Informita News

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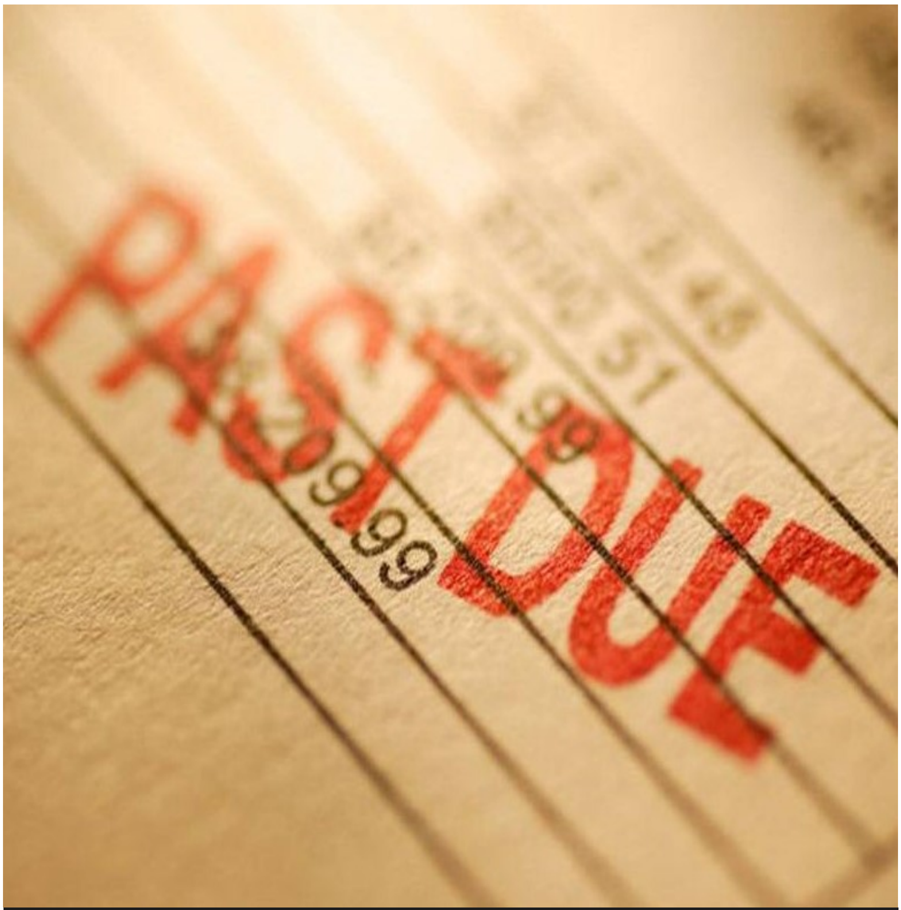
The cheapest is not always a good idea

The mishaps of public procurement

Which is better to strive for: the lowest cost or the best value? In the effort to deal with the “ten-percenters” of the procurement world many countries have adopted public procurement processes where the tender process strongly favours the cheapest bid. And this can have some serious consequences. In the US, the cost of an F35-A has reached $94 million. In the UK there have been numerous failures such as Carillion and Interserve who were routinely underbidding to secure outsource contracts and rail franchise failures where the operators discovered after the contract award that it was impossible to make the cost reductions they had forecast. In an ongoing case in Ireland, the cost of building the National Children’s Hospital has escalated out of control due to a flawed bidding process compounded by a lack of scope definition for the project. This contract even allows generous allowances for “wage inflation” protecting the contractor from almost any downside risk. The extent of the naivety of these public procurement processes can be breath-taking, but it is avoidable. The right procurement professional with an ounce of common sense would have pointed out these issues at an early stage. That doesn’t mean that they wouldn’t have happened, but it would mean that the risk of these failures would be very much decreased. And the prevention of these errors would have been very positive for the public purse. But instead many are forced to watch the pennies very carefully while the big dollars are totally out of control.

In This Issue



Receivables Risk is growing

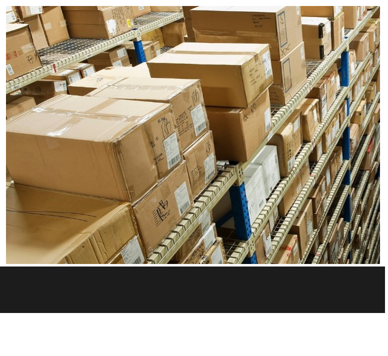
Are you collecting effectively?

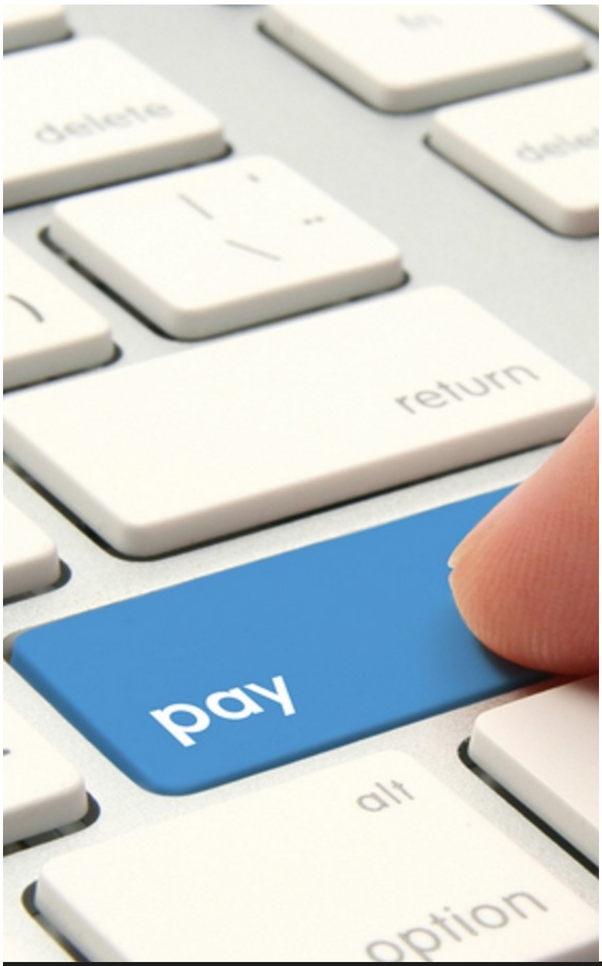
On a global level, the rate of business insolvencies is increasing at an alarming rate. The US and Brazil are the only major exceptions to this trend as Chinese insolvencies increased by 60% in the first three quarters of 2018. In parallel, global trade growth is decelerating as the Chinese economy cools and the US tax driven stimulus passes through the economy. It is always better to forecast the error and prevent it rather than deal with it. So if you are chasing the dragons of revenue growth and increased profitability, it is a time to be careful. Very often the first signs of trouble are not in risk indexes and customer debt ratings, but it will be in payment patterns from your own customers. Businesses that are in trouble often start to pay their bills erratically as they juggle competing demands for their depleting cash reserves. The best person to spot the signs will be a collector who operates effectively with that customer. That will be a person who is in constant contact, has a positive and informative relationship with the customer organisation and who will be trained to see the signs of trouble. Then mitigating actions can be taken. Credit limits can be reduced in a gradual fashion. Payment plans can be initiated. Payment terms may be reduced. Payment methods can be changed to reduce the risk of a payment failure while in transit. Specific credit insurance can be arranged. There may even be a decision to exit the commercial relationship entirely. Ultimately, protecting your business from this credit risk will be a competitive advantage as other companies in your sector fall into the hole of inaction and bad debt.

Inventory

The Quest Continues

There are still many companies who still fail to understand the relationship between the stock they are holding and real customer requirements. The result of these errors can be quantified as additional inventory holdings and stock written off as obsolete. The less quantifiable part of the problem can be the value of lost sales. So if the problem is so common, why don't more companies take action to optimise their inventory levels? The main answer in my experience is that everyone would like to reduce inventories but they don't know how and the safe route is to keep more stock so sales are not lost. The problem with this solution is that it doesn't work. One classic giveaway is where there is one stocking policy for all products. This ignores that facts that customer demand for all products will be different. An example was a client that was running out of warehouse space as sales were growing. They only had 20 products on sale but had a policy of keeping 2 weeks stock of all products. The result was that total inventory was growing in line with sales growth but the quantity of stock of slow moving items was growing even faster. The solution was to change the stock coverage policy so that it could be varied by product. This is only one example and there can be many different solutions. Maybe you should change the batch size of production. Maybe you should vary the lead time agreed with the customer. Maybe you should make to order and not to stock. The start point is to analyse the issues in order to take the right action.





Same-day ACH/SEPA

In 2018, same day ACH was the fastest growing payment method in the US, rising 137% in volume terms on the previous year. That amounted to $160 billion of payments across the 50 states. SEPA now accounts for 98.5% of Eurozone payment transactions and SEPA instant payment has been available since November 2017. And why are companies and individuals moving to these payment methods? Firstly, it is cheaper than the alternatives. Cheques are increasingly seen as being expensive. They also require an array of paraphernalia such as postage, specialised MICR printing and the like. Secondly, ACH and SEPA are more secure. It is more difficult for the payment to end up in the wrong hands and mistakes are 100% traceable. So if you are not already part of this trend, our advice is to embrace it.

Djibouti: Trade and Bases

Lying at a key juncture of international trade, the Port of Djibouti is well positioned to be a pit stop for goods in many directions. But it also has some accidental political advantages. While Yemen continues its civil war, Djibouti has been able to take full advantage of its geographical position at the mouth to the Red Sea and the Suez Canal. Also as its neighbour Ethiopia has squabbled with Eritrea, Djibouti has become the main channel for imports and exports in and out of that country. But the country is wedged between various centres of political instability. So while it remains a point of economic opportunity it is also ranked poorly as an investment destination. The country also is host to several military bases as various countries try to influence control over the sea trade routes in the Indian Ocean. These bases include the French, the Americans, the Italians, the Chinese and the Japanese. The Djibouti Franc is pegged to the US Dollar with economic growth being stable in recent years and there are low levels of inflation. So while not a rich country, Djibouti is still a land of opportunity.

Brexit: When will it be over?

The British Prime Minister stated 108 times over the last two and a half years that the UK was leaving the EU on 29 March 2019. But they are still in and we are still not sure what the final outcome will be. This has been equated to someone who arrives at your house party demanding to be allowed to leave only to find hours later that they are still there. From a political perspective, this has become utterly farcical but the business perspective is far darker. Foreign investment in the UK economy has plummeted. Numerous companies, particularly in the car industry, have made the decision to leave Britain. Companies who thought they had a Brexit plan have seen millions wasted as the political logjam continues. Stockpiling is continuing in the already full British warehouses and there does not seem to be any end in sight. In the absence of a path business will adapt, but the UK will be left behind. It is already estimated that the UK economy is 2.5% smaller than if Brexit had never been endorsed. So the damage is already happening. It's just a case of how much more damage will happen.

Deal or No Deal

China/US Trade

In the TV show, you need to guess what is inside the box to claim the prize. We still don't know what the outcome will be from the talks between the Chinese and the Americans but we do know a few things. We know that the Americans want the Chinese to open there economy to foreign competition and to change its laws on intellectual property. This ultimate will be the price China will need to pay for continued access to its largest export market. In turn, China needs to continue the path of fast-paced growth of the last 40 years or the regime risks domestic unpopularity. Logically that would suggest there is a deal to be done. But there is no deal done as the talks linger on and the language used by both sides continues to deteriorate. Is this because Donald Trump can't stop insulting everyone on the Chinese side or is it because Chinese economic growth has been better than expected lessening the need for concessions. It's hard to tell unless you are one of the people directly engaged in the dialogue, but the rest of the world is seeing the evidence of the instability created by the bad economic behaviour on both sides. In certain business sectors commerce has been hit hard. Agriculture and steel have been hit very hard. The Americans are working hard to delay the innovation of 5G since most of the technologies required will come from China. Stock markets are going up and down like yo-yo's at every positive or negative sign coming from the talks. At the end of the day, the world needs both parties to do a deal. Time to look inside that box.

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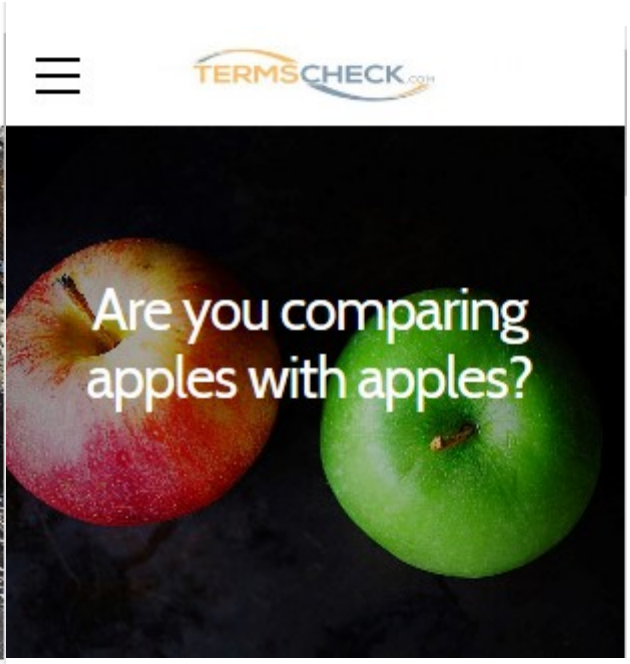

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