December 2020

McKinsey & Company

This way out: How leading companies chart a full-potential COVID-Exit

Half measures and incrementalism won't work when your company emerges from a crisis. Here's how leading organizations are thinking about holistic transformation to go all in.

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As CEOs look ahead to 2021 and develop their COVID-Exit strategies, one concern looms largest: "How do we get this right?" We've spoken with multiple CEOs across industries, geographies, and situations, from companies that are still in survival mode, to those that have regained their footing and are ready to leap, to those that have found ways to thrive during this period of unprecedented adversity. Almost to a person, these leaders tell us that they are now looking to hit the right trajectory out of the pandemic, and make the right COVID-Exit.

Like so much relating to COVID-19, "heading for the exit" is not straightforward. Achieving the right trajectory calls for making tough choices, including whether to transition from survival mode to normalcy—or, ideally, to something even better: an "optimized state" for the post-COVID-19 world. How much should your organization pivot, and how fast? Amidst so much tumult and disruption, how far should you go to change your steady ship to adopt faster and more agile approaches? In fact, as we've found, agility and stability go hand in hand. If your organization doesn't move quickly, it will lose balance; the race, *especially* over the long term, is to the quick.

All of which begs the question: If you are ready to transform, what does change actually look like? Our research on the "all in" approach to transformation illuminates what we've found to almost always be the best way forward: full speed ahead. Our findings from past downturns confirm, as well, that companies that take an all-in approach emerge stronger and sustain that competitive advantage for almost a decade afterward. Whether your organization's transformation should be primarily or equally about portfolio moves or performance improvements misses the point. To succeed, you need to consider both, and your transformations need to go big.

In this article, we dive deeper into the "how" of a successful COVID-Exit strategy and highlight two organizations that found success by going all in on their holistic transformations.

Three steps toward successfully optimizing for a post-COVID-19 future

Organizations that successfully manage portfolio and performance moves simultaneously in a transformation begin the process by investing in three foundational steps:

- attaining an unvarnished, no-holds-barred view of the *full potential of the business* across both portfolio and performance moves

- understanding the *interdependencies and implications of timing* for those moves

- structuring a *program with thoughtful sequencing* that maximizes value creation

In assessing a business's full potential, empirical evidence clearly shows the importance of setting a high aspiration. Our recent research has shown that companies that set gross transformation targets at 75 percent of trailing earnings (or higher) were more likely to create value in a sustainable way.[1]

As counterintuitive as this may seem, incrementalism is especially risky, particularly for organizations trying to break out of what feels like a COVID-19 perpetual crisis. Management teams seek safety to confront the prevailing uncertainty and, as a result, drift toward the familiar and avoid the discomfort associated with choosing this time to go for big moves. This might well be your best chance to put the "full" in "full potential," challenge assumptions, and overcome the social factors that so often block bold moves.

It's essential to your transformation that you follow through on the hard questions, particularly:

- Which businesses are the company no longer the natural owner of? And which businesses could be lifted by trends accelerated by COVID-19?

- What efficiencies and new-business models have been generated out of necessity as a result of COVID-19, and how can the organization capitalize on these in the next normal?

- Has the organizational health of the company changed? What elements of organizational health and capability building will be required to maximize the impact of the COVID-Exit?

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[1] Kevin Laczkowski, Tao Tan, and Matthias Winter, "The numbers behind successful transformations," *McKinsey Quarterly*, October 2019, McKinsey.com.

As you mind the balance between portfolio and performance moves, you'll also need to mind the sequencing. In practice, portfolio and performance initiatives need to be complementary—each move must be considered by defining the magnitude of impact, understanding the timing of impact, and evaluating the potential risk of impact.

Across a large sample of companies, we've found that stand-alone portfolio moves capture less than half of the value creation, typically through areas such as performance upside, deal premiums, or by growing new businesses. Even so, stand-alone performance moves still present an opportunity to capture significant upside, although they can take time and may be outweighed by acquiring the wrong businesses if your strategy is ill-conceived.

Making that first step

It's a must to consider both portfolio moves *and* performance improvements. But which of these do you execute first? The answer depends on the company and context. While broad lessons apply (put everything on the table and go big, especially in a crisis), how and when you implement the elements of your transformation must be guided by the unique circumstances and potential of your company at any given time.

Two recent all-in transformation examples shed more light on the nuances of sequenced transformation and its importance, as well as dependence on facts, on unlocking value. In both cases, the organizations conducted full-potential assessments, set high aspirations, and were deliberate about sequencing the portfolio and performance moves to get there. Yet the companies differed in how they advanced from there.

In the first case, the company found that the greatest opportunity for value creation existed in a corporate reorganization, followed by some operational productivity improvements, and then, lastly, by several portfolio transactions. The value creation and its sequencing played out as follows:

1. *The corporate reorganization enabled about 10 percent of total transformation value creation.* In this phase, the company streamlined its cost structure, focused management's attention on resource allocation, and prepared the company to cleanly carve out some of its competing lines after consolidating business units and simplifying the executive team structure.

2. *Operational productivity improvements enabled about 75 percent of transformation value creation.* The company supported broad-based margin expansion by improving the effectiveness of its sales force, which generated significantly higher revenue growth. The organization also implemented automation and simplification improvements to reduce overhead and adopted a strategic procurement approach to drive down external spend.

3. *Portfolio transactions enabled approximately 15 percent of total value creation.* The company divested a higher-performing but noncore business, invested in optimizing companies it had acquired, and integrated a complementary set of core capabilities.

The second case, although it too was an all-in transformation program, took a separate route: portfolio moves came first, followed by a transformation program focused on revenue growth and operational productivity improvements. That transformation played out in the following way:

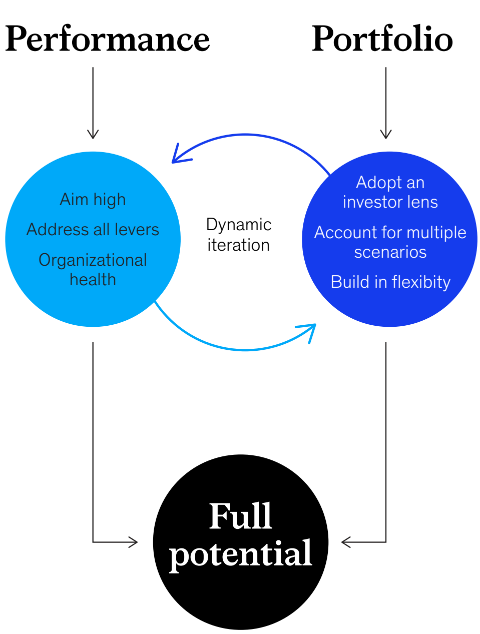
1. *A portfolio move enabled approximately 75 percent of value creation.* After completing a significant merger, the newly formed company reassessed its core business portfolio and divested a high-performing but noncore business. The transaction also enabled the company to focus on financial flexibility by using a portion of the proceeds to deleverage and buy back stock.

2. *Performance transformation enabled 25 percent of value creation.* The company streamlined its operations, focusing on revenue growth and margin improvements.

The most important lesson as you plot a COVID-Exit is not to fixate on choosing between a portfolio-first or performance-first approach. The order is not as important as the imperative; accept that you are going all in, set high aspirations from the very beginning, and then let the size of the prize—the realization of full potential—determine what happens when. Eschewing an ad hoc or piecemeal approach to value creation may have enormous implications over the long term. Our research has shown that companies that go all in yield the highest odds of lasting improvement and nearly triple their likelihood of reaching the top quintile of the power curve relative to other companies.[2]

Exhibit

Companies that adopt an all-in transformation embrace dynamism and build in flexibility to reach their full potential.



The path forward is rarely a straight line

After a year of sharp curves, steep hills, steady climbs, and even some sliding backward, CEOs know that the COVID-Exit path is unlikely to be a straight line. Companies that adopt an all-in transformation approach expect and embrace some dynamism and flexibility during the journey toward full potential (exhibit).

At one company, it seemed obvious that portfolio moves looked like the right answer given the company's starting point: multiple business lines with massively underperforming business, which seemed ripe for divestiture. Yet the portfolio-first perspective actually would not have been optimal. As the full-potential assessment

[2] Chris Bradley, Marc de Jong, and Wesley Walden, "Why your next transformation should be 'all in,'" *McKinsey Quarterly*, October 2019, McKinsey.com.

played out, it became clear that the route to maximizing value lay in turning around the performance of that chief underperformer; this offered a much higher potential than any premium the business would be able to obtain through a sale. Such a considered approach illustrates the importance of dynamic iteration in the full-potential assessment—looking at both portfolio and performance moves in parallel—to ensure that value is not being left on the table.

Ages ago, Heraclitus observed that "No one ever steps in the same river twice, for it is not the same river and they are not the same person." Left unspoken was the notion that no one wants to stand in the river for very long; you've got to get going. The challenge for our own time is clear. Launching an all-in transformation is one way you can break for the COVID-Exit while accepting that COVID-19 has changed many things—all of us, and the full potential of our organization too. Q

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The authors wish to thank Kevin Blasko for his contributions to this article.