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Executive Report: B2B Planning for Economic Recovery

Understanding Scenario Planning Through a Recession

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Understanding Scenario Planning through the Recession

By Andrew Duguay, Chief Economist

As a result of the COVID19-induced recession, it's no surprise that B2B businesses will need to retool their plans for the rest of the year. The first step comes by identifying new relevant indicators and creating a dynamic structure for their business. This process involves identifying and reacting to new business opportunities and setting structure to grow business in the coming months. Companies will also need to determine how to approach planning for the second half of the year.

Current State of the Economy

In looking forward and thinking about future planning, companies need to view this from a business standpoint. First, challenge the thought that this recession is unprecedented. If you look back at the last four or five recessions and point to a singular cause of the start of, it's always something different. Whether it's the secondary housing market and secondary credit of the last recession, the stock market bubble burst for the 2000-2001 recession, or the commercial real estate loans in the 1990s recession.

Throughout history, each recession looks different and we pull out of them all. Regardless, lessons can be learned on how the business cycle works with each recession. A place to begin, in looking for signals and clues about what the second half of this year is going to look like, we can ask how did businesses adapt and change on a macroeconomic level in previous recessions?

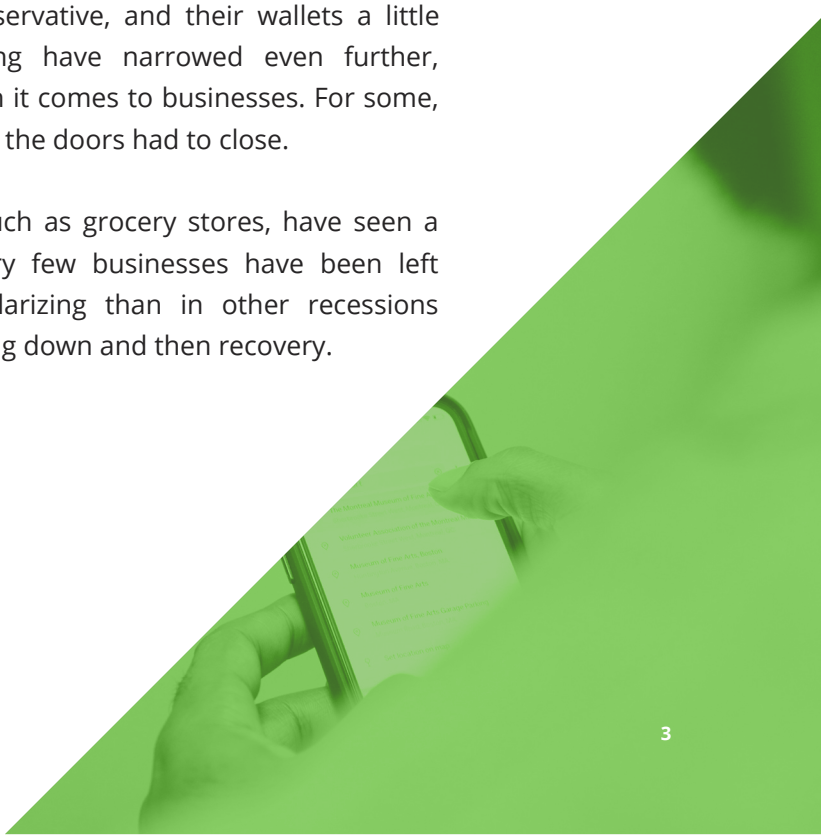
The current downturn is a health crisis turned economic crisis, which needs consideration in forecasting and planning. Another factor to consider is that financial and other relevant indicators are rapidly evolving in this situation, providing added effort.

When the crisis first began, it was difficult to get data that was even somewhat relevant, leaving us to conjecture. Even though it was just a few weeks ago that the first-quarter GDP was released, it was already old news in this fast-moving crisis. Simply stated, the data lag proved difficult. Because of the data challenges, there's been a shift in focus towards finding more real-time data with the effort to determine relevant and meaningful data rather than just whatever is the headlines of the day. Identifying relevant leading data signals is vital in picking up the nuances of where your business and industry segment is headed.

The Consumer

This downturn has a feast or famine aspect. Overall the U.S. economy is in a recession, but the necessitation of non-essential business closures has perhaps made the consumer more conservative, and their wallets a little bit smaller. Their options for spending have narrowed even further, creating big winners and big losers when it comes to businesses. For some, the supply chains have been disrupted, or the doors had to close.

On the other hand, some businesses, such as grocery stores, have seen a rapid increase in sales. Either way, very few businesses have been left untouched by this crisis. It's more polarizing than in other recessions where you might see every business going down and then recovery.



Many consumers have experienced an increase in income due to the stimulus, but how they spend that money will better illustrate what recovery will look like. Are they recirculating it into the economy, or are they saving because they are cautious in many ways?

And so how consumers feel about spending in specific categories is going to be much more important than their ability to spend in specific categories, at least over the next few months. There is cautious optimism on the reopening of the U.S. economy, while the number, even though the number of cases is still very high. Any move towards normalcy is positive in healing the economy and the damage caused.

There are still real hurdles ahead, as the U.S. transitions away from a stimulus-driven economy towards the traditional supply and demand in the labor market, including the fact that the PPP loans designed to cover payrolls for eight weeks are expiring. So the question becomes, are businesses going to keep people on the payroll as that expires.

Economic Outlook for 2nd Half of 2020 and 2021

Clearly, the previous foreacasting outlooks devised in 2019 are now rendered inaccurate. Back 'then', the indicators heading into 2020, particularly for the U.S. economy, were positive or at least suggested that overall B2C and then particularly B2B business could see a growth year. There were some signals that growth was going to slow in 2020, but not to the degree that has occurred with the COVID-19 related recession. So casting aside the outlooks that are no longer applicable, how do we start picking up the pieces from this and come up with an outlook?

To begin, consider the alphabet soup of potential scenarios coming out of economist's mouths lately. First, there was hope that this was going to be a V-shaped recovery. Because it was an economic crisis, it would be swift: people would lockdown, and then businesses would reopen, and everything would be back to normal. A quick downturn followed by a sharp upturn. However, the reality is that over 30 million jobs in the United States were lost, unemployment is climbing north of 10%, and you don't have a swift V-shaped recovery from that.

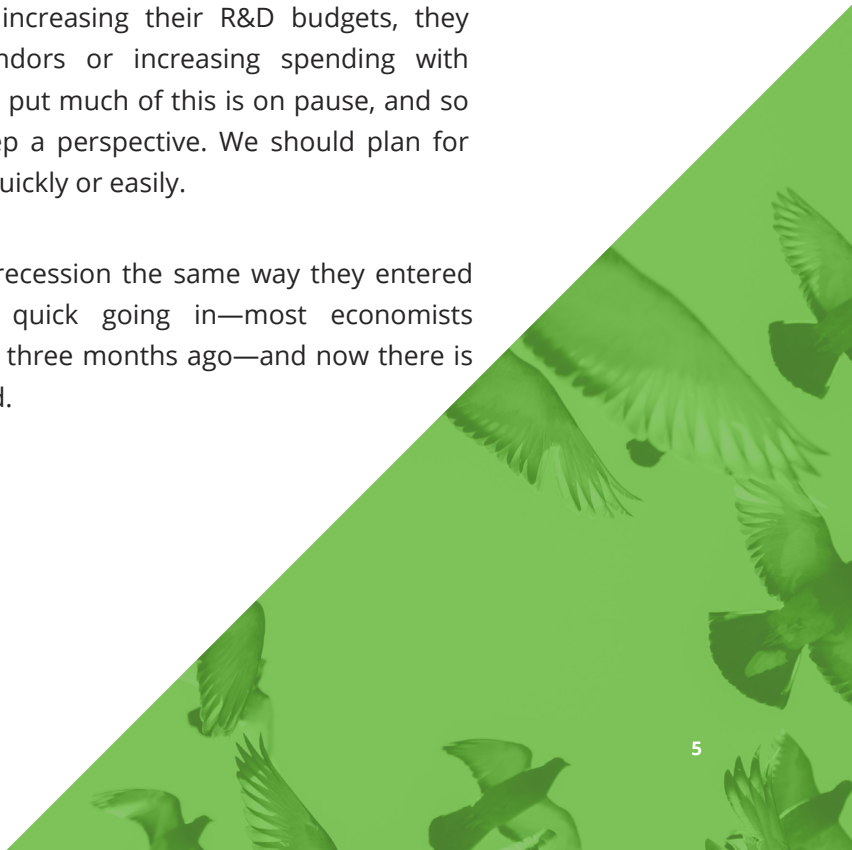
Another scenario is the L-shaped recovery, which translates to a very slow recovery. It is often referred to as sideways J-shape. There is a dip down, and you just keep going sideways for a more extended period. However, the data suggests a U-shape recovery is the most probable outcome.

Things are going to be weak throughout the second half of 2020, but not as weak as in April and May when businesses were forced to shut down. As businesses open back up and we control and bend the curve of COVID-19 cases, the economy will see a U-shaped recovery—a slow recovery but recovery nonetheless that will carry on until 2021.

For recovery to happen, consumer confidence needs to rebound. Currently, there are mixed signals as far as sentiment goes. Most indicators are adverse to some degree. There was not much positive news coming out of the latest data from March and April. What will be interesting is to see how fast recovery in May, June, and July progresses. We will all need to keep our collective eyes out of these leading indicators. This recession may start shaping up to look more like a 2008-type recession, or perhaps there will be some quick acceleration and confidence-building back in the economy as the health crisis subsides.

This all translates to considerable uncertainty, which poses the most significant challenge to B2B companies because they tend to win when there is overall confidence in the economy. When companies are spending on capital expenditures or increasing their R&D budgets, they are open to working with new vendors or increasing spending with existing vendors. Uncertainty tends to put much of this is on pause, and so in the B2B arena, we will need to keep a perspective. We should plan for recovery, but it's not going to come in quickly or easily.

A nation doesn't always come out of recession the same way they entered into it. This one was particularly quick going in—most economists weren't even thinking about recession three months ago—and now there is likely a long climb out of the downtrend.



Key Indicators to Watch

Historically, there are challenges during times of uncertainty, and they necessitate a strategic approach. There are three key indicators that economists look at for the B2B industry specifically.

1. The first indicator is Economic Policy Uncertainty. Uncertainty about economic policy translates quite well into hesitancy around big capital expenditures and other types of spending. Ideally, it won't be spiking considerably right now. However, these unprecedented times are generating elevated levels.

Week after week, month after month, through March, April, and May, we have seen elevated levels in terms of uncertainty. Fortunately, an aggressive policy from the U.S. Federal monetary policy's chair has been much more aggressive than the one in the last recession. But there's still the question about whether this will be enough to keep businesses surviving after being on pause for quite a while.

2. The next indicator is the Purchasing Managers Index (PMI). Another key indicator is from the Institute of Supply Management. The data comes out fairly early in the month, so it is quicker and more relevant than looking at something like GDP and the business confidence index from the OECD.

U.S. manufacturing PMI, dropped down into the 40s in April, near an all-time low. It looked a lot worse in many aspects than in previous recessions, but we also haven't had mandatory business closures like now in a very long time in U.S. history.

It will be important to see how this bounces back in May and June. Some of the China barometers show a recovery not quite to pre-recession levels, but at least there's some recovery. Soon, clues and signals will be available out of Europe.

3. The final indicator we are discussing here is the National Federation of Independent Business (NFIB) Small Business Sentiment survey. Business confidence indexes can provide a clue to how customers are feeling. And right now, they're feeling recession, contraction, disruption, which might be putting a lot of business activity on pause. These signals moving up could indicate that companies can be a little more aggressive about competing against other businesses. The big question is when the timing for that is.

Planning for the Next Phase

Planning for the next phase is an involved task, but can be broken into a three-step approach to respond, revised, and watch. This is a sequential process.

Initially, during the crisis, everyone is responding. During the response phase, it's not about thinking about 2021. It's thinking about asking what you need to do to stay in business? Do I have enough cash to stay afloat? How am I going to mobilize my workforce to work online that had been in-person? With all the disruptions, what parts of my budget should I freeze? Which part do I need to be more aggressive on?

In the middle of the crisis, everyone is responding to the day-to-day developments to adapt to what is happening now. But slowly, responding is shifting towards revision, and that's where most businesses are today, they are in this revised stage for the second quarter.

Once companies have shored up their near-term challenges, it's time to start planning again. That means starting to plan for the future, and the first step is understanding the outlook for your business and industry based on economic indicators that have changed. Depending on the crisis key performance indicators or key metrics may no longer be relevant.

For example, an oil and gas industry we worked with had a university do an analysis a few years ago to determine the external signals their business correlates against. The analysis stated for the oil and gas industry, they need to follow crude oil prices as a hard performance indicator. The study proclaimed that if you're looking at crude oil prices, you'll get a good idea of whether your business could go up or down.

But in today's world, they needed to re-forecast and plan according to what was now relevant for them. Fortunately, when oil prices moved to negative numbers, their business was not as tied to oil prices in the way they formerly modeled. Part of their business was in storage. And so even with the disruption in the entire supply chain demand cycle, there still was a need for storage of various petroleum products, which was able to insulate their business from the seismic industry drop in oil prices.

It ended up being a decisive maneuver that they didn't slam on the brakes because they eventually saw prices move back to where they were a few months ago. Existing indicators will change in a crisis. It's important to know what your key indicators are at all times, and how they impact your business.

Another relevant example relates to an industry-leading retail customer. The customer performed a historical analysis over the past 20 years and determined that they needed to follow industrial production as a leading indicator. They had a very high correlation at 80% to 90% using the indicator. When industrial production moves down, their sales closed down. As they work within the building materials space, they have both a consumer and contractor aspect. During the crisis, they knew that industrial production was going to decline significantly. Looking ahead, they were concerned about the summer buying season. Where they needed help was determining which other factors mattered. Just following one indicator wasn't going to be enough for them.

With the work-from-home policies spreading throughout the United States, the retailer saw its sales increasing year-over-year in certain regions. It was a new shift towards consumers at home looking at their backyard and saying, hey, I need to fix that. These consumers were spending more than anyone expected. What the business ended up doing was to identify and look at a new set of indicators. The old indicators are still valid, but in this economy, there was also the need to look at a new set of signals for a viable business opportunity. In this case, there's a do-it-yourself movement, and it has been very positive for them.

For this company, the new trend wasn't something they were closely paying attention to before. Still, it became an excellent proxy indicator for their movement over the past few weeks during the coronavirus pandemic recession. Now they have an indicator that they can track through the crisis. While they know that long-term factors like GDP and investor reduction matter because the consumer wallet matters, they also have some near-term factors to consider. This is all part of shifting forecast models to identify the right indicators and shifting them towards scenarios.

As mentioned, there's a lot of increased uncertainty right now. It's not enough to put together a forecast plan and believe that is the number. Many businesses are switching to scenarios and saying, this is a highly probable

scenario; however, we do need an upside and a downside as well. Uncertainty about the health crisis remains, but there is an opportunity to prepare for upside and downside risk through the unknown. This is the preparatory stage for relaunch.

There's going to be a new economy that appears before us as a result of this recession. The question is, how do companies thrive in this environment? In the long-term, businesses need to look at how prepared they are from a business standpoint. Did they institutionalize the resiliency and crisis planning? And do they have the workforce to take advantage of any new opportunities that come down the road?

Those plans have to be discussed in all the areas of the business so that everyone is executing the collective game plan. It's one thing to say that finance has a new forecast for the end of the year, but if marketing's not executing on it, or if production is not executing up to that same plan, then there could be many challenges.

Scenario Planning Considerations for the Future

To mimic what is going to happen in the United States or any other country from an economic crisis perspective, we generally look at leading indicators that often signal recessions one, two, three quarters in advance. Throughout the COVID-19 pandemic crisis, those indicators were virtually useless because of the rapidity of the economic downturn.

We've been through a shock factor, a lot like a light switched from on to off. The U.S. economy was humming along with relatively strong GDP growth a spending right up until we were all told to practice social distancing, and non-essential businesses, and finally to shelter in place. Quite literally economy was flipped upside down, spiraling into a recession. We don't have any traditional leading indicators for this crisis, but we can look at the timing of how events transpired in other countries to predict what the rebound might look like.

It's essential to determine a baseline scenario, something that is most probable to get started. It's clear that it is going to be a slow recovery, but there is going to be a recovery. From an economist standpoint, 35+ million people lost their jobs; historically speaking a

significant percentage of those jobs have probably disappeared for good. That means that it can take a long time for the unemployment rate to decrease again and improve the job outlook.

We're likely going to see a long recovery. What will be important is continuing to measuring how consumers are reacting to the ongoing concerns over the potential health threats. Therefore using a very macroeconomic level scenario, a high-side scenario might be recovery comes relatively quickly from the easing health crisis, where businesses can reopen sooner. The more pessimistic version might be a second wave of coronavirus that brings things to a halt again. For businesses, it's about taking these types of macroeconomic views and applying them to create a series of potential scenarios for their industry.

Ask yourself, what does it mean for your own traditional indicators? Is there a lead-lag relationship? Does recovery come later for my business, is my recovery on the verge of this? You must tie it to your industry to make business plans applicable.

Economists often say that recessions are creative destruction. When things are destroyed, new ideas emerge, along with new opportunities. It's a perfect time to start identifying new opportunities and new markets. Now might be the time to look at periphery industries and identify new opportunities available. Now is an opportunistic time to pivot and move some resources into expanding into new markets.

There is an unprecedented shake-up in the labor force of the United States. This is also going to create some pain, along with new opportunities for business growth going forward, because there's going to be more money spent in different places than there was previously.

Another topic to consider is that, given the high debt levels that we've accumulated, studies are showing that businesses have accumulated debt at a faster pace across industries over the past ten years. Heavily in oil and gas, the technology sector, information technology in particular, but almost every industry has seen rapid increases in debt levels. The debt level combined with a sharp recession, will probably create fire-sale opportunities. Additionally, if there are opportunities to merge or consolidate companies pivot into a new market. Downturns sometimes present the best opportunities to reshape how a business works.

Businesses that can come out of recession the soonest are those who can adapt to the new normal quickly. This boils down to having an agile workforce, as well as an agile work environment and agile planning. It is really about having the right people in the right places. One piece of strategic advice is to cross-train your employees during the downturn. Having those employees that are most adaptable is valuable at this time.

It is promising to see businesses reopening. Hopefully social distancing measures will still be encouraged to get the COVID19 cases to come down further. We will be continuing to monitor the influences we've mentioned with an expectation for a slow recovery to extend into 2021. As we get more comfortable in this new world, it might be easy to sit back and start to think that the range of possibilities has narrowed a bit. They're still pretty wide, at least by historic standards. Understanding how the shifting landscape is effecting your business is arguably more important now than ever.

Andrew Duguay, Prevedere Chief Economist

Andrew is Chief Economist for Prevedere, a predictive analytics company that helps provides business leaders a real-time insight into their company's future performance. Prior to his role at Prevedere, Andrew was a Senior Economist at ITR Economics. Andrew's commentary and expertise have been featured in NPR, Reuters, and other publications.

The Economic Scenario Planning Solution

Prevedere developed the Economic Scenario Planner Solution to address the current situation in which data is evolving at unprecedented rates and is not following the patterns that are used in traditional forecasting models.

The Planner provides companies with a clearer vision as they revise their forecasts and identify potential scenarios that could impact industries. This offering enhances the ability for financial executives to build dynamic planning models for their organizations and adjust quickly to possible market changes in advance of any key inflection points.

Prevedere's Economic Scenario Planning solution identifies which economic indicators will impact a company's business, alerts them at the first signs of an economic inflection point, and helps to answer questions as to the projected length and longevity of those situations.

The platform offers three scalable solutions that can be customized for an individual company:

- The Watch List monitors for industry-level directional changes as new data is released and identifies upcoming economic inflection points.
- "What if" Scenario Planning assesses the impact of plausible economic scenarios and identifies the potential impact on a business, through customized models that are developed by Prevedere's team of economists.
- The (Re)Planning Tool leverages external indicators within a company's planning models to deliver clearer guidance and accuracy on the evolving impact of the economic situation in 2020 and beyond.

The Economic Scenario Planner was built using Prevedere's ERIN Engine, which can be integrated into any data lake or data warehouse or can be imported into most BI and analytics tools, including Microsoft PowerBI, Tableau, SAS, Excel, and many others.

To learn more about Prevedere's Economic Scenario Planner visit:
www.prevedere.com/economic-scenario-planning

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