The Energy Hot Potato and Governance of Value Chains: 
*Power, Risk and Organisational Adjustment in Intermediate Manufacturing Firms*

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Outline

• Project background

• The ‘Hot Potato’ concept

• The 3 foundations — *the industry, the commodity, the firm*

• Summary
Project Background

*Energy user perspective* – study of manufacturing competitiveness in the UK

*Component manufacturers* – Intermediate Metal Processing industry (IMP)

*Energy intensive industry* – but applicable to other industrial energy users
The ‘Hot Potato’ concept …

HOT (don’t want it) →
PASS (negotiation of who’s responsibility it is) →
TIME PRESSURE (somebody ends up with it) →
OUT (causes a problem)
Foundation 1:
Industry Structure & Organisation of Production

- **Decline** in industry in UK

- **Low profitability** from history of competing with low cost producers, and **low capitalisation** from subsidising low profit margins

- Competitive position: predominately batch producers of complex and critical products
Foundation 2: The Relation of Energy price to Cost in the Firm

![Graph showing the relation of gas and electricity prices to cost in the firm over the years.](image)
Foundation 2:
Energy Supply Market Structure

Pre-denationalisation of UK energy market
- Stable costs under regulated market
- Fixed term contracts

Post-denationalisation of UK energy market
- Retail suppliers competing to sell energy so generate additional methods to suit increased price variability
- Flexible contracts
- Direct wholesale purchase
- Spot buying
- Brokers
**Foundation 3:**
The Firm as a Nested Set of Contracts

- **Fixed input cost for time period**: e.g., known labour rate negotiated for fixed temporal period
- **Differential purchase periods for specific inputs**: e.g., metal, additional temporary labour
- **Long term contracts**: e.g., energy
- **Discrete** (one-off orders)
- **Batch** (orders for a fixed quantity over short time periods)
- **Schedule** (long term orders)

Cost base: \( \text{Time}^i \)  \( \text{Time}^{i+1} \) \( \text{Time}^{i+2} \)  \( \text{Time} \ldots \)
The ‘Hot Potato’ concept ...

Sequencing of different contracts increases the *rigidity* of the cost structure and internalises the price risk to the firm.

Composition of order structure and purchases changes over time and between firms – potentially generating *competitive price differentials* between firms.

Synchronising agreements between firms allows suppliers to *transfer the price risk* to the customer.
Summary of key Points

Energy costs are increasingly significant to firms because of *price increases, volatility and supply market structures*

They create a *risk* to the firm because of wider adjustments to globalisation pressures – *a nested set of contracts*

Industry conventions limit to the ability to transfer the energy price risk to customers because *energy is perceived as an internally manageable cost*
Thank you