

The Impact of Inflation on SMBs: How To Come Out On Top

9 min read



Inflation has hit the news hard and our bank accounts. And more likely than not, it has hit your business too.

Key Takeaways

- **What Causes Inflation:** Inflation isn't caused by raising prices; it is raising prices. Instead, inflation is actually caused by the reduced purchasing power of a specific currency...
- **The Current Numbers:** In January, the United States Bureau of Labor and Statistics reported a 6.5% consumer price index (inflation rate) for December of 2022...
- **A Strong Back Office Supports a Stronger Business:** To know your numbers and have accurate, timely financial reports you can rely on, your business needs a robust back office that's outfitted with an experienced team...

According to the *Small Business Index* from MetLife and the U.S. Chamber of Commerce, 90% of small business owners are concerned about the impact of inflation on their businesses, and 54% are very concerned. Additionally, 50% say that inflation is the biggest challenge they're facing, and more than 70% believe the worst is yet to come [1].

What Is Inflation? By Definition...

The term inflation refers to the rate (represented as a percentage) at which the price of commodities increases over a certain period of time [2]. The U.S. Consumer Price Index, for example, represents the increased cost of consumer goods over an annual period.

What Causes Inflation?

Inflation isn't caused by raising prices; it is raising prices. Instead, inflation is actually caused by the reduced purchasing power of a specific currency, and a multitude of factors can result in the diminished value of a currency.

Generally, currency can lose value as a result of the supply of money increasing more quickly than a country's economy. It also occurs as a result of an imbalanced supply and demand where there is not enough supply to satisfy consumer demand (i.e. supply chain problems resulting in scarcity).

How Inflation Impacts Business

During inflationary times, most businesses must contend with two different challenges. These include increasing costs and decreasing consumer demand. (Businesses that provide necessities – such as housing and energy providers – do not always experience a decreased demand during inflationary times because their products and services are prioritized by consumers.)

As the price of commodities increases, almost every business's cost of doing business increases. This shrinks profit margins and can force businesses that already have slim margins to operate in the red.

On the other end, the average consumer (B2C businesses) or commercial client (B2B businesses) has less money to spend on goods and services. This means they are forced to restrict and prioritize their spending. If your product or service is not a necessity, then it might get cut from the budget.

As a result, businesses generate less revenue and smaller profit margins, and this means businesses are left with significantly reduced profits.

The Current Numbers: Today's Most Recent Inflation Report

In January, the United States Bureau of Labor and Statistics reported a 6.5% consumer price index (inflation rate) for December of 2022 [3]. While this means that average prices are still up 6.5% over the previous year, the rate itself has decreased from the high of 9.1% reached in June of 2022 [4]. From November to December, slowdowns were seen in individual categories, as well, including energy and food costs [5].

According to the Federal Reserve Bank, an acceptable rate of inflation is about 2% or lower annually [6]. So, inflation still has prices rising at a higher-than-normal rate and putting increasing pressure on consumers and businesses to balance their budgets and make ends meet.

Read More: [How to Survive When Inflation Is High: 5 Business Strategies for Inflation](#)

Will the Inflation Reduction Act Help SMBs?

Last year, President Biden signed the Inflation Reduction Act. According to a September 2022 fact sheet from the White House [7]:

"The Inflation Reduction Act makes urgent investments to lower prescription drug costs, health care costs, and energy costs to create opportunities for America's 33 million small businesses

and innovative startups. It is the most aggressive action we have taken to confront the climate crisis. It will help the Fed tackle inflation by reducing the deficit. The super wealthy and large corporations are asked to pay their fair share, and no small business or family making under \$400,000 per year will pay a penny more in taxes."

Despite this promising language, however, experts are mostly in agreement that the Inflation Reduction Act will not have a significant impact on inflation because the support and tax credits it's offering stand to mainly benefit individuals and businesses who are willing to spend more money to invest in installing clean energy in their homes and businesses. The legislation itself does little to actively lower or alleviate the strain of current energy and commodity costs [8].

So, unless your business already has goals to go green (in terms of your energy source) in place and in your budget, then the Inflation Reduction Act won't be providing you with much relief.

What's the difference between businesses that struggle to survive and those that succeed? It's more than just sales.

The difference is in your back office.

[Speak to an expert today to learn how an outsourced back-office helps organizations persevere through their financial challenges.](#)

How to Strengthen Your Small Business to Weather High Inflation Rates (10 Strategies)

Although the Inflation Reduction Act offers some promise for the future of the U.S. economy, businesses in the present have been largely left in the dust by this deceptively named legislation. Consumers and business owners alike are having to dig deep into their pockets to cover the everyday operating expenses that have skyrocketed in price over the past year.

As a result, it's necessary for business leaders to take action and implement new strategies to shore up their businesses in the face of inflation and increasing costs. So, what can you do to help your business weather this inflationary storm?

1. Focus on Profit Margins

You can't sell your way to profits if you don't have healthy profit [margins](#). Use meticulous expense tracking and cost allocation so that you can use unit economics to pull profit and loss statements on every aspect of your business. Pull P&Ls on by individual client and job in addition to client type and job type.

2. Adjust Your Pricing

If your profit margins aren't wide enough to accommodate today's inflation or potential inflation of the future, then you might need to adjust your prices and pricing model for inflation. When quoting prices to your clients, be sure you know your costs and are building ample profit margins into your prices.

Read More: [How to Adapt Your Business's Pricing for Inflation](#)

3. Know Your True Costs

In order to price your services right, you need to know your true costs. This includes direct costs and indirect costs. To understand your true costs, keep careful records of all expenses and properly allocate overhead costs to jobs.

4. Cut Costs Where You Can

Once you're aware of all your costs, go through them with a fine-toothed comb to determine [what can be cut](#). In inflationary times, your budget is going to be increasingly limited, so you should be avoiding waste and saving anywhere you can.

Another strategy for cutting costs is to look through your accounts payable and determine whether any of your vendors offer early payment discounts. If you have a healthy enough cash flow to take advantage of these discounts, then you should go after the savings to lower expenses.

5. Use Forecasting to Monitor Your Future Cash Flow

When costs are in flux, it's imperative to keep a close watch on your company's cash flow statements to ensure you have more money flowing into your business than out of your business (or at least equal amounts flowing in and out so you break even).

Additionally, use the trends found in your historic cash flow statements to forecast future cash flow. While these historic statements won't reflect the current inflationary climate, they will help you spot seasonality in your business or other trends that, when combined with higher costs, could push you into a shortage.

“GrowthForce helped our financial manager get the daily tasks done right, and more importantly- gain insight into our numbers which was a significant evolution in our path as a small business.”

- Peta Hoyas, COO tag1

6. Have Available Strategies for Overcoming Cash Flow Shortages

While no one hopes to encounter a cash flow shortage, every business leader should have a plan for overcoming a cash flow shortage if (and when) one is encountered. Your plan could include an ample cash reserve, an available line of credit, or an investor who's ready and willing to inject cash into your business.

7. Don't Lose Sight of Your Goals

Yes, seeing your business through inflationary times requires focus and business savvy. It's going to take part of your attention, and it will likely cause you some stress. However, don't allow inflation and increasing costs to let you lose sight of your [long-term goals](#). Of course, your short-term goal might currently change to something like "survive this economy," but this won't last forever.

Do not make budget cuts or changes to your business model now that will derail your long-term plans. Get your business through these current challenges and then be prepared to focus your attention back on your future vision.

8. Automate Low-Value Tasks

You're paying too much for any low-value tasks that are currently being handled by paid employees if these tasks can be automated. Even though you might have a larger up-front cost to invest in automation systems, you'll save money going forward. Plus, you'll be able to redirect your newly time-rich employees toward accomplishing tasks that generate a more significant ROI.

Read More: [4 Ways to Fight Employee Burnout With Automation](#)

9. Get Ahead of Supply Chain Issues

If you rely on any type of supplier for your business to function (such as construction materials), then you need a plan to navigate supply chain problems before you run into them. Work on maintaining strong relationships with your existing vendors, negotiate deals (if you can) to be first in line to receive supplies, and cast a net for additional vendors who might be able to work with you if your existing relationships fall through.

10. Work on Employee Retention

We often associate tough economic times with layoffs. During inflation, however, you're at risk of losing employees to higher-paying jobs elsewhere, and employee turnover is one of the biggest expenses in business. Remember that your employees are suffering from increasing costs in their home budgets, as well. They might be in need of a pay raise, and if you're not the one to provide it, they will go looking for it elsewhere.

A Strong Back Office Supports a Stronger Business

It's always important for a business owner to know their numbers, but during uncertain economic times, it's even more essential. To know your numbers and have accurate, timely financial reports you can rely on, your business needs a robust back office that's outfitted with an experienced team and a suite of advanced, easy-to-use tools and technology. A smart back office can help you accurately and thoroughly record, categorize, and track expenses, revenue, employee time, business changes, profit margins, and more to ensure you always have a clear view of your company's financial health and an as accurate as possible picture of its forecasted financial future.

[1]

<https://www.uschamber.com/small-business/inflation-concern-reaches-new-high-for-small-business-owners>

[2] <https://www.investopedia.com/terms/i/inflation.asp>

[3] <https://www.bls.gov/news.release/cpi.htm>

[4]

<https://www.bls.gov/opub/ted/2022/consumer-prices-up-9-1-percent-over-the-year-ended-june-2022-largest-increase-in-40-years.htm>

[5] <https://tradingeconomics.com/united-states/inflation-cpi>

[6] <https://www.federalreserve.gov/faqs/5D58E72F066A4DBDA80BBA659C55F774.htm>

[7]

<https://www.whitehouse.gov/briefing-room/statements-releases/2022/09/12/fact-sheet-how-the-inflation-reduction-act-will-help-small-businesses/>

[8] <https://treasury.ms.gov/2022/08/19/mcrae-the-inflation-reduction-act-will-not-reduce-inflation/>