The Industrial Economy in 2019: What to Expect and How to Prepare

For nearly a decade, the U.S. economy has been trending upward. But economies go through regular cycles of growth and recession, and many analysts agree that businesses should expect a downturn within the next couple of years.

“The economy will probably start slowing down in the second half of 2018,” says Alex Chausovsky, senior consulting advisor at ITR Economics, an economic research and consulting firm. “Our indicators show it bottoming out between June and September of 2019.”

Among the signs of an imminent slump are increased consumer delinquencies. According to the Federal Reserve, the rate of new delinquencies on credit cards rose 5.9% in the first quarter of 2018. Another key metric, personal saving as a percentage of disposable income, has been steadily trending downward, sinking from 6% in 2016 to 2.8% this year.[1]

The slowdown isn’t likely to result in a significant recession, but most businesses should expect to see declining revenues, says Chausovsky.

Not all businesses will be affected equally

Industrial suppliers may be harder hit than other companies, warns Chausovsky. That’s because the industrial economy depends on business investment, which Chausovsky projects will decline while other segments rise. “We expect GDP to slow dramatically but eke out positive growth for 2019,” he says. “But we expect industrial production to be

negative for the year." By comparison, industrial production typically represents about 15% of the GDP.[2]

Even among industrial suppliers, there will be significant variation in the degree to which the downturn is felt. "Some may escape relatively unharmed or even continue on an upward trend, but others will see a drop in revenue that correlates with the decline of the industrial economy overall," says Chausovsky.

Analyzing data is key

How each business weathers the downturn will depend on both its position in the economy overall and the moves made by top executives. To understand how your business will be affected and how losses can be mitigated or even avoided, it's important to have access to both accurate data and expert data analysis.

The success of industrial suppliers depends in large part on the economic health of the markets to which they sell. "Vertical markets are the foundational pillars for these businesses," says Chausovsky. So it's critical to monitor the fortunes of these markets closely as the downturn draws closer, and to direct sales efforts toward stronger markets whenever possible.

There's a raft of other external data relevant for industrial suppliers. Inflationary pressures, such as those driven by rising material prices and shipping costs, can have a major impact on business. Regional data could be key for companies operating in specific parts of the country. For companies that do business internationally, meanwhile, exchange rates are crucial data points. Keep a close eye on how these figures are trending to get out ahead of potential problems.

Careful analysis of internal data can help you understand where you fit in the context of broader market trends. Chausovsky recommends running metrics that measure the momentum with which you are gaining or losing business, such as tracking the rates-of-change on revenue, shipments or orders. Then, use those figures to predict how your business will fare in the coming months, and adjust your plan accordingly.

A playbook for slow times

Once you've run the numbers and have an idea of what to expect, you can start to take steps to mitigate the impact of the coming downturn. These strategies may not keep growth at the same level you've experienced over the past year, but they can help put your company in a strong position to thrive when the economy cycles back to a stronger business environment.

Hire more people

While it may seem counterintuitive to invest in more employees in the face of a downturn, doing so could help you enter new markets and compensate for some of your expected losses. The key is to hire the right kinds of people. “It’s late in the market to invest in operational staff, who take a long time to train and bring value to your business,” says Chausovsky.

Instead, he recommends bringing in sales people with a proven track record. These hires can leverage their experience and connections to win new business right away. What’s more, sales staff are typically paid based on performance, limiting the increase in your fixed costs.

Launch new products or services to tap into new markets

Just as new team members can help capture gains, so can new products or services. “Bear in mind, launching a new product or service isn’t a magic bullet,” warns Chausovsky. “But if the product addresses a gap in your portfolio, it can help you penetrate new market segments and buck the softness on the back side of the business cycle.”

Assess market needs that your business has yet to address, and consider developing new products or services to meet them. This strategy could be particularly effective for businesses that rely heavily on a few customers or markets. Diversifying your offerings can help your business weather unusually sharp declines in particular market segments if the new segments are in a different phase of the business cycle.

The development of new products or services does come with risks, however. During the development process you may face unexpected technical hurdles that cost time and money to overcome. The resources you devote toward a new product or service may divert resources from other important projects. And there is always the danger of the new product or service not being embraced by the market. Some arrive too late to meet the demand, while others arrive too early. Either way, the end result can be a failure to generate profit.

These risks can be mitigated by careful planning. Focus on one project at a time and ensure that you have the necessary resources to complete it. If you choose to diversify your offerings, be sure not to do so at the expense of the core competencies that have brought the company success in the past.

Invest in new technology to cut costs

While hiring new people or launching new products can help you gain profits, another option is to invest in technology that helps lower expenses. Consider, for example, online credit applications with automated approvals. An online credit app can accelerate sales by allowing prospects to convert faster. And it also eliminates manual inefficiencies in your credit team, which can turn into real cost saving. For instance, many suppliers are manually approving applications, meaning they spend hours checking references, contacting credit bureaus and inputting and tracking data.

Likewise, offering online customer account tools can save suppliers both time and money. When customers can easily view their purchase history, download statements and dispute charges online, that's less time your credit and sales teams are spending on customer service tasks. This new efficiency can add up to significant savings.

Another cost-cutting strategy is automating your cash applications process, given that it requires substantial manual effort to match payments to specific purchases. An automated process can match more than 80% of payments received to the lockbox with the proper customer and invoice.

Reduce your exposure to risk

Delinquencies in the industrial supply industry are already approaching recessionary levels, according to the latest quarterly BlueTarp Economic Index.[3] As the economy bottoms out over the next year or two, delinquencies are expected to rise even further. To avoid the losses associated with delinquency, suppliers should re-evaluate their risk assessment programs and make changes where necessary.

That means it's a good time to consider creating your own in-house credit model that can be customized by industry, by customer group and for different sources of customers. These approaches can be integrated into your application approval process to help drive instant decisions while keeping the necessary risk controls in place.

The flexibility afforded by an in-house credit model could prove especially useful as you look to reduce your exposure to risk. For example, your industry likely has unique payment behaviors, and you may even see behaviors change with the seasons. An in-house model allows you to extend less credit during slower seasons, and more during busier seasons. You can also use different credit policies for different sources of customers. For example, you may want to have stricter credit policies for customers sourced by your inside sales team than those sourced by your outside sales team.

Once a customer's credit is approved, it's easy—especially in a strong economy—to coast along assuming their risk profile isn't changing much. Knowing that a downturn is coming, it's more important than ever to monitor customers' credit regularly, at least three times a year. Likewise, taking on new customers should be approached with greater caution during a downturn. By regularly re-validating your credit models, you

can ensure that risk criteria aren't too loose and your models don't offer credit to those who present a real risk of delinquency or losses—while also ensuring that you don't run too tight and turn away good sales.

It's also a good idea to strengthen your preventive and detective controls for fraud. At a minimum, consult a third-party fraud defense expert to help diagnose vulnerabilities and identify ways to insulate. Screen for fraud flags on all transactions and credit screens, either via home-grown algorithms or external software. This screen is a seamless addition to your day-to-day operations, as it culls out for additional scrutiny those items that fail pre-set business rules.

At the same time, make sure you have strong detective controls to monitor spending patterns, particularly among new customer accounts. You need to know whether the brand-new customer blowing through their initial credit limit is a sales success to celebrate—or a fraudster who needs to get shut down.

Make strategic adjustments

Especially during periods of economic turbulence, it's important to continuously analyze data and make adjustments based on what you see. That analysis should be done on a client-by-client basis, says Chausovsky. Buffer against clients that are sinking more dramatically, and put more time and money into clients that are weathering the storm. It's also a good idea to look at your distribution channels and consider establishing new distributor relationships.

For distributors with a strong competitive advantage and demonstrable ROI, raising prices is a valid option to counteract falling demand. Chausovsky recommends increasing the frequency of conversations about pricing beyond the typical rate of once or twice a year.

Light at the end of the tunnel

Everyone remembers the last big downturn, the recession of 2008-2009. The industrial economy was hit particularly hard then, too, due to lower consumer spending that led to less demand for manufactured goods. While industrial suppliers should expect to see a slowdown this time that's as substantial as—or slightly more substantial than—the overall economic slump, the good news is that things shouldn't get as bad as they did a decade ago.

Not only is next year's downturn likely to be mild, it also probably won't last long. According to Chausovsky, business should bounce back in 2020 and 2021. Meanwhile, 2019 should be viewed as an opportunity, he says: "Recessions can be leveraged as

opportunities for growth if you know in advance they're coming and you take the right steps to prepare."

[1] https://fred.stlouisfed.org/series/A072RC1Q156SBEA

[2] https://fred.stlouisfed.org/release/tables?rid=331&eid=211&od=#

[3] https://enterprise.bluetarp.com/the-bluetarp-building-supply-index-2018-q1/