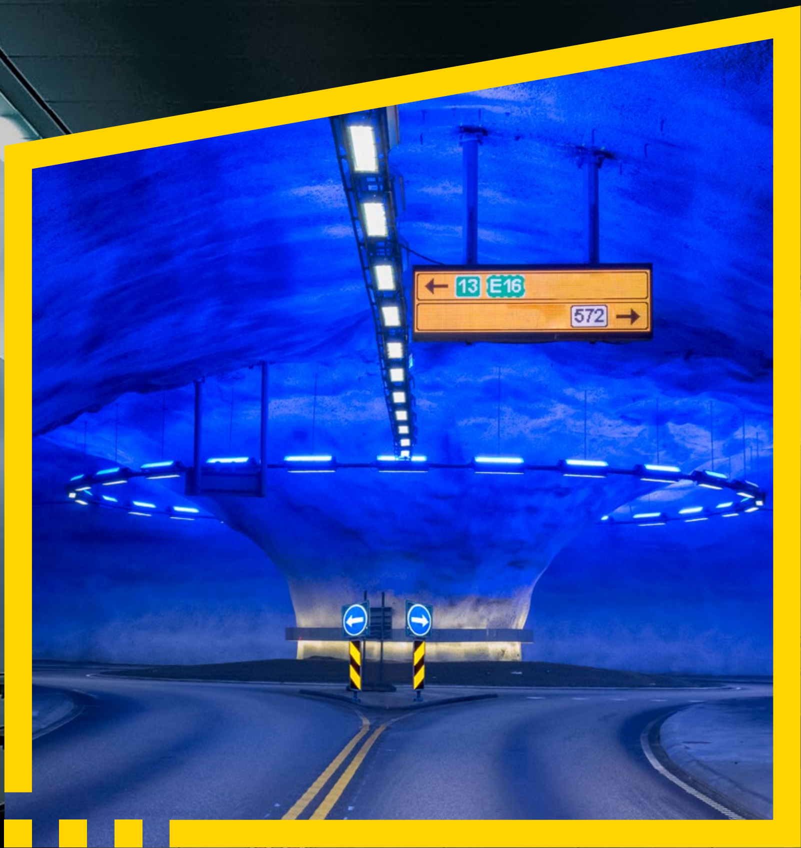
CEO Imperative Series



The CEO Imperative: How will CEOs respond to a new recession reality?

EY CEO Outlook Pulse Survey – January 2023
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Contents

CEO Outlook Pulse – January 2023 finds that CEOs are split on the impact of the global economic slowdown.

Moderate vs. severe; temporary vs. persistent: Divergent views on the economic outlook among global CEOs underline the uncertainty that looks set to define the business environment in 2023. An EY study of 1,200 CEOs globally finds that while almost half of respondents foresee a moderate slowdown in the global economy, more than half fear a recession worse than the global financial crisis for the period 2008–10 in terms of its length and severity.

The latest edition of the CEO Imperative Series, which provides critical answers and actions to help CEOs reframe the future of their organizations, finds companies addressing difficult challenges on many fronts. In response, they are combining bold strategic decisions with operational adjustments to weather the coming storm and maintain a course toward long-term value creation.

In brief

- CEOs are downbeat on the global economic outlook and their own sector but are drawing on pandemic lessons to navigate headwinds and a likely recession.
- Geopolitics is heavily influencing M&A strategies as CEOs focus investments on politically like-minded shores.
- CEOs are embedding ESG into strategy to create brand value and build trusted relationships with customers, employees and other stakeholders.

Chapter 1

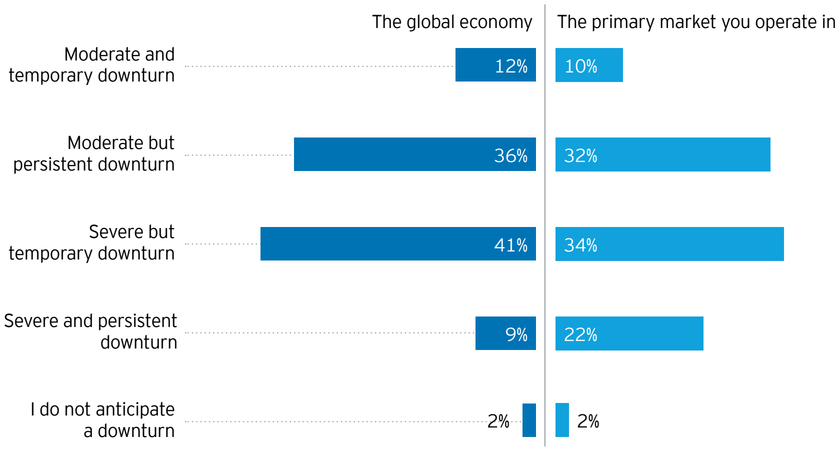
Planning for multiple possible futures

Half empty or half full, the economic outlook has a bitter taste.

Findings from the latest quarterly EY CEO Outlook Pulse show CEOs are split on the impact of the global economic slowdown. While the vast majority – 98% – expect a recession, there is little consensus on its length, depth and severity. Interestingly, CEOs are also divided on the outlook for their own addressable market, into which they will have greater insight into anticipated activity levels.

Q **Considering the current global macroeconomic environment, what scenario are you planning for in connection with a potential economic downturn?**

The respondents were allowed to select one option for each statement.



98%

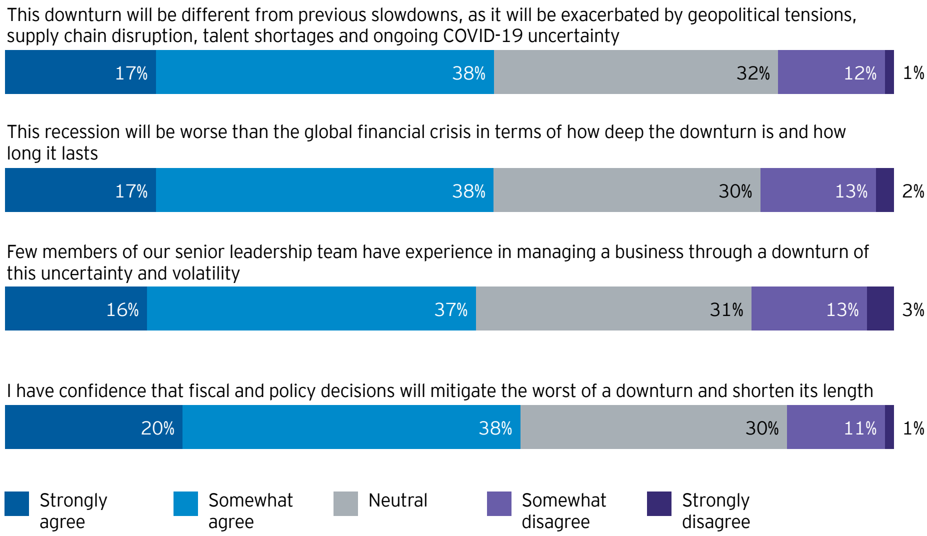
of CEOs expect a recession.

Whether they anticipate a moderate or severe downturn, more than half (55%) of CEOs agree that the recession will differ from previous slowdowns, exacerbated by a unique combination of new factors – from a realignment of geopolitics to a wholesale reassessment of global supply chains and operations.

A similar number (53%) also agree that few members of their senior leadership team have experience in managing a business through any potential downturn marked by uncertainty and volatility.

However, given the unique conditions, experience with downturns might be less important than understanding new geopolitical tensions, supply chain disruption, talent shortages and the ongoing COVID-19 pandemic fallout helping fuel the slowdown. Leaders in this current generation have built a new set of skills during a global pandemic that could serve them well now.

Q **You have indicated you are planning for a severe or persistent downturn in the global economy and/ or your primary market. To what extent do you agree or disagree with the following statements?**



55%

of respondents globally believe that the looming downturn will be worse than the global financial crisis.

Nevertheless, the level of uncertainty is highlighted by the 55% who believe that the looming downturn will be worse than the global financial crisis of 2008–10.

This concern could reflect the belief of many CEOs that the “safety net” factors that helped soften the previous crisis’ impact are now absent. That global downturn was ameliorated by strong growth in China creating demand — and in China’s increasing importance as part of a globalized economy — helping keep inflation in check.

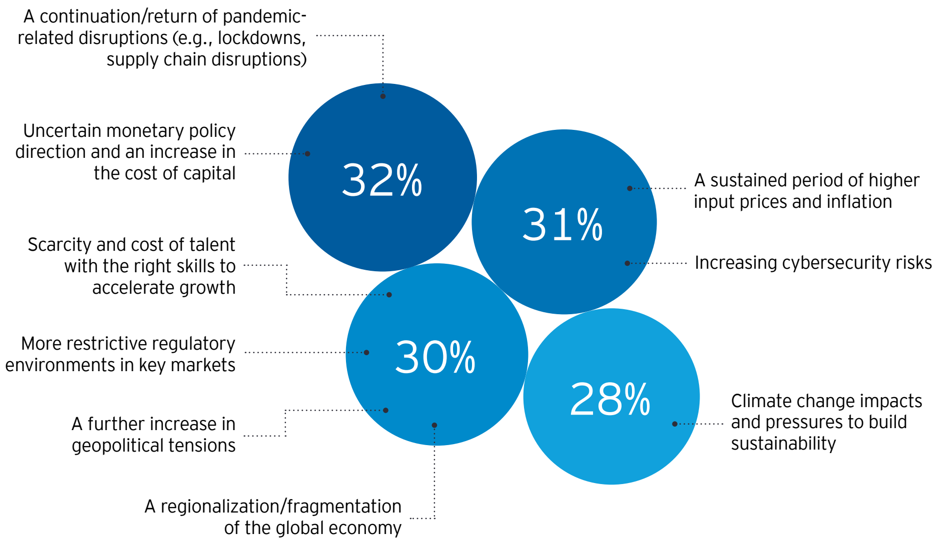
Given recent inflationary pressures and the upward movement in interest rates, central banks and other policymakers may have far less room to maneuver this time around should the recession become severe.

Once again illustrating the divergence of opinions, however, almost two-thirds (58%) of CEOs globally have confidence that fiscal and policy decisions will mitigate the worst aspects of a downturn.

Q **Which of the following do you consider to be the greatest risks to the growth of your business?**

The respondents were allowed to select up to top three priorities.

Risk radars on verge of jamming under a volume of potential threats



In our October study (pdf), the ongoing pandemic-related concerns stood out as the major issue. While these have receded, with a third of CEOs now citing pandemic-related disruption as the key issue (down from 43%), they remain significant.

But those concerns have now been supplemented by a host of other interconnected issues threatening CEO growth strategies.

Monetary policy uncertainty and the increase in the cost of capital are interrelated to higher input prices and inflation. Increasing cybersecurity risks are intertwined with heightened geopolitical tensions, with state-sponsored bad actors in the cyber realm a threat facing corporates.

Meanwhile, an increasingly fragmented global economy will lead to more restrictive regulatory environments in key markets. And companies' talent availability increasingly combines with their sustainability efforts under their wider environmental, social and governance (ESG) agendas.

Nevertheless, many CEOs see potential reward on the other side of the risks and identify opportunities to emerge from the downturn in a position stronger than their competitors.

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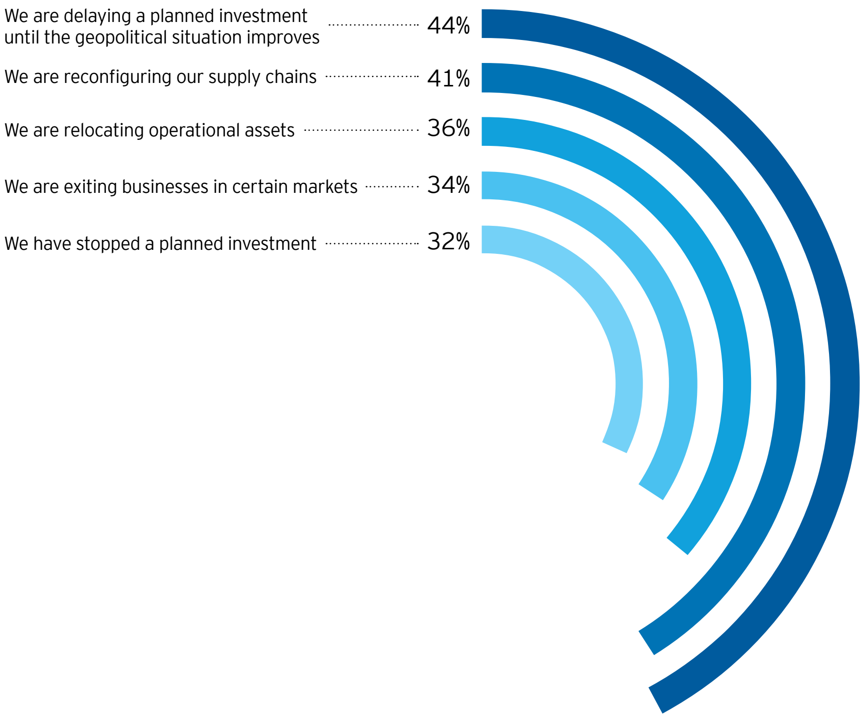
To do so will require a rapid response and proactive strategies to realign their operations and increase investment in the future of their business. And those responses are taking shape.

Embracing new geopolitical shifts and realignment

One area where we find CEOs acting decisively in a changing environment is the new geopolitical environment. Almost all CEOs (97%) have altered their planned investment strategies in response, with almost a third (32%) halting a planned investment.

Q **As a result of geopolitical challenges, have you made any of the following alterations to your strategic investment plans?**

The respondents were allowed to select multiple responses.



97%

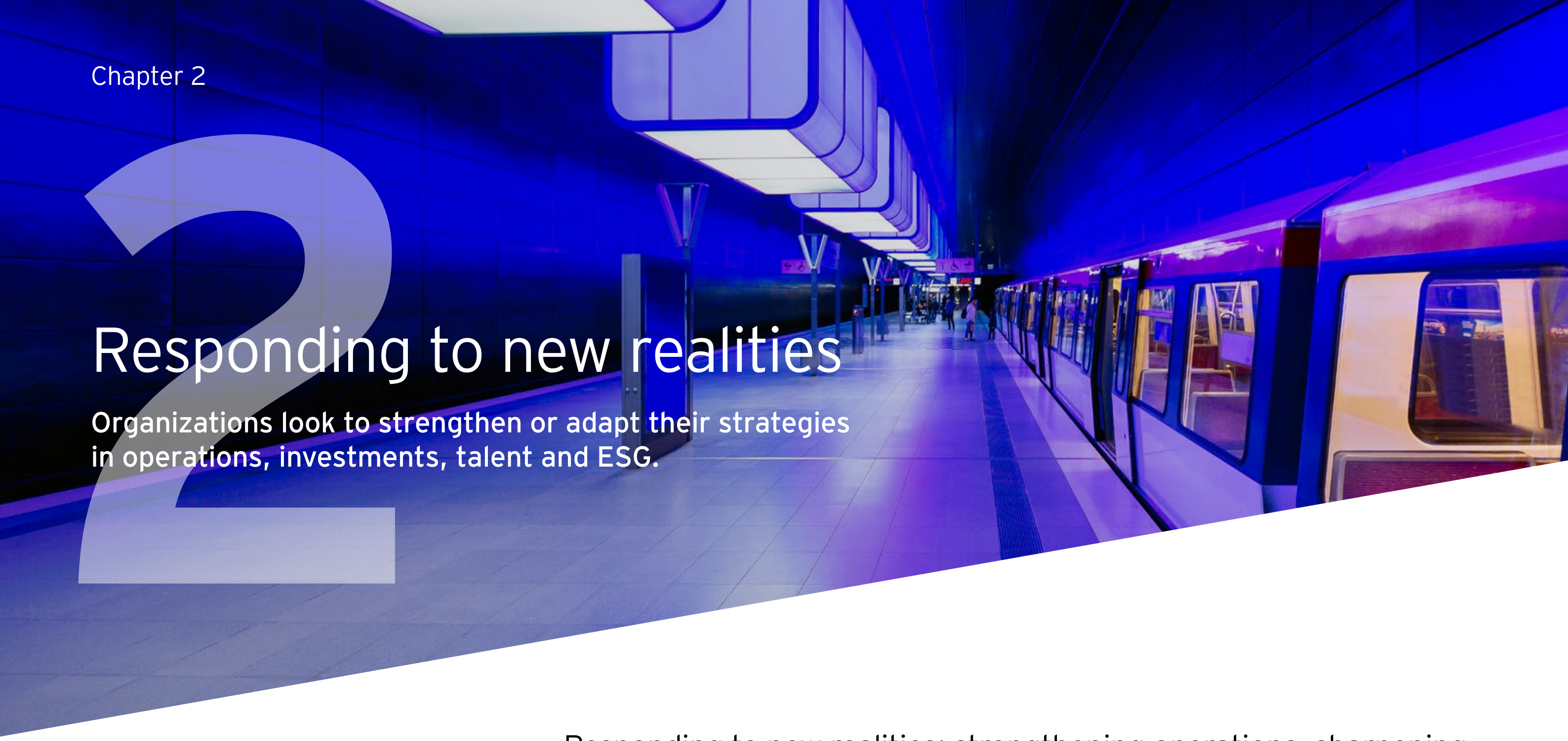
of CEOs say they have altered their planned investment strategies.

While this number is similar to the findings in the October survey, there is a key difference. Restrictive regulatory, trade and investment policies have supplanted ongoing COVID-related issues as the key reason for altering international investment plans, with 28% citing it as their main driver.

Geopolitics has been increasingly volatile in recent years, with US-China tensions and the rising assertiveness of a variety of middle powers driving a shift from a unipolar to a multipolar world.

The result is that the era of relatively liberalized global trade amid ever-increasing globalization has ended, at least for now. In its place is a transformed global operating environment in which geopolitical dynamics play an increasingly important role in business decisions. Compounding the challenge of heightened geopolitical volatility, the medium-term outlook for globalization is highly uncertain, as explored in EY scenario analysis of how the world may be in five years.

The importance of geopolitics to corporate strategies is at its highest in a generation. Leading executives are implementing a more systematic management of political risk through transformed governance structures and processes. This often also includes a regular assessment of how geopolitical developments affect current strategy and the proactive inclusion of political risk analysis in mergers and acquisition (M&A), market entry and exit, supply chain and international footprint decisions. By embedding geopolitical analysis into the company's DNA, the organization will be better able to account for political risks when making strategic decisions, giving it a potential advantage over competitors.



Chapter 2

Responding to new realities

Organizations look to strengthen or adapt their strategies in operations, investments, talent and ESG.

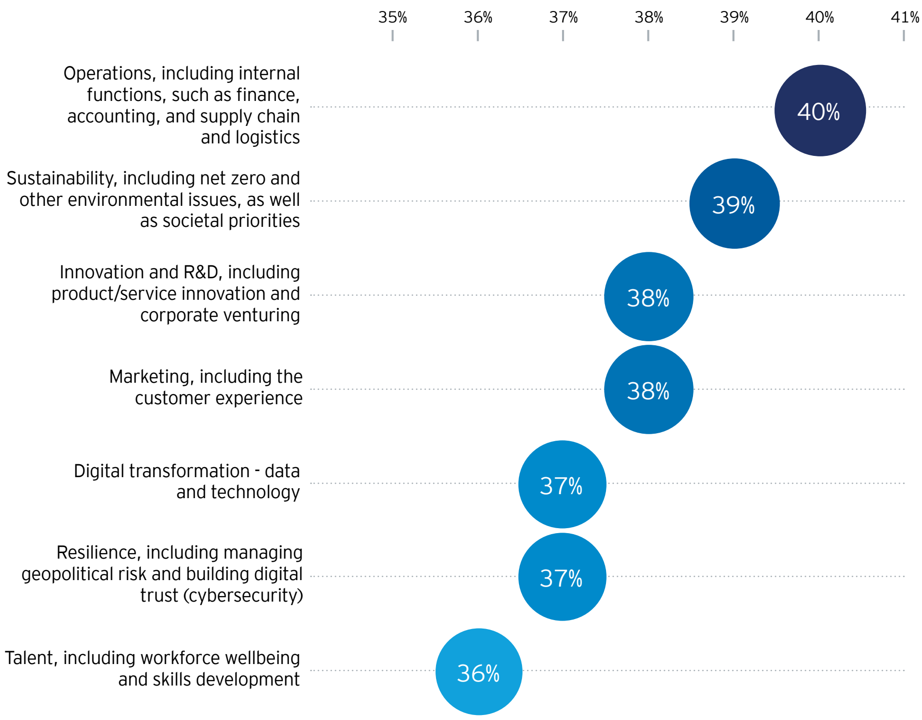
Responding to new realities: strengthening operations, sharpening investment strategies

In addition to their strategic geopolitical responses, CEOs are addressing a mix of short- and longer-term investment priorities.

On the one hand they are doubling down on "business as usual." This can be seen in plans to boost operations – including internal functions, such as finance, accounting, and supply chain and logistics – and focus on marketing, including the customer experience. These can be viewed as moves to protect against emerging challenges.

Q **In order for your organization to emerge from a potential downturn in a position stronger than its competitors, in which of these areas would you need to lean-in to and increase investment?**

The respondents were allowed to select up to top three priorities.

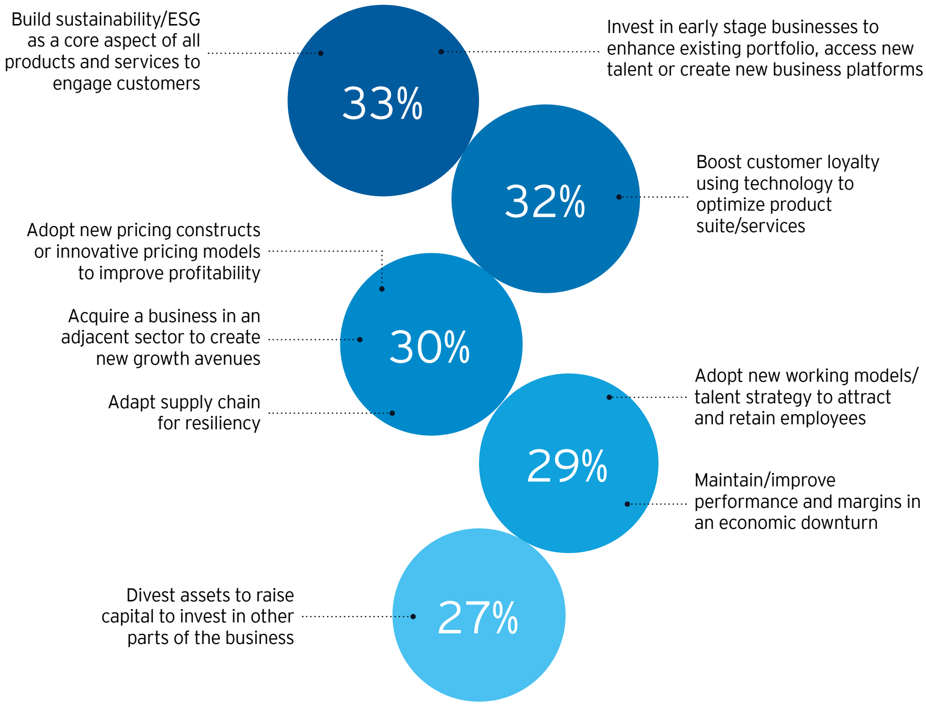


However, there are also clear long-term shifts. From increasing investment in sustainability, environmental and broader societal issues to a focus on innovation and research, CEOs are looking at a longer horizon.

In this context, CEOs are actively considering what specific actions will move the dial the most for their company, considering their strengths and weaknesses and where they sit within the competitive landscape. They are identifying the actions required to emerge stronger with an enhanced competitive position in the next six months and beyond.

Q **Which of the following are the most important strategic actions your company will pursue in the next six months?**

The respondents were allowed to select up to top three priorities.

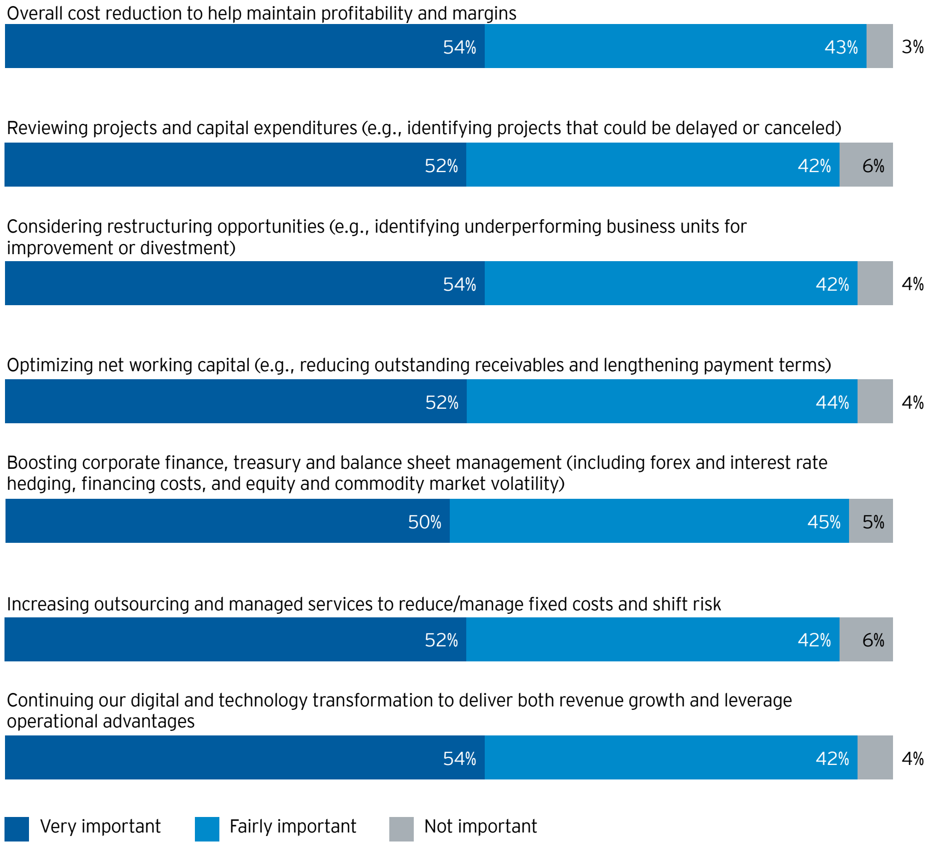


The key focus areas are becoming a more sustainable business, investing in innovation and new business platforms, boosting customer loyalty using technology, and adopting new pricing constructs or innovative pricing models to improve profitability.

These are bold, but measured, moves with an underlying discipline that supports the ambition to grow in an uncertain environment. Investment plans are being balanced with a strong focus on getting the fundamentals right.

Q To what extent are the following initiatives a priority for your business over the next six months?

The respondents were allowed to select one option for each statement.



Across every dimension that would construe a highly efficient internal management approach, CEOs are placing the required level of focus. The attention to controlling costs, reviewing projects and capital expenditures, and optimizing working capital will be a key enabler for financing digital and technology transformation to deliver both revenue growth and leverage operational advantages.

In the same vein, many CEOs will invest to emerge stronger in the near and medium term by taking three steps:

1. Identifying restructuring opportunities
2. Increasing outsourcing and managed services to reduce or manage fixed costs and shift risk
3. Boosting corporate finance, treasury and balance sheet management

This will lay the foundations to create long-term sustainable value for all stakeholders.

Responding to new realities: adapting the talent agenda

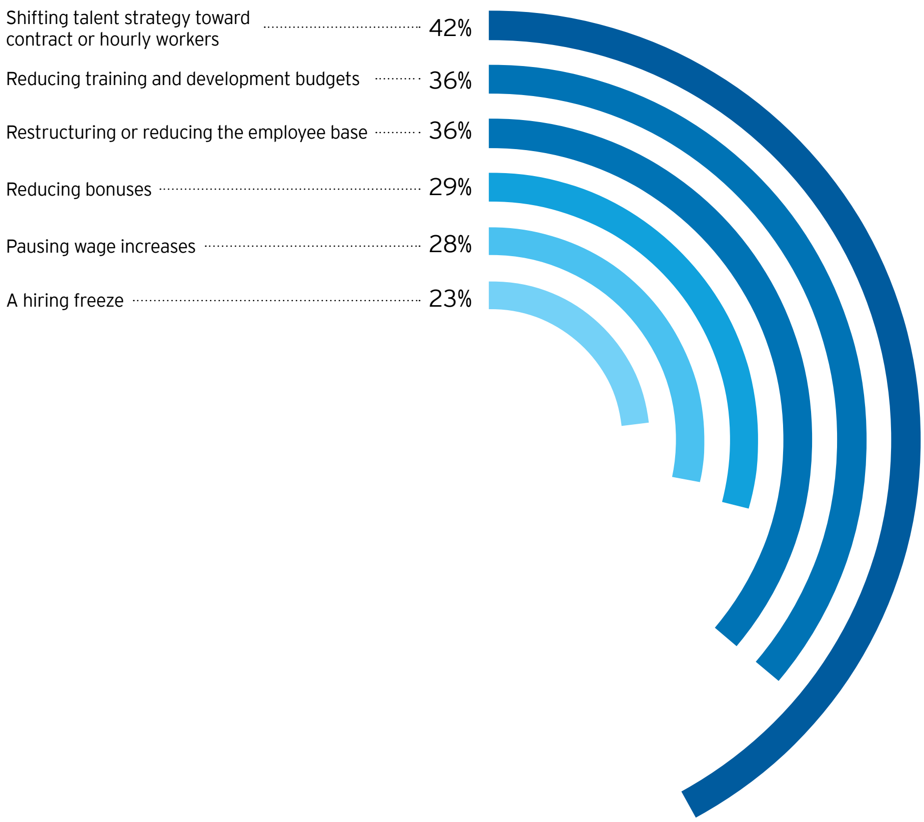
Even though the global economic outlook looks uncertain and some organizations – most notably prominent companies in the technology sector – have been reducing headcount, the overall labor market remains very tight.

This illustrates the fine line CEOs have to walk – the balance between managing costs and preserving investments in talent.

Some CEOs are weighing cost management options in relation to people – with 42% considering a move to contract employment. More than a third (36%) are considering a restructuring or reduction of workforce and a similar number plan on reducing learning and development (L&D) investments.

Q In response to economic headwinds, are you planning or considering any of the following steps in the near term?

The respondents were allowed to select multiple responses.



42%

of CEOs are considering shifting talent strategy toward contract or hourly workers.

This is in line with previous recessions. Pressurized labor markets have been a hallmark of previous downturns as companies managed costs. But almost three years after the COVID-19 pandemic hit, companies around the world are still concerned that the talent they need is in short supply. Consequently, only a third are actively considering a hiring freeze.

The number of CEOs focusing on managing talent costs is not only matched but outnumbered by those focusing on key ways to retain talent and find the skills they need for the future.

The experience of losing skilled talent and having to hire in a hot labor market, at great cost and lost efficiencies, is still fresh in CEOs' minds. Many are looking to expand their current talent pool, adopting to the new working realities that have emerged in a post-pandemic world.

Q **Thinking about talent, skills and employee resilience, to what extent do you agree or disagree with the following statements?**

The respondents were allowed to select up to top three priorities.

More than two-thirds of respondents agree that new working practices wrought by the pandemic experience – such as flexible and remote working – are increasingly critical to reducing employee churn and attracting new talent. More than half (59%) agree that during a downturn, there is an even greater need to focus on workforce wellbeing, including issues such as supporting childcare and mental health.

And there is a boldness in CEOs' desire to further improve their talent strategies. More than half (57%) say that other companies reducing their headcount during a downturn is an opportunity for their organization to attract and retain new talent. Even for those not looking to increase headcount, a similar number (56%) say they have begun shifting from hiring new talent to upskilling their current workforce.

57%

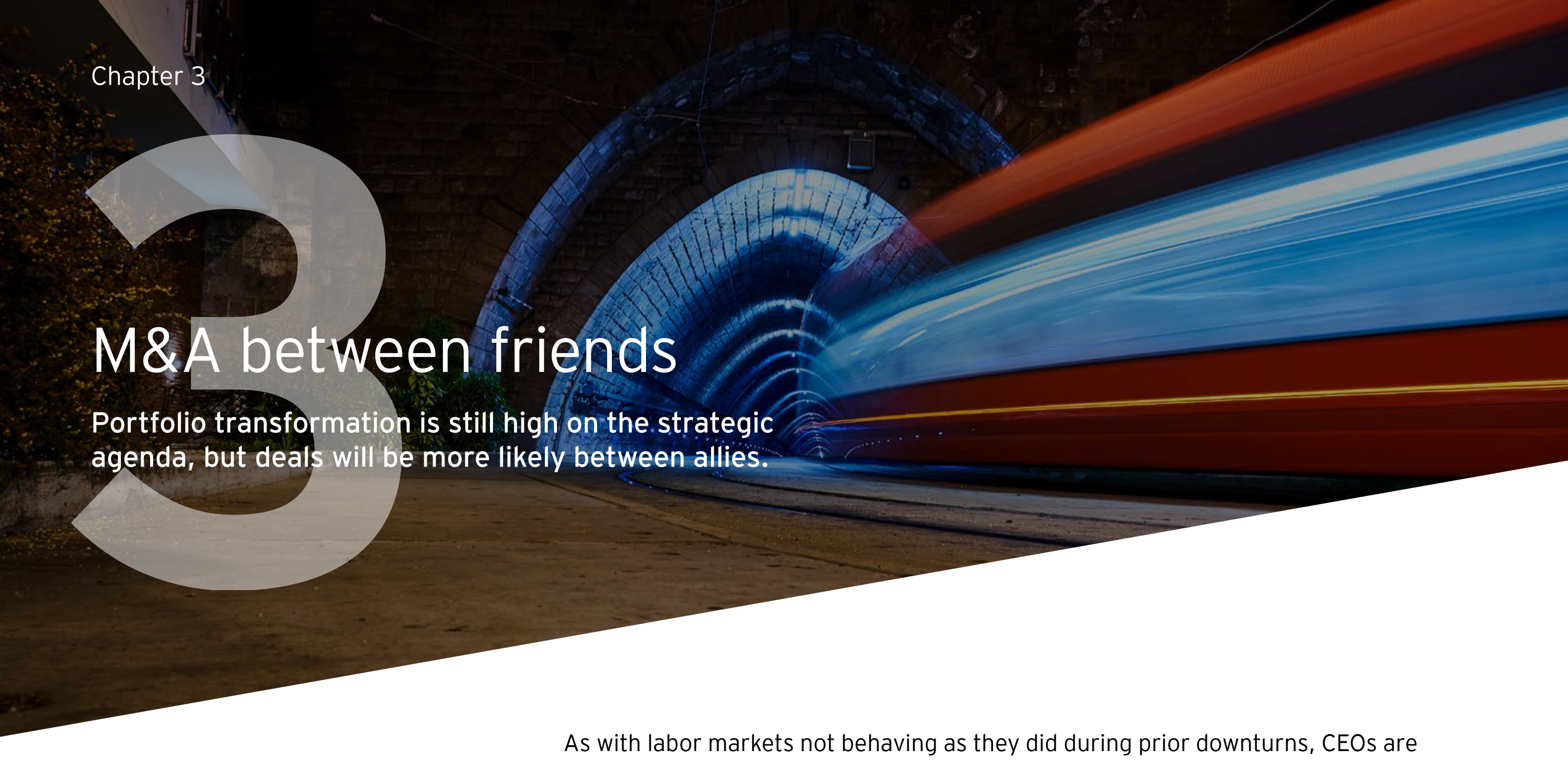
of CEOs say that other companies reducing their headcount during a downturn is an opportunity for their organization to attract and retain new talent.

Responding to new realities: embedding ESG in corporate strategies

CEOs also see critical advantages to embedding ESG factors into their strategic planning to strengthen the brand and build trust with key stakeholders, including employees, customers and communities.

Other advantages of a continued focus on ESG are diversifying their product or service offering and meeting the changing ESG demands of customers, or acquiring talent and capabilities to accelerate their ESG agenda — such as sustainability technologies from the startup or innovation ecosystem.

Another key consideration is responding to a changing political environment, including increasing scrutiny of corporate practices and the improvement of ESG ratings scores that can positively impact investor decision-making.



Chapter 3

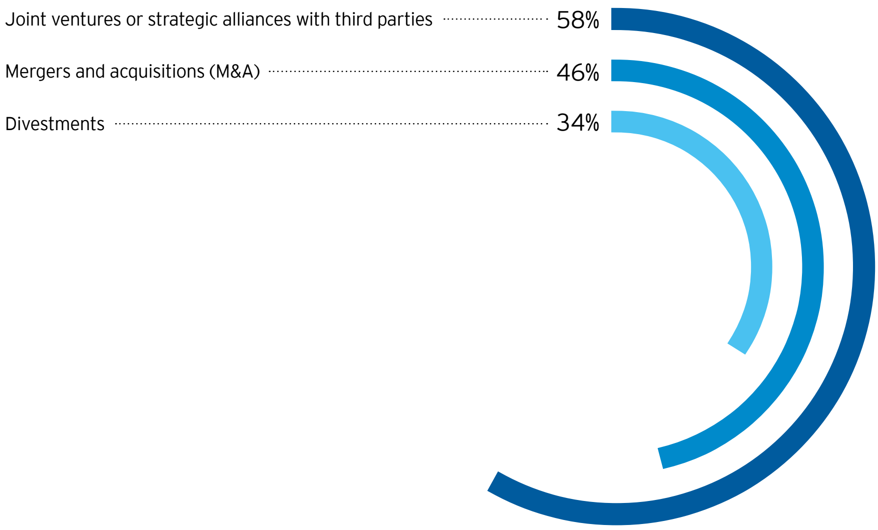
M&A between friends

Portfolio transformation is still high on the strategic agenda, but deals will be more likely between allies.

As with labor markets not behaving as they did during prior downturns, CEOs are signaling that while we may see a softening in the deal markets, we can expect the appetite to do deals to keep M&A above the normal downturn trend.

Q **Do you expect to actively pursue any of the following transaction initiatives over the next 12 months?**

The respondents were allowed to select multiple responses.



89%

of executives expect to actively pursue some kind of transaction over the next 12 months.

Nearly all respondents (89%) are looking to do some kind of deal over the next 12 months, with nearly half (46%) looking to buy assets, a third (34%) looking to divest, and 58% looking to enter a joint venture (JV) or strategic alliance. These ambitions mirror other proactive strategies demonstrated by CEOs throughout this survey.

The main focus on the buy side will be investing in early stage businesses to enhance existing portfolios, accessing new talent or creating new business platforms (cited by 33% as a key action in the next six months). But bigger deals will happen when the opportunity arises. It is on divestitures that the M&A market will likely see bigger deals in the first half of 2023, with companies ready to trigger larger carve-outs and spin-offs. Private equity will be well placed to snap up smaller divestments, and the IPO markets, while not booming through 2021, have shown that they are open to high-quality spins.

But the major action will be in JVs and strategic alliances, as companies look to transform their operations and ecosystems to build resilience, boost innovation and position for future growth.

M&A in 2023 will be a friendly affair

One key characteristic of transactions in 2023 aligns with CEO perspectives on critical geopolitical issues with investment plans determined by "friendshoring" considerations.

Of those planning an acquisition in the next 12 months, less than 1 in 10 CEOs will now consider acquiring in a market where their home country does not have a strong geopolitical and economic relationship.

On the other end of the scale, almost four-fifths (78%) will look to conduct M&A in countries geopolitically and economically aligned with their home country.

Given the robust deal appetite, CEOs clearly still recognize the accelerated transformation opportunities of M&A and are pursuing transactions to help position their organizations for future growth. There is still a strong appetite for cross-border investments, but CEOs will be more selective in who they do deals with in 2023 and will pursue transactions within friendly pockets rather than applying a truly global approach.

Explore the previous edition of EY CEO Outlook Pulse – October 2022.

78%

of CEOs look to conduct M&A in countries geopolitically and economically aligned with their home country.

5 KEY CONSIDERATIONS for CEOs in 2023

1

Get ahead of potential developments – CEOs should use scenario planning to understand the possible futures for their business and plan for a number of different outcomes.

2

Continually reassess everything – CEOs should analyze every aspect of their current business, operations, portfolio and ecosystem. They should also consider if the aspects are additive or dilutive to their journey and be prepared to make quick decisions on buying, building, partnering – or letting go.

3

Look up to see further – Despite the understandable inclination to manage through near-term complexities and challenges, CEOs also need to remain focused on longer-term opportunities for growth.

4

Stay close to the customer – Whether it is investing in new technology to foster loyalty or continuing to align with ever-increasing ESG expectations, CEOs should remain laser-focused on their consumers through turbulent times.

5

Be bolder by design – Previous recessions have shown that CEOs who invested in future capabilities during the downturn benefited the most during the upturn. Being bold to accelerate your strategy could pay dividends at a later date.

About the survey

The *EY 2023 CEO Outlook Survey* aims to provide valuable insights on the main trends and developments impacting the world's leading companies as well as business leaders' expectations for future growth and long-term value creation.

It is a regular pulse survey of CEOs from large companies around the world conducted by FT Longitude, the specialist research and content marketing division of the Financial Times Group.

In November and December 2022, FT Longitude surveyed on behalf of the global EY organization a panel of 1,200 CEOs in 22 countries and across six industries. Respondents represented the following industries: advanced manufacturing and mobility; consumer products and retail; energy and resources; financial services; health sciences and wellness; and technology, media and telecoms.

- Surveyed companies' annual global revenues were as follows: less than US$500m (20%), US$500m-US$999.9m (20%), US$1b-US$4.9b (30%) and greater than US$5b (30%).
- The CEO Imperative Series provides critical answers and actions to help CEOs reframe their organization's future. For more insights in this series, visit ey.com/en_gl/ceo.

Contacts

For a conversation about your capital strategy, please contact us:

Authors

Andrea Guerzoni
EY Global Vice Chair
Strategy and Transactions
andrea.guerzoni@it.ey.com
+39 028 066 93707

Nadine Mirchandani
EY Global Deputy Vice Chair
Strategy and Transactions
nadine.mirchandani@ey.com
+1 212 773 0090

Barry Perkins
EY Global Lead Analyst
Strategy and Transactions
bperkins@uk.ey.com
+44 20 7951 4528

EYG no. 000464-23Gbl

2212-4148562

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