How Financial Services Companies Can Navigate an Economic Downturn: 5 Actions for Leaders

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Whatever your view on whether we are in or headed for an economic downturn, the data supports the fact that conditions are certainly indicative of one in the coming months.

Growth in capital spending will also slow this year, with S&P 500 companies planning for an estimated 6% increase compared to 20% last year.

And World Bank recently announced global GDP growth forecasts at the slowest pace we've seen since 1993 (apart from the 2009 and 2020 recessions) – a mere 1.7%. Plus, World Bank experts said they expect the average growth from 2020 to 2024 to be the slowest five-year pace since 1960.

What does this mean for financial services?

Any economic downturn is going to drive up costs and prices, which in turn reduces demand. Combined, these two phenomena squeeze margins and put unprepared organizations in difficult situations.

Within this inflationary environment, financial services institutions will deal with a plethora of unique challenges, as well.

- An uptick in fraud is expected and will exacerbate the challenges organizations must overcome.
- Most financial services institutions will have to set aside additional reserves to cover anticipated future losses.
- The cost of labor is increasing. The cost of capital, likewise, is going up.

Downturn-Proofing Your Business: 5 Areas of Focus for Financial Services

So, what can financial services leaders do to position their firms to thrive in the coming months? Focus on five key levers.

This is not a sequence insomuch as it is a convergence of factors that, when monitored and managed successfully, can help financial services firms weather the economic downturn unscathed. And even, perhaps, better positioned for growth than they were pre-downturn. Those organizations that prioritize future-focused action will emerge stronger on the other side.

1. Identify Likely Scenarios and Outcomes

When there's uncertainty in the market, financial services executives rely on scenario-based contingency planning to find opportunities to cut costs, increase liquidity, and make strategic investments. To do so, they need access to timely, accurate information that can aid in quick, agile decision making.

The first step is to identify how things could play out given a variety of factors. How likely are you to see declining transaction volumes? Where might your costs rise the fastest? And then forward-thinking leaders will get out in front of those potential disruptions.

When developing these strategies, scenarios, or contingency plans, it will also be critical to nail down the indicators that will give leaders the signals to execute specific plans (see action three below for more details on this).

Keep in mind that these roadmaps should be regularly reviewed to take into account new information and shifting goalposts.

2. Identify and Execute on Quick Wins

There are short-term preventative measures financial services institutions can take at the front end of an economic downturn.

On the cost side, consider locking in interest rates, deferring expenses, or renegotiating with suppliers. On the pricing side, think about modifications to your pricing and product mix.

You'll also want to take every opportunity to strengthen your balance sheet and ensure you have sufficient liquidity to cover any potential downturns. Proactively refinance debts as required and keep access to capital top of mind. Consider locking debt and capital in at a target interest rate before conditions worsen. Plus, with interest rates rising, firms with variable rates on their debt should consider a hedge to better understand what their interest costs will be.

There may also be opportunities to reduce systemic costs related to selling, general, and administrative expenses. Evaluate your existing processes for quick efficiency gains (e.g., insurance companies may reclassify some claims as small, which can be easily handled).

Talent is another area that might be worth exploring, but now is not the time to make aggressive reactionary cuts. Be intentional and long-sighted about any reductions in force before making any decisions.

3. Monitor Timely Early-Warning Signals

Another key step in navigating any economic downturn revolves around ensuring leaders have the right data at their fingertips in a timely fashion to be able to make quick, strategic decisions.

Why can this be challenging? Often, the critical data needed sits in various different places, is difficult to access, agnostic of third-party data, and inconsistently presented. The latter is especially important so that modern analytical techniques can be applied (e.g., exception reporting, artificial intelligence, and machine learning).

For example, if you are looking at the underlying drivers of margin or cash flow data, and the numbers you have are a day old, the opportunity to adjust or optimize returns could be lost, resulting in decreased profitability.

While many of us are familiar with the concept of dashboards, especially coming out of the COVID-19 pandemic where there was much uncertainty, your executive dashboard should enable your organization to envision how you manage through any current or future uncertainty. For three key financial services subsectors, dashboards should focus on the following areas:

- Banking examples of key analytics and metrics
  - Analysis of the yield curve impact on commercial and retail loan pricing and margins
  - Understanding of credit quality trends at the customer and transactional level
  - Measurement of customer-level performance highlighting behavior and leading to proactive interactions
  - Rigor in liquidity management to include cash inflows and outflows
  - Market trends and activity such as acquisitions, divestitures, product, and rate movement

- Insurance examples of key analytics and metrics
  - Prioritize margin over market share
  - Control the increase in claims and fraud costs impacting operating performance
  - Added focus on investment portfolio performance reinvestment strategy
  - Monitor a range of metrics, including liquidity and asset valuations
  - Leverage open insurance to provide additional insights and risk analysis through digital historical data

- Wealth management examples of key analytics and metrics
  - Real-Time monitoring of asset inflows/outflows
  - Continuous evaluation of client reallocations from equities to fixed-income investments (and vice-versa)
  - Analysis of fee income impacts via scenario analysis / Monte Carlo simulations
  - Visibility into sector exposure metrics to monitor portfolios and limit downside risks
  - Monitor hedging positions/opportunities to align with market shifts to maximize alpha and limit beta
  - Evaluate shifting client behaviors from quantitative to qualitative portfolios

4. Remain Agile

Agility is one of the most important factors in determining which organizations will weather economic downturns successfully. A big part of ensuring that agility comes from not only having access to good, timely data but also from being able to interpret it. Those organizations that can optimally leverage their data to quickly pivot in important areas such as product mix, customer engagement, and operational efficiency, will come out on top.

Consider how you can prepare your organization in advance to be agile, even through difficult, disruptive periods. When you know your challenges, have information at hand to understand your options, and your leaders have been prepared to lean into their agility, your organization will be better positioned to succeed and thrive in uncertainty. Advancing and optimizing your operating model to ensure you have the right leaders looking at the right data (and that they are empowered to act on that data) can differentiate agile organizations from their peers. Simple actions such as modifying the frequency of key meetings, establishing discipline around email updates, or even going so far as to establish "war rooms" to address and manage key risks can all be helpful tools to manage and communicate the need for agility.

5. Invest for the Long Term

Most organizations will focus on the first four actions, which are primarily focused on the short term. However, the most forward-thinking organizations will see an economic downturn as an opportunity to invest and leapfrog competitors.

To start, make sure you have a long-term plan that looks beyond the current economic turbulence and into the future. A plan that is grounded in both customer needs and expected structural changes in the industry.

Long-term investments that align with this future vision will likely be those that aggressively manage costs and drive productivity but also strengthen your ability to differentiate and command a price or margin premium over the competition. What tools, modules, and experiences will you need to become the provider of choice in the future? Are there opportunities to acquire capabilities (perhaps at a lower premium than in recent years) that might accelerate your path toward that future vision?

For some organizations, an economic downturn represents an opportunity to accelerate investments in digital as a part of your overall strategy to compete. The firms that emerge on top will be those that make longer-term decisions and investments to evolve their organization, meet the most pressing challenges, and drive growth for the future.

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