

Energy Efficiency Improves the Bottom Line

by Alan Makim

Whether you are a business owner or advisor, the business community is constantly looking at ways to optimise the performance of their enterprise. This can be achieved in a variety of ways; through small tweaks and new tactical initiatives; large changes in the strategic direction of the company; launching new products or services; or potentially entering new markets, which is an area that has come into greater focus with the potential threats of Brexit.

These types of strategic changes in a business can bring significant rewards and, in some cases may be necessary to ensure that the business can sustain itself into the future. But they are not without risk and it is incumbent on the business owner along with their advisors to weigh up that opportunity and ensure that it is the right investment for the business in terms of both human and capital resources. When making investment choices most businesses seem to opt for a top-line growth strategy rather than a cost saving strategy, when in many cases the latter has the potential to deliver a better return.

The general costs of doing business in Ireland are increasing. And while the current low unemployment level is very positive for the country, it pushes up the cost of attracting and retaining the right talent for a company. The rising cost of insurance has been well publicised, and depending on the industry, has risen to the point that it has threatened to make some businesses unviable. In many cases the costs associated with doing business are outside of our control, imposed upon the business owner with few alternatives, however that is not the case when it comes to energy consumption. In the vast majority of businesses there is potential to reduce energy costs and there are many options that are low or even no cost.

There are generally two avenues to explore that do not require any significant investment. The first is instigating behavioural change in your workplace and creating a culture of energy awareness in the work

environment. The Sustainable Energy Authority of Ireland estimate that businesses can reduce their energy consumption by 10% through the adoption of behavioural changes by their staff and encouraging energy conscious actions throughout the workplace. The actions can be very simple such as ensuring that computers or equipment are properly powered off in the evenings, reducing the volume of printing in offices and importantly don't have heating and cooling systems in conflict with each other.

The second action that can be taken to reduce the cost associated with energy is to reassess your energy procurement. While you may think tendering your energy is something for large energy users, savings can be made by businesses of all sizes. The obvious first step is to look at the unit cost of energy, or what you are paying per kilowatt hour ("kWh") of energy consumed. Then you can challenge whether it is possible to negotiate a better unit rate with your current supplier or see if there is value in moving to a new supplier.

The kWh rate you pay can vary, particularly by the size of company and volume of power it consumes, but a business owner can get an idea of rates by talking to their peers and finding out what businesses similar to them are paying. Alternatively, you can go directly to the source and shop around the various utility companies to find a better rate.

Many people focus exclusively on the unit cost, but it is equally important to understand the charges on your

bill, some of which are standard in nature. These include the PSO levy or the standing charge that is applicable to all, but others can vary business by business, such as the Maximum Import Capacity charge or "MIC".

The MIC is the upper limit for power consumption by your business and is agreed with ESB networks. The MIC level should be set marginally above your business's peak capacity, i.e. your highest point of energy consumption during the year, this way you are getting close to your MIC limit without breaching it. This is important because breaching your MIC limit can cause you to incur what is called an "excess capacity charge" and to be far below your MIC limit on a consistent basis means you probably pay for capacity that will never be required.

After tackling the low hanging fruit of low or no cost measures, the next step to making more substantial savings is to consider capital investment in energy efficiency. The reasons for investing in energy efficiency are broad and range from purely focusing on the environmental sustainability in an altruistic way to trying to improve the sustainability credentials of your business in a bid to enhance performance.

The performance of a business in relation to environmental sustainability can have a significant impact on its reputation, for better or for worse. Consumer businesses that have a "greener" image will often have greater appeal to the general public than those who don't, and conversely those that are perceived to have a



negative environmental impact as a result of their core operations may be viewed poorly.

The impact of your sustainable credentials doesn't stop with your customers' opinions, other stakeholders are looking at your business through this lens too. Your customers, particularly if you are a small business selling into much larger firms, may have sustainability agendas of their own and will extend the parameters of their sustainability strategy to include their supply chain. This can lead to a preference for suppliers that can demonstrate a greater level of awareness and activity in this area and in some instances this may stretch to compliance with certain international standards on energy or environmental management. The other major stakeholder group that evaluates your sustainability is your employee or prospective employees, with millennials in particular viewing environmental and socially responsible companies as more desirable destinations.

Finally, and for some, potentially the most important reason to invest in

energy efficiency, is the economic benefit to the business. The right choice of energy efficiency project should always reap a financial return and now, with the improvement in efficient technology those returns are materialising quicker and quicker. For example, payback periods on simple LED lighting retrofits are averaging between two to two and a half years with some as short as one year.

It's after the payback period that the end user enjoys a financial benefit lasting many years longer through reduced operational expenditure. While LED lighting is one of the technologies often highlighted as having a relatively short payback, there are many other technologies with similar payback periods, such as heat pumps or high efficiency condensing boilers that SMEs should be evaluating depending on their energy usage and activity. Whatever equipment a business utilises, if it is at all dated, there is likely to be a more efficient version of it on the market that may make the capex investment worthwhile when the opex returns are material.

The financial savings are not purely in the form of energy bill reduction, there are other benefits associated with this type of investment with a range of grants and financial supports available to stimulate investment. The Energy Efficiency Obligation Scheme is an excellent example of this. This scheme, which is less formally known as "energy credits", is an obligation imposed on the larger energy suppliers to generate energy savings from business and residential projects.

This has led many energy suppliers to offer a level of support to companies considering energy efficiency investment as an extra incentive, with this incentive often being a level of cash support per kilowatt hour saved. These cash incentives get paid to the end user very soon after installation of the project and with some energy solution providers they may even discount this value from the upfront cost.

An SME business owner should definitely ask their technology supplier or energy supplier about energy credits if considering an investment. The often-forgotten

To deliver that same level of EBITDA uplift through sales growth would require approximately an increase in turnover of €500k, which in a mature sector such as retail revenue uplifts of 17% is highly unlikely without very significant capital investment far in excess of the €25k energy efficiency project.

Despite the positive investment case for energy efficiency there still seems to be less investment in this area than expected. There is still a mind-set to look at top line growth as the first option to improve financial performance, but often management of overheads can have the fastest impact on your bottom line.

With many costs in business fixed or outside of the business owners control, investment in energy efficiency should be encouraged as standalone projects but also as business as usual. In addition to stimulating best practices amongst employees, any investment decision on equipment should consider the energy impact and assess the total lifecycle cost of an asset rather than the upfront cost and seek bank support if required. The savings generated through energy efficiency not only improves the performance and competitiveness of a business it also increases the cash available for future investment.

Convenience Store Example

	Pre-Energy Investment		Post Energy Investment	
Turnover	€3,000,000.00		€3,000,000.00	
Gross Margin	€870,000.00	29.0%	€870,000.00	29.0%
Less		0.0%		0.0%
Wages	€420,000.00	14.0%	€420,000.00	14.0%
Rent	€135,000.00	4.5%	€135,000.00	4.5%
Light & Heat (Energy)	€45,000.00	1.5%	€32,500.00	1.1%
Other Overheads	€195,000.00	6.5%	€195,000.00	6.5%
EBITDA	€75,000.00	2.5%	€87,500.00	2.9%

savings made from energy efficiency are in the areas of repairs and maintenance, where installation of new assets can reduce direct cost of repairs and indirect costs such as operational downtime and labour required to maintain or fix equipment. Accelerated Capital Allowances are also available for acquisition of assets that are deemed to energy efficient, improving the cash position of business by writing off 100% of the purchase value of the asset against their taxable profits in the year of purchase.

An energy efficiency project can have a material impact on a company's financials. As an example, let's review the impact of energy efficiency on an average mid-sized convenience store with turnover of €3m annually and a gross margin of 29%. Using typical performance metrics for this industry it is fair to expect the business to be paying approximately €45k per annum in energy costs.

If the retailer decided to invest €25k in an LED lighting project with a simple payback of 2 years it would result in a €12,500 annual saving that can flow straight to the bottom line.

"An energy efficiency project can have a material impact on a company's financials."



Alan Makim,
Sector Specialist in AIB Business Banking and leads a team of specialists across a range of SME sectors including Energy, Retail, Hospitality and Professional Services.