Facing headwinds, finding tailwinds: How companies can build enduring value and stability through an economic downturn

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“Prediction is very difficult, especially about the future”

Signs of economic slowdown dominate the news: GDP has declined over two consecutive quarters. A once-in-a-generation disruption to geopolitics and the global systems that build and deliver physical products has pushed inflation to 40-year highs. Interest rates are rising, and stock markets are falling.

Some companies are playing defense with hiring freezes and calling out the potential impacts to revenue and profit. Many leaders report they expect a slowdown over the next 12 months.

Yet unemployment remains historically low, consumer spending remains strong, and corporate cash reserves are healthy.

Inconsistent signals and evolving market conditions create significant uncertainty, and today’s conditions make comparisons to previous downturns an incomplete guide.

So, while there is much discussion on the possible depth and duration of a coming downturn, or when it might begin, rather than guess about what might happen, the more important task is to focus on what leaders can do today to sustain enterprise value regardless of the challenges ahead.

What We Know

Recent headlines don’t tell the full story of what’s ahead. Elements of a downturn will likely be different than what we’ve seen in the past, in part because both the business environment has changed post-COVID and many enterprises have evolved as they’ve adapted to the significant shocks of recent years.

Companies can do more than brace for economic headwinds. The characteristics of companies that outperform their peers point to strategic and operational choices that help companies succeed—even amidst challenging times.

Leaders can prepare for a downturn and pave a path toward future success. While businesses will act to cut costs, manage cash flows, and invest in essential strategic initiatives, proactive moves can be made to focus on long-term value and market leadership.
The world is different, and so are you

The last few years have led companies to invest in new capabilities, innovate how they work, and incorporate new sources of value. The result: a foundation for resilience that can serve companies well if the economy slows.

**FOUNDATIONS OF RESILIENCE**

**DIGITAL TRANSFORMATION**

85% of CEOs prioritized digital initiatives during the COVID-19 pandemic, leading to increased workflow automation and improvements in how enterprises interact with their customers and their own workforce.

**WORKFORCE TRANSFORMATION**

Leaders embraced and implemented management practices and technology that enabled remote work and a more holistic view of contributions made across their workforce. As a result, many organizations are better able to respond to changing business environments while efficiently deploying critical capabilities.

**NEW VALUE DRIVERS: DEI and ESG**

71% of global private and public companies have moved beyond compliance to increase investment in DEI. Organizations implementing diverse hiring practices reported better decision-making and increased talent retention, as well as higher employee engagement with workplace culture. Enterprises responding to climate risk with ESG investments are boosting their revenues in the process, as 59% of those investing in ESG since 2020 reported higher revenue, and 48% reported increased customer satisfaction.

**Pandemic. War. Supply chain breakdowns.**

A confluence of macro-level conditions have altered the state of the world, and as a result, changed how companies operate.

Volatility and recent shocks have challenged enterprise operations. Legacy processes were fundamentally tested, and some companies face ongoing need to recalibrate their approach to changing circumstances.

**SOURCES OF VULNERABILITY**

**SUPPLY CHAIN DISRUPTION**

Pandemic lockdowns in China and the war in Ukraine extended global supply chain pressures, reduced manufacturing output, and limited shipping capacity by air and sea. Spillover impacts of the war exacerbated port congestion as average delays for shipping vessels doubled since 2019 and continue to disrupt distribution times. Furthermore, both governments and corporations face recurring challenges getting access to semiconductors, commodities, and energy.

**FLUCTUATING CONSUMER DEMAND**

Unpredictable pandemic cycles and rising inflation have increased volatility of consumer demand. Quarterly consumer spend has fluctuated more than twice as much since 2020 compared to the five-year period before the pandemic.

**TALENT SHORTAGES**

In the wake of the pandemic, voluntary resignation rates have grown to levels not seen in nearly 50 years, challenging organizational productivity and strategic planning. While digital tools and employee engagement enabled a transition to new ways of working, the “Great Resignation” reduced leaders’ ability to rely on tenured talent to foster productive, collaborative, and inclusive teams.

The next downturn will take place in a very different landscape than executives may have experienced in the past. Fortunately, Deloitte research has identified characteristics that grow enterprise value—even through periods of broad economic challenge.
What doesn't change: Two key dimensions of market leadership

Deloitte research identified a set of characteristics shared by companies that find enduring value through periods of disruption.\cite{DeloitteReference} We examined the performance of 500 large-cap public companies since 2016, plotted below, and found that long-term success is linked to the degree to which enterprises exhibit strength along two dimensions: the ability to win and the capacity for change.

Research shows that economic disruption can reorder the competitive business landscape, as actions taken in a downturn can amplify strategic successes and errors.\cite{EconomicDisruption} Given this finding, we sought to answer the question: how do successful enterprises build value and ease volatility through challenging times?

Through Q2 of 2022, our data showed that leading enterprises, those exhibiting the highest degree of “ability to win” and “capacity for change” report higher valuation and lower volatility than lagging enterprises, defined as those that fall below the median on these dimensions. Leading companies have sustained a competitive advantage through a range of disruptors, including economic shocks and supply chain disruptions.

From 2016 to 2022...

Leading enterprises drove...

- Higher Forward P/E Ratio* 50%
- Lower Share Price Volatility* 18%

than lagging enterprises

Methodology: Companies are given “Ability to Win” and “Capacity for Change” scores, based on their performance across several parameters correlated to each characteristic as indicated in public statements and filings. Parameter scores are industry-adjusted and factored together to create composite index scores for ability to win and capacity for change. An index score greater than 50 (out of 100) indicates that a company is performing better than the median company in its industry in that dimension.

*Value and volatility values are calculated from averaging 2016–Q2 2022 Forward PE and Share Price Volatility, respectively, comparing enterprises in the top versus bottom quartile of average ability to win and capacity for change scores.
Putting it in practice: Enhance the “ability to win” and “capacity for change”

Enterprise leaders can apply the findings of this research to our current moment even as the specific contours of what the economy has in store remain uncertain. Any downturn would of course require real-time cost and cashflow management, consistent stakeholder alignment, and a clear understanding of how to maximize the scale of shared services models. Shifting from defense to offense, though, we see important opportunities for business leaders to activate enterprise value.

As previously noted, periods of economic challenge can lead to a reordering of the competitive landscape. What transformative growth options do you see to drive your long-term strategic positioning?

How can you transform your competitive position by acquiring new capabilities and exploring new revenue sources that will:

- Accelerate digital transformation and build “as-a-service” plays to capture new revenue?
- Capture cross-sector convergence opportunities to create new products, IP, and new market segments?
- Increase customer centricity through new go-to-market models, channels and user experiences enabling better customer interactions, richer data analytics, and consistent customer value?

Putting it in practice:
Enhance the “ability to win” and “capacity for change”

As previously noted, periods of economic challenge can lead to a reordering of the competitive landscape. What transformative growth options do you see to drive your long-term strategic positioning?

How might you permanently increase your productivity through:

- Advanced analytics and AI / machine learning to improve internal decision-making and capital allocation processes?
- Inventory management with dual focus on supply chain resilience and efficiency informed by real time customer analytics and supply data?
- Selection of leaders empowered to drive business model transformations through data-driven insights that enable bold decisions to increase return on invested capital?

Today’s volatile conditions such as supply shocks, unpredictable demand, and labor shortages require leaders to rethink how enterprises can improve their ability to sense, respond, and adapt to change. What options for investing in new talent and technology will enable a new level of productivity and higher return on invested capital?
Next steps

What can leaders expect in coming months? Each new release of economic data revises forecasts and generates new headlines, yet the outlook remains unclear. We expect change to continue and cannot predict when broad economic recovery might begin. To navigate confidently through the coming business cycle, leaders should incorporate these recommendations into their specific operating environment and enterprise strategy.

To prepare to find the tailwinds that could help propel performance beyond the current cycle, leaders may want to consider:

**TALENT AND ORGANIZATIONAL ASSESSMENT**
Perform holistic workforce scenario planning to support business operations and ensure deployment of critical capabilities through a downturn cycle. Identify opportunities to employ alternative talent models that enable adaptability to changing market conditions.

**COST TRANSFORMATION**
Identify cost containment, new financing, and liquidity management opportunities to sustain strong operational performance and position for opportunistic investment in strategic, high-growth initiatives.

**M&A READINESS**
Identify opportunities to respond to or capitalize on market changes by integrating new capabilities or divesting non-core assets, or selecting purpose-led alliances aligned to ESG-led transformations.

**MARKET SENSING AND SCENARIO PLANNING**
Improve enterprise resilience through assessment of existing capacity to sense and respond to changing market conditions. Considerations for scenario planning might include consumer sentiment and spend, demand sensing, and supply chain planning.
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