How to make the most of a downturn

Technology, media, and telecom

As the economy faces more headwinds, many companies in the technology, media, and telecom (TMT) sector have preemptively scaled back by controlling costs, freezing new hiring, reducing business travel, etc. But these are obvious steps everyone takes. To successfully navigate the downturn and come out stronger, companies should revisit lessons learned from previous recessions and consider adapting them for this downturn while crafting a strategy to take advantage of the next growth cycle.

What to prepare for

Business leaders know that it pays to act early when the economy is faltering to protect margins and look for growth opportunities. But what kind of downturn should they prepare for this time?

The current data presents a mixed outlook. The U.S. economy contracted 0.9 percent in the second quarter after falling 1.6 percent in the first quarter. But employment, consumer spending, and production have remained resilient. Even with inflation still running high and the Federal Reserve raising interest rates sharply to halt the spiral, the KPMG Office of the Chief Economist expects a mild (but possibly prolonged) recession.

Recessions, however, impact different sectors of the economy in varying degrees, with some industries hit early and others later. Technology and telecom (to a smaller extent) are generally regarded as somewhat recession-resistant since customers continue to invest in ways to save costs and operate more efficiently.

Three moves for TMT leaders now

01. Fine-tune commercial/revenue strategy. This is the time to double down on the best customers and make sure you are not losing any sales because of an outdated commercial strategy.

02. Hold on to talent. Companies that outperform during downturns recognize, reward, and retain talent, and use financial and nonfinancial incentives.

03. Use M&A for offense and defense. A downturn is a good time to prune the portfolio—and to pick up assets that can deliver new sources of growth.

Certain subsectors within TMT will feel the brunt of the current economic volatility. For instance, if household budgets get squeezed because of inflation and higher interest rates, consumer-facing companies in streaming media are likely to feel the impact immediately. Like travel, leisure, and hospitality, entertainment is a discretionary expense that consumers can quickly cut. An extended period of higher interest rates could also dampen capital investments for enterprise customers, impacting digital infrastructure-focused TMT companies.

This paper focuses primarily on what technology and telecom companies can do now to prepare for a downturn (for more on challenges for media, see "How media companies are different" on page 3).

How companies are getting ahead of the downturn

In the second quarter of 2022, KPMG surveyed 406 business leaders about the impact of inflation and recession fears on their plans. Nearly three-quarters of respondents from TMT companies said they have a high level of concern for the U.S. economy, and 70 percent believe there's a greater than 50 percent chance that the U.S. will enter a recession in the next 12 months. Some of the biggest recession-related worries for technology and media executives are losing top talent. Telecom executives are worried about slower customer additions and higher churn rates.

Seventy-two percent of TMT companies expect the recession to last less than a year and 88 percent have begun planning for navigating a downturn. Planning exercises typically involve reevaluating the long-term strategy (71 percent) and margin improvement programs (68 percent). However, there's a low appetite for divestment, with only 38 percent saying they would consider it.

What you can do now

There is still time to take the steps that can help companies prepare for potential volatility in the near term and make the most of a downturn. We have selected three tactical moves that TMT companies can make now to help blunt the impact of slowing sales and take advantage of new growth opportunities:

Fine-tune commercial/revenue strategy

In a downturn, companies must strike a delicate balance between preserving profits and maintaining (or growing) their customer base. The current levels of inflation make this an even more challenging problem. Make sure you don't lose more customers than necessary, especially the ones you really need to retain. Companies can use difficult times to get closer to key customers—helping them today can pay dividends tomorrow.

Technology and telecom companies have diverse customer bases, and companies will need different approaches to retain different kinds of customers. If you sell subscription consumer apps, for example, your actions to retain customers would be very different than if you are a telecom operator trying to keep customers from trading down to less expensive plans or carriers. If you are a B2B SaaS provider, some of your end-user industries will be harder hit during the downturn, and you will need to manage recurring revenue from those customers accordingly.

Here are some high-priority steps to adapt commercial strategy now:

Managing customer retention

Assess the impact of recession on renewals and revenue based on end-customer segments and other factors such as enterprise size, renewal/payment history, etc. Define potential impact scenarios and model revenue under each scenario. Accurate forecasting is important to identify contracts coming up for renewal, understand recession exposure, and define retention strategies. Outputs and insights should include:

- An assessment of customer-base resilience to the economic disruption
- Identification of lower-resilience "pockets" within the customer base
- Upcoming revenue at risk of nonrenewal and potential actions to mitigate
- Potential revenue impact under various recovery and depth-of-impact scenarios

Lean into your existing customer relationships. Use data and advanced analytics to identify your best customers, better understand their immediate needs, and meet them where they are (build up their awareness of other services and product features that may drive greater value).

Pricing/discounting

As the needs of your customers continue to evolve during a more volatile period along with their willingness to pay, your perceived value may change. Review your packaging and pricing (including discounting) strategy to drive intended business outcomes:

- Review your customer segmentation using a monetization lens. As your buyers react to changing macroeconomic sentiments, you may need to revisit the drivers of price sensitivity to see if different segments will be willing to pay differently based on the perceived value that they get from your offerings.
- Consider the impact of changing willingness to pay on how you package or create bundles of your offerings. Features or capabilities that were considered key to driving incremental revenue may lose some of that shine—at least for more price-sensitive segments. You may want to lean on your core offers and move optional components to your list of add-ons.

- Don't act hastily to reduce your price. Develop robust discounting guidelines based on customer and deal characteristics and manage channel discounting. Double down on ways to accelerate sales of higher-value, lower-priced items and surgically raise prices where competition is lower.

Make sure these changes align well with your strategy and your identity in the market. On the one hand, you don't want to break your bundles to the point where your customers see you as nickel-and-diming them, leading to increased sales friction. On the other hand, you do need to respond to market signals and adapt how you offer strategic concessions to key customers, strengthening your relationship with them while adding to your stickiness.

Hold on to talent

More than any other industry, talent is the lifeblood of the TMT sector. In today's unusually tight job market, companies must take prompt action to retain critical employees and keep them motivated, including:

- Updating your understanding of the employee experience. Solicit feedback through resource groups, employee survey apps, or exit interviews to identify quick wins and opportunities to engage with critical groups of talent.
- For a hybrid work environment, developing more purposeful, creative, and safe options for people to meet and connect with leaders or peers to build their community.
- Providing real-time business updates. Engage employees in the business performance and how they contribute to move the needle.
- Revisiting your compensation strategy and programs. Benchmarking survey results from one year ago is outdated already in the competition for talent. Assess the unique nature of the TMT industry and in-demand roles to determine if midyear adjustments or new grants are warranted.

Use M&A for offense and defense

Despite mixed economic signals and associated uncertainty (valuations, length and depth of a recession, etc.), the underlying drivers for M&A remain the same. Companies should be ready to use a low-valuation period to scoop up assets to strategically position themselves for future growth. Just as important, companies should be looking to sell noncore assets to help maximize shareholder value. As we demonstrated in our paper, Think Like an Activist, executives who utilize a portfolio approach (i.e., divestitures, acquisitions, etc.) can outperform their competitors.

Leading companies are regularly assessing their business and product/technology portfolios for divestiture opportunities using an active portfolio management approach and asking themselves:

- What capabilities truly differentiate us in the market?
- For businesses with disparate growth, margin, and capital profiles, is there a valid reason to keep them all, or can incremental value be unlocked?
- How should we invest more in our "keepers"?

As you develop a list of potential M&A targets, keep your strategy focused on strengthening competitive advantages during the downturn. And for timely reaction to rapid changes in the market environment, build scenario planning into your M&A evaluation process that looks at, among other things:

- Cost of capital rising
- Continued high inflation and impacts to profitability
- Opportunities for synergies and margin expansion as customers potentially cut costs and input prices rise
- Employee retention amid a tight job market (see above)

How media companies are different

Most media firms are primarily driven by consumers. As they tighten purse strings, they could quickly cut back on discretionary spending, including media consumption. With consumers "trading down," companies will need to carefully manage promotions, churn, etc. Advertising is also highly correlated to GDP growth, and the slowing economy will put pressure on ad-supported business models. However, companies can use a downturn not only as an opportunity to reduce overall costs but also to reinvest in areas of growth and needed capabilities. Common areas to investigate include cost to serve, content, and technology, as well as overall organizational structure. On the bright side for many media companies, the current downturn may be relatively mild compared to what they went through during the COVID-19 lockdown (for example, live events and movie theaters had zero revenues).

One area of media that has market-growth tailwinds and can be a cheaper source of entertainment for cash-strapped consumers is video gaming. During the pandemic, bored consumers took up gaming in droves. As video games tap into exciting new technologies (e.g., virtual reality, augmented reality, nonfungible tokens), gaming companies would need to carefully manage investment levels to continue growing their customer base coming out of a downturn.

How one company is preparing

A $2 billion privately held provider of software and services has been positioning for a downturn for months. Leadership has launched aggressive cost management, including creating a lean organizational structure to fit current business needs. To address below-industry-average gross and net revenue retention performance, it continues to invest to transform the customer experience. For example, it is optimizing services packaging and pricing. At the same time, the company is actively reviewing its portfolio, splitting up one business and evaluating underperforming business lines for possible divestiture. These steps are helping the company make the most of the volatile period and better position for growth by: 1) refocusing the organization on its core business; 2) investing in its capabilities, offerings, and talent base; and 3) resizing the organization to create agility when growth resumes.

How KPMG can help

In good times and in recessions, we help clients address their greatest challenges and pursue the most profitable opportunities. KPMG advises leading organizations on strategy, transactions, and performance transformations. We have extensive experience helping companies plan and implement growth strategies, cost improvement initiatives, and M&A programs. Our teams bring deep knowledge of corporate functions—HR, sales and marketing, customer success, technology, finance, supply chain, ESG, etc.—and have decades of industry experience. We rely on data-driven techniques to help clients quickly address problems and uncover new sources of value.

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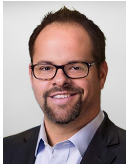

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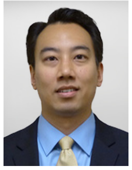

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