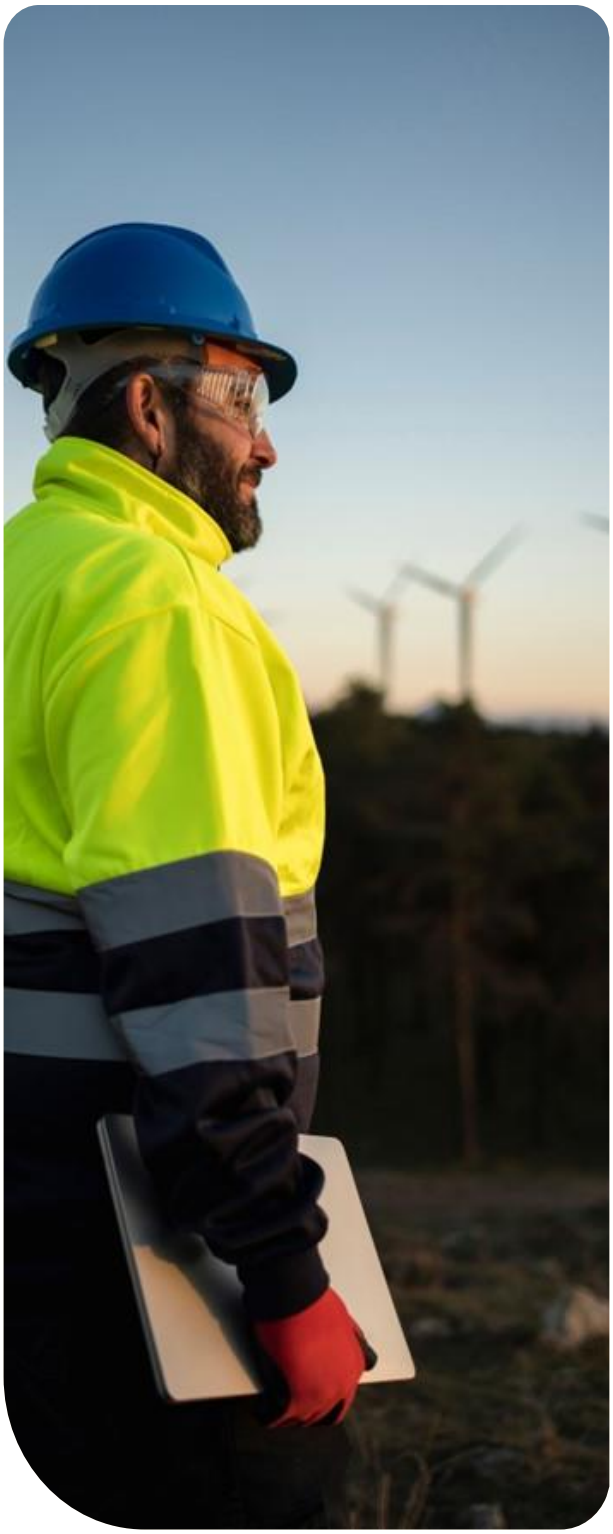
Grant Thornton

The impact of changing energy costs on the global mid-market

August 2024

The impact of changing energy costs on the global mid-market

There is a clear concern about the impacts of energy costs on business across the global mid-market. Over the last seven years, Grant Thornton's International Business Report (IBR) has shown a rollercoaster in this indicator which reveals the perception of leaders in more than 30 countries.



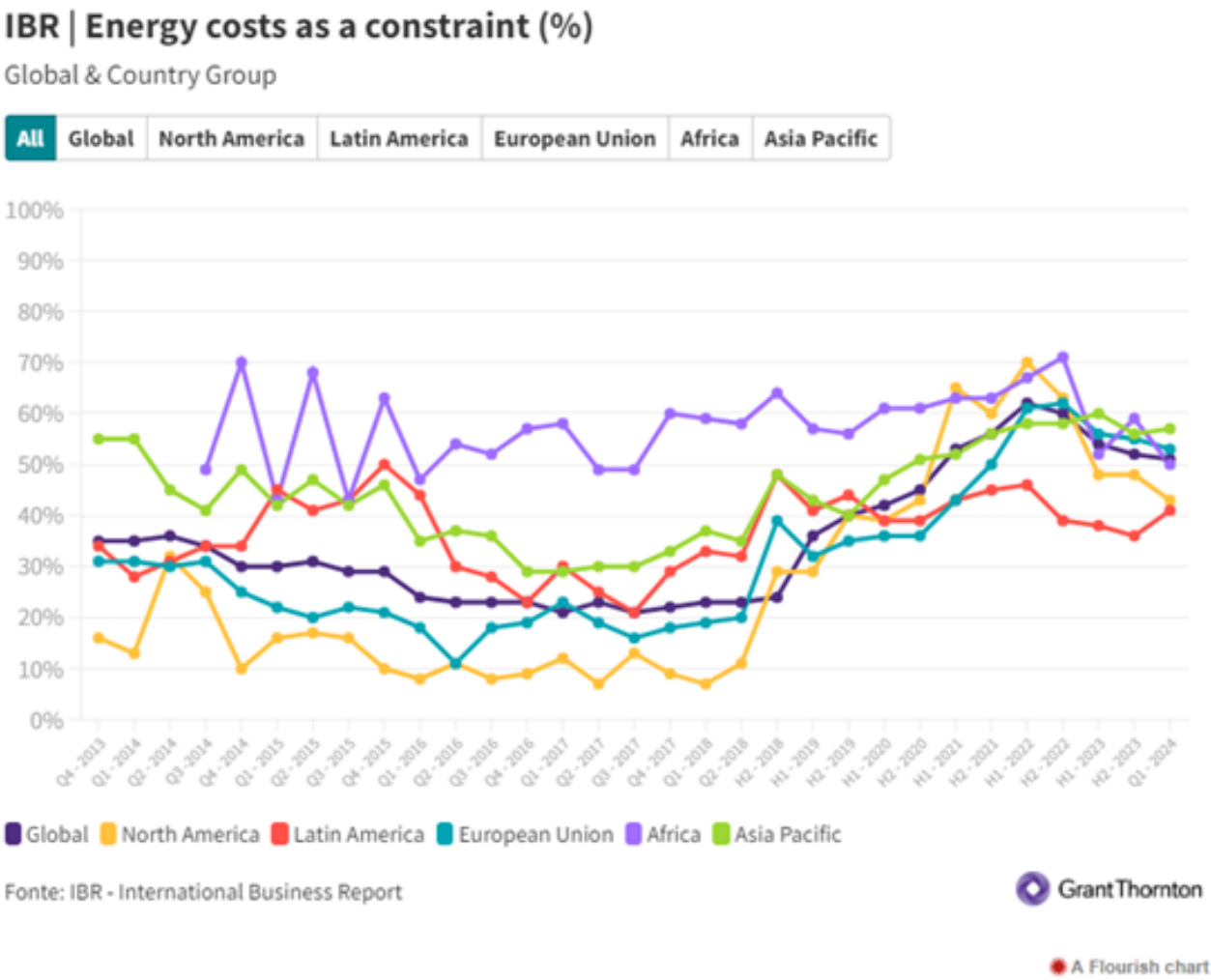
In H1 2022, 62% of the global mid-market saw energy costs as a constraint, the highest this figure has ever been in IBR history. The significant rise in energy costs during the first half of 2022 can be attributed to several key factors: The war in Ukraine had a substantial impact on global energy markets, particularly affecting the supply chain and prices of natural gas and oil, followed by an ongoing increased cost in energy production and distribution caused by COVID-19 pandemic and its aftermaths.

The overall inflation rates reflected on a higher cost of feedstock, including energy related materials, and although the renewables market registered a growth, industries are still heavily dependent on fossil fuels, a source subject to price volatility.

The IBR has been measuring this indicator since 2013. Now, despite starting a slight sequence of decline in this concern, the results are still relatively high when compared to 2016 level. This decline corresponds to the trends forecast by the **IMF (2024)** of declining inflation at the global level and a slow, albeit stable, economic recovery.

All off these changes must be observed carefully given the global demands for sustainability and strategies for long-term results - without major impacts in the small and medium term for business. Overall, the global energy landscape remains complex, with opportunities for clean energy adoption and challenges related to costs and supply.

We approached energy industry leaders in the Grant Thornton network to find out how businesses in their countries are considering energy costs according to their specific energetic circumstance and local realities.



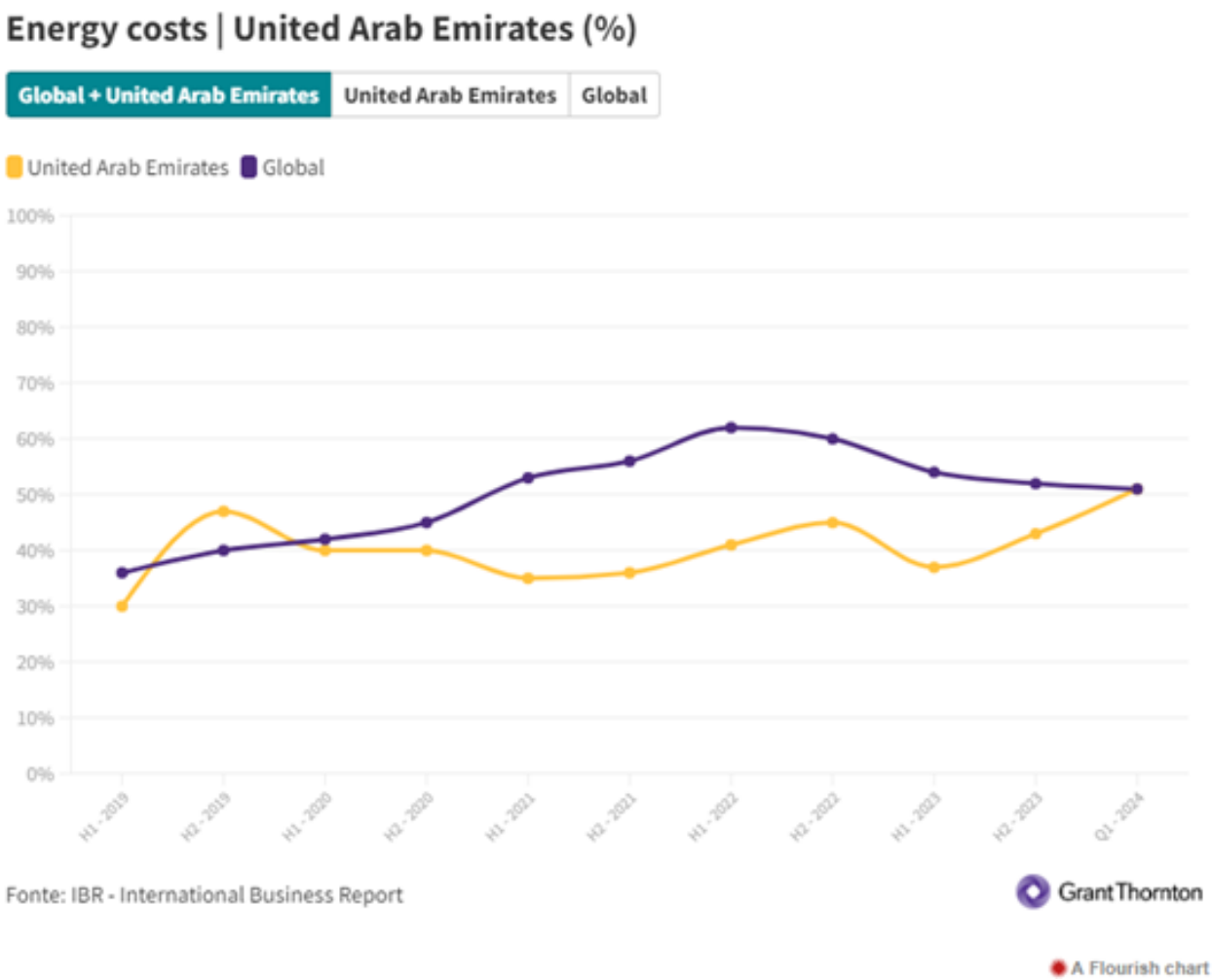
Energy cost rollercoaster

As concerns about inflation reach unprecedented levels, the world grapples with the intricate dance of energy costs. The landscape has shifted dramatically over the past few years, catching many by surprise. Let's delve into the key factors shaping this energy cost rollercoaster.

Oil and gas prices

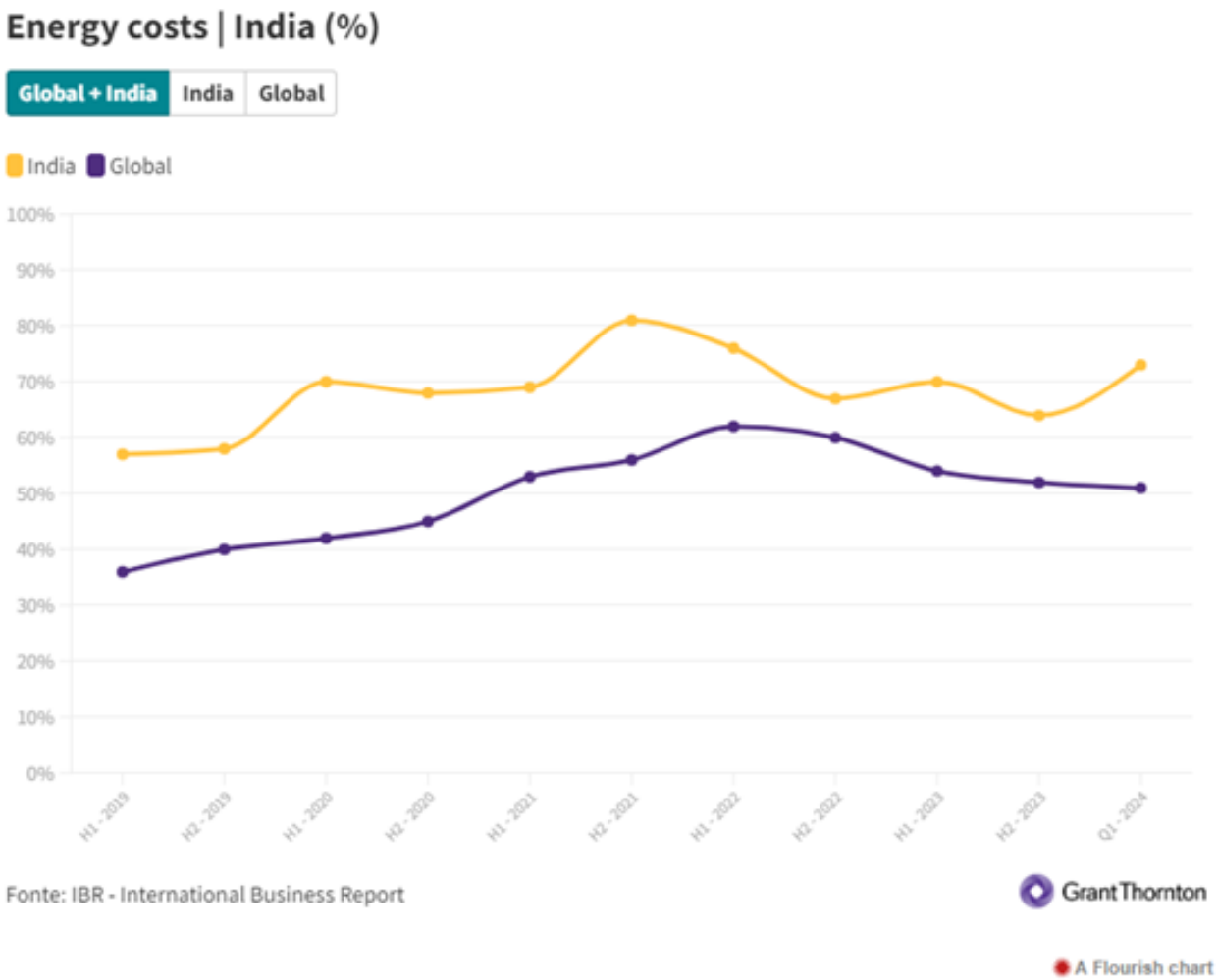
Oil and gas prices have increased in recent years compared to historic levels, benefiting those working in the energy industry, but it also has contributed significantly to overall inflation in the global landscape according to **World Economic Forum**. When oil prices are high, manufacturing input costs also rise, affecting the entire supply chain. As a major oil producer, the UAE's energy costs are inherently tied to the global oil prices, any fluctuations in oil market have a direct impact on the cost of energy production, transportation, and overall consumption within the country. **Mohamed Elewa**, **partner at Grant Thornton United Arab Emirates**, adds also Natural Gas plays a significant role in the UAE's energy sector, mainly for power generation and industry application, however cost of natural gas is influenced by the regional supply-demand dynamics and infrastructure investments, contributes to overall energy cost fluctuations.

"Historically, the UAE government played a role in keeping energy costs lower for consumers and businesses. However, the UAE went through reforms that have focused on phasing out subsidies to promote efficiency and reduce wasteful consumption".

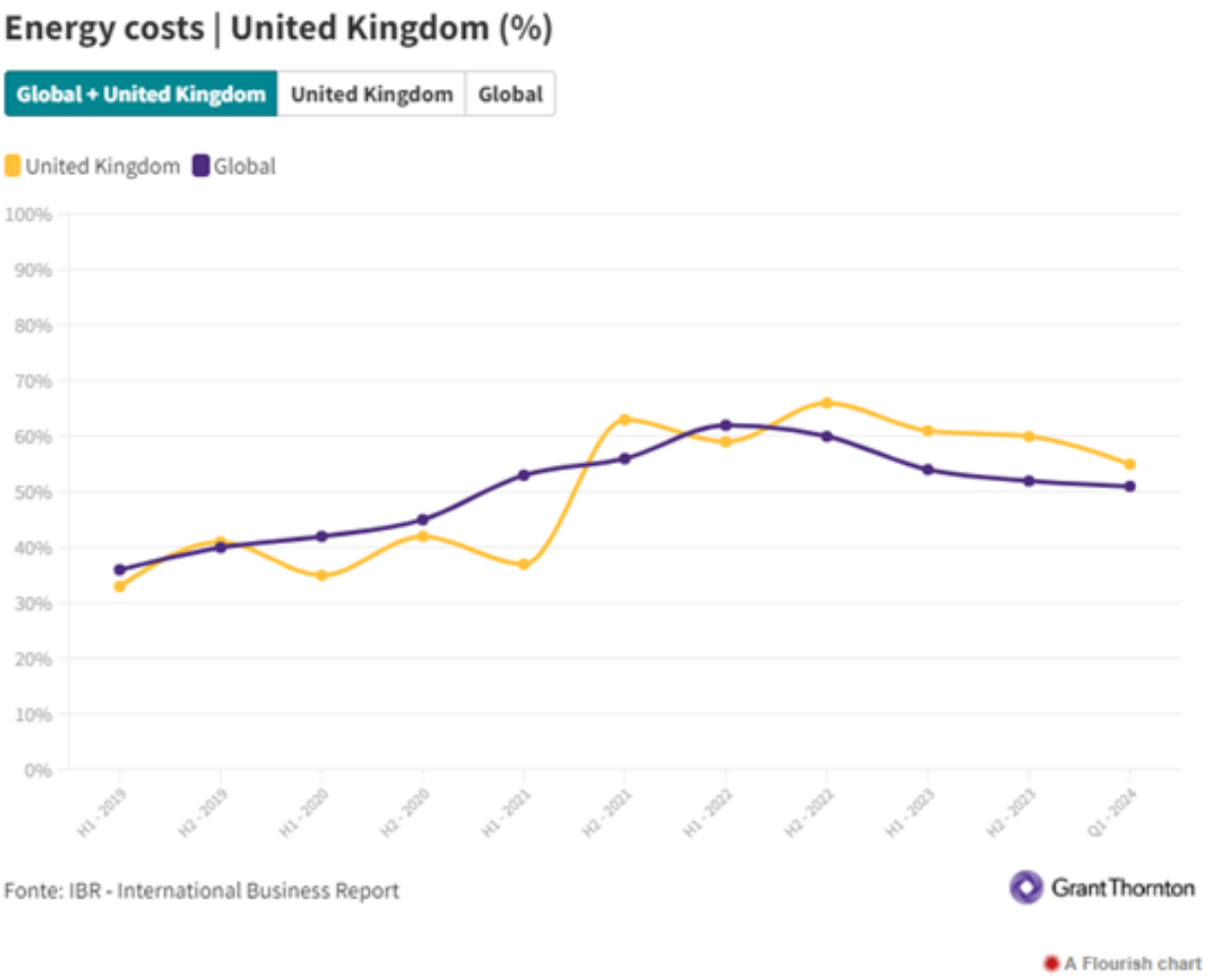


Over 90% of India's energy needs are met by two fuels: coal and crude oil. In FY 2023, **India's energy consumption** comprised coal (59%), crude oil (31%), natural gas (7%), and renewable electricity (3%). Coal remains the largest single fuel in the energy mix, with 70% of its consumption directed towards electricity generation. India is also highly dependent on energy imports (34%), sourcing 88% of its crude oil consumption and 43% of its natural gas consumption from abroad.

From a peak concern in H2 2021, where 81% of business leaders cited energy costs as a major growth constraint, significantly higher than the global average, recent data indicates a decreasing trend in these concerns. Optimism levels have rebounded slightly above 2020 levels and are now only 6% below H2 2019 levels. This improvement is particularly noteworthy when compared to global figures, with India experiencing a 6-percentage point increase in optimism levels against a global increase of just 2%.

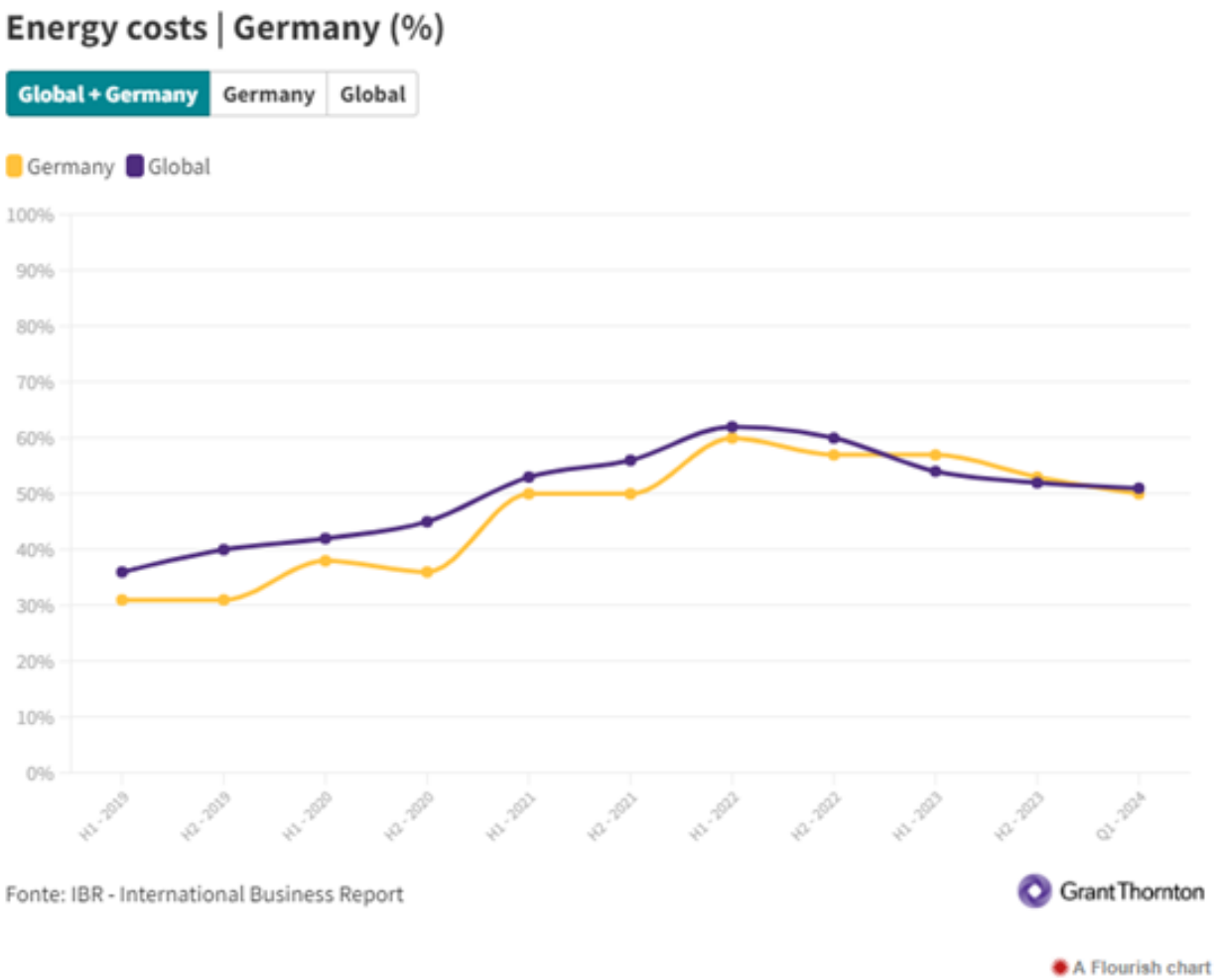


Barry Fraser, Advisory Director and Energy Lead at Grant Thornton UK analyzes that overall concern increased by 7 percentage points in the second half of 2022 to 66% of executives, when average oil prices were above $100 for the first few months and then remained above $90 for the remainder of that period. Concerns then reduced to around 60% throughout 2023, at a time when average oil prices fluctuated in the low $80 per barrel range for most of the period. "As such, there appears to be a link in UK concerns around energy prices and oil price movements over recent times" suggests Barry. "Concerns from UK business leaders around energy costs, combined with cost inflation in many other areas as well as higher interest rates places additional cash flow pressure on businesses".



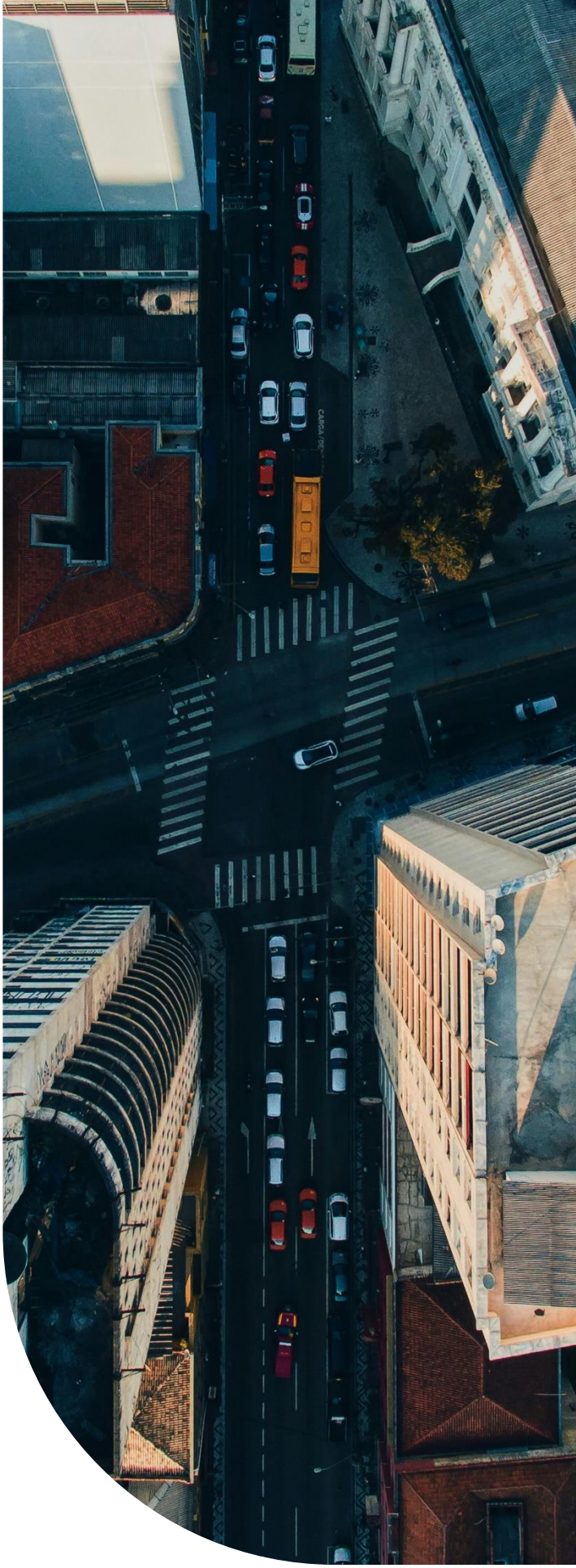
The outbreak of the war in Ukraine led to high uncertainty and rapidly rising energy prices in Germany, observes **Alexander Budzinski, Advisory Partner and Energy lead at Grant Thornton Germany**. The forward prices for natural gas were almost eight times higher in the summer of 2022 compared to 12 months prior. “A main supplier for natural gas having been Russia up to this point. The loss of this previously comfortable source of cheap energy explains the perceived increase of importance of looking at energy cost that can be seen in the graph”.

A mild winter and the quite costly achievement of filling up the gas storages through other sources, led to a continuous decline of natural gas prices in 2023. The same is true for the price for coal which had increased significantly in 2022 as well. “So, while the initial shockwaves have calmed down, there is still a variety of topics on the table regarding energy costs” says Alexander.



The current state of oil and gas prices has a significant impact on mid-market companies. Higher energy costs increase operational expenses, which can squeeze profit margins. This is particularly challenging for mid-market firms that may not have the same financial resilience as larger corporations. Additionally, these companies often face higher transportation and production costs, which can lead to increased prices for consumers, says **Élica Martins - Audit Partner and Energy lead at Grant Thornton Brazil.** The impact of energy costs on the production process in companies can represent up to 40% of their operating costs, according to a study by the Federation of Industries of Rio de Janeiro (Firjan) Brazil.

Thus, the pace of price increase may slow down as global economic growth stabilizes and alternative energy sources become more prevalent against predictions for oil and gas prices. Investing in renewable energy sources such as solar or wind can provide long-term cost savings and reduce dependency on fossil fuels, and government incentives and programs aimed at reducing energy costs can also be beneficial. Currently, some oil and gas companies are channeling profits into renewable energy projects such as carbon capture and storage (CCS) technologies, digitalization to improve efficiency and reduce environmental impact, and other green energy initiatives to align with global climate goals.

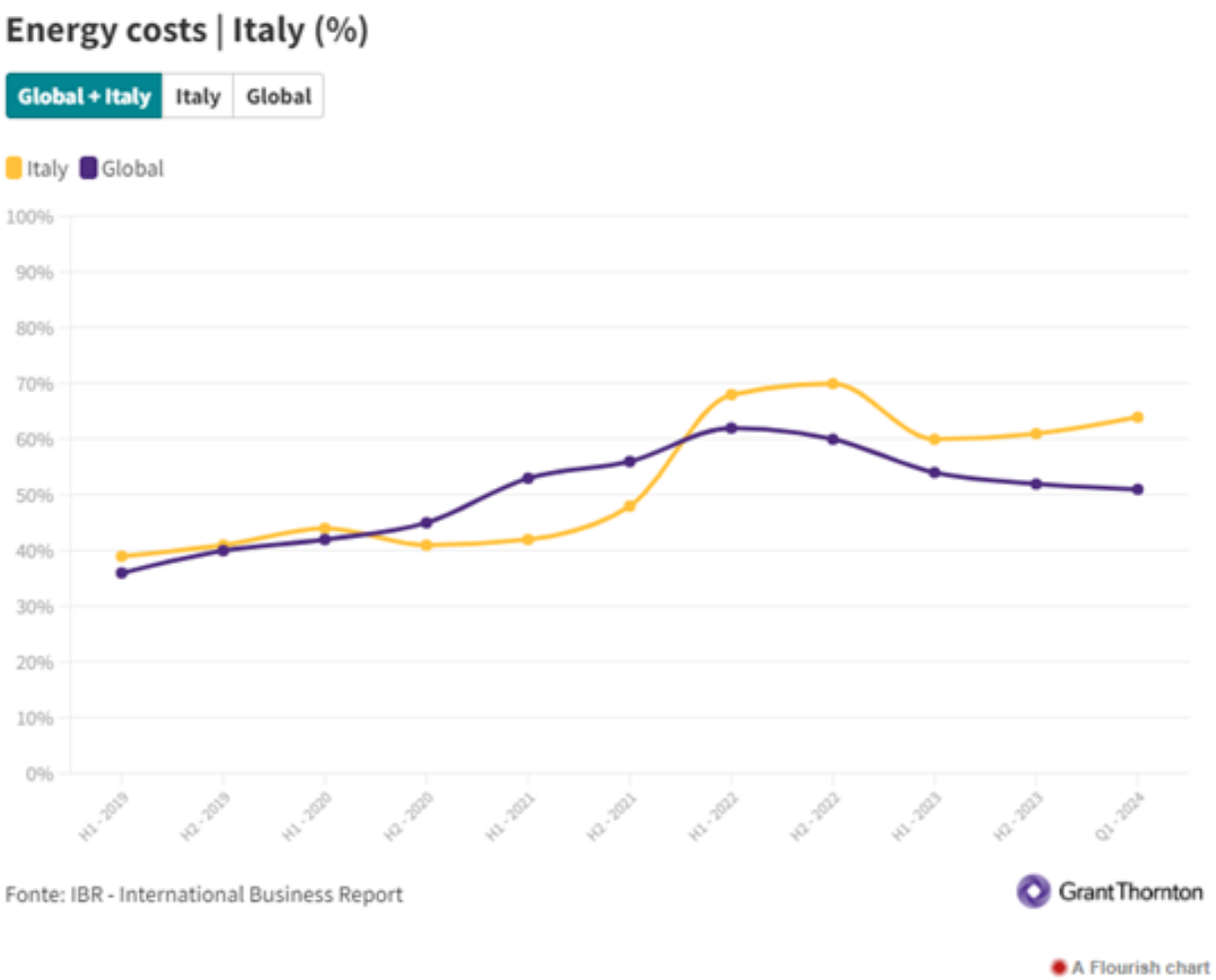


Electricity cost

Electricity costs have also risen over the past few years in Europe. A drastic increase was noted in countries who form part of the European Union seeing energy costs as a constraint after the outbreak of the war in Ukraine, with 61% of the European Union mid-market in H1 2022 noting this as a constraint; 11pp higher than in H2 2021.

This number has gone down for the European Union since H1 2023, and now 52% of the European Union view energy costs as a restraint. This is still above the global average of 51%. Some EU countries are still especially feeling the strain of energy costs, specifically Italy. 64% of the Italian mid-market see energy costs as a constraint, which is above the global average of 51%. Prudent strategies are required to mitigate the financial impacts high energy costs can have on a business.

Rossana Pieringer and Marco Pane Energy Lead at Bernoni Grant Thornton Italy say that in this context, it is crucial to examine both internal dynamics and global comparisons to develop smart and sustainable approaches. “In the current macroeconomic scenario, characterized by high energy supplies costs, Energy Communities will surely represent a source of saving and consumption efficiency”, they agree.



Renewable energy - Diversifying is the key

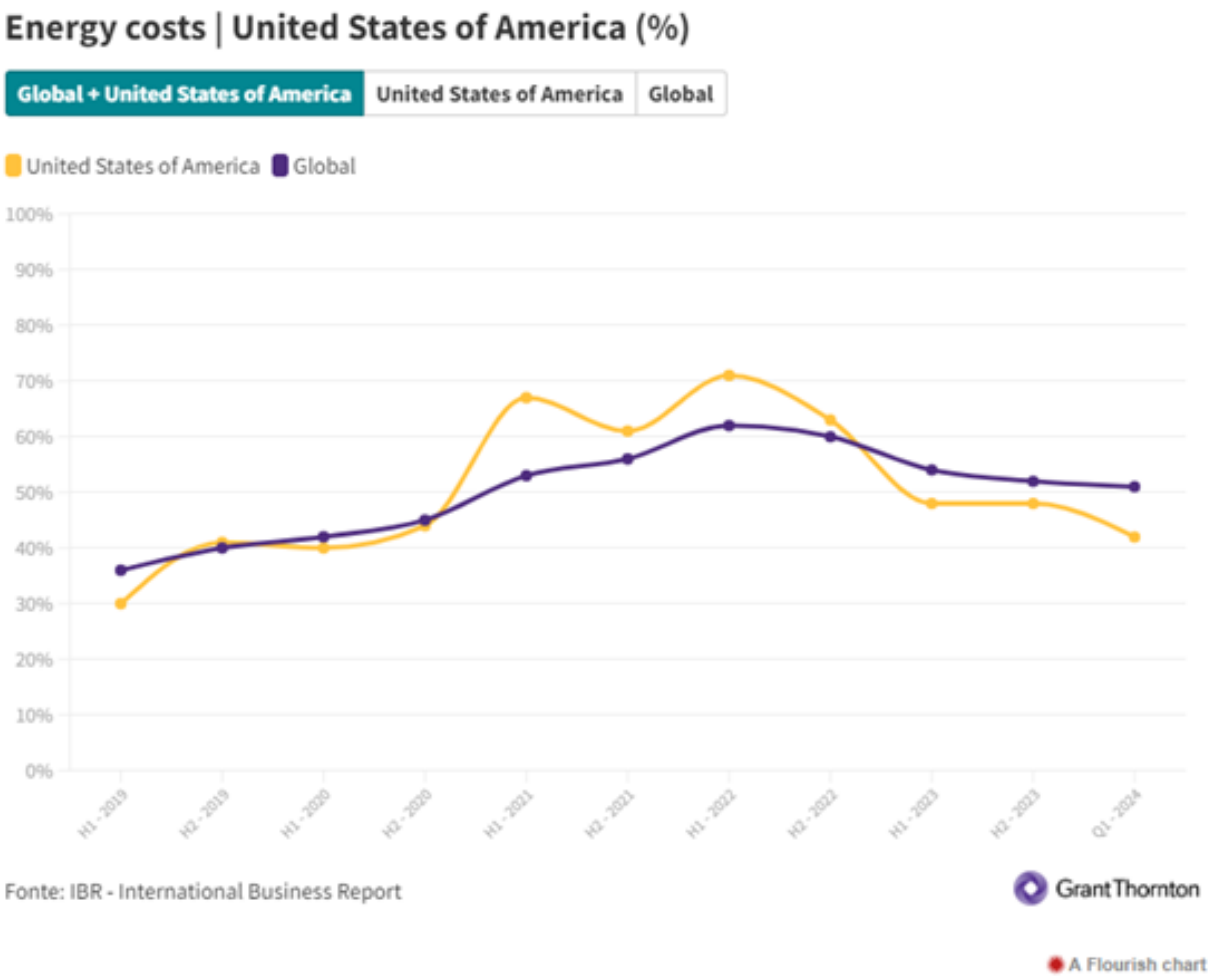
According to the **United Nations**, diversifying energy sources can help the mid-market manage energy costs sustainably, specially when renewables are prioritized. Around 6 billion people around the world depend mostly on fossil fuels energetic matrix, particularly in emergent countries. This figure points to highly vulnerable economies, that are subject to external geopolitical and logistical crisis. However, according to the same institution, at least 90% of the countries have conditions to explore local renewable sources, being able to become less dependent on importing of inputs and technologies.

Diversifying energetic matrix and prioritizing renewable sources is a proven way to become more independent regarding external fluctuations, being also a manner of developing internal industrial chains.

We can see the impact of it when looking at how different regions are doing this.

US

The US mid-market saw a drop of 15pp in the number of businesses that saw energy costs as a constraint from H2 2022 (63%) to H1 2023 (48%).



Bryan Benoit, global head of ENR at Grant Thornton International comments that this drop reflects a combination of market dynamics, supply-demand balance, renewable energy adoption, efficiency measures, policy interventions, and technological progress. “Higher electricity generation costs globally in 2022 were driven by surging energy commodity prices. Regions dependent on short-term markets for fuel procurement experienced more significant cost increases when compared to the current year since the prices showed some moderation but remained high, as a balancing act we in the US grappled with fossil fuels vs. renewables, and natural gas upward trends in natural gas prices persisted globally”. Wholesale electricity prices averaged $3.29/MMBtu in 2023. The US, with its diverse energy mix, grapples with the delicate dance of fossil fuels and renewables in accordance with the “U.S. Energy Information Administration - EIA”.

Brazil

After showing stability for two consecutive semesters, the worry among Brazilian entrepreneurs of the mid-sized company leaders about the impact of energy costs on their businesses gained momentum in the report for the second semester of 2023. The percentage of executives reporting this fear was at 43% (a four-percentage point increase), while in Latin America it reached 36% and globally, 52%, both with a two-percentage point decrease.

Élica Martins, Audit Partner and Energy Lead at Grant Thornton Brazil emphasizes the importance of considering each country's energy reality and primary energy source. “Brazil has a diversity of energy sources in its energy matrix. The recent period has shown surplus energy supply and attractive Price Difference Settlement (PLD), which indicates favorable pricing due to good conditions for energy generation in power plants and the favorable levels of reservoirs in hydroelectric plants during this period, the main source of Brazilian electrical generation”. In the Brazilian market, as highlighted by Élica, it is expected that the opening of the free energy market for large consumers in early 2024 will benefit many companies in terms of costs. “Companies authorized to negotiate energy purchases in the free market can secure more attractive prices, thus reducing their high energy costs, a concern identified in Grant Thornton’s research”.

Argentina

Encouraging the potential for diversity in the energy matrix is also the key highlighted by **Gabriel Righini and Estanislao De Leon, respectively audit Partner and Energy Lead at Grant Thornton Argentina.** During 2023, the new national government resulted in incremented optimism and showed a decrease in the perception on limitations such as energy costs.

However, with the passing of these first quarter of 2024, companies are beginning to show concern over the governments decisions to end or minimize energy subsidies, both for consumers and for the industrial sector. This will impact especially the city and the metropolitan area of Buenos Aires, which is the main industrial region in the country.

In this context, energy costs are again a strong consideration in the mid-market's mind. Nonetheless, it is important to remember the Argentine matrix of energy is diverse. The new gas pipeline which began operating during 2023 promises to decrease energy cost by aiming to gradually cover gas consumption throughout the Argentine territory. There are also other very relevant sources of energy to be exploited such as oil from the "Vaca Muerta" site and lithium from the north-wester provinces. At the same time, green energies are on the rise through windmills, green hydrogen projects and other alternative forms of energy production.

Germany

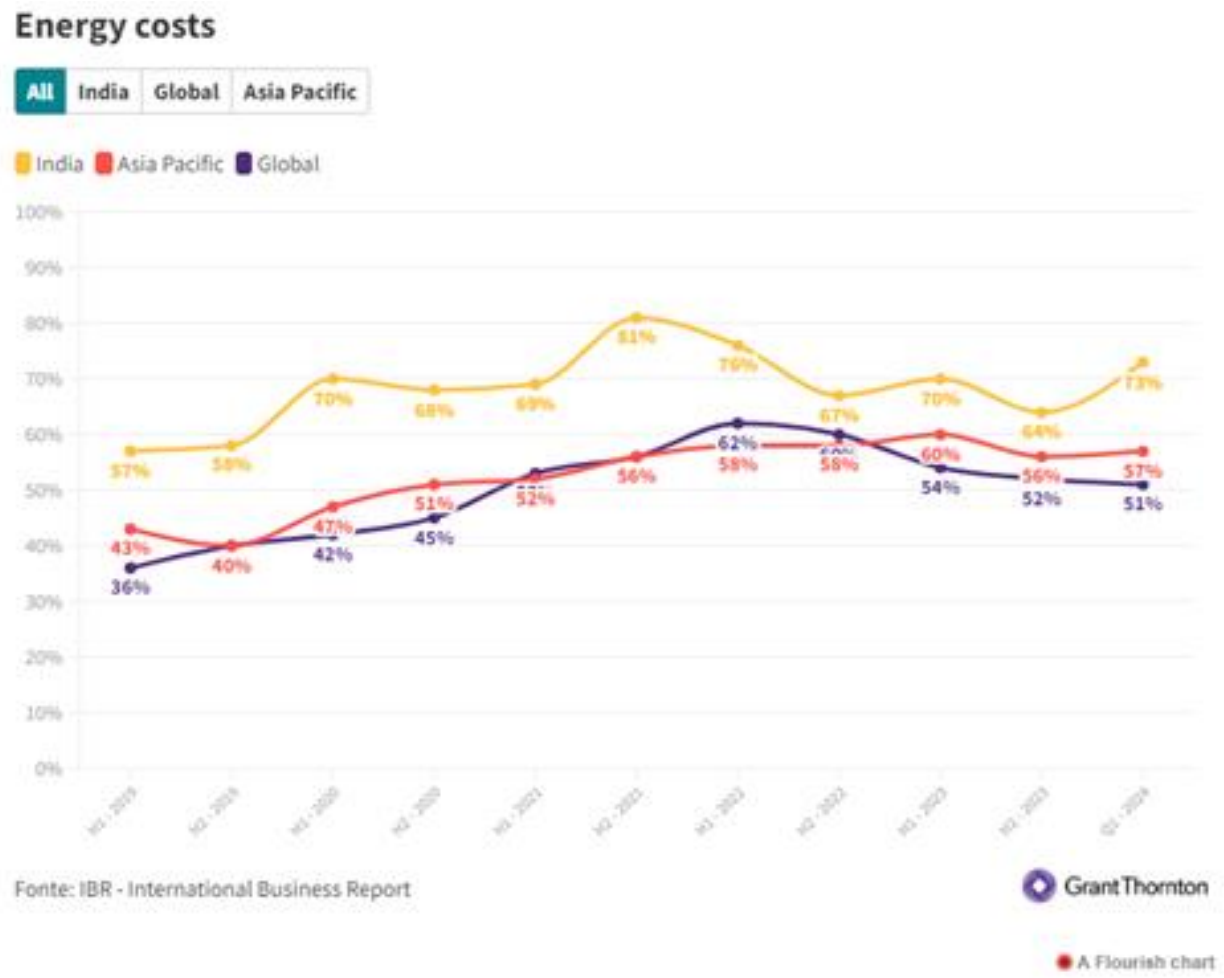
Alexander Budzinski from Grant Thornton Germany also says that the whole sector is in transformation regarding the targets of the energy transition. This requires immense investments in renewable energy production, grid connections and backup power plants for grid stability. He says the heat market needs urgent solutions not only for energy efficiency but also for the replacement of natural gas by green gases like hydrogen especially in energy intensive industrial processes.

“Germans are known to be concerned about the current state of things as well as the future. Therefore, it should come as no surprise that the questions of future energy consumption and of keeping the energy prices at a competitive level remain amongst the focus topics of entrepreneurs. The ability to preserve the competitive edge of the German industry and energy intensive production depends on making this work”.

UAE

Primary energy mix is predominantly based on oil and gas, and historically fossil fuels has been the backbone of the UAE’s economy. In recent years, “the UAE has made significant strides in diversifying its energy sources, including investments in nuclear and renewable energy, aiming to have a diverse energy mix comprising oil, natural gas, nuclear power and renewable sources like solar energy”, says Mohamed.

India



Recognizing the pivotal role of energy in driving progress, India has set its sights on achieving energy security—a goal that encompasses reliable, affordable, and sustainable access to energy resources. The government has implemented a series of strategic policies and initiatives to address energy challenges. These include setting ambitious targets to **50 percent cumulative electric power installed capacity from non-fossil fuel-based energy resources by 2030**, promoting renewable energy, energy-efficiency, sustainability, and implementing reforms in the coal sector.

The renewable energy sector has seen significant advancements. Solar power tariffs are now competitive with variable costs of coal power, with the levelized cost of electricity (LCOE) from solar energy in India are lower than fossil fuel LCOE. As the overall share of renewable energy in India's electricity mix increases, electricity prices are expected to decrease further.

Government initiatives like the National Green Hydrogen Mission and the identification of **'Green Growth' as a key development pillar** in the Union Budget FY '24 underscore the commitment to sustainable energy solutions. **Long-term green energy open access** contracts offer businesses predictability in energy costs, facilitating better planning and budgeting. Green initiatives like the National Green Hydrogen Mission and the identification of **'Green Growth' as a key development pillar** in the Union Budget FY '24 further underscore the government's commitment to sustainable energy solutions. **Long-term green energy open access** contracts offer businesses predictability in energy costs, facilitating better long-term planning and budgeting.

Energy transition cost – the new challenge

Renewable energy projects once hailed as the beacon of a sustainable future now face a reality check. Their costs have soared beyond initial predictions. Why? Here's the crux: these costs directly influence energy prices and in order to achieve success, it depends on several factors, as Élica points out, clear policies, and incentives once aligned can accelerate the transition to renewables. Regional supply and demand, government policies, and market competition influence energy prices, although Government support can mitigate the impact of renewable costs on consumers.

Recently, the UAE, a nation heavily dependent on fossil fuels economic exploration, has shown a commitment to renewable energy with projects like the Mohammed bin Rashid Al Maktoum Solar Park. "Transitioning to renewables will impact energy costs over time, with initial investments offsetting long-term operational expenses, so with a robust renewable energy strategy the UAE may experience lower energy costs in the coming decades", says Mohamed. "As Countries are increasingly prioritizing clean energy initiatives and carbon reduction targets, which can influence energy costs. The UAE's efforts in this regard, such as investing in carbon capture and storage technologies, contribute to the broader discussion on sustainable energy".

It is noteworthy that ensuring a stable energy supply requires balancing intermittent renewables with dispatchable sources (like natural gas or hydroelectric) and upgrading transmission lines and grids looking for infrastructure investments can affect overall energy costs, independently of the energy source utilized. Industry collaboration and international cooperation are essential for a sustainable energy future. Continuous research innovation and development will drive down costs.

Achieving this delicate balance ensures not only adequate returns for investors but also sustainable energy practices. The journey toward a greener energy landscape involves harmonizing costs, environmental impact, and societal benefits.

How we can help

We hope you find the information in this article helpful in giving you some insights about energy concerns. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or your local member firm and count on our ENR leaders.

Bryan Benoit
Global Head of ENR
at Grant Thornton International

T +1 832 476 3620
E bryan.beniot@us.gt.com

Mohamed Elewa
Advisory Partner
at Grant Thornton UAE

T +971 4 388 9925
E mohamed.elewa@ae.gt.com

Barry Fraser
Advisory Director and Energy Lead
at Grant Thornton UK

T +44 (0)1224 925 988
E barry.g.fraser@uk.gt.com

Alexander Budzinski
Advisory Partner and Energy Lead
at Grant Thornton Germany

T +49 211 9524 8515
E alexander.budzinski@de.gt.com

Élica Martins
Audit Partner and Energy Lead
at Grant Thornton Brazil

T +55 19 2042-1036
E elica.martins@br.gt.com

Gabriel Righini
Audit Partner and Energy Lead
at Grant Thornton Argentina

T +54 11 4105 0000
E gabriel.righini@ar.gt.com

Estanislao De Leon
Audit Partner and Energy Lead
at Grant Thornton Argentina

T +54 11 4105 0000
E estanislao.deleon@ar.gt.com

Rossana Pieringer
Energy Lead at Bernoni Grant
Thornton Italy

T +39 02 783 351
E rossana.pieringer@bgt.it.gt.com

Marco Pane
Energy Lead at Bernoni Grant
Thornton Italy

T +39 02 783 351
E marco.pane@bgt.it.gt.com

Abu Dhabi

Unit 2, Floor 14
Sila Tower
ADGM Square
Al Maryah Island
Abu Dhabi, UAE

T +971 2 666 9750
F +971 2 666 9816

Dubai

The Offices 5
Level 3, Office 303
One Central, DWTC
PO Box 1620
Dubai, UAE

T +971 4 388 9925
F +971 4 388 9915

Sharjah

Al Bakr Tower
Office 305
7/9 Al Khan Street
Sharjah, UAE

T +971 6 525 9691
F +971 6 525 9690

Grant Thornton

grantthornton.ae