# ACTIVATE

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## Can you weather the storm?

**Inflation is back! And it's not just in Australia; it's making a comeback around the world.**

**Inflation is a rise in the general level of prices of goods and services in a given economy over a period of time. It changes an organisation's profitability, productivity, and viability.**

**What measures does your organisation have in place to guard against inflation?**

**In this edition of Activate we consider some of the potential drivers of inflation, and suggest some strategies to help your organisation weather the current inflation storm.**

**Or if you are seeking a customised solution to guard against inflation, Active Cost Management's expert consultants would welcome the opportunity to work one-on-one with you.**

**Yours in good business!**
**The Active Cost Management Team**

## Quick hints

- Watching inventory weekly will prevent you from being saddled with left over merchandise that ties up your cash flow.

- Separating the 'nice to do' from the 'have to do' will cut costs.

- Getting aggressive with debt collecting will improve your cash flow and save you money.

- Strengthening your banking relationships will get you a better deal from your bank. If not, change banks!

## Inflation – how to combat it

The past decade has been one of relative stability, with good economic times, steadily rising property prices and consistent Federal Government policies creating a business environment with relatively few surprises.

But 2008 and beyond will be different. Inflation is a very real threat.

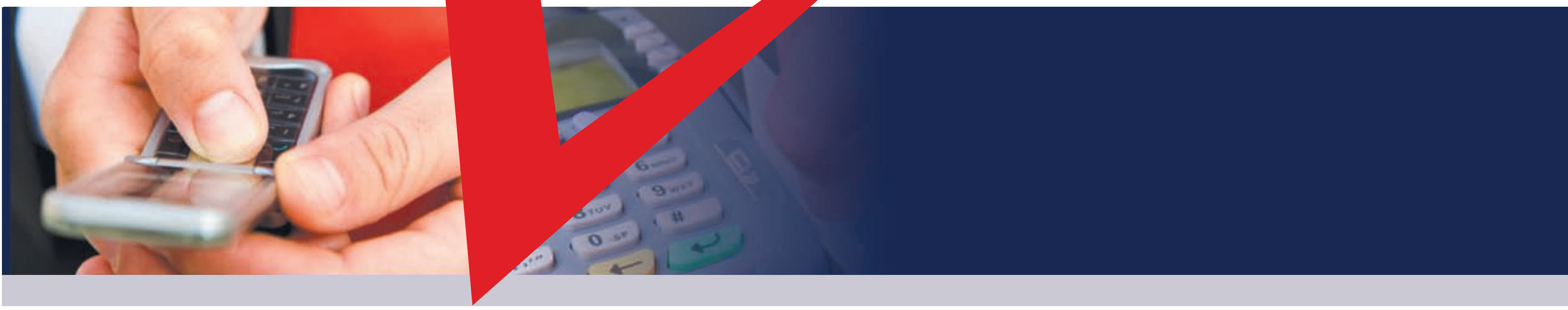
So what's the secret to your business success whether inflation is high, moderate or low?

It's business efficiency.

Achieve efficiency in everything you do – from the price you pay for goods and services through to bank charges and wages – and the more resilient your business will become to changes in inflation.

Consider the following strategies and how they might apply to your business. It pays to use Active Cost Management's experience when developing inflation safeguards – as you can see, with every advantage there is a disadvantage. It's important to carefully consider which strategies are right for you.

| Strategy | Advantages | Disadvantages |
|---|---|---|
| Independent 'real time' pricing policy: e.g. tiered by volumes, or payment terms, or location of markets, or current stock availability. | Promotes clarity of thinking and consistency throughout the business. | The wrong strategy can turn customers away. It can take time to change internal attitudes and systems. |
| Increase prices in line with CPI. | Steady rate of increase. Justifiable. | Limited flexibility as it only allows you to follow the market and hold margins. |
| Increase prices by more than CPI. | Profit goes directly to your bottom line. | Customers may shift business to competitors or reduce volume purchases. Your value proposition needs to demonstrate improved on-going benefits to customers. |
| Hold original equipment manufacturer (OEM) prices, increase service and spares prices. | Does not impact OEM sales values. | Reduces customer loyalty and the likelihood of second generation sales. |
| Increase productivity. | If this can be achieved through automation, sourcing machines from overseas may be cheaper at present with the high Australian dollar. | May encourage wage demands for productivity related increases that erodes any savings. |
| Reduce value: reduce size of product or increase response time. | May not be transparent. | Potential loss of customer loyalty. |
| Reduce waste. | Increases profit without increasing selling prices. Improves formal internal and external processes and records. Demonstrates senior management leadership and commitment. | Takes time to implement successful waste strategies and change organisational culture. |



## Inflation – what drives it?

Mainstream economists around the world overwhelmingly agree that high rates of inflation are currently driven by rocketing oil prices and high rates of growth in money supply. There are also many other drivers:

1. Increased finance costs – Australia's banks borrow money from international sources. When interest rates rise, the cost of borrowing increases. If interest charges kill a business, there are also losses due to bad debts. These costs are passed on to surviving businesses and consumers as banks recover their losses.

2. Increased buying costs – raw materials and products and services cost more for businesses to buy when commodity prices rise, the Australian dollar falls, or when costs rise in 'low cost supplier countries'.

3. Increased property costs – when the Consumer Price Index (CPI)* climbs, lessees find their property costs climb too. Most leases have a CPI clause.

4. Increased wages – this is typically the single largest cost for businesses. When staff resources are scarce and competition is high, wages increase. Re-negotiations under enterprise bargaining and workplace agreements for 'catch-up' settlements can also bring about wage increases.

* The CPI is one of several price indices measuring the average price of consumer goods and services. The percentage change in the CPI is a measure of inflation.

| Strategy | Advantages | Disadvantages |
|---|---|---|
| Offshore production / staffing. | Reduces costs of acquiring, training, housing and equipping staff and has low labour costs. | Increases risk with the value of the Australian dollar changing regularly. Loss of production control, longer supply lines, and larger production runs and inventories required. |
| Reduce supplier input costs. | Any pain worn by suppliers. | Suppliers may try to reduce non-contractual elements to save costs (sales support, customer services, and timeliness of supplies). |
| Lock in supply prices through long-term contracts. | Predictable pricing. | You may have incorrectly called the trend and have to buy out the position. |
| Dominate the market: buy-out competitors or specialise until you own 80% of the market. | Allows higher degrees of price control and bargaining power. | ACCC interest. Potential to attract smaller competitors. High cost of goodwill on purchased businesses. |
| Invest in non-cash items. | Non-cash items rise with inflation, while cash decreases in value. | Most non-cash items do not have a liquid market. Inventory increases require more costs for storage, insurance, handling, obsolescence etc. |
| Borrow. | Highly geared companies repay in depreciated dollars. High gearing means higher risk to liquidity. | Increased price elasticity in demand could exert downward pressure on selling prices/margins and expose gearing vulnerability. |
| Improve cash flow. | Reducing stock levels and 'day's debtors outstanding' minimises cash invested. | Risk of being out of stock or losing customers to competitors with more generous terms of trade. |
| Go back to basics: redesign the product. | 80% of cost is determined by the design and specification of the product. Redesign can see significant cost reductions, and if features are better, then may increase selling prices and margins. | Risk of market redirection. Delays due to partners, licence holders and gatekeepers. Cost of customer research and product development, retooling plant. |

## Keep your business on track in any inflation climate.

Contact us to find out how Active Cost Management's advisors and practitioners can help you reach your cost management goals in:

telecoms and data, freight and couriers, office supplies, printing, catering, energy, advertising, packaging, cleaning, waste management, document storage, and more.

Telephone: 1300 300 969
Email: info@activecost.com.au