

One Step Forward Two Steps Back

Working Capital up in 2012 A four year review of Working Capital and Liquidity Development

By Stefanie Jungmann and Julia Haydn

Since the financial crisis in 2008 most years have been recovery years for the global pulp and paper industry. However, since the last quarter of 2011 and in 2012, new clouds appear on the horizon. The recovery in most developed economies has been slower than expected and 15 million jobs have been permanently lost since the last crisis¹. Indicators are signaling a rocky road ahead. Drivers are:

- Increasing financial and fiscal uncertainty
- Record budget deficits
- Instability of the Euro caused by high debt and budget deficits in many south European countries
- Decreasing trust in both the USD and EUR
- Interest rates maintained at relatively low levels with rising inflationary pressures
- Overall high valuation of stock markets
- Record gold prices
- High levels of unemployment and increasing social unrest and protests
- Declining growth rates in China
- Uncertainty about future economic developments

The pulp and paper industry is naturally impacted on both the demand and the supply side by these developments.

Demand was good in the first half of 2011, but was slowing down for most segments in the second half, with increasing payables levels. Despite a recovery since 2009, demand in many segments is still below pre-crisis levels. In general, the global pulp demand is expected to stay stable but there are significant geographical differences – whereas demand is expected to weaken further in the US and especially in Europe, strong demand growth is expected in the emerging markets. While demand in the packaging segment is currently still relatively good, it is expected to drop in the fourth quarter of 2012. In the printing and publishing sector, the development remains overall negative – a trend that attests to the general structural changes in these segments.²

Global pulp prices reached their peak in summer 2011. However, after falling about 20% from July to December 2011, there were again moderate hikes at the beginning of 2012. Since May 2012, the pulp prices have been declining again. Except for some individual announcements of price hikes, no significant changes are expected for the last three months of the year. In the packaging business, price hikes have been announced both in the US and in Europe, however it remains to be seen whether they will be implemented. Recovered (Waste) Paper has remained relatively stable since the beginning of 2012. For some of the grades that dropped from April to July 2012, the prices are expected to stay stable or decline slightly in the fourth quarter of 2012. However, due to large Chinese recovered paper imports, RISI suggests that volatility in the medium-term is probable.³

As forecasted in our industry overview from March 2012⁴, the first two quarters of 2012 continued to witness a decline in wood costs that commenced in the fourth quarter of 2011. In many markets, wood prices have come down to 2010 levels. Especially costs of hardwood fibers have fallen significantly. The Hardwood Wood Fiber Price Index (HFPI) reached its lowest level in two years in the second quarter of 2012, after falling by 4.4% to 104.88/odmt (compared to 109.71/odmt in Q1/2012 and 117.94 in Q3/2011). The Softwood Wood Fiber Index (SFPI) fell by 4.1 % to 100.54/odmt from Q1/2012 to Q2/2012. Due to the many factors that cause uncertainty in the market (political as well as economical), along with softening markets on the buyers' side, wood prices are likely to weaken further during the upcoming months.

In a press release from September 6th 2012, the OECD reports that economic growth in the major industrialized economies (G7) has nearly come to a halt. According to their forecast, the three largest economies of the euro area (Germany, France and Italy) will shrink at an annualized rate of 1% in the third quarter and at 0.7% in the fourth quarter. In the United States, GDP growth is forecasted to accelerate to 2% in the third quarter of 2012 and to 2.4% in the fourth quarter, compared to 2% and 1.7% in quarters one and two respectively. In Japan GDP growth declined by 75% from 5.5% (impacted by Tsunami recovery) in quarter one to 1.4% in the second quarter. For the third quarter in 2012, a negative growth of 2.3% is forecasted. In its most recent publication on the World Economic Outlook from July 2012

¹ Source: OECD

² Source: Preliminary statistics CEPI 2011

³ RISI VIEWPOINT: What is behind the turbulent global recovered paper market and where is the market headed? – Accessed on Sept 20, 2012

⁴ StepChange "Rollercoaster rides II: What goes up will come down – an update review of the global economic climate and the state of the industry", published for the 2012 RISI European Pulp and Paper Conference

(update on WEO from April 2012, mentioned above)⁵, the IMF has adapted its previously more optimistic forecast for 2012 (downward revision of 0.1-0.2 percentage points). Although the downward revision was not as significant the last time it occurred in January 2012, the IMF repeats its warning about a dangerous phase in the global economy. According to the paper, the biggest threat is the possibility of the euro area crisis escalating further due to deficient policy actions. Some of the other downside risks that are stated include the fiscal problems in other advanced economies as well as the potential further slowdown in the growth of the emerging market economies.

Whereas the U.S. Economy has grown slightly throughout 2011, the growth in Asia continued to be moderate. Although only to a limited extent, the euro area crisis weakened Asia's exports in the last quarter of 2011. While China will continue to grow (IMF estimation >8% in 2012 and 2013), the question will remain, whether its domestic demand will be resilient enough to counterbalance negative influences from the US and Europe. Every percent lower growth will automatically lead to declining growth rates in western economies, especially in export oriented countries like Germany.

With the massive debt problems and shrinking confidence of the bond markets in some EU member states the European Central Bank has had to step in by buying up bonds from some of its member states. Additionally the ECB provides almost unlimited financing to financial institutions to restore confidence and availability of liquidity between banks as the inter-banking lending was drying up in 2011. The provision of this cash at record low interest rates is pushing significant risks into the future - a potential time bomb.

With another potential economic slowdown on the horizon it is worthwhile to revisit the actions taken by many companies in the industry since 2008. As financing became short, companies had to look more closely at their Working Capital in order to improve cash flows from internal operations.

This publication reviews the development of Working Capital across regions and different segments of the industry over a period of four years. The analysis is based on publicly available information of companies in the pulp and paper sector with results based on the largest public companies in the sector, excluding pure-play pulp producers⁶.

In 2011 asset consolidation and closure continued within many areas of the industry. Major players sold some of their assets in order to improve their equity ratios and improve their balance sheets.

According to the PPI magazine, in 2011 the closures in Europe reached > 2.3 million tons, with more than half in the graphic papers segment. New capacity totaled > 0.3 million tons, of which almost half of the capacity came from the tissue sector. Having learned from the financial crisis, managers are well aware about the importance of cash, and a short cash to cash cycle. The faster a company can get the cash to turn, the lower their borrowing rate will be. Nevertheless current figures point to a deteriorating discipline.

Working Capital Development

Working Capital continued to remain an important agenda item for the majority of companies within the industry. Until 2010, especially in Europe, Working Capital programs established during the crisis seem to have continued to deliver good results with Working Capital discipline mostly maintained. However, in 2011, most companies have again increased Working Capital levels. On average the Working Capital ratio has increased by 1% since 2009. In 2009, the weighted average Working Capital to turnover ratio was 14.3%. After decreasing to 13.6% in 2010 the average ratio has increased significantly to an average rate of 15.3% by the end of the second quarter 2012. There are no signs that the remaining two quarters of the financial year will be any better. It can be observed that the spread between the lowest and highest Working Capital levels widened in 2011⁷ but became smaller again during the current financial year 2012. This development questions whether improvements made in 2009 & 2010 really were based on sustainable measures.

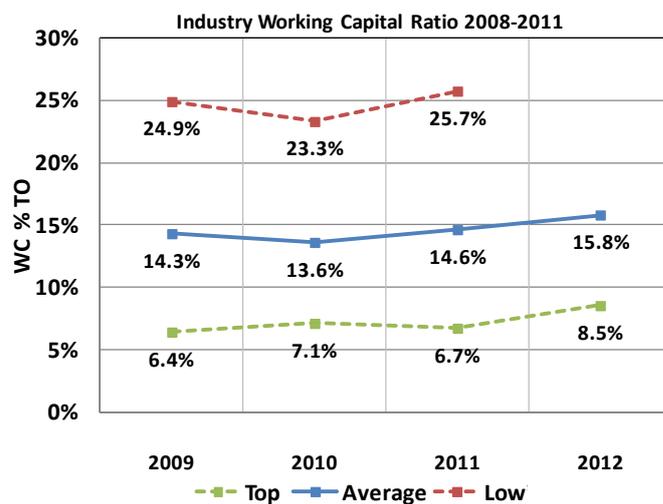


Figure 1: Development of Working Capital 2008-11⁸

⁵ Source: IMF – World Economic Outlook – Slowing Growth, Rising Risks (WEO), Sept 2011

⁶ As no financial information selected Asian companies was available for 2012, the average global value in 2012 (where available) only considers the development of European and US companies.

⁷ A company with a Working Capital turnover ratio below 10% is considered as a top-performer where as low-performers report a ratio above 20%. No companies in the selected peer group had a Working Capital ratio of over 20% in 2012

⁸ In H1 2012, none of the peer group companies reported a Working Capital >20%

It seems that until 2010, companies set a priority on Working Capital. Low performers focused on their Working Capital levels and managed to decrease by 1.7 percentage points to 23.3%. In 2011 however, levels of low performers increased again to 25.7%. Only the top performers succeeded keeping Working Capital levels low even in 2011 (from 7.1% in 2010 to 6.7% in 2011).

Looking at the Working Capital levels in a bit more detail reveals significant regional differences: European companies reduced Working Capital significantly during the crisis in 2009. Since then (although only slightly higher in 2010) Working Capital levels have increased significantly to 14.8% in 2012. In 2009, the Working Capital of North American companies was significantly higher than that of European peers. A significant reduction was achieved in 2010. Since then there has been a continuous increase in line with the European peer group. However, YTD 2012 levels in the US are 14.8% - still well below the crisis levels of 15.6%. Working Capital levels in Asia have remained high and have actually increased continuously since 2009 (from 16.3% to 19.2%)⁹.

hough still significantly above pre-crisis levels.¹⁰ In light of these predictions it becomes natural to refocus on liquidity management.

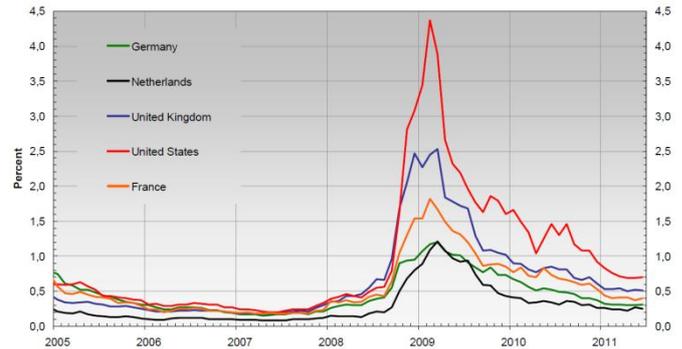


Figure 3: Credit default frequencies by country

The analysis of the Working Capital by receivables, payables and inventories provides more insight. DSO (days sales outstanding) indicates how fast companies are collecting money from their customers, DIO (days inventory outstanding) shows the total inventory levels in days including raw materials and finished goods. DPO (days payable outstanding) shows how many days companies are being provided with credit from their suppliers. In short it can be said that the increase in Working Capital levels comes mainly from worse results in receivables and payables. Suppliers and customers seem to have put a good amount of pressure on the industry – or the industry has lost focus and Working Capital savings made with customers and suppliers are rebounding. Interestingly the lever internally most influenceable - inventories – was not significantly reduced during the crisis. This is an indicator that short term savings (DSO & DPO) have been in focus, savings which are also lost most quickly.

After improving 3 days from 2010 to 2011 (59 and 62 days respectively), customer credits have remained stable. On the supplier side, the payment days have remained stable after decreasing from 54 to 51 days in 2011. During the first half of 2012 inventories were turned into sales 2 days later (45) than in 2011 (43).

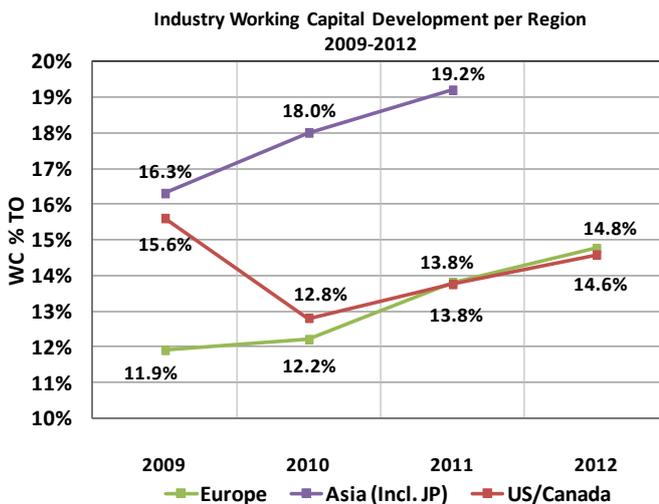


Figure 2: Industry Working Capital ratio per Region 2009-12

In 2008 and 2009 there was an overall downgrade of the pulp and paper sector by rating agencies. Credit insurance companies in turn were forced to reduce their exposure and reduce coverage levels. Subsequently, companies had to cover a higher portion of the risk internally which has led to a need for managing Working Capital more tightly. Further downgrading has occurred in 2010 and 2011. According to Atradius, a major credit insurance provider, the expected default frequency rate (EDF) has been continuously declining since 2009, alt-

⁹ The overall share of Asian companies within the total sample of companies is 22%. European companies represent 47% and US companies 31%.

¹⁰ Source: Atradius Economic Outlook September 2011, The EDF chart is based on publicly listed companies and the likelihood of default within next year. Default is defined as a failure to make payment, or the initiation of bankruptcy proceedings.

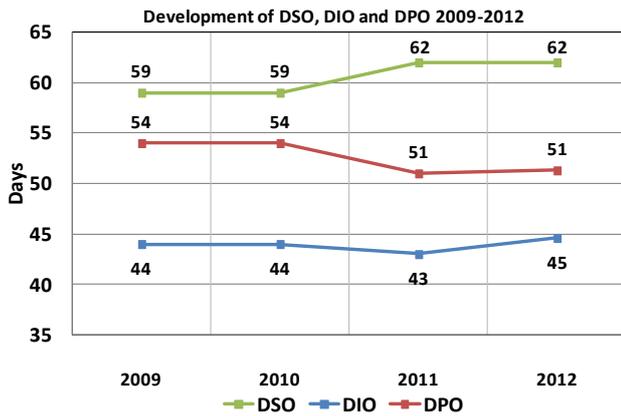


Figure 4: Working Capital levers 2009-12

As Figure 5 shows, DSO development has been quite different across the regions. North America has the lowest DSO values. After increasing by 4 days from 2010 to 2011 (48 to 52 days respectively), the levels have again decreased by 1 day to 51 in Q2 2012. In Europe receivables remained stable at around 63 days from 2009 to 2011, however, contrary to their US peers, they have actually increased by 3 days in Q2 2012 (deterioration by 5%). In Asia the DSO have continuously remained much higher than in the US or Europe. From 2009 to 2011, the gap has further widened, as the Asian DSO increased by 9 days (or 13%) from 69 days in 2009 to 78 days in 2011). It has to be stated that especially in Europe the average is influenced by a wide range of very short (Germany, Austria, Switzerland) and very long (Italy, Greece, Spain) payment terms.

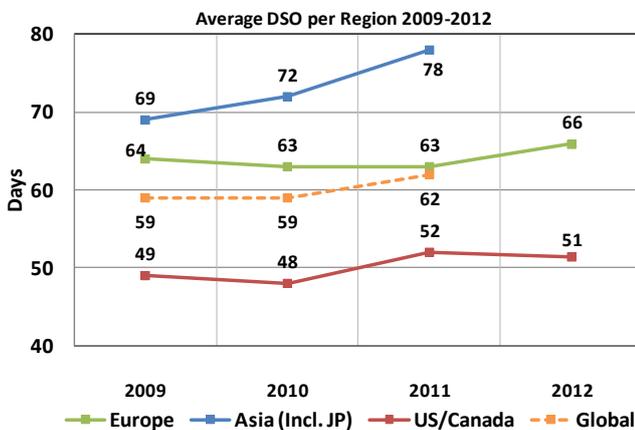


Figure 5: DSO per Region 2009-12

The inventory comparison in Figure 6 shows a more homogenous picture. North American companies have the lowest average inventory levels. Asia and Europe show similar (higher) levels which can traditionally be explained with higher transfer times in some cases because of country or natural borders. All regions have kept inventory levels fairly stable over the years. North America improved inventory levels by 2 days from 41 days in 2009 to 39 days in 2011. However, during the first two quarters of 2012 the inventory levels have increased above the levels of 2009 – to 42 days. Europe

has remained stable at around 46 days, while the Asian DIO have increased from 45 days in 2009 to 47 days in 2011 (a decline of 4%).

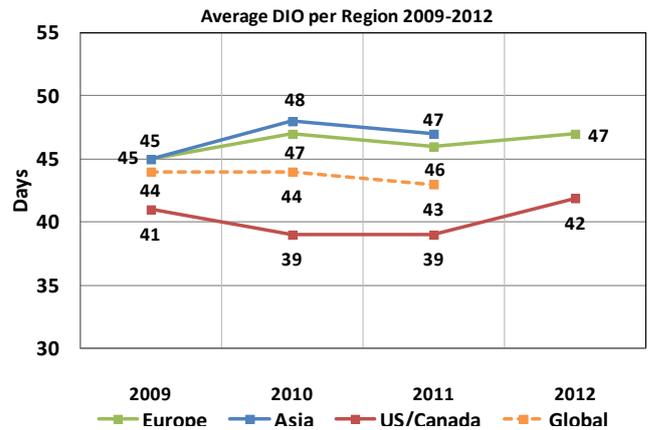


Figure 6: DIO per Region 2009-12

On a global level, payables have remained fairly constant during the observed 4-year period. In Europe, however, there was a large drop of DPO in 2011 (decrease of 7 days from 66 days in 2010 to 59 days in 2011) which indicates that suppliers may have reclaimed lost territory. DPO in the US has remained on very stable level of around 40 days for 4 years in a row, which also may indicate that Working Capital improvements have not focused on Payable improvements.

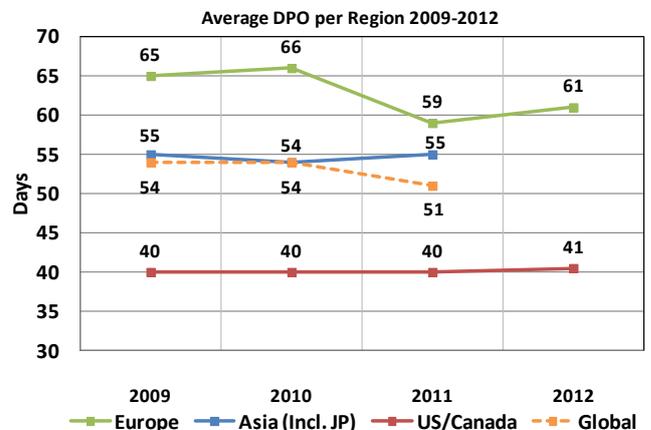


Figure 7: DPO per Region 2009-12

Improving Working Capital through payables by pressuring suppliers is the fastest (and potentially easiest) measure to implement. Results can be achieved through negotiations instead of structural improvement of internal processes.

However, this approach to reducing Working Capital typically leads to a higher long term level as payables on one side are receivables on the other, along with the fact that compensating high receivables with high payables may lead to market chain reactions, which is why some countries (e.g. France) have passed legislation to reduce payment terms in order to improve liquidity.

CCC

The development of the cash conversion cycle (CCC)¹¹ was also analyzed for the timeframe 2009-2012. The cash conversion cycle measures in short how many days a company needs to finance the value chain from order of raw materials via inventories to delivery of finished goods. Results of this analysis are shown in Figure 8.

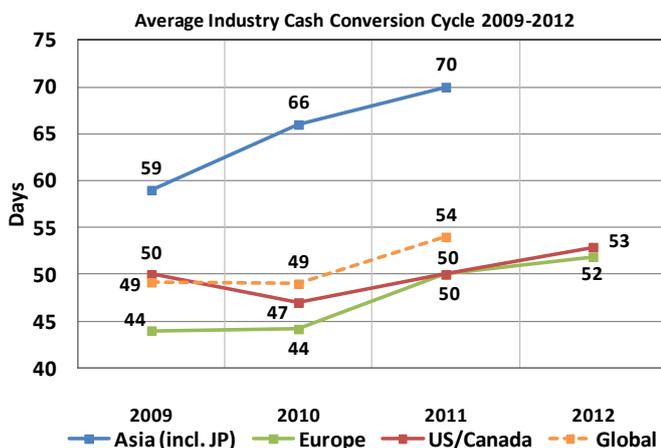


Figure 8: Average industry cash conversion cycle 2009-12

The regional comparison of CCC outlines the global negative trend since 2010. In 2011, North America and Europe both showed a CCC of 50 days, which was still below the global average of 54 days due to the high CCC of their Asian peers. However, during the two first quarters of 2012, the trend has continued to be negative in both regions. The CCC for US companies has increased by 3 days to 53. The cash conversion cycle for European companies has increased by 2 days to 52,

Asian companies increased their CCC by 19% from 2009 to 2011 with the highest increases from 2009 to 2010. In 2011, the CCC for Asia only increased by 4 days to 70 days, which was mainly due to pressure on payment terms by their customers.

In general, this graph shows an increase in the cash to cash cycle in the last years. On a global level, CCC has increased from 49 days in 2009 to 54 days in 2011.

Gearing Ratios

The debt-to-equity ratios (gearing ratios) provide an insight into the exposure and leverage of companies in the industry.¹² On a global level, there are signs of stagnation. The overall improvement from 2009 to 2010 was 0.2 points but since then the gearing ratio has

been increasing by approximately 0.1 points a year, ranging from 1.6 to 1.8.

However, geographically there are notable differences: US companies have been reporting significantly higher gearing ratios than their European peers. After the US companies successfully decreased their gearing from 2.7 in 2009 to 2.2 in 2010 (by 0.5 points or 19%) their debt-to-equity ratio has again returned to similar levels during the first two quarters of 2012. While this might partially reflect the tightening debt levels in the US, it is also the result of the big acquisitions that have taken place in the US during the last years. Moreover, this is in some cases also a natural development, as excessive equity ratios are not useful with respect to maximizing ROE. Over the last years, many companies had to clean up their balance sheets and improve financial health over the last years. With improved financial health the companies were able to afford new acquisitions. This has led to an increase in gearing for some companies as some of the biggest acquisitions have taken place in 2010 & 2011 (e.g. Rock Tenn / Smurfit Stone, UPM / Myllykoski, IP / Temple Inland).

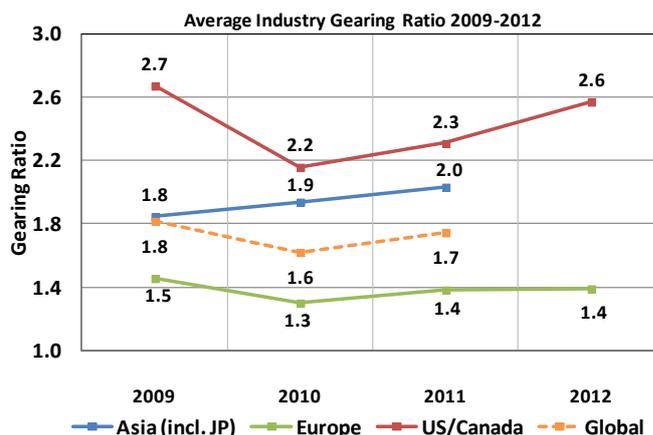


Figure 9: Average industry gearing ratio 2009-12

The gap between the two Western continents seems to be growing again, as the average gearing ratio in the North America has continued to increase. Whereas in 2010 and 2011 the gap between the US and Europe was +0.9 points (2.2 to 1.3 and 2.3 to 1.4), in 2012 the US companies were on average 1.2 points above the European levels.

Active Working Capital Management has been an important part in reducing financial leverage. Tapping the internal bank to repay loans or co-finance acquisitions in order to reduce premiums for external credit lines has been a key priority of many companies in the last years.

¹¹CCC = DSO+DIO-DPO In this case the CCC was calculated by mathematically normalizing the denominator for inventories, receivables and payables using a turnover-based calculation to make the CCC for different companies comparable. This is contrary to the typical CCC calculations where DPO are subtracted from DIO and DSO despite different denominators (DIO and DPO are calculated through division by costs of goods sold)

¹²To compute the gearing ratio of peer group companies, all disposals announced in their financial reports have been excluded

Finding the money

As illustrated above the key influencers of Working Capital are inventories, receivables and payables. Payables and receivables management are related to financial processes whereas inventories are depending on physical processes and are tied directly to operating practices and supply chain processes.

Typically the financial levers influence a bigger share of Working Capital. Reducing Working Capital by managing the collection and payment processes almost seems too obvious to discuss. However, tight Working Capital management requires a breakdown of the processes that drive the Working Capital levels. Additional value can be captured through managing the details.

Payment terms often have a historical background and are typically not revisited frequently after the initial contract closure. Prices, service levels and volumes change whereas payment terms often remain static. Therefore, it is even more important to put emphasis on negotiating favorable payment terms both with suppliers and customers periodically.

Customer payment term harmonization goes hand in hand with customer segmentation. In other words, what is the relation of the customer value to current payment terms? Sometimes less profitable and low-margin customers receive better payment terms regarding net payment days than customers that are more profitable. Suppliers can also be segmented for payment term renegotiations. Sometimes suppliers with lower spend offer better payment terms when compared to larger suppliers in the same spend category. However, with respect to spend it is important to focus on main spend items and volumes to achieve an improvement in Working Capital. Although it is important to have standardized minimum payment terms the benefit of switching hundreds of C-suppliers by a few days is often limited compared to tough negotiations on payment terms with big suppliers.

The categorization of payment terms of customers according to margin, and of suppliers according to spend category provides greater visibility and control in the negotiation process. Payment terms need to be standardized. Only a limited number of payment terms should be allowed for each customer and supplier segment. Some companies even manage 80% of spend with only one payment term and limit customer payment terms to only a few depending on their power position. Although not fully comparable, best practices concerning payables management can be identified in other industry segments such as consumer goods or global retail. These industries standardize their payment terms and payment processes and force them upon their supply chain partners. Some of these processes and practices may also be applicable for companies in pulp and paper.

Enforcement of guidelines for keeping Working Capital under control is also crucial for the handling of credit limit overruns. If a customer order exceeds the insured amount of receivables a delivery stop should be placed onto the order and sales should not be able to override it.

Potentials can also be found in the internal process set-up and the responsibilities in the process chain. The frequency and intervals of the dunning runs play an important role in pursuing overdue customers early in the process. Experience shows that some customers trigger payments only after receiving the first or second dunning letter.

Additionally, the defined grace period determines when a customer is considered overdue. Reducing grace periods may incur additional work as most customers tend to pay within the defined boundaries but also demonstrates that agreed terms are enforced strictly.

In addition to payment terms defined, overdue amounts have a significant impact on the Working Capital performance. Although varying by country, weighted overdue amounts of >7 days can be considered poor performance whereas average weighted overdue amounts <3 days of receivables can be considered top tier. A company's ERP system can be customized to support these processes.

With respect to overdue collection responsibilities much is often left to the sales force resulting in settlements in favor of the customer. To help sales maintain good customer relationships a "good cop / bad cop" approach can be applied to segregate duties. Much of the process responsibility for follow-up, dunning and collection can be assigned to the finance and sales support functions. In combination with strictly standardized payment terms outside the responsibility of the sales force these processes can be very effective in reducing overdue amounts.

With respect to creditors (payables), potentials can be found in the process details of the payment process.

Often supplier payments are made before the due date. This can be the case if for example ERP systems are set up to make payments once a week. Payments are often programmed to be made on the last possible payment run date before the due date in order to avoid late payments. In case of a weekly payment run this would mean that the ERP system set-up would generate 3.5 days of early payments on average.

Alternatively it can be communicated to suppliers that payments will be made on the first payment run after the due date. In case of weekly payment runs this would statistically lead to a Working Capital improvement of 7 days on average compared to the situation prior to the change. To avoid conflicts with suppliers, payment run frequency can also be extended to two

runs a week improving Working Capital by 5.25 on average with the same logic.

Money in storage

The second lever to improve Working Capital is inventory. Inventory seems to be the easiest Working Capital lever to control, as the assumption is that inventory can solely be controlled internally. However, the objective of inventory management is to balance customer service level requirements against inventory holding costs and production changeover cost. Finding the optimum stock levels is a skillful art of forecasting demand and managing against volatilities in the supply chain which includes many external influencers.

Many companies tend to apply a rather simplistic approach with respect to managing stock. A simple but misleading formula is to apply “lead time plus a little surplus” to define the amount of inventory per stock keeping unit (SKU). However, managing same service levels with less stock requires definition of cycle stock and safety stock. The cycle stock required is calculated based on average demand considering lead time or production cycle time and by taking order frequency into consideration. The safety stock needs to cover against future volatility in demand, transportation time or volatility in production. Models with any given level of sophistication can be built to define optimum stock levels. Most ERP systems technically support calculation and determination of optimum stock levels improving decision making in many cases dramatically.

As identified above, the key influencer of stock keeping decisions is based on future demand volatility. This can be tackled by improving transparency of demand, taking historical data into consideration and applying forecasting processes.

Many companies already use statistical methods to analyze demand patterns and trends of historical data. This approach is the first step towards demand based inventory management as it allows recognizing past order behavior and seasonality patterns. Leading practice is the application of a forecast which enables timely adjustments of inventory levels and positions. To avoid an over-complication of business processes and to achieve quick results forecasts should focus the biggest inventory drivers. To maximize the benefits for top inventory items, a sales forecast on SKU - or article level is advisable. More sophisticated methods considering the profitability of an inventory item such as “turn-and-earn” concepts can be applied to identify which items to forecast.

To handle the vast amount of data a forecasting application can not only automate the process but also provide a statistical forecast as a base for manual review. Very often the forecast engine of such applications produces excellent results in recognizing historical patterns

and seasonality. The manual interface provides customer insights and serves as a decision basis for marketing activities, customer promotions and capacity management.

Equipped with such information inventory levels and positions can be determined more accurately and synchronized with the expected demand changes.

A focus on the high volume and high value items can yield significant savings quickly. Nevertheless, overstocking can still occur if demand unexpectedly drops. Therefore, processes to monitor and address the symptoms of inefficient inventory management, high stocks, need to be in place for all inventory items.

In addition to the management of stock levels against defined inventory targets there is often a lack of operational stock management guidelines and principles. Although total stock levels may be in line with overall targets, the inventory age and detailed churn analysis may show a different picture. Often the age analysis of inventory reveals that operational potentials exist in reducing aged stock. Aged stock is often caused by insufficient focus on physical inventory management. This is sometimes related to physical storage principles without application of “first-in-first-out” (fifo). The root cause is sometimes warehouse management practices and warehouse layouts. In case goods are stored against a wall, forklift drivers try to minimize the number of handling maneuvers which leads to a “last-in-first-out” (lifo) principle.

Potentially aged stock becomes dead stock not only with an impact on Working Capital but in this case directly on profit. The remedy is to continuously monitor aged stock lists and to have guidelines about which actions to take. With respect to short term Working Capital improvements, aged stock should be assessed against opportunities to sell it, use it in the production processes, potentially charge it to customers or if no alternatives exist, to devalue and dispose of it. Overall processes need to be established that enable monitoring and enforcement of processes that lead to avoidance of aged stock.

Making sure the money rolls in

According to the principle “you get what you measure” and “you cannot control what you don’t measure” it is essential to have performance metrics, targets and responsibilities to empower the organization. The performance metrics and the related reporting system will help to align inventory levels and positions to the actual demand situation. A performance management framework measuring the key Working Capital parameters in all three Working Capital areas is a pre-requisite for a flexible and adaptive organization which adjusts itself to important business events. Additionally, the performance measurement system needs to be in line with

personal performance targets. An example is a target-conflict between Working Capital and sales targets. It is common that sales managers are expected to reduce Working Capital, but at the same time their personal bonuses are only dependent on sales volumes. In this case initiatives may fail when a sales manager has to trade between either achieving his own bonus or achieving the company targets. Therefore, performance systems need to encompass growth, profit and Working Capital targets to balance scorecard achievements.

Sustainability – Keep the money flowing

It can clearly be seen that companies have retained a Working Capital focus from 2008-2010, trying to maintain the achieved levels from 2009 rather than improving further. In 2011, levels have again increased. This can potentially be explained as Working Capital management was critical for many companies during the crisis. The recent emphasis of many companies has been on strategic growth (M&A), and transformational sales and supply chain projects. Therefore it is understandable that Working Capital has not decreased further. However, it seems that control measures implemented during the crisis help to stabilize Working Capital levels, especially as many prices have increased during the period from 2008-2011 leading to naturally higher Working Capital requirements.

As comparison shows though, the majority of companies have not improved their Working Capital levels during the last year. To improve Working Capital ratios further it will become increasingly important to continue increasing the payables levels while at the same time reducing receivables and inventories. A key to further and step-change reduction will be an improvement of overall supply chain management capabilities. Inventory level can only be reduced so much through operational measures. Further improvements require a sophisticated transformation of supply chain processes which tend to be rather traditional in the pulp and paper sector. Many companies have started to focus on overall supply chain improvements - not just for the sake of reducing Working Capital but for the sake of overall service improvements and capturing competitive advantages.

To improve Working Capital levels sustainably further companies will have to focus even more on improving their internal processes and linking them to external partners. Long term successful and world class Working Capital management cannot be achieved in isolation. A comprehensive supply chain approach is needed in order to improve inventory levels effectively and sustainably. This can be applied in multiple ways. One aspect is to take a holistic view on all relevant processes and interfaces related to inventory management – re-order definitions, replenishment processes, inventory management responsibilities, order processes, material

intake and handling processes. Significant improvement potentials are hidden in the interfaces between all these processes. A different aspect is to synchronize all processes with external parties – standardizing data, information and process flows across supply chain partners need to target management with significantly lower inventories. Increased transparency and shared objectives fosters the reduction of redundancies and duplications across the supply chain for mutual benefits of all involved partners. Another aspect is to expand the definition and span of control within the entire supply chain. This means actively managing the inbound & outbound supply chain. This will support visibility and control of externally held and controlled stock, mode of transport selected, time and condition of deliveries and support management of total supply chain costs.

In summary, it can be seen that there are different levels of sophistication with respect to Working Capital management. Taking an operational approach is only a start. Trying to achieve world class Working Capital levels sustainably will require a holistic view on the drivers of Working Capital. In the pulp and paper industry this will most likely only be achieved through an integrated philosophy of Working Capital management and supply chain excellence.

About StepChange Consulting

StepChange is an industry focused and independent management consulting company with a proven track record in supporting clients to achieve sustainable value. StepChange provides support to top tier organizations in the industry from strategy development to implementation of operational improvements. With an international team of industry experts StepChange can hit the ground running. StepChange provides innovative and yet pragmatic solutions, placing an emphasis on delivering measurable business results.

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