

Navigating Economic Headwinds

How Small Businesses Are Responding to Inflation and Recessionary Risks



Business Impact Group
Research Program

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Insights



Business Impact Group, the University of Washington's largest consulting student organization, is dedicated to advancing small business growth. In partnership with the University's Consulting and Business Development Center, we consult women and minority-owned businesses. Our Research Program generates insights for small businesses, while training students on essential skills.

Phillip Meng

President, Business Impact Group

Rebecca Rong

Director, Member Development and Program Innovation, Business Impact Group

Research

Greyson Artis

Finance, International Business (Korean)

Kristen Ishizuka

Finance, Information Systems

Arihant Parusuram

Business Administration

Tejan Patel

Finance, Information Systems

Mary Tran

Finance, Information Systems

Leo Wang

Finance, Information Systems

Visualizations

Chun Hin Matthew So

Data Analyst, PODUW

Program Support

Sree Lekha Pamudurthi

Program Consultant, Business Impact Group

Learn more about the report's research team at this end of this report. With thanks to the Polling and Open Data Initiative at the University of Washington (PODUW) for their support with data visualizations.



Introduction

With rising inflation rates, faltering markets, and buyer uncertainty, small businesses in Washington face significant challenges. Adverse macroeconomic conditions have raised recessionary risks to their highest levels in over a decade. Yet despite the challenges presented by these uncertain times, local businesses with the right team, knowledge, and strategies have the potential to not only survive, but thrive.

In this report, we provide an overview of recent information on consumer confidence and inflation. We have also interviewed small businesses in Seattle and abroad for case studies on how businesses are responding. We are deeply grateful to business owners for sharing their insights with us.

Case Studies

Thanh Vi
University District, Seattle

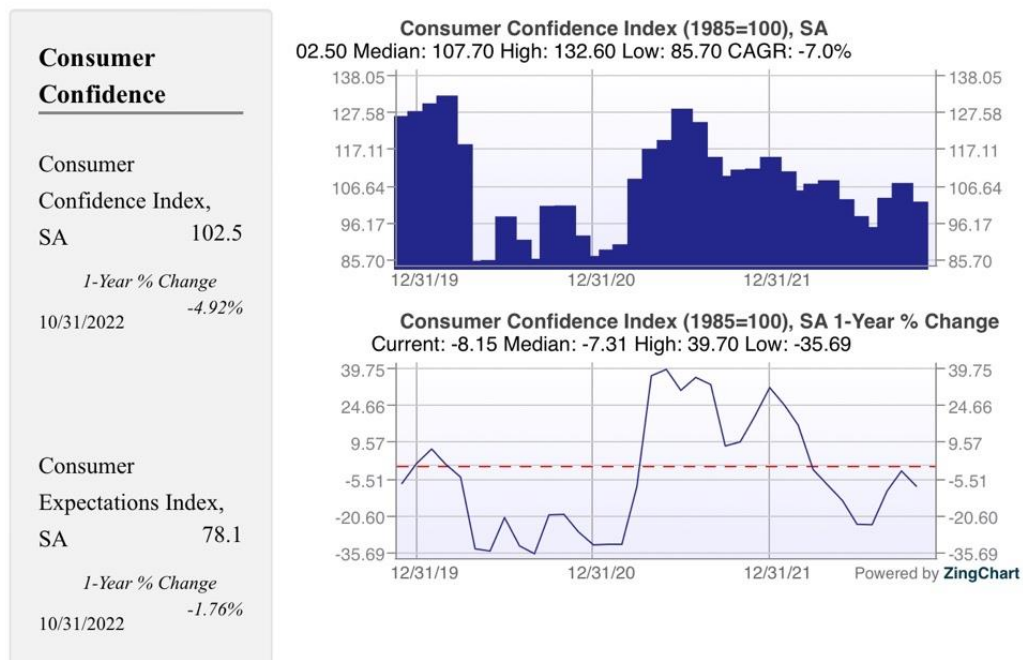
Magnus Books
Seattle, University District Neighborhood

Badenbear Fashion
Australia

Consumer Confidence Fell in 2022

Macroeconomic conditions do not only impact balance sheets for small businesses: they can determine their survival. The Consumer Confidence Index (CCI) is one of the most accurate ways to determine the health of the economy, a measuring tool that gives warning to businesses before times of turmoil.

The confidence index is via a survey sent out to a random sample of American consumers. The consumers are asked to answer five questions about current national economic situations and their personal security. Answers from all respondents are compiled into an aggregate number, which is compared to a base year and is the "index." Knowing how individuals feel about prominent situations is largely important to small businesses: consumers are less likely to spend money if they are not feeling confident in the economy, which decreases quantities sold or spending, and ultimately decreasing profits for small businesses.

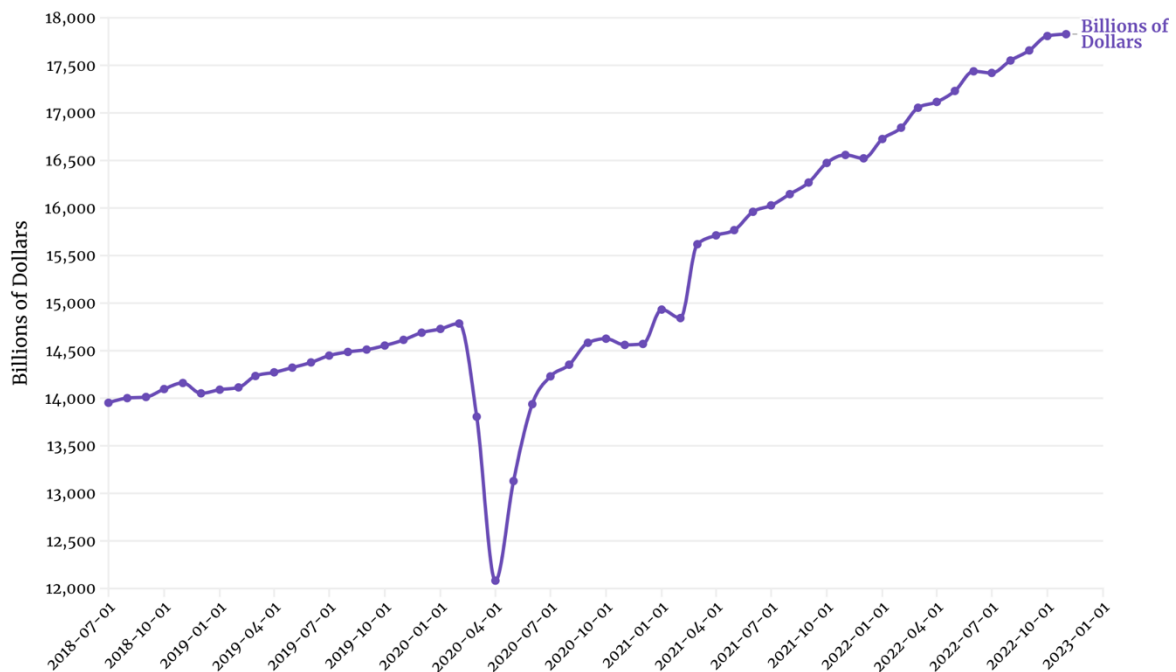


Source: The Conference Index

In the charts above, the CCI and the 1-Year % change in the three-year span from October 31st, 2019 to October 31st, 2022 are recorded. The bar graph records the CCI with the base year of 1985, measuring how confident consumers were feeling

during these troubling economic times. At the beginning of the pandemic, in April 2020, consumer confidence plummeted to the lowest amount of the three-year span, all the way to 85.70. Accordingly, during these times, the personal consumption price index decreased as well, from \$13,806 in March 2020 to \$12,082.40 in April 2020. On the other hand, a rise in consumer confidence also signals more spending by consumers. While setbacks caused by the pandemic were major, the announcement of stimulus checks in December 2020 caused consumer confidence to skyrocket, almost returning to pre-pandemic levels. With this also came an increase in consumer spending, as seen by the increase in PCE from December 2020 to January 2021.

Personal Consumption Expenditures



Source: [Economic Research Federal Reserve Bank of St. Louis](#)

So why do these economic indicators really matter in today's economic situation? Understanding consumer behavior becomes increasingly important to smaller businesses in times of economic uncertainty as people become less willing to spend that additional dollar. Small businesses may have loyal customers but cannot have established and large customer bases to rely upon in times of hardship as they do not have the economies of scale to have lower prices and compete with corporations. By recognizing that we are in times of decreasing confidence,

knowledgeable business owners may arm themselves with mitigation strategies before their competitors.

Inflation Pressures Small Businesses to Reduce Quantity and Cut Supply Costs

Since the beginning of the pandemic, one of the most central issues of the economy in the United States has been the steep rise in inflation. Over 80% of small businesses have increased their prices as a result of inflation, with tighter profit margins and reduced inventories also being major effects of the issue (Camberato). Attempts to counteract the negative effects of inflation have led to businesses cutting marketing costs and have made it extremely difficult for them to remain competitive and profitable due to the nature of small businesses.

The past two years have also been the steepest rise in the consumer price index since the economic recession of the early 1980s (Economic Research, Federal Reserve Bank of St. Louis). Price shocks across the world have had a detrimental effect on small business owners, with many challenges

coming externally with the rise of the cost of inputs. There have also been a lot of challenges regarding supply chain management and overall wage and labor costs, but the pressures are projected to fade within the next few years which relieves a bit of the stress for these small businesses. The majority of small businesses surveyed believe that the worst is still yet to come for them, and many are still very concerned about entering an economic downturn in the near future.

A survey from the US Chamber of Commerce shows that 90% of small businesses were very concerned about their business, which is a significant rise compared to 31% in 2022 Q1.

Customer purchasing power has decreased as a response to price increases in logistics and living expenses, caused by inflation. People tend to save more instead of spending, leading to a downward customer demand slope. This change imposes a significant change in the business's pricing strategy since customers mainly spend on essential products, such as food, health care, etc. Customers are not prone to promotions as before the pandemic; therefore, businesses must wisely consider how they can price their products that could satisfy their customers while maintaining profits.

Perhaps some good news to small businesses is that while most consumers reported noticing price raises in small businesses, they are still consumers' priority in choosing to shop. Consumers empathize with small businesses because of the fewer resources they face.

17%

of small businesses decided to reduce product quantity (U.S. Chamber of Commerce)

23%

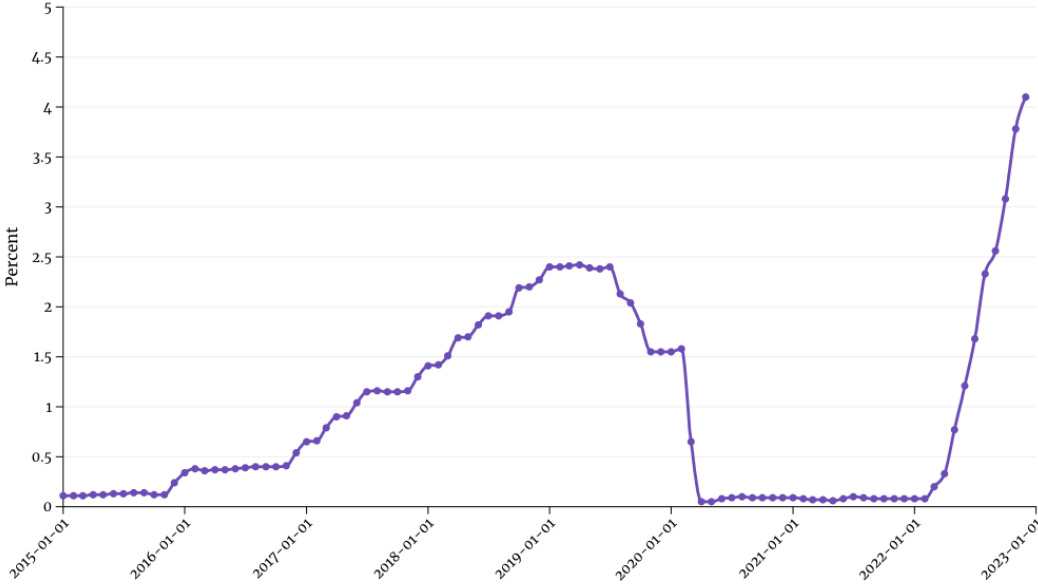
of small businesses decided to reduce cost of materials and suppliers (U.S. Chamber of Commerce)

With the rapid rate of inflation, they must raise their nominal prices by 4-9% to cope with the situation. However, increasing prices have not led to revenue growth, even 82% of owners report lowered business income because real prices have not effectively reflected the real effect of inflation.

Borrowing Costs Are Rising

As the federal government acts against inflation with hikes in interest rates, small businesses are disproportionately impacted.

Federal Funds Effective Rate



Source: Economic Research Federal Reserve Bank of St. Louis

Despite increases in interest rates over the past year, demand for business loans remains high. With greater volatility, lending institutions may choose larger companies: small businesses typically sport more volatile margins and lower cash flow. Small business may want to look to the SBA (Small Business Administration), which is often the most accessible option.



Local Focus

Thanh Vi Increasing Efficiency to Improve Resilience

Thanh Vi is a local family-owned Vietnamese restaurant that has been in operation for years. Its owner, Jay, was able to give some insight into how their business has been affected by the pandemic and their change in business practices due to inflation. Jay described how the current economic situation has reminded him of the 2008 recession and how he has concerns that the economy may face something worse than that.

He also described how the restaurant industry has shifted more towards take-out and delivery since the start of the pandemic, and more specifically on how Thanh Vi's customers have purchased fewer items off the menu and tipped less.

As for internal operations, the restaurant has been cutting costs in inventory and has closely managed kept its inventory and surpluses.

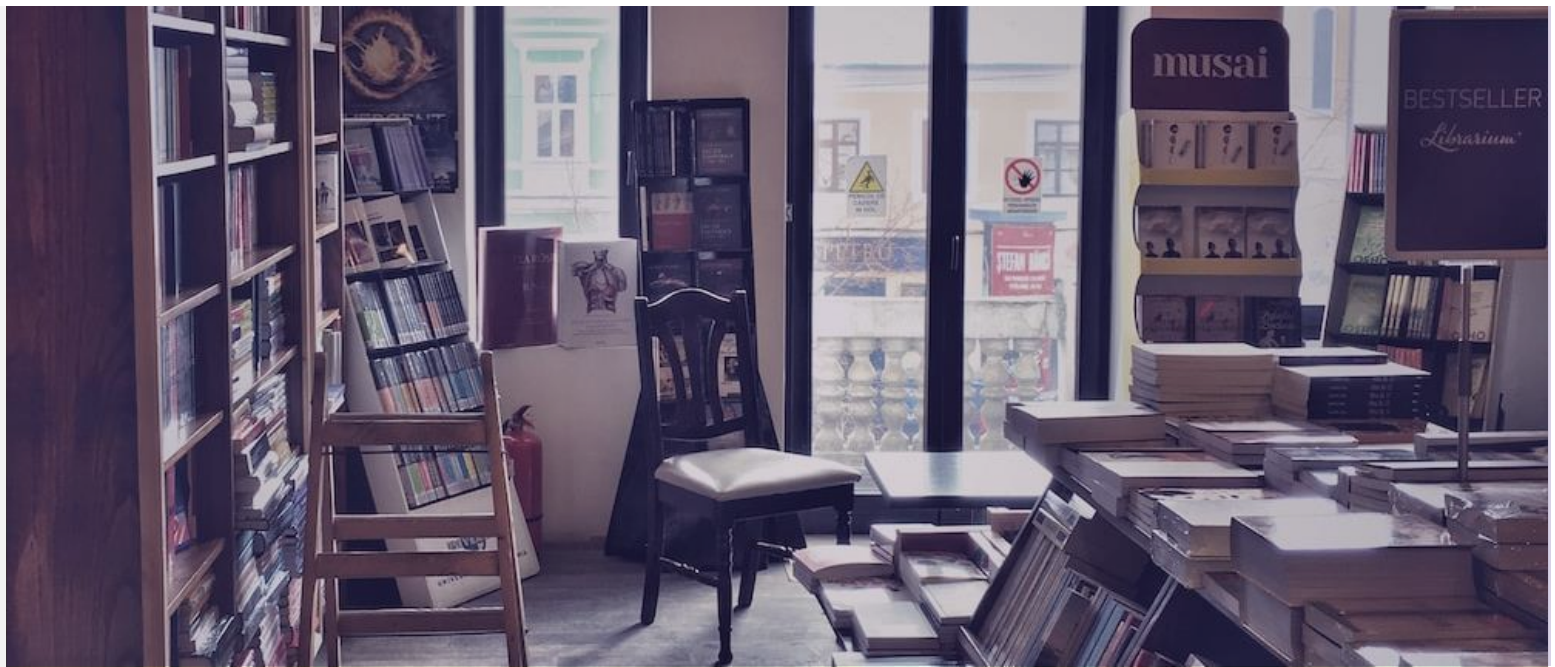


Global Focus

Badenbear Fashion

Responding to Reduced Consumer Spending

Babenbear Fashion is a small retail start-up located in Australia. According to the owner, her customers have experienced reduced purchasing power due to inflation. She identified the patterns of them to reduce spending and save more; they are prioritizing buying essential goods. Although there are policies to support small businesses in the rise of recessions, they still have struggles meeting the loan requirements. Employee lay-off and wage adjustment are among the issues the owner faces to keep her business afloat. Because the money supply is limited, she must make considerations on which employees to keep according to which departments she supposes are most vital. In conclusion, inflation imposes uncertainty on her business as measuring the effect of the economic downturn is not straightforward for small businesses and reduced customer purchasing power has lowered Babenbear profit margin.



Local Focus

Magnus Books Opportunities Amid Economic Uncertainty

Magus Books is an indie bookshop situated in the University District that buys and sells used and rare books. The store has been open since 1978 and has become a staple for many generations of University of Washington students. Magnus Books is owned and operated by the McElroys. Hanna McElroy is less worried about rising inflation in the economy: recessions can increase demand of used goods. As an established yet still local business, Hanna gave the advice to not waste money or overextend, and to not use credit. She also suggested focusing on inventory management and looking for new avenues of revenue. The couple created merchandise like hats and t-shirts as another stream of revenue in order to diversify and mitigate the loss of income. The pandemic, minus the lockdown, was especially profitable for Magus Books as consumer habits started to change as more people wanted an escape from technology by reading paper books. Magus Books is an example of how small businesses can find opportunities in difficult times; innovative business practices, affordable prices in the used goods space, and strong support base in the University District has kept it going strong.

Strategies for Managing Risks

Taking strategic steps during a recession will ensure success for local businesses. With interest rates on the rise, many business owners fear the worst in the upcoming economic downturn. Making data-driven decisions rather than acting ignorantly or falling for common misconceptions is critical. During a recession, many business owners incorrectly assume that the only way to stay afloat is to acquire additional customers, but this is an ineffective strategy since buyers become less likely to shop at new businesses during recessions. It is far more cost-effective and practical to focus on customer retention rather than new customer acquisition. According to Bain & Company, “increasing your retention business by as little as 5% can result in a sizable jump in profits amounting to 25% or more” (Bain & Company). One way of maintaining customer retention is to implement loyalty programs that incentivize clients to continue utilizing their services. These programs increase communication between the customer and the business and personalize their shopping experience. Another way to ensure fiscal stability during times of economic downturn is to reinvest funds into advertising with the goal of increasing market share. This can be done by shifting some of the business’s marketing efforts toward brand-related initiatives.

When a business is important to its clients, it is more secure through economic swings—this makes focusing on customer retention one of the most valuable investments a company can make. One important way that businesses can improve customer satisfaction is by investing in buyer insights. Building a better understanding of your clientele will keep small businesses from wasting resources targeting the wrong buyers. To develop this improved understanding while reducing waste, companies should do a deep dive into their customer analytics. In doing so, businesses can better identify their interested customers, target that demographic, and optimize their product for that customer.

Conclusion

During times of economic recession, local businesses should focus on maintaining their loyal customer base, eliminating waste, and creating improved value for their buyers. In prioritizing customer needs and remaining cognizant of current financial trends, small businesses can drive growth and profitability despite fluctuations in the market.

A city skyline at dusk with a crescent moon in the sky. The text is overlaid on the image.

Economic uncertainty
calls for **fostering
customer loyalty,
increasing operational
efficiency, and
watching consumer
trends.**

Meet the Research Team



Greyson Artis

Finance, International Business (Korean)



Kristen Ishizuka

Finance, Information Systems



Arihant Parsuram

Business Administration



Tejan Patel

Finance, Information Systems



Mary Tran

Finance, Information Systems



Leo Wang

Finance

