Strategic Leadership in a Recession

Forbes recently reported on a survey of 750 CEOs and other C-suite executives that found 43.3% of those executives think there will be a recession by the end of 2022. Another 17.8% predict a recession by the end of 2023. While a recession is not inevitable, the prolonged economic uncertainty due to supply chain disruptions, labor shortages, and Russia's invasion of Ukraine is affecting organizations everywhere. Many C-suite executives are concerned about warning signs of a recession, such as increasing corporate debt, lower GDP growth in China, and a cooling housing market. There are many differences between the current economy and the "Great Recession" of 2008, but one thing is clear. The question is not *whether* leaders should prepare for a recession but *how* they should prepare.

Lessons from Past Economic Downturns

Lessons can be learned from organizations that not only survived past economic downturns but thrived. Not surprisingly, companies that acted early to prepare for the downturn fared the best.

In December of 2008, Harvard Business Review conducted a study to identify strategies companies deployed during economic downturns to evaluate their effectiveness. They studied periods of recession in the 80s, 90s and early 2000s, collecting financial data for 4,700 companies in the years prior, during and after each recessionary period. They

identified four main strategies employed by these organizations:

- **Prevention-focused companies:** These organizations made primarily defensive moves, focusing on minimizing risk and avoiding losses.
- **Promotion-focused companies:** These firms focused more on offensive moves, increasing expenditures in key areas.
- **Pragmatic companies:** These organizations employed a combination approach, reducing spending on either expenses or payroll but increasing spending in areas like research and development or sales and marketing.
- **Progressive companies:** These companies reduced costs but did not cut employees as much as their peers. They also allocated more resources to marketing-related items, providing an optimal balance of defense and offense.

After analyzing the above approaches, the study revealed that organizations that chose a progressive approach were 37% more likely to outperform their competition. These companies cut costs by improving operational efficiency rather than laying off employees, and their offensive moves were more comprehensive. They invested more than their competition in marketing, research and development and pursued opportunities to acquire assets such as buildings and machinery at depressed prices.

The other approaches may seem logical but are less successful for several reasons. A prevention-focused company may rush into crisis mode too soon. Fear about the immediate term drives the decisions and overrides any vision for the future. A leader implementing a prevention-focused strategy may believe their sole responsibility is to mitigate damage and prevent the company from going bankrupt. They may implement painful cuts to operating costs, eliminate frills, make deep cuts to staff, stop investing in research and development or decline to purchase new assets. This approach can cause a pessimistic mindset to take hold across an organization, decreasing morale and innovation just when it is needed most. According to the Harvard Business Review study, very few prevention-focused organizations do well post-recession. Their growth remains slow for years longer than other organizations, with post-recession profits for prevention-focused companies rising by $600 million, compared to progressive companies that rose by an average of $6.6 billion.

In contrast, promotion-focused companies can swing too far in the opposite direction. These leaders pursue opportunities to acquire available talent and assets during the downturn. While some of these gambles may pay off, they may rely too heavily on optimism and slip into a denial of reality. Often these overly-optimistic cultures will suffer from groupthink and be blindsided by financial difficulties. Despite their focus on growth, promotion-focused organizations grew profits by $1.5 billion, out-performing the prevention-focused companies but still far lower than their progressive counterpart's $6.6 billion.

Pragmatic companies are 29% more likely to outperform their competitors, coming closest to the success of progressive organizations. The pragmatic CEOs understand that cost-cutting is necessary during a recession, but investing in the right areas is essential for long-term growth. They will typically cut costs both by reducing employees and increasing operational efficiency. Then they increase investments in both market development and new assets. This is a balanced and rational approach, but different from the most successful progressive approach in terms of the balance of measures taken.

Progressive enterprises choose a slightly different balance of cost-cutting measures and new investments. They cut costs mainly by improving operational efficiencies rather than laying off fewer employees than their peers. In fact, only 23% of the study's progressive enterprises cut staff compared to 56% of the prevention-focused companies. They combine that approach with a comprehensive offensive approach, innovating to develop new business opportunities by investing more in research and development, marketing and physical assets than their competitors.

New Challenges Facing CEOs

Today's CEOS have different challenges when cutting costs than in previous decades. Most organizations have already reduced spending throughout the pandemic, making it difficult to find new ways to trim expenses. The current rate of inflation can also make cutting costs very challenging. Raising the prices of a company's goods or services to cover increased costs can cause loyal customers to look to competitors. Likewise, cutting corners on quality or slowing down production and delivery of a product can frustrate customers, causing them to seek other options. Strategic leaders will look to opportunities to innovate and automate to increase efficiency throughout their organizations.

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Additionally, unlike previous economic slow-downs, the post-pandemic job market is very tight. In July 2022, the US unemployment rate was down to 3.5%, a historically low rate last seen in February 2020. Despite economic concerns, employers must do more to attract workers and fill empty positions. CEOs must carefully consider their current job openings and hiring plans now to avoid layoffs later. Layoffs can hurt a company's reputation, damaging an employer's brand with potential employees for years to come. Now is the time to attract, develop and retain the right candidates. by improving the recruitment process, providing purpose and increasing workplace flexibility.

Three Leadership Strategies for an Economic Downturn

Considering the circumstances of the current economy and lessons learned from the actions taken by organizations in past recessions, three strong leadership strategies are important in preparing for an economic downturn.

Manage Emotions

One of the biggest challenges facing leaders in a recession is managing their and their teams' emotions. When analyzing what actions to take to prepare for an economic

downturn, leaders may fear actions that could threaten their status or worry that the perception that their decisions to cut budgets are unfair. In addition to fears about declining profits, leaders may worry about a decline in morale, lack of focus, and the possibility of losing top talent. These emotions can cause delays in taking necessary actions like budget reallocations or other changes.

One way to manage these fears is to set the strategic frame for tough decisions. If leaders can focus on a positive vision of the future, they can find the courage to move forward. Leaders can build confidence in the organization by aligning teams around a vision for the future and connecting the organization's larger mission to the actions and sacrifices being made today. Leaders can also focus on transparent and meaningful internal communication. In uncertain times, employees can make negative assumptions when there is a lack of information. Being transparent about the current state of the business and how leadership plans to address challenges is the best way to reassure employees.

Focus on Long-Term Growth

Like the progressive enterprises in the study, leaders need to look toward long-term growth in these volatile global markets. CEOs can look for opportunities in digital transformation and develop new lines of business to ensure growth for years to come. When possible, avoid cutting research and development. Investing in those areas will ensure organizations have innovative products and services ready to launch when the economy begins to recover, providing an advantage over organizations that cut spending in those areas.

Now is also the time to identify critical suppliers and

distributors and determine if they are at risk due to an economic downturn. Many companies learned during the pandemic that supply chains are fragile and can cause major disruptions to business operations. Strategic leaders will assess the business's risk if critical suppliers cannot continue operations and look for ways to support them in difficult times. Building relationships with alternative suppliers is also a wise move.

Additionally, this can be an opportunity to learn more about the competition. Who are their customers? Can a strategic approach to an economic slow-down attract customers left behind by other organizations? It could also be a strategic time to hire top talent. Are other companies laying off employees that have been hard to find in a tight job market?

Upskill and Develop Existing Employees

Investing in the upskilling and development of existing employees will strengthen an organization's culture and improve productivity and employee retention. Many organizations will cut their training and development budget, but leaders should consider taking a different approach. Organizations that upskill their current leadership team will see improved morale and increased employee retention. They will also develop a team ready to strategically innovate, solve problems, and drive the company forward through a recession and beyond. Preparing the existing workforce for the challenges will benefit the entire organization. In uncertain times, leadership skills like emotional intelligence, decision-making, business storytelling, and creative problem-solving are needed more than ever. In fact, 70% of the variance in team engagement is determined by the manager. With the high rate of employee resignations, developing strong managers is key to employee retention and attracting new talent when needed. Today's workers want organizations to invest in their career success and leaders with the skills needed to ensure a great work experience for everyone.

The Role of Leadership in Uncertain Times

Leadership is never easy, and leading through an uncertain economy is especially challenging. The best leaders know to learn from the past while taking steps to prepare for the future. Leaders with the courage to take a balanced approach of offensive and defensive moves will be best positioned to survive and thrive in an economic recession. Now is the time for leaders to focus on resilience, creativity and transparency— and inspire their teams to do the same.

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