**INFLATION- THE IMPACT ON BUSINESS AND HOW MNC’s COPED WITH IT**

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**Abstract**

Recent political and societal developments have led to a backlash against a prevailing world order that for nearly four decades has favoured globalisation and the free movement of goods, capital, innovation, and people. This will challenge the economics, business models and governance structures of established multinational corporations (MNCs).

However, while we are clearly facing a rise in “nationalism”, “protectionism” and “deglobalisation”, the pace of change and the end-state is unclear. There is hope that the current flux settles in an equilibrium that still allows favourable terms for global business models, but there also is a clear risk that current waves of populism could swell. MNCs need to prepare for and respond to these developments.

**Keywords :** Inflation, business, MNC’s, government, structure.

**Introduction**

The impact of the pandemic and the war in Ukraine has driven inflation to surge across the globe. Few C-suite executives have experienced these combined inflationary pressures and navigated their company through such an environment. In a high-inflation context, three imperatives are crucial for success and enduring competitiveness:

1. Pay close attention to **industry** specifics. Inflation doesn’t always have broad-brush effects. A nuanced understanding of industry context will influence what levers you need to pull, and when.
2. Use **technology** to improve efficiency and agility as quickly as possible to strengthen resilience.
3. Be intentional about solving issues with **stakeholders**—customers, partners and employees. Doing so strengthens a company at its core.

After two years of pandemic and a war in Ukraine that threatens modern globalization, many economists, business leaders and policy makers agree: We have entered a high inflation environment that is fundamentally challenging business leaders and the way companies operate. New dilemmas emerge every day, spanning supply chain, manufacturing operations and workforce management to financial management and customer retention.

**Are leaders prepared?**

The Global Financial Crisis of 2008 proved to be the flashpoint that propelled many to re-examine the benefits and trade-offs brought about by a globally integrated economic system. In many countries, the economic consensus has shifted back towards a preference for a stronger role for the state in the oversight of markets and of corporate behaviour. As national policies are veering away from an emphasis on international free trade, there has been a clear rise in the introduction of protectionist measures by the world’s leading economies.3 With momentum behind “deglobalisation” increasing, some market environment assumptions of recent decades may be reversed.

Although the current shift is unambiguously towards greater protectionism, the degree to which it will persist is not clear. A few of the liberal democracies in the West that championed free trade are starting to push back against the free movement of capital, goods and labour, with a pivotal shift in their politico-economic agendas.

On the other hand, despite similar emerging populist sentiment in parts of Asia, efforts are still being made towards greater regional banding (intra-Asian or intraASEAN), triggered in part by the withdrawal of the US from the Trans-Pacific Partnership.

Moreover, with economic powerhouses China, Japan and India closer home, developing economies in Asia have alternative sources of foreign direct investment (FDI) at attractive terms (the most notable being China’s $900 Billion Belt and Road Initiative) and are less hesitant to steer away from Western FDI and MNCs. For example, while US FDI into ASEAN fell by 50 percent in 2016, Chinese FDI into the region increased by 44 percent the same year.

One cannot discount the possibility of a return to some new version of globalisation with more favourable terms for MNCs, or a reversal in the trend towards increased populism. Our assumptions in this article are: (a) Protectionism will rise at least in the short term, and MNCs must take heed and plan for the consequences; and (b) We cannot exclude a potential rapid acceleration into populism which should be considered a crisis scenario for most global operators. MNCs have increasingly become targets of attention and criticism by this new wave of nationalism. Specific events linked to tax avoidance, executive compensation, local market infractions (such as environmental standards, health safety, labour laws), accounting scandals, and government bailouts have been cited by the populists as examples of MNCs’ abuse of the system.

Since the global financial crisis of 2007–2009, companies have enjoyed ongoing economic growth and low volatility. However, even before the war in Ukraine, many economies were already experiencing inflationary pressures caused by extensive fiscal and monetary support measures, a shift of consumers buying more goods versus services and supply chain disruptions. As of January, 70% of global C-suite executives were expecting significant inflation in 2022, potentially reaching double-digit rates in select countries. As a result, inflation is topping the priority list of many business leaders.

As war compounds issues like supply chain disruption and energy prices, the challenge has become real. Natural resource shortages along with soaring energy and housing costs, and constrained supplies of consumer goods have led to unprecedented inflation levels across major markets. As of March 2022, inflation reached 8.5% in the United States, 7.0% in the United Kingdom and 7.4% in the eurozone.

**Drivers of recent Consumer Price Index inflation**



When inflation will peak remains unclear. [Economic and business impacts](https://www.accenture.com/in-en/about/company/war-in-ukraine-business-impact) will largely depend on the length and severity of the crisis as well as policy response. Few business leaders today have experienced anything similar over their tenure. Now, this new reality is testing their supply chains, their people, their customers and their stakeholders.

**The good news**

Despite the outlook, leaders may be better prepared than they realize. The operational changes they made to navigate the COVID-19 pandemic helped their businesses survive and thrive: In fact, our research shows the largest 2,000 companies globally grew by 11% between Q4 of 2019 and Q4 of 2021.

Value generation differed among them, however. [The more digitally advanced companies navigated the crisis without compromising profitable growth](https://www.accenture.com/in-en/insights/technology/scaling-enterprise-digital-transformation). From December 2021 to January 2022, 90% of c-suite executives reported that their organizations were undergoing rapid digital transformation. Some companies—we call them ‘[Twin Transformers](https://www.accenture.com/in-en/insights/strategy/european-double-up)’—also combine digital transformation with an acceleration of their sustainability agenda.

## Economic cost pressures

Many forces have come together to drive high inflation, and the effects differ by industry. The impact depends on cost structure—including energy, materials and wages—as well as the ability to pass costs on to consumers.

Inflationary cost pressures on profit margin are amplified as they pass through the various layers of the economy:



### Round 1 - Energy (direct)

Direct impact on operating costs depends on the industry’s intensity of use of these inputs.

Round 2 - Supply chain (indirect)

Cost pressure passing from upstream industries to downstream industries depends on intensity of use of inputs from industries heavily impacted in Round 1.



### Round 3 - Wage and demand erosion

Inflation erodes consumer purchasing power, placing upward pressure on wages. The size of the effect on wages depends on the tightness of the labor market and the negotiating power of employees.

## How cost pressures affect different industries

Industries will face different levels of cost pressure on margins, based on their cost structure.

 **Cost structure and cost pressure on margin by industry in Europe**



\*Energy impact = Cost increase due to direct energy usage, Raw materials & supply chain impact = cost increase due to direct usage of raw materials and transmitted through the supply chain, wage & demand = cost increase due to inflation induced wage increase and demand erosion. \*\* Before pass-through. Ranges for high and low scenarios consistent with ongoing impact and protracted impact scenarios: Energy price scenario $110-150/Bbl for oil, $157-194/MWh for natural gas, $155-188/tn for coal. Utilities correspond to supply of electricity/gas/heat, excluding water/waste.

Source: OECD, Accenture Research energy price impact on margin simulation model.

Utilities, like power generation and distribution, are greatly affected due to their dependence on oil and gas. However, they may be able to manage impact by passing on costs, but within the constraints of regulatory price controls.

By contrast, the consumer goods industry is exposed to the high cost of energy indirectly, as many of their manufacturing processes rely on food, raw materials and resources from directly impacted industries. Food, beverage and consumer durables are likely to see significant disruption due to their reliance on agricultural commodities and raw materials; together, Ukraine and Russia supply 26% of global exports of wheat.8 The food, beverage and consumer durables sector also is highly price-sensitive and vulnerable to consumer switching.

Other industries may suffer cost pressure even more indirectly. For example, the health industry is not a heavy direct user of energy or raw materials, but much of its cost structure depends on employee compensation. As prices of products they consume rise, workers will demand higher wages to try to maintain their purchasing power.

## To identify your specific challenges:

* Track market/industry insights
* Watch for internal indicators that point to the three types of economic cost pressures
* Consider how location factors in

Remember that challenges also vary by geography and industry. Areas that rely on production from other regions may be more exposed to energy and food inflation. Other geographies may have social, political or institutional constraints that prevent them from handling inflation shocks, resulting in volatility.

The US, meanwhile, would primarily be affected by higher oil prices and their knock-on effect on household wealth and consumer spending. In the event of a protracted impact scenario, Oxford Economics estimates that US GDP could decline relative to pre-war estimates by 1.0 percentage points in 2022 and 0.6 percentage points in 2023.

## From insight to action: Use technology to help weather the storm

Will I lose my customers if I pass on the cost of inflation? Will my competitors price me out of the market? How will I pay my employees? What’s the best procurement strategy for a highly inflationary environment? Will I remain competitive overall?

Leaders may need to make tough choices quickly. Anticipating change and planning for a range of scenarios is essential, and the more intelligence, the better.

[“Intelligent” enterprises](https://www.accenture.com/in-en/blogs/business-functions-blog/the-cfo-ibs-to-energize-growth-and-revenues) use integrated, cloud-enabled planning and performance analysis tools to improve how they capture and analyze data. From there, they can garner valuable insights to fuel decision-making around critical issues, including:

* Pricing
* Sourcing and procurement
* Labor costs and compensation
* Input costs
* Supply chain disruptions
* Competitor pricing
* Customer relationship management
* Consumer spending power
* Vertical integration

**Trade-offs: What to expect and how to address them**

The optimal strategy improves the company’s data gathering and analytics capabilities and uses technology-enabled solutions to calibrate the best response to the difficult trade-offs that inflation demands:

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**Be transparent with stakeholders**

While insights are crucial, transparency is equally so. Be forthcoming with stakeholders about the changes you’re making to address inflation, especially with customers, employees and ecosystem partners. This could be as straightforward as:

* Taking an end-to-end view of the entire value chain to identify additional value pools.
* Giving customers advance notice of price increases.
* Setting employee expectations around midcycle wage adjustments and other nonmonetary benefits.
* Updating suppliers regularly on purchase decisions.

Be sure to collect feedback and response data so you can understand how stakeholder reactions may affect your business and adjust accordingly.

**Conclusion**

Inflation may be here to stay, but with solid insights and sharp decision-making, it is still possible to create value for your stakeholders. Understand how inflation will affect your industry, your ecosystem and your employees (in the short-, mid- and long-term), and act early to improve your data capabilities and build transparency on all fronts. It’s all part of the foundational strength businesses need to survive and grow—both now and when high inflation is no longer a critical concern.

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