

Facing the future: how UK businesses can thrive in the next normal

The UK economy has been profoundly shaken, and reshaped, by the COVID-19 pandemic—just as the country has entered a new trading relationship with the EU. Although the route to recovery and growth will be different for every business and every sector, each will require a combination of strategic foresight and built-in agility.

by Tera Allas, Yuval Atsmon, Andrew Goodman, and Virginia Simmons



It was Britain's greatest public-health crisis in more than a century, and a stark reminder that humankind remained at the mercy of nature; many thousands lost their lives. The economic impact was just as severe: the UK's GDP shrank by nearly 15 percent in just one year as commerce stalled and demand dwindled. The crisis coincided with political upheaval as Britain noisily debated its relationship with its neighbors—and its identity as a nation. With recovery far from assured, the only certainty was that Britain's economy and society would be profoundly transformed.

This is the story of the Great Frost of 1709, a three-month-long cold snap that brought untold human suffering as crops withered and rivers froze¹. In the 300 years since, no crisis has affected the British economy as sharply—until COVID-19 struck (Exhibit 1). The pandemic is reshaping the economy just as the UK's new trading relationship with the EU takes effect. How will Britain, and its businesses, face the future?

There are no clear answers. To begin with, the evolution of the pandemic is fraught with unknowns. The UK appears to be on a trajectory to achieve [vaccine-based herd immunity](#) by the third quarter of 2021, but there is still enormous uncertainty about how virus variants, vaccinations, seasonality, and behavioral patterns will interact. The timing of any

economic rebound is inherently tied to the lifting of lockdowns, social distancing, and other COVID-19-related restrictions—and sectors that are sensitive to social-distancing measures face particular uncertainty. With some scientists predicting the need for further local lockdowns, regional patterns may also vary.

The pandemic has accelerated digitization, e-commerce adoption, and a shift to remote working—yet it is by no means clear to what extent these shifts will be permanent, nor how deeply they will affect different parts of the economy. Recovery will not be linear or uniform, and the paths of different economic sectors and businesses could diverge dramatically. And while firms in every country must navigate these pandemic-related complexities, those in the UK must also adapt to the country's new trading relationship with the EU.

In this environment of ambiguity and flux, the most adaptive businesses, with the most comprehensive scenario planning, are likely to pull ahead. Smart companies will embrace the new habits of both customers and employees to strengthen long-term competitiveness—while ramping up innovation and engagement. If firms invest now in strategic foresight and hone the agility of their organizations, they could lead the recovery and foster new prosperity—for their stakeholders, and for Britain.

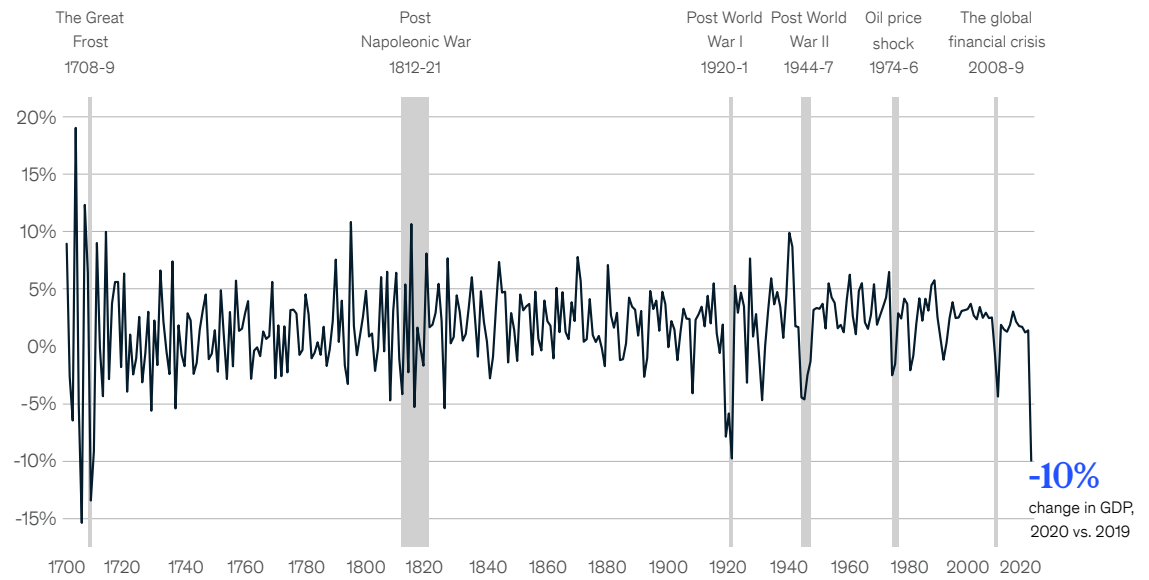
Recovery will not be linear or uniform, and the paths of different economic sectors and businesses could diverge dramatically.

¹ Taylor, Adam, "Amid pandemics and protests, is Britain facing its worst economy since the Great Frost of 1709?", The Washington Post, June 12, 2020.

Exhibit 1

2020: Largest reduction in UK economic output since the Great Frost of 1709

Annual change in GDP and key recessions in the UK, 1700-2020



Source: A millennium of macroeconomic data for the UK, Bank of England, August 2018; ONS, McKinsey analysis

Divergent paths for UK sectors and businesses

Once social-distancing restrictions are lifted, the UK macroeconomy might post a fairly swift recovery. After previous recessions, the sectors experiencing the biggest slumps have been, on average, also the [fastest to rebound](#). The UK's depressed consumer sectors—unable to serve customers fully for much of 2020—are a case in point: with average household-savings ratios running at two to three times historical rates², significant latent demand is likely to be unleashed when lockdowns come to an end. The UK government's fiscal stimulus also supports recovery in 2021³.

However, in addition to uncertainties around timing, there are reasons to question the expectation of a straightforward rebound for the UK economy. First, the pandemic has accelerated digitization and the use of remote working, but the penetration of technology-driven changes in firms' operating models has varied greatly by sector and business. The extent to which technology adoption continues apace in the future is likely to vary just as much. Second, the challenges and opportunities arising from the UK's new trading relationships will also differ by sector. As a result, the prospects and paths of the UK's sectors—and of individual businesses within those sectors—could diverge significantly.

² Office for National Statistics (ONS), "Households (S.14): Households' saving ratio (per cent): Current price: £m: SA", 22 December 2020.

³ Office for Budget Responsibility, "Overview of the March 2021 Economic and fiscal outlook", March 3rd, 2021.

Technology adoption: some firms racing ahead, others left behind

It is also important to note that broad-based technology adoption—the type that leads to competitive advantage⁴—has been concentrated in already digitally capable businesses. For the rest, [digitization](#) due to the pandemic has tended to be fairly narrow, involving remote collaboration tools (such as videoconferencing), online customer interactions, investment in cyber-security, and a shift to cloud-based applications. Moreover, many smaller businesses could be left behind: in one survey, two thirds of small businesses, and nearly half of medium-sized businesses, said they had no further plans to introduce new technologies⁵.

There has been a significant shift to online consumption during the pandemic: for example, online sales as a percentage of total retail sales in the UK jumped from 20 percent in January 2020 to 36 percent in January 2021⁶. In McKinsey's November 2020 [sentiment survey](#), the majority of UK consumers said they intended to continue some of their new shopping behaviors post-pandemic. A tendency towards “nesting”—spending more time and money at home—is expected to stay and will likely result in more digital entertainment, food delivery and home fitness, for example. But McKinsey Global Institute's [recent report](#) also finds that the pre-pandemic trend of spending on

experiences—such as holidays—is likely to stage a strong return when restrictions are lifted. Different demographic groups' expenditure will also vary, given the [uneven impact](#) of the crisis on households' livelihoods.

A similarly mixed picture is emerging for remote working. Plenty of office workers say that they are keen to continue with some home working⁷, and many employers have announced hybrid working policies for the post-pandemic future⁸. However, only around a quarter of workers can meaningfully [work remotely](#) three to five days a week, with an additional 20 percent estimated to be able to do so one to two days a week (Exhibit 2). The rates of remote working seen during lockdowns are therefore unlikely to last. Among UK businesses surveyed in February 2021, only nine percent said that remote work had improved productivity, while 33 percent stated that productivity had decreased⁹. Two thirds said they were not planning to use increased remote working as a permanent business model.

This reflects the fact that experiences of remote working differ dramatically between [different workers](#), sectors and firms. In the UK, the two sectors that indicate that they are most suited to continued remote work are information and communication, and professional, scientific and technical services¹⁰. These account for just 14 percent of total UK jobs.

⁴ McKinsey & Company, The Next Normal: The recovery will be digital - Digitizing at speed and scale, August 2020.

⁵ Enterprise Research Centre, State of Small Business Britain 2020.

⁶ ONS, “Internet sales as a percentage of total retail sales (ratio) (%)”, 19 February, 2021.

⁷ Taneja, S., Mizen, P. & Bloom, N., “Working from home is revolutionising the UK labour market”, Vox.EU, 15 March 2021.

⁸ Microsoft Surface UK / Chartered Institute of Personnel and Development (CIPD), “Work Smarter to Live Better: Understanding the new expectations of the UK workforce when it comes to hybrid working”, 2021.

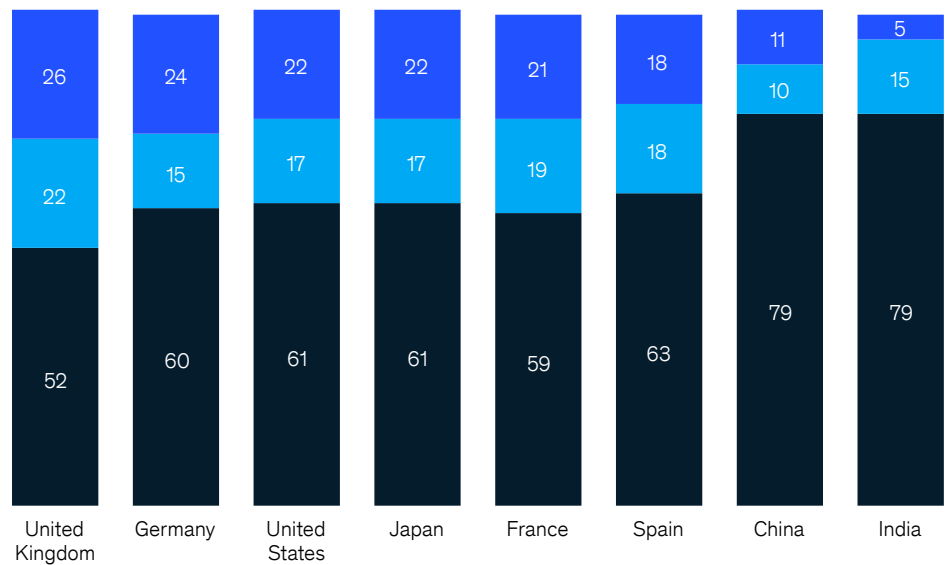
⁹ ONS, “Business insights and impact on the UK economy”, BICS Wave 24 (published 25 February 2021, reference period from 25 January to 7 February 2021).

¹⁰ Ibid

Exhibit 2

Only a quarter of the UK workforce can work remotely 3–5 days a week

Workforce with remote work potential by number of days per week
% of 2018 workforce



Number of days per week of potential remote work without loss of effectiveness:

- 3 – 5 days
- 1 – 2 days
- <1 day

Example occupations:

- Financial managers
- Market-research analysts
- Statisticians
- Civil-engineering technicians
- Physicists
- Psychologists
- Barbers
- Farm workers
- Aircraft cargo handlers

Note: Theoretical maximum includes all activities not requiring physical presence on-site; effective potential includes only those activities that can be done remotely without losing effectiveness. Model based on more than 2,000 activities for more than 800 occupations. Note: Figures may not sum to 100% because of rounding.
Source: McKinsey Global Institute analysis

Challenges and opportunities from the UK's new trading relationship with the EU

Compared to the pandemic, the effect of the change in the UK's trading relationship with the EU is less abrupt, impacting far fewer people and businesses directly. In the short term, importers and exporters are facing some operational disruption, as they get used to doing business outside of the European Customs Union. In February 2021, more than 80 percent of manufacturing exporters and 75 percent of wholesale and retail exporters reported experiencing challenges; 70 percent and 60 percent of them, respectively, attributed this to the UK's new trading relationship with the EU¹¹.

However, only around 15% of UK businesses either import or export directly¹²; the broader economic impacts will therefore likely percolate through in subtler ways in the months and years to come. The main effects are likely to be somewhat higher costs for importers from the EU and lower demand for exporters to the EU, primarily caused by non-tariff barriers such as new requirements for customs declarations, export and import licenses, certificates, conformity assessments, and safety checks on specific products¹³.

These impacts, too, are highly sector specific, and create both challenges and opportunities. Businesses for which the EU is an important export market—such as financial services or manufacturing—will likely see a reduction in demand¹⁴. Sectors using significant amounts of imported products, such as apparel retail or hotels

and restaurants, are expected to face increased costs for goods from Europe. For example, among importers in the wholesale and retail sector, more than 50 percent said their costs had increased, mostly due to transportation and customs fees¹⁵.

However, there are also opportunities. Within sectors, any business that has a cost advantage is generally well positioned to grow domestically if other players' costs also rise. Those most prepared, or able to adjust fastest to the new arrangements, stand to gain. Overall, more sophisticated companies' costs are likely to rise by less than their competitors', creating a price umbrella under which to grow their market share, or to improve margins. This might be the case, for example, in agriculture.

At the sector level, there are two additional types of opportunity. First, so-called "import substitution": with EU imports now somewhat more expensive, some domestic providers may be able to take EU companies' place in supplying UK businesses or consumers. British manufacturers in particular have an opportunity to grow their share of the domestic market. Second, sectors that were already strong exporters to the rest of the non-EU world may find it advantageous to turn more of their energies to these other, [often faster growing](#), markets. For example, the UK has a global comparative advantage in service sectors such as finance, information and communication, and in professional services; more than 70 percent of these sectors' exports already go outside the EU. Exhibit 3 shows how specific UK business sectors are positioned to grow in these ways.

¹¹ ONS, "Business insights and impact on the UK economy", BICS Wave 26 (published 25 March 2021, reference period from 22 February to 7 March 2021).

¹² ONS, "Annual Business Survey exporters and importers", 25 November 2019.

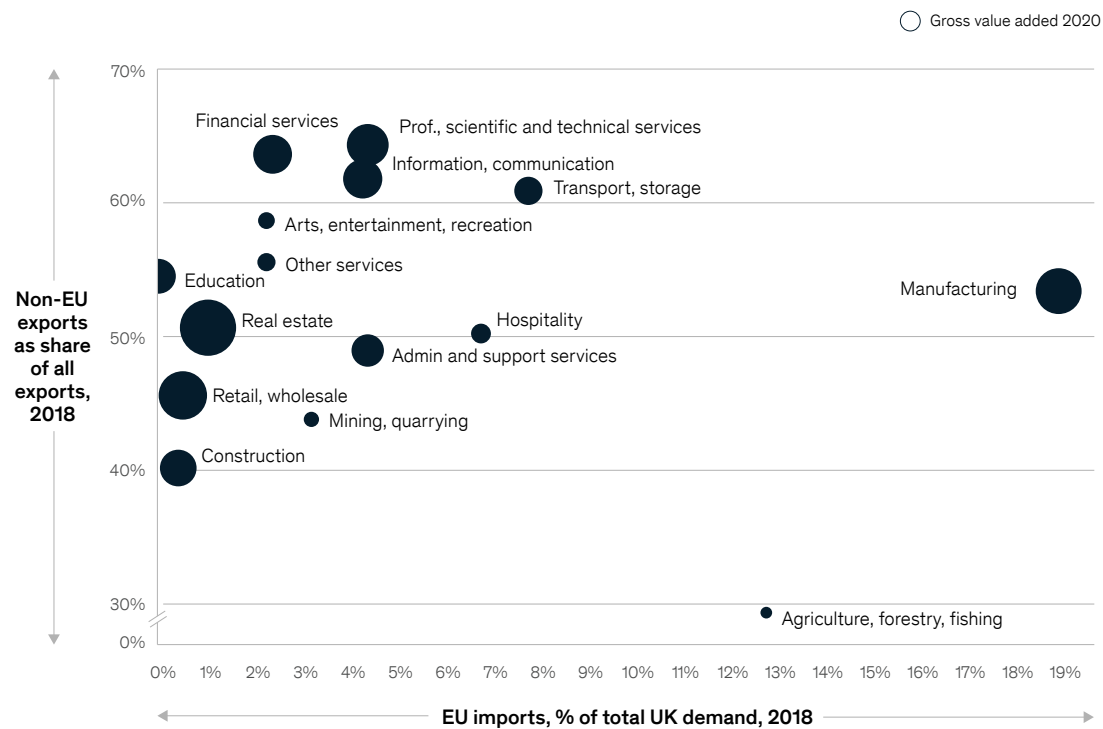
¹³ Fusacchia, I., Salvatici, L. & Winters, A., "The Costs of Brexit: Briefing Paper 51", UK Trade Policy Observatory (UKTPO), December 2020.

¹⁴ Dhingra, S., Huang, H., Ottaviano, G., Pessoa, J.P., Sampson, T., Van Reenen, J. "The costs and benefits of leaving the EU: trade effects", *Economic Policy*, Volume 32, Issue 92, October 2017, Pages 651–705.

¹⁵ ONS, "Business insights and impact on the UK economy", BICS Wave 26 (published 25 March 2021, reference period from 22 February to 7 March 2021).

Exhibit 3

UK businesses may grow by taking share from EU imports or exporting more beyond the EU



Source: ONS; McKinsey analysis

Headwinds and tailwinds, sector by sector

The speed and trajectory of the post-pandemic recovery for each sector will be shaped by many factors. Sectors that are least sensitive to social distancing have seen the least damage; they can restore normal operations sooner, and have already started to do so. Those buoyed by consumer demand are likely to bounce back quickly as confidence returns, but only once COVID-19-related rules allow. As is evident in Exhibit 4 (first two columns), these two factors tend to pull in different directions. For example, utilities and financial services have been relatively mildly impacted by COVID-19, but are also less consumer-driven. Arts, entertainment, restaurants and bars have been hugely constrained, but will likely benefit from pent-up demand when venues can finally reopen.

Exhibit 4 (middle columns) also shows that the UK's new trading relationship with the EU creates similarly complex dynamics across different sectors, with a mix of challenges and opportunities. For example, many manufacturing sub-sectors are highly exposed to EU trade, and have reported significant short-term border disruption—but they will also have opportunities to grow their business in the UK and in non-EU countries. High-value-added services could lose some market share in the EU, but are well positioned for global growth. Many domestically facing sectors will see less immediate impact from Brexit.

The overall upside in 2021, then, looks relatively similar across sectors ("Overall assessment" column in Exhibit 4), but for very different reasons. What looks like grey territory when out of focus is in fact a mosaic of different shades of black, grey and blue at a higher resolution.

Business implications: strategic foresight and agility at a premium

And so we see the contours of future growth opportunities starting to emerge—from the post-pandemic recovery, the UK's new trading relationship with the EU, and the intersection between the two. For businesses hoping to capture

these opportunities, there are three crucial strategic approaches to consider: decisive moves, granularity, and optionality. These will need to be combined with a flexible and agile approach to execution.

Decades of data show that the sectors that a business competes in really matter. Most recently, McKinsey's Corporate Finance and Strategy practice showed that the difference between the most and least profitable industries is [getting wider](#). An analysis of thousands of companies' strategies showed that big, [decisive moves](#) regarding where and how to compete determine more than half of corporates' economic performance. Programmatic M&A, dynamic allocation of resources, strong capital expenditure, a constant drive for productivity, and genuine product differentiation—for example, through R&D and user-centric design—were all found to boost success.

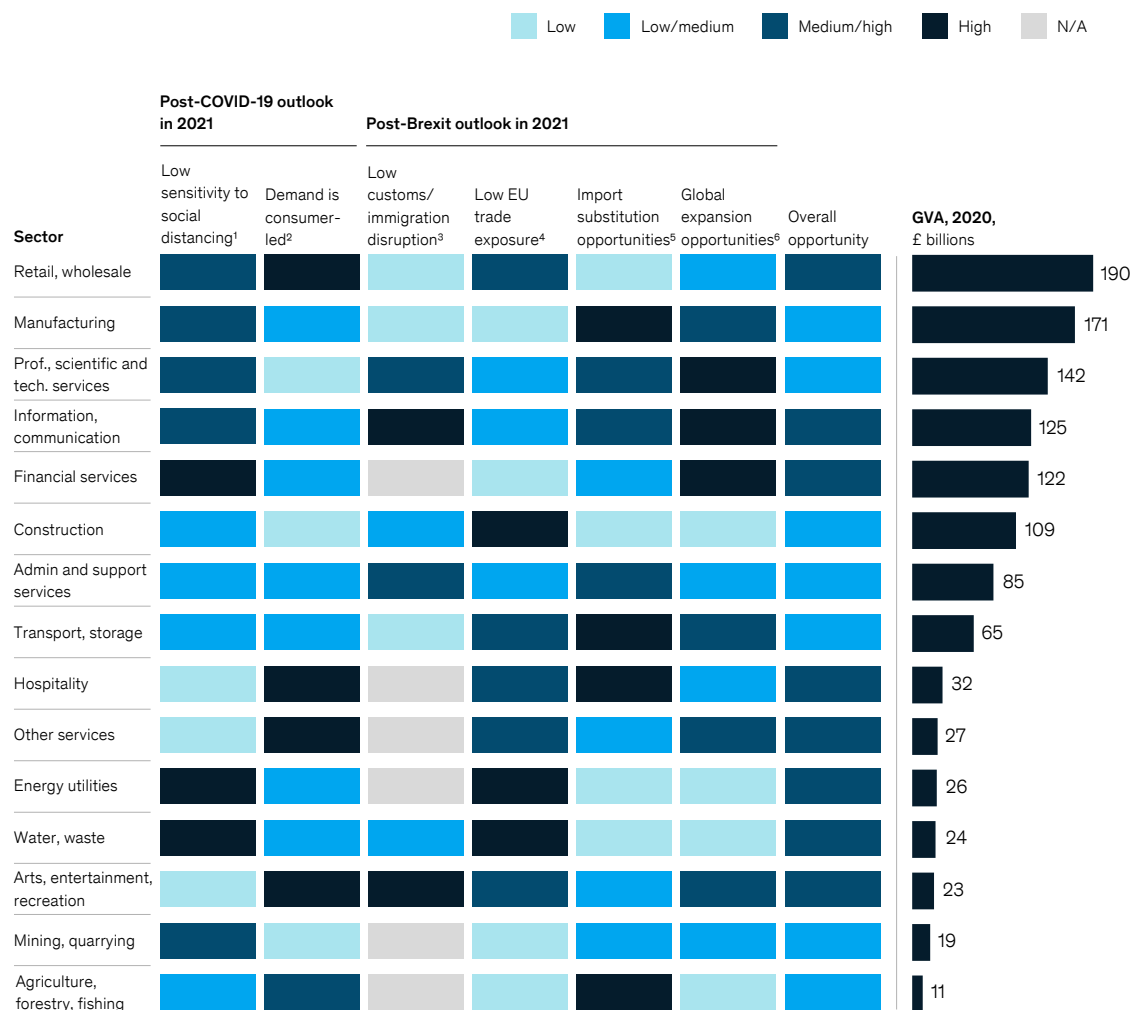
However, it is not enough to look at broad sectoral or geographic trends to pick the right moves; nor is it typically feasible for companies to shift successfully to a different industry altogether. An examination of long-term growth at 400 of the world's largest companies highlighted the importance of *granularity*. In other words, while sectors matter, the specific product or service lines and customer segments that are overweight in companies' portfolios [matter more](#).

This has been starkly demonstrated in the pandemic, with hospitality venues with outside space and those suitable for COVID-19-safe "staycations" seeing high demand, online retailers and platforms posting record profits, and pharmaceuticals companies with strong vaccine capabilities attaining higher valuations. The challenge for strategists now is to analyze the historical and emerging consumer-behavior data to spot the market segments that will grow fastest in the coming years. For exporters navigating the UK's new trading relationships, the search will be for promising profit pools across the globe.

There will, of course, be some uncertainties that mean it's too risky to make bold moves across all areas of a company's portfolio. That's where *optionality* comes in. Research shows that, while big

Exhibit 4

Most sectors in the UK economy face both headwinds and opportunities



¹Average reduction in GDP relative to same month in 2019 for each unit change in stringency index, reversed;

²Share of sector total demand coming from households' final consumption expenditure;

³Severity of export disruption due to Brexit, average of January and February BICS surveys, reversed;

⁴EU exports plus intermediary imports as share of GVA, reversed;

⁵EU imports as share of total UK demand;

⁶Non-EU exports as share of all exports.

Source: ONS; OECD Trade in Value Added database; Blavatnik School for Government Stringency Index; McKinsey analysis

bets make sense when there are reasonably clear pay-offs, if the future is deeply uncertain, a better way forward may be to build options. An “option” in this context is a relatively modest investment that provides a basis for ramping up or scaling back as the market evolves. A classic example would be a minority stake in an adjacent segment, or a set of licensing agreements for potential future technologies.

With a robust growth strategy, and a clear framework for responding to market dynamics, a business is equipped to set a course for recovery. However, it’s unlikely that everything will go to plan, or that every assumption underlying a company’s strategic projections will turn out to be correct. This is where organizations need inbuilt [agility](#)—the ability to innovate and course-correct rapidly, while maintaining a stable financial, operational and organizational environment. A key part of this will be investment in human capital, [upskilling and retraining](#) staff to gain the competencies they need in a more digital and faster-moving future.

According to McKinsey [research](#), business units that had undergone agile transformations were

better prepared to respond to the COVID-19 crisis than their non-agile counterparts, outperforming on customer satisfaction, employee engagement, and operational performance. For instance, some telecommunication companies were able to restore customer-service standards within weeks of disruption by moving retail staff to support call centres, and deploying chatbots to triage and handle customers’ queries at scale. Organizations with this kind of agility are faster at bringing out new products and services to react to changing customer demands—and understand the need to bolster their [resilience](#). The COVID-19 crisis has already more than proved the value of such approaches.

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As the UK moves into a new era, it will be businesses with well defined, forward-looking strategies and agile operating models that are poised to capture the most growth. Thoughtful companies will draw lessons from the turbulence of the past year and embed them into their future plans, actively investing in their ability to remain at the forefront of events, whatever the outlook.

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The authors wish to thank Marc Canal, Eoin Daly, Spencer Dowling, and Akshata Suresh for their contributions to this article.