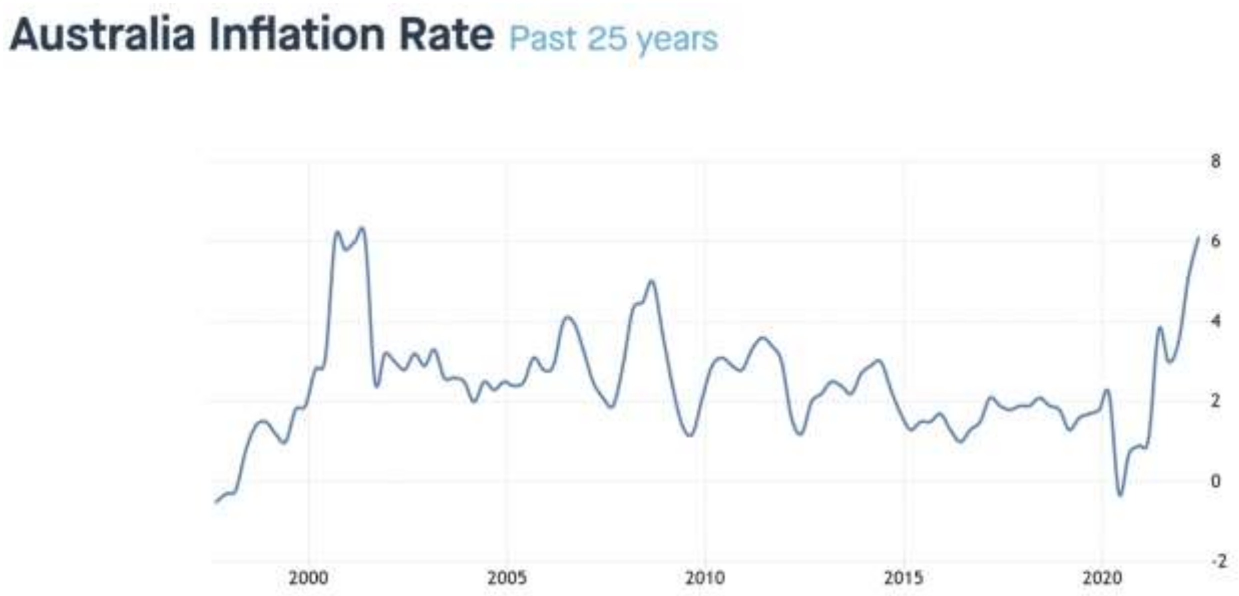
BusinessPlus+ Newsletter

Issue – October 2022

Business Essential Briefs: Operating in an Inflationary Environment



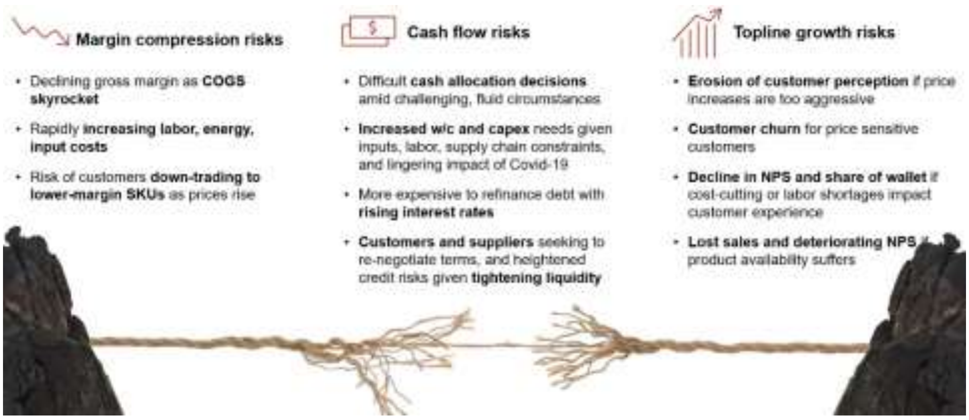
When inflation occurs, companies typically pay more for input material. One way for companies to offset losses and maintain gross margins is by raising prices for consumers, but if price increases are not executed thoughtfully, companies can damage customer relationships, depress sales, and hurt margins.

According to McKinsey & Company, done the right way, recovering the cost of inflation on a case-by-case basis can strengthen customer relationships and overall margins.

There are five steps companies can take to **ADAPT** (Adjust, Develop, Accelerate, Plan, and Track) to inflation:

1. **Adjust discounting and promotions** and revisit other aspects of sales unrelated to the base price, such as lengthened production schedules or surcharges and delivery fees for rush or low volume orders;
2. **Develop the art and science of price change**. Don't make across-the-board price changes; rather, tailor pricing actions to account for inflation exposure, customer willingness to pay, and product attributes;
3. **Accelerate decision making tenfold**. Establish an internal "inflation action group" that includes dedicated cross-functional, inflation-focused decision makers who can act nimbly and quickly on customer feedback;
4. **Plan options beyond pricing to reduce costs**. Use "value engineering" to reimagine your portfolio and provide cost-reducing alternatives to price increases.
5. **Track execution relentlessly.** Create a central supporting team to address revenue leakage and to manage performance rigorously.

A summary of the key inflationary impacts that businesses need to vigilant around for - gross sales margins, business cashflow and total sales revenue - are shown in the diagram below (COGS = Cost of Goods Sold):



The potential impact of wage pressures will also need to be actively monitored and controlled where possible. The cost of living pressures at the personal employee level will no doubt mean potentially significant wage increases may be sort by individuals and groups with union support in the bargaining process.

The diagram below shows a good comparison of the historical wages growth in (both nominal and real terms) and inflation levels from 1998 to the current position today – perhaps indicating that wage pressures may be more constrained than general expectations being speculated in the media. Supporting this are some economists forecasting the inflation spikes are likely to be short lived and cost of living pressures may get some relief too with the cash interest rate perhaps peaking in 2023 and then reducing.

Additional Resources

If you would like a copy of McKinsey & Company's article "***What is Inflation and Related Inflation Guidance***" from August 2022, please click on the link **HERE**.

Providing you professional direction

Our liability may be limited by a scheme approved under Professional Standards Legislation.