

Unless You Have Been Like Tom Hanks in the Hit Movie Cast Away.....



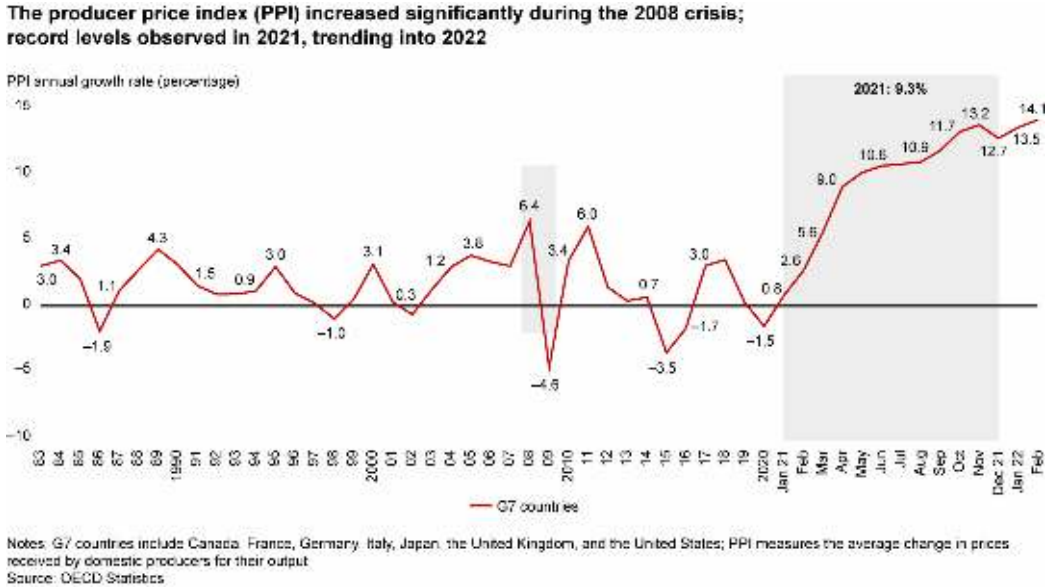
As the title of my article indicates, unless you have been in the same predicament as Tom Hanks was in the 2000 movie 'Cast Away', you have read by now that inflation is running rampant on a global basis at levels not seen in over 40 years. Before we turn to our discussion about inflation, I thought it might be interesting to shed some light on the Cast Away movie what starred Helen Hunt and Tom Hanks.

The movie was released in December 2000 and was a box office smash. The 143-minute film had a budget of USD 90m and the total box office revenues since then are now over USD 400m. In the movie, Hanks plays a FedEx troubleshooter stranded on an uninhabited island after his plane crashes in the South Pacific, and the plot focuses on his desperate attempts to survive and return home. The movie received generally positive reviews from critics who praised its screenplay and Hanks' performance, for which he won Best Actor – Motion Picture Drama at the 58th Golden Globe Awards and was nominated for Best Actor in a Leading Role at the 73rd Academy Awards.

But let's get back the real world and leave the fantasy land of being stranded on an island in the South Pacific behind. The initial part of my article will look at the data on the current surging wave of consumer and producer price indexes in the United States and elsewhere and then I will present some ideas on how we can adapt and manage our global factoring firms in the future to successfully navigate these record increases in the cost of labor and capital.

I began to write and publish articles based on the reading and research I was doing at the time in early spring 2021 on inflation well before it was on many if not most radar screens. Since then, inflation has gone from an afterthought to a political and economic hot potato. Much has been written about inflation and the blame game is in full swing by politicians and others about whose “fault” it is. The culprits include but are not limited to the war in Ukraine, President Biden, former President Trump and his administration, post Covid-19 surging demand for products by consumers globally, China, the supply chain bottlenecks, large oil companies, price gouging by large corporations and others. There is no shortage of blame being spread around and this reminds me of the famous quote attributed to the famous author Aesop, “after all is said and done, more is said than done.” Amen.

There is also no shortage of data available on the current inflation situation at the present time in the United States. One of the most accurate ways to document inflation in any economy is to look at producer price index data, commonly referred to as PPI. I selected the following data on the annual growth rate (on a percentage basis) from OECD Statistics and it charts PPI over the past 40 years +/- for key G7 countries including Canada, France, Germany, Italy, Japan, the UK and the United States.



As clearly can be seen on the graph, there has been an unprecedented acceleration in PPI since the end of 2020 and never in the period charted (going back until 1983) have these G7 nations ever experienced such a rapid and pronounced leap in the PPI. In fact, the current increases in PPI are about double the previous largest percentage increase recorded in 2008. We are in by any measure in uncharted waters on PPI increases at the present time.

In the United States and elsewhere globally, the inflation data has turned the American consumer sour about the near-term prospects for the balance of 2022 and beyond. This is very important as consumer optimism and spending are highly correlated and if or when the American consumer turns skittish about spending it is not a matter of if but when the overall level of GDP is negatively impacted.

The data on consumer sentiment in the United States (and most other places globally) is not promising; in fact most Americans are angry about the economy and the data confirms that they have less confidence in the overall economic conditions in the United States today than they did before the Covid-19 pandemic happened. The central reason for this bearish perspective is the high and increasing levels of inflation at the grocery store, gas station, fine dining and fast-food restaurants and just about everywhere else consumers spend money.

I think what is often overlooked when we look at forces like inflation is that unlike other economic events (say unemployment or a short-term layoff), no one can escape the grip of inflation. It is ever present, and it impacts all of us regardless of economic status, geographic location or livelihood. It also I sense materially increases a feeling of helplessness or a loss of control or power. The unfortunate reality is that we as individuals have little or no control over inflation and this fact can lead to a sense of less optimism in the future.

One other compounding issue is that for the first time in recent history, workers in the United States and globally have seen significant increases in wages they are being paid. This is due primarily to well documented labor shortages and the “great resignation” well underway all over the planet. While in most situations this usually causes consumer sentiment to soar, just the opposite has happened in the United States. For many if not most, hyper-

inflation has robbed workers of any gain they otherwise might have had in their overall financial situation by the raises they received. This leads to a further deterioration in consumer sentiment and reinforces the fact that many Americans (and others) are falling farther and farther behind others.

The textbook solution to quell heightened levels of inflation by the Central Bank (Federal Reserve) in the United States has in the past been to aggressively increase interest rates to reduce growth and perhaps even “choke” the inflation fire. The risk of course is that these actions backfire and lead to a recession or worse as a result. As we all know the Federal Reserve announced a rate hike of 50 basis points earlier this month and has publicly said that more rate hikes will come in the future. Whether this plan works to materially reduce inflation without causing a recession remains to be seen.

One might ask what this discussion about inflation has to do with the factoring industry and what might be the impact of future rate hikes on SMEs and our industry in the future? It is no understatement that much is riding on actions taken (or not taken) by the Fed to quickly reduce inflation in the United States simultaneously guiding us to a soft economic landing (rather than a recession or worse). The impact of a miscue by the Federal Reserve on the SME ecosystem and their future financial performance is likely to be significant and could have a direct impact on their revenue stream and the amount of factoring of their B2B and B2G invoices for working capital purposes.

So what is the current sentiment among SMEs in the United States and what does their outlook portend for the B2B and B2G factoring industry right now? The answer to this very important question is quite simple: lousy.

The most accurate and consistently published data on SME sentiment and their perspective about near term economic trends has been compiled and published since 1973 by the National Federation of Independent Business or “NFIB”. The NFIB was founded by C. Wilson Harder in 1943 and maintained its headquarters in San Mateo, California, until 1992 when it was relocated to Nashville, Tennessee. The NFIB Research Center has collected Small Business Economic Trends Data with Quarterly surveys since 1973 and monthly surveys since 1986. The sample is drawn from the membership files of the NFIB, and the charts and data are copyright of the NFIB Research Center. © NFIB

Research Center. ISBS #0940791- 24-2. The Chief Economist of NFIB William C. Dunkelberg and Executive Director of the NFIB Research Center Holly Wade are the initial authors of the data and text in the monthly survey results.

I have read and used their research and findings in my articles and presentations over the past 20+ years and it has been consistently accurate and insightful into what SMEs are thinking and worrying about on a daily basis. The most recent monthly results (May 2022) contained a brilliant synopsis of the current state of what many if most SMEs in the United States today are saying about the near-term economic prospects for their businesses. Written by William Dunkelberg, it echoes what I hear all the time from our SME clients, prospects and partners and is reproduced below.

“Small business owners continue to try to fill their record high levels of job openings but are finding it difficult. Labor supply is not responding strongly to their high wage offers. Job growth will continue opportunistically but not robustly as the available supply of workers is small.

Owners are very pessimistic about sales and business conditions in the second half of the year. This dampens capital investment and, eventually, will feed into employment if sales actually slow as expected. Financial markets have already made significant adjustments to changes in Fed policies and the uncertainties of war and Covid shutdowns that continue in China. More is likely to come as assets, financial and real estate, are highly overpriced. Trying to “catch up” runs a growing risk of “overshoot,” hopefully that won’t happen.”

A very sobering assessment and one that I believe is spot on. It also seems to me that the current scourge of inflation could lead us quickly into a recession before we ever anticipate it occurring. Why? If we objectively look at consumer spending, history provides us keen insight into patterns of future behavior.

When everything costs more, consumers not just in the United States but everywhere make up for it by doing what? Cutting back on spending on both “essentials” and other purchases best defined as “non-essential”. I documented another recent article that the use of credit cards (and debt) has increased to record levels in the United States in Q1 2022. Individuals on fixed incomes have no other choice than to spend less when prices on basics have increased as rapidly as they have done in 2021 and 2022.

To offset spiking inflation, government policy makers primarily at the State and Local levels have approved tax cuts and other stimulus programs to help consumers and SMEs make up for higher costs. But ironically these programs have often caused inflation to increase even more due to higher levels of consumer demand and spending.

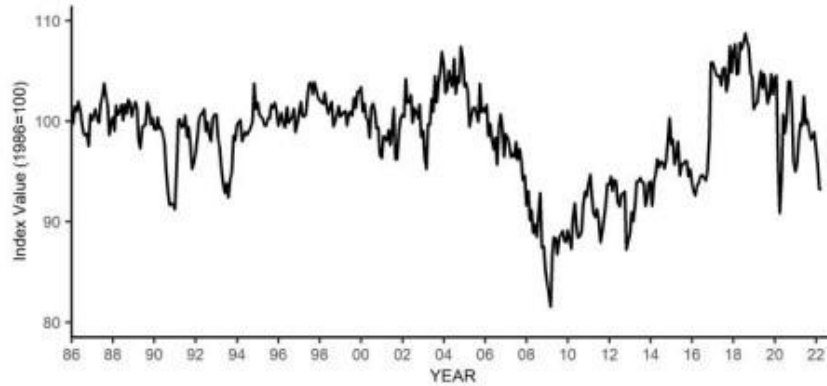
The monthly NFIB Surveys are comprehensive and make great reading. However, there are five key data metrics that I have consistently tracked and monitored to keep a pulse on SMEs and the impact their sentiment might have on the factoring industry in the near- and long-term future. These include the following: Optimism Index, SME outlook, sales, earnings and prices. I have included each of these data sets from the May 2022 NFIB Monthly Report below.

As can be seen on the first set of data, the NFIB Small Business Optimism Index continues to weaken and is now at 93.2. This is not a favorable sign and even worse is the SME outlook “if this is a good time to expand and expected general business conditions” (the second chart immediately found after the Index data below). The thin line on the chart (defined as those who believe conditions will get better before they get worse) has never been lower at any point in the 36 years of tracking by the NFIB than in April 2022.

OVERVIEW - SMALL BUSINESS OPTIMISM

OPTIMISM INDEX

Based on Ten Survey Indicators
(Seasonally Adjusted 1986=100)



OPTIMISM INDEX

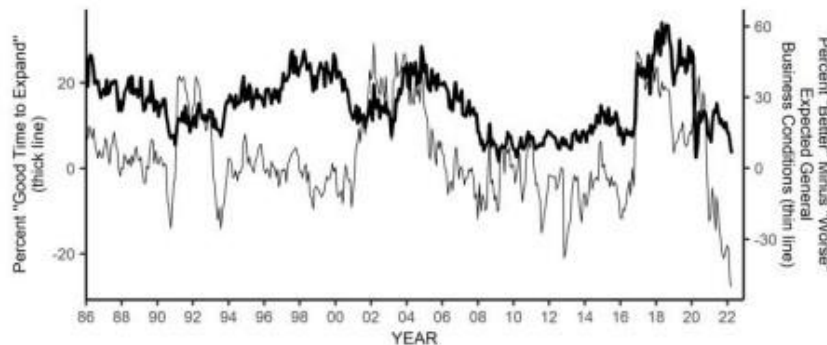
Based on Ten Survey Indicators
(Seasonally Adjusted 1986=100)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2017	105.9	105.3	104.7	104.5	104.5	103.6	105.2	105.3	103.0	103.8	107.5	104.9
2018	106.9	107.6	104.7	104.8	107.8	107.2	107.9	108.8	107.9	107.4	104.8	104.4
2019	101.2	101.7	101.8	103.5	105.0	103.3	104.7	103.1	101.8	102.4	104.7	102.7
2020	104.3	104.5	96.4	90.9	94.4	100.6	98.8	100.2	104.0	104.0	101.4	95.9
2021	95.0	95.8	98.2	99.8	99.6	102.5	99.7	100.1	99.1	98.2	98.4	98.9
2022	97.1	95.7	93.2	93.2								

SMALL BUSINESS OUTLOOK

OUTLOOK

Good Time to Expand and Expected General Business Conditions
January 1986 to April 2022
(Seasonally Adjusted)



The next data set tracks actual and projected sales for SMEs monthly over the period January 1986 to April 2022. Using seasonally adjusted data, the trend line is currently in the 10 per cent to 20 per cent negative area. This is not good news for future revenue and the overall volume of potential SME invoice factoring volume. The current levels of decline have not been this significant since the recessionary period of 2008 - 2009 in the United States occurred.

SMALL BUSINESS SALES



Not surprisingly, the actual last three months of earnings for SMEs tracked in the period January 1986 to April 2022 using seasonally adjusted data continues to weaken and is down 20 per cent+/- since peaking in 2018. Weak revenue (along with skyrocketing costs) combines for the poor overall SME earning performance so far in Q2 2022.

SMALL BUSINESS EARNINGS



What is perhaps even more foreboding is that nearly all SMEs have had no choice but to raise prices due to materially higher labor costs, raw materials and overhead and they have not seen any significant increase in revenues. The current rate (on a percentage basis) of price increases already done by SMEs is unprecedented in the nearly 40-year period of NFIB surveys completed monthly. This fact is perhaps the most distressing data metric in all the information published by the NFIB and is something that merits careful watching in the future. If at some point in the future SMEs are unable to increase prices on their goods and services (due to market competition, slowing consumer demand or both) and if they continue to incur spiraling costs of labor and overhead, the bottom-line results could be a financial disaster for many SMEs.

SMALL BUSINESS PRICES



This data on prices provides the perfect Segway into the final part of this article when I will discuss what steps SMEs can take to combat rising costs and inflation and how we in the global factoring industry could also adapt to perhaps permanently higher levels of real inflation in the future.

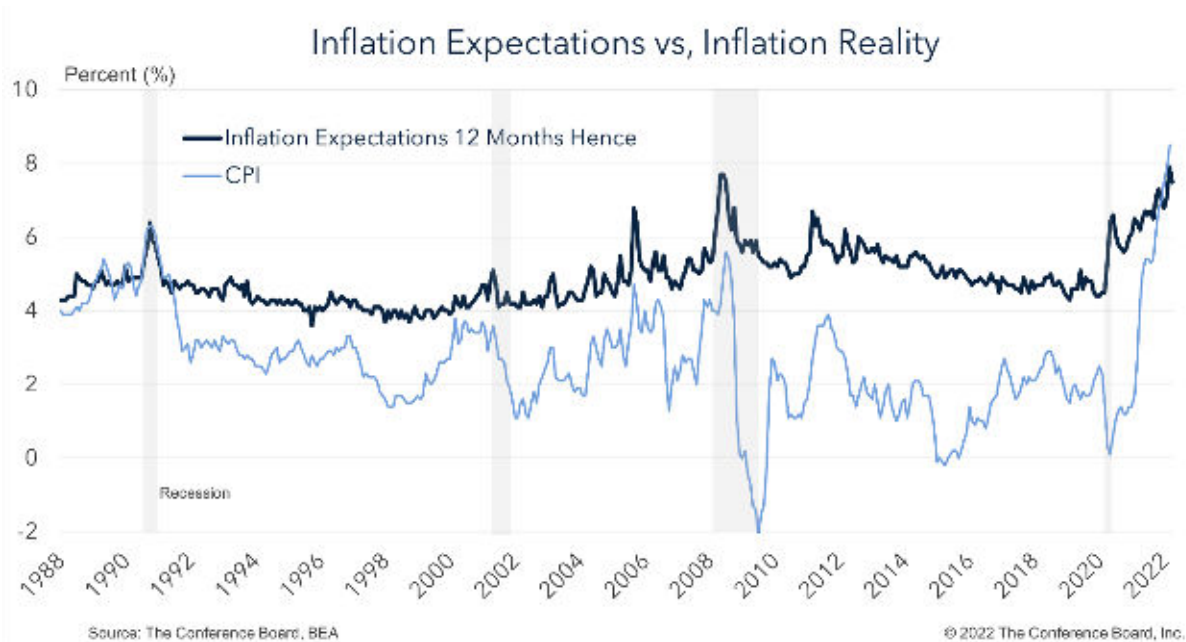
One additional area of research of interest to me is how much future levels of inflation are driven by “expectation” versus reality. I found some fascinating data going back as far as 1988 on the relationship between actual the consumer price index (CPI) and what inflation expectations were 12 months before. As you can see on the Conference Board chart/data below, there is a strong positive correlation between the two and my interpretation of the current data is that American consumers expect/anticipate that CPI will not only remain elevated in 2022 and 2023 but is likely to increase in the future.

The Conference Board also came to this same conclusion when it published in a recent blog¹ that “according to the April Conference Board Consumer Confidence Survey, US inflation expectations remain extremely elevated. While the most recent reading of 7.5 per cent is down slightly from March’s all-time-

¹ www.conferenceboard.org Blog May 2022.

high of 7.9 per cent, US consumers continue to expect the current wave of inflation to continue into 2023.

In 2020 and 2021, the Covid-19 pandemic brought with it disruptions to global supply chains, elevated demand for durable goods, and other factors that drove inflation higher. Those forces began to moderate towards the beginning of 2022—leading to a decline in inflation expectations. However, Russia’s invasion of Ukraine in February 2022 yielded a surge in energy and food prices that may keep inflation rates high even if pandemic-induced drivers moderate. While The Conference Board expects consumer inflation rates to peak in Q2 2022 and then gradually slow, our forecast calls for inflation rates well-above the Federal Reserve’s 2 per cent target through the end of 2023.”



Let’s finish up this article by looking at practical ideas and tactics the global factoring industry (and our SME clients) can take to successfully manage these higher levels of anticipated inflation in 2022, 2023 and perhaps even into 2024.

In anticipation of this article, I did a great deal of research and reading specifically trying to find an excellent roadmap to help us on the quest to manage effectively and profitably sustained higher levels of inflation in our factoring enterprises. One of the best comprehensive studies I found was published by Bain & Company² and it outlined some key moves that have helped companies in the past successfully overcome high levels of inflation.

For purposes of this article, I am only going to present their 6 key takeaways and then provide a limited number of comments. I found their research of great value and would highly recommend to all.

A quick overview of their research; they performed analysis on 5,700 global companies that took decisive steps to deal with a similar spike in PPI in 2008 and found several common denominators in the most successful firms in their research. Their research found that firms that cut costs the most to improve productivity the most during previous inflationary periods achieved higher total shareholder returns (TSR)—27 per cent was the median—than companies that took less action. (They determined productivity by measuring EBITDA and revenue growth.)

So it makes perfect sense that cost cutting was a key part of a successful plan to combat rampant inflation. But what were the specific six steps these most successful firms took according to their data?

1. They got spending visibility. Their research concluded that “high-resolution spending visibility is the foundation of any expense management capability. It enables managers to fully understand where money is spent and who spends it. In an inflationary period, it is critical to establish repeatable, end-to-end, actionable visibility of spending by cost category, business process, function, and business unit. This is the foundation for all other productivity efforts.”

² Turning Inflation Disruption into Value with 6 Strategic Steps, April 18, 2022; Research authored by Jason Heinrich, Simon Henderson, and Megan Portanova.

2. They differentiated between strategic and nonstrategic spending. They noted that “in any disruptive environment, odds are higher that executives will make choices that jeopardize the company’s long-term strategy. Instead, clearly distinguish between strategic and nonstrategic cost-cutting, the protecting of signature customer and employee experiences, and fiduciary requirements, for example. Use consistent, accessible financials to prioritize higher return on investment (ROI) decisions.”
3. They unpacked the drivers of spending. The next step as determined in their research was to “develop a more robust understanding of the real enablers of cost in an inflationary environment. Dissect the rate (prices paid) and consumption (quantity or volume), including the underlying drivers, for critical cost categories.”
4. They reduced consumption. By having increased spending visibility and the ability to isolate drivers, they found that the most successful firms tailored their consumption approach to match the inflationary environment. They suggest setting up a “spending czar” or “spending control tower.” I would suggest that we already have one of these in our accounting area but nevertheless an interesting idea.
5. They eliminated work. This is perhaps the most obvious and simplest step we can all take. It makes perfect sense to ask ourselves what and why we do certain activities and identify all that we can eliminate and or automate. Ask simple but difficult questions: is the task or function necessary or not? Can we do without it? Can we deploy the cost and use our limited labor and other resources more productively and efficiently or not?
6. They automated. Along with eliminating work, this is the next logical step in the process to combat heightened levels of inflation. There is a myriad of tools (AI, RPA, IDP) and others that can free up our factoring industry personnel and make them more effective and add value. This is an area that we all need to think about and be open minded on how to

better harness the power of digitalization and technologies not just in periods of hyper-inflation but on a permanent basis.

In summary and conclusion, I believe it is coming increasingly clear that unprecedented periods of very high inflation are likely to remain in place for the rest of 2022 and into 2023. We need to acknowledge that a quantum shift in our payroll costs and related benefit burdens are likely to also see significant increases soon and take prudent steps now to adjust and adapt accordingly. This will require that we accept that the damaging disruptions caused by global inflation are here to stay and will likely have long lasting effects on the factoring industry.

Now more than ever, insightful and bold leadership will be required to transform our status quo factoring organizations into more agile, nimble and focused enterprises. We can do this by carefully implementing some or all the 6 ideas I summarized in this article. When we do, we will find ourselves positioned to perform at the highest level and serve our clients, partners, employees and communities we live in successfully and profitably for years to come.