



BEATING INFLATION

AN AGILE, CONCRETE
AND EFFECTIVE
CORPORATE
GUIDE

Hermann Simon
Adam Echter

 Springer

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Preface

For the first time since the 1970s we are experiencing inflation, and this inflation will probably persist for several years. Today's generation of managers has no experience with inflation, which brings major risks for companies and consumers alike.

Inflation does affect not only pricing and prices but also all activities and functions of the company. It starts with the CEO, who must induce a culture change, and extends to the management of finance, purchasing, supply chain, costs, production, and human resources. Of course, the sales force is hit particularly hard as sales reps must push through larger and more frequent price increases to customers.

As costs, prices, consumer attitudes, and interest rates are subject to constant change, the company must massively increase its agility. This applies to information, processes, and implementation on the sales front. It's about getting in front of the cost wave and not trailing it.

Price plays a central role, but it is naïve to pass on cost increases one-to-one to customers. It is critical to understand the changes in customers' willingness to pay prices and to assess one's own pricing power correctly. In this respect, many companies show weaknesses. Only one-third have significant pricing power. One must take advantage of the opportunities of digitalization. On the one hand, digitalization brings increased price transparency, which makes price increases more difficult. That's why you should focus on value-to-customer; offer more benefits, such as additional services; and above all communicate the value-to-customer more effectively in order to create a greater willingness to pay. Innovation plays an important role in this endeavor.

Inflation-adjusted pricing tactics such as price escalator clauses or incentives for fast payment are useful. Innovative price systems such as dynamic

pricing or performance-based pricing can mitigate customers' resistance to higher realized prices. Cost reductions through digitalization and automation help close the profit gap.

Based on our extensive experience as partners of Simon-Kucher and Partners, the world's leading price consultancy, we offer concrete analyses and implementation-oriented solutions in this book. It addresses managers and employees from all functions. This book is an effective corporate guide to beating inflation.

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1

Comeback of the Inflation Specter

The specter of inflation is back. Businesses and consumers are spooked. After a decade of unusual price stability, we are experiencing the highest rates of price increases since the 1970s. There is much to suggest that inflation will be with us for years to come. This presents companies and managers with challenges they are not familiar with. After all, the last wave of inflation of a similar magnitude happened more than 40 years ago.

In this book, we would like to demonstrate the great danger that inflation represents for consumers, the State and, above all, for companies. The interrelationships and consequences are more complicated than one might think. Simply passing on cost increases to the next stage of the value chain or to the consumer can be a serious mistake. One needs to deeply understand possible reactions of stakeholders and the impact on business actions. It is this deep understanding that we want to bring to you, the reader. A special focus is on agility as inflation has come fast and its extent surprised most of us; costs and prices now rise daily. Failure to take quick and effective countermeasures can threaten a company's existence. This book explains why this is the case, what actions should be taken by which functions – depending on the industry and the product category – and what should be avoided. For market analyses and case studies we repeatedly draw on our extensive experience with inflation and on recent projects of Simon-Kucher, the world's leading pricing consultancy. To understand today's inflation better, we start with a look back at recent decades.

Central banks generally aim for an annual inflation rate of around 2 percent. The idea behind this is that a slight growth in the money supply, and thus in prices, stimulates economic growth. And indeed, we observe rising

prices in the long run in most countries. Figure 1.1 shows the development of consumer prices in the United States from 1971 to 2021.¹ In 1971 the gold standard was abandoned.

Prices have increased 6.7 times over these 50 years. This increase corresponds to an average annual inflation rate of 3.87 percent, which is far above the targeted rate of 2 percent. As the lower curve shows, the cumulative loss in value of the dollar amounts to 85.1 percent. In other words, for a product that cost \$14.90 in 1971, you have to spend \$100 today. In the 30 years since 1991 the U.S.-consumer price index increased by 99 percent. The dollar has lost almost half of its value in these three decades. However, in the 2015–2020 five-year period, there were unusually small price increases in the U.S. On average, the consumer price index rose by only 1.77 percent per year. This value was just below the central bank target rate and is generally interpreted as “price stability.”

The development shown in Fig. 1.1 for the U.S. was similarly observed in most highly developed countries. In the last three decades the German consumer price index rose from 100 to 166.6. This corresponds to an average annual rate of price increase of 1.72 percent. One exception to the long-term inflation trend is Japan, where prices have risen by only 160 percent in the last

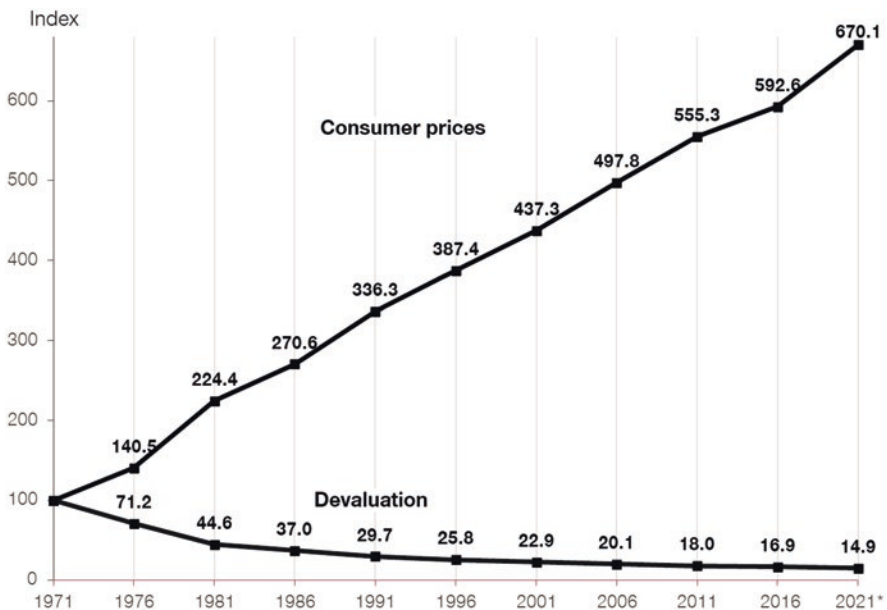


Fig. 1.1 Consumer price index U.S. 1971 to 2021

¹ <https://www.minneapolisfed.org/about-us/monetary-policy/inflation-calculator/consumer-price-index-1913->

50 years and have actually trended downward since the mid-1990s. Even in June 2022, when U.S. inflation rose to 9.1 percent, Japanese inflation reached only 2.4 percent, and was expected to be in a similar range for the year. However, deflation, or very low inflation, was accompanied by stagnation in the Japanese economy, a highly undesirable development. The combination of mild inflation and reasonable economic growth is preferable to the alternative of deflation combined with stagnation. However, it is dangerous when inflation rates get out of hand. When stagnation is added, as happened in the 1970s, this is the least desirable combination. It is then referred to as stagflation.

Monetary vs. Commodity Value

In the common understanding, inflation means that goods become more expensive. In reality, however, exactly the opposite happens. It is not goods that become more expensive, but money that loses value. This perspective is clarified when the value of goods is measured in gold rather than in “fiat money.” Fiat money, in reference to the biblical act of creation, is the term used to describe the money created by central banks. In the Bible, God created the world out of nothing by saying “Fiat Lux” (“let there be light”). And similarly, in the modern system, money is created “out of nothing” and thus can be multiplied at will. Inflation ultimately results from too much money chasing too few goods. In gold, which is not arbitrarily multipliable, value relations are completely different. “You can buy 300 loaves of bread today for an ounce of gold, and you got this in Christ’s time,” says precious metal expert Uwe Bergold.² In Rome 2000 years ago, a tailored tunic cost about an ounce of gold; today, you can get a tailored suit for an ounce of gold.³ The price of the garment, measured in gold, has not changed significantly over 2000 years; the same is true of bread. Of course, the statement that the value of a commodity has remained the same applies only to products whose utility has not changed significantly over time, not to products such as steam locomotives or slide rules, which have become obsolete and no longer provide any benefit. What changes in inflation is the value of fiat money. This value decreases. Such considerations give rise to concrete consequences for financial and cash management, to which we return in a later chapter.

² https://www.focus.de/finanzen/banken/gold-teil-2-stabiler-wert-ueber-jahrzehnte_id_3663290.html (accessed April 10, 2022).

³ Nathan Lewis, *Gold: The Once and Future Money*, Hoboken: Wiley 2007.