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Going Green

Or is it just trying to reduce cost?

In 2022, the number of companies that are getting serious about green energy solutions has massively increased. Is this because they were all in Glasgow for COP26 with the scientists, the politicians and the environmentalists who were predicting climate doom. For most, the answer was no. It has become much simpler than that and there are two key reasons. The first is the rise in energy prices driven by Covid and the situation in Ukraine. It seems unlikely that oil and gas prices will drop back to 2019 levels any time soon. In particular, companies that are high users of energy are looking for cheaper sources of energy. The good news is that the cost of installing solar panels, wind turbines and heat pumps has fallen dramatically in recent years. As fuel costs have gone upwards, the equilibrium point between oil and gas and greener sources of energy has changed just as dramatically. One big advantage of green energy is that the cost of production is linked to known levels of capital investment and maintenance cost and not to geopolitical risk. This brings us to the second driver. Even if you can afford the increased prices of oil and gas, what is the likelihood that there will be shortages of oil and gas next winter? Many countries in central Europe are now planning for energy rationing given the risk that Russia may stop natural gas supplies. If that were to happen, many businesses would be forced to decrease capacity as electricity is rationed to industrial customers in order to preserve gas supplies for domestic heating. The biggest problem now for those engaging in green energy projects is that the cost of implementation is rising due to scarcities that started during Covid and are now being compounded by large increases in demand. So the early adopters should have a huge advantage unless their immediate supply chain is impacted by companies that were not so farsighted. In the short run, this will probably mean a bumpy road for many companies but in the longer term should mean cheaper green energy that mitigates against supply chain risk.

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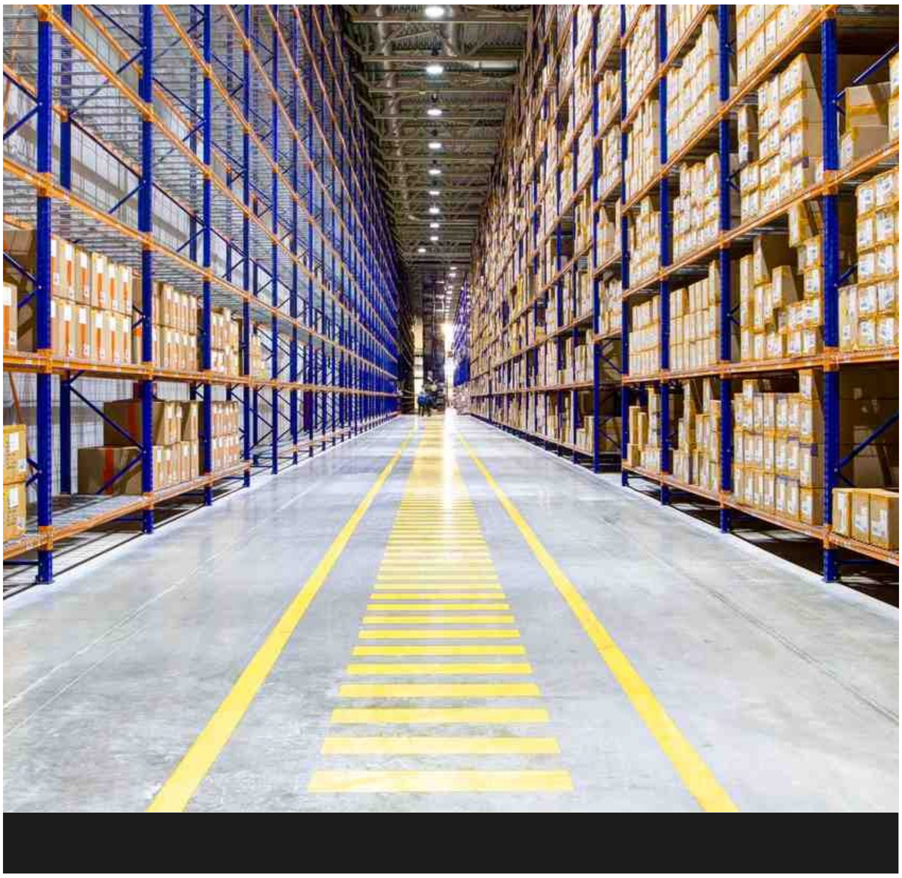

Time to Increase Inventory?

In a time of inflation and supply chain disruptions, there will be many who will be tempted to stockpile inventories to avoid higher prices and stock rationing from suppliers. But there are many risks with taking such an approach. The first is that you may be draining your company's cash reserves in an economic climate where money supply is tightening due to central banks raising interest rates, increased liquidity holding requirements of banks and a general retrenchment from risk by commercial banks trying to avoid future bad debts. The second is the risk of "ghost demand". Sales projections tend to be optimistic about the future. What if this projection of increased demand is not realised? Then you may be left with a lot of inventory that is unwanted by the market leading to significant losses because of stock write-offs or deep discounting to clear warehouses. If you intend to take the risk of deliberately increasing inventories in this economic environment be sure that there is enough cash to cover any potential loss. It should be remembered that companies don't fail because of bad ideas or a missing a revenue target. They fail because they run out of cash. Enron, Carillion, Parmalat and many others went to the wall ultimately because they could not pay their bills and took financial risks that turned out to be extremely reckless. That is not a list that anyone wants to join. For those who do not have endless reserves of cash, it is time to knuckle down and do the boring stable things well and sharpen up on risk assessments. The biggest challenge is trying to forecast what might happen next. Banks call this stress testing, but companies should do this too. Model what would happen to your cash flows if something unexpected was to change. And model several scenarios, however unlikely they might seem at this point. Then you have a much better chance of surviving and prospering in our crazy world.

Invoice Automation

Opportunity Knocks

It's not that long ago that solutions to intelligently scan supplier invoices were prohibitively expensive to all but the largest corporations. By intelligently scan, we mean that an invoice arrives, is read by software and automatically posts to the purchase ledger without any need for human intervention. Thankfully, there are now many solutions out there that are in a price range that can even work for small and mid-sized companies that will take away the workload that traditionally happened in the accounts payable department. But you still hear of disaster stories where invoice processing was heavily disrupted by an invoice automation project. The key to success is good project management and accounts payable resourcing. It is rare that the software doesn't work but work is required with suppliers to improve invoice quality and maintaining accounts payable resource while the software learns the layout of your invoices.

Bundling

An old term that is still relevant

In procurement, bundling is a term that means consolidating spend in with a smaller group of suppliers. The logic is if one or two suppliers could supply the same things that 20 suppliers are supplying now that it will create an economy of scale for the new supply arrangement resulting in lower prices and possibly an improved level of service and increased process efficiency. Bundling can often have the greatest cost impact with indirect suppliers. Classic examples where this regularly happens would be in categories such as cleaning, car hire, travel and expense, car leasing, logistics and spare parts. The key to success is data. You will need to understand everything that is being purchased, particularly in the long tail of lower value spend. Without this data, you will be clueless as to any potential.

Rwanda: The price of peace?

Many will remember Rwanda for the 1994 genocide that happened over 100 brutal and horrific days. But the country has moved on from that tragedy. Rwanda has made a trade between political plurality and peace. Although technically a democracy, it is fact a one-party state where the opposition can be suppressed if any of their views are deemed discriminatory in any way toward a particular subset of society. The only upside of this fact is that Rwanda has remained peaceful since 1994. And in any country peace will allow trade to flourish. Rwanda remains a poor country with few natural resources and with a huge section of the population engaged in subsistence agriculture. Rwanda exports cassiterite, wolframite, gold, and coltan but the mining industry is small by international standards. Tourism has been a great success in recent years as foreigners seek to see the rare mountain gorillas in the Volcano National Park. And the government has tried to be open in trade and economics with its immediate neighbours. The economic scorecard is very much “could do better”.

Sanctions

What works?

The recent sanctions that have been imposed on Russia are not the first or the most severe economic sanctions to be imposed on a country. Arguably the sanctions that are still in place with Iran are far more stifling and that largely has to do with the West’s need for oil, gas, nickel and other metals. Iran has had various levels of sanctions imposed since 1979 and while its economy is a mess, the sanctions have not managed to topple the regime. When sanctions work, it is because the general population gets the message that they need to change their government and have the ability to do so. Or that their government gives in to the demands of those imposing the sanctions before the regime is removed. The only time that international sanctions could be argued to have worked was in South Africa. The economic sanctions were quite mild in comparison to what is going on with Russia, but the sport and cultural sanctions were highly effective. South Africans wanted to compete in international sport and see the latest artists perform in their country. And that was the end of Apartheid.

Covenant Breaches

What can be done?

A major reason why banking covenants are breached is due the impact of trading difficulties on the structure of the balance sheet. An example would be if your overdraft is secured against the value of accounts receivable and the level of revenue drops. Another might be that working capital is growing due to inflation. If your company is at the stage where you are forecasting that you will be in breach of your banking covenants there are generally two courses of action open to you. The easiest is to go cap in hand to your banking partners, explain the situation and hope for mercy. Banks are not in the habit of withdrawing facilities from troubled companies since they want a long term relationship and it may be that your company will trade its way out of a temporary difficulty. But there must be a plan of action in place before you speak to your banks. That brings us to the second possible course of action—reduce working capital. Understanding the potential to reduce working capital and the actions required to release that potential may be essential in convincing your banks to treat you kindly. Some may want to depend on the perceived strength of their lender relationships, but banks are all about liquidity and risk and not friendships.

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