Abbott Moore

How our business clients can cope with rising inflation

Uncertainty is rarely good in running a business but like most challenging situations, its best to concentrate on what you can control or influence rather what you can't. Here are our tips:

Segment your costs to focus your efforts

You need to concentrate your efforts on the costs that will impact your business most:

1) Firstly, designate each of your costs into low, medium or high impact on the business, particularly if they change. This might be based on annual spend for example.
2) Secondly, designate those same costs into low, medium or high exposure to the risks of inflation.

The above will give you six boxes to put all costs in. For example, if your business has a significant annual rent bill but you are one year into a fixed cost 5 year lease, you might rank that as high impact on the business but low in terms of exposure because the amount is already fixed. This cost would go into the 'high/low' box. If your wages bill is 60% of your turnover and you normally do pay reviews in October each year, this is likely to go into the 'high/high' box.

Focus time and attention planning a strategy on the top 3 boxes for your business starting with costs that appear in the high/high box. A business with a 10% net profit margin spends 90% of its revenue on costs. If inflation is running at 10% per annum and that flows through to all the businesses costs it is obvious the business will then spend 99% of revenue on costs a year later making the net margin only 1% and be unprofitable the year after. A point that sharpens the incentive to review and plan in good time.

Focus on fixing

If you have costs that are particularly suspectable to inflationary pressures in the short or medium term, speak to your supplier about whether there is an opportunity to fix them now. Remember that this may mean that you pay more overall because the supplier is taking the risk of fixing, but this will help provide certainty for the future.

Seize the opportunity to invest

It's tempting to cease investing when uncertainty increases but now might very well be the best time to invest for many businesses. As confirmed in the latest mini-budget, £1m annual investment is set to be in place for the foreseeable future and this allows you to write a lot of types of capital investment off by 100% in the year you invest. In addition, the current super deduction allows a 130% write off for many investments also. I suspect the 130% write off will cease 1 April 2023 onwards as it was brought in to encourage businesses to invest ahead of the corporation tax increase on the same date.

In addition, many of your competitors will be hunkering down so have a think whether it is worth taking on some risk and investing now to get ahead.

Up to date and accurate numbers, focusing on what really matters, gives you confidence to make good decisions

A lot of businesses don't have full visibility over their current financial performance and their future expected performance. If you are one of those now is the time to work on improving visibility and sharing that with those that need it. Once you have visibility you are likely to ask yourself questions like 'what if?' and 'should I?'. If you don't have it, seek financial support in making those decisions, especially the large or complex ones.

This doesn't have to be full blown daily profit and loss accounts, focus on things that really matter. Abbott Moore produces quarterly accurate numbers for our management team but this would never be regular enough to make good decisions about running the business. Instead, we have the WINK (stands for What I Need to Know – I should trade mark it!!) process and every Monday I get the numbers that really matter on turnover, cash and gross margin.

People and productivity

People are the backbone of any business and your team will be feeling the pinch of inflation as much as you are. Give some thought to how you can plan for salary increases and review what other benefits you could offer. The key thing with benefits is that they have to be valued by the team to provide the right incentive so don't just concentrate on what might qualify for special tax breaks. Think more creatively for example by investing in IT or training for career development which may also ensure the business is more efficient and productive.

Remember that even if you can't afford to protect your team entirely from the impact of inflation, every little helps and will certainly be appreciated.

Pricing – bite the bullet?

There will be few businesses that won't be thinking about how they price for their goods and services. Indeed many current business owners have never really had to manage a business through a wider high inflation environment, even if certain costs have always been subject to particular pressure.

Pricing is often under-optimised in smaller businesses which means there is usually more room for review. In a higher inflation environment, maintaining margins and the financial health of a business is vital to survival.

The extent to which pricing can be reviewed will depend on many factors such as whether you sell 'must-have' goods or services or whether they are 'nice to have'. You might have more pricing power if what you sell is critical, low cost, difficult or impossible to get elsewhere and/or you have a strong brand. Ultimately if you need to increase your prices you should, your businesses survival may depend upon it. Just remember that your prices are typically someone else's costs and we live in a highly connected economy.

Cash buffer (and act like a 3 year old)

The cash reserves of businesses have been depleted as a result of the pandemic and are therefore lower than feels comfortable for many.

Every business is different but as a general goal, having sufficient cash to cover three months of costs is a good minimum target.

Profit and cash are interlinked but can be misleading if you only look at one or the other in isolation. For example, good cash flow can hide an unprofitable business and vice versa. If your business is short of cash, take steps to understand why that is the case and seek help if you need it. For example, is it because the business is profitable but customers aren't paying you quick enough? Act like a three year old, keep asking yourself why until you get to the root of the problem and there are no more 'why's', e.g.

Q: Why is cash flow bad?

A: Because our customers don't pay us quick enough.

Q: Why?

A: Because they dispute our invoices

Q: Why?

A: Because they don't agree with the amounts

Q: Why?

A: Because they haven't been agreed upfront

Q: Why?

A: Because our contractual terms aren't made clear at the beginning and we don't receive a purchase order agreeing the sum payable and when

Q: Why?

A: It gets forgotten, we are too busy, its urgent for the customer etc….

Q: Embed getting purchase orders into the business's process. Make it the businesses policy that no orders / work is done until the customer has sent back a signed purchase order / contract. No ifs or buts

The above is an over simplification but the principle is right, if the value of addressing the issue exceeds the cost of introducing the solution, why wouldn't you do it?

If you feel you are over-cashed, separate that extra cash into a separate account, consider whether to invest this surplus in the business and keep that business savings account out of reach unless you really need it. Don't allow comfortable cash flow to allow you to become complacent about credit control for example.

Summary

Hopefully the above has provided some ideas on what you can practically do and as always, the team and I are here to help if you need us.

James Abbott

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