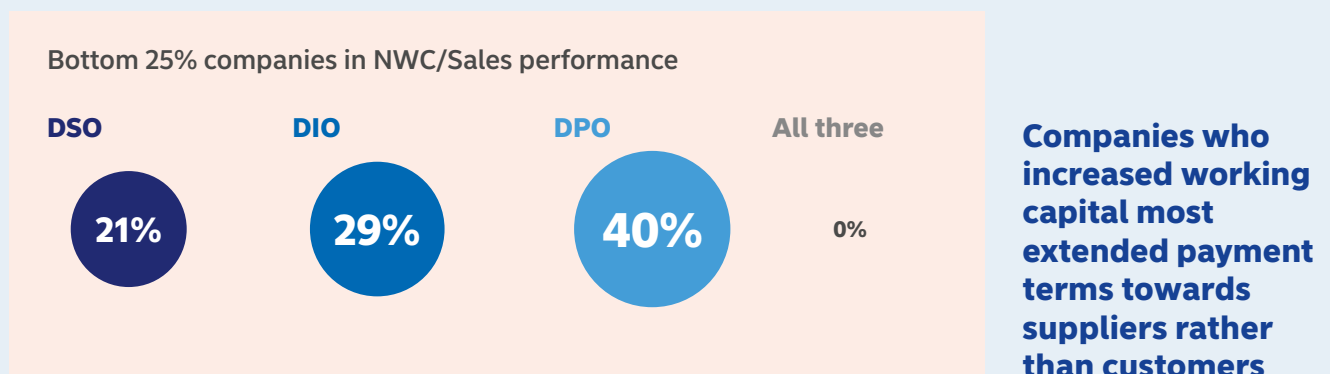
For the top performing companies almost 20% managed to improve all three parameters at the same time.

Parameters improved during 2016–2019



Displayed below, out of the worst performing companies 0% managed to improve all three parameters and 21% improved Days Sales Outstanding.

Parameters improved during 2016–2019

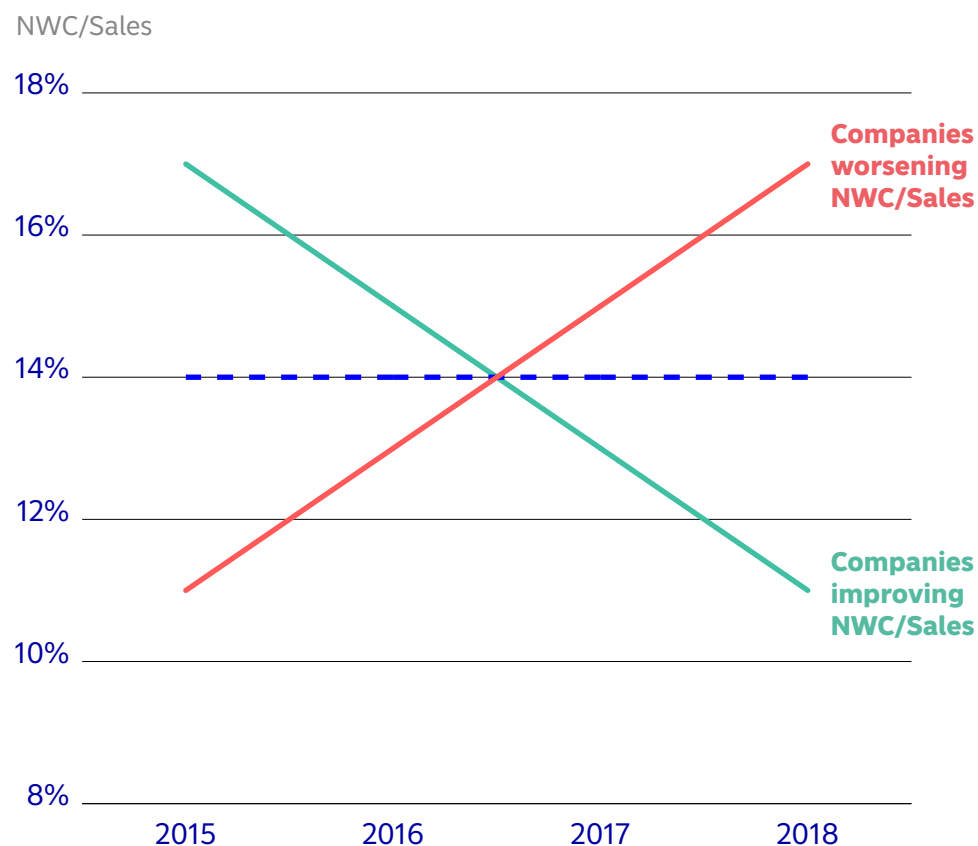


## Focusing on continuous improvements in working capital has a great effect

The graph below shows that companies that have improved the working capital to sales each year between 2016-2019 have 6 percentage points lower NWC/sales in 2016 compared to 2019. The worst performers have on the other hand seen a drop in working capital of 6 percentage-points.

**+6  
percentage  
points**

**-6  
percentage  
points**



Are the best performers mainly larger companies who, in general, have better possibilities within economies of scale, a stronger bargain power when pushing suppliers and customers, while utilising working capital instruments?

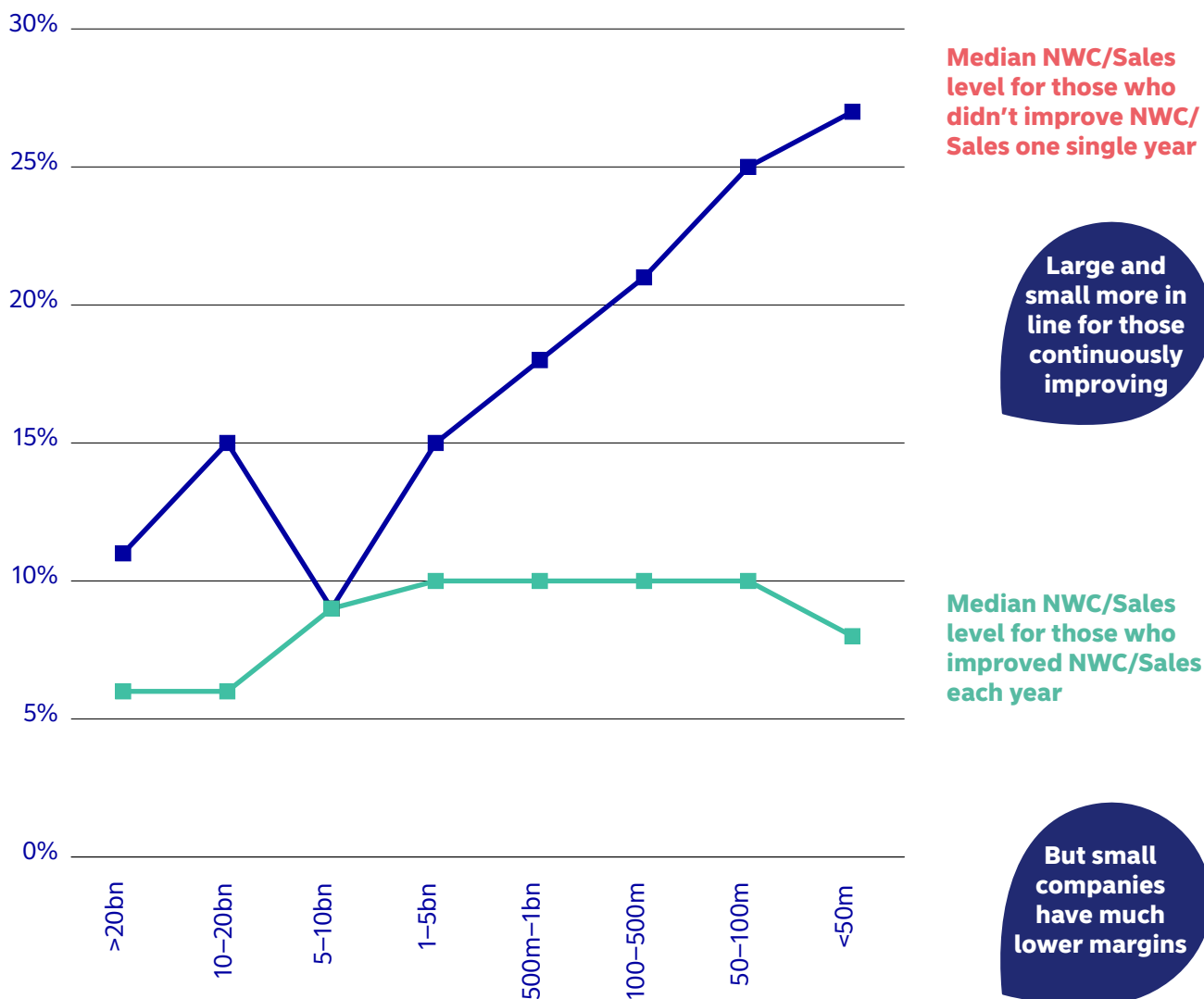
When investigating the NWC/Sales levels for the different market caps, we see that small companies are able to maintain a low level of Working Capital – As long as they improve year after year.

**For a company trading at an Enterprise value/Sales of 1, a 6 percentage point change in NWC/Sales has the same impact on the company's enterprise value**

## NWC gap less pronounced for those who improved continually

The NWC/Sales level for those who did not improve NWC/Sales one single year between 2016 and 2019 is higher, regardless of the market cap and size of the company. The study shows that large and small companies are in line for those continuously improving on the Working Capital. Small companies, with a market cap below 50m EUR, are actually able to maintain a low level of NWC/Sales by focusing and improving the Working Capital each year.

NWC/Sales



Median  
EBITDA  
margin 2019

25%

18%

15%

13%

10%

6%

3%

A high level of Working Capital equals more capital tied up which must be financed somehow. This can be expensive for smaller companies with low ratings and high interest rates.

# Industries & peer comparison

**When discussing Working Capital Management and best and worst performers it is relevant to ask the question “How do we do compared to our industry peers?”**

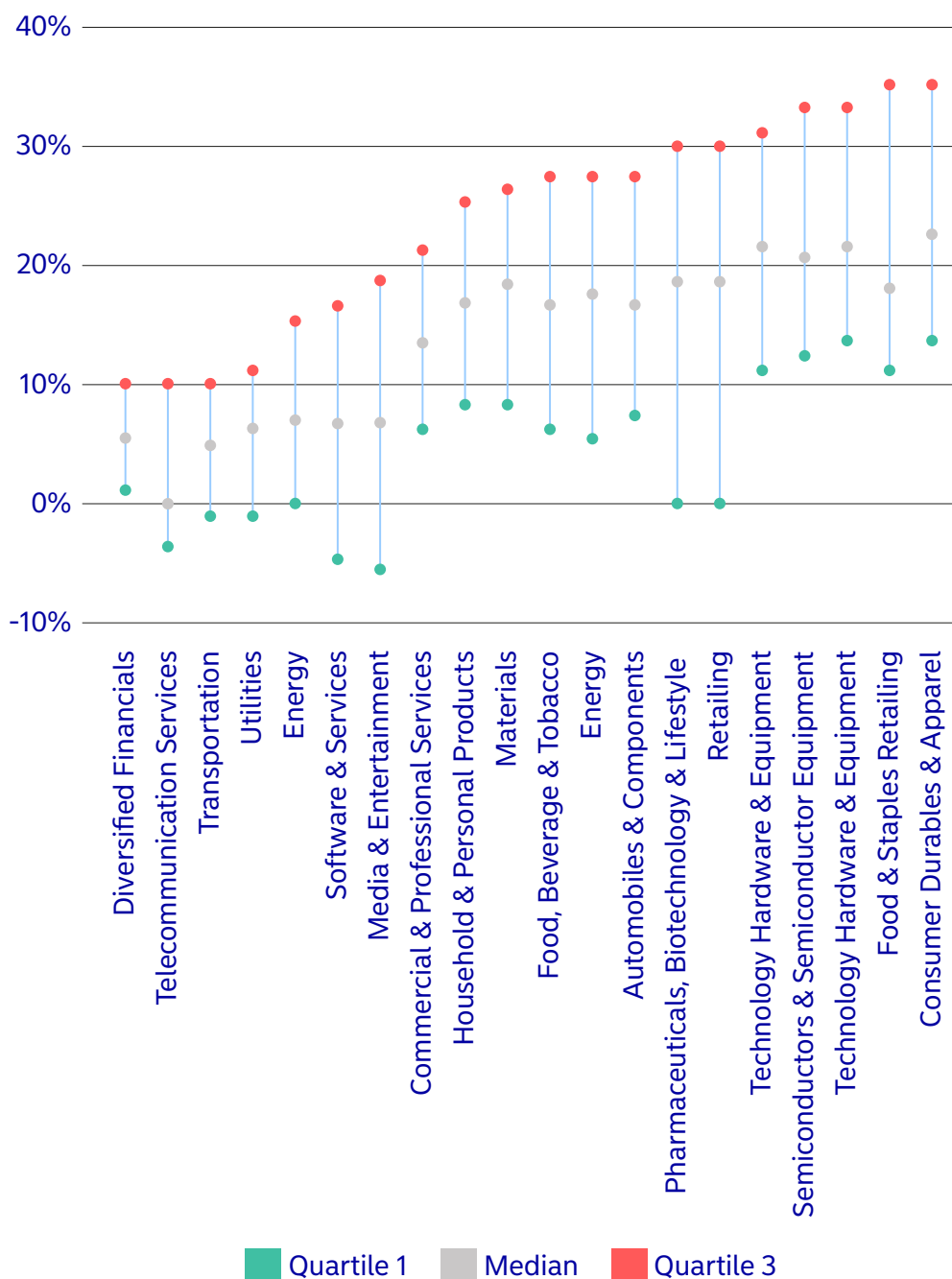
Peer comparison can be difficult and the same applies for comparing industries. The variation within industries are great and each industry has a different customer segment. Other factors that vary a lot are inventory needs, bargaining power and position in value chain.

The following graph displays the level of NWC/Sales for different industries and the differences between top 25% and bottom 25% within that industry. For example, for Utilities the average level of NWC/Sales is 6%, where the best performing company has -1% and the worst has 11%.





NWC/Sales 2019



4 % of market cap corresponding **3.2bnEUR** to be released if companies with NWC/Sales between 3rd quartile and the median moved to the median level

## Industry variation driven by

- Customer segment – B2C, B2B, B2G
- Inventory need – Media, service, software vs. production
- Other assets driving revenues (Energy)
- Bargaining power
- WCM focus and competence
- Etc.

It is no surprise that industries with a low need of inventories, such as Telecommunication Services, Energy, Software and Transportation have the lowest level of NWC/Sales. The gap between best and worst performers in these industries are very tight as well.

Focusing on industries like Retailing, Pharmaceuticals and Automobiles the difference between the top 25% and worst 25% performers are significant.

In industries like these there seem to be some competitive advantages to gain by focusing and decreasing the level of NWC/Sales as this would mean less capital tied up in working capital.

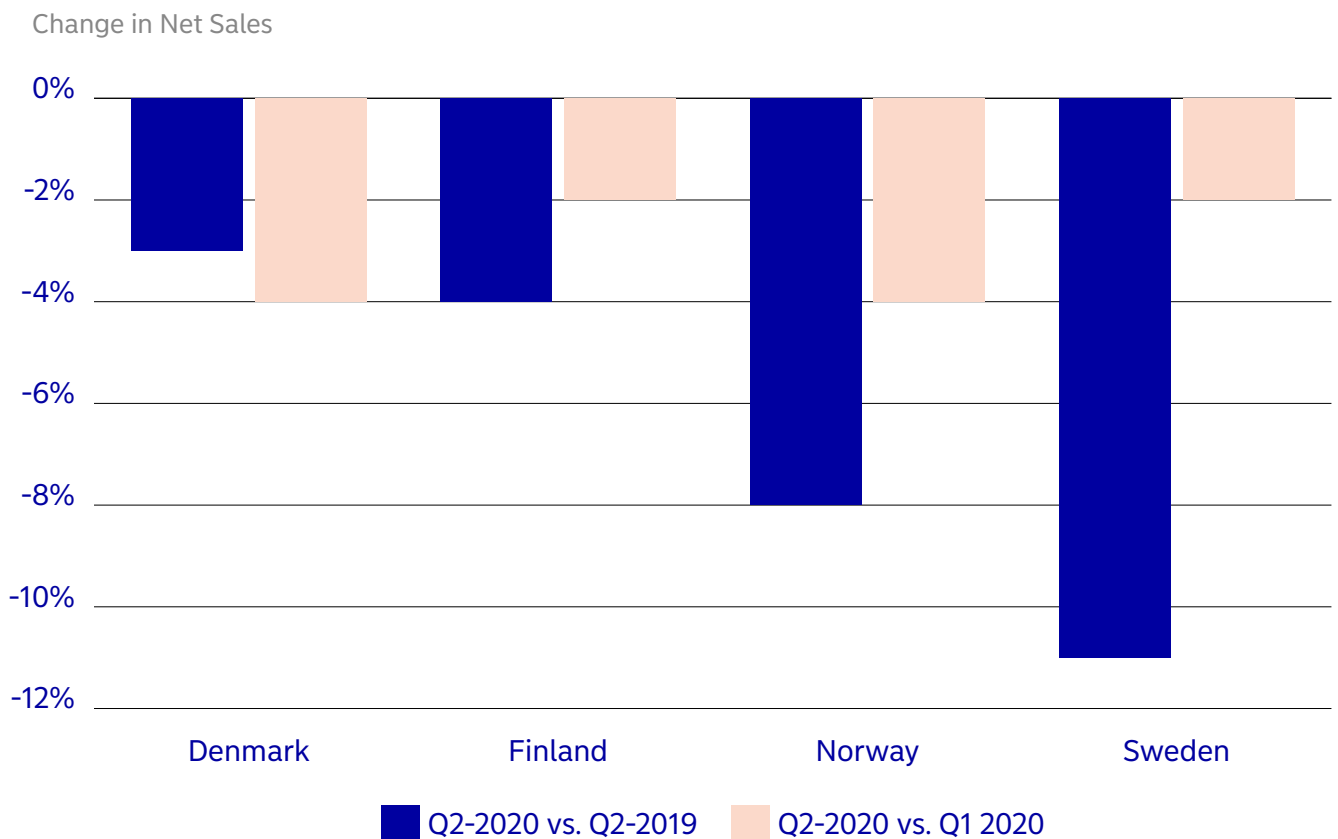
# Economic Consequences of Covid-19

**Increasing debt and decreasing revenue caused by lockdowns and lower demand**

**Nordic revenues are down 7% and NIBD/EBITDA is up 25% compared to first half year 2019**

It is no surprise that the pandemic's impact on global trade has been significant. According to the World Trade Organization, The Global Container Throughput is down 20% and the Number of New Export orders are down 40%.

Nordic companies have been heavily impacted as well. The study reveals Nordic revenues are down 7% compared to last year interim reports, with Sweden and Norway's heavy industrial and commodities industry taking the biggest hit.



Value creation and working capital management is much correlated with the state of global trade and world economy, as it is difficult to manage and forecast receivables, inventory turnover and payables with uncertainties of demand. The study therefore dives into how the Covid-19 has affected trade and working capital management.

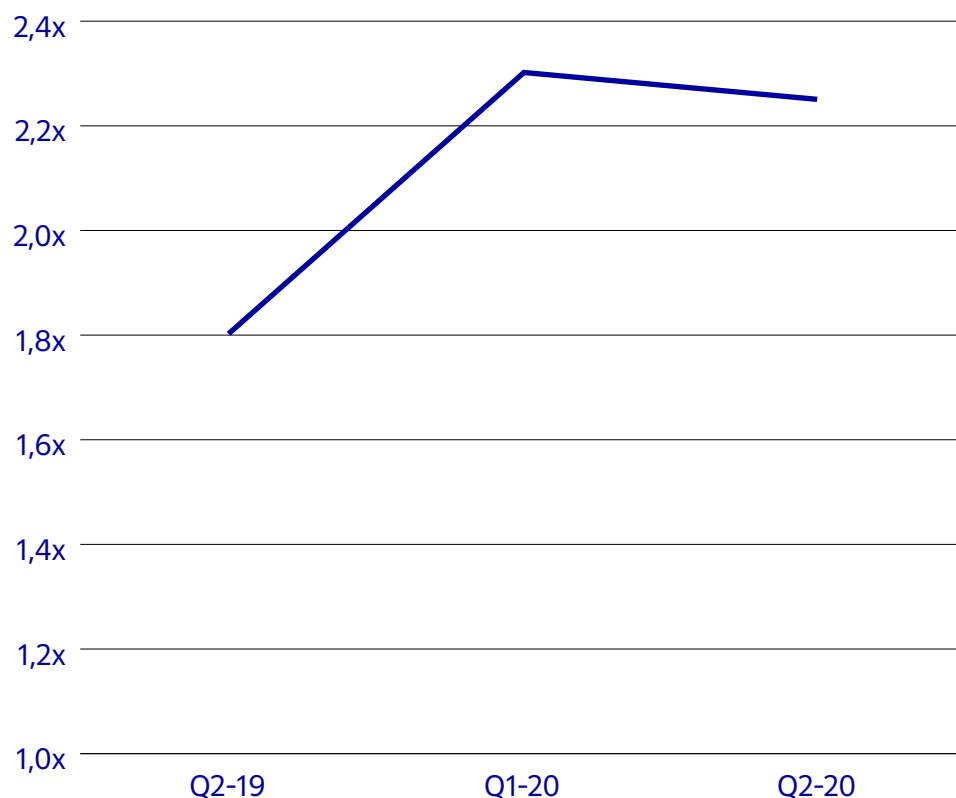
When comparing second quarter results to the first quarter a 3% decrease in revenues is seen. In addition to revenues operating profits are struggling as well. The operating profit for Nordic Companies fell with 21%, with Sweden seeing the largest decrease of 28% compared to 2019 half year results.

With decreasing revenues and margins, the study reveals a slightly increasing level of net working capital during the first half year. The increase in net working capital has to be financed and the graph below shows that this have been done with interest bearing debt as credit facilities by financial institutions.





NIBD/EBITDA



### Looking into future

The analysed period 2016–2019 saw a decrease in operating margins which in turn affected companies' value creation / Return On Capital Employed. Companies were though able to decrease Working capital and thereby somewhat mitigating the overall fall in ROCE

In 2020, with Covid-19, the economy has been greatly impacted where sales and margins have taken a severe hit for many companies, and there are still great uncertainties about the economic recovery.

The question is what kind of recovery will we see? Will it be W, V or U shaped and what impact will this have on companies' financial situation?

In these times of uncertainty, it is even more important than ever to focus on working capital in order to secure cash flow, liquidity, debt levels and return.

**The Nordic level in interest bearing debt measured to EBITDA has increased with 25% compared to second quarter last year. With increasing debt and leverage, decreasing trading volumes and revenues together with a slightly increasing inventory levels, a great uncertainty follows.**



## Size and geography

[illegible]

| Size     | Denmark | Finland | Norway | Sweden | Europe | USA | China | South America | Hong Kong | India | Japan | Middle East | Grand Total |
|----------|---------|---------|--------|--------|--------|-----|-------|---------------|-----------|-------|-------|-------------|-------------|
| >20bn    | 1%      | 1%      | 0%     | 1%     | 25%    | 51% | 5%    | 2%            | 1%        | 2%    | 10%   | 0%          | 100%        |
| 10–20bn  | 1%      | 1%      | 1%     | 1%     | 23%    | 44% | 9%    | 3%            | 4%        | 2%    | 12%   | 0%          | 100%        |
| 5–10bn   | 1%      | 1%      | 1%     | 2%     | 20%    | 36% | 10%   | 7%            | 3%        | 1%    | 16%   | 1%          | 100%        |
| 1–5bn    | 0%      | 1%      | 1%     | 2%     | 21%    | 35% | 23%   | 4%            | 4%        | 0%    | 9%    | 0%          | 100%        |
| 500m–1bn | 1%      | 2%      | 1%     | 4%     | 19%    | 28% | 37%   | 2%            | 6%        | 0%    | 0%    | 0%          | 100%        |
| 100–500m | 1%      | 1%      | 2%     | 4%     | 20%    | 25% | 29%   | 2%            | 14%       | 2%    | 0%    | 1%          | 100%        |
| 50-100m  | 2%      | 2%      | 2%     | 4%     | 18%    | 26% | 10%   | 0%            | 27%       | 9%    | 0%    | 1%          | 100%        |
| <50m     | 1%      | 2%      | 1%     | 2%     | 16%    | 14% | 5%    | 0%            | 20%       | 37%   | 0%    | 1%          | 100%        |
| Total    | 1%      | 1%      | 1%     | 3%     | 19%    | 28% | 19%   | 2%            | 11%       | 9%    | 4%    | 1%          | 100%        |

## Size and industry

| Size     | Consumer Discretionary | Consumer Staples | Energy | Health Care | Industrials | Information Technology | Materials | Utilities | Communication Services | Grand Total |
|----------|------------------------|------------------|--------|-------------|-------------|------------------------|-----------|-----------|------------------------|-------------|
| >20bn    | 13%                    | 12%              | 9%     | 13%         | 18%         | 14%                    | 6%        | 6%        | 9%                     | 100%        |
| 10–20bn  | 13%                    | 9%               | 6%     | 10%         | 21%         | 14%                    | 11%       | 10%       | 7%                     | 100%        |
| 5–10bn   | 16%                    | 8%               | 5%     | 12%         | 21%         | 12%                    | 11%       | 7%        | 7%                     | 100%        |
| 1–5bn    | 16%                    | 8%               | 6%     | 10%         | 24%         | 13%                    | 12%       | 5%        | 6%                     | 100%        |
| 500m–1bn | 18%                    | 4%               | 7%     | 12%         | 27%         | 12%                    | 12%       | 3%        | 5%                     | 100%        |
| 100–500m | 22%                    | 7%               | 7%     | 9%          | 22%         | 14%                    | 12%       | 2%        | 5%                     | 100%        |
| 50-100m  | 22%                    | 6%               | 8%     | 10%         | 20%         | 16%                    | 9%        | 1%        | 8%                     | 100%        |
| <50m     | 22%                    | 7%               | 5%     | 9%          | 21%         | 15%                    | 14%       | 1%        | 6%                     | 100%        |
| Total    | 19%                    | 7%               | 6%     | 10%         | 22%         | 14%                    | 12%       | 3%        | 6%                     | 100%        |

[illegible]

## Industry and geography

| Size                   | China | Europe | Hong Kong | India | Japan | Middle East | USA | South America | Denmark | Norway | Sweden | Finland | Grand Total |
|------------------------|-------|--------|-----------|-------|-------|-------------|-----|---------------|---------|--------|--------|---------|-------------|
| Consumer Discretionary | 18%   | 18%    | 12%       | 10%   | 4%    | 1%          | 28% | 3%            | 1%      | 2%     | 2%     | 2%      | 1%          |
| Consumer Staples       | 18%   | 20%    | 8%        | 9%    | 6%    | 1%          | 30% | 3%            | 1%      | 1%     | 3%     | 3%      | 1%          |
| Energy                 | 20%   | 19%    | 12%       | 8%    | 3%    | 1%          | 28% | 3%            | 1%      | 1%     | 3%     | 3%      | 1%          |
| Health Care            | 20%   | 20%    | 11%       | 6%    | 4%    | 1%          | 29% | 2%            | 1%      | 1%     | 4%     | 4%      | 1%          |
| Industrials            | 20%   | 20%    | 11%       | 8%    | 5%    | 1%          | 27% | 2%            | 1%      | 1%     | 3%     | 3%      | 1%          |
| Information Technology | 19%   | 18%    | 13%       | 9%    | 4%    | 1%          | 28% | 2%            | 1%      | 1%     | 3%     | 3%      | 2%          |
| Materials              | 19%   | 20%    | 11%       | 11%   | 4%    | 0%          | 28% | 2%            | 0%      | 1%     | 2%     | 2%      | 1%          |
| Utilities              | 22%   | 21%    | 5%        | 3%    | 7%    | 0%          | 34% | 2%            | 2%      | 1%     | 1%     | 1%      | 1%          |
| Communication Services | 17%   | 20%    | 11%       | 8%    | 5%    | 0%          | 30% | 3%            | 1%      | 1%     | 1%     | 1%      | 2%          |
| Total                  | 19%   | 19%    | 11%       | 8%    | 4%    | 1%          | 28% | 2%            | 1%      | 1%     | 1%     | 3%      | 1%          |

[illegible]

# About the authors

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Mathias has been working in Trade and Working Capital Advisory since 2018 conducting Trade & Working Capital reports and analyses that support sales teams and relationship managers throughout Transaction Banking. Prior to Working Capital Advisory, Mathias worked with Trade Finance and export financing.



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Henrik is a Senior Working Capital Management advisor at Nordea Trade and Working Capital Advisory. Henrik joined the team in 2013. Prior to this Henrik has more than 10 years of experience in various positions within Nordea, working towards large corporate customers.





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