What Happened to Profit?

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Cheap money, cheap services, cheap products. Combine this with inflated stocks and inflated Assets and market fragility is about to get very real. Debt is crippling everything from the economy, investments and business operations. Not since the tech bubble has there been so many businesses fuelled on speculative funds (let's not even suggest this is true investing) hoping to drive top line revenue in an attempt to cash in on the big IPO. These unicorn's include businesses such as Uber, Lyft and WeWork. The value for these grossly inflated businesses defies logic and many are now coming crashing down to the ground. Some have lost 30% - 40% since floating and others have literally withdrawn an IPO altogether and are facing bankruptcy.

The big issue with these businesses is not just the losses they present but the damage they do to the wider markets. Low interest rates driven by the Reserve feed bubbles that eventually pop and compress inflation. Anything that is cheap gives rise to easy come easy go behaviours that do great damage to the economy. These debt funded businesses have a cost to serve that is not factored into the customer price point. Supported by an endless supply of investor revenue (debt), top line sales and market share growth is the priority, and to achieve this, customers are bought via transactional losses. Essentially, these businesses are selling $2 for $1. This creates huge stresses on competitors who are running genuine businesses and selling $2 for $3 or attempting to compete directly by cutting costs via employers, operations or even borrowing debt themselves to keep trading. This has a negative impact on the economy, creating deflation not inflation and destroying many companies - in turn reducing customer choice. The chain of losses linked to these unicorns extends to the workforce and suppliers who will be both be out of work and out of pocket.

This dynamic is not just linked to start ups. Government involvement via artificially compressed interest rates also allows businesses to trade cheaply (at a loss) in an attempt to muscle in on new market sectors or geographies, putting pressure on businesses that are attempting to trade without leverage or who have to make a genuine profit.

Fiscal concepts like reverse factoring via businesses like Greensill Capital compound the issues. Smaller businesses who are already compressing margin to meet artificially deflated price points then have to reduce margin further to get paid. Another issue with reverse factoring is its ability to hide liquidity risks as working capital is artificially elevated.

A well run business creates value to its core customers by providing a good or service that is in demand. Value is created to the employers who have a job, the suppliers down-stream who get paid, the customers who have choice via competing offerings and the shareholders/owner who return a profit. Unicorn start-ups have one customer and it is not the end user but the investors who only care about inflating the assets value so they can cash in at the IPO. The long term viability of the company seems to not be so important.

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It seems the word profit is somehow negative from a buyers point of view and is no longer necessary when investing. With companies added investment in procurement, operations are constantly attempting to standardise the market place and compress supplier price points under the guise of value and partnering. Is this quest for compressed pricing and increased value destroying capitalism? Is this pressure on forever cheaper engagements the reason why business starts ups are attempting to sell $2 for $1 just to get on the radar?

Attempting to standardise engagement across competing businesses defies the very reason why a business exists, which is to make profit and do so by creating different value propositions. Standardised pricing & terms combined with nonexclusive engagement or the threat of disengagement are a poor carrot to incentivise improved performance and innovation. In fact, standardisation seems to show complete disregard for the differences between companies. Outside of B2B procurement, as consumers, we truly understand the difference between products and services. We know what we like. We are prepared to acknowledge that quality, service levels, taste, feel etc are important and come at varying prices. Our choices dictate how businesses compete and this competition without regulation dictates the market place. We could not buy anything at a personal level dictating a standardised set of engagement terms. We have to make a choice and we cannot have it all.

Value is subjective and is relative to a position held. Profit or loss is absolute and without dispute. In the unicorn enterprises value was significant to the venture capitalist who cashes in at IPO, but where is the value to individual investors who lose money when the share price plummets, or the suppliers who did not get paid or the staff who are let go? The chain of destruction has many tentacles.

Profit is a good thing. If a business is profitable and holds its pricing amongst its competitors, it likely means the business is doing things correctly and not cutting corners within its operations. Good things such as giving its employees annual payment reviews, improving FTE retention and in turn capability, re-investing to innovate or factoring in a higher cost to serve due to not cutting corners. Even if we factor in scale and efficiency, every business has a break-even point per unit that has to be understood and margin has to be added.

Whether you are investing in a stock or a supplier, a business's ability to turn $1 into $2 should be viewed as a good thing. Profit creates a sustainable business with true value being the returns to investors, employee's, suppliers and adding to the health of the wider economy.

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