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TRENDS

How CFOs Can Prepare for Recession With an Eye Toward Opportunity

Robust Scenario Planning on a Modern Platform Gives Organizations an Edge in Uncertain Times

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EXECUTIVE SUMMARY

Rising interest rates, persistent inflation rates, supply chain disruptions, and the aftermath of the pandemic have ushered in a period of economic uncertainty. Prognosticators and pundits have been quick to predict an impending recession, yet as of Q3 of 2022, consumer demand and employment figures remain strong. Every responsible financial leader knows it's time to prepare for a downturn, but how best to be prepared for the unique combination of forces in today's market? And how can organizations ensure maximum financial flexibility so they can seize on emerging market opportunities?

This report details seven ways CFOs and financial leaders can prepare for an array of possible outcomes, ranging from soft landing to severe recession, and advises leaders on documenting specific trigger points and proactive action plans for a range of scenarios. These steps will give business and financial leaders maximum flexibility to seize on emerging market opportunities. The report also provides recommendations related to people and cultural changes, technology implementation, and deployment best practices.

BUSINESS THEMES

- Data to Decisions
- Technology Optimization

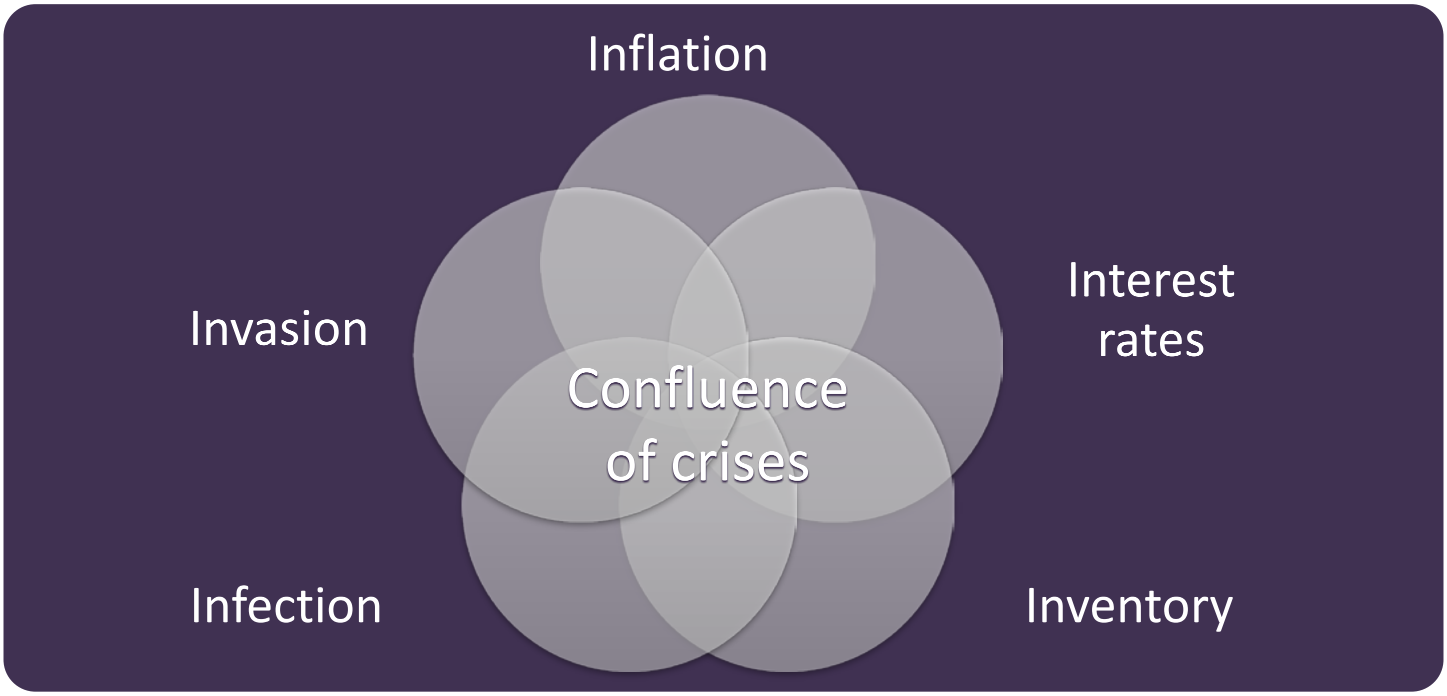
FIVE I'S STOKE UNCERTAINTY AND RECESSION

"May you live in interesting times." It's a popular English expression also said to be a translation of a traditional Chinese curse. Indeed, the "interesting times" the world has experienced in the early 2020s have felt like a curse as governments, individuals, and businesses have had to grapple with five interconnected i's that are fueling uncertainty and laying the groundwork for recession (see Figure 1):

- **Inflation** has reared its ugly head for the first time in decades, stoking price increases, crimping consumer budgets, and forcing suppliers and manufacturers to make hard choices on whether to pass along or swallow price increases.

- **Interest rate hikes** have been the inevitable response to inflation as central banks, including the U.S. Federal Reserve, have sought to hold inflation in check. But in raising the cost of capital,

Figure 1. The Confluence of Crises



Source: Constellation Research

interest rate hikes also threaten to slow consumer demand, increase unemployment, and sink the economy into recession.

- **Infection rates,** specifically COVID infection rates, continue to wreak havoc on supply chains and the willingness of people to work. This, too, stokes inflation. Granted, it's now nothing like the fearful cycles of infection in 2020 and 2021: Death rates have plummeted, but continued spikes—regionally, globally, and with the emergence of new COVID variants—continue to bring uncertainty.
- **Inventory problems** have plagued suppliers and manufacturers, with chip shortages and supply chain bottlenecks being particularly nettlesome challenges. It's another vicious circle that feeds inflation and makes it harder for organizations to plan, be productive, and predict future revenue.
- **Invasion-sparked geopolitical uncertainty** continues in the wake of Russia's invasion of Ukraine. Europe, in particular, is being whipsawed by inflation and energy supply woes. There's much more at stake than the health of the global economy, with the specter of a wider war and the threat of famine tied to curtailed shipments of Ukrainian and Russian agricultural products.

All of these forces, taken together, threaten economies worldwide with the combination of inflation and recession—also known as "stagflation"—the likes of which has not been seen since the 1970s.

Why Recessions Bring Opportunities as Well as Risks

It's important to note that times of recession and instability can also present business opportunities. Hard times often test business and consumer relationships and loyalties. It's at these times that upstarts, aggressive competitors, and innovators can capture market share and perhaps even end up acquiring faltering competitors.

Constellation Research has seen many more disruptors and innovators emerge during times of recession and instability than during stable economic periods. Conversely, times of recession tend to be hard on complacent incumbents, with disruptors and innovators grabbing market share and knocking “fallen stars” off their pedestals.

Constellation sees effective planning as the difference between the disruptors and innovators and the fallen stars that all too often fall victim to their own missteps. Companies that plan effectively have financial flexibility and decision-making agility that enables them to seize opportunities. Companies that fail to plan effectively aren’t prepared for bad outcomes. And when bad outcomes emerge, organizations that haven’t planned tend to overreact, relying on the blunt instrument of across-the-board cuts. That’s when ham-fisted cuts to sales and marketing and R&D cut off future growth, and the ill-advised layoffs make it hard to find talent to drive a rebound once growth returns.

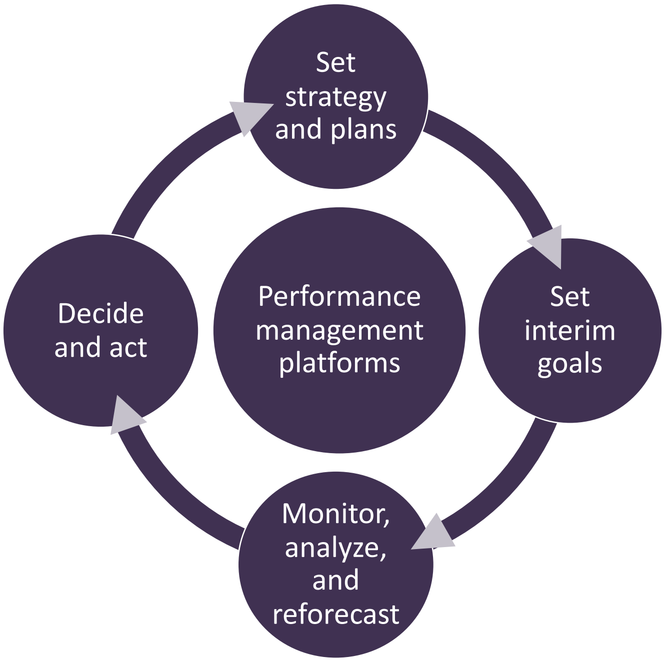
PLANNING IS THE KEY TO AGILE, PROACTIVE ACTION

Effective planning is a differentiator, and in Constellation’s view, it’s only possible with a modern corporate performance management platform. As shown in Figure 2, modern performance management platforms ensure that there’s a single, consistent, and collaborative system for planning, budgeting, analysis, and forecasting.

Organizations that attempt to drive performance by using spreadsheets and e-mail spend as much as 20% of their “planning and analysis” time collecting data and as much as 30% validating that information. Validation is particularly challenging when reconciling corporate and business-unit versions of data and extracts from inconsistent time periods and versions of analyses lost in e-mail and siloed in executive laptops.

A modern, centralized platform enables organizations to slash the time spent on low-value data-collection and data-validation efforts. That time and energy can then be shifted to more-frequent planning and analysis and higher-value activities, such as what-if scenario planning, contingency planning, and integration of financial and operational plans and proactive actions designed to prevent or ameliorate bad outcomes.

Figure 2. Modern Platforms Speed the Cycle of Planning and Analysis



Source: Constellation Research

Modern performance management platforms also offer the advantages of machine learning (ML), artificial intelligence (AI), and computer augmentation. Examples of ML/AI-powered planning, forecasting, and analysis include:

- Predictive anomaly-detection features designed to provide early warning of variances, spotting the biggest risks to reaching targets and goals.
- Automated ML (AutoML) features that test myriad algorithms behind the scenes to yield more-accurate models without requiring data science expertise.
- Predictive sales-planning features that harness AI to spot the most promising sales targets, sales capacity requirements, and appropriate sales goals and incentives.
- Predictive workforce planning applications that guide head count, hiring, skills development, and compensation planning.

- Predictive marketing applications that automate budgeting and planning while guiding course corrections—in collaboration with sales and financial leaders—based on emerging market opportunities and budgetary constraints.

SEVEN WAYS TO PREPARE FOR RECESSION AND EMERGING OPPORTUNITIES

The following seven ways to prepare for recession are not presented in a sequential, step-by-step order. Ideally, CFOs and business leaders would calmly pursue all these actions together as part of their ongoing, integrated budgeting and planning activities. They could then see the impacts of interrelated actions and could better consider long-term impacts.

But sometimes stock market slides and sensational headlines spark nervous requests from CEOs or an urge by cautious CFOs to take a closer look at costs and liquidity. As evidenced by the layoff announcements and corporate financial moves creeping into the news in 2022, many companies are trying to get their financial house in order ahead of 2023 budgeting and planning cycles.

It’s never too early to plan on any front, so here are seven ways to prepare for recession while keeping an eye out for the opportunities that lie ahead:

1. **Restructure costs.** Think scalpel rather than machete when looking at costs. The idea is to get lean and mean rather than cutting into the muscle of your organization. Work with business and human resources leaders to delay hiring plans and/or consider layoffs of underperforming staff. Consider pruning low-margin or slow-selling products and services. Now is the time to bolster core, proven products and customers.

2. **Drive automation.** The pandemic sparked a wave of automation initiatives, and the Great Resignation and talent shortages of the post-pandemic period have only increased the need to harness computers wherever possible. Why bog down available staff with rote, manual tasks and work steps that could be automated?

Organizations are harnessing workflow, robotic process automation, business process automation, process-discovery technologies, and bots to digitize gaps where humans are either unnecessary or could focus only on the exceptions. Work with your fellow CxOs and line-of-business leaders to examine order-to-cash, employee and customer onboarding, lead-management, and other processes to identify opportunities that promise to not only drive efficiency but also speed service and improve customer and employee satisfaction.

3. **Strengthen the balance sheet.** The obvious starting points on improving liquidity include getting aggressive with aging accounts receivable and pushing out accounts payable (without straining the most valued supplier/vendor relationships). Now is also the time to lock in any debt financing or equity capital deals that may be in the works. The certainty of rising interest rates means there's no better time than the present to secure financing.

   Balance sheets can also be strengthened by making revenue more predictable. Approaches on this front include preselling via annual contracts, bulk discounts, and subscription models. Constellation has talked to CFOs at accounting firms and security services providers, for example, that have managed to both automate billing and renewals and improve revenue predictability by using subscription-based services models.

4. **Double down on scenario planning.** Better planning is the key to success in any economic climate, but in times of uncertainty or crisis it's time to redouble planning efforts. Don't just test base-case, best-case, and worst-case scenarios. Model the potential impacts of mild, moderate, and severe recession with, say, 10%, 25%, and 40% decreases in revenue. Test mild, moderate, and severe inflation scenarios and also model the combined impacts of simultaneous recession and inflation (the dreaded stagflation that some predict).

   What's more, planners all too often go through the motions of testing scenarios but aren't prepared to act when unwanted conditions come to pass. So don't just analyze multiple scenarios and retest them frequently—as often as monthly or even weekly rather than quarterly or semiannually—but predetermine trigger points for taking proactive action and document what actions you will take when the latest data points to those outcomes.

5. **Closely monitor forward-looking indicators.** Don't limit your scenario planning and ongoing analysis to (typically lagging) financial indicators. Finance should collaborate with sales and marketing teams to monitor the leading indicators tied to deal pipelines and campaign results that they likely already track.

6. **Get sophisticated about products, services, and pricing.** If inflation continues, develop a clear and granular understanding of costs and customer price elasticity. Rather than applying across-the-board price increases, consider new sourcing options or perhaps even product and packaging changes. For example, amid the chip shortages of recent months, some automakers changed their bundling of certain features into the premium model category. This approach reduced the demand for chips tied to (previously standard) features while improving availability for customers willing to buy higher-margin premium models.

7. **Know thyself.** Companies that plan and monitor frequently are in the best position to be self-aware, possessing a clear and realistic understanding of their competitive position and strengths amid market turmoil. This knowledge helps to guide them as to when to play defense, scaling back on noncore products and services, and when perhaps it's time to go on offense, accepting lower margins to gain market share or seizing an opportunity to acquire a faltering rival.

RECOMMENDATIONS

Constellation finds that change management may be the biggest impediment to building an agile, performance-driven organization. Financial leaders at market-leading companies—the top 5% of organizations—have embraced frequent planning and analysis and have proactive plans ready for the range of scenarios that they have modeled. Fast followers—the next 15% to 20% of organizations—are on the same path to agility. The remaining 75% to 80% of firms are cautious adopters or laggards and typically are stuck in annual budgeting processes and spreadsheet- and e-mail-based planning and analysis approaches.

Effective financial leaders have embraced collaborative planning with frequent analysis and forecasting to drive proactive action. They work well in teams and make a point of communicating and partnering.

Here are four additional recommendations for evolving your planning technology and culture:

- **Get deployment assistance from consultants or systems integrators.** Poor implementation leads to failed technology deployments. When choosing a new corporate performance management system, seek guidance from your vendor on available consulting or systems integration partners. These partners are experienced with the platform and will help accelerate the technology deployment and make the most of higher-level scenario-planning, modeling, and forecasting capabilities.

- **Land, learn, and expand your technology deployment.** When deploying a new corporate performance management system, start small with a focused area or business unit to get a taste of the platform before taking on the entire corporate view. At each step, focus on the 80% of requirements that are crucial. The remaining 20% of requirements can wait and will only benefit from the experience that your team has gained after using the platform.

- **Automate, automate, automate.** Whether it's capturing the latest data, rerunning what-if scenarios, or calculating the latest KPIs, automate wherever possible. Here's where consultants and systems integrators can help, drawing on their experience with built-in or third-party automation capabilities. Time saved on repetitive manual tasks can be put into higher-value planning and analysis activities.

- **Look forward and watch for opportunity.** Stay focused on the future and on opportunities that might emerge amid the turmoil of dynamic market conditions. The organization that plans well and that pays attention to forward-looking market signals and forecasts will be best prepared to grab market share, win new partnerships, and snap up faltering competitors.

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Doug Henschen is a vice president and principal analyst at Constellation Research focusing on data-driven decision-making. His Data to Decisions research examines how organizations employ data analysis to reimagine their business models and gain a deeper understanding of their customers. Data insights also figure into tech optimization and innovation in human-to-machine and machine-to-machine business processes in manufacturing, retailing, and services industries.

Henschen's research acknowledges the fact that innovative applications of data analysis require a multidisciplinary approach, starting with information and orchestration technologies; continuing through business intelligence, data visualization, and analytics; and moving into NoSQL and big data analysis, third-party data enrichment, and decision-management technologies. Insight-driven business models and innovations are of interest to the entire C-suite.

Previously, Henschen led analytics, big data, business intelligence, optimization, and smart applications research and news coverage at *InformationWeek*. His experiences include leadership in analytics, business intelligence, database, data warehousing, and decision-support research and analysis for *Intelligent Enterprise*. Further, Henschen led business process management and enterprise content management research and analysis at *Transform* magazine. At *DM News*, he led the coverage of database marketing and digital marketing trends and news.

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ABOUT CONSTELLATION RESEARCH

Constellation Research is an award-winning, Silicon Valley—based research and advisory firm that helps organizations navigate the challenges of digital disruption through business model transformation and the judicious application of disruptive technologies. Unlike the legacy analyst firms, Constellation Research is disrupting how research is accessed, what topics are covered, and how clients can partner with a research firm to achieve success. Over 350 clients have joined from an ecosystem of buyers, partners, solution providers, C-suite, boards of directors, and vendor clients. Our mission is to identify, validate, and share insights with our clients.

Organizational Highlights

- Named Institute of Industry Analyst Relations (IIAR) New Analyst Firm of the Year in 2011 and #1 Independent Analyst Firm for 2014 and 2015.
- Experienced research team with an average of 25 years of practitioner, management, and industry experience.
- Organizers of the Constellation Connected Enterprise—an innovation summit and best practices knowledge-sharing retreat for business leaders.
- Founders of Constellation Executive Network, a membership organization for digital leaders seeking to learn from market leaders and fast followers.

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