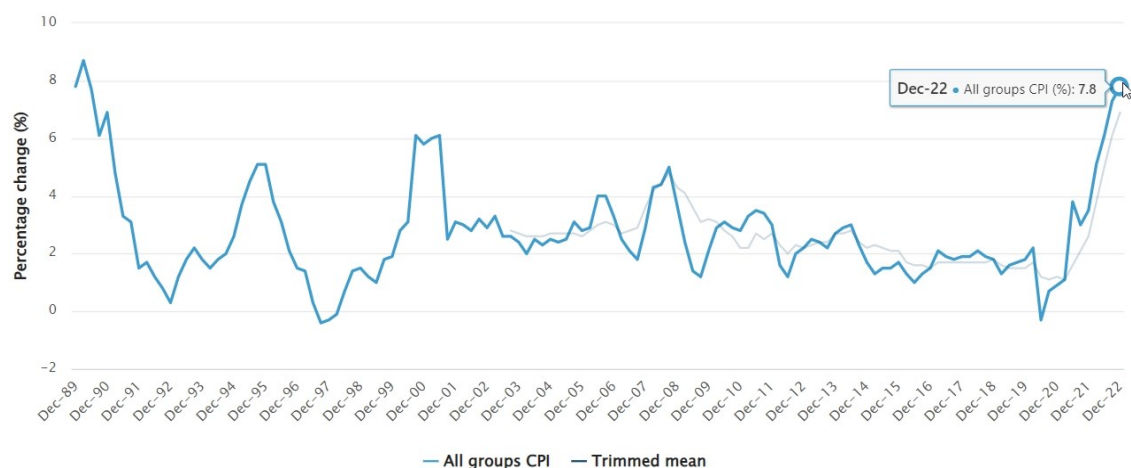


Effects of Inflation on Business Operations

Australia's annually adjusted inflation hit 7.8% as at the end of December 2022 and was 8.3% in Perth. Much of the changes to the Consumer Price index for calendar 2022 were driven by just a few components:

- Housing (*this category includes electricity, gas, and rent*) +10.7%
- Food & non-alcoholic beverages +9.2%
- Recreation and Culture (*this category includes domestic & international travel*) +9.0%

All groups CPI, Australia, annual movement (%)



Source: Australian Bureau of Statistics January 2023

Some Of the Negative Effects of High Inflation

- Inflation rates are complex
- Many different indexes exist
- Focus on core drivers
- Mistakes become more costly in an inflationary environment

Not every business is impacted equally by rising inflation numbers. For some, it may even generate higher profits. The level to which the below may impact any business depends on what industry it is in, its state of financial health, its level of stock, and other factors.

- **Rising prices often represent rising overheads** – Higher inflation can spell trouble for businesses that do a high volume of purchasing annually. These can be raw materials, goods to put on a retail floor, or other necessary items. As the prices for those essential goods rise, management needs to determine how much of this increased cost can be passed onto consumers. For goods with high elasticity of demand, the consumer base may not be prepared to take on the price hike.
- **Lower consumer sentiment** – As prices appear to unilaterally rise, consumers will naturally look to spend less and save more, conscious of their own budgets. This applies to discretionary or luxury goods. In Australia, the Westpac-Melbourne Institute Index of Consumer Sentiment has dropped from approximately 102.2 in January 2022, to 80.3 in December 2022. Businesses need to be careful to maintain revenue numbers, especially in the face of rising overheads.
- **Potentially lower investment** – This one depends on the business’s susceptibility to rising overheads and lower consumer confidence. If profit margins dwindle in the face of these factors, investment levels in that business may reduce. Investors may also be feeling the pinch in consumer confidence, adopting a more bearish approach to the market.
- **Increased interest rates** – Higher inflation has encouraged the Reserve Bank of Australia to raise the official cash rate from record low levels which has subsequently increased repayment amounts on loans.

Positive Effects of Inflation on Businesses

There can be positive impacts of inflation for some businesses, as higher inflation does not affect all businesses equally. Some enterprises may witness their profit margin increasing due to higher levels of inflation. Some of the general positive impacts of inflation may include:

- **High profits for businesses that sell goods with fixed demand** – Also known as inelastic goods, if the consumer base must continue purchasing your product, despite the rise in prices, then your business may see a surge in profitability. Your ability to pass on costs increases, as your goods are essential for your consumers no matter the economic conditions. The classic example would be a business that sells necessary medication to consumers, which they must buy despite changing conditions. Equally, a business with an especially loyal customer base may be able to sustain sales for longer at higher prices.
- **Rising investment in profitable business** – If, as outlined in the point above, your business can leverage price hikes to increase profitability then you may correspondingly witness an increase in investment. These investors may grow wary of other enterprises more grossly affected by inflationary prices, and funnel more of their investable income towards you.
- **Efficiency born out of necessity** – Some businesses may use rising inflation as an incentive to review their practices, outgoings, and productivity. Sometimes rising costs can stimulate ownership and management into acting, where otherwise they may not have. Perhaps you might renegotiate the price of your goods or review the costs of utilities and rent within the business. Innovation can be born out of times of pressure.

What Can Businesses Do to Combat Inflation?



Detailed below are some general suggestions that a business might consider combatting rising inflation. Recommendations more specific to your business will depend on the impact that rising costs and other factors have had on your bottom line, workforce and so on.

- **Pass on the price hikes** – Where applicable, passing on the increase in the price of the means of production or purchased stock to your consumers will stave off a lot of the cost pressures. As previously stated, this depends upon the elasticity of demand for your goods. The more discretionary the goods that you sell, the harder it will potentially be to pass on any increases to your customer base. If you forecast higher inflation on the horizon, you may even choose to raise your prices early in anticipation.
- **Review your costs** – This includes everything from rent to utility costs, workforce wages and any other overheads. There can be cost efficiencies found in most businesses, and perhaps higher inflation is the kick that your business needs to conduct such a review. Reducing your exposure to costs that are inflating will go a long way towards protecting the business.
- **Take advantage of fixed interest early** – If you're aware that interest rates could continue to rise to combat rising inflation, then you could take advantage of some of the fixed-interest debt options on offer to get out ahead of it all. Repayments will only stand to increase if interest rates keep rising, so it's important to pick the right time to increase liabilities.
- **Ensure you have multiple supply options** – As the cost of production inputs rises, ensuring that you have options from multiple suppliers will allow you to better identify the best deal or price option at any given time for your business. The more reliant you are on a particular supplier, the more vulnerable you are to their price increases.
- **Increase your levels of essential stock** – Now is not the time to be playing games with the supply of your goods. You need to ensure that you have enough stock to be able to supply your customer base without needing to reorder excessively from a supply chain under enormous stress. Excess stock, so long as it can be stored adequately, may be a boon during these times, as there are some long delays in ordering.

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