Make Your Own Luck

What COVID Can Teach Us About Building a Crisis-Resistant Business

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INTRODUCTION

Unlike other crises executives may have led through before, the coronavirus pandemic's effects know no geographical or societal bounds. All countries, industries, and individuals have been affected. And unlike a crisis with a human-made root cause, like an economic recession, the spread of this novel virus is largely outside human control. The endpoint is far less easy to predict, and the long-term implications are not clearly defined.

Just as we're only beginning to understand the ramifications of the virus on the human body, COVID-19's effect on business is only now being more closely examined. This exploration of the crisis's effect on industry and economies will continue for years to come.

The Sterling Woods Group undertook its own exploration into the effects of the pandemic on middle-market companies. We spoke to 40 executives from companies with $30 million to $1 billion in revenue. These organizations spanned industries, from manufacturing, healthcare, and utilities to professional services, software, and telecommunications.

Somewhat surprisingly, we found many companies that were initially hit hard discovered new ways of operating and are emerging stronger than ever before. They stumbled upon novel strategies and tactics that they wouldn't have discovered without the pandemic. These companies made their own luck.

Here, we explore the patterns unearthed in these conversations with executives and postulate what this means for middle-market organizations to crisis-proof their business in 2021 and beyond. In other words, how can you make your own luck?

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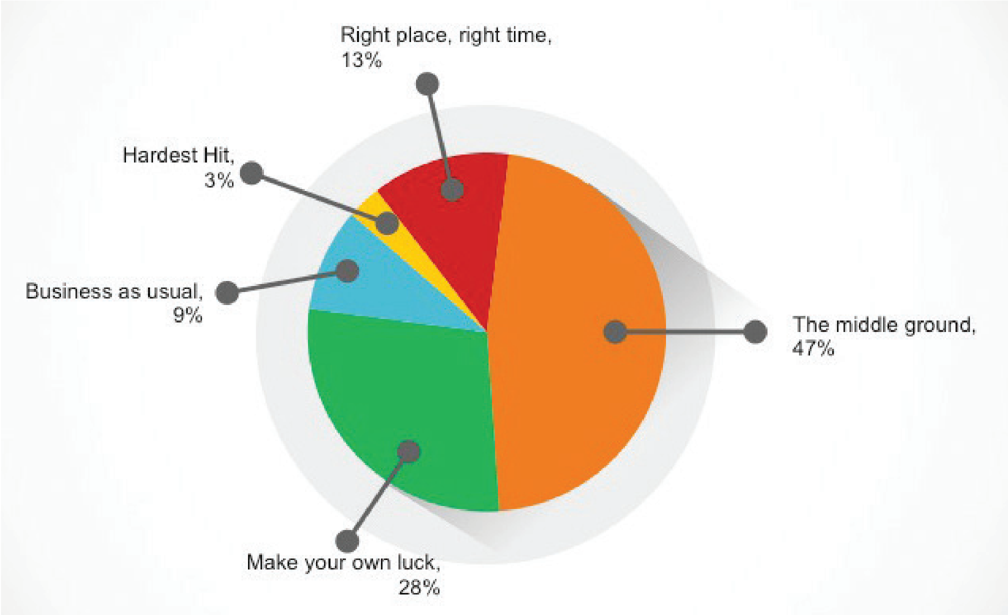
THE FIVE-BUCKET MODEL

The pandemic has not affected businesses or industries uniformly. Instead, some organizations have thrived during the crisis while others have shuttered. Before we dive deeper into the levers executives should use to make their businesses more resistant to external shocks, like COVID, we want to establish a framework for understanding how different organizations have experienced the pandemic.

The Sterling Woods Group has developed a five-bucket model for categorizing and talking about the range of ways that individual businesses have been affected by the crisis.



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Bucket 1: Hardest Hit

These organizations are struggling to remain solvent. Typically, this is because factors inherent to their business model are directly at odds with restrictions and limitations implemented to control the virus.

Hospitality, travel, restaurant, entertainment, and other industries that rely on large, in-person gatherings are most likely to be found in this bucket.

Many of these businesses are unable to change their models as radically as would be required to survive. For example, Broadway theater remains shuttered until at least May 30, 2021, despite its $14.7 billion contribution to the New York economy in its 2018–2019 season.

These organizations will remain at a significant disadvantage until a suitable vaccine is developed and widely distributed.

Bucket 2: Right Place, Right Time

The second bucket describes businesses that were in the right place at the right time during this pandemic. Their products essentially became a necessity for consumers, and the demand for these must-haves was insatiable the first few months of lockdown.

Clorox and Lysol are prime examples of consumer brands that fit in bucket two. Zoom is a clear B2B winner. In our survey, 13 percent of companies found themselves in this bucket.

Bucket 3: The Middle Ground

The third bucket consists of companies that were hit by the pandemic and continue to feel the effects but will ultimately be fine.

This bucket is where we predicted the majority of businesses would land. Our research indicates that our assumption was correct. In our survey, 47 percent of the respondents placed themselves into bucket three.

Bucket 4: Making Their Own Luck

Bucket four consists of companies that were initially hit by the pandemic but then found an opportunity to improve their business that they would not have realized otherwise.

To our surprise, this was the second-most popular bucket in our survey, with 28 percent of the participating executives labeling their companies in this manner.

This implies that the pandemic has exacerbated the existing "adapt or die" environment in business, initially caused by rapid technological progress and the rise of big data in driving transformation.

Companies that had a large safety net due to the industry they operated in, the firm's size, the ability to cut costs, or other factors could focus on innovation and positioning themselves for success in the new normal.

In contrast, companies in buckets one through three focused mainly on the short-term, scrambling to adjust to the present moment.

Bucket 5: Business as Usual

The fifth and final bucket describes businesses that remained relatively steady in terms of revenue and approach. Typically, these companies remained on track with their forecasted earnings despite the pandemic.

Less than a handful of interviews and surveys yielded companies categorized as bucket five. During the pandemic, business as usual has been quite unusual.

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HOW ORGANIZATIONS MAKE THEIR OWN LUCK

Organizations in four of the five buckets have found a way forward in this crisis. In some cases, it was more happenstance and luck; in others, there was a concerted effort to pull through. But across all of the businesses that have remained solvent, we identified four common threads.

1. Diversification

Companies with a degree of diversification in their market or business model had greater opportunities to pivot during the crisis. We identified geographical market, industry, and client base as three major areas where diversification was beneficial.

Geographical Market

One professional services firm that we interviewed seemed to survive the pandemic partly because it operated globally, which offered diversified geographical markets as protection.

While the US was largely locked down, it had other markets, such as South Korea, that had a more open and active economy.

This professional services company essentially hedged its bet on the world's collective ability to fight COVID-19, as opposed to individual countries. Given that the US is a major player in the global economy but has arguably handled the pandemic very poorly, this geographical hedging turned out to be a good bet.

Industry

Diversification of industry was a significant protecting factor as well. The same professional services firm also had clients across many industries.

Although two of their main client bases are hospitality and travel, which were severely hurt by the pandemic, they also cater to clients in the technology and healthcare industries. The technology companies boomed as consumers were driven to online shopping during lockdown, while the public health crisis increased the need for services and support in healthcare.

If this professional services firm exclusively served clients in hospitality and travel, it would likely have struggled to survive the pandemic. Without extreme cost variability, low overhead, and major cost-cutting initiatives, it would have had difficulty finding a way forward with little to no income.

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Client Base
Another firm we interviewed operating in the telecommunications business had a diversification of client base. Its clientele is from both sides of the transaction: consumers and businesses.

Just as modern portfolio theory encourages investors to diversify with companies that will respond in opposite ways to a market shock, thereby insulating a portfolio from negative risk, this telecommunications business plays on both sides of the transaction.

While demand from business clients dropped significantly this year, increased consumer demand offset that loss and ensured the company finished the fiscal year slightly above forecasted earnings.

In sum, the more layers of diversification a firm can provide for itself, the greater protection it has against economic shocks, which typically will hurt some areas more than others.

2. Digital Enablement
In March of 2020, suddenly most interactions happening outside of one's household were virtual. For businesses, this meant an overnight shift to selling virtually and interacting with a fully remote team.

Businesses that already had virtual capabilities in place and those that were able to quickly shift to virtual operations have found greater success in the post-COVID environment.

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Reaching Customers Virtually
Reaching consumers virtually has suddenly become a necessity. Businesses that had already undergone a digital transformation or embraced e-commerce tactics have been insulated from some of the initial shock of the pandemic.

One company we interviewed is a global online wellness education service that sells premium-level certifications to wellness professionals. The company has offered its services almost exclusively online for decades, so it was not negatively impacted by physical lockdowns.

On the contrary, the business saw an increase in sales, despite shrinking consumer budgets. Because its clients were forced to stay home, they had more free time and an increased desire to pursue continuing education as a means of differentiating themselves from others in an increasingly competitive job market. This combination of factors led to an uptick in demand.

This business also saw an increase in new clients. Caregivers in households who now had to prepare their own meals wanted to ensure they were cooking nutritionally-balanced options. They turned to the online wellness education provider to learn more about healthful eating.

Researchers have found that the amount of social distancing in effect correlates to drops in spending. These effects are most significantly felt in the retail and restaurant industries.

Restaurants that have built out their online ordering platforms have found a way forward, while those that remain dependent on in-person dining continue to struggle or have closed. However, spending on food delivery services increased at the start of the pandemic and has remained.

A massive shift from in-store retail consumption to e-commerce has been occurring for years. The pandemic only exacerbated the trend. One need look no further than Amazon's success to understand that e-commerce is the way forward for retailers: Despite massive spending to account for COVID-related expenses, the company's Q2 2020 earnings report showed a doubling of net profit year-over-year.

Building a Socially-Distanced Workforce

Forty-two percent of the American workforce is now fully remote. The ability to transition smoothly to remote work was critical in March of 2020, but now it's the ability to unearth creative ways to leverage remote tools and strategies that will further differentiate organizations.

One firm we interviewed operates in the cold chain space, a niche market within the vast industry of HVAC. Over ten years ago, this particular firm developed its own in-house software tailored to its business model and industry, allowing workers to share information and exchange other information with clients.

For years, the company believed this platform could allow many employees to shift to remote work, but it didn't have the justification needed to experiment with it. Although the organization was labeled an essential business, the management team agreed the pandemic was the perfect excuse to test this software.

As it turns out, the transition to remote work was fluid, and the company didn't see any significant disruption to operational efficiency.

Another firm we spoke with discovered that remote work enabled the expansion of its recruiting base. This firm works in the utilities industry, and its original hiring pool was small because its most needed position is engineers with a niche specialization. On top of the specific baseline job requirements, the firm is headquartered in the midwest, and prospective employees had to be willing to relocate.

By enabling its engineers to work remotely, the firm expanded its recruiting abilities. It was able to retain talent regardless of geographic location. During the pandemic, when one very talented employee wanted to move back home across the country, the firm's new remote capacity allowed for that relocation.

Some organizations are leveraging remote technologies to better onboard new talent. One healthcare company we spoke with reoriented its training program to be fully online. That shift likely saved time that would normally be spent coordinating in person-training and events.

In sum, thousands of companies shifted to remote work during the pandemic, and some have gone beyond the bare necessities of remote work. These organizations have found avenues to improve other areas of operations with remote-work technology and tactics.

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3. Nimble Cost Structure

It stands to reason that when earnings shrink, companies that scale back spending are better equipped to weather the storm. Unsurprisingly, we found that companies with low fixed costs -- or the ability to quickly reduce fixed costs -- had built-in safety nets for harsh economic conditions.

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Overall, 78 percent of the companies in our survey cut costs between March 2020 and October 2020.

Companies with virtual offerings were especially flexible in their ability to scale back costs. A number of software companies that participated in our survey and interviews, for example, cut costs because their virtual products had limited overhead and really high variable margins.

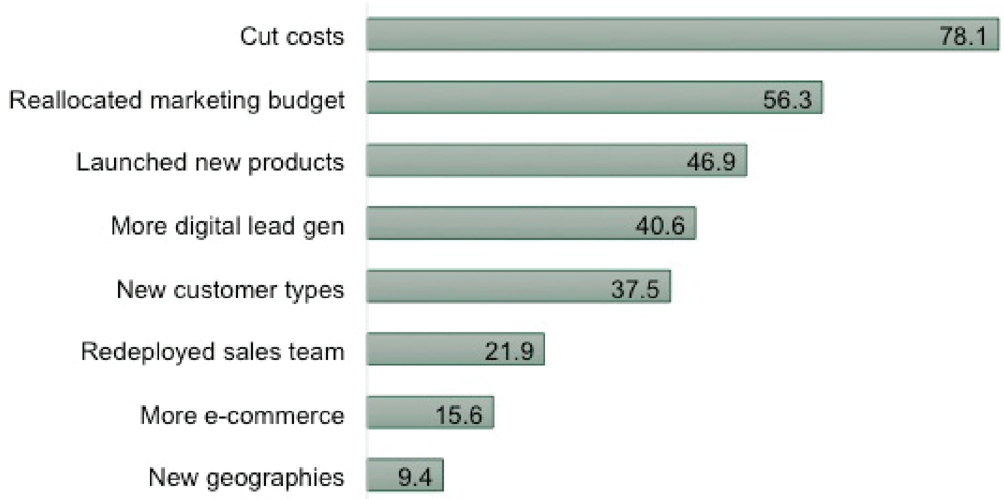
Other organizations looked internally to find savings. The previously mentioned telecommunications company found savings by offering retirement packages to some employees as a way to avoid layoffs or furloughs. Every employee who was offered a retirement package accepted the offer, and the company reduced longer-term costs.

The thinking behind variable costs is that a firm can scale its business up or down to account for changes in consumer demand, positive or negative.

Although the government's issuance of stimulus checks and improved unemployment benefits did offset some of the negative consumer demand shock from COVID-19, the businesses that managed to scale down costs in accordance with a decrease in demand enjoyed an additional layer of insulation.

4. Ability To Break Inertia and Try New Things

We found that 47 percent of companies surveyed launched new products or services between March and October 2020. It seems, perhaps counterintuitively, that the pandemic has been a period of great innovation in business. While crises can present challenges, they also open up new pockets of opportunity for those who know where to look.



We found that companies in the favorable buckets—those that are most likely to survive long-term—embraced innovation, either in spite or as a direct result of the pandemic.

Innovating Anyway

Some firms were on solid enough ground at the start of the pandemic that they were able to move forward with pre-planned launches and innovations in 2020, despite the shock of the pandemic.

One healthcare company we interviewed rolled out a new comprehensive service for a premium price that incorporated all of its existing services, along with a new service it created partnering with a second healthcare firm. This new offering will now be the company's flagship product, with the rest of its service model revolving around this premium package.

Crisis-Driven Innovation

Some companies realized product innovation as a direct result of the pandemic. The aforementioned global online wellness education firm introduced new programs to cater to a new audience: individuals who wanted to take ownership of their families' nutrition and wellness.

This firm's pre-pandemic program offerings didn't cater to this new client base. If it hadn't innovated quickly to bring a new program to the market, a competitor would have. Innovation during the pandemic was the difference between becoming a bucket three or bucket four company.

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One organization we interviewed in the utilities industry was spurred to investigate future opportunities for innovation as a result of the pandemic.

Pre-pandemic, the organization largely relied on in-person conventions to attract clients and build relationships in the industry. The vast majority of these events were canceled at the start of the pandemic. With the budget typically reserved for travel and conventions, this utilities company conducted market research on its industry and found a newly-developing unmet demand in their market.

This firm developed a product to meet the new demand, created a prototype, and spent the remainder of its travel and convention budget on testing the design. If trade shows hadn't been canceled, it would have been far less likely to unearth this opportunity.

Expansion Into Adjacent Markets as Innovation
Innovation is not just about bringing new products or services to market. It can include the expansion into an adjacent market with your existing offerings.

Alternatively, it can be targeting new customer types or segments. That's the approach 38 percent of executives we spoke with were pursuing. Most companies likely found more end markets to protect themselves against potential demand shocks during the pandemic. But once normalcy returns, they can improve forecasted earnings reports if they choose to keep selling to these new markets.

While companies targeted new customer types, they tended to stay close to home. Only nine percent of organizations entered new geographic markets. This is likely due to the global travel restrictions.

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The companies that have innovated during the pandemic are the ones that have balanced maintaining the status quo with innovating to meet new needs and markets. It's also important to note that the companies that were able to innovate during the pandemic often had all of the protective factors we discussed earlier.

Go-To-Market Innovation
With conferences and trade shows canceled or moved online, companies that rely heavily on face-to-face networking for business development found themselves in a bind.

In our survey, 56 percent of companies reallocated their marketing budget, primarily toward more digital lead generation strategies (41 percent of all participating companies). In many cases, companies increased their investment in thought leadership and content marketing, including webinars and research. This was especially true for bucket four (or, make your own luck) companies.

As for deploying the sales team, 22 percent of respondents indicated that they reorganized how their sales team focused on opportunities. One utilities company moved their sales force to remote and expanded the geographic reach of each individual rep.

To our surprise, only 16 percent of the companies surveyed focused more on e-commerce sales, which suggests that most organizations had already made the switch to e-commerce in prior years. Or, on the other end of the spectrum, they may have felt this change was too daunting. The latter was especially true for B2B businesses.

As with the other types of innovation, those companies with a stronger handle on the use of digital channels and data-driven decision-making pre-pandemic fared better in shifting their go-to-market model. Preparation led to agility.

CONCLUSION

While the COVID crisis is not over yet, we are at a point where we can begin to explore its short- and long-term ramifications on middle-market businesses, then synthesize learnings from these patterns to build a more shock-proof organization.

Companies that can stack the odds in their favor by diversifying their revenue streams, accelerating their digital transformation, operating effectively in a remote or hybrid environment, and disrupting inertia will survive—and maybe even thrive—after COVID and any future unforeseen crises.

In the end, the best way to move forward is to continue to listen to industry and customer trends, looking for pockets of opportunity. The only constant is change, and if you can find positive opportunities for change in a difficult period, you will weather the storm and make it to the other side.

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