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Trade Wars

How will the supply chain be disrupted

The Smoot-Hawley Tariff Act of 1930 had the effect of halving United States imports and exports during the Depression. Tariffs were imposed on 20,000 items and the whole scheme succeeded in choking off trade, increasing prices and deepening the Depression of the 1930's. Today we seem to be repeating the same mistakes. Tariffs have been imposed on Canadian aluminium and steel and we have a trade war with China. US farmers are already feeling the pinch and even Harley-Davidson, an icon of American manufacturing, are taking production out of the United States to avoid tariffs. But what effect should companies expect from this situation. We already know that a shipment of soya beans from the US to the Chinese port of Dalian on the merchant ship Peak Pegasus arrived hours after the tariffs were implemented on the Chinese side as a retaliatory measure. The vessel is has been stuck offshore for weeks and when it does get to offload a 25% tariff will need to be paid. This might feel like an extreme, but it is not that much of an extreme. Companies will try to stockpile goods before the imposition of tariffs (like the Chinese case above) or will need to re-source supply from a different country (like in the UK because of Brexit). These disruptions will cause increases in inventory levels, imbalances in demand due the stockpiling efforts and ultimately the cost of shipment for the goods affected will increase. There has never been a single case in history where a trade war has resulted in freer trade or decreased prices of goods. This type of trade balancing has not been attempted since the days of the Soviet Union and Comecon and it thoroughly failed. The best way known to promote wealth at all levels of society is free trade. Then people from all over the world will work out the right balance through free and fair transactions.

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Working Capital Funding

How Amazon is changing the game

There is no doubt that Amazon are an extremely innovative company. From an online book company they have now expanded their product range to almost everything that can be bought in a shop, manufacture electronics and sell music and television on demand. What more can they do? Lots is the answer. Amazon have had various schemes in different countries where delivery drivers can lease vans through Amazon and then pay for the lease through deductions from their delivery fees. This has meant that a lot more people can afford to be delivery drivers and it is more likely that they will have a delivery vehicle that is reliable in service. All this helps Amazon, the driver and the customer. The latest news is that Amazon intends to offer working capital loans to their retailers. The idea is that many smaller retailers cannot hold enough stock to maximise their sales on Amazon. If they hold more stock then there is the capacity to sell more products through the platform. It works for Amazon too. They have so much cash that they just don't know what to do with it. By offering working capital loans they will strengthen their own supply chain and make more money off their surplus cash than other wise would be possible. But is all this good for the retailer involved. There have been many complaints from delivery drivers that they are totally controlled by Amazon. Could this also happen to these small retailers who often reply on Amazon's distribution power for core sales? The answer is: probably. But in a world where the internet is taking over retailing and small companies continue to struggle to get funding from banks at a reasonable rate then this trend will continue. In fact, Amazon would not have this opportunity if it were not for the fact that the banking systems of almost all developed countries do not work in favour of small and start up businesses. So if all this contributes to growth it will be a good thing. But will Amazon require regulation like a bank?

Is the cheapest always the best?

Procurement in many countries means an avenue for fraud. In the world of public procurement much has been made of having transparent tender processes in order to achieve the best price. But does the best price on its own deliver the best value? There are many instances where it has shown not to be true. The very worst case in recent times has been the Grenfell Tower disaster. The lack of clear specifications and the pressure to cut costs resulted in cladding on a building that proved fatal. Better contracting processes and more detailed specifications and testing of the cladding product would have highlighted the problem during the tender process and no-one would have lost their lives. One client many years ago tendered for 200 stationery products. The tender was won by the company offering the best prices. Expenditure on stationery grew by 27% in the following year. It turned out that not only could people buy the 200 specified products but also everything from the entire catalogue. In service contracts it is very easy to go for the cheapest price but this could put delivery at risk. This is a common problem in outsourcing contracts where the winning bidder enters into a loss making contract and later they try to resign the contract. So the lesson is that it is better to understand value than cost.

Pay Immediately?

The landscape is about to change

There have been many pieces of legislation, particularly in Europe, over the last 20 years that have done very little to prevent late payment or to short payment terms for smaller suppliers. Supply Chain Finance was supposed to be the solution but all too often we have found that the main beneficiaries of supply chain financing have been large corporates leveraging off the credit ratings of even larger corporates. For smaller suppliers, supply chain finance has had pretty much no effect since it is rare that they are even approached to be part of such a scheme. One company trying to change this dynamic is a UK based outfit called Previse. In their model, suppliers who regularly present clean invoices that can be processed straight through can be paid immediately. They are focusing on organisations with very large amounts of data and on smaller suppliers that normally would be unattractive to the supply chain finance providers. And in their process the regular invoice process of the buying organisation does not need to change. They have already been identified as one Europe's hottest Fintech companies. All this suggests that something significant might be about to happen to the culture of late payment.

Jordan: In the middle

Most people will have heard of Jordan as the country sandwiched between Syria, Israel, Saudi Arabia and Iraq where we hear lots of stories about thousands of refugees from the various conflicts in the region. But there is a lot more to Jordan. Although it is one of the smaller economies in the region, the country is attractive to foreign investors largely based upon a skilled workforce considered to be the best educated in the Arab world. The two big economic issues in the country are unemployment and poverty. While nowhere near as bad as other Arab countries these issues still present significant problems. Also the various conflicts in the region seem to always impact Jordan even though it is not directly involved. The most recent problem being the massive influx of refugees from Syria's civil war. Jordan has a diversified economy where nearly a third of GDP is accounted for by trade and finance. Other major sectors are tourism, communications, construction, mining and manufacturing with a strong pharmaceuticals industry. The fastest growing sector of the economy is science and technology. Jordan also has a free trade agreement with the United States and enjoys advanced status with the European Union. With a fixed exchange rate to the US Dollar, investors are also protected from currency devaluation. All up a good place to business but you always have to be mindful of the region's instabilities.

All fizzed out?

Co2 Shortage

The first headlines came out in June to warn that Europe might run out of beer. It all seemed funny at first but only once people started to understand all the processes that Co2 is involved with did the seriousness of the situation sink in. Animals could not be slaughtered, soda pop was to be rationed, crumpets could not be made, plastic bottles could not be filled. Then we found out there were plans to shorten the shelf live of all sorts of fresh produce since Co2 is used in their packaging processes. Why did all this happen? The answer turned out to be ammonia fertiliser. Co2 is a by-product of the process to make ammonia fertiliser and since farmers don't use fertiliser in the summer, most fertiliser plants shut down around this time for annual maintenance. The unprecedented European heatwave and the World Cup increased consumption of fizzy products and depleted stocks. The plants were in no hurry to re-open quickly since their input costs have increased with natural gas prices and they have not been able to pass these costs on. Again proving that we live in a very connected world.

Capex Deposits

A risky practice

Recently a client in Germany that told us that it was standard practice to pay 30% deposits to their engineering capex suppliers. This was a real shock since this practice had largely been stamped out by large corporates across the world more than 20 years ago. It is worth examining the reasons why this practice was frowned upon all those years ago. Firstly there was the cash flow point. Paying this kind of deposit is effectively the corporate acting as a bank to the supplier. Surely the supplier is capable of financing their own working capital. The second issue is financial risk. If the supplier is incapable of funding their own work it would suggest that they are under-capitalised as a business. This means that there must be a serious risk that the capex item is not completed due to a lack of funding from the supplier and, if you paid a substantial deposit, you have now increased your exposure to that risk. There may be certain situations where paying a deposit is justified. It may be that the price was so low compared to competitors that the risk was reasonable. It may be that what the supplier does is truly unique. But in the vast majority of cases payment of deposits on capex is not a standard process anywhere and should be strongly discouraged.

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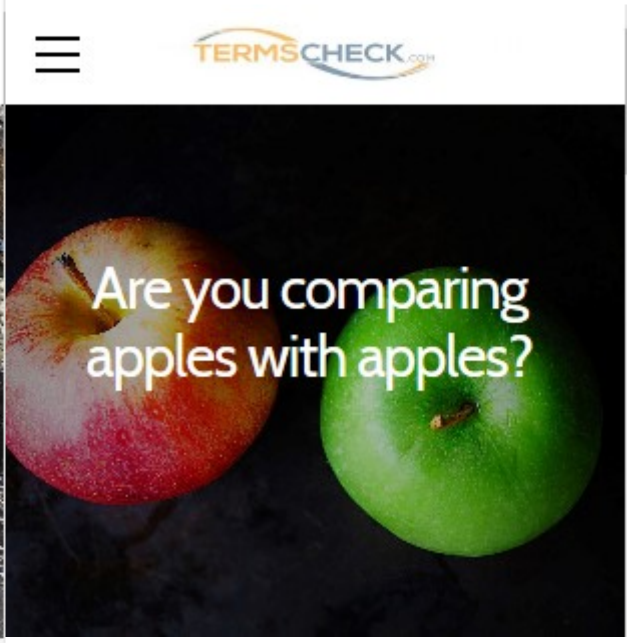

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