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Commercial Insights with Regions Bank

Episode #16

How to Make Your Business Inflation-Resistant

One word is on the minds of business owners everywhere: inflation. What does a new period of inflation mean for your business, and how can you set policy to mitigate it in the future? This episode covers everything from pricing to internal policies and strategies for weathering inflationary pressure.

Episode Transcript

SME: Brian Willman, EVP, Head of Commercial Banking, Regions Bank:

I do think that business owners are in a much better spot than we historically have been. Because of the COVID pandemic, they have realized ways to strip out costs, to use the technology and to try to, as much as they can, control the inputs of goods and services and supply chain disruption and labor. They have not had an easy road the last couple years, and so it just seems like things are piling on now with inflationary pressures being exacerbated. But, I do think the business owner is pretty resilient.

Chris Blose, Host:
Welcome to Commercial Insights with Regions Bank. I'm your host, Chris Blose, and the perspective you just heard comes from Brian Willman, Executive Vice President and Head of Commercial Banking.

If Willman sounds optimistic, that's because he's already seen businesses weather plenty of storms through his 13 years at Regions Bank, including the pandemic. Willman was the one of the first-ever guests on this podcast, and now he's back to offer his perspective on a topic dominating headlines and the thoughts of consumers and business owners alike: inflation.

Brian, welcome to the podcast. You helped us kick off our inaugural season last year, and it's nice to have you back.

Brian:
Yeah, it's great to be back. Thanks for having me.

Chris:
We want to talk a little bit about how the landscape has changed in the last year, and obviously we're going to be focusing on inflation today. From the end of 2020 to the end of 2021, inflation was up 7% in the country. Are we expecting similar trends for the rest of 2022?

Brian:
Unfortunately I would say we're not gonna expect similar trends around 7%. I think it's gonna be much higher.

I think the federal reserve has signaled that they're unwinding some of their monetary support for bond purchases, coupled with expectations of quarter-point rate rises through the balance of 2022, which would help a soft landing for the economy and inflation, you know, potentially in that 4 to 5%. Everything changed with the invasion of Ukraine by Russia. That's put tremendous price volatility on energy, coupled with even things that folks might not realize Ukraine supplies. One of those is, they are a 90% supplier of semiconductor grade neon for the chip manufacturers.

And so if you're looking to see any more automobiles or trucks on the lots anytime soon, I think that's gonna further delay that. And then anytime you have short supply, basic economics 101 would indicate that's gonna cause prices to continue to go up.

I think a long-winded answer of saying yes, inflationary pressures are here. But there will probably be short term, volatility and even higher inflation.So crazy times, but certainly an opportunity for us to give advice and guidance and help our business owners navigate these unprecedented times.

Chris:
Now, is the sort of shock of that exacerbated by coming off of a low relative rate of inflation? And does that affect the way consumers react to it?

Brian:
Yeah, absolutely. And I do think we have to think about both the consumer and the business owner because you cannot separate the two. The US economy still is driven primarily on consumer behavior and what they do with their disposable income.

Chris:
Now obviously things like gas prices are the things that grab headlines, you know, but it goes much deeper than that if you're a business owner or if you're a business decision-maker. So when it comes to inflation, what are the factors that are most important for you to consider when you're setting policy and thinking about what the next few months or the next couple years are going to be like?

Brian:
As a business owner, your ability to pass through your own cost of goods that are priced much higher than they were two years ago is a major concern. I mean, at some point the consumer will push back and their ability to absorb price elasticity, I think is a challenge.

A lot of customers are trying to pre-buy inventory because they don't know what the future will hold. One, the availability of those inventory of goods, but they're getting at much higher prices. And so you can't pass on that pricing, then you are subject to margin compression. And so coupled with that, if you're a net borrower, borrowing costs are going up. Still from a very low basis, but they're going up. And based on what the latest Fed projection is, there could be potential of five to seven quarter-point rate rises in 2022 alone. That would be almost double the core borrowing cost and floating rate perspective for our commercial customers.

And so we certainly need to be, as a bank, giving them options, looking at ways that they can lock in a portion of their budget, whether it's borrowing cost or can they prefund inventory and so they have as much certainty as they can in today's world, the ability to run their business and at least keep their margins as flat as possible if not growing somewhat.

Chris:
So you brought up the pass-through cost factor and how much consumers and customers are willing to bear. Are there ways to assess or predict how much consumers are willing to bear? How do companies actually feel that out?

Brian:
Well, certainly, understanding your customer is the main way. That's often hard to do because customer behaviors change; they change rapidly. We saw that evidence certainly with the pandemic and consumer behavior. There's a lot of research that's out there that will tell you that consumers feel pretty good about where they are. I mean, debt levels relative to income are down. When you had a lot of assistance coming out of the pandemic, balance sheets on the consumers are relatively healthy, as they are in businesses.

At the same time, you still have tremendous volatility of prices and jobs and labor, employment. I think volatility is here to stay certainly for the near term. It's great to have a three year strategic plan, but oftentimes, you have to be agile and augment that on a moment's notice.

Chris:
And how much does that planning, or that need to be agile, vary by industry?

Brian:
Yeah. A lot of variation, certainly the ability to pass through costs. If you have a shorter sales cycle, like a service-based business or groceries, I mean, you're looking at dynamic inventory just in time. I mean, there are things that you can forecast a little bit better, but obviously companies and businesses that have longer sales cycle — if you're trying to get raw materials, certainly the challenges and logistics, supply chain disruption has been very evident over the last couple years.

I do think businesses that are having longer sales cycles are trying to lock in contracts at a cost-plus basis, so they're protecting their margin.

So I think service base versus manufacturing or other longer sales cycles, they do differ. But at the end of the day, business owners have to sell something, they have to generate revenue, and there's a cost of doing so, whether that's service base with labor or it's manufacturing with raw materials. And then what is that profit that they can generate over time, to have a sustainable growing business?

Inflation doesn't help, but there is some benefit too. If you think about the ability to pass on price increases. One of the things that I do expect to see as inflation does start to dissipate at some point — I stopped predicting a long time ago, 'cause I don't think anybody has a crystal ball — but you do expect at some point inflationary pressures to dissipate. Well, those price increases that were passed on, you can bet that business owners are gonna try to keep as much of that margin, if their costs go down, and keep prices up as they can. But the basic supply and demand forces, you know, competitors will then see opportunities to cut price, to gain share and so that will be the equilibrium over time.

But I do think there could be some benefit 'cause we are coming off such a low-inflation and low-cost basis and price basis that a lot of business owners are happy to see a little bit higher prices they can charge for their goods and services.

Chris:
I'm glad you brought up the difficulty of making predictions or forecasting too. And I'm curious just in general, is forecasting changing in this era of high volatility? Do you have to revisit your forecast on a more regular basis for everything across the board?

Brian:
Absolutely. I mean, I think you still have to have a plan, but those plans have to be nimble. You have to be willing to adjust on a moment's notice. You can't certainly run a business and be fickle by the hour or day. And now with 24/7 news and geopolitical risks, there's always gonna be something that's out there. What as a business owner you have to do is really navigate what is relevant and what will impact my business versus what is just noise.

There are so many different factors now that cause things to change on a dime. And so business owners, as much as they can, if they can take some of that risk off the table, whether it's locking in inventory, pre-funding the cost of goods or locking in their borrowing cost. I think they wanna do that because then that's one less thing that they have to worry about. But obviously when you do that, you're placing a bet basically on if the price is gonna rise or fall from where you locked in at. So there is that component to think about.

Chris:
There are a lot of components to think about with inflation, clearly. You actually mentioned growth, as well. How does the thought of growth fit into planning during an era of inflation?

Brian:
Well, if you think about just the cost structure, so you have the revenue piece, you have the top line, how do you grow your business? How do you sell your goods or services? And then, let's say that's a dollar, everything below that line is a cost. There's a cost of acquiring labor. There's a cost of technology. There's a cost of your raw materials, goods and services. All of those things for now, and certainly for the foreseeable future, are much higher than they once were even a short time ago. And so businesses have to think about, do I need scale, do I need better purchasing power? Are there competitors or things that I need to look at if I have capacity from a capital or borrowing perspective? Maybe if I got larger, that allows me to have better pricing power, for some of these inputs into my business.

And so we are seeing that. We're seeing a lot of M&A activity. We're seeing a lot of businesses that are willing to sell, or they're just saying, hey, now's the time to get out because my top line and my profitability over the last couple years has been at an all-time high. I see significant headwinds in the future, and so now's the time to take some chips off the table and monetize their business.

And then the ones that want to continue to be consolidators, whether that's through strategic buyers or private equity, there's certainly more liquidity in the system than I've ever seen in my career. And I think with volatility that's out there and some of the challenges some businesses are seeing this as an opportunity to take share away from potentially weaker players or ones that wanna sell.

Chris:
Are there lessons from past inflationary periods that carry over that businesses can learn from now?

Brian:
You know, that's an interesting question. I think the top line yesterday was the highest inflationary measurements in 40 years. Well, most business owners either have not been in business that long, they might not even have been in existence that long. So those lessons learned are very hard.

I do think it's a lot different from where we were, certainly in the '80s, from a standpoint of when we saw this level of inflation, because that was a different time. It was more of a truly domestic economy. Obviously gas and fuel and mortgage rates got the headlines. But, you had very high unemployment at that point. It was a different economy that was really coming out of a recession in the '70s, and we're not in that spot now. Even though you have some things that are driving — certainly energy prices that are much higher and, and probably are predicted to go a little bit higher — you have a very strong economy coming out of the pandemic.

And so, I personally think that we'll weather the storm much better.

Chris:
How much should a business focus on internal factors, such as spending, such as, you know, their HR policies, such as their growth plans, versus external factors such as price pressure?

Brian:
I think you have to go back to controlling what you can control. Great strategies that rely on external factors to be perfect, that's a recipe for disaster. I think business owners have to look at what can I do around my inputs and costs? Labor, do I have to raise minimum wage or do I have to pay more, but in doing so, I can guarantee a workforce that can have the output to generate more top-line revenue. That's a question that they have to balance.

At some point, there is a limit to the cost of that labor that they can absorb, but that's something the business owner is certainly looking at now. The raw materials, their ability to prefund or to acquire those materials at a price that based on what we expect the future to be probably more than likely will be higher. So if they lock in as much as they can now, then that's a one less variable that they'll have to think about going forward in terms of running their business.

But again, there are things that are always gonna be outside of a business owner's control. And so going back to being nimble, having to augment your strategy or plan at a moment's notice sometimes is gonna be a factor, and those that can navigate the storm, so to speak, and doing it in a prudent way, a thoughtful way, a consistent way will come out on the other side much stronger. And I do think there are tools that we want to help them with.

Brian:
I mean, we deal with all different sizes, different types of businesses each and every day. And so we can share best practices that we see business owners doing to combat some of this, whether that's locking in some of their cost structures with forward contracts, locking in their borrowing costs, if they're a net borrower, looking at potentially expanding the use of their capital allocation so they can go acquire share or businesses.

Chris:
You've really highlighted the importance of having a plan to weather inflation. What is the best way to track the outcomes of that plan along the way, and then to be able to adjust and pivot as you need to?

Brian:
Absolutely. I think having a plan is great. And then ultimately you have to look at it, if not every day, frequently. And then if it's not going according to plan, then what can you do to change or augment that strategy to get it back on track?

And I think that's the biggest thing that I see running a commercial bank, is the ones that are successful, they have a plan. Not only does the owner or the leader know what that plan is, but that's permeated throughout their organization so everyone has clear expectations around what they can control. They have a sense of urgency and passion around executing that plan, and they celebrate their success as a company.

Chris:
Perhaps never before have planning and agility needed to go hand in hand so closely, and that's certainly the case for our period of inflation. Surprises may keep coming, but many post-pandemic businesses have the toolkits to prepare themselves for surprises.

Thanks to Brian Willman for lending his insight today, and thank you for listening. Get related resources for your business and listen to future episodes at regions.com/commercialpodcast. And subscribe to this podcast on your favorite podcast service.

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