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The ascent of Nordic companies in the global machinery market

Nordic machinery companies are setting new performance benchmarks for growth, margins, and other metrics. What's behind their recent success?

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Many of the world's leading machinery companies and solutions hail from Germany, giving the country a well-deserved reputation for quality and efficiency. Their performance has led many industry experts to claim—understandably—that German companies set the benchmark to which others should aspire. In recent years, however, the German machinery market has been under intense margin pressure. By contrast, our new research shows that Nordic machinery companies have been quietly gaining ground and now outperform German players on several important metrics, including profitability, resilience, and growth.[1]

To identify the forces behind this recent shift, we researched about 50 German and Nordic companies to see where they excelled and struggled. In addition to reviewing company-specific data, we also interviewed executives at some top performers. Some of our information comes from the McKinsey Machinery Benchmark, which contains data from more than 100 major European machinery companies. (For more information on this tool, see sidebar, "McKinsey Machinery Benchmark.")

The Nordic machinery market: A new global force

The Nordic machinery market experienced 5.7 percent annual growth from 2016 through 2019, outpacing the 5.2 percent reported for Germany (Exhibit 1). During the same period, margins for Nordic companies ranged from about 12 percent to

Most well-performing Nordic machinery companies focus on serving industries that are large enough to generate sizeable demand but have a limited number of competitors. They are often market leaders that have earned a reputation as visionaries.

McKinsey Machinery Benchmark

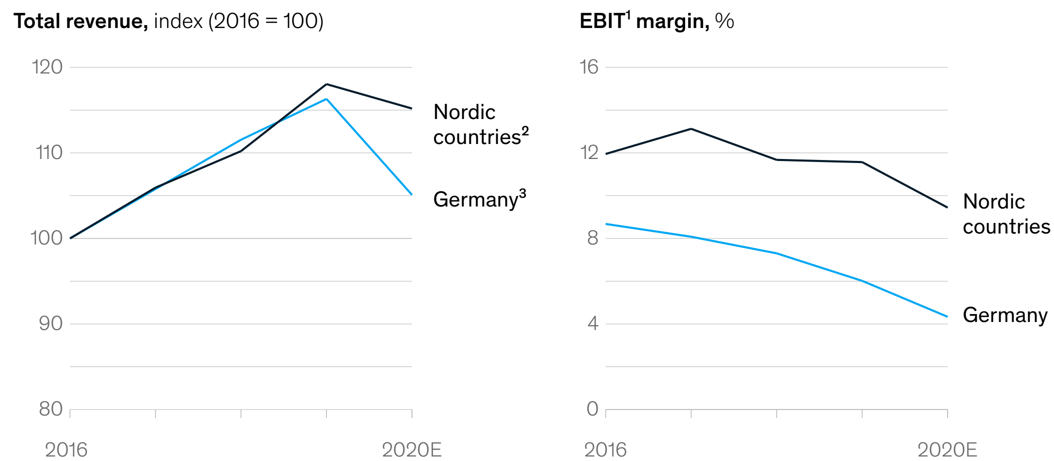
More than 100 European machinery companies are covered in McKinsey's Machinery Benchmark, with data from 2013 to 2020. It is updated annually in the spring and includes all major income-statement and balance-sheet items, selected cash-flow elements, and data points such as head counts and share prices. Instead of relying on blind syndicated information, we use high-quality data that are extracted and double-checked from verified sources such as annual reports.

[1] The Nordic countries include Denmark, Finland, Iceland, Norway, and Sweden.

Exhibit 1

Nordic machinery companies have seen robust financial performance over the past five years, outpacing their German peers.

German and Nordic machinery industry financial performance



[1]Earnings before interest and taxes.
[2]Based on Q1–Q3 2020 results of n = 20 players from each geography.
[3]Based on the 10 companies that have already published 2020 results.
Source: McKinsey Machinery Benchmark

13 percent, compared with about 6 percent to 9 percent for German companies. That pattern continued in 2020, a year that was challenging for every country, when Nordic companies displayed greater resilience and maintained margins of about 9 percent, compared with about 4 percent for German companies.

When we looked more closely at Nordic companies to discover the secret to their success, we found that they outperformed their German counterparts in productivity, salary management, and capital management (Exhibit 2). (These were all measured before the COVID-19 pandemic had an impact.) The German companies were more likely to focus on controlling product costs, and they scored higher in this area.

The best of the best: Standout Nordic companies

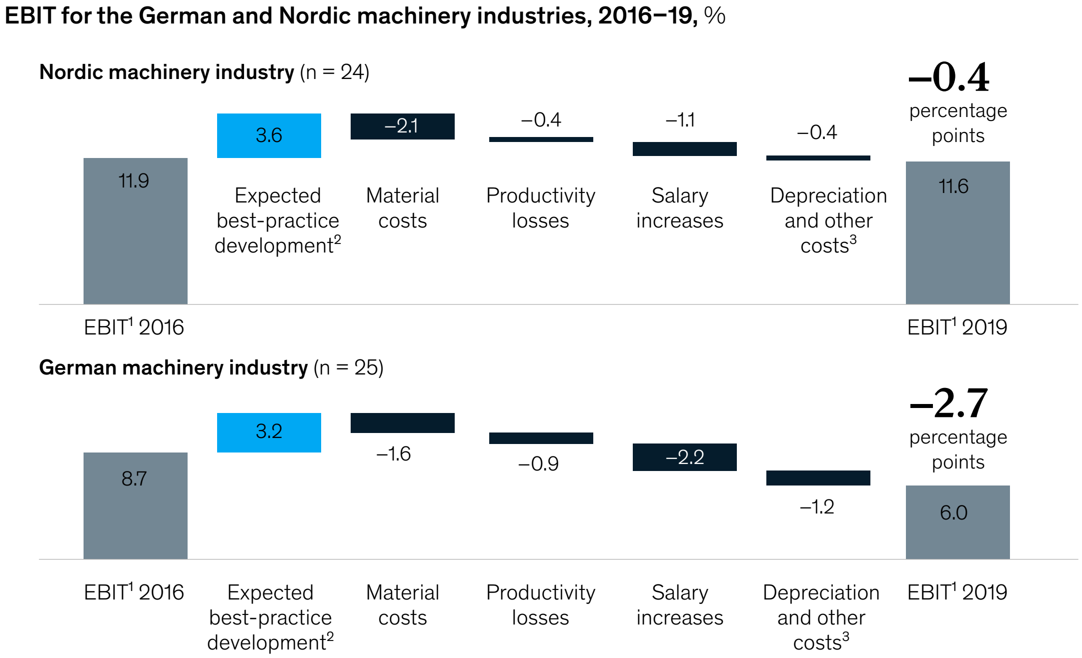
While the Nordic market has performed well overall, there were some distinct variations within individual machinery sectors. Some companies in our sample moved up one or more performance quartiles from 2017 to 2019, while others dropped from the top quartile (Exhibit 3). Our interviews with executives at the leading companies, combined with a thorough performance assessment of each one, revealed six common success factors:

— *A focus on sizeable niche markets experiencing growth.* Most well-performing Nordic machinery companies focus on serving industries that are large enough to generate sizeable demand but have a limited number of competitors. They are often market leaders—among the top three serving their niche—and have earned a reputation as visionaries.

— *A strong performance culture with an operating model that emphasizes delegation.* Almost all Nordic machinery players share a deep-rooted belief that managers at all levels

Exhibit 2

Nordic companies saw fairly stable margins from 2016 through 2019 and outperformed their German counterparts in most areas.



[1]Earnings before interest and taxes.
[2]Expectation modeled along revenue growth; assumptions based on typical best-practice values in the industry.
[3]Increase in provisions and accruals, other selling expenses, other administrative expenses, foreign-exchange losses, rent, etc.
Source: McKinsey Machinery Benchmark

have responsibility for profits and losses. Executives up to three levels below the CEO may have accountability in this area. To ensure success, the leaders create a culture that emphasizes the need for strong profit-and-loss metrics, as well as practices geared to increase the likelihood of success.

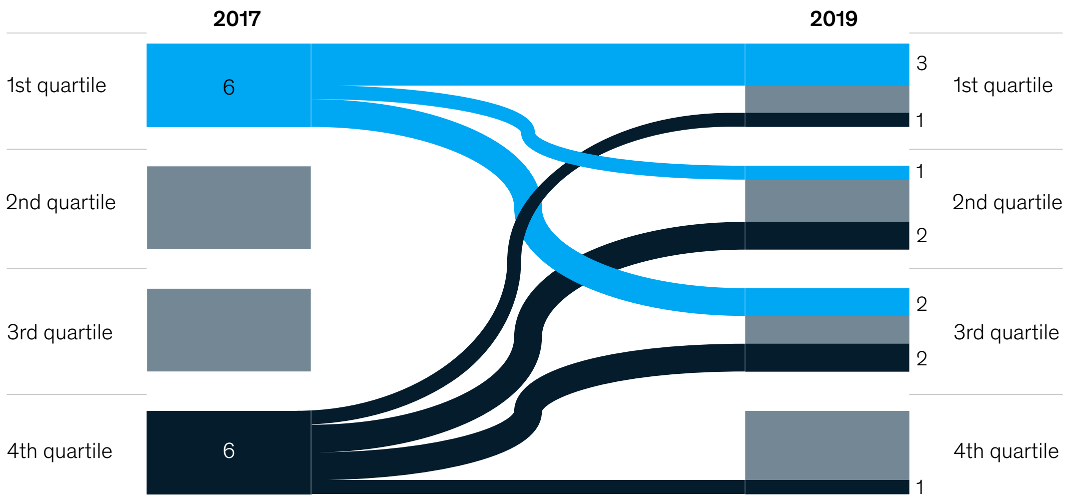
— *Systematic, programmatic M&A activities.* Some top performers are very active in acquiring and divesting companies. Their moves are designed to keep their portfolios relevant, focused, and primed for growth. In recent years, some leading companies have also undertaken M&A to gain a long-term advantage. For instance, many companies have adopted M&A to position themselves to capture growth related to the increased need for sustainability, which has become a major concern within the machinery sector.

— *A robust business model that emphasizes resilience at all times.* Machinery companies that offer strong aftermarket services can achieve stable revenues throughout the product life cycle, making them less vulnerable to variations in demand resulting from rapid changes in customer budgets for capital expenditures. Not surprisingly, our analysis showed that leading Nordic companies have highly sophisticated aftermarket and services businesses that provide them with profitability

Exhibit 3

Only half of 2017's top-performing Nordic machinery companies stayed on top, while five out of six players left the bottom quartile.

Changes in quartile for top and bottom performers,[1] Nordic machinery industry, 2017–19, number (n = 24)



[1]Top/bottom quartile based on average of earnings before interest and taxes (EBIT) margin and revenue growth.
Source: McKinsey Machinery Benchmark

that is two percentage points higher than that of their peers throughout the product life cycle.

— *Strong talent management and rotation practices.* Within the Nordic market, key individuals routinely rotate both across and within companies, allowing them to share best practices and learn from other leaders. Those best-performing companies are often strongly influenced by private-equity owners, which typically provide significant management incentives and closely monitor performance at their portfolio companies.

— *Highly standardized and modular products.* The most successful Nordic players are very successful in creating standard but customizable products. That allows them to capture scale benefits in manufacturing and R&D, as well as scale revenues faster than their peers. Overall, aftermarket- and product-focused companies—those that emphasize standardization and think about connections between different offerings—had double the earnings before interest and taxes (EBIT) margin and higher growth than peer companies that tended to focus on individual projects (Exhibit 4).

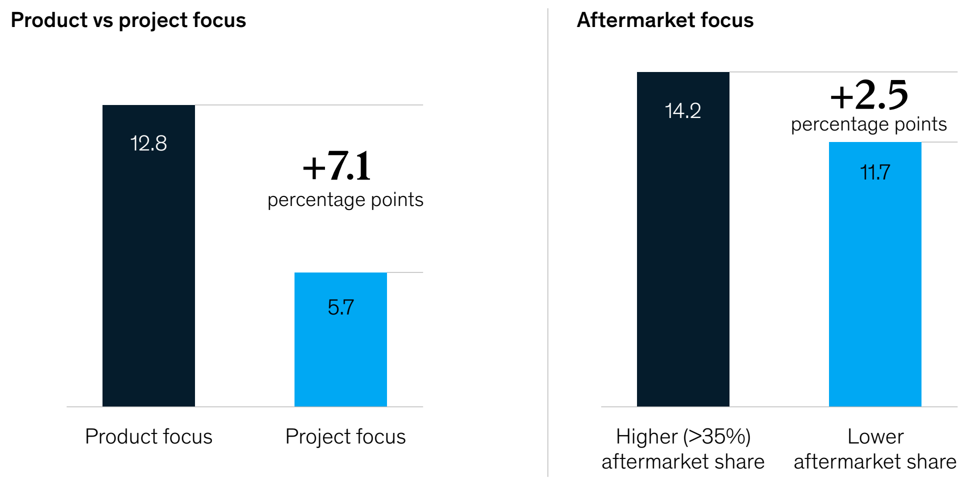
The way forward for machinery companies that want to move up the pack

While COVID-19 vaccines have been developed and signs of hope are emerging, the machinery sector is still dealing with the economic effects of the pandemic and will continue to do so throughout 2021. Prices remain under intense pressure because end customers, including those in the automotive and aerospace industries,

Exhibit 4

Product- and aftermarket-focused machinery companies have up to two times higher margins than their peers.

Average EBIT[1] margin, Nordic machinery industry, 2017–19, % (n = 24)



[1]Earnings before interest and taxes.
Source: McKinsey Machinery Benchmark

are still attempting to reduce capital expenditures. Many machinery companies are also struggling with cost management because salaries are rising faster than productivity, which is stagnating, and some material costs are rising. But even in this challenging environment, machinery companies can improve their performance by applying four levers that were common at leading Nordic players.

Product-platform transformation

Companies often overlook changes in the product portfolio when investigating levers to increase their long-term competitiveness, partly because such undertakings are complex and take longer to generate impact than other measures, such as reducing selling, general, and administrative costs. This oversight may be costly, since companies often gain a competitive advantage by adjusting their product platforms to suit changing circumstances and future trends. To emulate such leaders and obtain the same gains, machinery players can undertake thorough product-platform reviews in which they describe key product segments, identify where they should compete, discuss how they can solve important customer needs, and review their product features. Other topics to address might include the right level of modularization, the use of design-to-value tools to reduce product costs, and strategies for increasing product sustainability.

Excellence in (digital) services

To maintain stable and predictable revenues throughout the business cycle, machinery companies should closely assess their current aftermarket performance and take service excellence to the next level. Important activities will include the following:

— developing a detailed map of their current aftermarket penetration and identifying underpenetrated areas for both their own equipment and that of competitors

— optimizing aftermarket channels and the approach to winning customers

— creating business models that best suit customer needs

— reinforcing the importance of service sales during the equipment-sales process

As companies rethink their aftermarket approach, they should focus on digital solutions, which are expected to become a major driver of both customer satisfaction and productivity. For instance, customers might appreciate solutions that provide greater transparency about a product's condition and performance, as well as those that maximize product reliability and minimize maintenance costs. Similarly, companies can gain by developing digital tools that increase workforce efficiency, such as smart tools that technicians can apply in the field and analytics-enabled solutions that managers can use for work planning, capacity management, and technician dispatching.

Sales and go-to-market transformation

Rather than relying on the direct-sales force, as they have traditionally done, machinery companies should adopt an omnichannel, customer-first approach. Many players still have a limited digital presence, however, and they must accelerate their efforts to catch up with their counterparts in other industries. The best digital channels will allow customers to understand product features and unique selling points. Despite the growth of digital solutions, companies should still enable strong phone and in-person channels, since some customers prefer them.

As they become more customer focused, companies may need to adjust their sales operating model, especially the interplay between the sales force and sales support. In some cases, they may also need to revisit their customer-segmentation and customer-interaction models.

Private-equity-like, full-potential M&A approach

Systematic M&A has consistently been proven to be the best value-creation strategy for companies. While many machinery companies take pride in undertaking numerous deals, they often achieve subpar results. To improve, they would be wise to emulate private-equity companies by thoroughly assessing the value-creation potential during the due diligence phase, rather than being content with high-level estimates. Proper integration planning, which focuses on the company's deal rationale, is also essential. And once a deal closes, machinery players must set clear and reachable ambitions and incentives for management to maintain their momentum and reach their goals.

Before the COVID-19 pandemic hit, Nordic companies were already setting new benchmarks for performance excellence. They have remained resilient during the pandemic and could reach even greater heights once we enter the next normal. For other machinery companies, including those that are now lagging behind in performance, the ascent of Nordic players contains important lessons—and with many machinery players now rethinking their strategies and preparing for a post-COVID-19 recovery, this is an opportune time to take a page from the Nordic playbook.

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