Recession or not, family businesses benefit from these strategic and tactical tips

Authored by Gary Plaster, Principal, MBA and Laurie Price, Senior Consultant, Baker Tilly US, LLP

The U.S. economy shrank for the second consecutive quarter in July signaling the onset of a technical recession as defined by The National Bureau of Economic Research (NBER). According to the Commerce Department, Gross Domestic Product (GDP) shrank by 0.9% on an annualized basis last quarter. This is the largest decline since the spring of 2020 when the country was in the midst of the pandemic. The slowdown is being driven by higher interest rates, raging inflation, declines in private inventories and reduced government spending.

Typically, recessions are also accompanied by high unemployment, reduced consumer spending and reduced exports. To date, some of these other economic drivers have not manifested, leading some economists to suggest that the U.S. is not officially in a recession.

Regardless of the technical definition and determination of a recession, many family-owned businesses feel like a recession has started already, due to rising material and energy costs, continued labor shortages coupled with wage increases, higher transportation costs and interest rates, decreasing demand and shrinking margins.

Companies in an inflationary environment heading towards a recession should consider a combination of internally focused cost cutting and operating improvement measures, as well as market and customer facing strategic measures.

Reduce operating costs to maintain profit margins

To maintain or even improve margins, companies must begin to measure and then reduce the cost of inefficient operations. Making an organization leaner by reducing waste and improving process efficiency is a must regardless of economic conditions.

Understanding costs at a product and customer level is critical. Having this visibility end to end allows for addressing issues that erode profit margins—rather than raising prices.

Evaluate supply chain risk to reduce costs

To date, the pandemic continues to disrupt some supply chains. Coupled with current economic conditions and volatile world relations, a business can be crippled by these supply chain factors seemingly overnight. A critical evaluation of supply chain risk can help a business proactively prepare or repair a vulnerable supply chain.

Frequent areas of vulnerabilities include the following.

- Dependence on very few or only one supplier
- Global suppliers, often with long lead times
- Specialty materials requiring nonstandard shipping and/or storage
- Operating a just-in-time (JIT) procurement process

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After the evaluation of risks, suggested mitigation steps and activities to reduce costs may include the following.

- Explore and establish alternate supply strategies
- Consider insourcing, near-shoring or re-shoring
- Where holding costs permit and the business is able, stockpile critical and/or specialty supplies
- Review and adjust safety stock levels if operating a JIT system
- Engage in commodity hedging, where appropriate

Monitor labor market susceptibility

U.S. businesses are still experiencing a talent shortage. Employee wage growth has not kept up with the inflation rate and companies are beginning to raise wages to match inflation. Some labor categories will be affected more than others will, such as high-demand professions like tax accountants, engineers and IT professionals; low-wage and minimum wage jobs and 1099 contract laborers, who typically can reprice their wages faster than W2 workers.

If a business is highly dependent upon these professions, it must develop a human resources strategy to attract and retain talent that includes:

- Market compensation studies
- Market-rate pay raises
- Nonmonetary compensation such as career development, employee benefits, remote work, flexible hours, etc.

Source: Top 5 Small Business Inflation Strategies - CFOshare

Invest in business technology

When labor markets are tight and economic conditions uncertain, another way a business can protect its bottom line is through investment in technology to help accomplish more with fewer resources. Opportunities should be identified and prioritized based on their ability to simplify operational processes and increase internal efficiencies.

Technology investments to consider may include any enterprise level software the business isn't already using, such as payroll, inventory management, project management, point-of-sale or customer relationship management. If an existing system is antiquated or dated, an update may be appropriate. Other areas of investment to consider include information security or cybersecurity.

Rationalize then streamline the product portfolio

Another strategy for high inflation is prioritizing profitable products, particularly if a business is constrained in its ability to meet customers' demands. Initial considerations should include eliminating slow-moving or nonprofitable stock keeping units (SKUs) with high resource requirements such as warehouse space, specialty materials, labor or any other resource that represents an excess cost or increases the complexity of offering the SKU.

Further and more complex considerations to streamline a business product portfolio may include considerations of materials, fastening methods or other engineering changes used in manufacturing products. Because materials are affected differently by inflation, feasibility studies for substitutions or engineering changes for a less affected option could be explored.

Create differentiated value with your customers

Smart business leaders will use the economic slowdown as an opportunity to build long lasting partnerships with their customers by understanding how to create differentiated value. An enlightened company will help its customers create value for their own customers. By collaborating with its customers, a business can maintain profit margin, win market share from the competition and strengthen the customer relationship in anticipation of the economic recovery.

Source: Beyond six sigma: profitable growth through customer value creation: Plaster, Gary

Strategically raise prices

To maintain profit margins, a business affected by inflation may consider passing price increases to its customers. According to Forbes, over 80% of small-business owners have increased their prices in order to counter inflation. To increase pricing power companies should:

- Leverage competitive differentiators
- Target less price sensitive customers with new selling, product positioning and marketing strategies
- Define new pricing strategies based upon additional services, warranties, bundling of products, commodity price increase pass-throughs or subscriptions
- Offer one-stop shopping through vertical integration

Learning from the past

Finally, family businesses can learn from strategies that helped businesses survive past recessions.

1. **Diversify your customer base.** By not relying on revenue from very few customers in very few markets, businesses can diversify revenue risk similar to diversifying a stock portfolio.
2. **Strengthen your operating systems.** Businesses should come out of the recession stronger and poised for growth by removing process inefficiency, bottlenecks and associated costs. Additionally, they should implement new technology and automation.
3. **Preserve cash**. Hold on to cash and reduce debt as soon as possible. Too much leverage in an economic downturn is a problem.
4. **Always be prepared.** Do what-if scenario planning. Be prepared to zig or zag! Do not overreact – be thoughtful in your response to changing economic conditions.

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5. **Seize the opportunity.** Look at a recession as a time of opportunity. As less financially stable companies struggle, there may be an opportunity to acquire complete businesses or market share. As demand decreases and companies take action to right size, there may be more available labor and downward pressure on input prices.

Questions? Contact Gary, Laurie or a Baker Tilly professional to learn more.