Recalibrate for the New Reality

How to turn market disruption into competitive advantage

Executive Summary

The current business cycle is unique, making it difficult for executives and consumers to navigate. While classic indicators point to a recession, business performance is resilient, and executives generally are cautiously confident about a favorable future.

In sharp contrast, consumers have a grim perspective and historically low sentiment. Their shifting behavior suggests they're buying fewer goods—but many seem willing to pay for experiences.

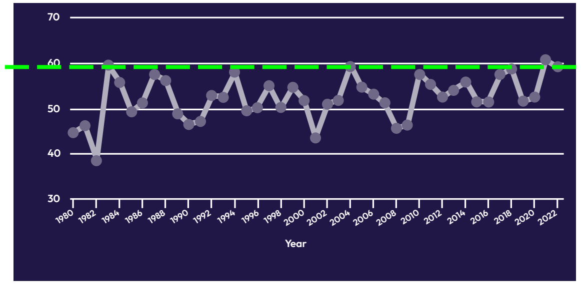
In short, it's a highly volatile and uncertain business environment out there. Some companies might think it's time to step back. At Brillio, we say it's time to recalibrate and ACE it.

Taking Economic Stock

The US GDP declined in the first and second quarters, meeting the technical definition of a recession. And overall, the economy experienced a 1.1% contraction in the first half of 2022. There were, however, a variety of economic indicators that suggest the US economy is not presently in a broad-based recession. These include favorable wage and jobless rates. So, while the debate about a recession continues, many expect a business cycle that remains very cloudy with a chance of recession. Federal Reserve Chairman Jerome Powell recently said, "I do not think the US is currently in a recession, and the reason is, there are too many areas of the economy that are performing too well." These areas include:

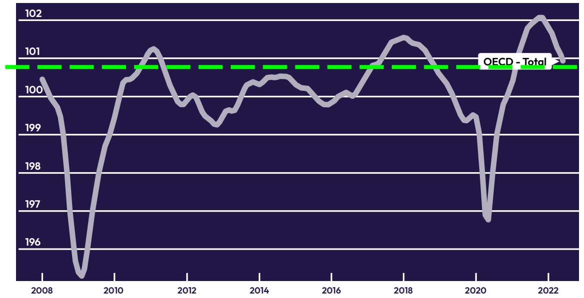
1. Both business sentiment and business confidence remain particularly strong at the mid-year point. The IBISWorld Business Sentiment Index, which gauges the overall health of the business environment, shows that pent-up demand for services led to an inflated business sentiment level in 2021. In 2022, business sentiment eased slightly, but remains elevated. And the OECD's Business Confidence Index, which provides information about the future, remains strong and in the range of historic highs.

Business Sentiment Index



Source: **IBISWorld**

Business Confidence Index



Source: **OECD**

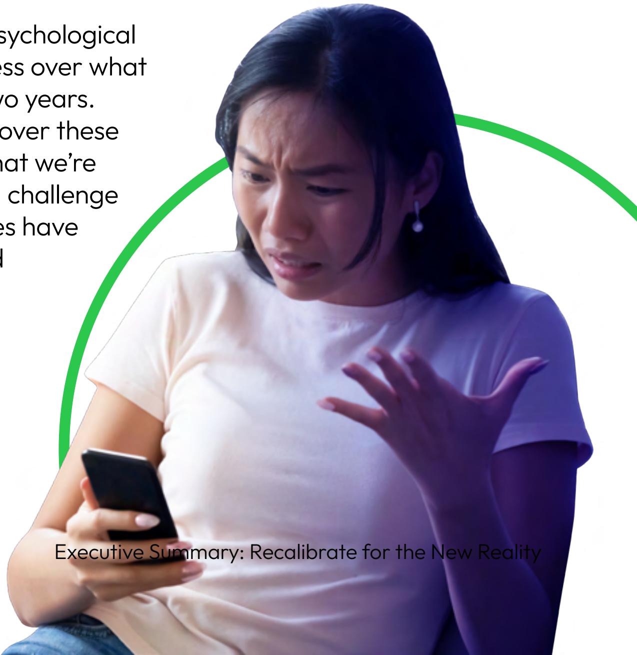
2. The US employment rate has achieved historic growth and achieved full recovery as the jobless rate fell to 3.5%, returning to the level before the onset of the pandemic. This is the best performance in jobless rates in 50 years. In addition, US workers continue to see wage gains.

3. Of the S&P 500 reported earnings, about 75% of organizations did better in the second quarter than Wall Street expected. This is only a 5% variance from normal business cycles. While businesses and investors maintain a cautious stance, overall, this is very favorable news.

So, we are all good right?

Whether we are in a recession or not does not change the facts on the ground. Consumers are experiencing a significantly different situation, one that requires specific understanding and focus for business leaders. The population has dealt with an onslaught of concerning news and market activity.

According to research conducted by the American Psychological Association, 87% of Americans report feelings of stress over what feels like a constant stream of crises over the past two years. "Americans have been doing their best to persevere over these past two tumultuous years, but these data suggest that we're now reaching unprecedented levels of stress that will challenge our ability to cope," the association says. These forces have created an unprecedented period of uncertainty and volatility.



Five Forces Shaping Today's Business Cycle

In totality, this is a very complicated environment, much more complicated than any previous economic cycle. This makes it particularly challenging to forecast and navigate. While historic business cycles were mostly driven by a central event, this environment is fueled by **five main forces, including turmoil, shocks, waves, headwinds and a financial pinch.** Much has been written about these individually, but they must be considered as a collective force:

- **Geopolitical Turmoil:** This includes Russia's invasion of Ukraine, concerns of global conflict escalation, global geopolitical tensions, ongoing domestic political debate, societal instability and central bank policy changes.
- **Supply Chain Shocks:** The global supply shocks began during the early stages of the pandemic. Many factories either reduced production or shut down entirely, most notably in China, is the world's largest manufacturer of goods (~29% of global manufacturing output).

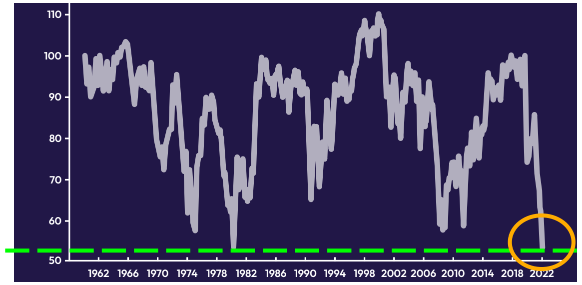
Supply chain disruption continue with lock downs, global conflicts, container ship and trailer shortages and congested port traffic.

- **New Variant Waves:** The overall pattern of the coronavirus pandemic has been a series of COVID-19 waves: surges in new cases followed by declines. As of mid-year 2022, an estimated 594 million people have been infected globally. New variant transmissions will make that total even greater.
- **Business Headwinds:** Businesses are impacted by record-high levels of employee resignations, higher oil prices, higher community prices, supply chain disruptions, higher capital expenses and shifting customer behaviors, but overall, their performance currently remains resilient.
- **Inflationary Pinch:** Inflationary trends and record-high consumer prices combined with higher federal funds rates means households must deal with an increased cost of living across goods and increasing debt costs.

These Forces Are Affecting Consumer Behavior in Unprecedented Ways

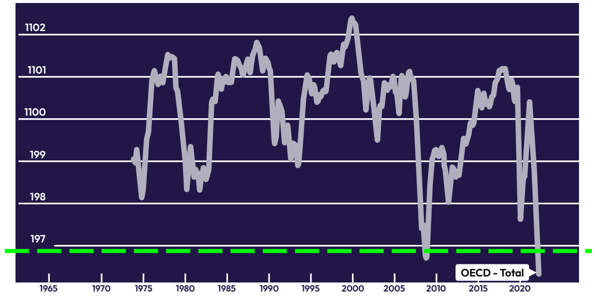
US consumers, whose spending constitutes about two-thirds of the economy, have a very different view of their situation compared with business sentiment. What is alarming is that consumer sentiment and consumer confidence indices have both sunk to their lowest levels ever—since the studies started in the 1960s. The University of Michigan tracks consumer sentiment in the US based on surveys of random samples of US households. August results remain at record lows. The composite consumer sentiment increased to 55.1 in early August, up from 51.5 in July and a record low of 50.0 in June. The Organization for Economic Co-operation and Development (OECD) produces the Consumer Confidence Index, which provides an indication of future developments in household consumption and savings regarding their expected financial situation and economic conditions. Consumer confidence levels are also currently at a record low, indicating serious concerns about their financial outlook.

The Index of Consumer Sentiment



Source: **University of Michigan**

Consumer Confidence Index (CCI)



Source: **OECD**

The dislocation between business and consumer sentiment and confidence has never been greater. Consumers are spending from savings recent consumption increase of 1% was propped by historic pandemic savings (~30% rate). Wealth decreased as S&P investments are down 38% year to date. Prices are higher, with consumer prices still at historical levels of 8.5%. Real wages are down 3% after a recent 5.2% increase is adjusted for inflation. Both debt and debt expense are rising, with credit card balances up 13%, the biggest jump in more than 20 years.

Collectively, this is eroding buying power and driving consumers to rapidly adjust their behavior in fundamental ways.

"It's still critically important that we figure out how much inflation is coming from excess demand due to fiscal and monetary stimulus and how much is coming from supply shock." "One of the lessons of the 1970s is that when you start getting supply shocks, it's extremely uncomfortable. It's not obvious that the Fed can fix that problem."

-- Austan Goolsbee, former Chairman of the Council of Economic Advisers under President Obama

Recalibrate for the New Reality

Digital helped companies remain resilient during the pandemic. A new wave of digital adoption will continue to keep businesses resilient and relevant to their customer base. Even global research firm Forrester promotes the idea that "disruptive forces necessitate bold decisions." "The old ways of working no longer work. The future is up for grabs. Leading firms will use the crucibles of 2020 and 2021 to forge a path to an agile, creative and resilient tomorrow," Forrester says.

We already see some emerging business recalibrations happening based on first-quarter and second-quarter earnings transcripts. More disciplined business spending reduced operating expenses, restricted discretionary funding and strategically reallocated capital expense to digital initiatives, and realigned portfolio and engagement with sentiment.

The **ACE approach** provides the ability to quickly identify initiatives that will mitigate exposure to recessionary forces and create competitive advantage:

A

Agility to Respond Nimbly and Quickly

Drive agility and reduce operating costs earlier in the recession cycle, to increase EBITDA. Focus on building more flexibility into investment-planning and operations. Optimize OpEx and reprioritize CapEx investments to maintain competitive advantage. Continue to virtualize new programs and the supporting IT infrastructure.

C

Customer Focus on Loyal Segments

Focus on maintaining loyalty among high-value customers and clients that are central to the company's organic growth. Consumption patterns are changing, rapidly. Protect loyal customers as a primary source of cash flow and organic growth. Rely on a continuous stream of advanced analytics from various forecasting resources to quickly understand relevant shifts in customer behaviors. Use advanced analytics and AI for intelligent pricing and a better customer experience for innovative trust and engagement programs.

E

Exit Strong With Pipeline of Innovation

Strategically increase capital expenditures with differentiated products and platforms for when the economy recovers. During the last two recessions, companies that reinvested into the downturn grew significantly faster than those with a lower reinvestment rate. Counter-cyclically increase capital expenditures on a pipeline of innovations ready to roll out on short notice. Companies that wait until the economy is in full recovery to ramp up will be at the mercy of better-prepared competitors.

ACE at Work

While the outlook remains uncertain, it is important to act now in the areas that matter most and identify the initiatives that will mitigate exposure to recessionary forces, maintain loyal customers and drive deeper market relevance. Equally important identifying, designing and delivering new initiatives quickly that will have the desired impact in the time needed. Focus on technology partners that are equally agile and have the tenacity to accelerate time-to-market.

We'll ACE this Market Together

Let Brillio help you identify, design and deliver new initiatives so your organization can align its offerings with what your customers want most right now while ramping up to deliver on their new expectations tomorrow. We have the business and digital expertise to help your organization succeed in today's challenging market conditions and beyond.

Let's recalibrate for the new reality and create something brilliant together.

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About Brillio

At Brillio, our customers are at the heart of everything we do. We were founded on the philosophy that to be great at something, you need to be unreasonably focused. That's why we are relentless about delivering the technology-enabled solutions our customers need to thrive in today's digital economy. Simply put, we help our customers accelerate what matters to their business by leveraging our expertise in agile engineering to bring human-centric products to market at warp speed. Born in the digital age, we embrace the four superpowers of technology, enabling our customers to not only improve their current performance but to also rethink their business in entirely new ways. Headquartered in Silicon Valley, Brillio has exceptional employees worldwide and is trusted by hundreds of Fortune 2000 organizations across the globe.

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