Finance Function Opportunities: Inflation article 1

Inflation – a challenge for chief financial officers

'Inflation is as violent as a mugger, as frightening as an armed robber and as deadly as a hit man'. This was the assessment of former US President Ronald Regan reflecting upon the period of inflation in the 1980s. How should chief financial officers (CFOs) and their finance teams assist their organisations in addressing the current inflationary pressures.

Challenges for CFOs and their teams

The period of inflation that we currently face **differs** from its predecessors in that its drivers affect **most lines** in the profit and loss account. Whereas the approaches adopted in the past may have focused on address the specific causes, on this occasion the pervasive nature means that a more co-ordinated approach across all aspects of the organisation is needed.

For many the first reaction is to seek to reduce costs or to drive to become more efficient. However, over recent years organisations have generally become leaner and do not have the ability to apply cost reduction techniques as easily as they once did. A **more holistic approach** is required which brings finance together with supply chain, operations, technology, human resources and customer facing groups across the organisation and also demands engagement with groups such as customers and suppliers. Automation may offer a partial solution, however the benefits of the investment required may take a time to filter through and it cannot be a total panacea.

In looking to the longer term, it is important to recognise that the imperative of net-zero and sustainability goals cannot be forgotten. This remains a time for investment to ensure the sustainability of the organisation. Affordability of these investments needs to be built into the scenarios if organisations are to remain sustainable.

Understanding and controlling your cost base is not the only consideration in inflationary times. There is also the debate around to what extent price increases should be passed on to the end consumer. The nature of the interaction with the consumer had changed since we last experienced a period of increased inflation. **Customers are now better informed** using social media, for example, and have more power in the model.

What steps can CFOs and their teams take

There are three key actions that CFOs and their teams can take to assist their organisations at this time.

Firstly, they need to **maximise the use of the available data** from across the organisation. It is important to understand the behaviours of customers and suppliers and focus on **customer profitability** at a detailed level.

Secondly, they need to **model scenarios**. The nature of this inflationary cycle is that it is far from predictable, but we are seeing is that individual cost and revenue components are impacted in vastly different ways. There are many potential outcomes and the inflationary trends either at a local or a global level are not predictable with any certainty. Interest rates are increasing placing a focus on cost of capital. In contrast, employment rates remain high and talent management requires innovative strategies. Finance needs to look these drivers and model them at a micro level if their scenario analysis is to be meaningful. Understanding the inflationary pressures in key markets and in the locations of key suppliers is essential. Translating this into a range of scenarios that inform decision making is essential and facilitates managing further unexpected shocks.

Thirdly, **collaboration** is key. Finance teams need to work within their organisations to drive decision making. This means a greater understanding and collaboration with others across the organisation who have insight into cost or revenue streams. Planning centrally from finance alone will not yield great value to the organisation or ensure the plan is agile and resilient to cope with future challenges. In addition, finance needs to be involved in and influencing the discussions with key customers and suppliers to understand the impact of inflation on every aspect of their business. Be flexible in the solutions developed and maintain key relationships.

In developing their scenarios, they need to start from the **purpose** of the organisation and ensure that they have the longer-term vision front and centre. Focusing upon this will assist to identify actions which facilitate long-term growth whilst maintaining short term focus on operations and liquidity.

This article was developed with the insights of Alistair Roman, portfolio CFO, United Kingdom, Matthew Washington, Chief Financial Officer, Mitre 10, New Zealand and Richard Jacobitz, Chief Financial Officer, Rino, Australia.