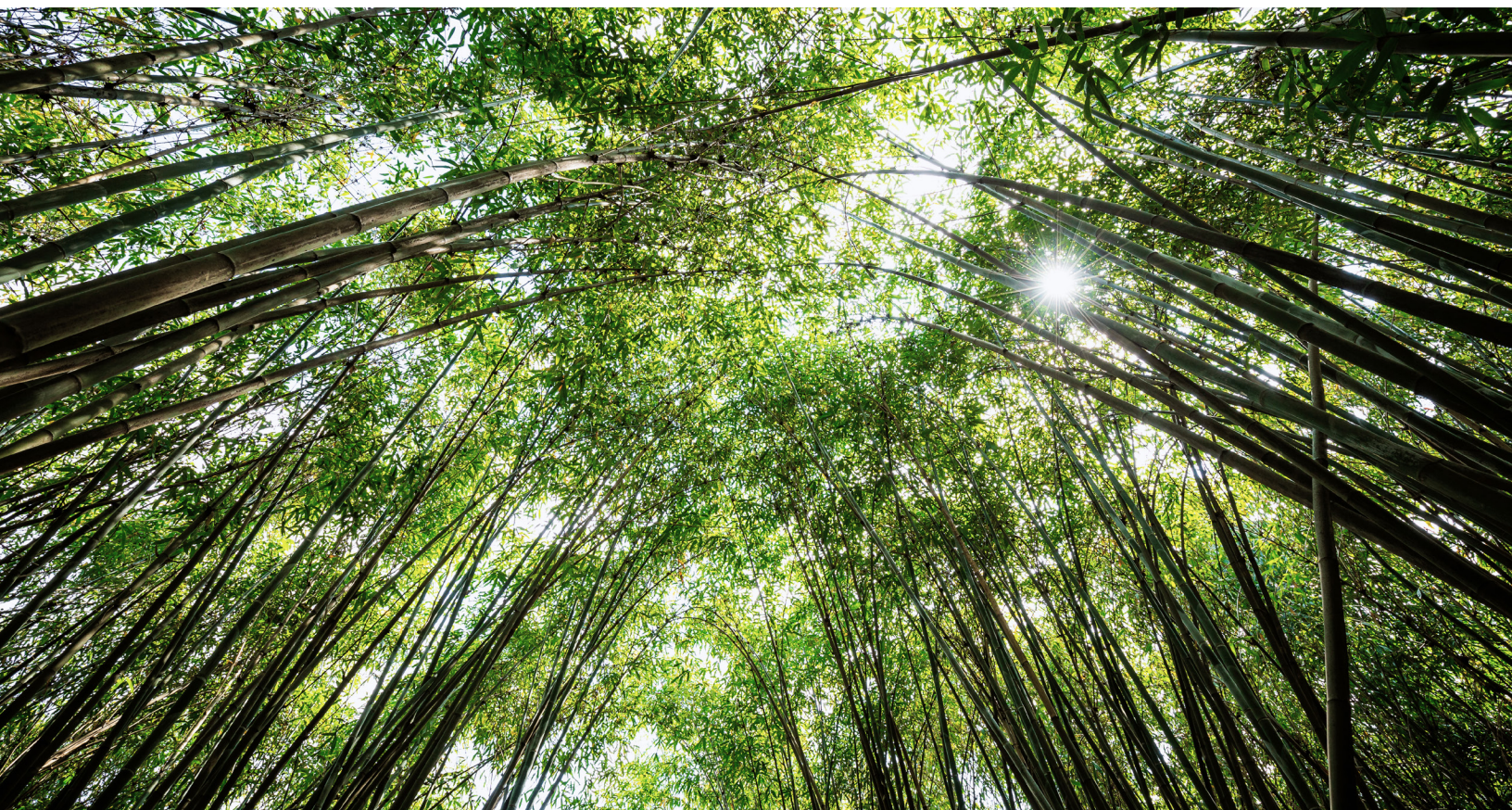


Strategy & Corporate Finance Practice

Rev up your growth engine: Lessons from through-cycle outperformers

Your decisions now will determine how strongly you come out of the COVID-19 crisis—and how well you perform in the next normal.

by Rebecca Doherty and Anna Koivuniemi



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Some corporate leaders still wrestling with the immediate challenges stemming from the coronavirus pandemic may see growth as a distant priority. Once the health of employees is protected and the financial stability of the business secured, however, executives will shift their focus to what's next. For most, restarting the stalled growth engine will become an imperative—but those who wait until all lockdowns are lifted and a recovery takes hold may find they had waited too long.

Previous economic crises have shown us that companies' paths to recovery are shaped by their industries, regions, and individual corporate characteristics—but also very much by the actions they take before, during, and after the crisis. Recent McKinsey research found that the outperforming companies during and after the financial crisis entered it ahead of competitors, and came out of it stronger than before. Our analysis of the performance and growth strategies of approximately 2,000 companies between 2007 and 2017 reinforces those conclusions: staying focused

on through-cycle growth is critical for long-term survival and the ability to generate excess total returns to shareholders (TRS). That means you need to plan ahead for the next stage of this crisis and for the post-pandemic era even as you navigate the current economic shocks.

Our study shows that roughly one in ten companies achieved higher revenue growth and profitability than the others in our sample over the entire 2007–17 economic cycle as well as during the downturn years. These through-cycle outperformers also delivered excess TRS of roughly 8 percent while the rest hovered around zero throughout the period (Exhibit 1).

What did the through-cycle outperformers do differently?

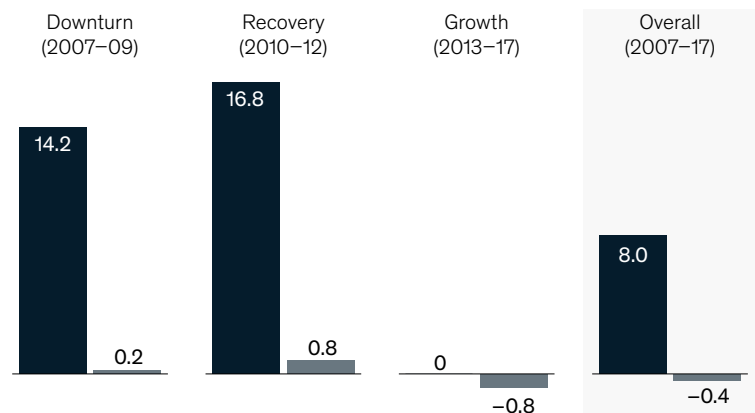
First, leaders of these companies had a clear through-cycle mindset. They were prepared to modulate their spending in the short term, pulling back in some areas but ramping up in others,

Exhibit 1

Through-cycle outperformers achieved high excess TRS during downturn and recovery.

Median excess total returns to shareholders (TRS) performance,¹ %

■ Through-cycle outperformer²
■ Others



¹ Calculated as median of TRS performance per category; revenue-weighted xTRS calculation. Sample includes 2,098 companies across industries, excluding financial companies.

² Companies that outperformed both during the crisis and over the full time period.

Source: Corporate Performance Analytics by McKinsey; McKinsey analysis

all the while protecting their innovation and sales capabilities. Critically, they also remained committed to their long-term growth strategies, not shying away from making big bets.

Secondly, they aggressively freed up resources before and during the crisis—enough to enable them to invest early in their own recoveries. The through-cycle outperformers secured cash ahead of the crisis: compared to other companies, they had 20 percent more excess cash on hand. And while they temporarily slowed their expenditures on operations, R&D, and other areas, they diverged from their peers by quickly ramping up spending during the recovery period. These outperformers increased their absolute capital expenditures by 90 percent during the recovery period, compared with an average increase of 25 percent.

Importantly, the through-cycle outperformers launched specific growth interventions, focusing on three dimensions:

1. **When to grow.** The biggest winners grew right through the downturn, but other outperformers managed to catch up by stepping hard on the gas in the first two years of the recovery.

2. **Where to grow.** Some outperformers reallocated resources to less-cyclical parts of their existing businesses, thereby strengthening the core; others moved into adjacent industries to capture new opportunities or complement existing ones; and still others expanded into high-growth geographies beyond their home markets.

3. **How to grow.** Many outperformers went beyond organic growth initiatives, launching or expanding M&A programs or building new capabilities, such as digital channels and offerings, to enhance productivity and improve access to high-growth customer segments (Exhibit 2).

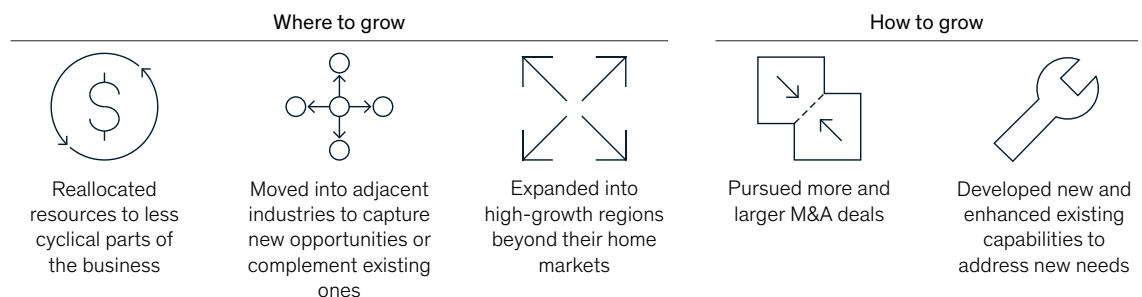
As business leaders begin to think again about growth, the actions of the through-cycle outperformers a decade ago provide valuable lessons. Some companies, especially in Asia, that are already pivoting toward life in the postcrisis phase are showing how those lessons can be applied today.

When to grow

Growing your business while the economy is collapsing around you is a tough job—but not an

Exhibit 2

Through-cycle outperformers accelerated their decisions and explored where and how to grow.



Companies seeking to shift resources toward less cyclical opportunities should first analyze their business portfolios.

impossible one. Some companies are doing so today thanks to their presence in sectors such as healthcare or logistics that are experiencing surging demand. For others, this crisis may pose challenges unlike any they had experienced before, yet planning or even launching growth initiatives could deliver big payoffs as long as your cash position and balance sheet are strong.

Of the through-cycle outperformers during the financial crisis, a full 95 percent managed to grow during the downturn, achieving an average compound annual growth rate (CAGR) of 5.2 percent between 2007 and 2009. The outperforming companies spanned most industries except for consumer packaged goods (CPG), automotive, and materials, the last largely due to low commodity prices. This portion of the through-cycle outperformers did not grow during the actual downturn but made up for it by revving up their growth engines soon after. As the recovery started, they launched aggressive growth moves, and grew three times faster than their peers throughout the recovery phase.

The takeaway? Starting growth during a downturn produces the best results, but if that isn't possible, you can make up ground in the recovery provided you accelerate boldly. However, if you wait until the economy has fully stabilized, you will have lost the opportunity to gain an edge on competitors.

Where to grow

The outperforming companies in the 2008 crisis focused their growth interventions on three areas in order to account for changes in their markets during and after the downturn. First, they **reallocated resources** to less-cyclical parts of the business. One global manufacturer, for instance, doubled down on its services business, which was less vulnerable to demand volatility; the equipment it sold or leased would need monitoring and repair in any economic conditions. The company developed a new approach to maintaining the equipment that reduced the length of time it was unavailable. It also invested in people, training technicians on a new maintenance protocol, which in turn improved employee engagement. As a result, the revenue from services (mainly maintenance) grew at double the annual rate, from around 5 percent in 2007 to 10 percent in 2012.

Companies seeking to shift resources toward less cyclical opportunities should first analyze their business portfolios at a very detailed level for performance, growth potential, and connection with economic cycles. They should then dedicate both money and talent to addressing the opportunities they identify.

The through-cycle outperformers also moved into adjacent industries to capture new opportunities or complement existing ones. For example, one large

construction and engineering firm, whose main business was in construction and maintenance of waterways, adapted its core offerings during the crisis to include services for maritime, oil and gas, and environmental-technology customers—niches experiencing higher growth and poised for strong performance during the recovery. By 2017, more than 30 percent of the firm's revenue was coming from this work, up from 2 percent a decade earlier. Another company, a South American retailer, added a financing arm during the downturn to serve its low-income customers. By 2011, the new business line was growing at five times the rate of the core business.

Thoroughly understanding the trends and emerging needs of customers is crucial when looking for attractive adjacencies. Today, companies should explore and prioritize adjacencies against a set of boundary conditions, such as the ability to leverage an existing technical competency or build on existing customer relationships. Companies also need to weigh whether to enter these priority areas organically, by adjusting their business models or investing in innovation, or by proactively sourcing potential acquisition targets.

The third growth strategy pursued by many outperformers during the last crisis is expansion into high-growth regions beyond their home markets. These companies achieved 1.5 to 2.0 times higher share of revenue from noncore regions during the last crisis than the others in our sample. One global retailer, for instance, expanded its operations in a rapidly developing Eastern European country, doubling its number of stores there between 2007 and 2012 to capture that market's growth.

As with moves to adjacent industries, expansion to high-growth geographies requires a systematic vetting process and a granular analysis of market opportunities beyond just country borders. The first step should be defining the company's objectives—for instance, is the goal wider distribution, more sales, or simply establishing a new core market? Understanding those objectives can make it easier

to size potential markets and identify and pursue both organic and inorganic growth opportunities there (through partnerships or licensing agreements, for instance). Given that emergence from this economic crisis is likely to be highly uneven, it is also important to take a "micromarket" view of growth, as some regions, countries, cities, and even neighborhoods will ease lockdowns sooner than others.

How to grow

Many of the through-cycle outperformers during the last economic crisis sought to grow in two ways: through M&A, or by developing or enhancing new capabilities. In fact, three-quarters of these outperformers executed transactions during or right after the last downturn.

During the financial crisis, the outperformers invested in larger deals, with the median deal size almost double that of their peers'. Then, during the recovery period, they did 10 percent more transactions than other companies in our sample. And throughout both periods, a programmatic approach to M&A—meaning several deals per year amounting to a meaningful portion of market capitalization—proved to be most successful. For example, one large industrial company pursued acquisitions in the double digits to enhance its technical capabilities—up from only two such deals two years earlier. Another industrial player was able to expand its presence in the US market through an ambitious M&A strategy during the recovery period; in 2011, for instance, this company completed four deals while its three largest competitors averaged only one.

In pursuing M&A during the recovery, the through-cycle outperformers focused on two core principles. They stuck to deals that were in line with their existing corporate and M&A strategies, avoiding the lure of "bargains" that did not quite fit. They also focused on "right to own" deals in areas where the company already had core competencies and competitive advantages to bring to the table.

Additionally, many of the through-cycle outperformers in our research introduced or invested in critical capabilities, especially in digital. A number of consumer-facing companies are accelerating on that path today, doubling down on digital capabilities in the form of new channels and offerings. For instance, shortly after a mass quarantine was imposed, one Chinese bank rolled out a contactless banking service that builds on the functionalities of its existing app. Consumers quickly embraced the service, generating more than 116 million transactions within the first two weeks. An Asian fashion brand, meanwhile, realigned talent and operations to digital channels at the outset of the pandemic and has been using them to livestream more than 100 events, host social-media influencers, and launch email campaigns. During the lockdown, the company reached almost three million consumers to whom it now continues to market.

It's clear from our research that profitable growth requires executives to regularly and rigorously reevaluate both their internal capabilities and external market forces. In this way, they can ensure they are putting their resources toward capturing the most-promising opportunities.

As you shift from addressing immediate safety and stability concerns relating to the pandemic to thinking about growth in the near and long term, you should ask yourself the following questions:

- Are you adopting a through-cycle mindset with a focus on a long-term strategy?
- Are you managing to walk the line between shoring up the balance sheet and investing for growth?
- Are you creating enough flexibility for the organization to ramp up quickly once the recovery period kicks in?
- Are you focusing on less cyclical and regional opportunities or looking at adjacencies that could unlock revenue during the crisis?
- Are you looking for inorganic growth options that fit your strategy and where you are the natural owner?

The leaders who take time to answer these questions will be better prepared to stay the course with their growth strategies. Crises demand quick, decisive reactions from business leaders, but the future can't be put out of mind. Successful recoveries require a through-cycle mindset—that is, a long-term vision for and commitment to growth, backed by a proactive stance on achieving it.

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