CEO Mission: Lean into the unknown

Amid enormous uncertainty, leaders must maneuver through the unprecedented COVID-19 shock, prepare for recession, and make bets on future strategy

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Efforts to contain COVID-19 have resulted in a uniquely rapid and deep economic slowdown. But the experience from previous downturns applies: companies that take aggressive (yet thoughtful) action to prepare for a post-recession world do far better than ones that simply ride out the storm. Even as CEOs are stabilizing their businesses, it is not too soon to position their companies for success in a very different world.

Introduction

Suddenly, we are living in a time of radical uncertainty. Nobody has a clear line of sight into the impact of the COVID-19 pandemic on the U.S. and world economies. We're consumed with keeping our people, families and communities safe. Yet CEOs cannot wait to plan and act--and do so before we know when the COVID-19 emergency will end or have a fix on the likely severity of the looming global recession.

This is a moment no CEO expected. The global pandemic and the deepening economic impact are developments of historic proportions, yet without clear historic precedent. Leaders will need courage and imagination in the coming months.

In this paper, we focus on three perspectives to help CEOs:

The future favors those who act

While the COVID-19 shock is unprecedented, there are proven approaches from previous recessions that apply today. Above all, we know that companies that remain inwardly focused and defensive are the least likely to survive or get back to where they were before COVID-19.

We are in uncharted territory

The speed and depth of this economic contraction are unique. One of the biggest questions among our clients now is how this will alter patterns of demand after the emergency has passed and how relationships with customers will change.

Building a robust response amid uncertainty

We believe that as companies plan for the post-COVID-19 world, the two most important factors shaping strategic options will be access to capital and the "inertia" or stickiness of their customers. Strong customer relationships will be critical for adapting to new patterns of consumption and ways of doing business (e.g., meal delivery, rather than restaurant dining).

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The key lesson from previous downturns

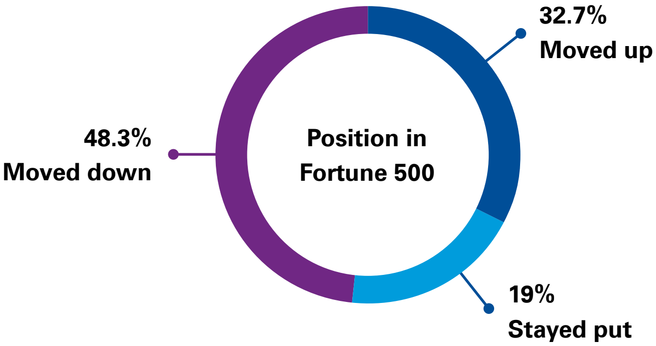
Companies need to act aggressively—yet thoughtfully

We know from past recessions that the companies that simply pull back and wait for the storm to pass do not do nearly as well as companies that focus on the future and act decisively. Forward-looking companies use downturns to gain share over weaker competitors, build new capabilities, enhance customer relationships, and innovate with new products, services and processes. They are agile, aggressive, and opportunistic; they do better in recession and go into overdrive afterwards.

Companies that do not mount an aggressive response to recession may survive, but they are more likely to be among the companies that lose ground. In the Great Recession following the 2008 financial crisis, KPMG research found almost no correlation between returns of companies before and after the recession; a pre-recession top performer was as likely as any other company to wind up in the ranks of poor performers in the recovery.[1] Indeed, nearly half the companies in the Fortune 500 fell in rank (Exhibit 1).

Companies have more to lose than their Fortune 500 ranking: inwardly-focused companies are more likely to seek bankruptcy protection, be acquired, or never return to pre-recession levels of success. However, big bold bets are not the complete answer, either. Companies that pursued growth in the 2008-09 recession but failed to do the hard work to control costs had highly variable results, averaging 6.2 EBITDA growth over the three years after recession vs. 4.4 percent for purely defensive companies, according to Harvard Business School research.[2] A small share of companies --less than one tenth of the Harvard sample—used a balanced approach, combining performance improvement with ambitious forward-looking actions; they averaged 12.2 percent EBITDA growth over the first three years post-recession.

Exhibit 1. Among Fortune 500, no relation between pre- and post-recession performance



Note: Fortune 500 data, 2006-10.

[1] KPMG analysis looked at relative TSR (total shareholder return) performance for the 2006 Fortune 500 during the period of 2006-2010. Data was not available for all companies for all years.

[2] Ranjay Gulati, Nitin Nohria and Franz Wohlgezogen, "Roaring out of Recession," *Harvard Business Review*, March 2010.

This is uncharted territory—for the economy, companies, and customers

We can understand why it is difficult to think about the world beyond the current disruption--nobody has seen this before. By April 1, more than three-quarters of the U.S. population were "sheltering in place" to contain the pandemic and many types of commerce had come to a standstill. KPMG economists estimate that U.S. consumer spending dropped 30 percent in March and could fall 75 percent in April.

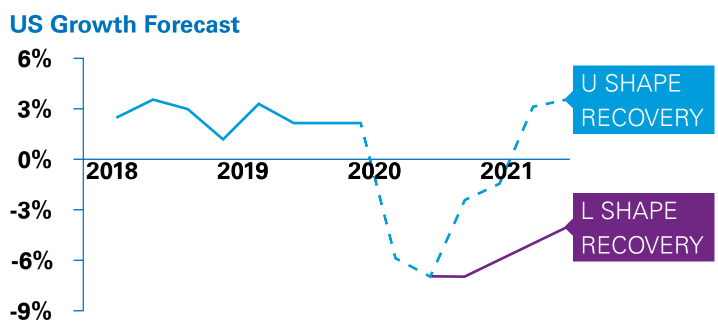
What should CEOs be planning for after the COVID-19 pandemic is under control? Early hopes for a V-shaped recovery—a steep drop in GDP followed by an almost equally rapid rebound—have faded. The best hope now is for a U-shaped recession, a shallower but longer-lasting downturn, according to KPMG economists. Their model shows U.S. GDP falling from the first quarter of 2020 through mid-2021, with total output down 4.9 to 5.5 percent for the full year 2020 and 1 percent in 2021 (Exhibit 2).

The L-shaped recession is the worst-case scenario—a sharp drop in GDP followed by years of minimal growth. An L-shaped recession is typically the result of a credit crisis—like the 2008-09 U.S. recession that followed the housing crisis or Japan's "lost decade," following its credit-bubble collapse in 1989 (Exhibit 3). The longer the COVID-19 lockdown lasts the greater the chances of an L-shape downturn. It is important to remember that countries will go through recession and recovery on different timelines, which will affect recovery for U.S.-based companies that rely on overseas markets and supply chains and will affect offshoring decisions.

Uncertainty about the path of the economy is not going to go away anytime soon. Even so, companies can start planning for a post-recession "new reality." The COVID-19 crisis is likely to accelerate certain trends that were already underway, such as the shift from bricks-and-mortar retail to e-commerce. It is also likely to accelerate changes in ways of working that are being adopted now and may continue after the COVID-19 emergency has passed.

For example, teleworking and reduced travel for face-to-face meetings may become to new norms. This has implications for technology and communications suppliers as well as public transit, airline travel, and aerospace. Consumers, meanwhile, might permanently adopt behaviors such as ordering groceries and meals online and avoiding trips to the mall. Across consumer and B2B markets, we expect that digital customer connections will become even more important.

Exhibit 2: Two recession/recovery scenarios



Note: Forecasts are inherently time sensitive and projections are dated as of March 19, 2020.

Source: KPMG Economics, BEA, Macroeconomic Advisors by IHS Markit, Haver Analytics

Developing a robust and winning response to the downturn

The range of choices companies have to rewrite their futures during a downturn depends a good deal on their starting positions. But we believe that companies that start developing plans for improving profitability, gaining share, and entering new markets—no matter where they start–will come out ahead. In this chapter, we describe a way to plan the strategic moves during the recession as well as actions needed now to withstand the impact of COVID-19.

Assess your starting position

The framework below (Exhibit 3) shows how companies are positioned on two critical dimensions: access to capital and customer inertia, which is the degree to which customers will tend to continue to buy products or services from a company. When companies have low inertia, customers can stop buying easily and are likely to do so whenever a better offer emerges.

We make customer inertia a central theme of our analysis because we believe that one of the great strategic challenges will be understanding how customer behavior will change in the wake of COVID-19 and the recession. That understanding will build the customer inertia that not only allows the company to keep selling existing goods and services, but also gives it "permission" to move into new markets or lines of business.

Exhibit 3: CEO action matrix

Access to capital: High / Low

Leverage capital
position to improve customer inertia
Strategic Questions:
- What new products / services can I offer to improve my customer relevancy?
- Is an organic or inorganic strategy better given our strong cash position and competitive dynamics
- What technologies matter to my business?

Seize opportunities
to expand advantage through capital deployment and customer fulfillment
Strategic Questions:
- How do I use this downturn to protect and expand my customer relationships?
- What additional spaces / geographies can I move into? Can I move into them or do I need to buy into them?
- What is the right balance approach to use given all the uncertainties in the market
- What is the right balance between performance improvement and investment, given the uncertainties in the market?

Create optionality
given capital and customer constraints
Strategic Questions:
- What business units should I sell for cash? Should we consider selling the entire company?
- How deeply can we cut costs without limiting future choices? What happens if we don't make cuts?
- Which customers do I need to focus on? Can I drop unprofitable customers or charge them more?
- Should we sell the company

Optimizers
without hurting or risking customer relationships
Strategic Questions:
- Should I sell non-essential assets?
- Which functions can I target for cost improvements with minimal risk to customers?
- Is my CAPEX plan aligned to the new environment?

Low — Customer inertia — High

Note: Forecasts are inherently time sensitive and projections are dated as of March 19, 2020.

Source: KPMG Economics, BEA, Macroeconomic Advisors by IHS Markit, Haver Analytics

Moving up (improving access to capital)

Access to capital is critical now, to fund operations when the COVID-19 lockdown has choked off income (see "Stabilize" below), but it is also essential for rebuilding growth strategy during recession. The ways to improve access to capital are well known:

- Pursue performance improvement, starting with projects that are less capital intensive and can improve free cash flow quickly.
- Divest non-core assets.
- Use this as an opportunity to adjust pricing and service levels.
- Refinance debt.
- Free up working capital by tightly managing expenses.
- Rethink large capital programs.
- Access tax and government aid opportunities, where possible.

Moving over (improving customer inertia)

The unique customer element of this crisis is emphasizing the need for strong actions that improve the company's hold over customers. In the months since the crisis began, we have seen a range of creative responses that not only shore up fragile customer positions, but create opportunities for long-term value creation.

Accelerate direct-to-customer offerings

- With the COVID-outbreak, Chinese cosmetics company Lin Qingxuan closed nearly half of its retail locations. Rather than wait to re-open stores, the company redeployed its store-based beauty advisors as online influencers, who now reach customers via digital apps, like WeChat. As a result, its sales in Wuhan jumped 200 percent.
- Faced with more, rather than less, demand, some healthcare providers are handling the surge by accelerating digital transformations. Sanford and Essentia, two Great Lakes hospital networks, have launched tele-health options for their patients, and have added features to their electronic medicine portals to serve their customers at home.
- While its stores are closed, a major home-goods chain is spending $250 million on strategic growth, including investments in digital capabilities, such as improving the buy online/pickup in store process. This effort is intended to pay dividends long after the crisis is over.

Update go-to-market models

- Online car-buying has been growing emerged in recent years, but adoption has been largely outside traditional new-car sales—with companies such as Tesla and used-car platforms such as Carvana. Now enterprising new-car dealers are racing to catch up, embracing new models to reach customers in their homes. Rather than only offering online evaluation and selection, dealers are trying to match the end-to-end e-commerce capabilities of the upstarts, including curbside delivery.
- Tock, a reservation platform for high-end restaurants, quickly built out order-taking capabilities as the crisis deepened, increasing customer usage of the platform at a time when restaurant visits are impossible. Long-term, this opens new revenue streams for both Tock and the high-end restaurants on its platform.
- Zoom, the popular videoconferencing platform, is providing unlimited free use for K-12 schools across the world. The company is investing in education-specific features like lecture-friendly camera angles. On top of providing invaluable services today, this approach unlocks a whole new industry segment outside of Zoom's current corporate base.

Support customers

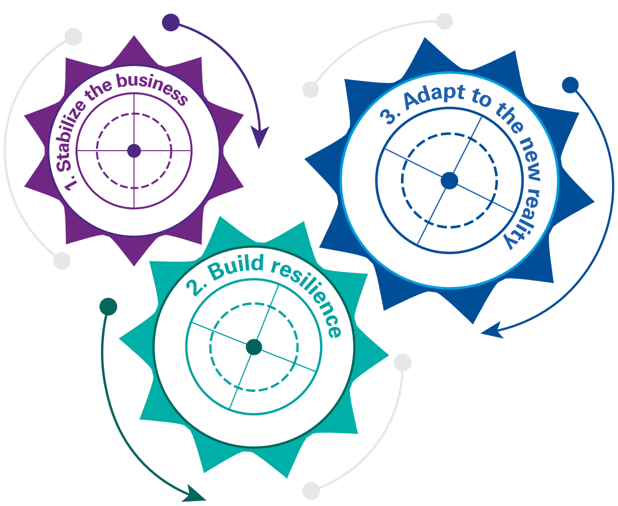
- Facebook is launching a broad relief program for small businesses that use the platform for advertising. The company is providing over $100 million in cash grants and advertising credits to 30,000 small businesses across the world. Grants can be used off-platform for rent and other expenses. Facebook has created a small-business learning hub, offering free resources and training.
- To support independent restaurants shuttered by COVID-19, Grubhub announced plans to waive $100 million in fees for independents and give them optimized app placement. Other meal-delivery platforms have made moves.
- Walmart and Amazon suspended payment obligations for sellers in their stores through April 30. Walmart is not collecting rent from the 10,000 businesses that operate within Walmart stores and Amazon Lending is pausing payments and interest accrual for loans.

Action plan: Stabilize, build resilience, prepare for a "new reality"

In the coming months, companies will make difficult decisions about how to cut costs and continue to operate. Companies that want to exit the recession in fighting shape will make these decisions with an eye to the future—taking strategic cuts rather than across-the-board reductions, maintaining investments in R&D, streamlining and automating processes. To prepare for new post-recession market realities, they will also frame these decisions around building capital and improving customer inertia.

A robust response involves three linked steps: stabilizing the business, building the resilience to manage through recession and developing strategies for a new post-recession reality (Exhibit 4). The overall effort should start with transparency about the company's financial and operational performance. Use data analytics to truly understand sources of value and value leaks—and back up the analysis with insights from managers on the front lines. In this environment, the pace of decision making also must accelerate. Eliminate layers of decision making and use simulation tools to test decisions. The COVID-19 SWAT teams that companies have set up can be a model for the agile decision making that can help throughout the recession—and beyond.

Exhibit 4. Three coordinated steps in a robust response to recession



1 Stabilize the business	2 Build resilience	3 Adapt to the new reality
Immediate actions that preserve cash, give confidence to customers and employees and ensure business continuity. Must be revisited throughout the disruption.	Performance Improvement actions to make it through the disruption and maximize options in the face of uncertainty.	Actions resulting from the development and evaluation of scenarios that lead to the business model the company will need in the new reality.

Note: Forecasts are inherently time sensitive and projections are dated as of March 19, 2020.
Source: KPMG Economics, BEA, Macroeconomic Advisors by IHS Markit, Haver Analytics

Stabilize the business

The most important priority is getting a handle on liquidity. Beyond securing the cash needed to continue operations, companies that have good liquidity now will have more choices as the downturn continues. Today, the U.S. does not face the kind of debilitating crisis in the financial system that chokes off credit, as happened in 2008. But some sources of funding, such as high-yield bonds, are closed off. Companies should carry out thorough and rapid diagnostics to understand their cash positions and make plans to preserve liquidity. They should be tapping lines of credit and revolving loan facilities. Some companies are cutting dividends to preserve cash. Others are creating cost "control towers"—committees made up of top executives who meet weekly to review all spending and spending policies.

Build resilience

Inevitably companies will have to bring costs in line with recession market conditions. This is a good time to address performance-improvement issues, to make processes as efficient as possible, reduce waste, and drive revenue. Headcount, of course, will be a consideration. While the COVID-19 lockdown is in effect, there may be access to government support (to companies and employees), many companies will still need to trim headcount permanently after the COVID-19 crisis passes.

Right-sizing for recession should be done in ways that allow the company to retain and develop critical talent and capabilities.

Companies will need more creativity, more agility, better teamwork, not less. Creative approaches to talent—redefining roles, job-sharing, flexible work arrangements—can help companies remain whole and do a better job for customers. Firms that that cut too soon or too deeply will have a harder time growing during recession and afterwards.

Some companies will want to consider sales of non-core assets as part of their recovery strategies. Divestitures can help sharpen strategic focus and provide money to sustain and strengthen the core.

Adapt to a "new reality"

Using scenario planning, companies can build a picture of the post-recession environment. These scenarios should take into account the trends that can already be seen, such as changes in workstyles, as well as changes in the global business environment.

In general, companies may want to double-down on initiatives that improve digital connections to customers (in B2B and consumer markets). Where possible, companies may want to start thinking about acquisitions that would help them move into adjacent markets or new lines of business. If globalization is going into reverse and if the U.S. and Chinese economies are about to decouple—as some economists expect—companies will need to rethink overseas market opportunities and supply chains. Finally, companies should think about what it will take to make their companies more resilient to future shocks, such as natural disasters and future disease outbreaks. Such threats will be part of the future landscape, too.

How we can help

It will take a disciplined and methodical approach—and courage—to protect businesses in the next few months and prepare for what could be many quarters of negative or slow growth. KPMG is working with clients in this difficult time to identify strengths and vulnerabilities and build strategies for recovery. We can assist you to identify and implement strategies to preserve liquidity, improve financial performance, and set the stage for future growth.

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Talley has nearly 20 years of consulting experience working with clients across industries, including industrial goods, airlines, medical technology, health care, telecom, and automotive. He has specialized in operational transformation, including cost reduction (reorganization/delayering, headcount rationalization, procurement), sales growth (adjacent growth, pricing, sales force effectiveness, channel management), and talent management. Talley also has extensive experience in corporate growth strategy and business development, M&A (including strategic due diligence and post-merger integration), and business model innovation.

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