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INDIA SURVEY ON

INFLATION: IMPACT AND RESPONSE OF SMALL & MEDIUM FAMILY ENTERPRISES

4 April, 2022

CENTRE FOR FAMILY BUSINESS & ENTREPRENEURSHIP

Bharatiya Vidya Bhavan's
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- Promote value-based growth

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FOREWORD

The Indian growth story is crucially dependent on its Micro, Small and Medium Enterprises (MSME) sector[1]. India's 6.33 crore MSMEs , of which 99% enterprises are micro-enterprises , contribute 30.27% of India's GDP, and 33.5% of India's Gross Value Added (GVA). They also account for 11.10 crore jobs in the rural and urban areas of the country, besides contributing to 50% of the country's exports. India's vision of achieving a $5 trillion economy by 2025 is crucially dependent on the growth of SMEs, most of which are family enterprises.

Unbridled inflation- of the sort that India has been experiencing, especially since December 2021- would affect both topline and bottomline of all corporates, and more so that of the SMEs. While the retail inflation has been rising at 6.07% in February 2022 (up from 6.01% in January 2022), it has breached the psychological ceiling of 6% set out by the Reserve Bank of India two months in a row. Such retail inflation is likely to affect consumer purchases and hit SME topline hard. The impact is likely to be worse, because of the higher inflation in operating costs, triggered by supply chain shortages in the wake of the Covid-19 pandemic, exacerbated by geo-political developments associated with the Ukraine- Russia War. The Wholesale Price Index for February 2022, for instance, was 13.11%, with prices of crude rising at 55.17% in February 2022.

We undertook an exploratory survey of Family Enterprises - mostly SMEs- to understand the impact of the current inflation on their businesses and how they seek to mitigate such impact. We surveyed 170 family enterprises across 65 cities, from North, South, East, West, and Central India between March 18-25, 2022. The enterprises studied belonged to the manufacturing and service sectors, with the latter comprising of

[1] We use the term SMEs and MSMEs interchangeably throughout the report.

trading and retail enterprises. We used statistical tools to analyze the differential impact of inflation on these enterprises, based on differences in sectors, the type of enterprises and their geographical locations. Finally, we also sought to understand the inflationary expectations of the small and medium family enterprises, and their plans to raise prices to combat such inflation.

Our study reveals that while rising inflation has been a cause for concern for all family enterprises, with the operating cost increase going up by more than 50% in some cases, such cost inflation has affected the small and medium family enterprises differentially based on their sectoral affiliation, as well as their size. Some family enterprises have chosen not to increase their prices, despite rising costs. There are others which have resorted to price increases despite no increase in operating costs, in anticipation of future cost increases and/or in line with competitor actions.

The family enterprises studied have responded to operating cost increases mainly through price increases. Other responses have included improving their cash flow cycles and through renegotiating contracts. The family enterprises we studied did not cite grammage reductions or quality reductions as means of covering the rising costs. This is in line with family firm literature, which envisages trust to be a far more important value among family enterprises compared to non-family firms.

Since inflationary expectations play an important role in sustaining high inflation, we surveyed the respondent family enterprises on their cost expectations and their expectations regarding price increases as well. Family enterprises expect costs to rise both in the 3-month ahead and the one-year ahead horizon. A majority of the enterprises studied plan to increase prices in the 3-month ahead time period.

This survey reveals the huge impact of raw material cost inflation on Indian small and medium family enterprises. It also reveals the relationship between such cost increases and the resultant price increases taken by small and medium family enterprises. Whether SMEs have the pricing power to sustain such increases remains a moot question. The survey also points to the inflationary expectations held by the small and medium family enterprises over both the short-term and a medium-term (one-year ahead) horizon, and the price increases planned to counter such inflation.

Tulsi Jayakumar
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KEY FINDINGS

KEY FINDINGS

THE IMPACT

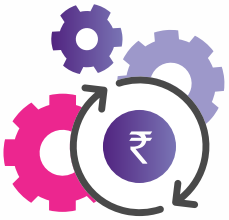
More than 85% of the enterprises surveyed have experienced increase in operating costs.

The average increase in operating costs among small and medium family enterprises is by 19.5%. This is statistically larger than the cost inflation suggested by the Wholesale Price Index (February 2022) at 13.11%.

The average increase in operating costs, however, masks a wide variation, with cost increases ranging from 2% to 200%.

The proportion of manufacturing enterprises reporting cost increases is statistically larger than that of service enterprises. Manufacturing enterprises also seem to be bearing the brunt of the cost increases, reporting an average increase of 24%, whereas service enterprises experienced an increase of 14.4%

Cost increases also impacted the different-sized family enterprises differentially. Thus, the proportion of medium enterprises experiencing cost increases was the highest, and that by small enterprises the least.



REASONS FOR HIGHER OPERATING COSTS

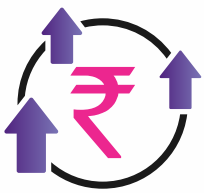
Most increases in operating costs have been attributed to an increase in the prices of raw materials.

Other reasons for increasing operating costs have been cited as the increase in energy and fuel prices and transportation costs, and the increase in labour costs.

Increase in the fuel and energy prices and transportation costs pinched service enterprises more than they did manufacturing enterprises among family SMEs. The same was true for labour cost increases.

The family enterprises surveyed did not cite a rise in financing costs- the bane of the SME sector- as a significant factor putting pressure on operating costs.

RESPONSE TO HIGHER OPERATING COSTS



Most small and medium family enterprises surveyed have responded to the cost increases through passing on the price increases.

The average price increase that has been taken is 18.5%.

How such price increases will affect small and medium family enterprises, and whether they enjoy pricing power similar to large corporates remains to be seen.

Some of the family enterprises surveyed have used other methods to cope with cost increases. These include strategies such as improving the receivables and ensuring better cycling of cash flows, through scrapping old contracts and renegotiating contracts based on new raw material rates, through borrowing from banks and financial institutions and through changing the product portfolio mix.

Unlike large corporates and multinational corporations which have dealt with inflation through grammage reductions[2], family enterprises seem not to have resorted to such methods to counter cost increases.

Some enterprises, paradoxically and counter-intuitively, have taken price cuts, to boost demand, to dispose of inventories and/or to match competitor prices. There are some others, who have chosen to raise prices, despite not experiencing operating cost increases, possibly in anticipation of price increases in the future.

[2]https://www.business-standard.com/article/companies/price-hike-not-enough-to-cushion-fmcg-companies-margin-pain-121111400813_1.html

COST EXPECTATIONS

Majority of the respondent family enterprises expect costs to be higher through both a 3-months and a 1-year ahead period. Most family enterprises plan to raise prices either definitely or tentatively, while a small minority plan not to raise prices in the coming 3 months.

POLICY IMPLICATIONS

Policy initiatives need to address the specific concerns of small and medium family enterprises.

The Reserve Bank of India (RBI), increasingly under pressure to give up its accommodative monetary policy stance due to higher retail inflation, will need to extend special credit lines to the SME sector.

The government may think of placing a price cap and/or provide subsidies on the energy and fuel consumed by SMEs.

SME advocacy and capability-building groups will need to work pro-actively to identify opportunities for the SMEs amidst the geo-political uncertainties.

Such groups would also need to help MSMEs equip themselves with the requisite hard and soft skills which will help them raise their pricing power.

THE DATA

170 Family Managed Businesses Surveyed	**67** Cities Covered Pan-India	**31** Micro Enterprises	**86** Small Enterprises
35 Medium Enterprises	**18** Large Enterprises	**92** Manufacturing	**78** Service

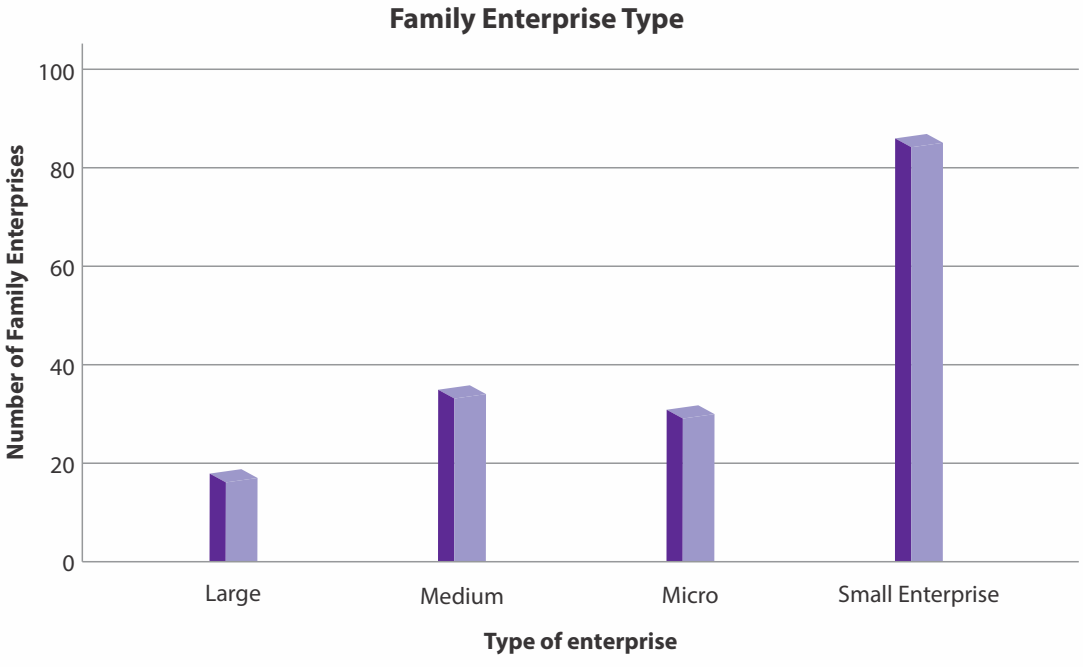
ALL FAMILY MANAGED BUSINESSES

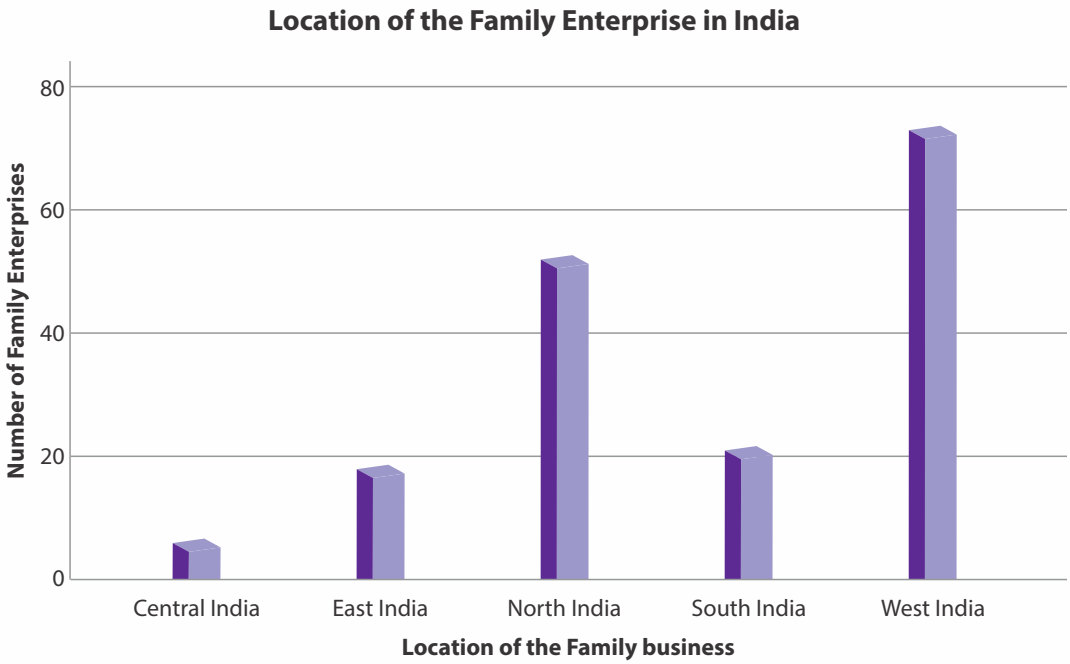
From Steel to Pharma to Hospitality to Jewellery

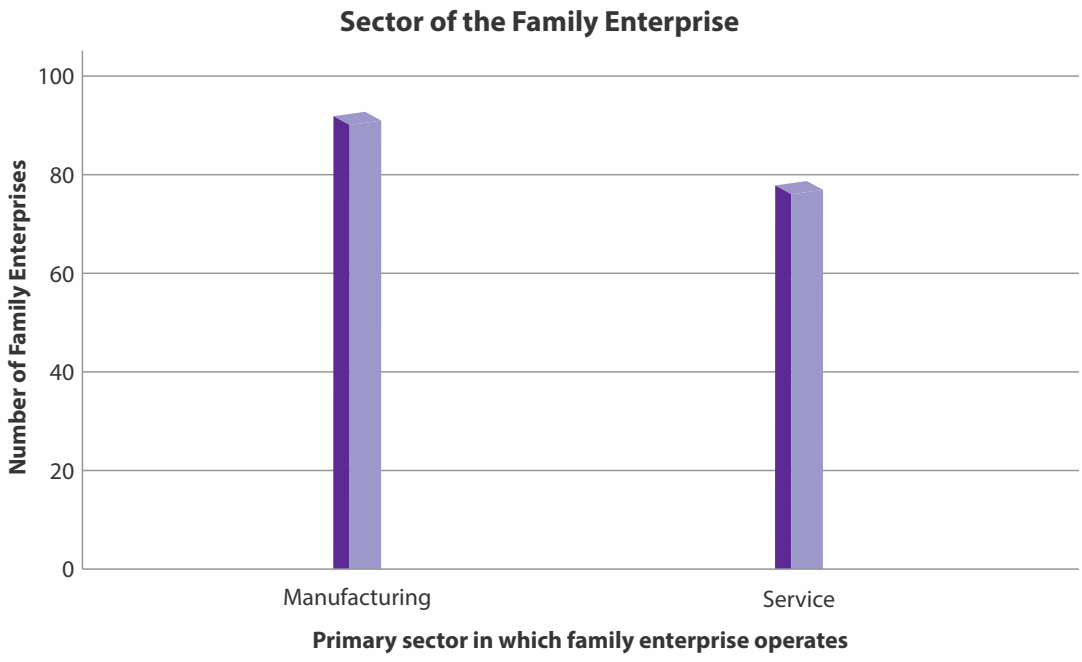
Average Age of the Companies Studied	Oldest Company	Youngest Company
28.25 years	**135** years	**1** year

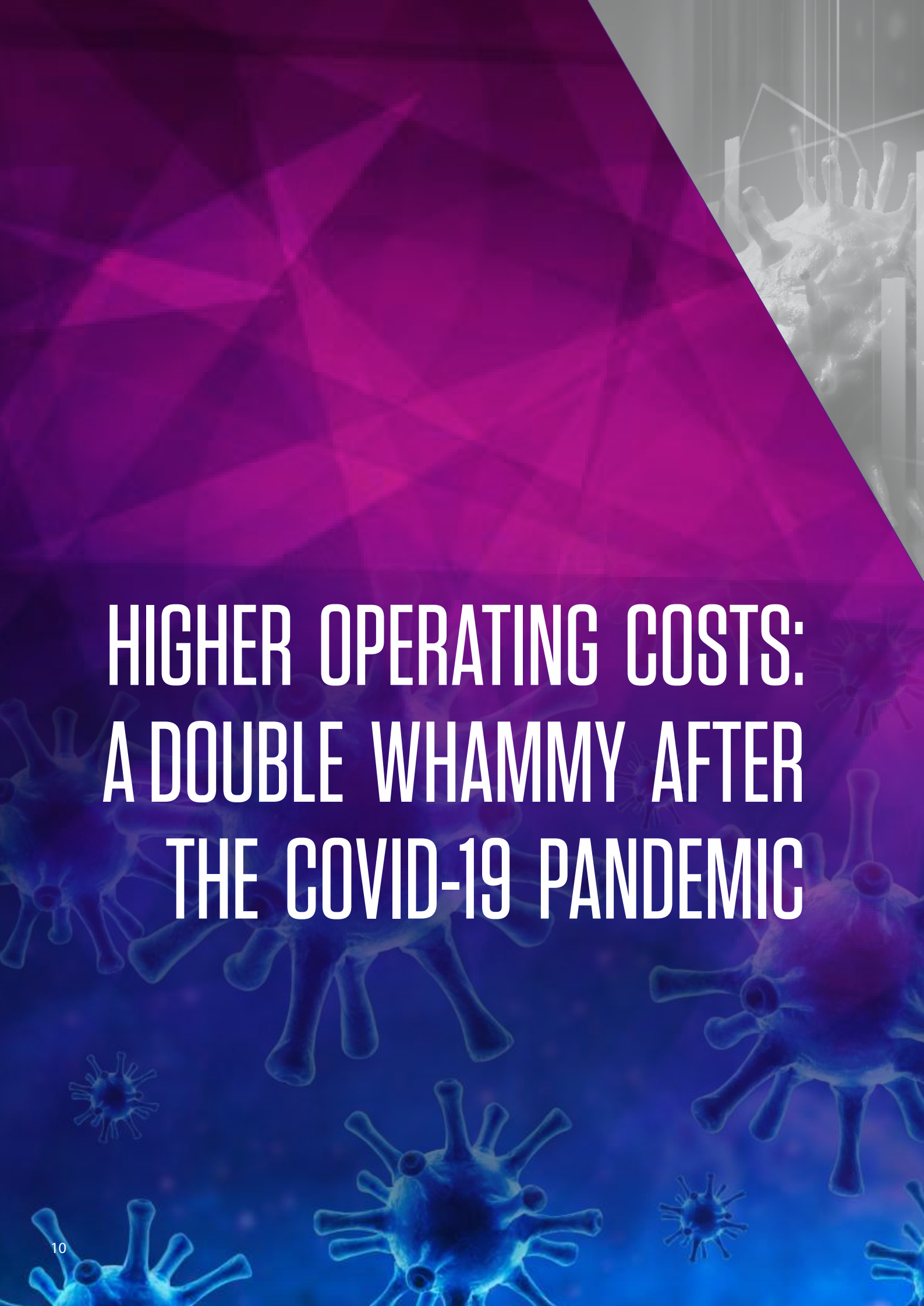
PERIOD OF SURVEY: MARCH 18-25, 2022

PROFILE OF ENTERPRISES




Location of the Family Enterprise in India
Number of Family Enterprises
80
60
40
20
0
Central India
East India
North India
South India
West India
Location of the Family business


Sector of the Family Enterprise
Number of Family Enterprises
100
80
60
40
20
0
Manufacturing
Service
Primary sector in which family enterprise operates



HIGHER OPERATING COSTS: A DOUBLE WHAMMY AFTER THE COVID-19 PANDEMIC

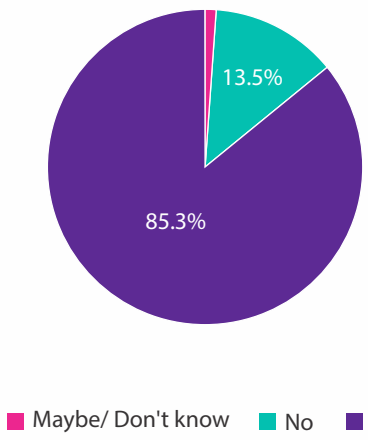
HIGHER OPERATING COSTS: A DOUBLE WHAMMY AFTER THE COVID-19 PANDEMIC

I. THE IMPACT

Most small businesses hit by an increase in costs

More than 85% of the enterprises surveyed have experienced an increase in operating costs in the last 3 months

Increase in operating costs in the last 3 months



INCREASE IN OPERATING COSTS RANGED FROM 2%-200%

13.5% of the businesses surveyed experienced no increases in operating costs

29.5% of the businesses have experienced a positive operating cost increase of up to 10%

58% of the businesses have experienced a positive operating cost increase of up to 20%

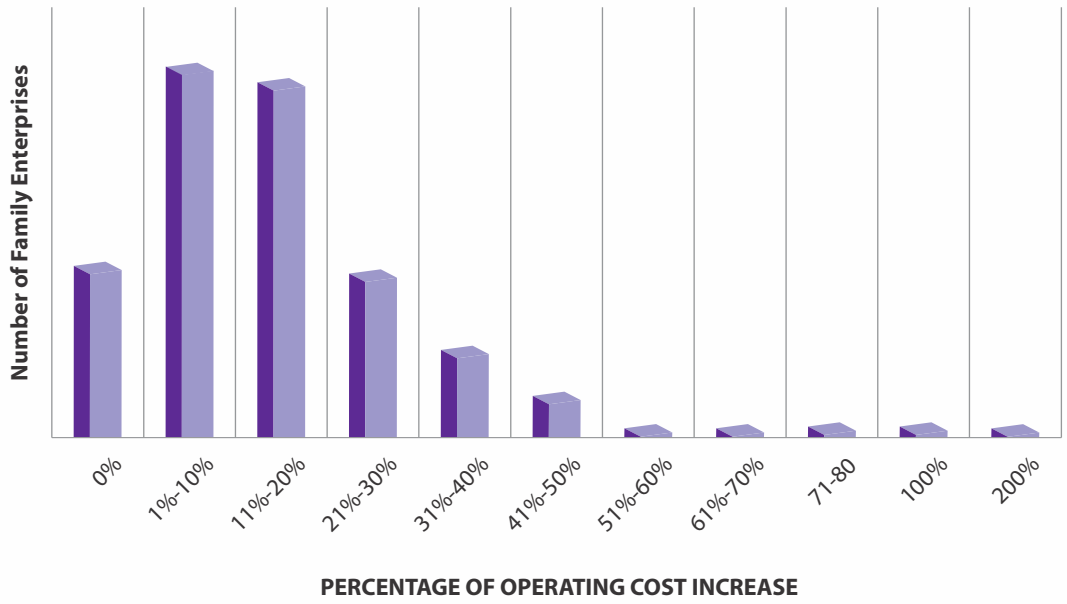
71% of the businesses have experienced a positive operating cost increase of up to 30%

78% of the businesses have experienced a positive operating cost increase of up to 40%

81% of the businesses have experienced a positive operating cost increase of up to 50%

4% of the businesses have experienced a positive operating cost increase of above 50%[3]

EXTENT OF OPERATING COST INCREASES



INCREASE IN OPERATING COSTS HIT ALL SECTORS, ESPECIALLY MANUFACTURING

92.4 % of the manufacturing enterprises experienced cost increases

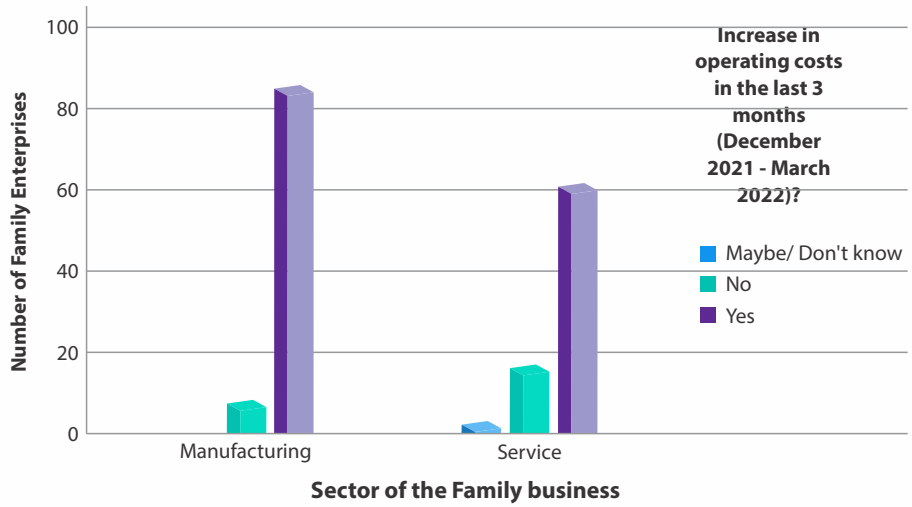
77% of the service enterprises experienced cost increases

The proportion of enterprises (by sector) who witnessed an increase in operating costs is significantly larger than those who haven't.

While manufacturing enterprises reported an average cost increase of 24%, service enterprises reported an average cost increase of 14.4%

[3] Totals may not match up to 100%, since there were some missing values.

Operating Cost increase across sectors



	Manufacturing	Service
Chi-Square	89.200	107.147
DF	20	18
Significance level	.000+	.000+

PROPORTION OF FAMILY ENTERPRISES EXPERIENCING COST INCREASES WENT UP WITH THE SIZE OF THE ENTERPRISE AMONG MSMEs[4]*

It appears that the proportion of family enterprises citing cost increases increased with the size of these enterprises. Thus,

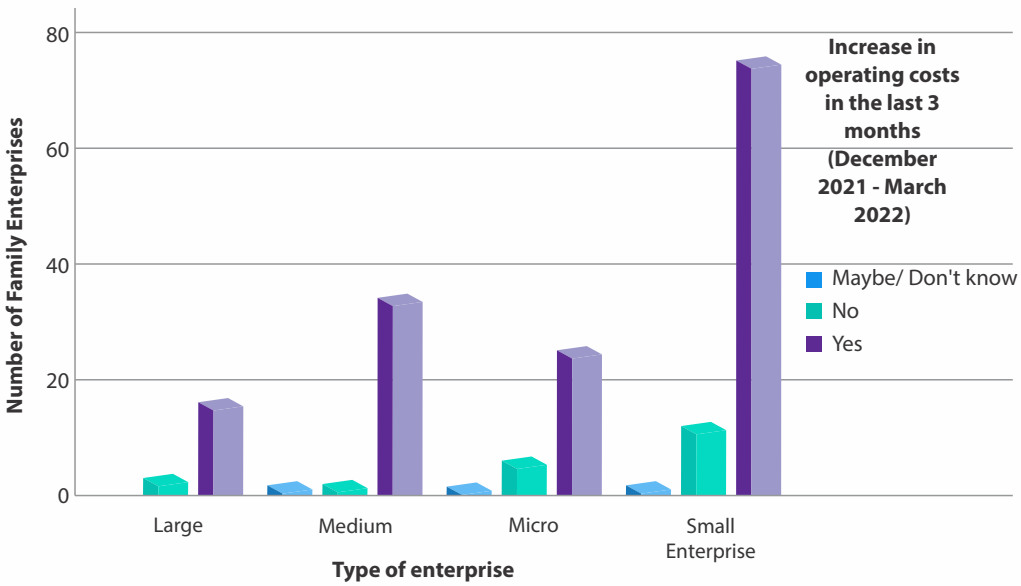
78.1% of the micro enterprises experienced cost increases

85.2% of the small enterprises experienced cost increases

89.5% of the medium enterprises experienced cost increases

The proportion of enterprises (by size) which witnessed an increase in operating costs is significantly larger than those who haven't.

Operating cost increases across different-sized enterprises



[4] 84% of the large enterprises experienced cost increases

Chi-Square Analysis for increase in operating costs in the past 3 months				
	Micro	Small	Medium	Large
Chi-Square	30.063	108.705	53.895	8.895
DF	2	2	2	1
Significance level	.000+	.000+	.000+	.003+

+ indicates the value is significant at a 5% significance level

COST INCREASES BY GEOGRAPHICAL REGIONS

A larger proportion of family enterprises located in the North (92.3%) and in the West (84.9%) reported increases in operating costs. A chi-square test of independence showed that there was a significant association between geographical location and operating cost increases for family enterprises. The cost increases were significant for family enterprises located in North, South and West India.

Family enterprise by geographical location and operation cost increase

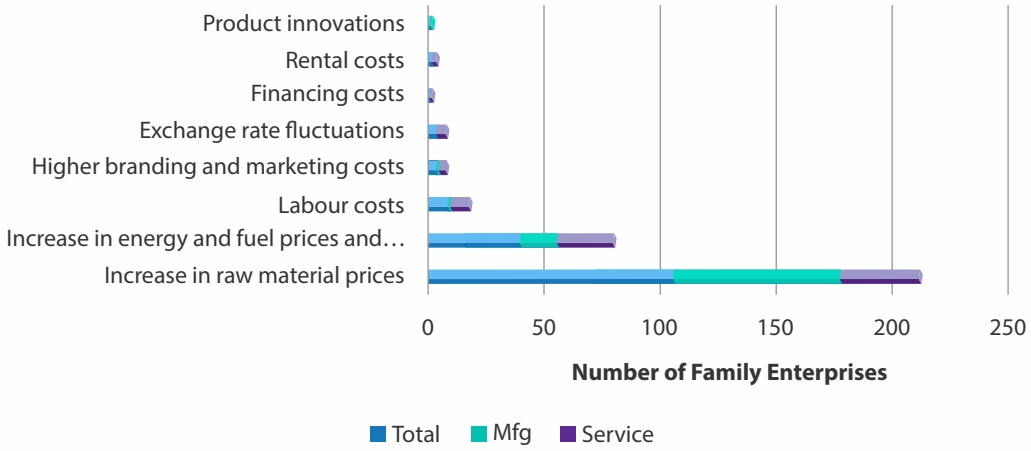
Chi-Square Analysis for increase in operating costs in the past 3 months					
	NORTH	SOUTH	CENTRAL	EAST	WEST
Chi-Square	81.5	10.714	0.667	3.556	88.466
DF	2	1	1	1	2
Significance level	.000+	.001+	.414	.059	.000+

+ indicates the value is significant at a 5% significance level

II. THE REASONS FOR THE INCREASE IN OPERATING COSTS

The top factors contributing to an increase in the operating costs were:
#1 Increase in the price of raw materials
#2 Increase in energy and fuel prices and transportation costs
#3 Increase in labour costs
#4 Exchange rate fluctuations.
#4 Higher costs of branding and marketing[5]

The #1 factor responsible for higher operating costs: Sector-wise analysis



- 79% of the manufacturing firms surveyed (72 of the 91 firms) rated increase in raw material prices as the #1 factor responsible for operating cost increases, while only 45% of service firms surveyed (34 of the 76 firms[6]) rated increased raw material prices as the top factor responsible for higher operating costs.
- 17.6% of the manufacturing firms surveyed rated increase in energy and fuel prices and transportation costs as the #1 factor responsible for operating cost increases, while 31.6 % of service firms surveyed rated such increased fuel prices as the top factor responsible for higher operating costs.
- 1% of the manufacturing firms surveyed rated increased labour costs as the #1 factor responsible for operating cost increases, while 10.5 % of service firms surveyed rated such increased labour costs as top factor responsible for higher operating costs.
- Financing costs- the bane of the SME sector- do not seem to have increased enough in the period surveyed to put enough pressure on costs

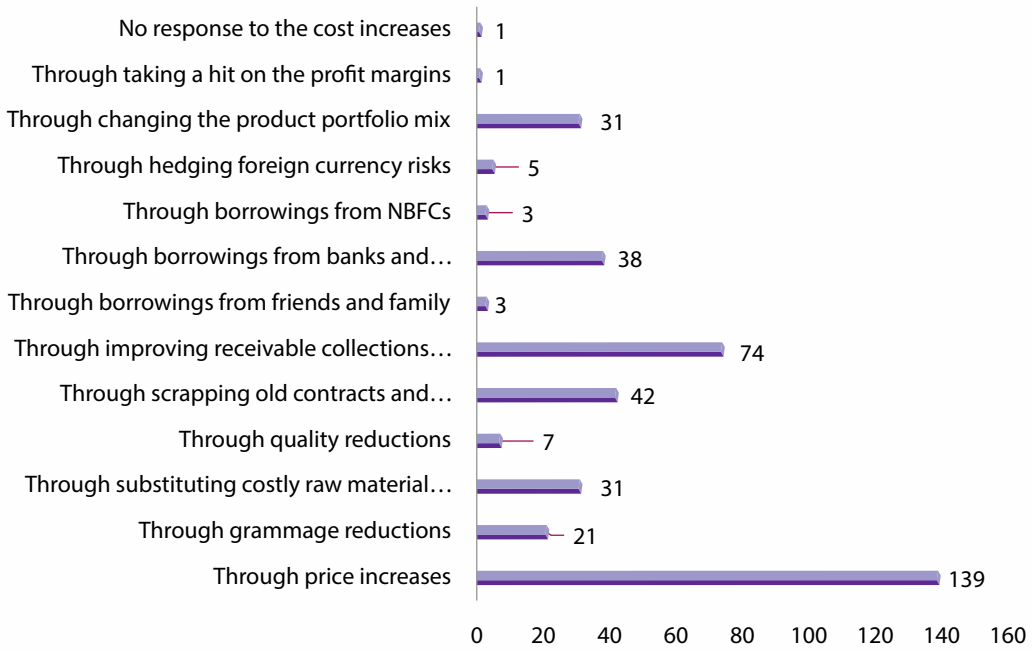
[5] There were two factors which tied at #4

[6] 3 firms (1 manufacturing and 2 service firms) did not respond to this question

III. THE RESPONSE TO THE INCREASE IN OPERATING COSTS

The top 5 ways in which the family enterprises responded to the increase in the operating costs included:
#1 Through taking a price rise (79%)
#2 Through improving receivable collections and ensuring better cash flow cycles (42%)
#3 Through scrapping old contracts and renegotiating contracts based on new raw material rates (24%)
#4 Through borrowing from banks and financial institutions (21.6%)
#5 Through changing the product portfolio mix (17.6%)

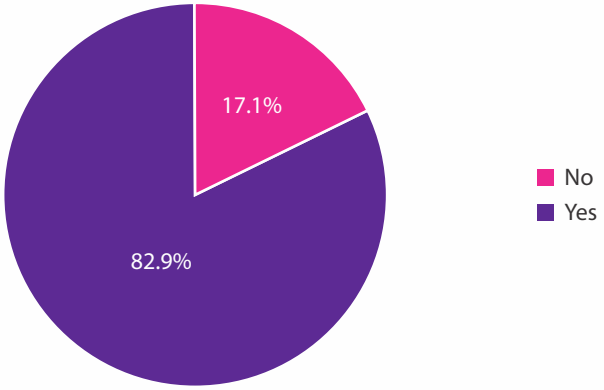
FAMILY ENTERPRISE RESPONSE TO OPERATING COST INCREASES



PRICING RESPONSES TO THE INCREASE IN OPERATING COSTS

Most family enterprises (83%) increased their prices in response to operating cost increases.

Increase in price by the Family Enterprise in the last 3 months



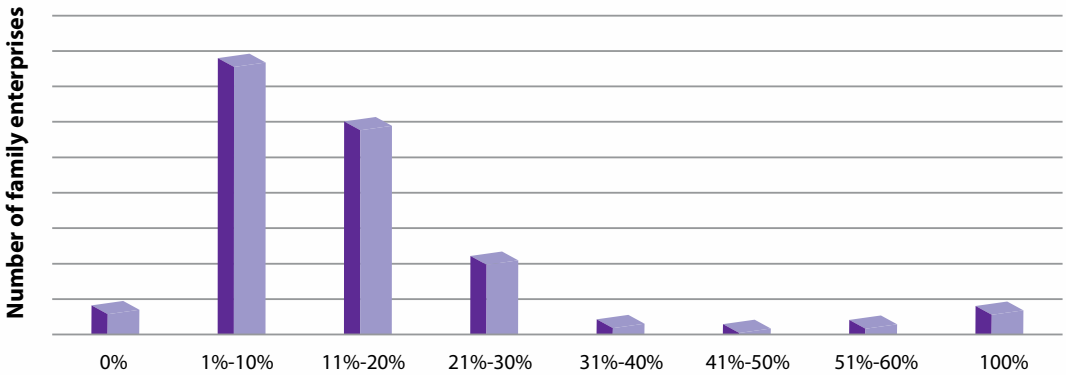
93 of the 170 respondents stated the extent of price increases taken by the family enterprise. Of the 93 who stated the extent of the price increases:

42% of the family enterprises stated a price increase of up to 10%

74% of the family enterprises stated a price increase of up to 20%

86% of the family enterprises stated a price increase of up to 30%

Family Enterprises' Pricing Response



Reasons for the price increase as stated by the respondents:

#1 Increase in costs, which have to be passed down to the customers: 108

#2 Demand has increased: 14

#3 Have introduced product improvements: 6

#4 To match competitor prices: 5

#5 Instability in global markets due to geo-political conditions: 3

Interestingly, amidst the uncertain environment, some small and medium family enterprises have actually gone in for price cuts. The reasons stated by them are:

#1 To match competitor price cuts

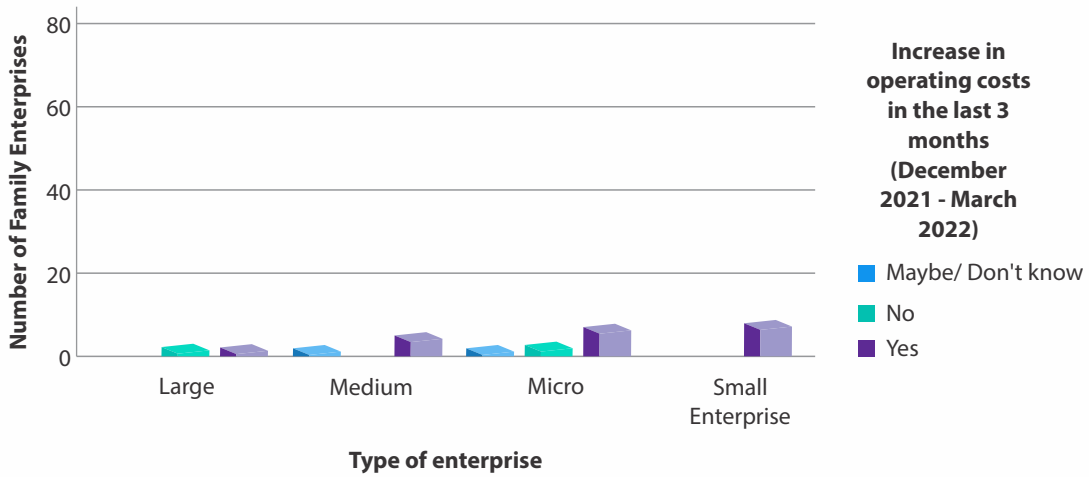
#2 To dispose of inventories

#3 To attract demand, which is now lower

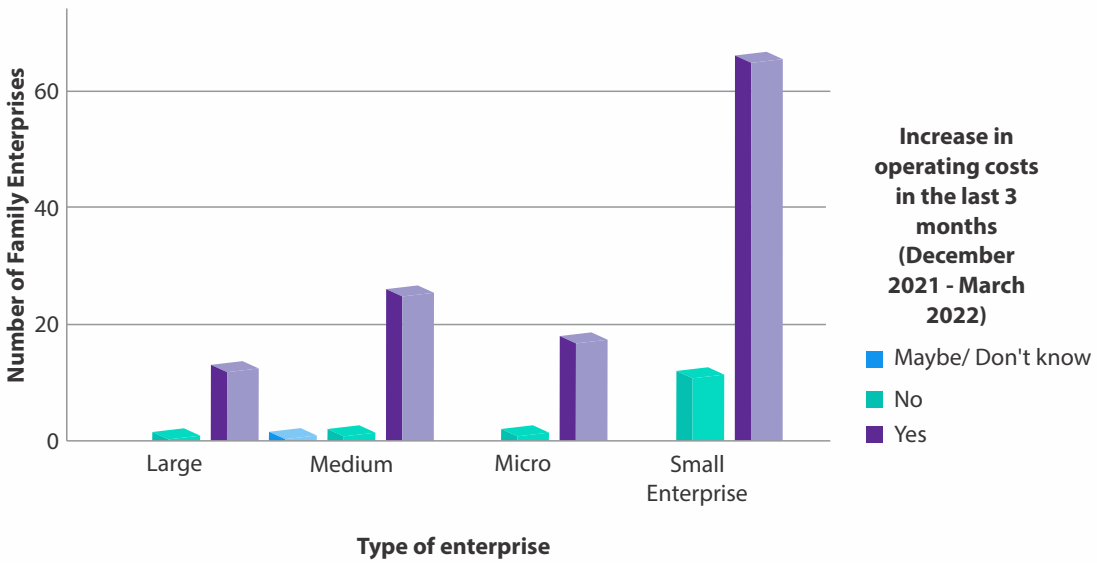
HOW DID DIFFERENT SIZED FAMILY ENTERPRISES RESPOND TO OPERATING COST INCREASES THROUGH PRICING RESPONSES?

- 29 family enterprises chose not to increase prices despite an increase in operating costs
- 11% of the large family enterprises, 14% of the medium enterprises, 22.5% of Microenterprises, and 9.3 % of small enterprises did not increase prices, despite increase in operating costs
- 123 family enterprises chose to increase prices with an increase in operating costs
- 72% of the large family enterprises, 74% of the medium enterprises, 58% of Microenterprises, and 77 % of small enterprises increased prices, with an increase in operating costs
- However, interestingly 17 of the family enterprises increased their prices, despite no increase in operating costs. Thus, 10% of the Micro enterprises, and 15.4% of the small enterprises which took price rises had not experienced cost increases.

Increase in the prices of products/services in the last 3 month=No



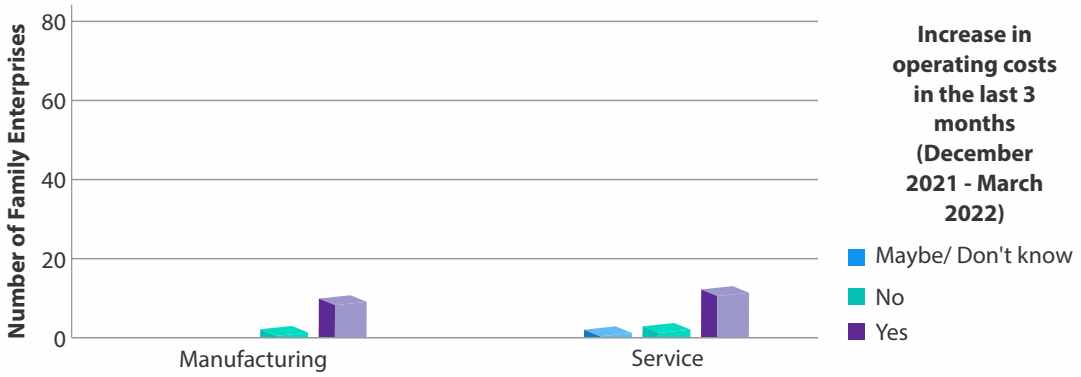
Increase in the prices of products/services in the last 3 months=Yes



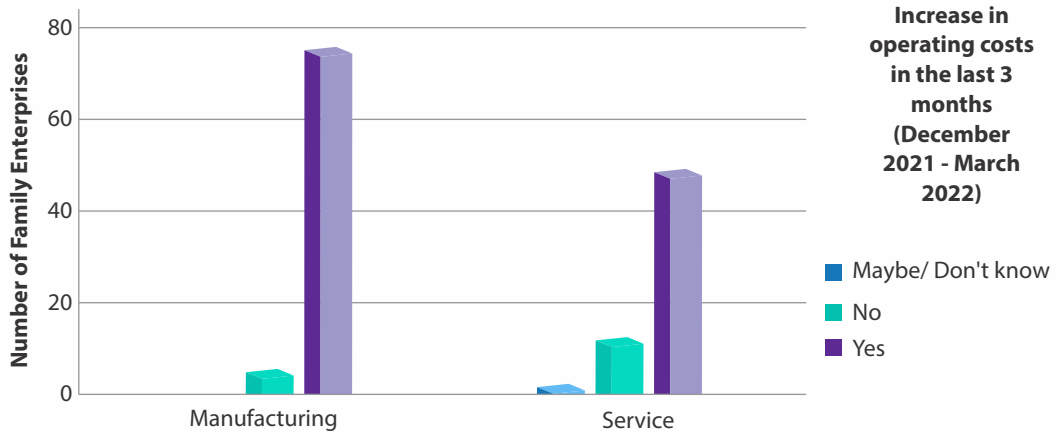
HOW DID FAMILY ENTERPRISES ACROSS SECTORS RESPOND TO OPERATING COST INCREASES THROUGH PRICING RESPONSES?

- 29 family enterprises chose not to increase prices despite an increase in operating costs
- 11% of the manufacturing enterprises and 15.3% of the service enterprises did not increase prices, despite increase in operating costs
- 123 family enterprises chose to increase prices with an increase in operating costs
- 81.5% of the manufacturing enterprises, and 61.5 % of service enterprises increased prices, with an increase in operating costs
- However, interestingly 17 of the family enterprises increased their prices, despite no increase in operating costs. Of these, 12 were service companies.

Increase in the prices of products/ services in the last 3 month=No



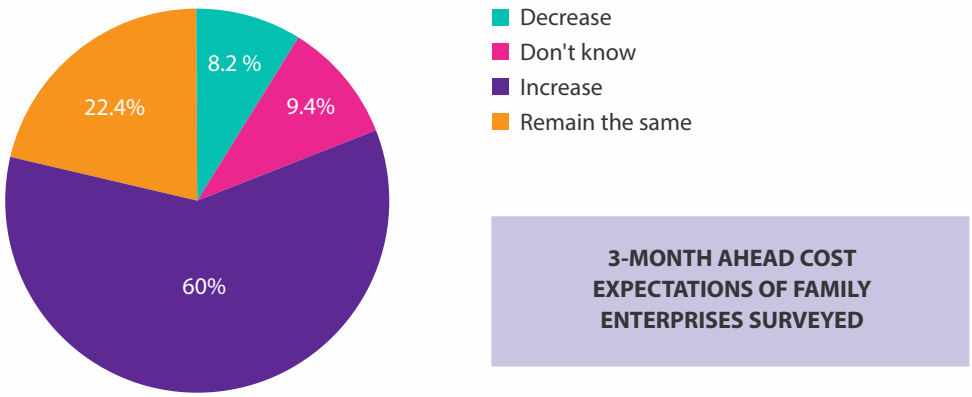
Increase in the prices of products/services in the last 3 months=Yes



IV. COST EXPECTATIONS AND PRICE RESPONSES AMIDST THE UNCERTAIN BUSINESS ENVIRONMENT

- Majority of the family enterprises surveyed (60%) expect costs to increase in the coming 3 months (Q1 2022-2023)

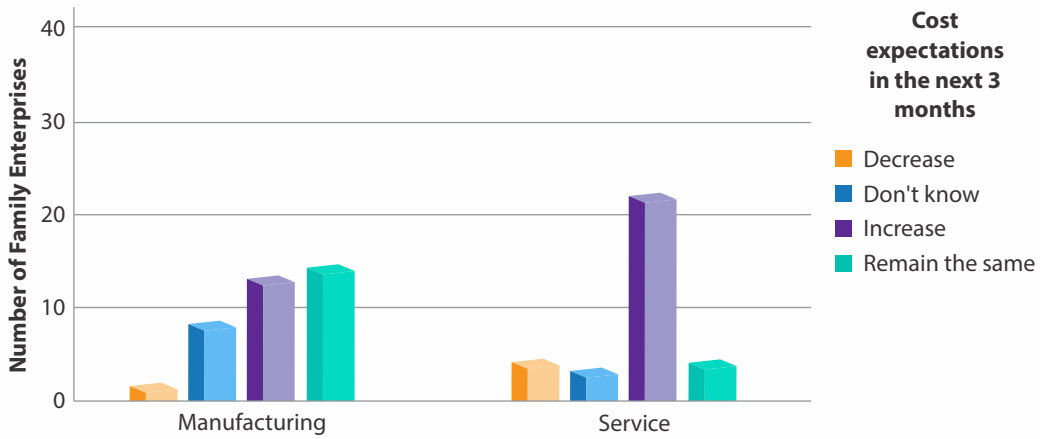
Cost expectations in the next 3 months

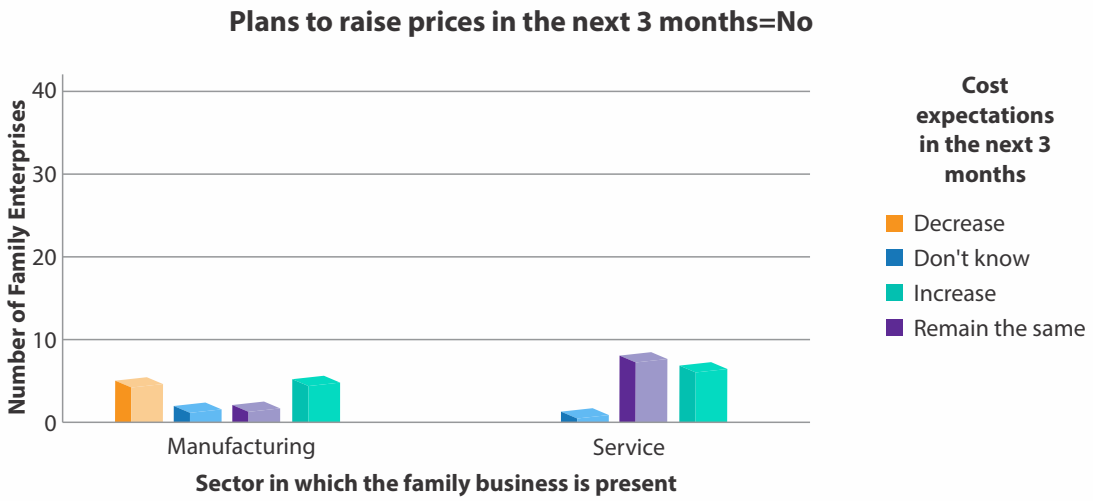


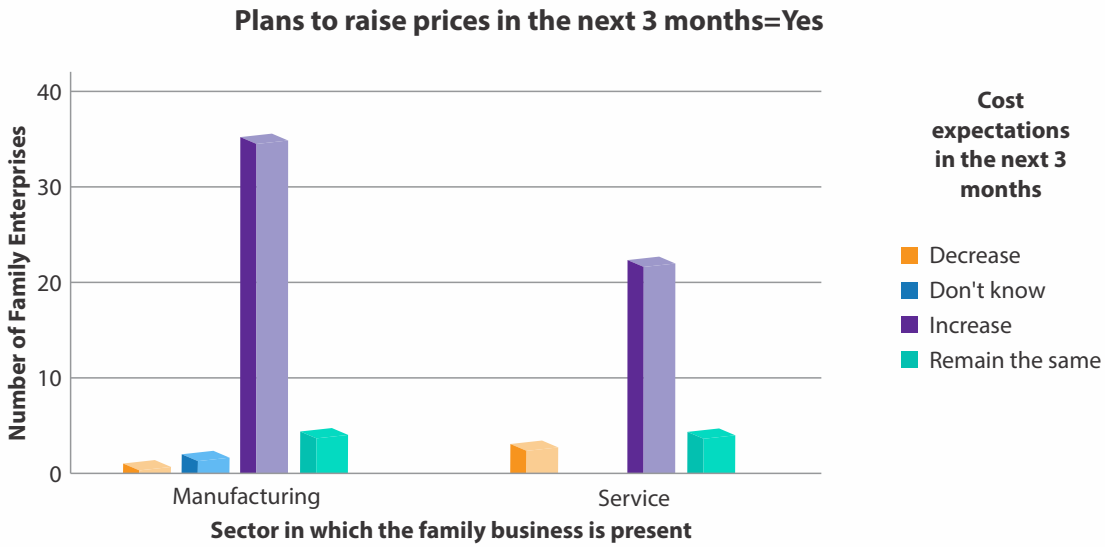
3-MONTH AHEAD COST EXPECTATIONS OF FAMILY ENTERPRISES SURVEYED

- 52% of the manufacturing enterprises expect costs to increase in the next 3 months and plan to take a price rise in the next 3 months, either definitely or tentatively
- 56.4% of the service enterprises expect costs to increase in the next 3 months and plan to take a price rise in the next 3 months, either definitely or tentatively

Plans to raise prices in the next 3 months=Maybe



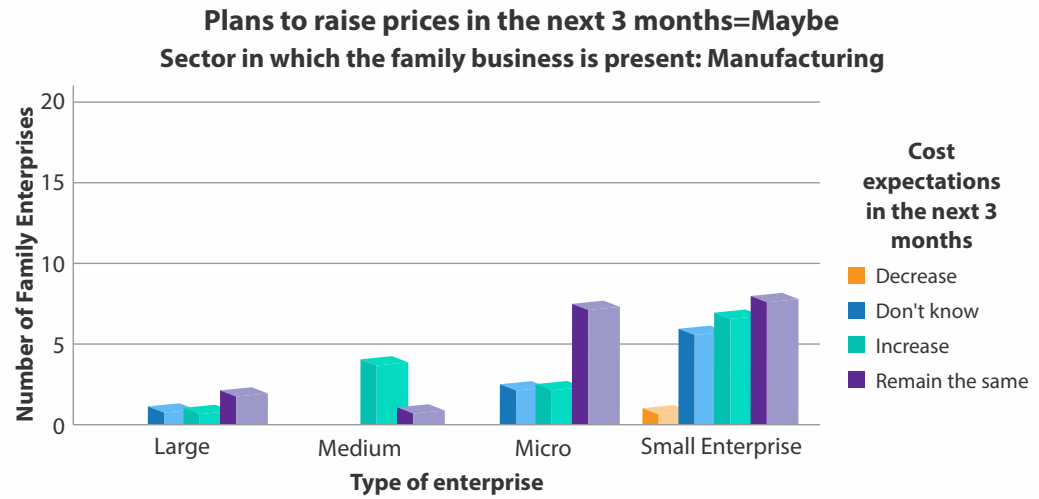


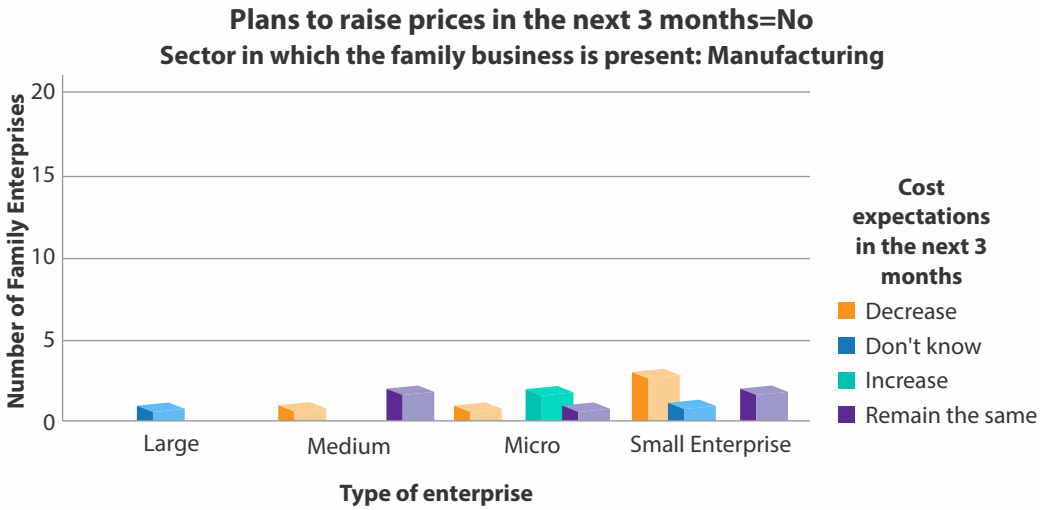


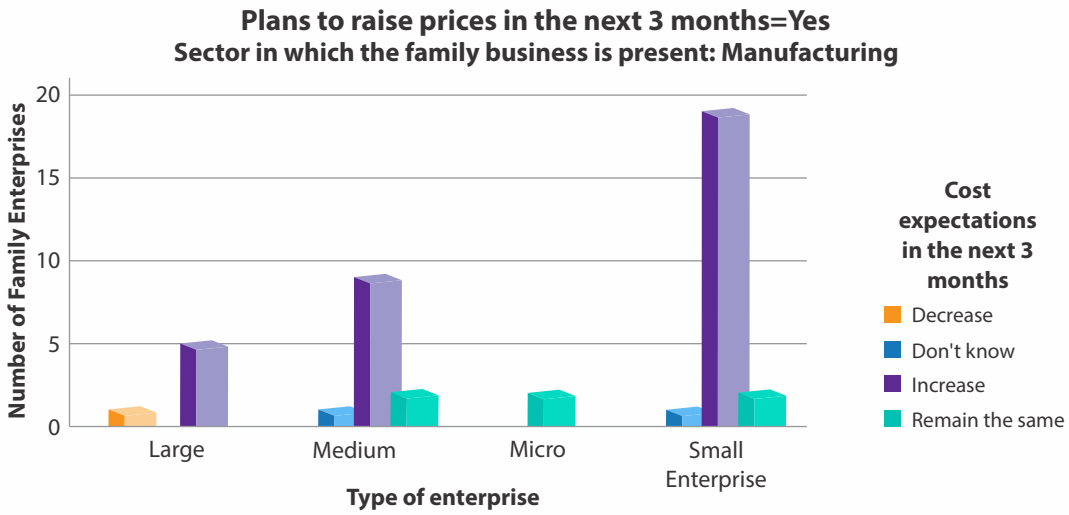
Chi-Square Analysis for cost expectations in the next 3 months		
	Manufacturing	Service
Chi-Square	48.087	75.538
DF	3	3
Significance level	.000+	.000+

+ indicates the value is significant at a 5% significance level

- 54.5% of the large enterprises expect costs to increase in the next 3 months and plan to take a price rise in the next 3 months, either definitely or tentatively
- 27% of the micro enterprises expect costs to increase in the next 3 months, and plan to take a price rise in the next 3 months, either definitely or tentatively
- 52% of the small enterprises expect costs to increase in the next 3 months and plan to take a price rise in the next 3 months, either definitely or tentatively
- 65% of the medium enterprises expect costs to increase in the next 3 months, and plan to take a price rise in the next 3 months, either definitely or tentatively







Chi-Square Analysis for cost expectations in the next 3 months				
	Micro	Small	Medium	Large
Chi-Square	22.29	56.977	33.914	9.111
DF	3	3	3	3
Significance level	.000+	.000+	.000+	.028+

+ indicates the value is significant at a 5% significance level

One-year ahead cost expectations

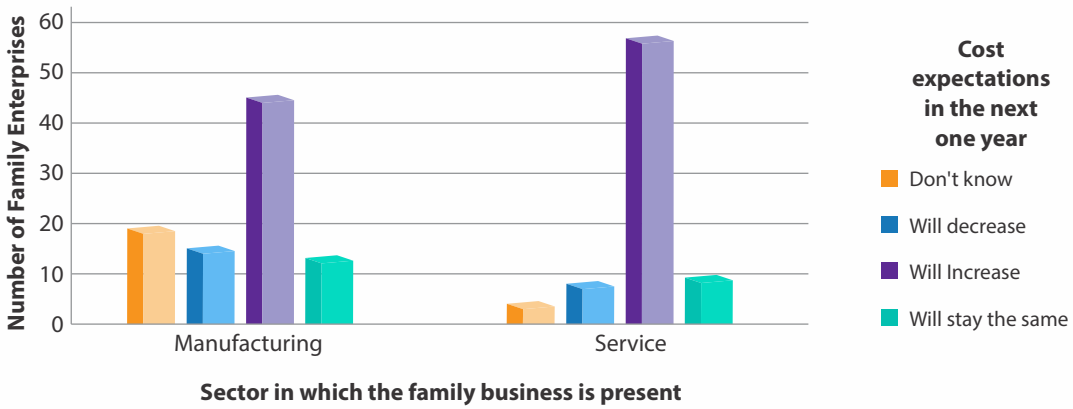
About 60% of the enterprises surveyed expect costs to be higher one-year ahead.

13% expect costs to remain the same

13.5% expect costs to decrease one year ahead.

49% of the manufacturing enterprises and 73% of the service enterprises expect one-year ahead costs to increase.

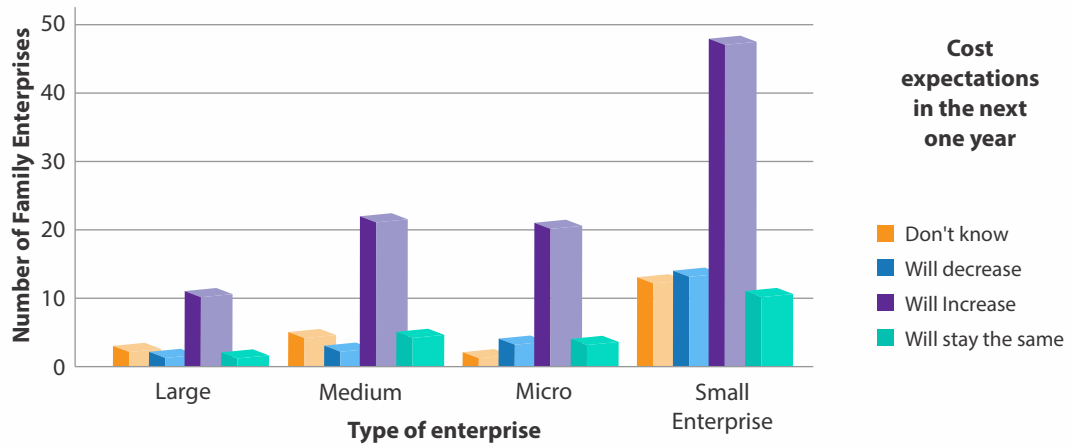
1-year ahead cost expectations by sector



Chi-Square Analysis for cost expectations in the next 1 year		
	Manufacturing	Service
Chi-Square	28.87	96.872
DF	3	3
Significance level	.000+	.000+

+ indicates the value is significant at a 5% significance level

1-year ahead cost expectations of different-sized family enterprises



Chi-Square Analysis for cost expectations in the next one year				
	Micro	Small	Medium	Large
Chi-Square	30.548	43.767	27.057	12.667
DF	3	3	3	3
Significance level	.000+	.000+	.000+	.005+

V. POLICY IMPLICATIONS

Small and medium family enterprises constitute the backbone of the Indian economy. A Credit Suisse Report in 2018, based on a study of 1,015 companies of $250 million or more in market capitalization, pointed to the fact that India ranks third on the list of countries with the highest number of family-owned business.

Current policy initiatives have not been able to address the requirements of the MSME sector- many of which happen to be family enterprises.

The Reserve Bank of India (RBI) may need to continue with providing greater access to credit to the SME sector, in order to take care of their financing needs. This is needed even as the RBI moves away from the current accommodative monetary policy stance, as is expected in the wake of the retail inflation crossing the psychological ceiling of 6%.

While the Union Budget 2022 did contain provisions for an Emergency Credit Line Guarantee Scheme (ECLGS) to provide additional credit to over 1.3 crore MSMEs to be extended till March 2023 with its guarantee cover expanded by Rs 50,000 crore to Rs 5 lakh crore, this is not sufficient for India's 6.3 crore MSMEs.

The government may think of placing a price cap and/or provide subsidies on the energy and fuel consumed by the SME sector, and also certain crucial raw materials. Further, SME advocacy and capability-building groups (such as the SME Chamber of Commerce etc.) will need to work pro-actively to identify opportunities amidst the geo-political uncertainties, and with support from the government- both at the central and regional levels- encourage SMEs to step out of their comfort zones. SMEs which have continued to tap foreign markets through the pandemic, may help in filling the gaps brought about by the Ukraine-Russia War. They will also need to be provided the appropriate support for branding and marketing, which can help them increase their pricing power. A combination of hard and soft skills would be needed for the same. The government will also need to estimate the impact of inflation, specifically on the SME sector. The sector- with its contribution to the GDP and employment, will need to be supported due to its ramifications on the rest of the economy.

ACKNOWLEDGEMENTS

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Bharatiya Vidya Bhavan's
SPJIMR

ABOUT SPJIMR

S.P. Jain Institute of Management and Research (SPJIMR) is a constituent of Bharatiya Vidya Bhavan, an institution founded in 1938- almost a decade before India's Independence, with the objective of preserving and propagating Indian culture and Sanskrit. SPJIMR is among the top five business schools of India and as a premier management school is known for its pedagogic innovations and pioneering programs, particularly in socially under-managed sectors. The programs have helped SPJIMR stand out for its unique, innovative and distinct path in management education.

ABOUT THE CENTRE FOR FAMILY BUSINESS & ENTREPRENEURSHIP

The Centre for Family Business & Entrepreneurship (CFBE) is one of SPJIMR's flagship centres, which runs distinctive programmes for members belonging to family businesses as well as for entrepreneurs. The Centre's vision is to be the fountainhead for an agile, resilient, and sustainable family business and entrepreneurship ecosystem with a global outlook. Its Post Graduate Programme for Family Managed Business (PGP-FMB) was the first ever Indian management programme designed for members of the next-generation within family businesses. The Centre holds the distinction of having facilitated learning for members of family businesses across India and its neighbouring countries (including Pakistan, Bangladesh, and Nepal) ever since its inception in 1997. The Centre's 4000+ strong alumni base, with well- recognised and loved brand names, both within India and globally across multiple sectors, attests to the strength of the programme in nurturing and developing the family business eco-system.

The Centre also offers a Start Your Business (SYB) programme, directed towards aspiring entrepreneurs and early-stage start-ups. The goal of this programme is to provide knowledge and skills and instill among the start-up entrepreneurs the right attitude, which would help them create a sustainable venture.

The Centre, through its research and outreach activities, seeks to be a thought leader in the family business space. It is a member of the STEP Project Global Consortium - a global research initiative with specific focus on family businesses. The CFBE, in its role of supporting entrepreneurship, also runs capacity-building initiatives and programmes for continuous professional development. Its 'Vriddhi' accelerator initiative, available to SPJIMR CFBE alumni, seeks to help entrepreneurs and family businesses bridge their funding gaps and to grow and scale up through mentoring them. Vriddhi provides a platform for connecting fund-seeking family businesses/entrepreneurial ventures with those that are fund providers.

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