KPMG

Making the most of the downturn

In every recession, some companies come out on top. They act early, preserve profits, and take share. Who will be the winners this time?

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Introduction

In late July, the Bureau of Economic Analysis reported that the U.S. economy had contracted for the second quarter in a row. Technically, this does not mean recession is here.[1] But the GDP data make clear that the burst of growth coming out of the pandemic lockdown year—when GDP plummeted by nearly one-third in a single quarter—is over.

Now, headwinds created by the pandemic are pushing hard against economies around the world. The combination of pent-up demand and tangled supply chains set off the worst inflation in five decades in 2021. This year, the Russia-Ukraine war has sent the price of energy and food soaring. Efforts by central banks to curb inflation are likely to limit investment and consumption, which will also act as a drag on growth.

To prepare a down cycle, it is critically important to understand what kind of recession might be starting. So far, this downturn is unfolding in ways we haven't seen before. Consumer confidence has hit an all-time low, but consumption remains healthy.[2] Demand for air travel—usually one of the first industries to suffer in a slump—is more than airlines can satisfy. Unemployment is at the lowest rate in decades and household balance sheets remain strong. Supply constraints—both labor and material—remain bigger factors than weak demand. This is unlike 2008, 2001, 1992, 1980, or 1973. So, this downturn may be unlike anything we have seen before.

Whatever shape the downturn takes, some companies will outperform by successfully navigating the challenges and using the downturn to invest in growth. In our analysis of the "Great Recession" of 2008-09, we learned that a select group of companies maintained profits and managed to grow revenues and margins, despite falling demand. By acting early, they managed to sustain nearly all of their shareholders' value, while the Total Shareholder Returns of the poorest performers fell by more than 23 percent.

How did the winners win? They not only took cost actions to preserve margins when sales slowed, but also used the downturn to plot new growth strategies—investing in technology, snapping up new assets and shedding businesses that no longer had sufficient growth potential.

In this paper, we examine what companies should prepare for this time, based on the patterns of previous downturns, the insights of KPMG economists, and our survey of more than 400 top business leaders in July. We look at how companies have outperformed during past recessions and how those lessons can be applied now.

Finally, we share counsel from KPMG advisors across functions and industries about what to do now. With more than a century of combined experience and lessons learned in previous downturns, this is what they advise:

Eight steps recommended by KPMG experts

01. Build dynamic scenarios for strategic response. The downturn is just the latest external event that illustrates the need for agile, forward-thinking strategy development.

02. Use M&A for offense and defense. A downturn is a good time to prune the portfolio—and to pick up assets that can deliver new sources of growth.

03. Pre-emptively attack costs. Don't wait until margins begin to fall. Deeply analyze costs and think "greenfield methodology."

04. Fine-tune commercial strategy. This is the time to double down on the best customers and make sure you are not losing any sales because of a commercial strategy that is disconnected from market reality.

05. Use the data you have. Don't guess—know. Rely on the tools, data and simulations at your disposal to identify cost drivers, make cost-saving moves, and target tasks for automation.

06. Improve cash and liquidity. When revenues start to slow, companies have managed cash flow. They can implement systems that will serve them in the recession and long afterward.

07. Restructure debt. Falling revenue and rising interest rates can quickly add up to distress, particularly for middle-market companies. Head off this threat now.

08. Hold onto talent. The war for talent continues, winners will find ways to leverage their talent to take share and create advantages.

[1] Source: According to the Bureau of Economic Analysis, "A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales"—not just two consecutive quarters of GDP decline.

[2] Source: University of Michigan Consumer Sentiment Index, Aug. 12, 2022

What to prepare for

Based on our research and experience serving companies across industries, we know that leaders who take decisive action before downturns—and who find opportunities to invest in growth ahead of recovery—come out on top. But what should business leaders prepare for?

Will the recession be short and mild? Will it be a V-shaped recovery like the "COVID recession" that lasted for just two months in 2020? Or will it be a deep, prolonged downturn, with a U-shaped recovery, like the one that began with the financial crisis in 2008? Could it be a "W"—with a recovery followed by another contraction? Or should business leaders anticipate a recession that doesn't conform to established patterns?

A recession caused by a financial crisis, like the one that began in 2008, tends to be deeper and longer than a business-cycle downturn, as in the early 1990s. But cyclical recessions, like the one in 1992, tend to be milder and shorter. The 1970s "stagflation" recession lasted two years (see "How inflation can lead to recession," page 4).

The signs today are mixed (Exhibit 1). Unemployment is at 3.5 percent, equaling its 50-year low. In July, the U.S. consumer price index slowed to 8.5 percent annual rate from the 9.1 percent June reading. However, the Federal Reserve raised interest rates by 0.75 percentage points in June. It was the largest hike in three decades, escalating recession fears and driving equities into bear-market territory. A second 0.75-percent hike followed in July, setting the discount rate at 2.25 to 2.5 percent.

While economic growth contracted in the first quarter (by 0.3 percent) and second quarter (by 0.2 percent), consumption continued to grow. Despite inflation and higher interest rates, consumer spending grew by 3.1 percent, faster than the 2.7-percent average from 2015 to 2020. And consumer spending continued to grow in the second quarter, albeit at a slower rate. At the same time, companies continue to hire, and household balance sheets are exceptionally healthy—having added about $2 trillion in new savings since the pandemic began.[3]

Exhibit 1. These headwinds and tailwinds make this a different kind of downturn

Fundamental strengths of the U.S. economy	Fundamental pressures on growth
Consumption continues to grow • Inflation is having an effect on consumer behavior, but overall consumption has continued to grow. • There is still pent-up demand for goods and services.	**Inflation at a 50-year high; rising interest rates** • Inflation now tops 8.5 percent on an annual basis. • Higher interest rates mean less corporate borrowing to invest in borrowing power for consumers, who drive most of the economy.
Robust labor market • Unemployment is at 3.5 percent, equaling its 50-year low; ratios of new job openings to applicants are at record highs. • Year-over-year job growth is over 4.3 percent, the largest gain in almost 40 years.	**Supply chain disruptions continue** • Geopolitical turmoil has fractured global supply chains. • Companies will need time to find local suppliers and ramp up onshore production.
Healthy corporate and household balance sheets • There are no signs so far of fragility in corporate and household finances.	**Consumers are pessimistic** • The consumer sentiment index has fallen to its lowest level since May 1980, which could discourage spending.

[3] Source: Andrew Van Dam, "Two years into the pandemic, America has become the land of the bulging bank accounts," Washington Post, Feb. 23, 2022

We are now in "uncharted waters," according to KPMG Chief Economist Diane Swonk. The Federal Reserve is trying to manage a soft landing with aggressive rate hikes. "The Fed's greatest nightmare," she says, "is that it accidentally hits a trip wire that triggers a seizure in credit markets. That could force it to intervene to prevent a full-fledged economic meltdown before inflation has been tamed."

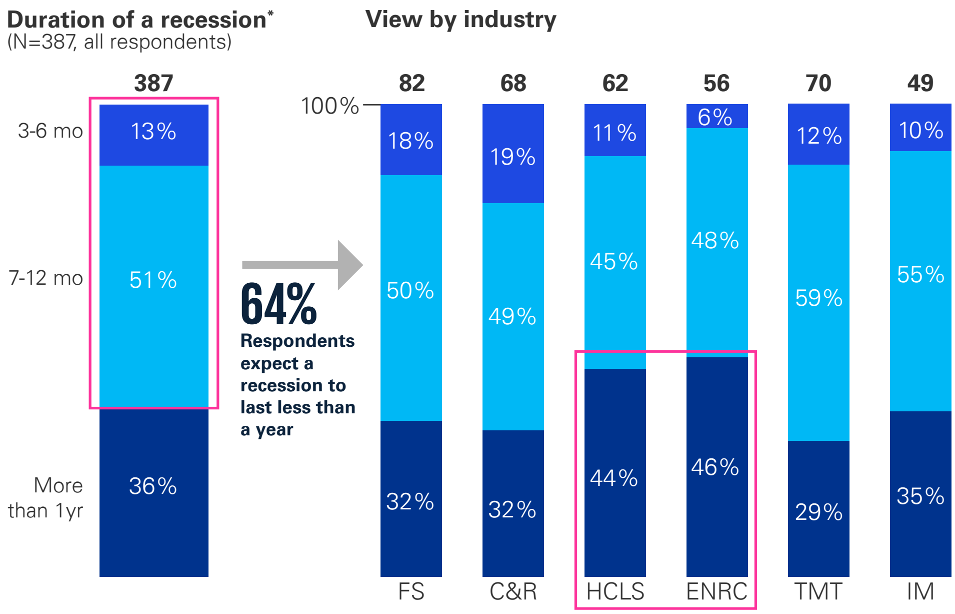
Swonk also worries about contagion: the same forces pushing against the U.S. economy are at work globally. "There's no Las Vegas" in the global economy, she says: what happens elsewhere does not stay there. Indeed, on July 26, the IMF lowered its global growth outlook.[4]

In its latest forecast, the KPMG Office of the Chief Economist raised the odds of recession in the next 12 months. In the KPMG Economic Survey in July, 37 percent of senior leaders of large companies said the country had at least a 75 percent chance of moving into a recession in the next 12 months. Respondents in financial services and industrial sectors were most pessimistic. But only about half of companies are talking regularly about recession in financial reporting.

Type of recession matters. While some economists are predicting a serious recession in the U.S.,[5] the consensus opinion suggests that a recession beginning in the second half of this year or in early 2023 could be relatively mild. One possibility is a mildish recession, with continued above-target inflation. That could discourage aggressive rate cuts to stimulate growth and lead to a sluggish recovery.

Companies planning for a severe or U-shaped recession, with sharp decline in demand that can endure for up to two years, would slash costs, horde cash, and hunker down. But if the recession turns out to be mild and short, companies taking drastic action could miss opportunities and be hobbled in the recovery, having failed to invest in growth strategies, capabilities, or innovation.

Exhibit 2. Business leaders expect a short recession



*N count is lower since some respondents have not answered the referenced question

Source: Economic Slowdown Survey Results.

Given today's unique economic circumstances, we're urging leaders to assess a range of likely scenarios and plan accordingly. In the July survey of 406 business leaders, only 46 percent said they are conducting scenario planning now. Only 41 percent have ramped up cash planning exercises.

How inflation can lead to recession

Inflation is an indirect cause of recession, but how companies and central bankers react to inflation has a more direct impact. As prices rise, companies facing margin pressure may cut back on investments, for example, limiting growth and slowing the economy. In a KPMG survey of top executives on the impact of inflation, a majority of respondents said they planned to postpone at least 9 percent of "non-strategic" spending.

Companies can also help drive an inflationary spiral, passing on costs to consumers and setting up inflation expectations among consumers and sparking demands for higher wages. Then central bankers move aggressively to halt the spiral, which is what has happened in 2022. The Fed raised the discount rate by 0.75 percent on July 27, bringing the target range to 2.25 to 2.50 percent, up from just 0.08 percent at the start of 2022.

The goal is to halt inflation by making it costlier to borrow, which curbs demand and investment. But there are other impacts in addition to curbing spending. Companies (particularly middle-market enterprises) can quickly face a liquidity crunch as the cost of debt service rises. Rising interest rates strengthen the dollar, hurting exporters. And rising interest rates can be disastrous for the finances of developing economies, including those whose sovereign debt is held by U.S. banks.

[4] Source: Alan Rappeport, "World At Risk Of Recession, IMF Says," New York Times, July 27, 2022

[5] Source: Reade Pickert, "US Consumer Spending Cools in Sign of Economy on Weaker Footing," Bloomberg, June 30, 2022

Industry matters. Recessions impact different sectors of the economy in varying degrees, with some industries hit early and others later. A drop in demand for industrial goods is often a sign that a recession is imminent, for example.

In past recessions, discretionary spending—such as on dining out and travel—has fallen first. In 2022, however, the pattern is different. Airlines can't keep up with demand,[6] but retailers and consumer packaged goods companies are feeling the effects of consumer sticker shock on food and other non-discretionary items. On July 25, Walmart cited soaring food prices in a warning that full-year profits would drop by 11 to 13 percent due to falling consumer demand and the cost of slashing prices to reduce inventories.[7]

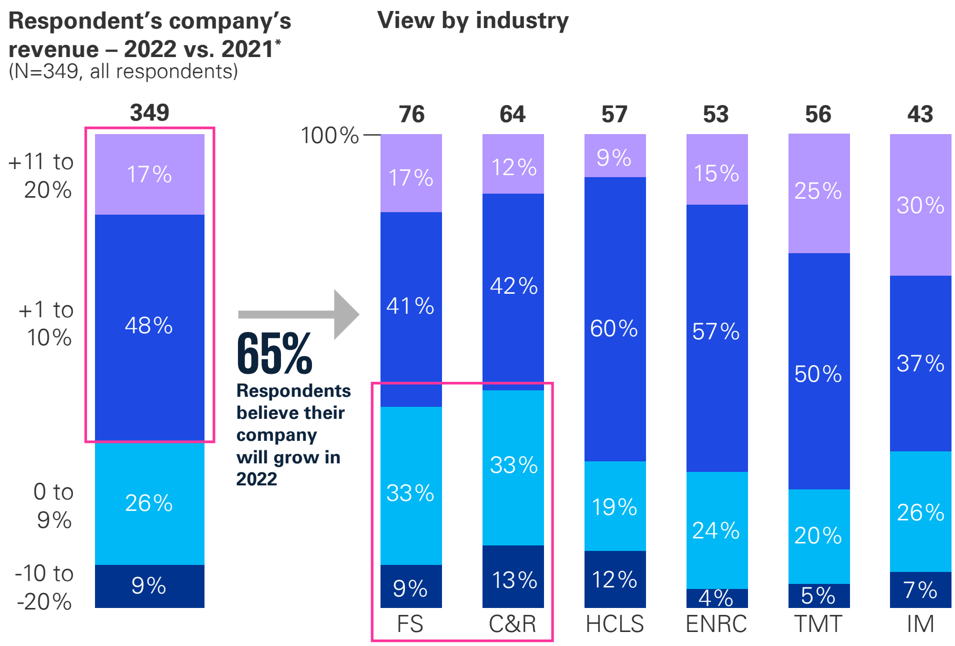
The automotive sector is still struggling with capacity issues, which is restraining output, so inventories are not building up on dealer lots. Automotive-sector leaders at KPMG expect that the chip shortage will ease by year-end and two years of pent-up demand could help blunt the impact of a recession. The picture is not as good for auto parts suppliers, which are still producing more than automakers can absorb. But the automotive aftermarket tends to do well in a downturn as people hang on to their older vehicles.

Technology is generally regarded as recession-resistant since customers continue to invest in ways to save costs and operate more efficiently. More than 80 percent of respondents in our survey say they are investing more in technology as a way to deal with inflation and a possible recession.

Even though only 10 percent of respondents in our July survey expect the U.S. to avoid recession, 65 percent still expect revenue to grow in 2022, and 60 percent expect operating profits to increase. Executives in financial services and consumer and retail (C&R) sectors were most likely to say that revenue would decline (Exhibit 3).

Respondents to business surveys, like consumers, tend to say they're doing fine even when they think the economy overall is doing badly. Business leaders should gather the data and run the numbers to confirm that their perceptions are valid.

Exhibit 3. Respondent's anticipated revenue change – 2022 versus 2021



*Some respondents responded beyond provided ranges

Source: Economic Slowdown Survey Results.

[6] Source: Alison Sider, "Airlines Are Making Money Again, But They Can't Keep Up With Surging Demand," The Wall Street Journal, July 21, 2022

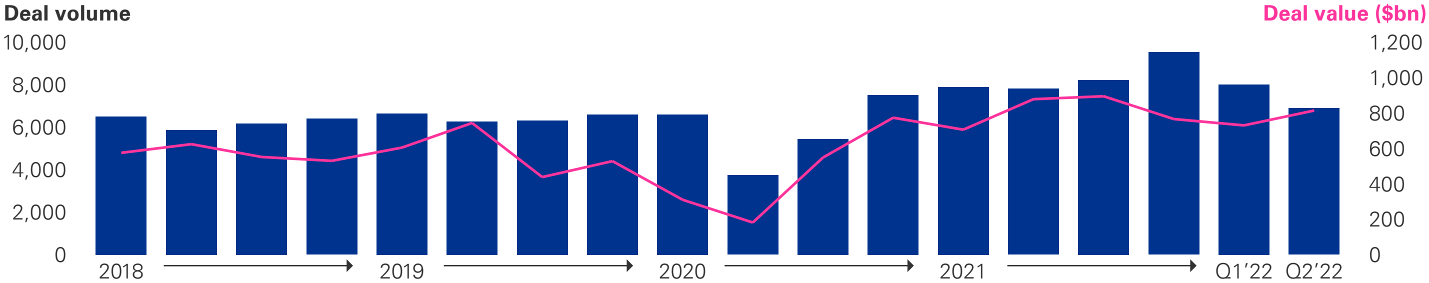
[7] Source: Brenan Case and Allison Nicole Smith, "Walmart Tumbles Most in S&P 500 as Forecast Warning Sows Gloom," Bloomberg, July 25, 2022

M&A in times of recession

While many companies continue to use M&A to support strategy during a downturn, economic uncertainty is—literally—a deal breaker overall. After a record-breaking year for M&A in 2021, the total volume of deals involving U.S. companies fell 14 percent in the second quarter from year-earlier levels. There were 28 percent fewer deals than in the blowout Q4'21.[8] In a KPMG survey of business leaders in May 2022, respondents cited growing concerns about inflation, recession, and rising interest rates for not doing deals.

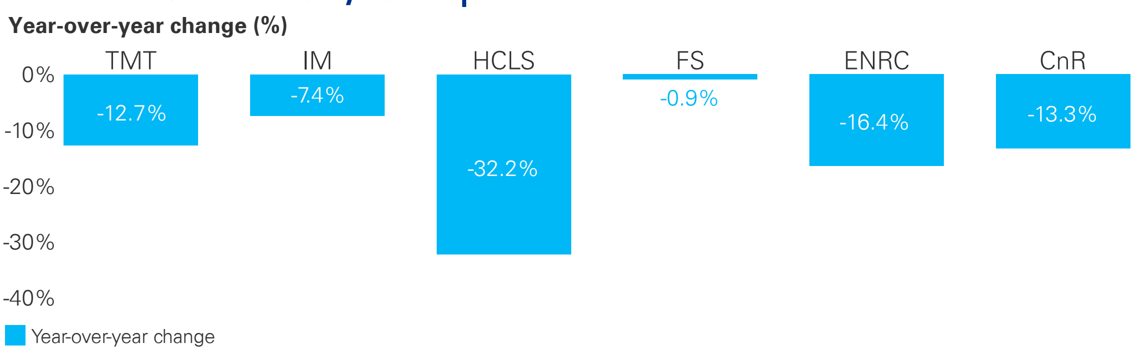
In the 2008-09 recession, deal volume dropped 37 percent from a peak in Q4'07 to a low in Q2'09. It took until Q4 2010 to exceed the Q4'07 deal volume. Like the economic downturn, the downturn in M&A could be different this time. One huge difference is access to capital; the 2008-09 recession was caused by a financial crisis that paralyzed banks. And the housing collapse resulted in a long and weak recovery. This time, there is no financial crisis. And PE investors still hold more than $1 trillion in dry capital, which could be used for bargain hunting. Large corporates also still have high levels of cash on their balance sheets.[9]

Exhibit 4. U.S. Deal volume and value | Q1'18 – Q1'22



Source(s): Cap IQ, Refinitiv, Pitchbook

Exhibit 5. Deal volume by sector | Q2'21 & Q2'22

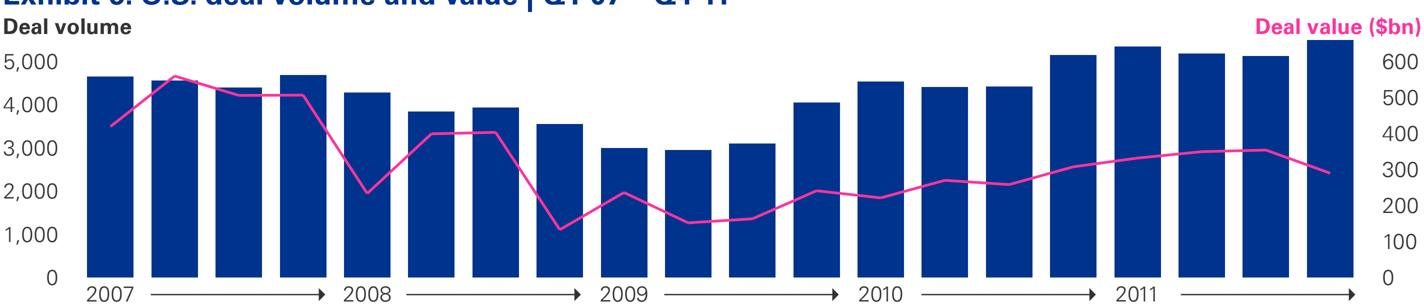


Source(s): Cap IQ, Refinitiv, Pitchbook

37%

Decline in deal volume 2007 to 2009

Exhibit 6. U.S. deal volume and value | Q1'07 – Q4'11



Source(s): Cap IQ, Refinitiv, Pitchbook

[8] Source: KPMG M&A Market perspectives survey analysis, June 2022

[9] Source: Charles McGrath, "Private capital dry powder share dips as AUM surges," Prequin, May 11, 2022

How best performing companies manage recession

While a recession, by definition, has wide-ranging impact across the economy, there will be some companies in every sector that will do a better job blunting the impact. The best performing companies not only preserve margins, but they also continue to grow and use the downturn to refine strategy for the recovery. They play offense: they act ahead of the recession to protect profits and seize growth opportunities throughout the downturn.

We reviewed nearly 2,000 publicly traded companies to see how they performed during the last recession. We focused on the period of September 2007 through September 2008, to see how companies that acted ahead of the recession performed. We ranked the companies in quartiles based on EBITDA margin and revenue growth (or losses) and then looked at how these companies performed (in terms of total shareholder return) through September 2010.

As Exhibit 7 shows, the companies that were still growing sales and margin as the recession unfolded outperformed the Russell 2000 index by up to 7.9 percent. The poorest performing companies in terms of revenue and EBITDA performance underperformed the same index by up to almost 17 percent, on average.

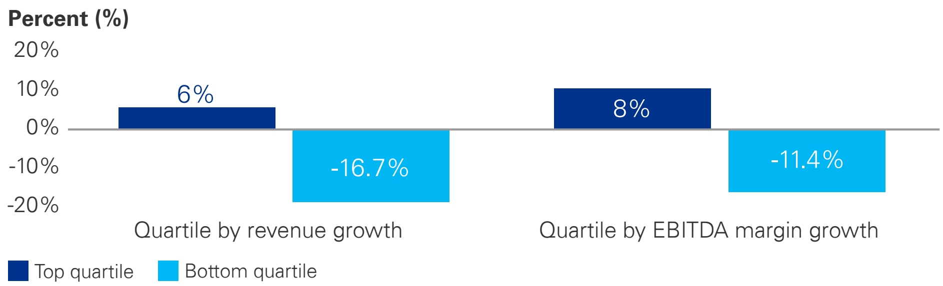
These top performers maintained profitability because they had been improving margins prior to the downturn. On average, top performers had cut sales and general administration (SG&A) costs by a median of up to 1.2 percentage points before the recession took hold, for example. Among the poorest performers, SG&A costs rose by a median of up to 1.1 percentage points.

Exhibit 8 shows the breakdown of top- and bottom-quartile companies in our sample. Not surprisingly, given the ravages of the financial crisis, financial services had the highest share of companies in the poorest-performer quartile. And financial services had the lowest share in the top quartile. Energy and natural resources (ENRC) and healthcare and life sciences (HCLS) had the highest share of top-quartile companies. In our July survey, HCLS and ENRC executives were most likely to expect a recession that will last more than a year—perhaps an indication that leaders in these companies will act more aggressively in advance again.

Perhaps most striking were the differences in growth rates: companies in the lowest quartile posted 8.7 percent declines in revenue versus 36.5 percent growth for the top quartile. This led to a 5 percentage-point decline in gross profit margin, and EBIT margin declines of 3.8 percentage points for the poorest performers. The top quartile delivered 1.1 percentage points growth in gross profits, and 0.9 percentage points growth in EBIT margin, on average.

Exhibit 7. Early movers who grew revenue and improved EBITDA margins won

Total Shareholder Returns (TSR) from October 2007 through October 2010



* 1,957 companies. U.S.-based public companies that 1. had a market cap greater than $500 million as of 9/30/2007, and 2. were still publicly traded as of 9/30/2010. Mutual funds and other investment funds were removed from the population. Grouped quartiles based on revenue and EBITDA margin growth from September 30, 2007 through September 30, 2008. The chart shows only top and bottom quartiles compared against the Russell 2000 index.

Source(s): Capital IQ, Bloomberg and KPMG analysis

Exhibit 8. How companies in different industries performed

Quartile by revenue*

Total Shareholder Return (TSR) Sept. 30, 2007 - Sept. 30, 2010

By quartile & industry		Median	Average	% of industry
HCLS	Quartile 4	-17.5	-7.4	38%
ENRC	Quartile 4	-1.7	2.3	42%
TMT	Quartile 4	-12.1	-9.7	27%
IM	Quartile 4	-27.9	-19.6	21%
FS	Quartile 4	-11.2	-12.8	13%
C&R	Quartile 4	-5.9	0.9	16%
IM	Quartile 1	-21.5	-29.1	12%
HCLS	Quartile 1	-41.5	-12.5	16%
ENRC	Quartile 1	-19.7	-14.0	10%
TMT	Quartile 1	-32.1	-24.7	21%
C&R	Quartile 1	-26.9	-28.7	30%
FS	Quartile 1	-31.1	-35.4	49%

Quartile by EBITDA†

Total Shareholder Return (TSR) Sept. 30, 2008 - Sept. 30, 2010

By quartile & industry		Median	Average	% of industry
HCLS	Quartile 4	-11.0	-6.1	36%
ENRC	Quartile 4	-9.5	-0.7	27%
TMT	Quartile 4	-12.7	-0.5	36%
IM	Quartile 4	-15.9	-13.4	19%
FS	Quartile 4	-1.5	-9.7	22%
C&R	Quartile 4	-14.2	-3.5	11%
IM	Quartile 1	-26.4	-25.1	13%
HCLS	Quartile 1	-35.4	-23.7	20%
ENRC	Quartile 1	-30.6	-19.5	27%
TMT	Quartile 1	-35.6	-22.2	22%
C&R	Quartile 1	-26.7	-26.4	25%
FS	Quartile 1	-21.5	-25.8	47%

* Here we quartiled companies by Revenue Growth % from September 30, 2007 - September 30, 2008. Then, we show the Total Shareholder Return (TSR) by quartile and industry.

† Here we quartiled by EBITDA Margin Growth percentage points from September 30, 2007 - September 30, 2008. Then, we show the Total Shareholder Return (TSR) by quartile and industry.

How did the top performers do so well?

Rather than retrenching, they plotted new growth strategies—snapping up new assets and shedding businesses that no longer had sufficient growth potential. Here are three examples from top performers:

01 **Vonage: New strategy, new cost structure.** Vonage, a business cloud services provider, took a new strategic direction when Jeff Citron took the helm as CEO in April 2007. In November 2008, he announced, "Our primary focus today is to improve the customer experience to reduce churn. While this will take time, we believe the company has the appropriate plan in place to improve customer satisfaction and build loyalty." The company told investors that it would slash marketing expenses by $110 million and G&A costs by $30 million through layoffs and consolidating operations. The company's strategic aim was not only cutting costs but acquiring more customers with the highest "lifetime value." It worked. While spending less on marketing, the company gained subscribers through the downturn. Revenue grew by 5.2 percent between October 2007 and October 2009, while companies on average saw declines of 0.1 percent of revenue in those two years.

02 **Edwards Lifesciences: Optimizing the product portfolio through M&A.** Edwards, a medical technology company, carefully positioned its product offerings as the economy tightened, becoming more competitive. In December 2007, it acquired the CardioVations product line from Ethicon, strengthening its position in heart valve replacement, and it also sold its LifeStent product line to fund new investments in its core competencies of heart valves and critical care. In May 2008, it announced extending the company's leadership in valve replacement and repair. Revenue growth from October 2007 to October 2008 was 16.1 percent, and 24.6 percent over the two years through October 2009, outpacing the HCLS sector median by 0.4 percent over the one-year period and 8.2 percent over the two-year period.

03 **LKQ Corp.: Using the recession to build margins.** In early 2007, LKQ, a provider of alternative aftermarket, specialty salvage, and recycled auto parts, anticipated declines in demand. That July, it agreed to merge with KeyStone Automotive. The alliance significantly improved LKQ's competitive advantages by adding complementary aftermarket product offerings. The merged companies made sharp reductions in corporate overhead costs and increased sales. EBIT margins remained steady at 10.5 percent in the 12 months beginning in October 2008, and rose to 11.5 percent over the next two years, while margins for its main competitors declined over the same time periods.

How companies are getting ahead of the downturn now

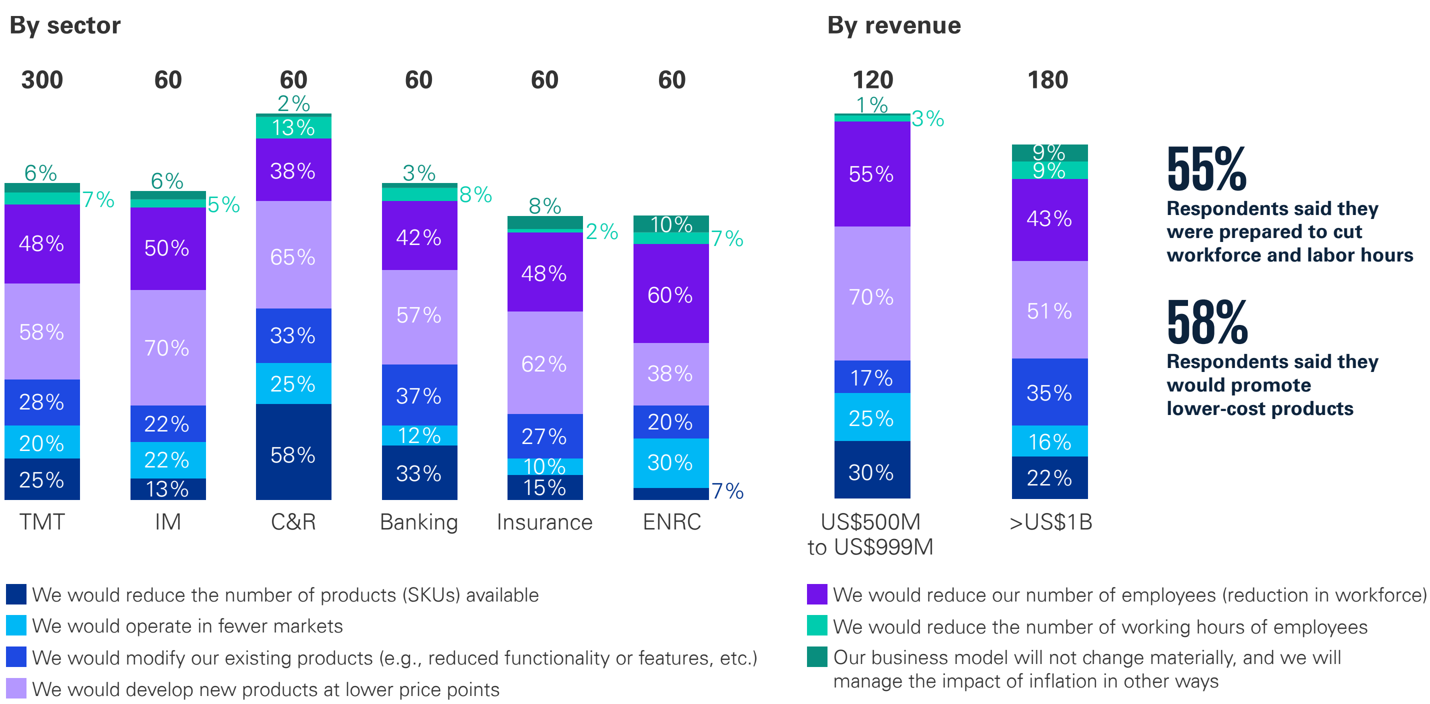
Starting in late 2021, business leaders became increasingly alarmed about the prospects for the U.S. economy. When rapid economic growth collided with constrained supplies of everything from plywood to semiconductor chips, inflation took off. Russia's decision to invade Ukraine in February 2022 doubled the cost of oil and wheat. Fearing the effects of inflation on profits and demand—and the impact of higher interest rates to halt inflation—business leaders began to act.

In the second quarter of 2022, KPMG surveyed business leaders about the impact of inflation and recession fears on their plans. More than half said they were prepared to reduce headcount and working hours, and 58 percent said they would develop new products at lower prices (Exhibit 9).

As the second quarter ended, many leading businesses told investors about their plans for managing economic uncertainty. In Hasbro's quarterly call with investors on July 19, CFO Deborah M. Thomas said the company is in a strong position to meet demand. "While economic conditions are challenging," she explained, "we took that into account in our full-year plan. And our businesses of toys, games, and content are historically very resilient during down economic periods."

Jon K. Snodgres, CFO of Repligen, told investors the company is "definitely seeing" inflation, especially in freight charges. "But overall," he added, "we are passing along price increases to our customer."

Exhibit 9. Most large companies are already acting to cut costs and offer less-expensive products



55%
Respondents said they were prepared to cut workforce and labor hours

58%
Respondents said they would promote lower-cost products

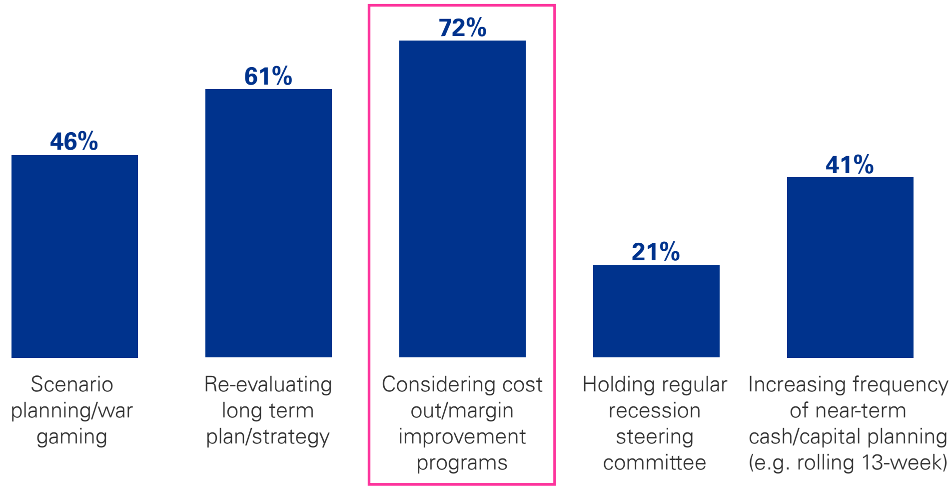
When we surveyed top executives in July, we asked detailed questions about how they are preparing for an economic downturn. While the level of preparation varied across industries, most respondents said they were already moving to protect the bottom line by passing costs to customers. About half of respondents across sectors said they were using online tools to measure changes in customer buying behavior and brand sentiment to determine how much they can raise price without damaging their standing with consumers or limiting sales.

Outside the energy sector, most respondents foresee developing new products at lower prices as a short-term response to a downturn; 60 percent of those in consumer and retail sectors say they're inclined to reduce the number of SKUs.

Across sectors, five out of six respondents say they're investing more in technology to boost efficiency, cut labor costs, harness data, serve customers better, and so on. And to protect the bottom line, three out of four say they will consider paring payrolls; more than half intend to shift the geographic locations of workforces, renegotiate real estate leases, and/or refinance debt.

Exhibit 8. What companies are doing to prepare: looking for costout opportunities, re-evaluating long-term strategy, and scenario planning

Planning exercises the company is currently undertaking*
(N=374, all respondents)



*N count is lower since many respondents have not answered the referenced question

Source: July KPMG economic slowdown survey.

What you can do now

The impact of slower growth is still not translating into sharply lower demand across the economy. There are pockets of weakness in highly interest-rate sensitive sectors such as real estate. Consumer sentiment has plunged, but unemployment has reached a 50-year low and consumption has continued to grow (albeit at a slow rate). So, there is still time to take the steps that can help companies make the most of a downturn. We have called on some of our top leaders to lay out the quick, tactical moves, you can make now to blunt the impact of slowing sales and take advantage of new growth opportunities.

Build dynamic scenarios for strategic responses: As we have shown in this paper, there is great uncertainty about how this downturn might play out. In such uncertain circumstances, scenario planning helps companies determine how to act before the impact of the change is clear—providing a critical advantage over competitors who wait too long to act, or who act on what they believe they "know" will happen. To identify the right moves to make for your company—to protect profits and seize new opportunities—follow these steps:

- **Start scenario planning:** Map a range of scenarios to help determine what is most likely. This will give you the ability to act more confidently and quickly, as winners in downturns must do.
- **Engage your broader team in the dialogue:** Get your top leadership and board involved to discuss your analysis and coordinate execution plans.
- **Understand your industry/function-specific implications:** Draw out business implications of different scenarios for your specific industry and functions.
- **Recalibrate forecasts:** Many market or business assumptions you had a few months may be obsolete. Update forecasts and use that data to help refine strategy.
- **Create action plans:** Translate scenarios into action plans that can be executed rapidly based on how the economy plays out.

—Per Edin

Use M&A for offense and defense: A downturn can be an excellent time to rebalance a portfolio of businesses. Most complex corporate portfolios have businesses that are no longer core or do not provide sustainable differentiation. These outliers, and the value destruction they cause, become more painfully obvious in a downturn. In advance of a downturn, take a hard, data-driven view of all the businesses in your portfolio to identify those with a negative value trajectory, due to positioning in the market or value chain, or because the company is unable to differentially create value with them.

By acting quickly to divest non-core assets, companies can capture two key benefits:

- **Add liquidity for investments in your core businesses:** Downturns provide opportunities for companies with strong balance sheets to buy "good for you" assets at good prices.
- **Free up management time and resources:** Without the distraction of non-core businesses, leaders can focus on the businesses in the portfolio with the greatest potential. They will benefit from additional attention during the downturn.

—Ramahi Sarma-Rupavtarm

Pre-emptively attack costs: Early and aggressive cost management and an unrelenting focus on liquidity are still the most important actions management can take to recession-proof operating plans.

Key early actions that companies should take include:

- Benchmark the organization, rethink structures using a "greenfield" methodology.
- Create a lean organizational structure to fit current business needs.
- Assess all operational processes for improvement.
- Evaluate every income statement line item and aggressively eliminate waste at every level.
- Ensure all plans are tracked, and each action has dedicated ownership.

—Michael Musso

Fine-tune commercial strategy: Fine-tune commercial strategy: In a downturn, companies must strike a delicate balance between preserving profits and maintaining (or growing) their customer base. The current levels of inflation make this an even more challenging problem. Companies can use difficult times to get closer to key customers—helping them today will pay dividends tomorrow.

Here are some high-priority steps to adapt commercial strategy now:

- **Lean into your existing customer relationships:** Stay on top of customer success programs. Use data and advanced analytics to identify your best customers, better understand their immediate needs, and meet them where they are (build up their awareness of other services and product features that may drive greater value). Embrace profitable loyalty programs.
- **Don't act hastily to reduce your price:** Strong market performers will likely use this time to get ahead and lock in favorable terms. Accelerate sales of lower-priced items and raise prices on supply-constrained items. Develop robust discounting guidelines based on customer and deal characteristics, and manage channel discounting.
- **Collaborate with supply-chain partners:** Enforce the terms of your contracts to control costs, understand potential supply constraints, and build appropriate plans to ensure that you can meet delivery expectations. Remove or minimize price escalation lock-in periods.
- **Review promotional programs:** Analyze current promotions and cut ones that are not delivering. Cut ineffective marketing and trade investments, avoid blanket price increases and adjust assortments.

—Sudipto Banerjee

Use the data you have. We find that many companies do not take full advantage of their data for decision-making. At one large manufacturer, for example, we found that only about 5 percent of decisions were truly data driven. In a downturn, it is critical to use data analytics to determine the best moves actions that can deliver the points of margin that can keep companies profitable when revenue growth slows. The good news is that most companies have the data on hand and may even have the proper tools. Here are three quick ways to use them now:

- **Identify true drivers of cost:** Humans think they know what drives costs in their operations, but by using machine learning techniques, companies can find the true—and often hidden—drivers of cost. Use digital twins to simulate and optimize supply chains, for example.
- **Get the biggest bang from your cost-saving bucks:** Using data analytics, companies can also model the net costs of cost-saving moves. For example, banks might identify branch operations as the biggest cost-saving opportunity. But which branches to close? Where would closing a branch lead to unacceptable customer losses? The answer is in the data the banks already have.
- **Finding processes to target for automation:** In recessions companies invest in labor-saving technology. But do you know which tasks to automate first to get the biggest payoff? Do not guess. Analyze existing data such as log events and audit trails.

—Matteo Colombo

Improve cash and liquidity: Optimize working capital and develop robust forecast and variance analysis capabilities (13-week rolling cash flow forecast and 12-month cash flow forecast):

- **Improve visibility:** Monitor working capital performance and cash metrics with improved reporting to support cash and liquidity forecasting.
- **De-risk accounts receivable:** Review past due balances and get caught up before market risk impacts receivables. Review customer payment behaviors and adjust credit policies to reduce risk.
- **Optimize inventory:** Revisit demand plans built into inventory purchase commitments and open purchase orders. Analyze and then sell/consume slow moving inventory before reduced demand renders it obsolete. Understand possible impacts on lead times.
- **Improve accounts payables:** Renegotiate payment terms with vendors. Defer or minimize discretionary spend and optimize pay-cycle frequencies.

—Florian Lindstaedt

Restructure debt: When a downturn is imminent, it is important for businesses to clearly understand the how their current capital structure could be impacted by near- to long-term liquidity issues. Interest rate increases, inventory expansion, AR collection slowdowns, and slowing demand will all contribute to potential challenges related to lender covenants and leverage ratios. Companies can expect tightening credit markets and increased scrutiny from lenders and bond holders. Waiting to refinance in a stressed and distressed state during a recession is challenging and expensive. Companies with adjustable loans, term loans, and junior debt facilities should assess the potential impact of these market factors on their borrowing base, debt service, and, ultimately, their liquidity. Here are a few key steps:

- Build covenant testing models.
- Communicate with extreme transparency and urgency to your lenders.
- Work with capital structure advisors to ensure adequate liquidity through a downturn.

—Michael Musso

Hold onto talent: The simple—reactive—approach to human capital in a downturn is to look only at cost-out opportunities. Companies that successfully navigate a downturn recognize that they need talent with the right capabilities in the right roles to execute defensive and offensive initiatives. Companies should quickly assess organizational structures to ensure alignment with the evolving commercial, operational, and financial operating models. Focus cost-cutting on moves that create ongoing improvement: adjusting management spans and layers, standardizing or automating tasks, and broadening responsibilities in leadership roles to unlock value.

Pay attention to organizational health:

- This is a time of growing stress, but it is still a strong labor market—employees have choices.
- Assess cultural strengths and employee sentiment. Identify the advantages you can use to outperform through a downturn.
- Communicate and engage. Give employees reasons to believe in the future of the company and contribute to the company's success through a difficult period. A more engaged workforce leads to higher retention and lower turnover costs.

Finally, use the downturn to invest in your human capital. Search out the in-house talent who can step up into hard-to-fill roles. And when business is slow, there's time for training and developing talent.

—Lyna Sun

How KPMG can help

In good times and in recessions, we help clients address their greatest challenges and pursue the most profitable opportunities. KPMG advises leading organizations on strategy, transactions, and performance transformations. We have deep experience helping companies plan and implement growth strategies, cost improvement initiatives, and M&A programs. Our people bring deep knowledge of corporate functions—HR, technology, finance, supply chain, ESG, etc.—as well as decades of industry experience. They rely on data-driven techniques to help clients quickly solve problems and uncover new sources of value.

A note of optimism

We know that our clients have been confronted with an unrelenting series of external challenges over the past two years, from the pandemic shutdown to clogged supply chains to soaring inflation. In this paper we have tried to help clients prepare for the next challenge, a likely recession. We would like to conclude on a note of optimism. We are confident that whatever the economy has in store, business leaders will rise to the occasion. The past two years have taught us all to expect the unexpected and to be agile in adapting strategy to changing conditions–and even to scenario-plan for the next disruptive event. We look forward to helping you succeed in what promises to be a very challenging environment.

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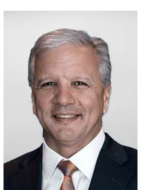

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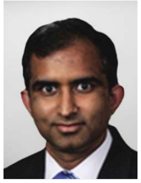

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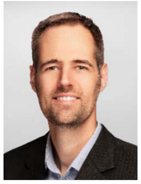

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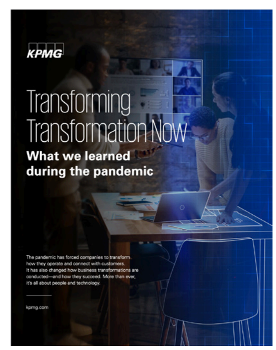

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