FINDING STABILITY AND OPPORTUNITY AMID ECONOMIC UNCERTAINTY

With the economic outlook constantly shifting as if it were a moving target, directors need to embrace change and set a tone of focus and confidence when looking to the future. It all starts with asking the right questions.

Growth across the global economy is slowing. With the growth rate projected to shrink in 2022 and 2023 by half of what it was in 2021, business conditions have likewise declined. As the months go by, projections continue to worsen.[1] Well-known factors could further exacerbate the picture. Of course, there is the war in Ukraine — its continuation for a protracted period, the threat of expansion beyond Ukrainian borders, further escalation of Russian sanctions, and the impact of spiraling food and energy prices as a result of the global crisis. There is also the risk of a sharper-than-anticipated economic decline in China as its strict zero-COVID strategy is tested by omicron variants and pandemic spikes from the onset of more virulent virus strains.[2]

The extraordinary public policy adjustments on a global scale to enforce lockdowns, quarantines, crowd limits and social distancing spawned supply chain disruption and congestion, acute shortages of essential commodities, materials and components, massive fiscal spending, sharp pivots to monetary easing by central banks, shutdowns of entire sectors, and

1 "World Economic Situation and Prospects: June 2022 Briefing, No. 161," United Nations Department of Economic and Social Affairs, June 1, 2022: www.un.org/development/desa/dpad/publication/world-economic-situation-and-prospects-june-2022-briefing-no-161/.

2 "World Economic Outlook (April 2022): War Sets Back the Global Recovery," United Nations OCHA Services, May 24, 2022: reliefweb.int/report/world/world-economic-outlook-april-2022-war-sets-back-global-recovery-enarruzh#:~:text=Global%20growth%20is%20projected%20to,percent%20over%20the%20medium%20term.

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the growth of unusually strong pent-up demand from consumers eager to get back to pre-pandemic norms. To no one's surprise, inflation began to emerge in the latter stages of the pandemic, and its fire was further fueled by war-induced commodity price increases, sanctions on Russian oil and gas exports, and broadening price pressures driven by surplus demand.

Currently, global inflation is expected to rise to 6.7% in 2022, well above the 2.9% average experienced between 2010 and 2020.[3] Spiraling inflation has swung the pendulum to faster-than-expected monetary tightening by developed country central banks. For example, in the United States, the Federal Reserve has signaled targeted interest rates of 3.4% by the end of 2022, the highest level in almost 15 years.[4] Meanwhile, investor and market confidence in institutions and policymakers is on the decline as conditions deteriorate and the stock and bond markets continue to drop precipitously.

The impact of the slowdown in economic activity varies across countries and regions, depending on trading relationships, financial ties, exposure to commodity price increases, the strength of inflation, exposure to the war, the state of the pandemic and the strength of the recovery. Accordingly, fiscal and monetary policy responses differ across economies. The tightrope balancing act by policymakers is further challenged by efforts to retain focus on longer-term goals (e.g., climate change policy initiatives).[5]

Economies across North America, the United Kingdom, the European Union, Latin America, Africa and more are on recession watch. According to one poll, many economists believe that the U.S. will fall into a recession in 2023.[6] Ten-year yields have dipped below two-year yields, a sign in the bond markets of the possibility of a recession looming on the horizon.[7] But there remains a contrarian view. While companies are dealing with inflation, rising interest rates, escalating commodity and energy prices, and broad economic uncertainty, corporate balance sheets generally remain strong. U.S. corporate bankruptcies in 2022 are off to their slowest start in years.[8] As the economy slows and the flow of easy money dries up, there are signs that supply and demand in a strong labor market are drawing closer to alignment.[9] That said, the risk of consumer and mortgage defaults is likely rising.

The bottom line is that global markets may be facing a bumpy ride and potential economic downturn over the next 18 to 24 months. Amid the uncertainty, one thing is clear: A mindset bent on emphasizing short-termism with an excessive focus on near-term results and smaller-scale, low-cost, quick-impact projects can result in lost opportunities due to a lack of focus on values, strategy, fundamentals and long-term value creation. Now is the time for leadership and clarity of purpose, for looking beyond the horizon. It is a time for leaders to focus on opportunities they can extract from existing business realities.

3 "World Economic Situation and Prospects: June 2022 Briefing, No. 161."

4 "Fed Raises Interest Rate by 75-Basis Points in Historic Move to Fight Inflation," by Megan Henny, Fox Business, June 15, 2022: www.foxbusiness.com/economy/fed-raises-interest-rates-75-basis-points-ramps-up-inflation-battle.

5 "World Economic Outlook (April 2022): War Sets Back the Global Recovery."

6 "70% of Economists in a New Poll Say America Is Headed for a Recession in 2023…," by Anna-Louise Jackson, MarketWatch, June15, 2022: www.marketwatch.com/picks/70-of-economists-in-a-new-poll-say-america-is-headed-for-a-recession-in-2023-heres-how-pros-say-to-approach-investing-in-light-of-that-01655243151.

7 "2-Year Treasury Yield Tops 10-Year Rate, a 'Yield Curve' Inversion that Could Signal a Recession," by Patti Domm, CNBC, March 31, 2022: www.cnbc.com/2022/03/31/2-year-treasury-yield-tops-10-year-rate-a-yield-curve-inversion-that-could-signal-a-recession.html.

8 "U.S. Corporate Bankruptcy Filings Drop in May," by Michael O'Connor and Chris Hudgins, S&P Global Market Intelligence, June 7, 2022: www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/us-corporate-bankruptcy-filings-drop-in-may-70653280.

9 "Could the Tight Labor Market Finally Ease?" by Justin Ho, Marketplace Morning Report, June 2, 2022: www.marketplace.org/2022/06/02/could-the-tight-labor-market-finally-ease/.

To that end, strategic conversations in the boardroom leading to actionable steps are needed to support forward-looking leadership that will engender confidence. Leaders offer a vision of the way forward with passion and focus. They remain grounded in values that provide the sails and rudder for navigating choppy economic seas. They are innovative and focused on resiliency and challenging the status quo in shifting markets. Most importantly, they are transparent and authentic through their genuine empathy for their people. In toughening economic times, when fear is emerging, true leaders are a calming, stabilizing force through their clear thinking and direct communications. They maintain a steady hand at the helm and recognize that they are the ones who must point to the lighthouse that offers stability to everyone aboard the boat, whether they require direction or are seasick.

True leaders are connected because they keep the communication lines open. Steeled during the pandemic, they recognize that the current times are a necessary transition to unravel the effects of public health, fiscal and monetary responses by governments and central banks in developing countries around the world. Furthermore, recovery from the pandemic has been stalled by Russia's aggression in Ukraine.

The seven questions below provide a basis for grounded discussions in the boardroom. Addressing them with a commitment to values and preserving reputation and brand image helps organizations emerge stronger in the recovery.

How do we visualize our business from a competitive-positioning standpoint looking out two to three years given current and expected market realities? This conversation is about understanding the distinctive advantages of the company's brand that should be exploited. It entails stacking up the organization's strengths and market opportunities against those of its competitors (e.g., comparative cost structures, differentiating strategies, relative financial strength, resilience in addressing shifting customer preferences and level of digital maturity). Anticipating actions that competitors are most likely to take can inform strategies for positioning the brand as a leader during the market recovery.

Are we sufficiently focused on the customer experience? Companies should assess whether fundamental adjustments are needed to product mix, sourcing strategies and pricing as customer behaviors shift in response to rising prices and product shortages. Obstacles and distractions as reflected in data around the customer experience should be eliminated. Customer-facing employees should be empowered to enhance responsiveness.

Have we sharpened our focus on the recruitment and retention of talent? Regardless of senior management's bias toward where work should be located, the organization needs to pay close attention to remote and hybrid work realities in the marketplace. This is a time to focus on retaining "A player" talent. It is a time to upgrade executive capabilities and boost executive bench strength.

Have we reimagined our supply chain to minimize disruptions in the future from another pandemic or regional conflict? Disruption and congestion risk considerations should be equated with the traditional quality, cost and time factors that have shaped supply chains in the past. Public health responses to pandemic spikes in different countries, the Ukrainian war and the focus on achieving net-zero carbon targets have altered the fundamentals underlying globalization. Emphasis on resiliency is giving rise to such supply options as friend-shoring, near-shoring and reshoring.

What digital acceleration and innovation opportunities should we pursue at this time, with an emphasis on product development, to strengthen customer engagement, flexibility and relationships? The board chair should allocate sufficient agenda time to cover innovation strategy and culture while encouraging open discussion on direction and progress with management. Such discussions should be supported with appropriate metrics. Digital technologies such as artificial intelligence factor strongly into innovation initiatives. Open innovation options should be considered to unlock fresh opportunities. Attention should be given to enabling a hybrid workforce model to facilitate resiliency. As these initiatives are pursued, companies should pay heed to cybersecurity, the increased risk to data and the implied brand promise around trust. The importance of the chief technology officer is elevated in times such as these when stakes are high in making the right bets with finite resources.

Are we establishing the proper tone at the top on sustainability matters and achieving alignment through appropriate performance expectations and reward systems linked to the sustainability strategy? Environmental, social and governance (ESG) matters offer the highest level of strategic thinking in the boardroom. They cannot be put aside as the belt tightens. In the U.S., 576 ESG-related shareholder proposals were submitted through April 12, 2022, a 15% increase from the prior year.[10] Directors should resist getting frustrated with the details and nuances. The big picture is what matters. Sustainability opportunities should be integrated with strategic discussions, and close attention should be given to strategic communications around these topics, both internally and externally. One research study reports that less than 10% of companies have fully integrated their business, technology and sustainability strategies.[11]

If a severe economic contraction occurs, do we have an up-to-date, vetted, proactive contingency plan to enhance our agility when circumstances warrant its implementation? Such plans should sequence, prioritize and group actionable steps by function and operating unit to establish clear ownership, authorities and accountabilities. They should be supported by key metrics to be managed against specified targets. The plan should provide for actions in different scenarios (e.g., revenue declines of specified levels or interest rates exceeding specified thresholds). As it focuses on margin and balance sheet management, the plan should allow for future investments by sustaining key on-strategy investments during the downturn to retain critical talent, preserve market image and branding, and foster a strong recovery when the economy bounces back. Directors should review and approve the plan.

The above thinking will help directors and management focus on the fundamentals during these interesting, uncertain times. The resulting action plans should be monitored by the board and refreshed as market conditions change. Reconfiguring the board's skills and experience in light of the major changes taking place in the economy and around the world is another consideration.[12]

10 "Annual Meetings Are the New Frontline in the Battle Over Corporate Purpose," The Economist, April 23, 2022: www.economist.com/business/annual-meetings-are-the-new-frontline-in-the-battle-over-corporate-purpose/21808834.

11 "Uniting Technology and Sustainability," Accenture, June 7, 2022: www.accenture.com/_acnmedia/PDF-177/Accenture-Tech-Sustainability-uniting-Sustainability-and-Technology.pdf.

12 "What Boards Can Learn from FedEx's Governance Moves," by Matthew Scott, Corporate Board Member, June 17, 2022: boardmember.com/what-boards-can-learn-from-fedexs-governance-moves/.

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