

**The Power of Knowledge Series**

***“We Didn’t Create this Economy, We Create Solutions”***

**July 19, 2022**

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**We Didn’t Create this Economy, We create Solutions**

# Inflation vs. Recession vs. Stagflation

How to tell what’s happening, Why It Matters, What’s Next, What Smart Moves a

SMALL Business can make to Protect themselves and Survive

The purpose of this webinar is not to make any investment recommendation. Rather, suggestions on how to weather the economic storm that is on the horizon.

It comes as no surprise that the biggest challenges facing small business for the rest of 2022 and all of 2023 are:

**Economy**: we are looking at a slow down

**Labor:** small business should concern themselves with attracting and keeping loyal talent

**Supply Chain**: plan on late deliveries and develop multiple sources when possible or order more than needed and be prepare to pay for higher storage fees.

**Financing:** with rising interest rates, businesses are going to be challenged to find affordable financing.

Today we are going to discuss two of these challenges: Economy and Supply Worries. We will cover the others in future Monthly Zoom meeting. This is not political marketing rather the reality we all are faced with for now and in the foreseeable future.

# Introduce Panelist

Ash Edwards – President & CEO, Gulf Coast Business Council

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Judd Wilson – VP Chamber of Commerce, Community Development Foundation of Tupelo

# Inflation vs. Recession vs. Stagflation

**If you had to choose one, which will it be? It is like rain, there is a bad rain (destructive storm) or a good rain (a soaker). In both, you get wet.**

What are the differences, why does it matter, what could be next and what can you do to protect yourself?

All three of these are bad “juju” in terms of economics. Inflation feels bad because your money is worth less, while a recession feels very bad because the economy is creating fewer jobs. STAGFLATION is the worse possible of both worlds when inflation increases while the gross domestic product (GPD) or consumer demand falls, AND employment level plummets. The recession of ’73-’75 marked the longest economic slump since the Great Depression and was caused by a perfect storm of bad economic news starting with the oil embargo of 1973 when oil supply restricted, gas prices soared and American cut discretionary spending.

At the same time, the US Government tried to reduce inflation by instituting price and wage freezes in major U.S. industries.

Companies were forced to lay off workers. The result was “stagflation”, a stagnate economy with high inflation and low consumer demand, and a recession that spanned five consecutive negative-growth quarters. This 16-month recession saw a 3.4% reduction in GDP and a near doubling of the unemployment rate of 8.8%. It took until 1979 to get the economy stabilized. Take heart we survived in time for the second energy crisis and inflation recession in 1980 (January – July).

The U.S. Economy has weather 13 different recessions since World War II. On average, America’s post-war recessions have lasted only 10 months, while periods of expansion have lasted 57 months. As a commission sales rep, branch manager, business owner and corporate director for a 900-employee family-owned business, I have survived 8 of the past 13 and we will survive #14 which is on us today.

Like in the past, we are in a constant economic cycle a.k.a. business cycle, a fluctuating state of a market-based economy in which the laws of supply and demand determine prices. Supply and demand pressures influence the economy through different variables, such as global economic conditions, trade balances, productivity, inflation rates, interest rates, and exchange rates. There are 4 distinct stages:

* 1. **Expansion** – where an economy will experience strong growth and interest rates will generally be lower but will begin to increase as the expansion matures. The overall production level increases, and inflation rates begin to rise as the expansion matures.
  2. **Peak** - is reached when the growth of an economy reaches a plateau or maximum rate, usually characterized by higher inflation that needs to be corrected.
  3. **Contraction** – occurs by a correction, wherein the growth of the economy slows, unemployment rate rise, and inflation tapers off. This contraction continues until the cycle reached a trough.
  4. **Trough** – is characterized as a low point in the economy from which it can re- enter an expansionary phase.

Once the cycle is complete, it continues from the start again. There is no definite rule how long each phase last. However, historically a healthy economy will always go through a contraction phase. So where are we right now? Some would say we are in the beginning of the contraction phase, but inflation isn’t tapering off.

Are we headed for an economic meltdown? As wages struggle to keep up with the skyrocketing prices for basic goods and we are hearing the start of layoffs, the outlook for the economy looks scary. So, let’s take a look at each potential scenarios and what we can do to survive.

What was the common denominator in the previous recession? **INFLATION**. The economist, who haven’t worked in the real economy of running a business, say that inflation is measured by the CPI (Consumer Price Index), PPI (Producer Price Index), PCE (Personal Consumption Expenditures), Core PCE, Inverted Yield Curve.

To simplify this, we are going to identify the 4 types of inflation as:

1. Creeping Inflation occurs when prices rise by 3% or less per year. According to the Federal Reserve, when prices increase by 2% or less, it benefits economic growth.
2. Walking Inflation occurs when prices rise by 3-10% per year. It is considered a disruptive inflation, is harmful to the to the economy because it heats up economic growth too quickly. People start to buy more, drives demand even further so suppliers can’t keep up & neither can wages, common good & services prices rise out of reach for many people.
3. Galloping Inflation occurs when prices rise 10% or more and wreaks absolute havoc on the economy. Money loses value so quickly that businesses & employee income can’t keep up with cost & prices. And the evil of all
4. Hyperinflation occurs when prices rise > 50%. This is very rare. Examples include Germany in 1920s, Zimbabwe in 2000s and Venezuela in 2010s. The last time thw

U.S. experienced hyperinflation was during the Civil War.

The June Inflation report was just released on the 13th reporting the U.S. Annual inflation rate climbed to 9.1%, the highest level since November 1981. However, the CPI, which removed the volatile food and energy sectors, “eased” to 5.9%. A big discrepancy. As was stated in the beginning, the purpose of this discussion is not political marketing rather the reality we are all facing now and in the future. While Economist may not agree on precise definitions for these terms or how to measure, the basic problem is: too many dollars chasing too few goods.

Those of you that are trying to run a business, pay your employees and suppliers, simply put, inflation means a dollar bill doesn’t get you nor your customer as much as it did before. It is causes by either increased demand (such as COVID-wary consumers being finally ready to leave their home and spend their money) or

supply side factors like increases in production cost and supply chain constraints or government stimulus monies. Unfortunately, we had all three.

Typically, we see a 2% inflation rate from year to year. It is when this rate rises above this percentage in a short period of time that inflation becomes a concern. Currently inflation has surged by 9.1% (June 2022), reaching it’s highest level since November 1981. We are getting close to the top of Walking Inflation (10%). Some CEO’s and “Experts” have said that the middle class is doing OK financially, people with less discretionary spending are having a difficult time in the current economy, particularly low-income and fixed income Americans, are feeling sever financial strain. An Inflation tracker from the bipartisan Senate Joint Economic Committee found that price hikes are expected to cost the average American household an extra $7,620 over the next 12 months. As business owners you are faced with a more problems than what is cost your personal household, your business will be affected, and your employees are affected.

**Let’s address the Bull in the China Shop – PETROLEUM-DERIVED GOODS**, not just Gas Prices. Feedstock made from Crude Oil is used in more than 6,000 everyday products i.e., electronics, textiles, sporting goods, health & beauty products, medical supplies, household products, etc.

In the 1970 recession, inflation hit double-digit levels several times due to the OPEC oil boycott. This stimulated domestic production of oil. I do not foresee the same happening today.

How does the Federal Reserve try to get inflation under control? By raising interest rates, making borrowing more expensive. Which cause a trickle-down effect by

costing banks more to borrow from one another, who in turn offset it by raising rates on their consumer loan products.

Hiking interest rates can only reduce inflationary pressure so much, especially when one to the biggest factors is on the supply side and are worldwide. There is a lot of concern that with the projected three rate hikes this year, could spark a more painful economic downturn, and will put us in a “Galloping Inflation” stage, or create a recession.

But is that a bad thing?

# Note: Recession and inflation are not the same thing. The economy going

**backward isn’t the same as you getting poorer. Recessions fix supply/demand imbalances that create inflation.**

RECESSION – is a significant decline in economic activity that is spread across the economy and last more than a few months/ period of prolong economic decline and market contraction where unemployment rate goes up and production goes down, generally slowing inflation.

Are we currently in a recession? Officially, no, however the agency, The National Bureau of Economic Research, which makes the “official” call about a recession, meets later this month. “Technically” we are not in a recession until we see the Gross National Product (GDP), the value of all goods and service produced during a specific period, falls during two quarters back-to-back. Jan – Mar we saw the Gross National Product drop by 1.4%. When the 2nd quarter report is made expect to see another drop.

Historically, to lower inflated consumer prices, the Federal Reserve raises the federal funds rate, which makes borrowing money more expensive. But this year’s three rate hikes, including the most recent on June 25, which was the largest in

nearly three decades, haven’t made a dent in inflation.

# What might we see in a recession?

Since this is not a new phenomenon, we can go back and historically look at recession outcomes so we can manage our expectations. Every recession varies in terms of length, severity, and consequences, we will see more layoffs and an uptick in unemployment.

During past recessions, as rates go up and inflation cools, prices on good and services fall and our personal savings rates could increase, but that all depends on the labor market and wages. In the 2009, called The Great Recession, as the newly unemployed often seek ways to turn a small business idea into reality. At RCLF, our pipeline for applicants wanting to start new businesses is full.

# Should we expect layoffs?

The national unemployment rates as of May 2022 is 3.6%, with Mississippi at 4.0% (varies by county with the highest being Jefferson @ 13.8%). For comparison in 2020, at the peak of COVID the Mississippi rate was 15.4%. The unemployment rate seems for now to be the only stable part of the economy. However, when you close small business, force them to lay off their employees, reopen business and rehire employees, that is not record job growth. But that’s likely to be temporary with inflation, rising interest rates and weakening consumer demand. At the height of The Great Recession in 2009, unemployment peaked at 10% nationally.

# Stagflation

Stagflation, an economic word that ranks up there with Economic Depression and

is not spoken much by today’s economist, politicians, or media. It is a double-edged sword that adversely affects the economy.

This is not a new term; it was first used extensively during the 1970 and refers to a toxic combination of rising unemployment and negative gross domestic product (GDP) which creates economic stagnation. What causes this?

What Causes Stagflation?

Sluggish economic growth, rising inflation, and rising unemployment set the foundation for stagflation, but it takes an extra ingredient, such as a **supply shock** to fan the flames. What are supply shocks? They are unexpected events that cause major disruptions in a supply chain, like a war, natural disaster, or a global pandemic. Sound familiar?

# What to do to prepare?

* + **Plan more, panic less.** This is the time to assemble a plan without the real pressures and challenges that come with being in the thick of an economic slowdown.

 **Know your numbers**. Update your budget to see if there are places where you can cut back BEFORE HAND. Make sure you have your cash-flow numbers up to date. Know your real cost of your products, not just what you pay for them. Know your margins. If you have to reduce prices, know

your “walk away point” to maintain profitability. Drop non-profitable items or lines. Maybe “fire” some customers who are stretching out your

receivables or not paying you, demanding extra services that are costing you money, eating up your profit. Know your payroll cost. Look a real data about your profits during business hours. Adjust, if necessary, based on facts, not emotions. Don’t fall into the ”we have always done it this way” trap.

 **Do a stress test** to ensure that your company can survive a slowdown in sales. Ensure that the product or services is being produced in the most economical way and, if possible, explore ways to reduce inefficiencies. We

all “pressured tested” during the COVID lock down. Review your financial plan and map out some worse-case scenarios when your adrenaline isn’t running high.

* + **Bulk up your cash reserves**. A key to navigating a recession relatively unscathed is having cash in the bank. Consider retooling your budget to allocate more into savings NOW to hit closer to the recommended six to nine months rainy day reserve.
  + **Look at any adjustable-rate debt** you may have, see if you can pay down those balances or refinance them to a long-term fixed rate plan that can help lower cost over time.

 **Resist impulsive investing or capital expense moves or ‘stop-gap’ financing** to try to beat the odds. If you have more than 10 or 15 years until retirement and are invested, history proves it’s better to stick with the market ups and downs. History has also shown that during times like this, financial sharks smell blood in the water and offer instant cash to businesses very similar to ‘pay-day’ loans. Confidentiality agreements will not let me share details, but I can say, we have already seen the damage

this type of financing can have on a business with the double interest rates and payment demands that are taken out of the hands of a business owner. We cannot or will we ever provide any investing advice, but we can offer a

neutral opinion on any capital purchases or the temptation to ‘stop-gap’

financing. **All you need to do is call us.**

# Final Thoughts on a Recession

The last two recessions, which were respectively fueled by a housing bubble

collapse and the pandemic, this one’s outcomes seems to remain entirely within

the control of the Federal Reserve policies.

Important to remember that recessions are a normal part of the economic cycle. Recessions tend to be relatively short/sharp downturns in growth, whereas if inflation expectations are allowed to become well entrenched, they can lead to inflation spirals. Once the inflation genie is released from the bottle, it is not easy to get it back in. The typical cure for inflation is a recession (soft landings are mostly fairytales that the Fed Reserve tells worried investors to prevent panic or to avoid leveling with the public for political reasons). Any long-term financial plans will always experience some declining periods. Remember, since WWII, we have had 13 recessions and they typically end after a year of sooner. By contrast, periods of expansion and growth are more frequent and longer lasting.

# SUPPLY CHAIN CHALLENGES

Regardless of your business, you are affected by this global supply chain challenges.

In 2020, the pandemic caused business closure, layoffs, product shortages, delayed deliveries and halted production as factories sat idle waiting for parts and raw materials. And the dominos fell. Then in 2021, the Suez Canal blockage revealed additional supply chain vulnerabilities then to add insult to injury, the unexpected cold wave in Texas should down electricity through the state for a week.

These crises and now the world turmoil in Europe had caused business leader to question previously favored supply chain practices such as low-cost sourcing, Just- In-Time (JIT) sourcing, lean manufacturing, etc.

But these are not the only event that can disrupt your sources of supplies such as:

* + Weather is not limited to Texas and other catastrophes, such as tornadoes, hurricanes, earthquakes
  + Political or economic upheavals throughout the world and in the U.S.

 Labor strikes

* + Infrastructure failures such as bridge failures, road closures, water main breaks, etc.

 IT failures or cyber criminals

 World health crises

* + Vendor bankruptcy or insolvency during recession

 Power outages

Many companies focus risk assessments, *“what if analysis”*, for internal risks, but ignore dependence on vendors and suppliers. As many of you have experienced, supply delay and disruptions can seriously damage your ability to service your customers & adequately provide profits to operate the business. It takes time to vet and bring on new suppliers which can mean increased cost. All the while late orders and disappointed customers can reduce revenue and damage your market share.

The following recommendations come not from books or reading white papers. Rather in spending a career working for and with family-owned businesses, “boots on the ground” day-to-day work, making mistakes, making corrections, and improving operational efficiency.

How do you build in resiliency in your source of supply? Here are four steps you can begin to take to build a more resilient supply network.

# STEP ONE – Optimize the supplier network

The JIT (Just-In-Time) manufacturing model brought greater efficiency and cost savings to companies. This JIT model was passed down to the wholesale and retail level with next day deliveries, lower back-order rates, reduce inventory

requirements, better scheduling and forecasting, etc. However, recent disruptions showed that these benefits came at the cost of supply chain resiliency and the need for a JIC (Just-In-Case) model. As companies move forward, they must find a balance between cost control and fulfilling demand during unexpected events. Potential solutions include:

* + Dual sourcing or dual tooling whereby you use two suppliers for a component, raw materials, product, or services.
  + Choosing suppliers that are closer to areas of demand, or not in locations with trade concerns or rising cost.
  + Leverage modern cloud applications for improved supply visibility and demand forecasting.

# STEP TWO – Find multiple trusted, reliable partners

Supply chains are threatened by multiple uncontrollable forces, from natural disasters and geopolitical risks to cybercrime and government regulations. Managing the disturbances these forces cause requires a multi-pronged strategy, including optimizing supplier networks, reassessing your existing technology, and leveraging digital solutions for more accurate demand forecasting. As you move forward, you must find a better balance between cost control and fulfilling demand during these unexpected events.

# STEP THREE – Keep a close relationship with your suppliers

This is not an adversarial relationship. It is a partnership. You depend on them, and they depend on you. Make yourself known to as many people throughout the organization and as high up in the organization as you can.

Market yourself as the subject matter expert in your industry so they will depend on you when they need for market research.

# STEP FOUR – Assess Risk & Vulnerabilities

Each supplier will have its own set of vulnerabilities, depending on many factors like facility construction and emergency preparedness if located in an area prone to hurricanes, tornadoes, or wildfires. This can be something as simple as using the FEMA Waffle House Emergency Disaster Index. Yes, there really is such a thing:

Green = Restaurant has power, it is serving food and little or no damage.

Yellow – Restaurant has no power but is operating on generator power, serving limited menu.

Red – Restaurant closed, sever damage expected, “get out of dodge”.

This may seem odd, but yes, check their credit rating. They check your credit rating so why not check theirs? One of the hazards you must deal with during a period like this is your suppliers going out of business, being purchased and the new owners closing the manufacturing or consolidation the distribution centers.

# STEP FIVE – Incorporate Supply Chain Resilience in Your Business Continuity Plan (BCP)

To protect your business, your assets, your livelihood, you must understand where you are vulnerable. Everyone should have a formal, written emergency business continuity plan that lays out a course of action should a

disaster strike to minimize operational downtime and loss business. Train all your employees what you expect of them if ……. Happens.

This includes:

* Identifying core people work in areas of financial, insurance, strategy, and operations
* Mapping your business processes to your external supply chain dependencies and ranking areas of exposure. Where could a supply chain interruption prove just a bit problematic? Where could it cripple your business?
* Pinpoint your key suppliers – those your business relies heavily on, or whose goods and services are hard to replace. Then list second and third tier vendors, third-party manufacturers or subcontractors, warehouses, distribution centers, and transport and shipping partners.

If you need help doing your BCP, let us know and we can help get you started. Last suggestion: Do not participate in **SHRINKFLATION.**

What is SHRINKFLATION? Rather than raise prices, some manufacturers have begun to shirk their packaging or downsize their product offering, i.e., instead of 12 to a package, it will be 10 to a package. This is called **SHRINKFLATION**. This practice, according to some, comes in waves. And right now, we appear to be in a tidal wave because of inflation.

Every person in the U.S. is becoming accustomed to rising prices. Don’t be ashamed to raise your prices if necessary. Be embarrassed if you give them less than what they have come to expect.

Is this Legal?

Shrinking package size is not illegal so long as the product amounts are clearly labeled and “the business in not engaging in unfair or deceptive practices”

How can you protect yourself?

Rule of thumb: Your customers tend to pay more attention to pricing that package size. If you are selling a pre-packaged item and the manufacture had shrunk the quantity, be proactive and let your customers know.

If you find yourself seeing yourself continually faced with ‘Shrinkflation’; a top tip for steeling yourself against shrinkflation: learn the package sizes and per-unit pricing for your top selling or “A” item products. If you notice that a product has shrunk or reduced the number of included items, look for competitors who offer a similar product at a lower cost, example, lower cost per oz or item. Compare the per-unit prices to see which product provides a better deal.

Loyal customers will support you. They will not if they feel you are cheating them.

# The Good News – None of these economic issues are roads to Armageddon. Having been through this before, there are common lessons to help navigate a path. These practical techniques won’t make you inflation-recession or stagflation-proof, but they will form one cornerstone for success.

**Key Takeaways & Recommendations Inflation/Recession/Stagflation**

Key Takeaways

* + This has happened before
  + On Average lasted 10 months, while periods of expansion have lasted 57 months.
  + 4 stages of a business cycle: Expansion – Peak – Contraction – Trough
  + 4 types of inflation: Creeping (3% of less) – Walking (3-10%) – Galloping (>10%) – Hyper (>50%)
  + The elephant in the room is possibility of stagflation
  + Inflation/Recession can be viewed positively or negatively How to Prepare
  + Plan More, Panic Less
  + Know your numbers
  + Bulk up cash reserves
  + Review any adjustable-rate debt
  + Stay on top of receivables
  + Keep your suppliers happy
  + Resist impulsive spending

# Supply-Chain

Key Takeaways

* + Current problems were caused by: pandemic – Suez Canal Blockage –

Turmoil in Europe

* + Other problems can be caused by: Weather related catastrophes – Spread of worldwide and US political upheavals – Labor Strikes – Infrastructure Failures - IT failures – Cyber Crime – Vendor Bankruptcy – Widespread Power Failure
  + Start building resiliency in your source of supply and in your business

Step to Building Resiliency in your Supply-Chain and in your business

* + - Optimize your supplier network
    - Find multiple trusted, reliable partners
    - Keep a close relationship with your suppliers
    - Assess risk/vulnerabilities
    - Build your own written Business Continuity Plan (BCP)

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