Report

Working Capital Management 2017

– a survey of small and medium-sized Norwegian companies

Prepared by Norsk Arbeidskapital

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Acknowledgements

We gratefully acknowledge the efforts of our survey respondents who took valuable time away from their jobs to participate in this work.

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About This Report

THE IMPORTANCE OF WORKING CAPITAL

Managing working capital is crucial to the financial health of companies. If the working capital level deteriorates, companies risk being short on liquidity, which eventually can result in their bankruptcy. Too much working capital in the long term lowers the return on investment and reduces the value of the company. A reduction of working capital can, however, significantly improve cash flows and hence the value of the company. Working capital is interest-free and comes with no conditions, making it the cheapest and fastest source of cash for a company. Prioritizing working capital allows companies to free up cash, which can be used for (strategic) investments, reduce debt or pay out dividends to investors.

Research shows, however, that small and medium-sized companies often struggle with optimizing their working capital. We therefore decided to perform a working capital management survey amongst executives and financial managers of small and medium sized companies in Norway.

PURPOSE OF THE SURVEY

The purpose of this survey was to investigate how small and medium-sized Norwegian companies steer their working capital. We wanted to gain insight into their working capital management perceptions, practices, challenges and opportunities.

HOW THE SURVEY WAS CONDUCTED

We surveyed around 1800 executives and financial managers of small and medium-sized Norwegian companies. In this report, small and medium-sized companies are defined as companies with annual revenues below NOK 1,000 mln. and more than 20 employees. Between 19th June and 10th July 2017, 107 companies completed our 15 minute, self-administered survey online. More information about the survey demographics can be found on page 18 of this report.

With this survey, we hope not only to enable companies to compare their own methods concerning working capital with those of other companies, but also to make them aware of alternatives for optimisation of their working capital management. Contact information regarding the outcome of this survey can be found at the end of the report.

NORSK ARBEIDSKAPITAL

Norsk Arbeidskapital is a consulting firm specialized in working capital management offering support to small and medium sized companies in Norway. We support companies with our expertise to optimize their working capital. This enables them to free up capital and increase liquidity that can be used for strategic investments, the reduction of debt or the pay out of dividends to investors.

For more information about Norsk Arbeidskapital please visit our website: **www.norskarbeidskapital.no.**

Executive Summary

Companies need cash to operate and compete. In general, the more cash a company has on hand or the healthier the ratio between its current assets and current liabilities, the better able it is to take advantage of growth opportunities, whether this means investing in new products and services, acquiring another business, reducing debt or attracting the attention of potential investors.

Just how much cash a company has available is a direct result of how well it manages working capital. Specifically, how a company manages its receivables, inventory, and payables determines how much cash it has to meet its operating expenses, pay down its debt, support investments in strategic opportunities or pay its shareholders.

This study presents the perspectives of executives and financial managers of Norwegian small and medium-sized companies regarding their working capital management. It explores their views of how their companies manage working capital in practice.

Insights received through the survey revealed that most of the companies consider working capital management to be of importance to their organization. In addition, key highlights include:

- Less than half (42%) of the companies have plans or initiatives for improving their working capital in the coming 12 months despite the fact that about 60% of the respondents didn't see an improvement of their working capital in the last 12 months.

- Almost none of the participating companies have used or are planning to use external consultants to improve their working capital.

- Many companies (65%) don't have an incentive structure in place that stimulates continuous focus on working capital management.

- About half of the companies (49%) report working capital KPIs on a monthly basis while about 20% don't report working capital KPIs at all.

- Only 55% of the respondents sends a first payment reminder in the initial 7 days after the due date.

- Less than half of the participating companies (39%) makes use of specific software to purchase goods or optimize their stock level.

- Only 23% of the respondents make use of a team from different departments to decide which SKUs to add or remove from stock.

Even though most small and medium-sized companies say they are prioritizing working capital management in some way or another, the outcome of this survey shows that most of them still have significant room for improvement.

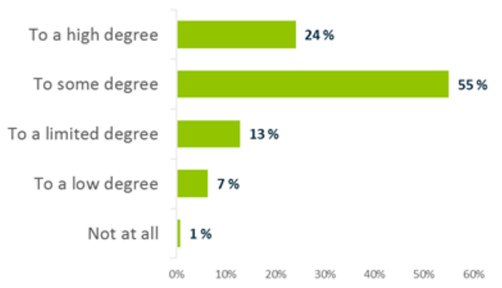
By creating a working capital management culture, focusing on more detailed, transaction based, analyses and putting improved policies, incentives and supporting software in place, these companies may well find themselves able to release substantial amounts of cash to expand their businesses and increase their value.

Working Capital Management in General

Importance of working capital

Working capital management is an important topic for most of the companies involved in our survey. In fact, nearly a quarter (24%) of the companies say they prioritize working capital management to a high degree, while 55% prioritize it to some degree.

To what degree does your company prioritize working capital management?

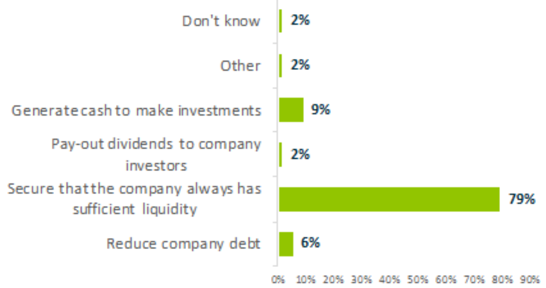


So why do so many small and medium-sized Norwegian companies focus on working capital management?

Motivation

More than 75% of the respondents mentioned securing sufficient liquidity as the main reason for focusing on working capital management, while only a limited number of respondents see working capital management as a way to generate cash for investments (9%) or to reduce their company debt (6%).

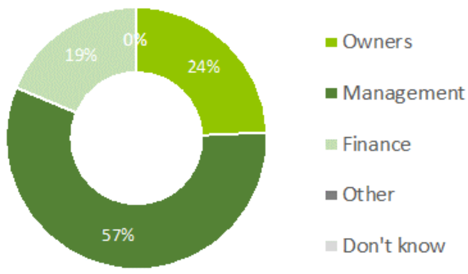
What do you see as the biggest motivational factor for focusing on working capital management?



Ownership

Leaders set the tone for the organization, as well as its priorities. Therefore, it is crucial that senior management of a company support the importance of working capital management and take ownership.

Who is primarily responsible for working capital management?



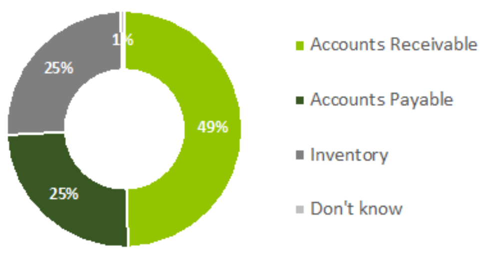
Around 57% of the companies answered that the responsibility for working capital management lies primarily with management, while 19% of the companies see working capital management as the primary responsibility of finance.

The analysis confirms that the responsibility for working capital management should lie with the management of the company. In this way, a company can enhance the possibility of influencing processes throughout the organization.

Focus areas

Looking at the different working capital areas, small and medium-sized companies focus mainly on improving their accounts receivable level, while paying less attention to accounts payable and inventory. The reason why they focus so much on accounts receivable is probably that they consider this area less complex compared with, for instance, inventory management.

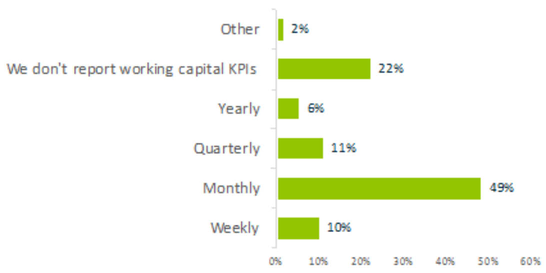
On which working capital area does your company focus the most?



Tracking performance

Another way to measure the focus on working capital management is by looking at management reporting. Only 10% of survey respondents monitor working capital performance on a weekly basis.

How often does your company report working capital KPIs?

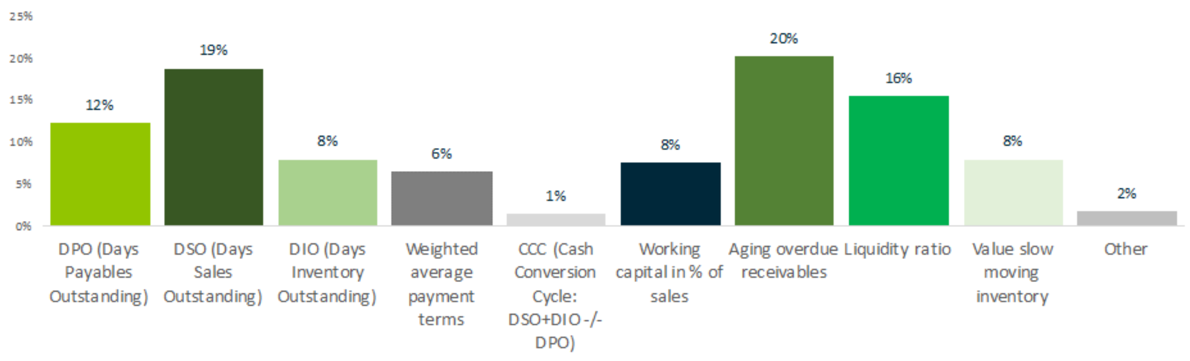


Most companies (49%) report their working capital KPIs on a monthly basis. This suggests that working capital performance monitoring is aligned with general month-end practices.

Interestingly, about 20% of the companies do not report working capital KPIs at all. As performance measuring is key for improving working capital management, this latter group of companies has significant room for improvement.

The most popular working capital KPIs are days sales outstanding (DSO), aging of overdue receivables, liquidity and days payable outstanding (DPO). This is in line with the fact that 49% of the companies focus mainly on improving their accounts receivable level.

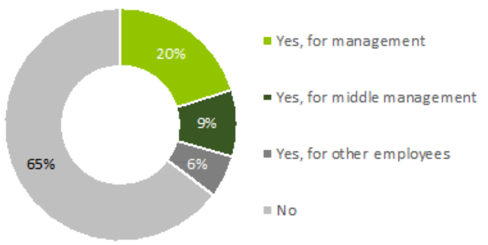
Which working capital KPIs does your company use?



Incentive structure

Companies were asked if working capital management is included in individual goals or remuneration of management and employees. Only 35% of the companies responded that this is the case, whether it involved management, middle management or the other employees.

Is working capital management included as part of individual goals and/or remuneration for the company's management and employees?

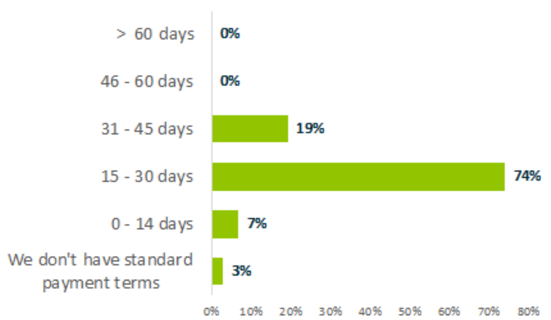


Our experience shows that successful optimization and sustained improvements require continued attention from managers and employees alike. Measurement and performance based remuneration can be effective tools to achieve this kind of optimization.

Payment term policy soundness

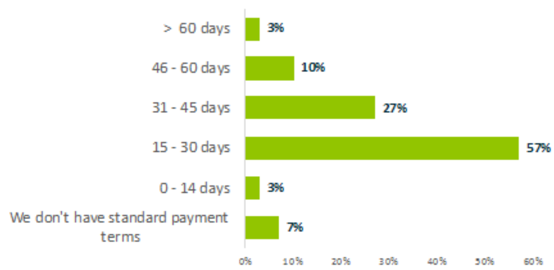
The included figures show that more than 70% of the participating companies have a standard payment term of 15-30 days for their customers, while the remainder are distributed above and below this range. This picture is consistent with the average payment deadline in the Nordic region of around 30 days.

What is your standard payment term for customers?



The equivalent for suppliers shows that 53% of the participating companies have a standard payment of 15-30 days. Here, however 37% of the companies report a standard payment term for suppliers, which lies above 30 days. We should mention that these terms are based on the perspectives of the respondents. The actual days of sales outstanding (DSO) and days of payable outstanding (DPO) can differ significantly between different suppliers and customers.

What is your standard payment term for suppliers?

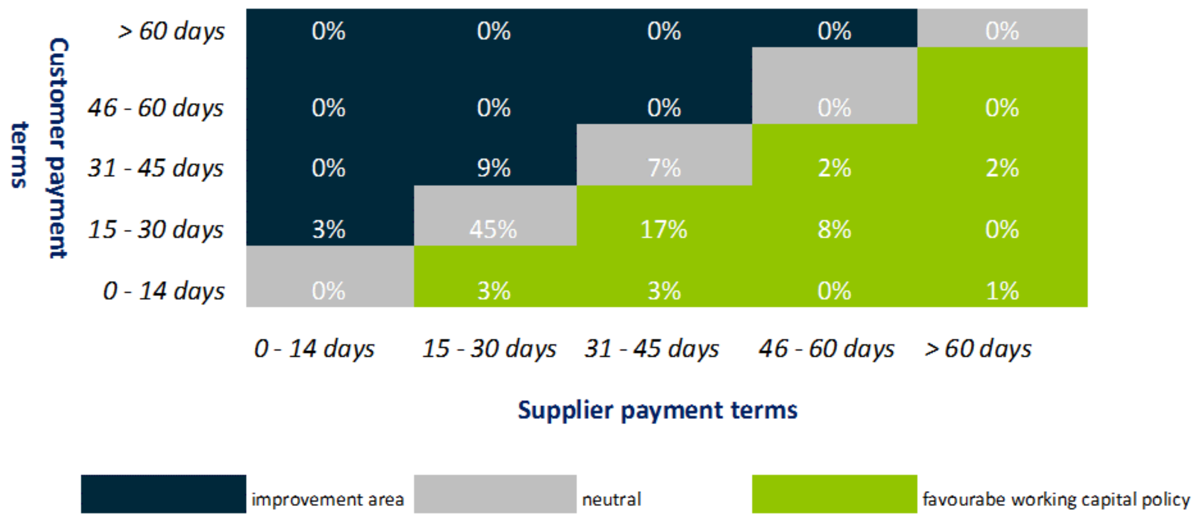


Good working capital management practice requires having a longer standard payment term for suppliers than for customers. The relationship between a company's DSO and DPO indicates a company's ability to collect money from its debtors faster than it pays its creditors.

Of the participating companies, 36% have a standard supplier payment term that is longer than the standard customer payment term. In contrast, 12% have a standard customer payment term that is longer than their standard supplier payment term. The remaining 52% have equal standard payment terms for customer and suppliers.

Whenever the supplier payment terms are shorter than the customer payment terms, there is an opportunity to improve working capital. Companies should, at least, strive to pay their suppliers in about the same amount of time that their customers pay them.

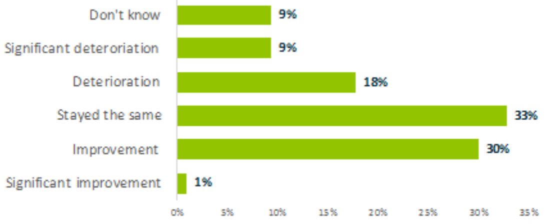
Payment term policy soundness



Performance last 12 months

Survey respondents reported mixed results over the last 12 months. We see that 31% of the companies have experienced improvements (a decrease in working capital), while 33% are at the same level and 27% have seen their working capital deteriorate (an increase of working capital).

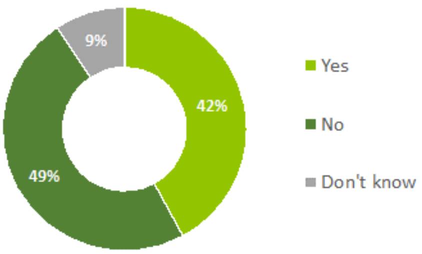
How has your average working capital changed over the last 12 months?



Planned improvements

Even though most companies say they prioritize working capital management, less than half (42%) have plans or initiatives to improve their working capital in the coming year.

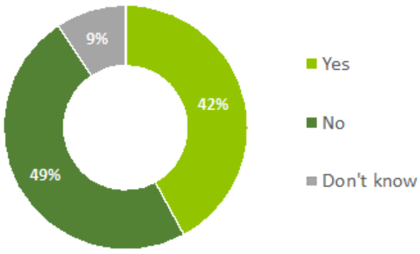
Does your company have any plans or initiatives for improving working capital in the coming 12 months?



The relatively low number of companies that have plans to improve their working capital is interesting, given the fact that only 31% of the companies reported an improvement in their working capital.

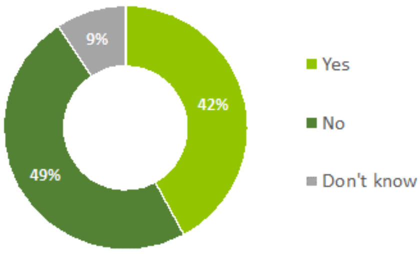
When asked whether their company has used external consultants in order to identify working capital opportunities, 88% of the respondents answered negatively.

Has your company made use of external consultants to identify working capital opportunities in the past years?



The same result applied to the question of whether their company was planning to use external consultants to improve their working capital management.

Is your company planning to use external consultants to help with improving your working capital management?



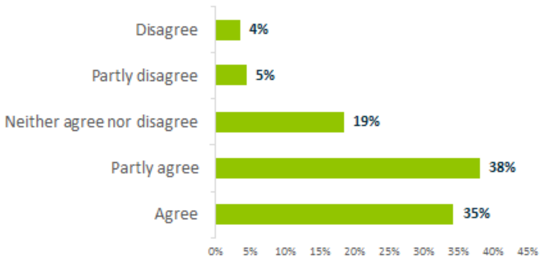
Using external consultants will often bring more specialized knowledge and experience that will enable a company to quickly realize a substantial working capital improvement. Small and medium-sized companies especially can benefit from external help as they often lack knowledge and time for doing a rigorous working capital assessment themselves. The cost associated with using external consultants is almost always only a small fraction of the cash generated from an improved working capital management.

Accounts Receivable

General

More than 70% of the companies answered that they are actively working with optimizing their days of sales outstanding (DSO).

We are actively working with optimizing our DSO

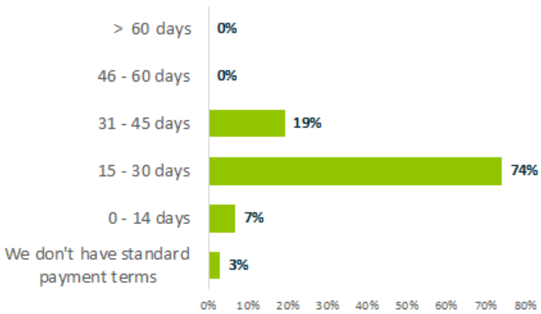


The DSO of a company is mainly influenced by the agreed payment term with customers and an effective collection management.

Standard payment term

The majority (72%) of the respondents replied that their standard terms of payment are between 15 and 30 days. Only 3% of the respondents mentioned that their company doesn't have a standard payment term.

What is your standard payment term for customers?



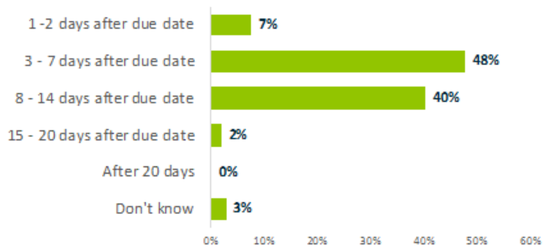
It is important to make sure that the standard customer payment term is lower than or at least equal to the standard supplier payment term. Otherwise the company runs the risk of having to pay its suppliers faster than it receives money from its customers.

Having a standard payment term says nothing, however, about the actual payment behavior of customers. Even though payment behavior in Norway generally is good, companies need to ensure that they have strict procedures in place to prevent overdue payments from their customers.

Reminder procedures

Regarding the company's reminder procedures, only 7% of the respondents said that they start the reminder procedure 1-2 days after the due date, 48% start 3-7 days after the due date, while 42% start 8-20 days after the due date.

When does your company send the first payment reminder?



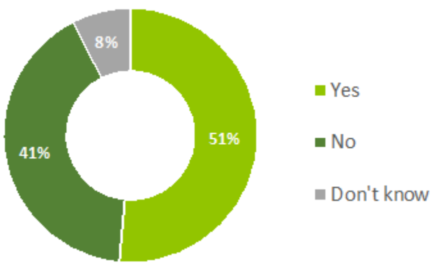
Companies would generally benefit the most from fast and effective reminder procedures. The outcome of the survey indicates that there is significant room for improvement in this area.

However, to reduce late payments from customers, it is important to analyze the reason for the need to send out reminders. In many cases, late payments may be due to ineffective internal processes. Late payment may be due to an error in an invoice or an error in delivery, for example. If a company improves these processes, it will not only save time spent handling errors, but also achieve a positive cash effect in the form of more prompt payments. Incorrect invoices are a source of frustration for customers and can often be a reason driving late payments. Ultimately, when there is a slow payment or a dispute, a company should first ask what they may be doing wrong or what internal processes can be improved to increase the number of on-time payments.

Specific software

More and more companies use specific software to support their collection management process. This software improves the efficiency of the credit management function, freeing up time to focus on high priority and more complex tasks.

Does your company make use of specific software to support the collection management process?



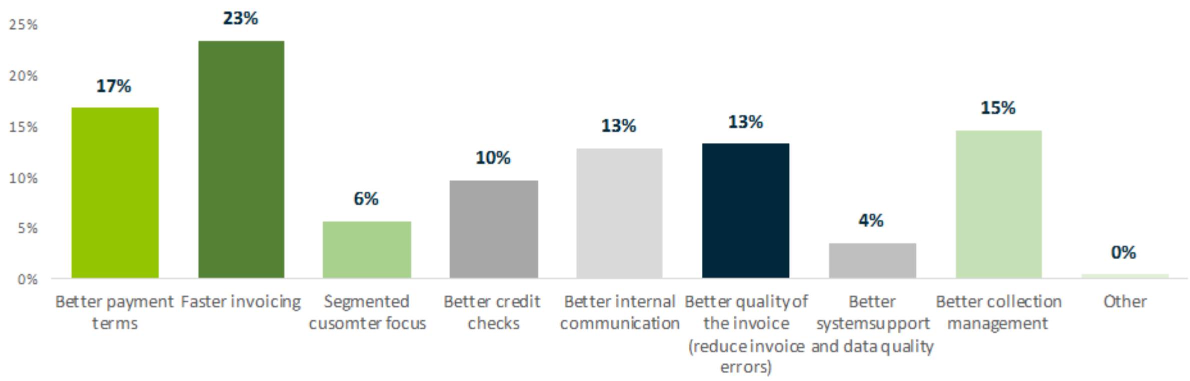
Of the participating companies, 51% stated that they make use of specific software, while 41% do not. Companies without specific collection management software should at least regularly review the payment behavior of their customers to identify habitual late-paying customers.

Opportunities

When asked where they think the greatest opportunities lies, most respondents see great potential in improving the speed of invoicing and improving collection management. So, there is considerable potential for optimization by focusing on internal processes. In addition, respondents also see potential in negotiating better (lower) payment terms with their customers.

Even though few respondents mentioned better system support and data quality as an opportunity area, our experience shows that it is worthwhile to regularly check that contractual payment terms are accurate reflected in the system master data.

Which area has the biggest opportunity for optimizing your DSO?

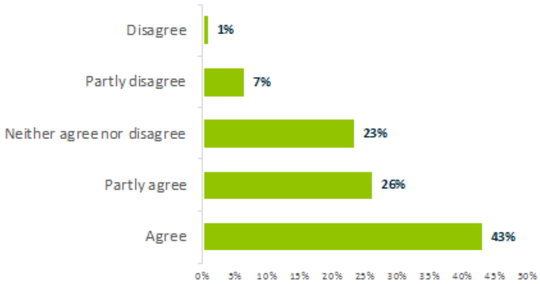


Accounts Payable

General

Around 70% of the responding companies answered that they are actively working on optimizing their days of payable outstanding (DPO).

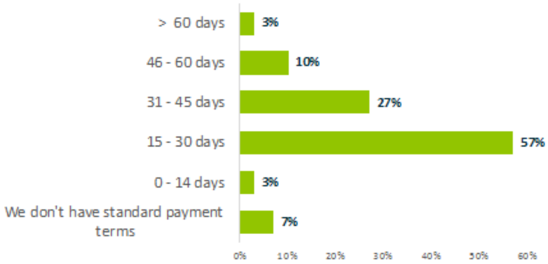
We are actively working with optimizing our DPO



Standard payment term

About half (53%) of the respondents replied that their standard supplier payment term is between 15 and 30 days, while 25% stated that this is between 31 and 45 days. Only 7% of the respondents mentioned that their company doesn't have a standard payment term for suppliers.

What is your standard payment term for suppliers?



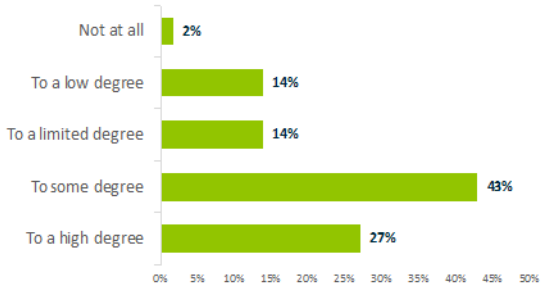
It is important to make sure that the standard supplier payment term is higher than or at least equal to the standard customer payment term. Otherwise, the company runs the risk of having to pay its suppliers faster than it receives money from its customers.

Despite having a standard supplier payment term, a company's actual payment term often depends on its ability to negotiate this term in practice. For many companies, it is a matter of balancing different contractual drivers to get the best overall result possible (price, terms, company's service level). As a result, most companies have various payment terms with suppliers.

Transparency

An important prerequisite for optimizing a company's DPO is transparency on spend and payments. It is beneficial to regularly compare the payment terms of different suppliers. This creates valuable input for the annual negotiation rounds with suppliers. In addition, transparency on timeliness of payments allows companies to find out whether their company is structural paying their suppliers too early.

To what degree does your company have transparency on spend and payments?



Of the participating companies, 27% answered that they have a high degree of transparency of their spend and payments, while 30% of the companies have limited, low or no transparency at all. This last group's answers indicate at least some room for improvement.

Cash discounts

On the subject of cash discounts from suppliers for early payments, more than half of the companies (57%) stated that their suppliers did not offer cash discounts for early payments. Only 10% of the companies always take the cash discount by paying on the discount date, while 22% of the companies sometimes take the cash discount.

What is your policy/practice with respect to cash discounts offers by your suppliers?

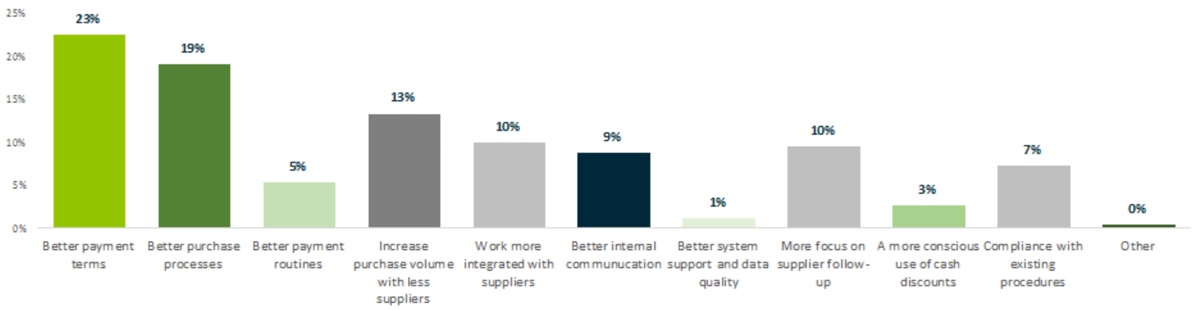
It is important that the decision whether or not to take a cash discount for early payment should always be based on a calculation and not on gut feelings.

Opportunities

When asked where they think the greatest opportunities lie, most respondents see potential in improving payment terms (negotiating longer payment terms), improving purchase processes and rationalizing suppliers (increasing purchase volumes with fewer suppliers).

Our experience is that many companies do not fully exploit the payment term they have agreed with their suppliers. Early payment is due to anything from incorrect entering of the agreed payment conditions in the company's bookkeeping system to "convenience" in the finance department, because it fits a periodical payment run. It is thus possible to free liquidity by fully exploiting the agreed payment term without the need for renegotiating with suppliers.

In which are can you find the biggest opportunity for optimizing your DPO?



Inventory

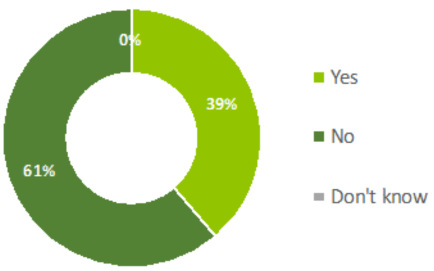
General

More than half (63%) of the participating companies carry inventory. Inventory management is a balancing act between carrying sufficient amounts to meet customer service level targets while not having excess that consumes cash and carries greater risk of obsolescence. In practice, many companies struggle substantially with optimizing their inventory level.

Specific software

When a company carries a broad assortment of goods from different suppliers in its inventory, it becomes more difficult to calculate the optimal safety stock and re-order points. More and more companies, therefore, make use of specific software that calculates exactly when to order what.

Does your company use specific software to purchase goods or optimize the stock level?

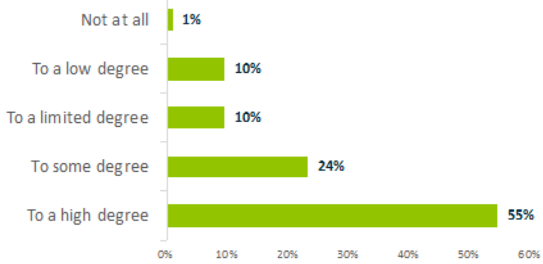


Around 40% of the surveyed companies use specific software to purchase goods or optimize their stock level, while more than half (61%), do not make use of specific software for these purposes. In our experience, companies using specific software can reduce their average stock level between 15 and 30%. Without specific software, companies should at least regularly assess their inventory by classifying their stock based on consumption variability and turnover. This enables a quick identification of improvement possibilities.

Transparency

A prerequisite for maintaining a healthy inventory is transparency on slow and non-moving stock with root causes understood. This enables a company to develop a clear action plan to clean up this part of the inventory.

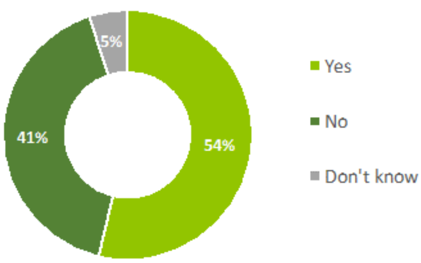
To what degree does your company have transparency on slow or non-moving stock?



Most companies (55%) report that they have a high transparency on their slow and non-moving stock, while 21% report that they have limited or no transparency at all. So, there are some improvement opportunities for nearly a quarter of the companies in this area.

To prevent stock keeping units (SKUs) becoming slow moving or obsolescent, it is important that companies have a formal policy for adding and removing SKUs from their inventory.

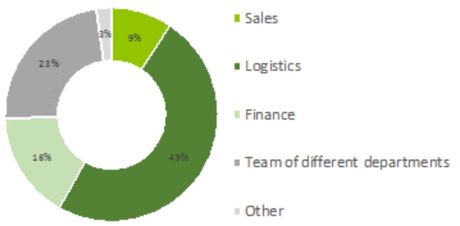
Does your company have a formal policy for adding and removing SKUs from your inventory?



About half of the participating companies (54%) answered that they have a formal policy for doing so, while 41% lack this kind of policy.

When asked who controls the process of adding and removing SKUs, 49% of the respondents replied logistics, while 23% of the respondents replied that this is being done by a team from different departments.

Who controls the process of adding and removing SKUs in your company?

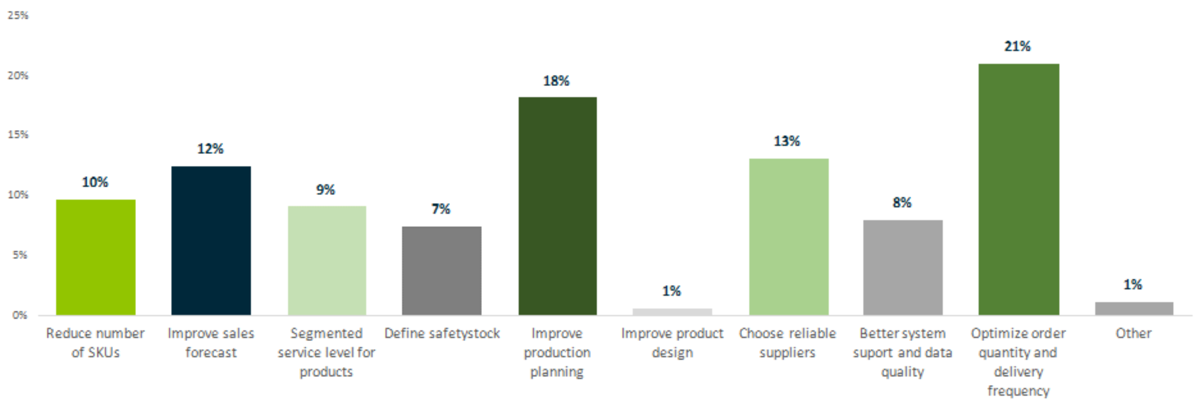


Our experience shows that best-in-class companies regularly discuss the need to add and remove SKUs from their inventory. These discussions involve multiple stakeholders from various departments (e.g. sales, marketing, procurement and supply chain) following clear preset rules. The outcome of the survey shows that there is significant room for improvement in this area.

Opportunities

Respondents indicated that many opportunities can be found in the area of optimizing order quantity and delivery frequency as well as improvement of production planning. Interestingly, the participating companies don’t see many opportunities in defining their safety stock. Our experience shows us that a rigid assessment of a company’s stock almost always reveals excess stock levels.

Which area has the biggest opportunity for optimizing your DIO?



Conclusion

Even though most small and medium-sized Norwegian companies say they prioritize working capital, less than half of the companies have plans or initiatives for improving their working capital in the coming 12 months.

In addition, they seem to be hesitant to use external consultants to help them with the improvement of their working capital management. Given the fact that only 33% of the participating companies reported an improvement in working capital in the last 12 months, one would expect more initiatives in this area.

Effective working capital management can free up significant cash, but also requires constant attention to avoid falling back into old routines. It is therefore important to ensure that companies implement a rigid and sustainable cash culture. This means putting KPIs in place to measure and track working capital performance and then incentivize and reward employees for achieving goals. Most participating companies have room for improvement in both these areas as the outcome of this survey showed.

The survey also indicated that companies focus mainly on their debtors when it comes to improving their working capital management. Even though most respondents say they are actively working to optimize their DSO, many of them send out a first payment reminder more than 8 days after the due date. Companies would generally benefit more from a fast and effective reminder procedure.

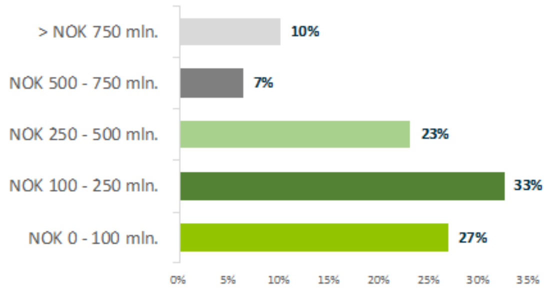
Nowadays, more and more companies are implementing specialized software to facilitate their collection management and optimize their stock level. Our survey indicates that about half of the small and medium-sized companies don’t make use of these specialized software programs. While it is possible to operate successfully without specific software, the use of it can be beneficial for companies that are growing fast and face increasingly more complex challenges.

With or without specific software, all companies will benefit from a regular assessment of their working capital. Our experience tells us that few small and medium-sized companies have undertaken a robust analysis of their working capital. External consultants can support this process as small and medium-sized companies often lack the knowledge and time for doing it themselves. Detailed transaction based analyses will almost always indicate opportunities to improve.

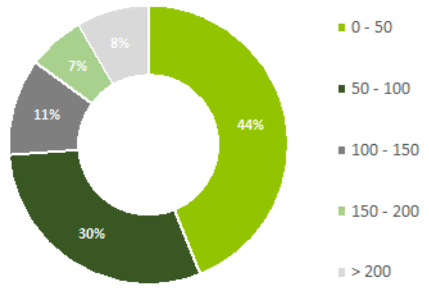
The outcome of the survey tells us that many of the participating companies find it difficult to turn their good intentions into action. By creating a working capital management culture, focusing on more detailed, transaction based, analyses, and putting improved policies, incentives and supporting software in place, these companies may well find themselves able to release substantial amounts of cash to expand their business and increase their value. An effective working capital management can therefore be the gateway to their next level of growth and profitability.

Survey Demographics

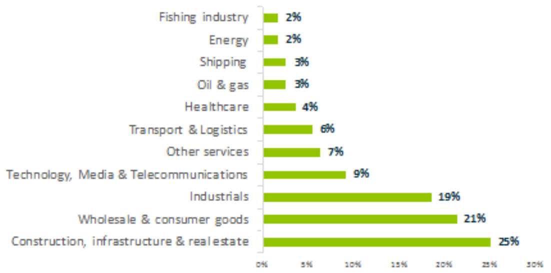
Annual Turnover



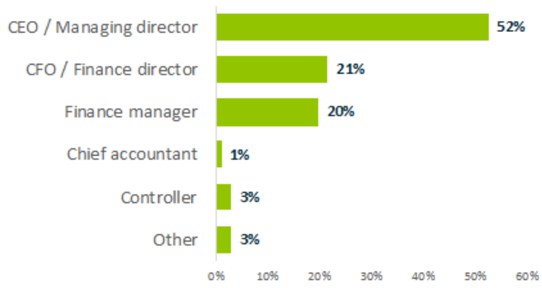
Number of Employees



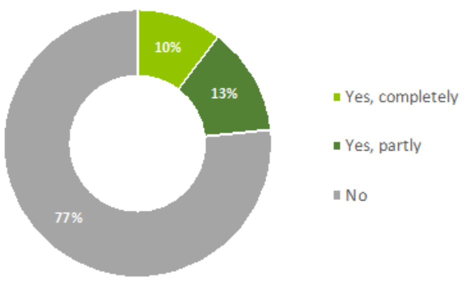
Industry Sector



Position of the Respondent



Has your company outsourced accounting?



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