STRATEGIA
Partners

Navigating the Economic Cycle

By
Ray Florio
President & CEO, Strategia Partners New York

July 28, 2024

Nearly every US business will admit that it is still dealing with the after-effects of inflation. For many, additional price increases will be necessary, but the US economy is at an inflection point that makes them highly risky. Some are optimistic, forecasting growth due to strong fundamentals, bolstered by recent Q2 GDP estimates, yet others fail to see any cause for celebration, feeling that any economy reliant on increasing household debt to sustain consumption is a weak one, indeed. One cannot blame executives for the level of anxiety they feel about what the future holds and what it means for their companies.

Thankfully, smart companies recognize that preparing for the worst will put them in a better position no matter what happens, provided they make smart, cost-effective investments in risk mitigation tactics. Given we are looking back on several years of cost inflation, the margin for error is even lower, and mitigation strategies cannot simply result in cutting prices.

Well, that was surprising…

In the latter half of 2023, there appeared to be a split in economic forecasts for the US. Some, bolstered by real GDP growth above 3%, were celebrating that the economy had returned to growth. Others, such as this author, said it was a sign of a lean 2024, as shoppers simply pulled forward major purchases, expecting inflation to continue its stranglehold, incenting them to spend now before their purchasing power declined even further.

As we entered 2024, not only did we see the Bureau of Economic Analysis revise the advanced real GDP numbers down for 2023, but then we saw anemic growth in Q1, particularly as US consumers cut spending on Durable and Non-Durable goods. It seemed the theory of pulling ahead purchases was correct.

Then, just this week, the BEA released its advanced estimate of Q1 GDP numbers, showing the US economy grew at 2.8%. Some were saying that the country may have managed that long-touted "soft landing" and we were well on our way to recovery. Doubts still lingered, however.

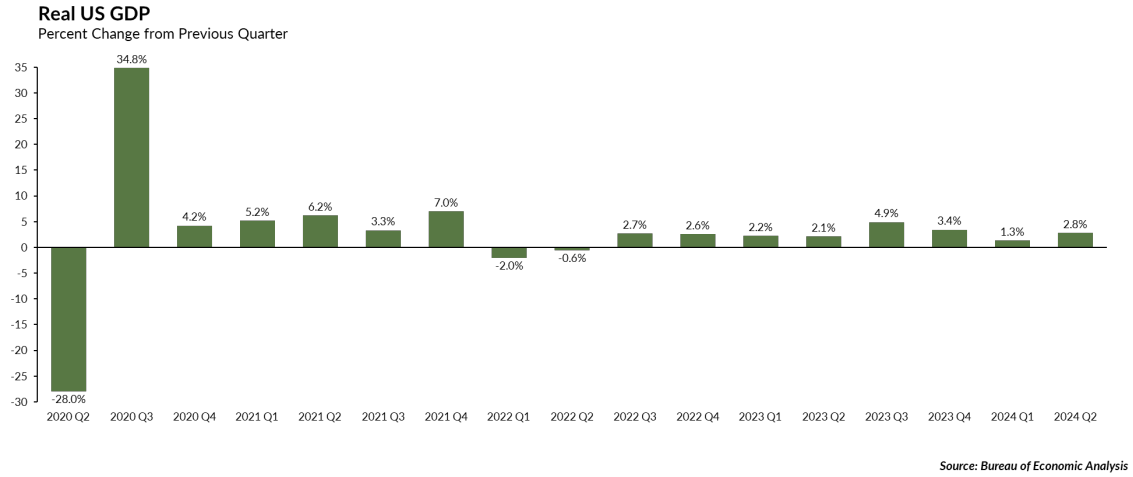


Figure 1: Prepare for what may lie ahead, following the post-pandemic bounce

Naturally, the topic of why this happened is inherently politically charged, and for our purposes, is not going to prove a valuable discussion. Instead, we should be looking at the future and what it means for businesses, especially given most are still dealing with the effects of unprecedented levels of inflation that have substantially increased costs. Unfortunately, simply increasing prices to maintain profits is far riskier, given the potential outlook.

A rough road ahead?

The second quarter of 2024 seems to be one where pessimism came in, despite the resulting positive GDP. First, in April, the president of the Federal Reserve Bank of Minneapolis reversed his prior prediction of two rate cuts within 2024, to suggest any cuts are unlikely as inflation remains stubbornly above 3%.[1] Markets have not been reacting particularly well to this news, as investors expect both elevated inflation and interest rates to continue weighing down the economy.

The following month, JPMorgan Chase's chairman and CEO, Jamie Dimon, said we cannot rule out the concept of a "hard landing" for the economy, even mentioning that the worst case scenario, stagflation, is on the table.[2] Moreover, in June, the Conference Board stated that, while it does not anticipate a full-blown recession to hit before the end of 2024, they do expect GDP growth to slow even further to under 1% over Q2 and Q3.[3]

---

[1] CBS News, *When will the Fed cut rates? Maybe not in 2024, one Fed official cautions, April 4, 2024*
[2] CNBC, *JPMorgan CEO Jamie Dimon says can't rule out 'hard landing' for the U.S., stagflation will be 'worst outcome', May 23, 2024*
[3] The Conference Board, *The Conference Board Economic Forecast for the US Economy*, June 13, 2024

Meanwhile, others have been more optimistic, just as they were at the end of 2023, touting underlying fundamentals, growth, and a host of other metrics. Despite those factors, some are calling the current period a "Silent Depression" where the true economic malaise is hidden beneath positive topline figures. The recent consumer sentiment survey from the University of Michigan showed that this key indicator plummeted to its lowest level in seven months, as shoppers in the US simply added debt to maintain consumption in the face of lost purchasing power.[4]

Now, wherever one may fall on where the US economy is going, there is cause for uncertainty, and no business has ever regretted being prepared for a downturn, especially if it provides a balanced approach to capitalize on leverage and offset lingering inflationary impacts. Most business leaders have been through a recession or contraction several times, but this time is different. Coming on the heels of an inflationary period longer and more substantial than any have experienced in the past 40 years, a new approach is necessary.

Looking at your own company

Before determining the path forward, it is critical to assess the recessionary risk across the portfolio so that companies do not spend limited resources ineffectively, or lose out on opportunities to maintain margin. Enterprises with multiple business units will likely see differing mitigation strategies across them, but this can even vary by brands, product lines, and even individual items or services.

Over the years, there have been several frameworks for corporations to follow in assessing macroeconomic risk on their businesses. Some delve into price elasticities, or financial impact, but the current environment demands starting with a higher-level perspective, whether we are discussing Business-to-Business or Business-to-Consumer elements of the portfolio: Differentiation from Competitors vs. Importance to Customers. This is a simple way to determine overall leverage to withstand the downturn, so that companies can focus efforts where they will drive the most benefit. More importantly, it avoids unnecessary investment where it is not needed.

---

[4] Mises Wire, *Why Consumer Sentiment Fell to a Seven-Month Low*, June 23, 2024

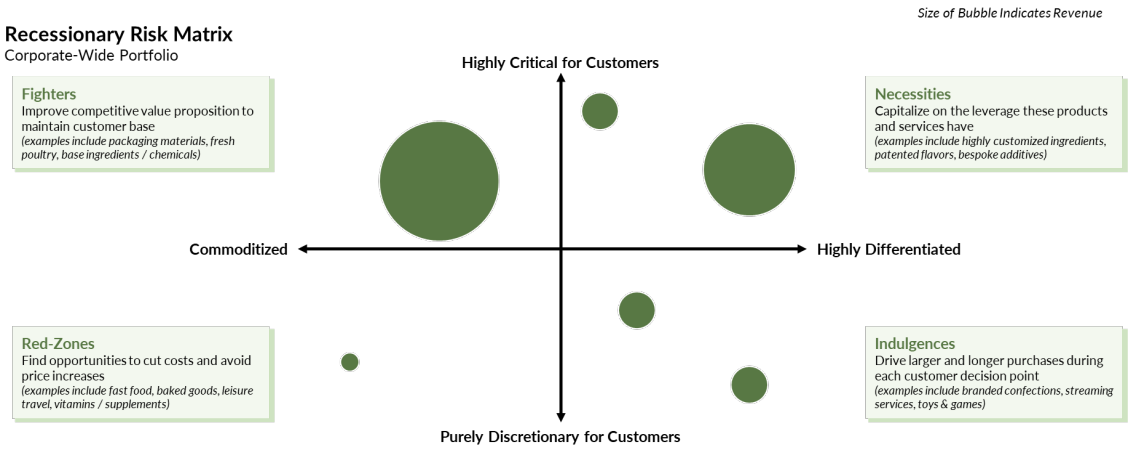


Figure 2: Determine the risk and the appropriate strategy across the portfolio

Based on where the different parts of the portfolio fall, the overarching strategy should change.

- *Necessities*: When products or services are both differentiated from competitors and highly important to your customers, little is required. In fact, these parts of the portfolio serve as your financial buttress, allowing you to pass on costs to maintain margins, and hold firm in negotiations with other businesses. A good example here are highly customized ingredients or patented flavors that play a key role in the resulting taste of iconic food and beverage brands.
- *Indulgences*: When products or services are indeed differentiated, but they are more discretionary in nature, companies need to work towards having their customers buy more during each decision point. This can come from higher volume purchases, extended subscriptions, auto-refills / renewals, or other such tactics that encourage the customer to incorporate more of the product into their business or daily life. Branded confections or streaming services typically fit into this quadrant.
- *Fighters*: In the opposite scenario, when customers actively need the product or service, but they have an abundance of similar choices, companies need to work on improving the competitive value proposition. Smart companies will recognize that this means far more than cutting price, as they introduce more flexible payment terms, update their positioning, or even adjust the components of their offerings to better align with their customers evolving needs. Typically, packaging materials, fresh poultry, or base chemicals will need this approach.
- *Red-Zones*: The riskiest quadrant is when the offering is both commoditized and discretionary. Customers have an abundance of alternatives, not just from the available alternatives, but also to simply do without. To make matters worse, coming out of an inflationary environment makes it nearly impossible to simply

cut prices, when most are feeling pressure to raise them. Provided there is a good reason for companies to keep these as part of the portfolio, the goal is to find cost-cutting opportunities to offset the needed price increases because, in the current climate, that can seem like a price cut. Look no further than the situation facing major fast-food chains for a clear example of this quadrant.

Of course, there can always be disagreement on the level of importance or differentiation, but the consensus placement needs to be consistent with the reality and context of the business. For example, some will say that baked goods are critical if they are customized and long-established in a restaurant, such as when a manufacturer is responsible for the unique bread a famous sandwich shop uses. However, if the business is one of the twelve brands of pre-packaged hamburger buns on the grocery store shelf, the story is quite different.

Once that is settled, and a company identifies areas of the portfolio most at risk, along with the overarching objective for each, it is time to work towards that. Just as when we segmented the broader portfolio, the goal within each quadrant is to make the most efficient investments, and balance that out by gaining margin on the still remaining opportunities.

Necessities – How do I capitalize?

Most may look at products and services that are critical for customers and hard to substitute and conclude that there is little to be done. This is only partly correct. While companies should not invest unnecessarily in this part of the portfolio, they do need to ensure they are effectively capitalizing on the leverage these products and services have.

Often, this will mean finding a means to pass through price increases to support investment in more vulnerable sectors of the portfolio. This can be easy if a single brand or product type spans quadrants, but there are several concerns that come up as we take a broader view across brands and even business units across the enterprise.

As an example, when an industrial equipment giant was preparing for the Great Recession of 2008/2009, two of its business units were in very different positions. One, dedicated to electrical products for autos and heavy-duty trucks, was a clear leader in its field, with substantial leverage with its customers. Another, dedicated to hydraulics for vehicles, was more commoditized, with heavy competition on price. Although everyone knew the winning formula was to maintain and strengthen margins on the electrical products, it also needed to reinvest part of the gains in mitigating the risk for hydraulics.

However, from a performance perspective, that meant the overarching plan would see stronger returns in the electrical space, and poor financials in the hydraulics business, which was both a critical business with a high source of revenue, but also

a key part of post-recession growth plans. It was also unlikely that both internal stakeholders and external shareholders would simply accept a business unit being allowed to drag down the company during the recession.

To solve this issue, the company restructured these two product-focused units into customer-focused ones. One combined both hydraulics and electrical systems for trucks, and the other the two product types for cars. In addition to allowing these BUs the ability to capitalize and invest as needed across the product types, it also presented a single face to its customers, enabling sales to combine contracts, bundling hydraulics into electrical deals, offsetting some of the need for outright discounting.

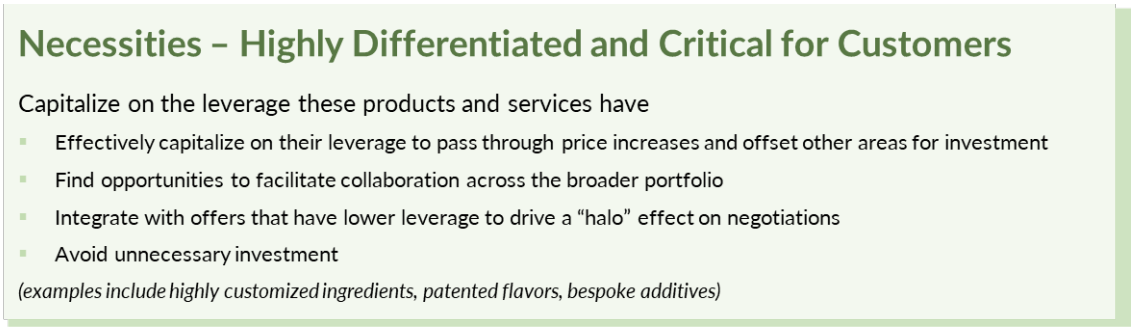


Figure 3: Capitalize on the leverage Necessities provide

Indulgences – How do I make them buy more?

In some ways, while Indulgences are in a stronger position than some other quadrants, they may be the most complex to address. Without an absolute need for the products or services, some companies undervalue the differentiation they have built, and, when faced with the aftereffects of inflation, are unwilling to pass through the price increases necessary to maintain margin. Some may even sacrifice margin further by cutting prices to incentivize consumption, or, if they're bolder, they may accomplish a price increase via a weight-out for physical products or a reduction in the offering for a service.

This latter tactic is almost certainly the wrong move. This part of the portfolio needs to focus on consolidating purchase occasions and reducing the customer decision points. It is not a lengthy leap to assume that a consumer with a larger supply of his favorite branded confections is more likely to eat more of them, which is why most every dietitian advises those trying to lose weight to have less readily available at home. Furthermore, buying at a higher volume does usually offer a discount compared to smaller packages. However, the shopper, in this case, rather than simply getting a discount for nothing, is buying, and likely consuming, more of the physical product.

For services, rather than tangible products, this tactic still applies, just looking at the famous example of Amazon Prime. While only a handful of streaming services offer an annual, rather than monthly subscription, they have proven very popular.

There is a rational benefit due to the savings compared to the monthly membership over the same twelve months, but those who sign up are now locked in for the full year, giving a longer runway for the service's use to become habitual. Since Amazon started reporting revenue from Prime subscriptions, it has been growing at an average of 20.2% per annum with nearly 170 million members.[5]

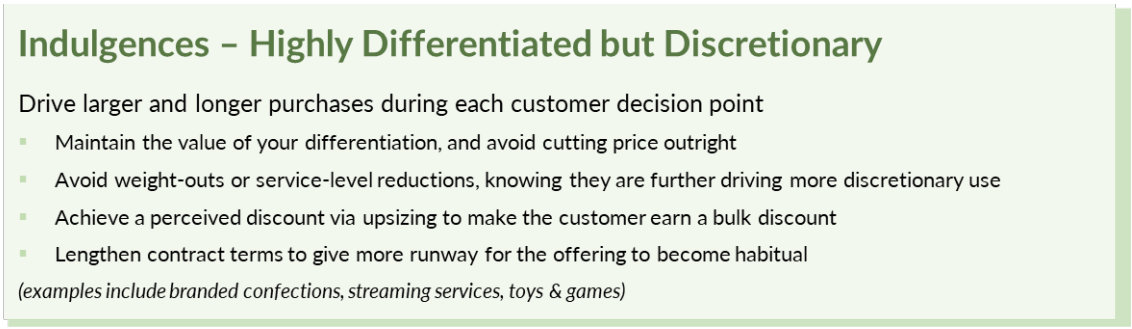


Figure 4: Make Indulgences a greater part of everyday life

Fighters – How do I drive value?

Sadly, whether a company sells a product or service, pricing can be an afterthought. Work out the details of the offer, then figure out the price based on that. The result is the same as with Indulgences: there is no willingness or ability to pass along the price increases from inflation, expecting that the only way to drive value is to reduce the price index against competitors.

Instead, companies need to consider the broader value proposition. While price is part of that, and becomes more important when wallets tighten, it is not the only factor. Everything about the offering plays a role here, from the product or service itself, to the branding and positioning, to the distribution channels, to the contracted terms, and even to the experience of the sales process itself. All are part of the equation, and smart companies will focus on strengthening all elements with the items that customers are most willing to pay for, above the cost of incorporating, and where they can do so better than competition.

A manufacturer of business computing and networking hardware learned this lesson well. Prior to the Great Recession, the company spent years introducing over 100 discount codes to remain top of mind despite an increasingly numerous and fragmented competitive set. By the time of the downturn, key channel sales partners created a very lengthy "survival guide" to steer their customers to the best discount, or just advised their customers to go with another supplier. Quotes would take more than two weeks, while competitors responded in a single day.

Clearly, this behavior could not continue. Instead, the company flipped the script

---

[5] BackLinko, *Amazon Prime User and Revenue Statistics (2024)*, December 13, 2023

by eliminating all but two discounts, and realigning base prices to be more market relevant, so the discounts were no longer a necessity. In the end, this actually meant most paid slightly more for the same products, but the experience was far friendlier to both the channel sales partners and the end customers. Quotes were almost instantaneous, and no more resources were required to decipher "survival guides."

Thankfully, in addition to being able to now serve customers with an urgent need, which were completely lost previously, the simplified experience led channel partners to push customers to the company's products, rather than dissuade them, as before. The result was a complete turnaround, as the company started growing revenues again for the first time in over five years, while increasing its margins.

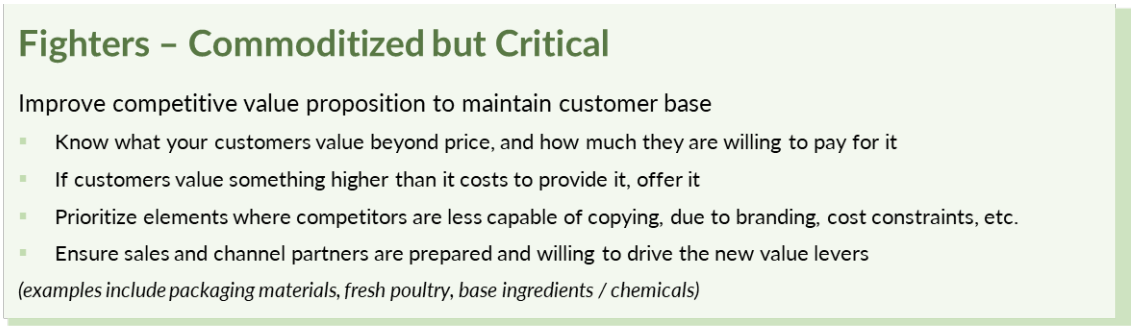


Figure 5: Find ways for Fighters to appear more valuable

Red-Zones – How do I mitigate costs?

With any luck, companies will recognize that their entire portfolio does not need to act as Red-Zones. The response here needs to be limited to the products and services that truly are commoditized and discretionary. Quite simply, with the inflation the US has experienced, and outright deflation being an historical non-entity, no company can find enough opportunities to stave off price increases across the entire portfolio.

Even for those true Red-Zones, price increases are likely to be necessary, unless something changes. Some may react negatively to that statement, assuming it means cutting back on features and benefits, eroding service levels, and driving lower levels of customer satisfaction. However, not everything a company offers its customers is truly valuable, and the opportunities for a win-win can be surprising.

A perfect example is when a brand of premium children's juice launched in the US market during an economic downturn and underperformed. The cause of its failure to capture the market was obvious, based on shopper feedback: it was too expensive. However, there was no room for a price cut. Clearly, it needed to try something different.

Through sophisticated and quantitative primary research, the brand was able to accurately estimate the impact on the price shoppers were willing to pay from

elements such as the packaging, bottle size, pack size, flavor, and other concrete product factors. Tying in the cost associated with maintaining those elements allowed for a solid, fact-based assessment of what the brand needed to sacrifice.

The findings were surprising, as the brand learned that one of the costliest packaging features, a sport cap, had no significant impact on willingness to pay. Considering that switching to simple screw-on caps would reduce costs by $0.60 on every six-pack, it seemed the brand found a clear win. After swapping caps, it only cut price by $0.30, and shoppers started buying, seeing a wildly different price position and much more positive value perception. Even better, the brand was able to pocket the remaining $0.30 of the savings, achieving higher margins despite the price cut.

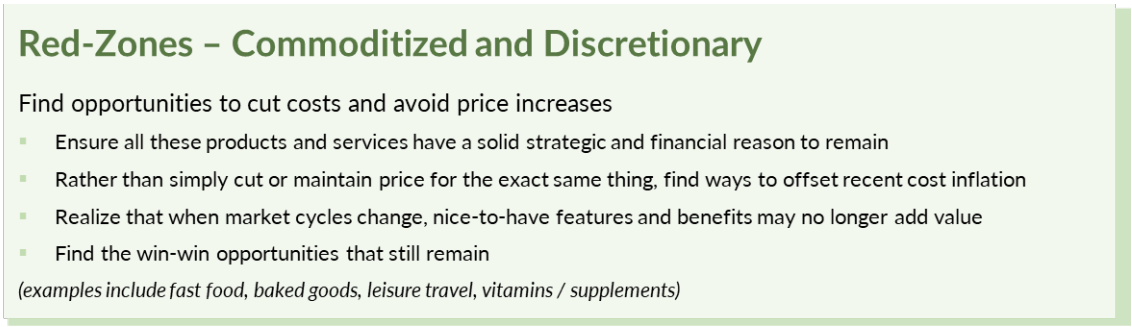


Figure 6: Be willing to make hard decisions on Red-Zones

Planning the route through the storm

Obviously, there will always be differing views on the future of the economy. The uncertainty has led to anxiety among many business leaders on how to prepare for the worst. Thankfully, mitigating the risk associated with the worst-case scenario carries with it no penalties if the economy should take an upturn. If anything, companies that did prepare and end up pleasantly surprised by an economic boom will only be in a stronger position either way.

To get started, business leaders need to assemble their leadership teams and make some hard decisions about where the different parts of their portfolios fall across the risk matrix of Necessities, Indulgences, Fighters, and Red-Zones. Often, it is helpful to gain an outside perspective, as Strategia Partners and its leaders have provided countless times, as most will be too close to the different products and services to take a truly unbiased, fact-based view. Everyone has an incentive to believe their own business is differentiated and essential, and breaking through that barrier will be critical to an effective mitigation strategy. This is especially the case if a company needs to make hard decisions on whether a portion of the portfolio is dragging it down, and things are likely to get worse.

More importantly, a company cannot leave this type of initiative to a series of vice presidents and directors. They will be too junior and too embedded in the day-to-day business to take a truly unbiased view. Moreover, we are talking about an

enterprise-wide set of strategies and tactics to sustain profitable growth in the face of economic uncertainty. This is clearly an initiative the CEO must lead directly.

However, once companies know the objective and general strategy for different areas of their portfolios, they cannot simply start broad-brush initiatives and generalized capability building. These will prove inefficient investments after years of cost inflation. Instead, they should prioritize the most cost-effective tactics that align with the overarching goals of each quadrant of the risk matrix and invest where it makes most sense. Once again, this is an area where Strategia Partners can accelerate the process. This is the formula for sustained, profitable growth, even in a downturn.

Strategia Partners

Strategia Partners *is an international strategy consulting firm based in Europe (Paris & Zurich), the United States (New York & Seattle) and China (Shanghai). It assists Boards, CEOs, Executive Committees of major European and North American groups in their growth strategy. Its approach integrates three perspectives on performance: strategic and financial, environmental, and human.*

Ray Florio *leads Strategia Partners New York, bringing over two decades of strategy consulting experience to our clients. He has led turnarounds and growth strategies across six continents, guiding some of the world's largest enterprises and private equity firms, as well as smaller, mid-market players. His work, along with commentary on economic and market trends, particularly the recent inflationary period, has appeared in the media worldwide.*

Contact: ray.florio@strategiapartners.com

Paris | Zurich | Shanghai | New York | Seattle

STRATEGIA
Partners

Strategy Consulting for Sustainable Growth

Strategy. Impact. Growth.

For Corporates

For Private Equity

Portfolio Strategy | Business Acceleration Strategy |
Operational Strategy | Due Diligence