HOW TO REACT AND RESPOND TO RISING COSTS

Advice for manufacturers

From rising input prices to logistics, energy, fuel, wages and higher tax bills, manufacturers across the UK and beyond are feeling the pinch from rising costs.

According to Make UK, manufacturers are enduring a cash and margins squeeze beyond anything they've faced in the past decade.

The March 2022 Make UK/BDO Manufacturing Outlook Survey found that domestic prices had grown at record rates in the previous year, with manufacturers struggling to keep pace and pass on costs to the consumer.

The most pressing cost challenge for manufacturers identified in the survey was material costs, with 54% of firms facing a major increase – some went so far as to say that the rising costs of materials could potentially put them out of business.

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However, there are other cost pressures too. Among them are the rising costs of shipping, wage inflation and higher energy prices.

Rising prices were also among the biggest challenges highlighted in conversations with our own commercial insurance customers from wood and electrical manufacturing firms. All of them said that the rising prices of raw materials, parts, shipping and energy were a real cause for concern.

As one manufacturer said: “Material costings are a challenge. Freight and transport costs have accelerated greatly. It’s gone from £2,000 to £8,000 for a freight from Poland since we left the EU.”

From Covid to Russia’s invasion of Ukraine

Businesses were hoping for more stable prices in 2022 after Covid lockdowns meant that material costs increased due to shortages. There was hope that some of this would ease, but the Russian invasion of Ukraine has seen this hope evaporate – costs are continuing to rise and the trend only seems to be getting worse.

For example, one manufacturer of sheds, workshops and home office buildings, told us that the price of timber had more than doubled during Covid. This affected demand for their products, which had become more expensive as a result. Given that a lot of cheap timber comes from Russia, further shortages are being created and prices are going up, which will have another knock-on effect on their sales.

Another manufacturer commented: “It’s so dysfunctional out there right now. Our biggest challenge is we can’t keep a lid on price increases, and we’re not talking about a few percent. One supplier of bespoke curved wooden products increased their prices by 80%”.

Rising energy costs

Many manufacturing businesses have been caught off guard by the significant increase in energy prices in 2022, especially those that use energy intensive production methods.

Make UK surveyed UK manufacturers about how they had responded to this energy cost inflation and nearly half (47%) said they had adjusted business practices to reduce energy consumption. A further 41% had renegotiated their fixed energy tariff and 39% had priced-in increasing energy costs into their final product.

There are fears that if prices remain high in the long term, then manufacturers won't be able to sustain output growth. In fact, according to Make UK, 43% of businesses expect material cost inflation to take over a year to settle, with a further 15% expecting it to take at least two years.

As a result, record numbers of UK manufacturers are raising their prices. According to the Confederation of British Industry (CBI), 80% of firms surveyed in March 2022 were expecting to raise prices this year.

What can manufacturers do to combat rising costs?

Unsurprisingly, the majority of individuals and businesses thrive in conditions of stability. Remove it and we start living hand-to-mouth, saving not spending, and stockpiling instead of trusting in the flows of goods and services we rely on. The result is shortages driving prices up and a potential crisis for business. But how can manufacturers respond?

In the short term, set expectations and plan for the here and now

In the current climate, it's safe to assume that production costs are going to increase for your manufacturing business, with wages, materials, transport, and many service costs driven up in an inflationary spiral. The challenge is immediate, and it's important to consider how to contain its effects.

Business Continuity experts Inoni, have shared the following advice:

- Plan for inflation effects on materials and wages – check financing and notify your bank or lender that you may need additional borrowing or overdraft facilities to facilitate cash flow.
- Understand key employees' individual circumstances – are rising living and transport costs forcing them to look elsewhere for better-paid or more flexible work? Recognise that the cost of replacing vital skills could be considerable in a highly competitive job market.
- Customer communication is key – keep customers informed of delays and/or price rises. Emphasise the benefits of loyalty.

- Monitor competitor behaviour and create opportunities from market instability; for example, delaying a price increase to attract customers, when competitor prices are rising.
- Review all possible outcomes and plan for them – when will the economy pick up, when will the war end, what will be the lasting effects? All are of course unknowable, but by examining the possibilities, you are better placed to recognise opportunities when they arise.

In the longer term, adapt to survive

Economic cycles are measured in years, triggered by world events that take time to play out, so we can assume with some certainty that price inflation will dominate strategic planning for many months and possibly years to come. It means we should take a longer-term view, adapting the way we think and operate to reclaim lost ground. Strategic options might include:

- Price, value, and product diversification, offering cheaper alternatives to those who need them.
- Some commodities see margins grow in times of inflation; for example, when petrol prices rise, fuel companies see their fixed percentage margin yield more cash. Explore your portfolio and look for products and services where this may apply.
- Rationalise and focus on where the margin is, or will be; for example, increased use of recycled materials might help you reduce dependency on price-inflated primary sources and simultaneously satisfy sustainability agendas.
- Adopt strategies that allow you to balance cash flow against the opportunity to win business from competitors. Consider making it easier to change prices and set customers' expectation that price volatility is a side-effect of inflation.
- Invest to reduce long-term unpredictable overheads. Consider replacing activities carrying a high staff cost or risk with automated production.
- Outsource non-core activities under fixed contract to create more stable pricing and transfer-out associated people and skills risks. This may include payroll, procurement and facilities management.

If you're critically affected now, manage the situation

To ensure continuity, we recommend you plan thoroughly and work through the following key steps:

1. Scan the macro-economic horizon and don't be taken by surprise. Be ready to act.
2. Confirm your continuity strategy. Assign actions such as those above to reduce exposure. Prioritise those that reduce impact in the most acceptable time.

3. Price inflation is driven by events and market behaviour, defining a changing set of possible endgames. Pick three paths you feel most likely to happen and draft a tactical plan for each, should it arise. Revisit, refine, and update your plan faster than the rate of change.
4. Check financing and notify your bank or lender that you may need additional borrowing or overdraft facilities to facilitate cash flow.
5. Be ready to communicate. Use a set of templated messages as the basis for updating interested parties, including existing and prospective customers, regulators, staff, owners and suppliers, on a need-to-know basis of any significant changes in business status.

At NFU Mutual we're here to support manufacturers build resilience for the future. We understand your industry and have the expertise to deliver an insurance and risk management solution that provides real value to your business, providing peace of mind and allowing you to focus on your day job.

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