THE REAL ECONOMY

VOLUME 87

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INFLATION AND THE MIDDLE MARKET

THE BALANCING ACT OF PRESERVING WAGE GAINS AND TAMING INFLATION

BY JOSEPH BRUSUELAS

WAGE INCREASES and rising inflation are now of paramount concern to policymakers and businesses.

While conditions are not yet ripe for the kind of wage-price spiral that wracked businesses in the 1970s, the economic growth and emboldened labor market of the past year require a different policy response than the previous two business cycles.

For the Federal Reserve and Congress, that means striking a careful balancing act of reining in inflation while preserving hard-won wage gains among the nation's workers—no easy task.

To this end, monetary authorities have started to take measured steps to contain price increases while not crimping advances in productivity or growth. At the same time, we would hope that Congress would create incentives for businesses to address shortages of housing and energy that are pushing inflation higher.

Make no mistake: The recent wage increases are not high enough to pose an immediate risk to economic stability, corporate profits or inflation. Instead, the rising wages have been supported by higher productivity among businesses.

Monetary authorities have started to take measured steps to contain price increases while not crimping advances in productivity or growth.

MIDDLE MARKET INSIGHT

Over the past two decades, wage growth has been generally higher for job switchers than for workers who remain in their jobs.

Productivity and wages

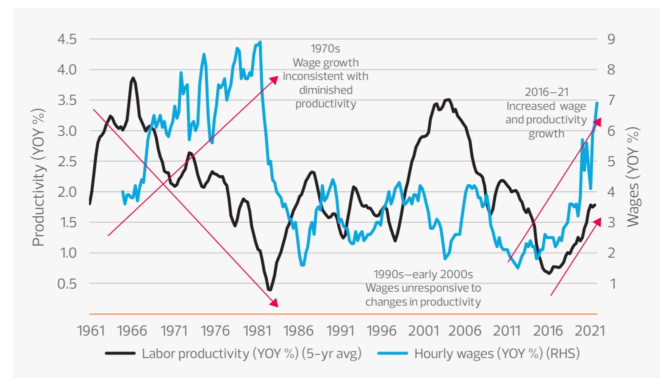
The economy can support higher wages as long as productivity increases at a faster rate. And this has indeed been happening. Productivity has been increasing since late 2016 because, in no small part, of the private sector's continued investment in its competitiveness.

Consider corporate profits. The 4% increase in the employment cost index during the fourth quarter of last year and the near 7% increase in average wages have yet to put a dent in those profits. This implies that productivity is rising as the economy booms.

In the 1970s, by contrast, cost-of-living increases were built into labor contracts, and wage growth was unresponsive to changes in productivity. But this time around, the pandemic has become the catalyst for a significant shift in the labor market, with wages in the private sector now more a function of the supply and demand for labor—and its productive abilities—than in previous generations.

During the fourth quarter of last year, nonfarm productivity increased by 6.6% amid a 9.2% increase in overall output. For businesses, the cost of labor should correspond to its contribution to profits, with labor churn a welcome sign of engaged employees working their way up the income ladder. As firms experience an increase in productivity and profits, they are in a position to retain their workforce via higher wages and salaries.

U.S. labor productivity and wage growth



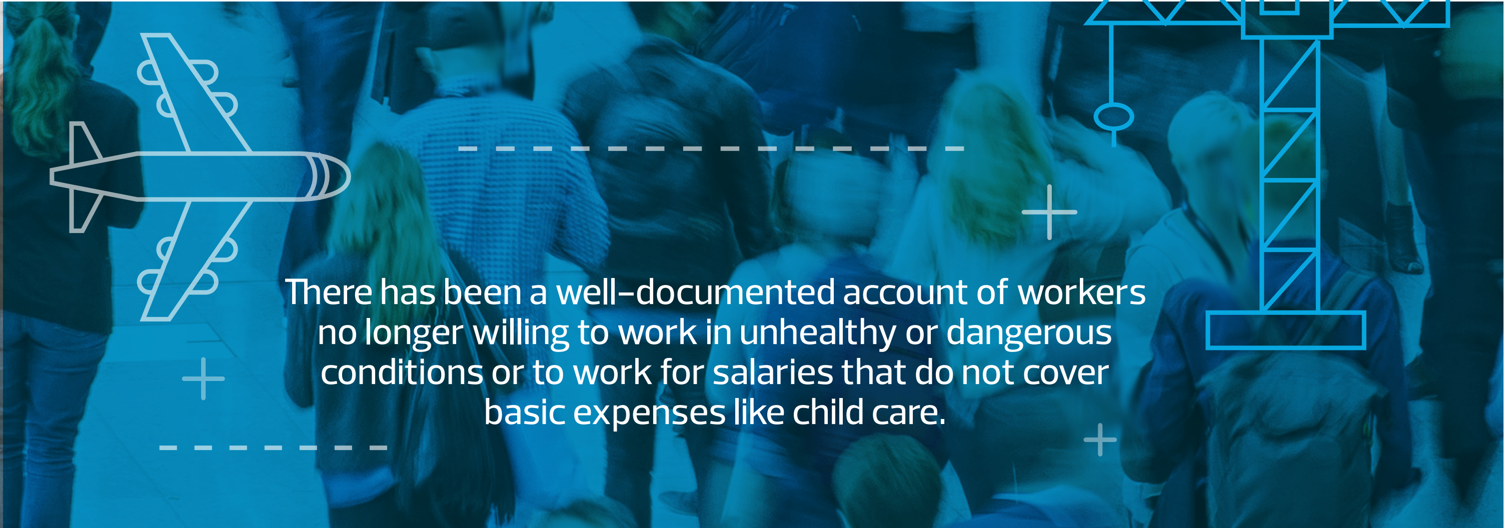
Source: U.S. Bureau of Labor Statistics; Bloomberg; RSM US LLP

A more efficient marketplace for labor

Wage growth in an open economy is a traditional measure of economic growth. And as with general price increases, a lack of wage growth signals stagnation. This was observed during the decade of slow wage growth and disinflation between the financial crisis in 2008–09 and the shock of the pandemic in 2020.

Today, that is not the case. Instead, the delivery of sophisticated technology to workers' computers and work sites is resulting in greater output per worker that supports improved wages even as it dampens inflation on the margin.

At the same time, and perhaps more important for the future of the economy, technological advances have created a functioning marketplace for labor. Workers are better able and more willing to match information on employment opportunities with their personal and financial choices.



MIDDLE MARKET INSIGHT

The economy can support higher wages as long as productivity increases at a faster rate.

Time spent at home during the pandemic and government income assistance gave workers the time and the means to reassess their priorities. Yet this two-year window is only part of a longer-term trend of worker advancement. As a result, workers have quit their jobs at record rates.

Workers, after all, quit their jobs because they can, whether it's for a better opportunity or because they can afford to.

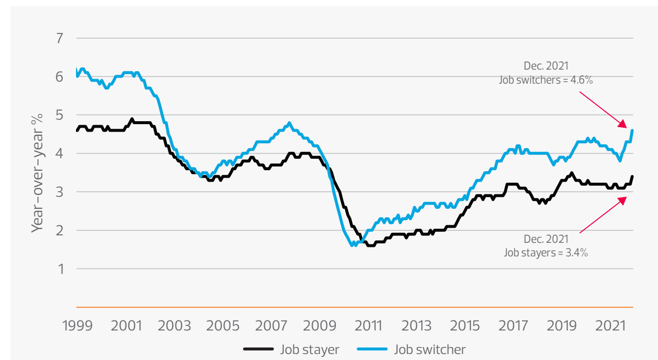
So when the bottom fell out of the economy in 2008-09, there were limited choices in employment and income, and the quit rate plunged.

As the economy slowly recovered, employment opportunities and the quit rate increased. We have been seeing a similar pattern of labor churn in recent months.

Over the past two decades, wage growth has been generally higher for job switchers than for workers who remain in their jobs. In the latest month, workers who switched employment had wage growth of 4.6% per year, while wages for those who stayed in their job grew by 3.4% per year. It makes sense that employees would walk away for a higher-paying job.

There are other signs of change, such as increases in the wage growth for part-time workers. We expect this labor churn to continue. It is a sign of a vibrant economy and should be welcomed by businesses looking for workers with entrepreneurial, self-selecting bent.

Wage growth of job stayers and job switchers*



Source: Atlanta Fed Wage Tracker; RSM US LLP *12-month moving average of monthly median wage growth

A shrinking supply of labor

Just as the Federal Reserve finds that "supply and demand imbalances related to the pandemic and the reopening of the economy have continued to contribute to elevated levels of inflation," we find similar circumstances in the labor market.

While we would expect wages to grow during an economic recovery as employers compete for employees, the distribution among occupations has not been uniform. It should be obvious to anyone who has had to wait for restaurant food or fuel oil delivery; a shortage in the number of service workers has driven up the cost of labor.

There has been a well-documented account of workers no longer willing to work in unhealthy or dangerous conditions or for salaries that do not cover basic expenses like child care.

The increase in corporate profits implies that productivity is rising as the economy booms.

MIDDLE MARKET INSIGHT

Workers might not have the bargaining power of earlier generations, but technology has given them the ability to optimize their earnings and their ability to meet family obligations.

Because of the shrinking supply of workers, wage growth in the lowest quartile of incomes increased from a 12-month average 4.2% rate of increase to a 5.4% rate. Wage growth in the second quartile increased from 3.6% to 4.1%.

By comparison, and at the other end of the income spectrum, wage growth in the third quartile was virtually flat on the year, and there was a decrease in the rate of wage growth from a 3.3% to 2.8% rate in the highest quartile.

The result is a smaller supply of labor to meet the growing demand for low-wage services, which pushes up the wage requirements for those willing to perform those services. The policy answer is a rational immigration program, which seems unlikely in the current political environment.

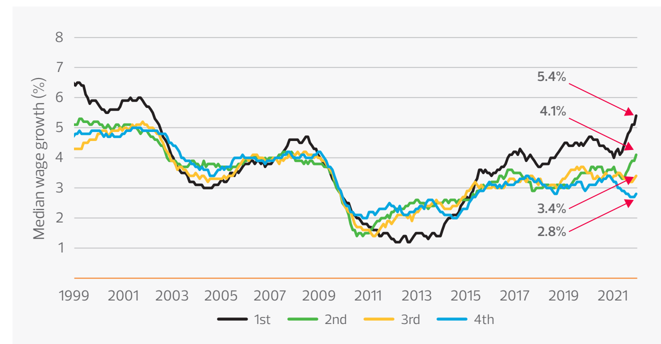
Each worker has a **reservation wage**, defined as the lowest wage for which they would be willing to trade their time and effort. For a young family, it takes simple arithmetic to decide who works and who doesn't.

For example, the cost of child care in Massachusetts eats up roughly 25% of earnings for the average family. If a family member's take-home pay is less than the annual $21,000 cost of child care, then it's simply not worth it for them to go to work. In Mississippi, that cost is $5,400 for a single infant, which is still unaffordable for many families.

The collision of a lack of affordable child care options and the need for families to protect their children during the pandemic has resulted in everything from unrecoverable loss of workdays as families care for children when day care centers are closed due to a drop in labor force participation among the prime working-age population, which is again an unrecoverable loss of workdays.

At the other end of the age spectrum, wage growth for older employees has hovered around 2.1% per year since 2015, barely keeping up with the cost of living. Health concerns and a sense of going nowhere have sparked an increase in the reservation wage for workers 55 and older, resulting in about 3 million workers retiring.

Average wage growth by quartile*



Source: Atlanta Fed's Wage Growth Tracker; RSM US LLP

*12-month moving averages of median wage growth in each quartile

The takeaway

There is no denying that the rapid recovery of economic activity has led to price and wage increases.

The economy is now operating above its pre-pandemic level and near full employment. Policy normalization in the guise of rising interest rates is not going to define the next few years but rather managing a policy that will protect the wage gains of low-income households by minimizing damage to their purchasing power caused by inflation.

Workers might not have the bargaining power of earlier generations, but technology has given them the ability to optimize their earnings and their ability to meet family obligations.

Rather than a concern for business, this should be seen as a way to maintain an engaged workforce able to adapt to changes in production even if labor force growth continued to diminish.

Without the return of immigration on a wider scale, firms should expect low-wage workers to remain in short supply and expensive relative to pre-pandemic levels.

INFLATION AND THE MIDDLE MARKET

INFLATION HAS RISEN—CAN I REALLY RAISE MY PRICES?

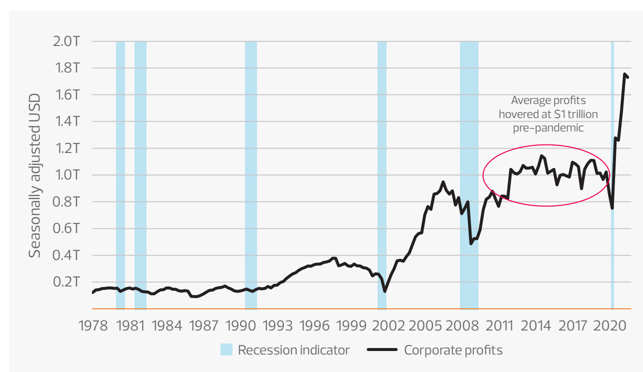
BY MATT DOLLARD

AS COMPANIES across industries continue to grapple with inflation at its highest level in 30 years, more executives are taking a closer look at whether to increase prices. But there are more dynamics at play than just rising costs, and businesses need to take a broader view as they assess whether now is the time to make such price hikes.

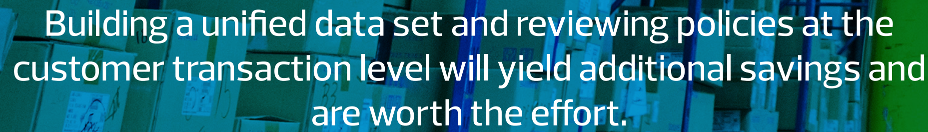
Rising costs were the second most pressing concern—behind labor availability—for chief financial officers in the fourth quarter of last year, according to a survey of CFOs conducted by the Federal Reserve Bank of Richmond. CFOs surveyed also believe the elevated costs will last throughout this year. Approximately 90% of firms surveyed reported larger-than-normal cost increases in late 2021—and that figure was up from 80% in the second quarter. Fewer than 20% of CFOs expected costs to decrease in the next six months—and most believe they will last 10 months or more into 2023.

The dour sentiment on cost increases contrasts with the narrative that corporate profits are at their highest level in 70 years. The increase was sudden and swift. In the last decade, U.S. nonfinancial corporate profits after tax hovered around the $1 trillion average annual mark, but by the fourth quarter of 2021, profits rose to $1.7 trillion—roughly a 70% increase since the start of the pandemic. This increase suggests businesses benefited from significant pandemic-induced pricing power and have raised prices more than their input costs, fueling more inflation.

U.S. nonfinancial corporate profits after tax*



Source: St. Louis Federal Reserve; RSM US LLP *Excludes finance and insurance, bank and holding companies



Larger firms passed on more of the cost; over 35.3% of large firms surveyed passed on most or all of their cost increases to customers, and 15.3% of small firms reported doing so.

Given that 66% and 70% of large and small firms already report reducing costs in other areas to compensate for increased prices they pay, cost absorption is likely on the horizon for many businesses. This is evidenced by the fact that 50% and 54% of large and small firms, respectively, said they intend to keep prices the same, which means these firms may need to find more ways to cut future costs if prices rise or continue to absorb them.

According to the survey, measures to absorb costs include accepting lower margins, seeking cost reduction, eliminating or substituting product offerings, adding contingency clauses into contracts, and turning down work. Large firms, here again, were less likely to absorb costs with 23.5% reporting having done so versus 35.8% of small firms. This again fits the narrative that the larger the business, the more likely they would pass on costs to the market.

Whether a business can raise prices also depends a lot on its industry. Recent research from the Capital Group looked at businesses with the most pricing power by evaluating gross margin and the standard deviation of those margins over 10 years. Industries with the highest gross margin and the least margin deviation included pharma/biotech, household products, beverages, semiconductors, media, and apparel and luxury goods. Tobacco and software also ranked high but showed the most volatility in margin performance over time.

Industries with somewhat lower but stable margins included groceries, health care services, materials, hardware, telecom, auto and aerospace. Those with higher volatility at the lower end of margin performance included transportation and energy. Making the point on volatility, the latter two are the largest contributors to recent inflationary increases.

MIDDLE MARKET INSIGHT

Businesses need a unified data set that combines information from their enterprise resource planning, customer relationship management and financial systems.

Where does this leave middle market businesses?

Does this mean that middle market businesses in some industries should charge ahead with raising prices further? Not necessarily—many middle market businesses can't raise prices further because of insufficient market share, low product differentiation or competition. But such businesses can still boost their competitiveness in this environment.

Most companies can continue to find low-hanging fruit across their operations. For starters, businesses can assess their pricing behaviors at the business end, where transactions take place with the customer. Performing a series of assessments focused on this area can answer questions about sales efficiency and sales policies, processes for improvement, serving costs of various accounts, and identifying and targeting the most profitable accounts.

Businesses need a unified data set that combines information from their enterprise resource planning, customer relationship management and financial systems. If that data set doesn't exist, then building it is one of the first steps in generating actionable insights.

Most companies can continue to find low-hanging fruit across their operations. For starters, businesses can assess their pricing behaviors at the literal business end, where transactions take place with the customer.

MIDDLE MARKET INSIGHT
Many middle market businesses can't raise prices further because of insufficient market share, low product differentiation or competition.

Analyzing data across these systems will illuminate how efficiently the business model functions. For example, such an analysis can show differences between invoice prices and actual prices paid—highlighting possible margin leakage. Additionally, it permits detailed segmentation analysis when slicing data by market, customer, channel or product, which, in turn, can be used to prioritize efforts on the most profitable segments and deemphasize or eliminate those that reduce margin.

Equally important is a qualitative analysis—run concurrently with the quantitative analysis—that includes structured interviews with key business stakeholders. This taps them for institutional knowledge and will concentrate efforts on where in the data to look for opportunities.

An important area to examine should include the sales processes, which should be documented from end-to-end using interviews as input. It's also critical to probe sales team compensation structures to understand current behavior incentivization. For example, are sales teams being compensated on sales volume or margins?

Completing these initial assessments can uncover quick, low-effort wins that—if executed properly—could result in a 1% to 3% lift in bottom line performance within 12 months. Initial, longer-term projects identified can be quantified from the level of effort, costs and potential payback.

This initial assessment will not reveal an exhaustive list of actions businesses can take. Rather, it lays the foundation for additional projects the business can investigate, such as customer demand modeling, competitive assessments, firsthand intelligence gathering on customers through interviews, detailed analysis on policies, effective tax rate analysis and technology assessments. The key is to find insights that permit decision-makers to prioritize efforts through understanding the costs to implement solutions and determine the expected payback. These insights provide management with a cost-benefit analysis that can help prioritize future projects and maximize return on investment.

The way forward

Inflationary input cost increases aren't permanent, but they will likely persist throughout this year and force additional increases in costs, prices and cost cutting. Middle market businesses that lack additional pricing power will be incentivized to find other ways to cut costs versus absorbing them in the future. Finding these areas of opportunity builds resiliency whenever margins are under pressure.

Companies need to look closely at the transaction level data in detail to understand pricing behaviors across their organization. Building a unified data set and reviewing policies at the customer transaction level will yield additional savings and are worth the effort. The reward for getting pricing behavior and profitability improvements right is one of the most powerful profit levers a company has, and it can become a competitive advantage that middle market businesses can sharpen over time. ■

AN ELECTRICAL CONTRACTOR CONTENDS WITH DELAYS AND HIGHER INPUT COSTS

AS A CONTRACTOR with $560 million in annual revenue, Hunt Electric has weathered its share of economic downturns over the years. But the pandemic has been an altogether different kind of challenge.

John Axelson, the company's president and chief executive officer, said that his firm had faced delays of weeks or even months as it waits for delivery of key pieces of equipment. Jobs have to be pushed back and contracts were rewritten as delays have convulsed the market.

The result is inflation.

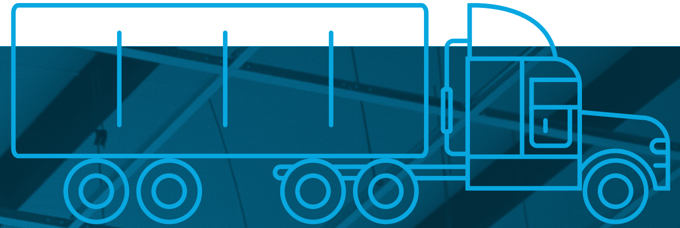
"We've struggled with higher costs," he said in a recent interview. "Our gross profit is down."

He cited a host of reasons for the rising prices. Some of the reasons are COVID-19 protocols on the job sites, which increase costs, he said. But in the end, the difficulty in securing raw materials have proven to be most problematic for Hunt.

MIDDLE MARKET INSIGHT
Hunt Electric is careful to word contracts differently to allow for rising commodity prices.

Up and down the supply chain, vendors struggling to retain and find workers, have had to adjust their timetables in delivering their goods. Products that used to take four to six weeks to deliver to a job site are in the 24- to 28-week timeframe, Axelson said. And those that used to take 12 weeks to secure can now take up to a year.

It leaves Axelson, whose firm is an RSM client, scrambling to adjust his firm's own timetables and costs to see jobs through. Scrambling to adjust is especially the case for contracts that were agreed to before the pandemic; pricing is now outdated. As costs have inexorably risen, it's not always possible to pass them on to the customer. Some developers are reluctant, or even unwilling, to adjust a contract. Everyone is dealing with these rising costs, they say.



Hunt Electric has faced delays of weeks or even months as it waits for delivery of key pieces of equipment.

Axelson recalled one job that required $400,000 in materials. But that contract was signed in 2018, long before the pandemic. Today, costs for the same materials have risen to $540,000.

"It is very difficult if not impossible to pass those costs on, and we're not able to do that to the customer," Axelson said. "You have to honor their price."

Axelson understands their position. "This general contractor was on the hook for other projects," he said.

Embedded inflation

Such stories are common these days as inflation has become embedded throughout the ecosystem of the construction industry.

Today, Hunt Electric is careful to word contracts differently to allow for rising commodity prices.

He said the challenge has only become more acute as demand nationwide has increased, especially in the past year as the economic recovery has gained momentum.

Consider the example of the missing switchgear on a major project in Massachusetts. It was a significant piece of equipment—kind of like an electrical panel in a home, but on a grand scale. The contractor told Hunt that the equipment would be 30 weeks late—a significant setback to the job.

For many contractors, that kind of delay would be a crippling blow, but Hunt Electric was able to draw on its strong relationships with its suppliers and its workers' creativity to find a solution.

MIDDLE MARKET INSIGHT

Products that used to take four to six weeks to deliver to a job site are in the 24- to 28-week timeframe. And those that used to take 12 weeks to secure can now take up to a year.

A custom manufacturer built a temporary piece of equipment that Hunt installed until the permanent piece arrived. The arrangement cost more, but the project owner agreed to the workaround, and the job moved ahead.

That solution is one way Hunt has weathered the changes set off by the pandemic.

If there is any silver lining, Axelson said, it's the workers who have been able to complete the jobs under trying circumstances.

Axelson's firm has largely been able to retain its staff even as its suppliers grapple with workers quitting their jobs in record numbers—known as the Great Resignation. Axelson attributes this to the culture of the electrical trades, with its strong work ethic and solid pay.

Without the commitment of Hunt's employees, he said, weathering the past two years would have been much more difficult.

HOW A FOOD COMPANY IS MANAGING ITS FRACTURED SUPPLY CHAIN AND RISING COSTS

BOB KAFAFIAN can remember when inflation began to bite. He is chief financial officer and chief operating officer of Epta America, the North American arm of Chipita Global, a manufacturer of popular baked snacks like 7Days croissants that have won a loyal customer base across the United States.

It was early 2021, and the trucking industry was starting to become a chokepoint. The firms that Epta relied on to deliver its goods were reporting delays, and fees were starting to rise.

So Kafafian faced a decision: Try to keep expenses in check and stick with the lower-cost firms, or pay up for more reliable service.

For Epta, an RSM client, there was little choice. Consumers can't buy a product if it's not on the shelf, so Epta, looking to continue its robust growth of 40% to 50% a year, paid up.

MIDDLE MARKET INSIGHT

All along Epta's supply chain, the company has encountered hurdles that were hard to imagine before the pandemic.

"We were forced to start paying more for quality," he said in a recent interview. "By the spring of 2021, we had pretty much moved to more expensive solutions to ensure reliability."

The trucking chokepoint is just one example of the challenges that Epta has faced in managing its supply chain during the pandemic. For the broader economy, these bottlenecks are a big reason that costs are rising and why the inflation rate in the United States—7.5% in January—is at its highest level in 40 years.

Consumers can't buy a product if it's not on the shelf, so Epta, looking to continue its robust growth of 40% to 50% a year, paid more for reliable delivery.

The container conundrum

All along Epta's supply chain, the company has encountered hurdles that were hard to imagine before the pandemic. Consider Epta's cost of ocean freight—a significant expense for a company that sources its products from Europe.

"Our top item is the croissant, so we ship a lot of empty space—a lot of air," Kafafian said. While a durable goods manufacturer can pack a lot of its products into a single container and make efficient use of the space, only so many croissants can fit in a container without being damaged. The result is shipping as a share of Epta's total costs is quite high.

And those costs have soared.

"The cost of our imports from factory to our door has gone up over 100% between April and September of last year," and as much as 150% depending on the specific shipping lane, Kafafian said.

Kafafian cited three reasons for the increase, and they hit every point in Epta's supply chain:

- **Factory to port:** The cost of getting the products from the factory floor and loaded onto a ship in Europe has increased. In addition, there are significant delays at European ports, which incur fees.
- **Port to port:** Ocean freight rates have spiked.
- **Port to warehouse:** In addition to the shortage of truckers, delays at American ports have become routine, with trucks waiting for hours to be loaded.

There are other costs as well. For example, port operators charge fees, known as demurrage, for containers that are not emptied in a timely fashion, and fees for containers that are not returned on time.

These rising costs and delays have forced Epta to change the way it operates.

For example, ambient containers—or those shipped at room temperature—were in short supply early last year, so Epta started to use frozen containers.

MIDDLE MARKET INSIGHT
He said one way to change the equation is to gain more control over costs and onshore the production of its popular products.

Not only did it cost more to keep the containers cold, but frozen containers also held fewer croissants, and there were higher charges once the containers arrived at the ports.

Still, as with the trucking delays, Kafafian had little choice.

"It was either don't ship products or find a way to ship products and pay through the nose," he said.

A breaking point

Finally, all of these cost pressures—shipping, trucking, ocean freight—came to a head last year. After years of holding prices steady, Epta raised prices in the second quarter. To Kafafian's surprise, Epta did not receive any complaints. Then in January, Epta raised prices a second time—and once again, received few complaints.

In fact, one customer, sensitive to the pressures Epta was facing, accepted a price increase sooner than Epta had planned. As unusual as that was, it spoke to the strong relationships Epta has built over the years with its customers, not to mention the appeal of its products.

The takeaway

Even as Epta navigates a difficult environment, Kafafian remains optimistic about the future. He said one way to change the equation is to gain more control over costs and onshore the production of its popular products.

But any decision like that will take time, and until that happens, Kafafian will continue to grapple with a difficult decision: Keep prices low and live with lower margins or raise prices and risk robust growth.

THE ONE-TWO PUNCH OF INFLATION—HOW INSURERS CAN BRACE FOR IMPACT

BY DAVID MAMANE AND MARLENE DAILEY

PROPERTY AND CASUALTY insurance carriers should be concerned as inflation continues to run hot throughout the global supply chain and is likely to increase the cost of claims for auto physical damage, property and catastrophe lines of business for years to come. The insurance ecosystem may be in for a rough ride this year because of the growing threat of social inflation affecting liability lines of business.

Parts and labor

Inflation isn't a new risk for insurance carriers; over the last decade, there has been a steady increase in claim costs, particularly related to advances in automotive technology and the rise of extreme weather events. But there are more recent changes—in technology, weather and supply chain disruptions to name a few—that are putting more pressure on costs.

Traditional private passenger vehicles are transforming at a rapid pace into connected cars, equipped with technologies such as RADAR, LiDAR, advanced sensors, cameras and advanced driver assistance capabilities to meet the needs of consumers. A recent Fortune Business Insights study found that the connected car market in North America will exceed $60 billion in 2022. These new, tech-enabled automotive parts are more expensive to replace in the event of an insurance claim, and the repairs rely on highly skilled and costly labor.

Another factor is climate events, which are expected to continue increasing in frequency and severity, as we wrote about in our previous insurance sector quarterly outlook. Such climate events will continue to put pressure on carriers to manage the accumulation of risk implications within their business better.

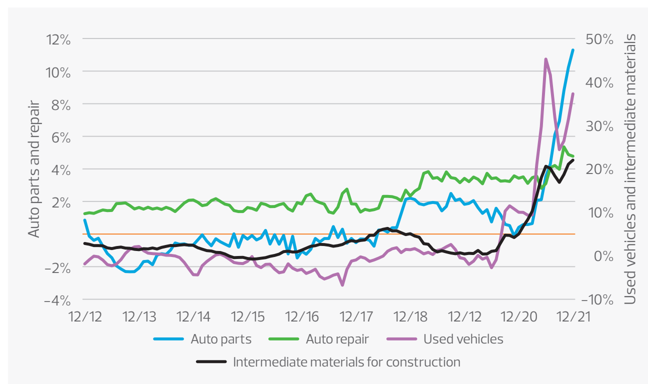
Social inflation—or the rising claims costs over and above the economic inflation— are rising, and are being influenced by societal anti-corporate sentiment, trends and behaviors toward social responsibility.

MIDDLE MARKET INSIGHT

Recent changes in technology, weather and supply chain disruptions to name a few are putting more pressure on insurers' costs.

Enter the pandemic and the exacerbated effects on claims inflation. Supply chain constraints have led to further increases in claim costs related to parts and intermediate materials, recent wage pressures and increased demand for used vehicles. Bottlenecks have also caused delays in the claim settlement process, resulting in higher costs for insurers as they provide their customers with rental vehicles and temporary housing.

Inflation in auto and homeowners insurance claims



Source: Bloomberg

Social inflation

The second side of the inflation coin that poses a growing threat to insurers is social inflation. This term is widely used by the insurance industry to describe rising claims costs over and above the economic inflation factors mentioned above, influenced by societal anti-corporate sentiment, trends and behaviors toward social responsibility. Understanding the numerous trends driving social inflation will help insurers proactively navigate the litigious environment the industry is facing.

Perhaps the most significant of these forces are public sentiment, tort reform and third-party litigation funding. Shifting attitudes about social injustices, inequalities and large corporations can factor into juror responses in claims cases, for instance. According to a 2020 study published by the American Transportation Research Institute, nuclear verdicts—those with awards greater than $10 million—nearly doubled between 2010 and 2018 in insurance claim cases. Such ripple effects of social inflation can be hugely consequential for insurance pricing, actuarial work, underwriting, valuations and claims.

In addition to public sentiment, tort reform is driving social inflation. Tort reforms are designed to provide fair compensation and control costs. These types of reforms can limit how much a plaintiff can collect for noneconomic and punitive damages. Many state legislatures have struck down these types of caps on damages. Tort reform has also brought more challenges to statutes of limitations for lawsuits arising out of accident or injury

The insurance ecosystem may be in for a rough ride this year because of the growing threat of social inflation affecting liability lines of business.

claims. The statute of limitations is a legally established limitation period—typically one to six years depending on the state—to pursue a legal claim. Extending the statute of limitations can potentially result in longer claims cycles, higher defense costs and higher jury awards.

Another contributing factor to social inflation is third-party litigation funding. Firms in this space provide funds to plaintiffs that could potentially result in large payouts in exchange for a percentage of any awards. These firms typically structure the investment as a prepaid forward contract instead of a loan to capitalize on gain tax benefits and are not restricted by a legal code of ethics. Third-party litigation funding might incentivize plaintiffs to pursue prolonged case settlements, hold out for larger recoveries or potentially increase unnecessary medical treatment options, for instance. Third-party litigation funding is a fast-growing multibillion-dollar global industry disrupting the insurance industry. According to a recent report by Swiss Re, third-party litigation funding totaled $17 billion in 2021, up 16% from 2020 despite pandemic-related delays and disruptions.

What can insurers do?

This inflationary environment is hitting the insurance industry hard in supply chain constraints, labor shortages and increasing litigation costs. Insurers are accelerating their business transformation plans centered around three primary themes to mitigate these risks: data, technology and talent.

Risk mitigation starts with data. Insurers use several methods to collect and analyze substantial amounts of information, such as process mining, statistical modeling and forecasting, and applying machine learning and algorithms. Data-driven insights help assess the capacity and performance of an insurer's network of suppliers and vendors, improve their ability to assess risk more accurately, optimize productivity and control costs.

MIDDLE MARKET INSIGHT

Climate events will continue to put pressure on carriers to better manage the accumulation of risk implications within their business.

Insurance is a heavy task- and transaction-based industry, and much of these tasks are still done manually. The mass exodus of skilled workers and unexpected retirements can pose workers' compensation-related risks. To counter future supply chain disruptions and social inflation, insurers are accelerating their digital transformation strategies, including expansion of their vendor networks and partnerships, application of intelligent workflows and automation of underwriting tasks. Companies need to exploit technology to operate more efficiently and accurately assess risks.

Much like other industries are navigating the labor shortage, many insurers are paying higher wages, offering increased benefits and more work flexibility. Staying competitive in this environment requires sophisticated talent acquisition and retention strategies that go well beyond wage considerations. Companies need discipline and consistency in creating clearly defined and achievable career pathways through mentoring, upskilling and training to address skill and knowledge gaps.

The takeaway

The multifaceted effects of inflation on the insurance sector will continue to be an issue that companies need to navigate. Still, those that think strategically about how to use data and technology to boost efficiency and more holistically cultivate talent will likely be the most formidable competition.

INFLATION AND THE MIDDLE MARKET

INFLATION AND OMICRON TAKE A TOLL

BY JOSEPH BRUSUELAS

THE OMICRON VARIANT and rising prices have taken a toll on overall economic activity as well as consumer and business confidence over the past three months, according to the proprietary RSM US Middle Market Business Index.

Top-line middle market business sentiment eased to 125.1 in the first quarter of the year from 130 in the final quarter of last year. Both of those figures were below the all-time high of 143.8 posted in the third quarter of last year.

Despite the easing in overall sentiment, the current reading reflects strong business conditions across the real economy. It is perhaps the first sign of relief inside the index on the risk to the outlook posed by inflation.

Two of the key components that underscore expectations around gross revenues and net earnings—prices received and compensation—eased during the first three months of the year, providing some relief to firms scrambling to address a shortage of goods and labor. ■

Among the survey's findings:

Executives were less confident about the overall economy ...

29% said the economy improved during the current quarter.

41% said the economy deteriorated.

33% noted it remained unchanged.

... even as there was some relief on expectations of higher prices...

71% reported paying higher prices for all goods and services during the current quarter.

67% expect to pay higher prices for all goods and services over the next six months.

... and at the same time, firms expect to try to pass those costs along.

53% reported having passed along those higher prices.

67% said they would attempt to do so over the next six months.

Read the latest RSM US MMBI Middle Market Business Index.

U.S. GENDER PAY GAP NARROWS, BUT WORLDWIDE EQUITY HURDLES REMAIN

BY KAREN GALIVAN

DO MEN CONTINUE to make more than women? Overall, it would appear so, but we see some encouraging trends below the surface.

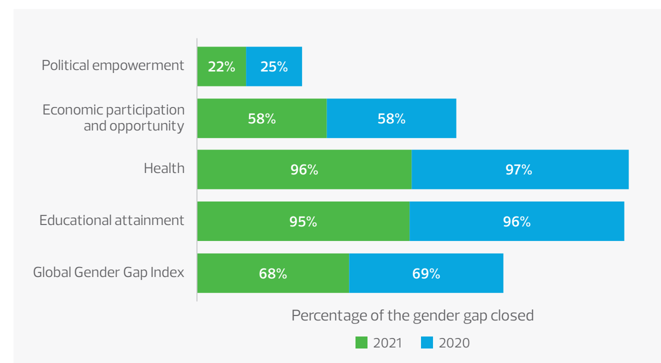
According to a 2021 diversity, equity and inclusion survey conducted by the compensation software company Payscale, women in the United States earn 82 cents for every dollar earned by men. Digging deeper, however, it appears that when men and women have the same job and qualifications, the median salary gap narrows to near equity, with women earning 98 cents for every dollar earned by men. While this number is positive, the data highlights other hurdles that have yet to be crossed. The gender pay gap widens with age and job level; in addition, men's salaries increase faster than women's salaries as they progress in their careers.

In honor of Women's History Month and International Women's Day on March 8, it is important to understand the factors behind these disparities in order for opportunities to improve for all.

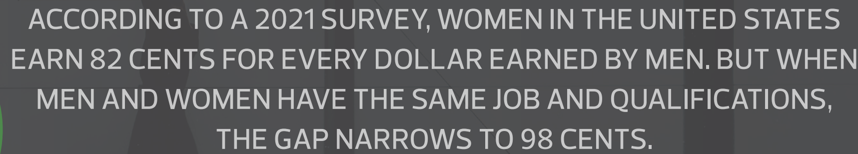
The global gender gap

Gender equity is about more than just wages. The World Economic Forum introduced the Global Gender Gap Index in 2006 to measure the progress of gender parity, which is measured based on improvement in four factors—economic opportunity, education, health and political leadership—from 156 countries across the globe. The index fell in 2021 from a year earlier, which is not surprising considering the effects of the pandemic both on health and the economy, women's fallback position as primary caregivers and additional work responsibilities. Using the results of the past 15 years as a proxy, it will take more than a century, roughly 135 years, to finally close the global gender gap.

Global gender gap



Source: World Economic Forum; Global Gender Gap Index


ACCORDING TO A 2021 SURVEY, WOMEN IN THE UNITED STATES EARN 82 CENTS FOR EVERY DOLLAR EARNED BY MEN. BUT WHEN MEN AND WOMEN HAVE THE SAME JOB AND QUALIFICATIONS, THE GAP NARROWS TO 98 CENTS.

Political empowerment seems to be the differentiator

According to the World Economic Forum index, Iceland leads women's advancement, having closed 89% of the gender gap with eight other countries closing at least 80% of the gap. Iceland's example is worth noting. According to Meghan Werft, editorial coordinator of the equity advocacy group Global Citizen, Iceland has several laws protecting women at work. It provides a framework for businesses to achieve gender equality, including a provision that company boards must include at least 40% women. The country also has a strong parental paid leave policy—nine months for both parents.

The United States showed great improvement, moving up 23 places to No. 30 overall, closing 76% of the gender gap. This increase is largely due to the increase in political empowerment, which doubled to a score of 32.9%, the survey found.

Despite these gains, throughout 2020, nearly 2.3 million U.S. women left the labor force, the Bureau of Labor Statistics data show. The pandemic pressures, including lack of child care and increased workplace demands, are considered largely responsible for the shift.

The exodus of women from U.S. job rolls prompted Reshma Saujani, author and founder of Girls Who Code, the nonprofit that supports educating women in computer science, to create a plan encouraging businesses and government to team up and find ways to accommodate working mothers better. The Marshall Plan for Moms promotes improved paid parental and sick leaves, equal pay, support for child care and more control over schedules.

Investors and businesses prompt change

Amid the rise in public awareness about social issues, consumers and investors continue to expect businesses to establish and document social policies for the workplace, including equity and inclusion for women. Companies are developing diversity, equity and inclusion initiatives because they are good business and because they are the right thing to do.

MIDDLE MARKET INSIGHT
If the past 15 years of the Global Gender Gap Index are a guide, it will take roughly 135 years to close the global gender gap.

Increasingly, investors want to understand and measure the results of environmental, social and governance (ESG) policies that businesses put into place. Bloomberg recently established a proprietary Gender-Equality Index (GEI) to standardize and measure the results of these efforts. Its 2022 index included 418 companies headquartered in 45 countries with a combined market capitalization of $16 trillion. The index reported many positive results:

- On average, the GEI companies' boards had 31% female representation.
- 72% of participating companies had a chief diversity officer or an executive in charge of diversity and inclusion.
- 67% of managers are required to complete unconscious bias training annually.
- 65% of participating companies sponsor community financial education programs for women.

The takeaway

As companies reimagine the future of their work environment and develop their strategies, it makes sense to consider the following:

- Review and implement measurable plans and processes for diversity in hiring, promotions and salary adjustments.
- Allow for a proper amount of flexibility and predictability in scheduling work to help all employees succeed.
- Consider policies that accelerate gender parity and close the pay gap.
- Evaluate benefit and wellness programs to include updated sick and parental leave policies. ■

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