POWER GROWTH… THROUGH A DOWNTURN

As a business leader, you should always be focused on your organization's long-term growth. However, when a potential recession is looming, it is easy to lose sight of long-term priorities and instead, focus more imminent risks. Conversely, when times are good, you may overlook opportunities to position your organization for an eventual downturn, concentrating instead on serving a still-robust pipeline of customers.

If either of these mindsets rings true for you, now is the time to focus your energy and resources on powering a sustainable, profitable future. A continuous growth mindset will serve you well, regardless of where we are in the economic cycle.

Whether the start of a recession is two months away—or two years away—it is never too early to take steps that will protect your organization from a downturn and establish a strong foundation for sustainable, long-term success. But there is risk in acting too late. That is why you should put a plan in place now to increase your operational efficiency, optimize your client base and strengthen your financial position.

At BDO, we have experience advising companies through all phases of the economic cycle, and we know that continuous progress is critical for surviving periods of uncertainty and change. In this report, we identify several steps businesses can take now to not just survive but thrive during a possible downturn, as well as in the years to come.

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More than 70% of economists expect the United States to enter a recession by the end of 2021, according to an **August 2019 survey** by the National Association for Business Economics. At this late stage of the economic cycle, *it may seem like exactly the wrong time to think about investments that would improve your operations or strengthen your balance sheet.* A recession may lead to budget cuts or layoffs, which would mean fewer internal resources to allocate to analyzing processes and work streams. At the same time, lower demand for goods and services could put pressure on your margins and create a more competitive industry environment.

In fact, many companies will respond to these pressures by taking what may seem like a safe approach. They will tighten budgets, take fewer risks on new ideas, make less investment in new technology and hope to ride out the rough seas. Beware that a passive approach puts your organization at the mercy of the prevailing economic winds and gives you little control over where your company is headed.

Savvy companies, on the other hand, are proactive in the face of a downturn. They reassess priorities and take steps to keep their organizations moving forward. While continuous improvement is always valuable, a proactive approach to increasing efficiency may be even more important when top-line growth is slowing. Operational weaknesses that might have been masked by a few extra employees or looser budgets can become critical flaws in highly competitive environments. In addition, there is an opportunity cost to inaction, as an assertive approach to finding and keeping clients during a downturn may allow you to gain market share from less-prepared competitors.

Balance Cutting with Investing for Long-Term Growth

Following the merger of Heinz and Kraft in 2015, the combined company began cutting costs in an effort to increase profitability. These cuts prevented the company from investing an adequate amount in innovation, and as a result, it "struggled to improve its products to satisfy shifting consumer tastes," as noted in **The Wall Street Journal**[1]. Four years later, the food maker reported falling sales and net income, booked an impairment of $15.4 billion in February 2019, one of the largest in corporate history, and wrote down the value of its brands by another $1.2 billion in August 2019, as the stock fell to an all-time low.

This stark example underscores how companies that focus on short-term savings at the expense of innovation can get trapped in a vicious cycle of cost-cutting that ultimately reduces their competitiveness. While some budget reductions may be necessary during a downturn, a better way to remain viable for the long term is to combine highly targeted and strategic cost-cutting with similarly precise investments in technology and innovation.

This discipline to keep improving during a downturn offers a significant competitive advantage, as it will not only yield results in the short term, it will also continue to drive growth over time. A **Harvard Business Review study** of recessions during the past few decades found that only 9% of almost 5,000 public companies actually flourished during those downturns, outperforming competitors by 10% or more in sales and profits2. What did the 9% do right? They not only cut, but they rebalanced their remaining spending to focus on strengthening long-term goals.

For example, in the office supply space, Office Depot and Staples took different approaches leading up to and through the 2000 recession, according to the Harvard study. Office Depot cut 6% of its workforce but wasn't able to significantly reduce operating costs. In contrast, Staples closed some underperforming facilities, but increased its workforce by 10%. By 2003, Staples had doubled its 1997 sales figure, and in the three years following the recession, Staples' profits exceeded those of Office Depot by an average of 30%[2].

1 The Wall Street Journal. Haddon, H. and Maidenberg, M. August 8, 2019. "Kraft Heinz Writes Down $1.2 Billion as Brands Wither." https://www.wsj.com/articles/kraft-heinz-books-1-22 billion-in-impairment-charges-11565267075

2 Harvard Business Review. "Roaring Out of Recession."

Seize Opportunities—Small or Large

While no one ever hopes for a recession, a downturn often offers a window of opportunity for an organization to make meaningful positive change. When operations aren't running at maximum capacity, it may be easier to shift personnel and other resources to improvement efforts without cannibalizing core business operations. Furthermore, declining revenues and cash flows may highlight the need for change and make employees more open to digital or other transformations that increase efficiency.

You don't need to completely transform your operations to strengthen your business. Below we offer several simple ideas for small steps that can lead to meaningful improvements.

1. **Challenge the status quo.**
Critically examine what you do, how you do it, and why you do it that way. Discover your biggest operational pain points, such as where you spend the most time, where processes overlap or where one team holds up another. Identify what systems and processes can be improved.

2. **Align your initiatives and resources with your most important goals.**
Take a strict stance to pursue only those projects that support your highest-value customers, products and services. You may need to make tough decisions, including saying "no"— or "not now"—to some projects that are lower on your priority list. Then, focus everyone's efforts in the same direction through clear internal communication about what is most important and why.

3. **Leverage technology tools.**
Today's technology market offers a range of relatively inexpensive automation tools that can generate efficiencies. Within finance or accounting departments, in particular, there are ample opportunities to eliminate manual data-entry processes and integrate redundant existing systems. In addition to making smart investments in new technology, look to use your existing tools to their full capacity. Consider whether employee training or simply asking your vendors for guidance, can help you use those tools to solve additional problems or gain valuable business insight. This will help you get a better return on the technology investments that you have already made for.

4. **Add flexibility.**
You may want to take advantage of opportunities to convert some fixed costs to variable ones. Although shorter contracts, leases or subscriptions may be more expensive on a per-unit basis, they can provide valuable flexibility to reallocate resources in an uncertain environment. Similarly, outsourcing some roles may make it easier to quickly retool your team to adapt to an evolving business outlook.

5. **Line up credit facilities.**
You may have heard the old adage that the worst time to starting thinking about getting a loan is … when you need a loan. Before a downturn starts to weaken your cash flow and balance sheet, establish and maintain strong relationships with lenders. Learn the debt-to-equity requirements, as well as how much flexibility you might have in the event you would need it. Then, monitor the risks to your balance sheet.

THE POWER OF DATA: USING ANALYTICS TO DRIVE YOU THROUGH THE NEXT DOWNTURN

In a recession, it is easy to become fixated on declining revenue and the resulting impact on your balance sheet. But these figures provide only a surface-level description of your company's financial position and trajectory. For the full picture, you need to dig deeper into your data. By employing robust data analytics, you can better understand the details of costs and revenue across your organization and gain valuable insight into the factors that drive profit margins. While you can't control the ups and downs of the broader economic environment, you can leverage your data to gain control over your profitability.

Turn Data into Actionable Insight

By taking into account all the factors that impact your profit margins, including how they interrelate, you can make fact-based decisions—about what to sell, how to price it, which clients to target and when—to maximize growth.

For example, a retail product manufacturer that wants to allocate its production capacity most efficiently should examine the sales and profitability data of its entire product line. The company might learn that most of its sales of one product occur in conjunction with the sale of a better-selling, complementary item. That insight might lead to a decision to strengthen cross-selling efforts rather than discontinue production of the poorer-performing product.

Follow a Proven Approach to Building Analytics

Data analytics has the potential to provide powerful business intelligence. However building a data-analytics process that will deliver a tangible return on investment (rather than serving as something like a science experiment) isn't as simple as adopting a new technology tool. Most important is putting the right foundation in place, including the right organizational infrastructure. Following are the key steps to using analytics to drive profitability:

- **Step 1:** Collect and analyze your organization's data. Examine all your processes, with the aim of understanding how long they take and the resources they use, including any interdependencies. At the same time, examine your internal resources, such as technology tools and the expertise of your in-house professionals. Create a complete picture of your profitability drivers, so you can identify your highest-yielding products and services, employees and customers, as well as your least-profitable areas.
- **Step 2:** Develop a plan to exploit strengths and address weaknesses. Create sales and marketing strategies to grow your highest-margin segments. Decide where investments—in training, tools or technology—are needed to support those efforts. Spell out how you will mitigate the impact of unprofitable activities, whether by scaling back or eliminating them from your operational portfolio.

Case Study: Bank's Investment in Analytics Raises Customer Retention and Lowers Risk

Situation: A bank was losing a significant portion of its retail customers each year. When the lifetime value of these customers was calculated, the bank realized that the financial impact was considerable. Moreover, the bank determined that improving retention rates was not only promising from a financial perspective, it was achievable from a data perspective; the bank had access to adequate historical data to power a machine learning model to strengthen retention.

Solution: The bank developed an advanced data-analytics model that identified a combination of behaviors—such as transferring money out of the bank or a sudden slowdown in account activity—that signaled that a customer was likely thinking about closing an account. Using that intelligence, the bank gained accurate foresight into customer retention risks. The value of this insight is both tactical and strategic. From a tactical perspective, bank employees now have a scalable way to filter through thousands of account-holders to identify the most at-risk clients. From a strategic perspective, there are future opportunities to mitigate retention risk by analyzing historical data about which demographics, products and behaviors are associated with high churn. The anticipated ROI and value of this data-driven insight has been more than met.

- **Step 3:** Identify key performance indicators (KPIs) that align with your strategy. The executive team needs to determine the internal and external metrics that are most meaningful and then determine target levels, as well as acceptable ranges. The right set of KPIs depends on your organization's specific goals. Many companies use sales leads, conversions, contracts, revenue growth, operational cash flow as well as profitability. Compliance with regulatory requirements or other business risks might also be useful. In addition to internal metrics, you should determine which global, national or industry-level benchmarks represent reliable leading indicators for your business.
- **Step 4:** Establish data governance and infrastructure. Business units won't apply insights from data they don't trust. That is why it is critical to set up the right internal infrastructure, with the right talent and processes, to generate reliable KPIs. This involves creating a roadmap that identifies the tools you will need to implement to predictive analytics and spells out how you will incorporate them. Establish a partnership between your technology team and business stakeholders to formalize data governance rules, including where individual data components will be found, how KPIs will be collected and measured and in what format they will be reported. Put procedures in place to ensure that these rules evolve as needed to account for operational or market shifts, so KPIs remain reliable and aligned with business realities.
- **Step 5:** Build the right team. As with any important initiative, it is essential to have the right people in place to execute the plan. Your technology team should include a data architect who understands scalable, secure utilization of data and can create a roadmap for getting from your current state to where you want to go. Other key roles include data engineers, project and program managers as well as a business analyst who can translate the data insights into a clear business story for your leadership team. If your existing technology team doesn't have these skills—or is managing a full work load already—you may want to leverage external resources to fill in any gaps. Working with outside partners to address any missing skill sets can be an efficient and cost-effective way to access the resources you need to manage this transition.

Case Study: Retail Food Operation Modernizes Analytics to Gain Insight

Situation: A food retailer was outgrowing its in-house business intelligence solution. The company recognized the need to modernize its analytics architecture and ecosystem, due to evolving product offerings and marketing initiatives, as well as new demands for operational insight.

Solution: The company invested in modernizing its data analytics technology and updating its visualization tools to align with the company's expanding geographic reach and operational performance. Armed with these modernized insights that drill down to the appropriate level, the management team is now equipped to use data to increase revenue, decrease costs and mitigate risks.

SCORING PROFITABILITY POINTS: APPLYING THE 80/20 RULE AHEAD OF A RECESSION

Business leaders often assume that more business means more profits. But not every transaction adds equal value to the bottom line. Across industries, nearly every company and non-profit organization, is subject to the Pareto Principle, also known as the 80/20 rule, which states that roughly 80% of effects come from 20% of causes. In a business context, evidence of the principle often appears across multiple dimensions. Most of your revenues come from a limited number of products and services. Most of your sales can be attributed to the efforts of your best performers on your sales team. Most of your profits are generated by a relatively small subset of customers. Most of your supply chain value is delivered by a select handful of vendors.

When companies start to struggle financially, they often look to strengthen the weakest links. But the 80/20 rule suggests the opposite approach. Rather than spending limited resources to improve the least-profitable segments, or to shore up all segments equally, you should focus on enhancing those that you know will have the biggest positive impact on your bottom line.

Even if you have already initiated a continuous improvement program intended to eliminate waste and defects, such as lean manufacturing or Six Sigma, an 80/20 lens adds value by helping direct those efforts where they will have the greatest impact.

While it is always valuable to look for opportunities to apply 80/20 thinking to your business, it is especially important do this before a downturn starts. The best time to sharpen your focus on your most profitable customers, business lines and markets is before the economic environment becomes more challenging. Not only will this help you weather the storm, it will enable you to act from a position of strength while your competitors may be struggling to survive. During a downturn, companies that have implemented 80/20 principles will be positioned to continue moving forward—including gaining market share and adding talented professionals from companies that haven't been disciplined about focusing their efforts.

Find 80/20 Insight in Your Data

The foundation of an 80/20 approach is a sound data analytics capability that generates reliable KPIs. You can use those measures to quantify the relative profitability of each of your customers, products and services, employees and processes. At the same time, your data holds clues about the factors, or combinations of factors, that contribute to the profitability or performance of each.

Case Study: 80/20 Approach Increases On-Time Delivery from 22% to 95%

Situation: A manufacturer and developer of marine and power sports accessories had an on-time delivery rate of just 22% for product-development projects requested by customers. An 11-person team handled an average of 100-130 engineering projects at one time, including the project management responsibilities. Engineers felt overworked and overwhelmed.

Solution: The leadership team considered adding additional engineering staff, but after analyzing operations through an 80/20 lens, they took the opposite approach. They stopped accepting product-development projects for all but the company's most-profitable customers. That step immediately reduced their active project list by more than half.

The company further simplified the product-development pipeline by centralizing project management responsibilities among just two people on the engineering team, who received appropriate advanced training.

By improving the efficiency of its engineering processes, the company increased its on-time delivery rate to 95% for its most profitable customers. And with more time to focus on high-priority projects, engineers developed more creative solutions. The company, which had held a single patent for the prior 40 years, applied for 11 patents in the first 12 months after implementing the 80/20 approach.

Invest in Motivating and Equipping Your Top Employees

Because an equal investment in all employees will yield unequal results, let your data about the relative performance of individuals and teams guide your decisions about where and how those resources should be allocated.

Identify employees with the greatest aptitude, then develop customized development programs to help them reach their full potential. Give your super-star performers the additional incentives and tools they can use to build on their success. And just as you critically examined your lowest tier of customers, determine where you might need to sever ties—or whether a relatively small investment of tools and training might make these employees more valuable.

Reduce Complexity in Your Supply Chain

For many years, businesses favored a multi-source approach as a way to manage risk and encourage price competition among suppliers. But a supply chain that is larger and more complex than you need is inefficient. When you use an 80/20 lens to consolidate spending among your best vendors, you may be able to optimize inventory levels and leverage greater volume discounts, freeing up additional capital you can invest more strategically.

Replicate and Build on Success

In addition to revealing your most profitable products and services, customers and employees, your data can also help you expand each of those top tiers. Dig into your data to identify the factors that contribute to the success of your best performers. Combine that insight with an 80/20 view to make decisions about which new products and services to add to your operational portfolio, which prospective customers to target and which job candidates to select or recruit.

Focus on Flawless Execution

The 80/20 concept isn't new—it was coined in 1895—and it isn't complex, but understanding a principle doesn't guarantee that you can apply it successfully. Most people know that losing weight "simply" requires burning more calories than you consume, yet most of us still struggle to shed extra pounds. It isn't enough to make a few changes in behavior or add some tasks to employees' to-do lists. Long-term success hinges on executing well and consistently over time. The best results are achieved when 80/20 thinking becomes ingrained in the company culture, so it guides decisions large and small.

That shift in mindset across the organization starts from the very top—with buy-in from the C-suite and as a part of the strategic planning process. But all employees should understand what needs to change, how they can further the goals and how the changes will affect them. Create a detailed action plan that spells out quantifiable metrics and the teams that will drive each of the top objectives. Maintain rigor and accountability by instituting regular reporting on progress. And equip employees with the training and time they need to learn to take an 80/20 view, to see old processes in a new way.

Small and mid-sized companies with limited resources may want to consider engaging an external partner with expertise in 80/20 principles to help develop and execute a plan that aligns with your organization's goals. At a time when internal resources might be stretched thin, an external partner represents flexible additional bandwidth. In addition, the objectivity of an outside perspective can be invaluable when evaluating your company's strengths and weaknesses, in particular to overcome any potential emotional connections to customers, suppliers or products that don't support the organization's renewed focus on maximizing profitability.

POWER YOUR GROWTH INTO—AND THROUGH—A DOWNTURN

Through all stages of the economic cycle, business leaders should focus on powering their company's long-term sustainable growth and profitability. With a downturn potentially around the corner, it is especially important to take action now to strengthen your company's ability to withstand adverse market forces.

Significant organizational changes—whether adopting an 80/20 mindset or leveraging the power of data analytics to strengthen your operations—take time and effort. But change for the better is always worth the investment.

At BDO, we know that successfully implementing meaningful change can be challenging for organizations of all sizes, but especially for small and mid-sized enterprises. We are here to help. Our team has extensive experience helping organizations leverage strengths, address weaknesses and devise right-sized solutions to capitalize on strategic opportunities to power profitable growth.

WANT TO LEARN MORE ABOUT POWERING GROWTH?

Throughout 2020 we are hosting a series of webinars that will dive deeper into each of the topics covered in this report:

- How Data Can Drive You Through the Next Downturn
  February 13, 2020, 3:00–4:00 p.m. ET
- Scoring Profitability Points Ahead of a Transition
  April 23, 2020, 3:00–4:00 p.m. ET
- Subtraction by Inaction: How Standing Still Could Cost Your Business
  June 17, 2020, 3:00–4:00 p.m. ET

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