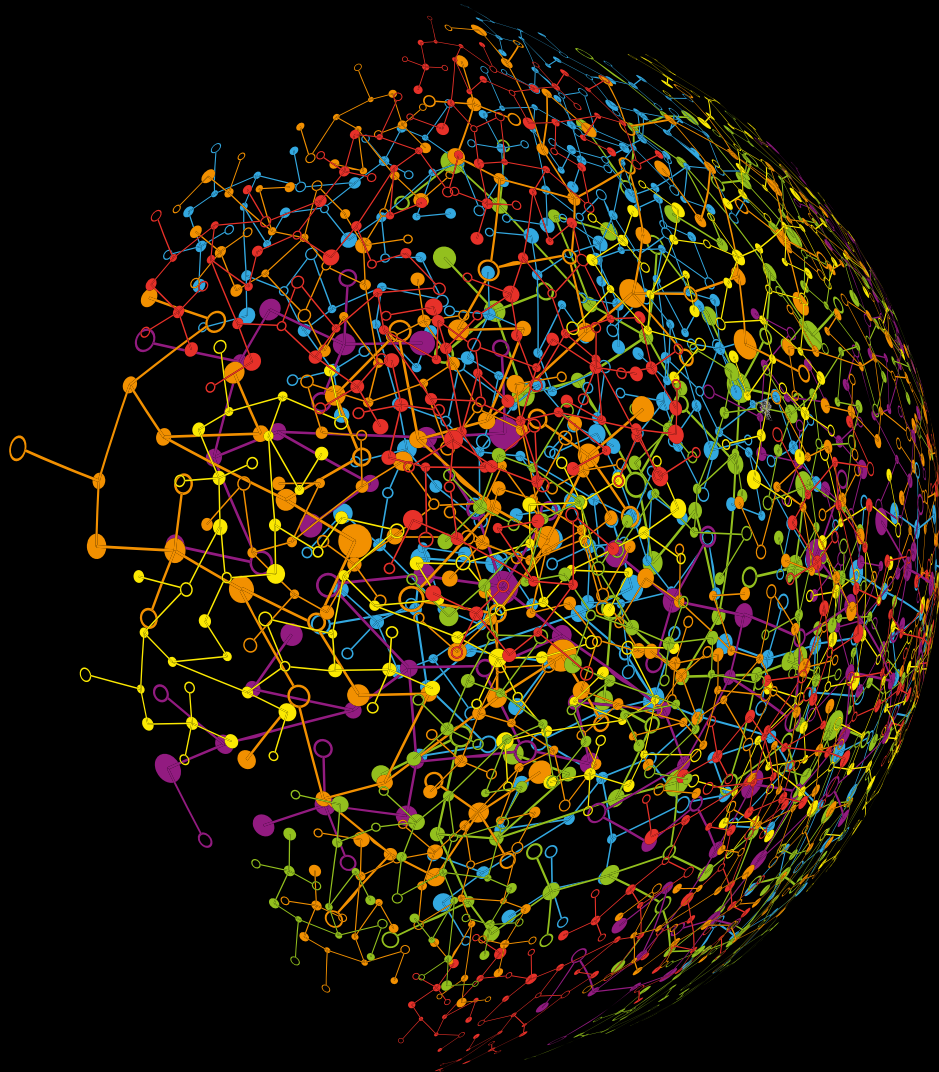


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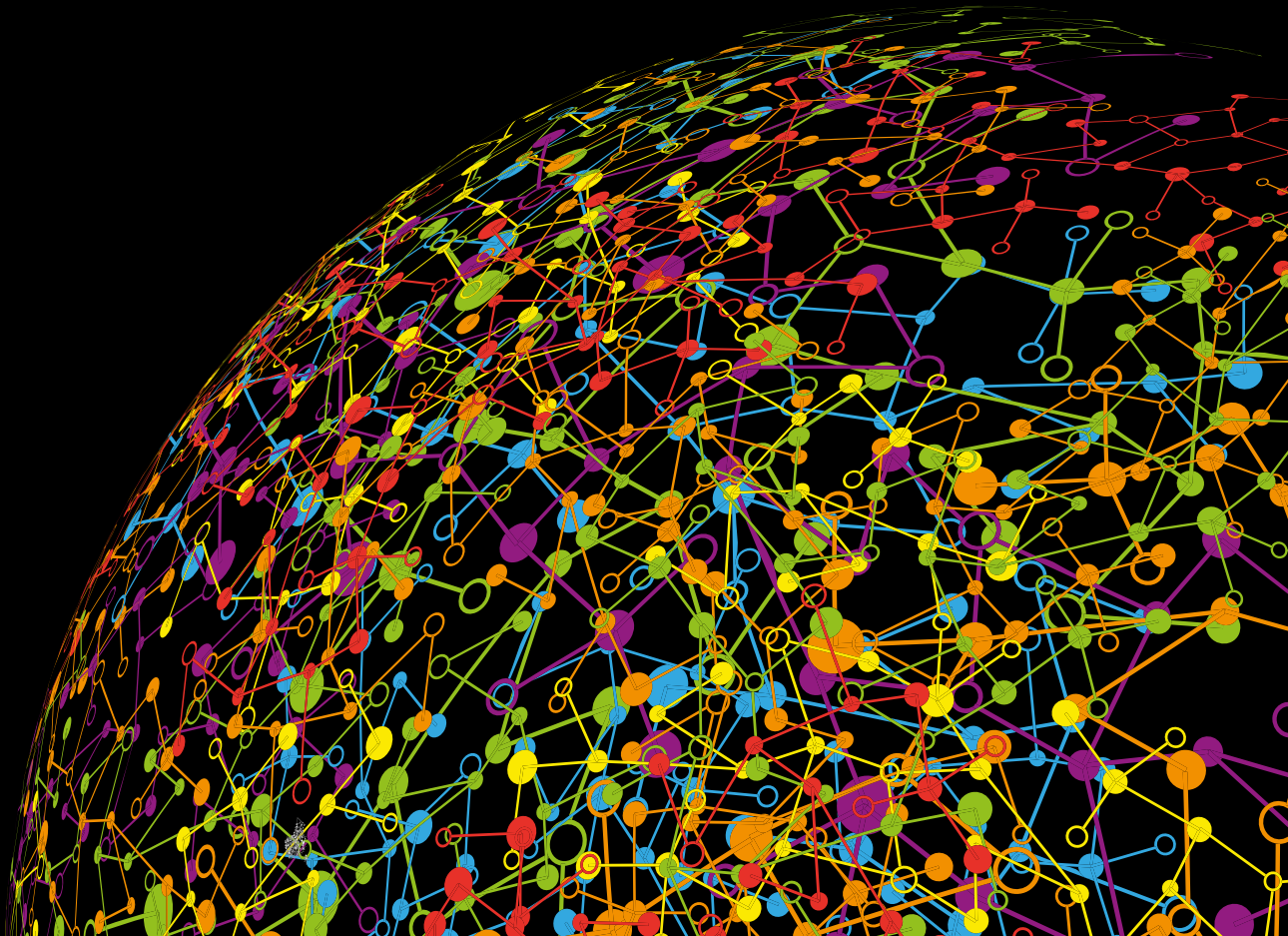


COVID-19

Finding cost certainty amid
economic uncertainty

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Introduction

COVID-19 has pulled the global economy into unprecedented times, leaving organizations exposed to unforeseen risks ranging from loss of revenues and profits, to the total shutdown of operations. Economic activity is on a constant decline, unemployment is rapidly increasing, and industries are facing major disruptions, all of which are indications that Europe and North America are in a deep recession.¹

Government and public sector

- Governments are putting costly emergency programs in place, with Canada committing over \$80 billion to date.²
- Many provinces and territories have declared a state of emergency.
- Public institutions are closed; classes have been suspended and virtual classes are now in full effect.



Global financial services

- Financial markets are in flux, resulting in unprecedented volatility.
- Insurers are serving as shock absorbers for the economy.
- Business loans are at risk, especially for small to medium-sized businesses, due to the total shutdown of operations.



Energy, resources, and industrials

- Supply disruption and cost escalation are prevalent.
- The price of crude oil dropped almost 50 percent between early January and mid-March, and demand is falling at an unforeseen rate of 90,000 barrels per day.³
- Mining facilities are being closed down and operations are being quarantined to reduce the risk of spreading the virus, creating significant uncertainties in the downstream supply chain.



Retail and consumer products

- Behavioural shifts are in full effect, with movement toward online shopping and delivery for consumable and grocery categories.
- Disruptions in supply chains are leading to inventory shortages.
- Retailers are forced to shut down operations as a response to government directives; numerous retailers are shifting to e-commerce to stay afloat.



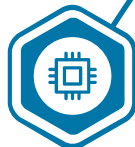
Transportation, hospitality, and services

- Global airline revenues are projected to decline by \$30 billion for 2020.⁴
- Hotels are under complete shutdown; two-thirds of hotel employees in British Columbia are potentially facing layoffs.⁵
- Restaurants are closed and have shifted their focus to food delivery.



Technology, media, and telecommunications

- Media organizations are strongly affected, with advertising demand dropping and sporting events and communication campaigns cancelled.
- Significant investments are being diverted to maintain core network infrastructure, given the increased load on networks due to high at-home usage.⁶
- The effect on telecommunications will most likely be short term; as we emerge from the pandemic, connectivity will resume and people will be increasingly accustomed to relying on digital tools.⁷



Life sciences and health care

- The health care sector is encountering shortages of a variety of items, including gloves, surgical masks, respirators, and COVID-19 screening test kits.
- Despite qualifying as essential services, many clinics are providing consultations and appointments virtually, as a response to social distancing.
- Dependency on international pharma ingredients may result in supply chain issues.



When faced with a crisis, organizations often turn to their financial statements and resort to managing costs as a first step to navigating the ambiguities of a recession. Cost management has been, and continues to be, one of the biggest challenges facing CEOs today.⁸ In a time of diminishing cash flows and declining profits, organizations should respond in a sustainable manner to stop the bleeding and create long-term strategies that enable them to thrive in times of uncertainty. By locking down costs, exploring methods to operate in the new normal, and preparing to emerge from the pandemic as things slowly return to business as usual, organizations can ride the downturn wave, and emerge as winners on the other side.

If recent downturns are an indication of what is yet to come, organizations will need to adopt the right strategies for managing their costs to enable them to successfully navigate the COVID-19 downturn.

Learning from the past

Research shows that during recent recessions, organizations deployed different strategies to manage their costs.⁹ Some players deployed defensive strategies that focused on minimizing risks and avoiding losses (e.g., setting aggressive cost-reduction targets coupled with headcount reduction). Others focused on offensive moves, taking advantage of low valuations to make tactical acquisitions to drive growth, or by investing in research and development. The few winners were the progressive companies that deployed the optimal combination of defensive and offensive moves (e.g., cutting costs to improve operational efficiency while reinvesting the savings in new business opportunities).

In the 2008 recession, the top strategy pursued by organizations was to rationalize their cost structures, followed by making investments in technology and in new markets.⁹ By maintaining a portfolio of both cost-cutting and growth-focused strategies, successful organizations posted a 13 percent post-recession EBITDA growth rate compared to all others.¹⁰ By responding in this way, these organizations were able to accept higher degrees of uncertainty by detecting early cost warnings. Consequently, they were able to recover quicker and were better prepared for when the economy rebounded.





The pathway through the COVID-19 downturn

Phase 1 – Cost containment

During times of distress, cash flow issues can emerge and prompt organizations to look for ways to reduce costs. To begin containing these, organizations should identify the areas that are non-essential and have minimal impact on business continuity. These are usually costs that can be reduced or stopped within a relatively short timeframe with limited impact on revenues (e.g., travel and expenses). Some of these quick wins might not be sustainable over a long period of time, and are often used to buy time to identify longer-term cost transformation strategies.

Here we focus on four key cost levers that organizations can target: begin with cash flow optimization, optimize the project portfolio, reduce discretionary spend, and manage external spend.

Begin with cash flow optimization

As profits decline and operations shut down to contain the spread of COVID-19, organizations are left vulnerable with low cash reserves.¹¹ Cash flow management poses a significant challenge for organizations, where immediate action is required.

To begin optimizing cash flows, organizations should focus on protecting their revenue streams. During a crisis, layoffs are often a cost-cutting reflex for organizations where labour cost represents a disproportionately large amount of total operating costs. Yet, organizations that rely solely on headcount reductions have only an 11 percent probability of achieving strong performance after a downturn.⁹ Retaining key talent is critical to business continuity, as these employees contribute to protecting revenue streams during a downturn and play an important role in enabling organizations to bounce back quickly when the economy recovers. With this in mind, organizations should consider alternatives to layoffs such as freezing pay increases, promotions, and bonuses to all but a small percentage of employees (i.e., the top performers). Other approaches include introducing voluntary workload reduction programs, where a decrease in workload would correspond to a salary decrease, and voluntary unpaid leave programs, where employees would take an unpaid leave of absence for a specified period of time (e.g., three months). An advantage of such approaches is that the

cuts are applied proportionally across the workforce, so they require equal commitment from all employees. Consequently, they can be seen as an opportunity for senior leaders to showcase commitment to their workforce, as they are willing to take a personal hit to protect their full-time employees.¹²

From a supply chain perspective, the unforeseen events are inevitably changing consumer demand and disrupting global supply chains, affecting the inventory management for organizations such as large retailers. For example, COVID-19 has increased demand for non-perishable foods, toilet paper, and disinfectants. Organizations will have to balance the management of cash flow with maintaining safety stock levels (extra stock that mitigates the risk of stock-outs) and reduce finished goods inventories, especially for perishable products, while minimizing disruption to operations and customer service. Being able to plan and prioritize limited resources, and quickly adapt to changes, can drive competitive advantages for organizations during a downturn.

“ Organizations that rely solely on headcount reductions have only an 11 percent probability of achieving strong performance after a downturn. ”



Optimize the project portfolio

During periods of greater cost pressure, it is critical that organizations only invest in the opportunities that will deliver the most value while reducing, or in some cases stopping, those that are not expected to achieve the right value threshold or have been negatively impacted by the economic circumstances. Organizations that have defined effective criteria for evaluating or shutting down projects that do not deliver the right value, and have the necessary data to apply this criteria, are typically better able to detect cost warnings early. This then enables the redeployment of resources to projects with a higher return on investment¹⁰. During a recent recession, one large retailer shut down underperforming facilities, and increased their workforce by 10 percent to support their high-end products and services. This approach doubled sales and resulted in the retailer being 30 percent more profitable than its peers, in just three years following that recession.⁹

Reduce discretionary spend

Discretionary spend relates to costs that are deemed non-essential for business operations such as office improvements, employee training programs, advertising, events, etc. Organizations should look at their discretionary expenditure to eliminate any costs that are not critical in the short term. These costs should not impact the organization's ability to operate and continue to serve customers, and can be significantly reduced in a short timeframe to decrease operating costs. Due to the social distancing requirements brought about by the outbreak of COVID-19, organizations can also take advantage of cost savings associated with the lack of in-person events, replacing these with more cost-effective digital alternatives. In the past, executives have explored different options from pushing events into the future, to decreasing their scope to reduce spend.¹³

Manage external spend

According to the 2019 Deloitte Chief Procurement Officer (CPO) survey, 70 percent of CPOs indicated that they are likely to cut costs as a response to a downturn, beginning with consolidating spend as the number one priority.¹⁴ In a time of economic slowdown and decreasing cash flow caused by COVID-19, spend consolidation is now a priority more than ever.

Organizations looking to consolidate external spend can do so by revisiting vendor contracts and third-party agreements to identify opportunities to move common services under a single partner or a shortlist of strategic partners. In some cases, it may be possible to consolidate multiple regional agreements into one national provider agreement. In all cases, the desired outcome should be rate reduction based on greater volume through each contract.

Another approach for reducing external spend is to revisit the highest-value contracts and ask these suppliers if they are able to offer further discounts, in return for continued business and a stronger relationship once the crisis has passed.

There is also the opportunity to place a temporary hold on non-essential contracts (e.g., meeting catering) or to simply shift the work to employees. In the past, organizations were also able to leverage strong supplier relationships during a time of distress by changing payment terms in the short term to generate increased annual cash benefits.

According to a survey conducted in 2019 by Suplari, 49 percent of organizations rated contract re-negotiation as their number one cost savings lever during a downturn, while vendor contract consolidation occupied second place with 45 percent.¹⁵ That being said, procurement executives face a constant balancing challenge between reducing costs and improving cash flow, and maintaining healthy relationships with key suppliers. These key relationships are crucial for business continuity as organizations emerge from the pandemic, so it is important not to damage them in the short term.

“ 70 percent of CPOs indicated that they are likely to cut costs as a response to a downturn, beginning with consolidating spend as the number one priority. ”



Key risks and mitigation

- As the implementation of quick wins begins, organizations must deploy change management strategies during this time to avoid rumour spreading of a “tightening the belt” culture that hinders employee performance.
- Employees can be engaged in the crowdsourcing of new ideas to avoid employee disempowerment.
- Organizations should manage expectations and provide transparency to both employees and customers by developing actionable communication strategies.



Phase 2 – Operating in the new normal

With the expectation that the COVID-19 restrictions will be in place for the next few months, organizations need to be able to operate comfortably in this new normal if they are to remain successful. After implementing the necessary measures to contain costs, organizations can pay more attention to protecting key revenue streams and business continuity, while maintaining a laser focus on costs, as the economic situation evolves. This includes galvanizing relationships with key customers, doubling down on quality of service, nurturing relationship with key partners/suppliers, and protecting key talent, while exploring growth-focused strategies in core areas. Here we focus on three key levers that organizations can use during this phase to thrive while maintaining business continuity: maintain the focus on customers, unlock flexibility through workforce optimization, and optimize the supply chain.

Maintain the focus on customers

In times of distress, the natural reaction can be to turn the focus inward to keep the ship from sinking. However, remaining connected to customers and focusing efforts on retention is crucial. Research indicates that even an increase of 5 percent in customer retention can increase profits by as much as 25 percent.¹⁶ Preserving relationships with key customers is vital for weathering a downturn; organizations should remain aligned and connected to changing customer needs and resort to new alternatives to keep customers engaged.

For example, as people remain at home, and financial pressures accumulate, customers will become increasingly value conscious, and will likely have an increased need for convenience. Organizations should avoid costly feature-creep that does not necessarily deliver the corresponding increase in customer value. Moreover, organizations can leverage technology to simplify the customer experience and adapt to the social distancing version of the customer journey. Many examples have come to light during this time, such as food delivery players offering contactless delivery, online retail stores waiving delivery and shipping fees, and fitness centres offering live-streamed exercise classes to keep members engaged. Optimizing the customer experience during these changing times builds long-term loyalty and has the potential to attract new customers through word of mouth, at a lower acquisition cost than usual. To understand the changing needs of customers, organizations should focus on mapping out the key priorities for each of their key customer groups, while considering whether there is the need to enhance existing customer journeys in light of any shift in customer priorities.

Unlock flexibility through workforce optimization

The social distancing aspect of COVID-19 has presented some unique opportunities to reduce the workforce cost, but has also presented the need to invest in the capabilities required to support alternative services that are emerging as the crisis continues. The need to support a home-based workforce enables organizations to yield cost savings through lower office maintenance, and utilities/amenities costs. However, organizations often need to make further investments in technological capabilities to enable their workforce to remain effective while working remotely. This includes making investments in online training (e.g., new ways of working, products/services, etc.), network infrastructure (e.g., additional VPN capacity), digital conferencing facilities, and personal IT equipment (e.g., monitors). In most cases, this will also place greater emphasis on the need for robust cyber security capabilities to protect a more technologically-dependent workforce.

“ Preserving relationships with key customers is vital for weathering a downturn; organizations should remain aligned and connected to changing customer needs and resort to new alternatives to keep customers engaged. ”



Many organizations spend years and millions of dollars developing and retaining key talent.¹⁷ As previously mentioned, organizations that employ creative workforce strategies fare better post-downturn than their peers who focus on headcount reductions. Early on, organizations should identify changes to key services required as a result of COVID-19, that will result in greater than usual demand being placed on existing capabilities or the need to build new capabilities. This change in demand can be addressed by diverting resources from de-prioritized areas of the business to deliver these alternative services and meet the shift in demand. If organizations can rapidly identify potential capability and talent redeployment opportunities across the organization, it can help mitigate talent retention risks, whilst retaining the critical business/institutional knowledge that these employees may have. An example of this is in the consumer packaged goods industry where some organizations have shifted talent and budget from less critical product groups, like luxury personal care items, to priority product groups that are in high demand due to COVID-19, such as disinfectants and other medical supplies. Being able to pivot rapidly in this way, while leveraging training solutions, enables the organization to retain key talent during the downturn.

For workforce planning, organizations can look to developments in technology and the “new workforce” to optimize how work is done. As organizations identify current talent/capability gaps and plan for the future state of their workforce, they can look to broader solutions such as the gig economy, which is characterized by short-term or freelance work, to fill these gaps. For example, organizations that have resorted to e-commerce due to social distancing may require search-engine optimization or web-design capabilities. They can look for temporary expert support in the gig economy to kick start this aspect of their business, rather than going through a lengthy and costly recruitment process. This could be leveraged as organizations begin to operate in the new normal to address immediate capability gaps brought about by COVID-19 related absenteeism or employee leave. New workforce ideas can also be considered for the future; organizations can identify areas with less continuous demand or the need for experts, and leverage full-time equivalent alternatives for those activities.

Ultimately, the workforce optimization moves made during a downturn can help sustain long-term business growth as they enable organizations to develop scalable platforms for the future. Many of the previously stated changes, such as remote working, and even business model shifts (e.g., dining restaurants offering home delivery) may persist post-COVID-19 as organizations qualify them as new sources of value.

Optimize the supply chain

Compared to the 2002 SARS outbreak, the impact of COVID-19 is likely to be much greater; China’s share of the world’s GDP has increased four-fold since SARS,¹⁸ so disruption to China, and any connected economies, will have significant financial implications. In fact, it is estimated that the crisis could cost businesses’ supply chains up to US\$400 billion.¹⁸

According to research, 20 to 30 percent of an organization’s purchases fall outside of contractual agreements.¹³ To drive sustainable savings from the contract re-negotiations, referenced in Phase 1, executives should look deeper into this external spend to identify ways in which it can be brought under existing contracts, with the benefit of further volume discounts and protections. Where this is not possible, organizations should look to consolidate similar services under new contracts, which should also deliver financial and risk-minimization benefits.

Going through such a process also introduces an opportunity to inject greater focus on contract management to ensure that existing contracts are used as effectively as possible and opportunities to further optimize external spend can be identified and actioned rapidly. Adopting best practices in contract management (e.g., standardizing contract creation) allows organizations to maximize performance, and minimize costly future risks such as maverick buying and pricing errors that put organizations at high risk of regulatory violations and cost overruns.¹⁹



Key risks and mitigation

- Disruptions to customers may cause brand-switching; customer engagement can be maintained through the use of digital communications. Organizations can provide updates on their key products/services and on how they are responding to the crisis.
- Workforce optimization can cause talent retention issues; employee communication and change management strategies continue to be critical.
- Supply chain changes can go awry without stakeholder collaboration and sufficient monitoring of quantified savings to ensure long-term stickiness.



Phase 3 – Emerging from the pandemic

As the pandemic is brought under control and the economy begins to rebound, organizations need to continue to ensure that as revenues grow, costs remain within the necessary threshold. During this time, organizations should revisit the changes made as a result of COVID-19 and determine whether there is a benefit in taking some of these forward based on evolutions in customer behaviour. Those that may no longer make sense can be phased out, whilst reprioritizing efforts accordingly. Here we focus on three key levers that organizations should consider as they look to emerge from the pandemic, while protecting their margins: industrialize new products and services, realign the workforce, and optimize external-spend management.

Industrialize new products and services

Organizations that go beyond cost cutting and invest in growth initiatives such as new markets, or products and services, outperform their peers and are 76 percent more likely to succeed post-recession.⁹ Organizations have an opportunity to take advantage of permanent shifts in customer behaviour (e.g., customers' expectancy of continued convenience post social distancing) by investing rebounding revenues in the industrialization of the new and enhanced products and services born out of the COVID-19 outbreak. Leveraging digital solutions is one approach organizations can use to industrialize these products and services, and provide further ways to increase agility while releasing costs. For example, fitness centres might introduce a new virtual membership with access to live-streamed exercise classes at a lower price-point, and physical grocery stores who did not provide an online grocery delivery service prior to COVID-19, might just consider doing so.

Not all of these products and services will be viable as social distancing is phased out. Organizations will need to think strategically with regards to how they decommission these to manage the impact on customers and the workforce that has been moved from lower priority areas to support these services.

Realign the workforce

Before exploring the broader lessons learned as a result of the COVID-19 workforce adjustments, organizations should realign their resources; employees may need to be repositioned based on the revised suite of products and services offered by the organization. For example, organizations that rapidly scaled up e-commerce capabilities and redeployed talent to this area may prefer to shift employees back to brick-and-mortar retail. Furthermore, employees may require training to empower them with the necessary skills and capabilities to support new offerings, such as training medical professionals on effective digital communication for virtual medicine services. Considering this, careful planning is required to ensure quality of service does not decrease, costs do not significantly increase, and business continuity remains intact.

As the workforce evolves from isolation and returns to their offices, organizations should consider the pace at which they transition back to pre-COVID-19 ways of working; the question they should ask themselves is "how flexible can our workforce truly be?" According to a recent study, 96 percent of workers say they value flexibility, while only 47 percent indicated that their workplace is flexible enough,²¹ which creates a significant gap that organizations can continue to narrow.





As mentioned in Phase 2, one of the key changes to leverage post-downturn is remote working. Now that employees have adjusted and are equipped with the appropriate tools and technology, and the organization has internally navigated the nuances of remote working, policies can be implemented to allow or mandate flexible working conditions for a portion or all of the workforce. The core benefits of continuing to enable employees to work remotely are two-fold: organizations can conserve costs through real-estate rationalization (matching space and facilities to strategic and operational needs²²), while providing an improved talent experience and value proposition for current and prospective employees who value autonomy and flexibility. This presents a rare opportunity as organizations can reduce real estate with minimal disruption by leveraging social distancing, and consider whether this is a viable option for extension as they emerge from the pandemic. Conversely, this will potentially drive the need for landlords and property management organizations to think differently about how they lease their office space and develop more flexible options to offer to their tenants.

Additionally, to aid in future-proofing the workforce, organizations should aim to achieve greater resource utilization through cross-skilling or cross-training employees. This will provide employees and organizations with enhanced flexibility moving forward, while helping to ensure the right moves are taken to prepare for the next market downturn. For example, cross-training marketing employees to be proficient across a number of different channels (B2B and B2C) or activities such as communications, strategy, and product development, results in diversely skilled employees and may enable improved talent redeployment options, such as crowdsourcing.

On the other hand, there are potential workforce changes that should be lifted as organizations return to business as usual. As the economy rebounds and profits return, organizations that halted promotions or bonuses should consider resuming non-monetary and monetary employee rewards, within reason, for the top contributors during the pandemic. Additionally, organizations that introduced voluntary unpaid leave programs for a specified period of time should prepare for employees' transition back into the workforce. Research shows that following the 2008 recession, two-thirds of employees remained disengaged from their jobs²³, which typically leads to lower performance. Organizations should engage employees by demonstrating appreciation for their participation in alleviating financial pressures during times of distress.

Ultimately, organizations can apply the lessons learned from COVID-19 to reimagine their ways of working. As the workforce transitions to the next phase, organizations can continue practices that increase flexibility, while halting the short-term compensation freezes, to emerge stronger on the other side and ensure costs remain within an acceptable threshold.

“ Organizations can conserve costs through real-estate rationalization, while providing an improved talent experience and value proposition for current and prospective employees who value autonomy and flexibility. ”





Optimize external-spend management

Organizations that have doubled down on contract management will continue to reap the benefits of better control of external spend. As organizations emerge from the pandemic and look for ways to sustain margins, they can potentially realize further benefits by investing in contract management technology solutions.¹⁷ Such solutions automate the contract lifecycle and provide organizations with contract performance analysis capabilities to provide better detection of cost anomalies. With these capabilities, organizations will be better placed to ensure that contracts yield their expected value and deliver sustainable savings. By automating the contract lifecycle, streamlining the processes, and putting in place the right measures (supported by accurate data), organizations can gain a cost advantage.

Additionally, organizations have the opportunity to address and enhance their spend policies as a result of COVID-19 changes. For example, the travel restrictions that are currently in effect enabled organizations to cut their travel and expenses (T&E) spend as a first step. These travel restrictions are likely to be lifted before the global economy fully recovers, however, organizations have an opportunity to tune their policies to keep T&E costs low once travel resumes. By introducing new expense policies or updating existing policies, organizations can reduce T&E spend by nearly 25 percent of their average spending limits.²⁰ This can be achieved by limiting ATM withdrawals, prohibiting automatic debit charges, increasing spend consciousness with more frequent trainings, and using a data-driven approach to identify violations or travel card misuse.

Whether it is investing in new solutions to optimize external spend or updating internal policies to stop costs from escalating, these moves will help to stabilize costs and position organizations for long-term growth.



Key risks and mitigation

- Increased data usage can bring concerns related to data security and privacy; organizations can emphasize their cyber security strategy, or create a strategy if one does not exist, and ensure consistent monitoring. When it comes to implementing digital solutions, the risk of inaction far exceeds the risk of action.
- Organizations must rethink transition support for their resources affected by workforce changes, as roles and responsibilities are inevitably disrupted across the organization.
- Organizations are at risk of increasing costs once they emerge from the pandemic, so they should put processes in place and follow best practices to ensure unnecessary costs do not creep back.



Conclusion

As the COVID-19 pandemic continues to unfold, organizations are faced with constantly changing realities. Economic activity will continue declining as businesses remain closed and consumers continue social distancing. However, organizations can adapt by taking control of their costs and preparing for continuing uncertainties. Those that can adapt quickly, tuning their current business models in light of the rapidly changing economic realities and consumer trends, while identifying the right offensive and defensive moves, will have a far higher probability of weathering the storm.

In five years from now, when you reflect on 2020 and the COVID-19 pandemic, how will you rate your organization's response?



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