

Automotive and Assembly and Financial Services Practices

# Subscribed to future auto finance yet?

Auto financing's future will be dynamic, disruptive, and different. Here's our perspective on the European market.

*This article was written collaboratively by members of McKinsey's Automotive and Assembly and Financial Services practices. The authors include Sebastian Kempf, Benjamin Koeck, Tobias Schneiderbauer, Ursula Weigl, and Romain Zilahi.*



# The auto-financing market has been evolving in response to macroeconomic developments, changing consumer behavior, and new regulations.

Now COVID-19 is stimulating even greater changes in these areas, and the abrupt economic shock has produced a steep and unexpected decline in sales of new and used cars. The pandemic has also triggered major, unprecedented shifts in mobility patterns, including use of ride-sharing services, public transportation, and private cars. All of these changes will ripple back to affect automotive financing.

To help European auto-financing players navigate this changing landscape, we have comprehensively researched the issues confronting their industry and surveyed more than 30 auto-finance executives within Europe about current trends and dynamics. (For more information, see the sidebar, “The nuts and bolts of our survey.”) This article consolidates our findings on potential growth opportunities, future strategies, and organizational challenges in the European market.



## The current situation and future prospects for the auto-financing market

The auto-leasing and auto-loan sectors are billion-euro industries in Europe, but slowing auto sales and changing mobility patterns have taken a toll. COVID-19 will likely to continue to depress automotive revenues through 2021, but the impact will vary by segment. Auto leasing is expected to recover sometime in the second half of the year, but the auto-loan market may not recover until around 2023 to 2024, partly reflecting its limited growth trajectory over the past few years. Depending on the scenario, the auto market will have a steep to very steep dip in 2020 followed by either a slow or somewhat faster recovery.

Despite the current challenges, many new players are entering the auto-financing market, including fintechs, independent leasing companies with digital channels, and automotive OEMs. The latter

have captive-financing arms that are partnering with or even building their own fintechs.

The emerging subscription business, one of the industry's fastest-growing segments, is also altering market dynamics. Industry players that want to stimulate long-term growth are increasingly exploring this model, because consumer interest is so high. The appeal of subscriptions is driving higher growth rates in the leasing market.

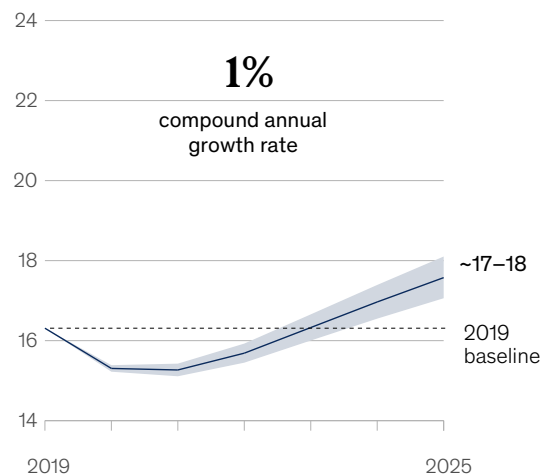
Our research suggests that both the European leasing and auto-loans segments will grow through 2025 (Exhibit 1). In the McKinsey European Auto Finance Survey 2020, respondents also anticipated many other changes ahead, including growth of the subscription market. These trends are discussed in more detail later in this article and summarized in the sidebar titled, "Facts about leasing and auto loans in Europe."

Exhibit 1

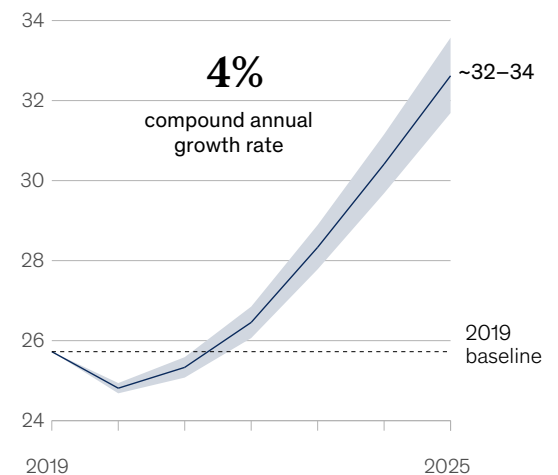
### Leasing will likely recover more quickly than auto loans.

#### Auto-financing retail and corporate revenues before risk cost (interest + provision result)

EU auto-loans market,<sup>1</sup> € billion



EU leasing market,<sup>1</sup> € billion



<sup>1</sup>Growth rates with sensitivities of +/- 0.5%.  
Source: McKinsey European Auto Finance Survey 2020

## The nuts and bolts of the McKinsey European Auto Finance Survey 2020

To research Europe's auto-financing industry, we interviewed more than 30 industry experts from leading leasing companies in the region. The respondents included professionals in sales, strategy, operations, and marketing (Exhibit). Most (39 percent) worked for the captive-financing

arms of automakers, 32 percent for non-captive banks, and 29 percent for non-captive, pure leasing companies. The respondents were from major markets across Europe, including the United Kingdom.

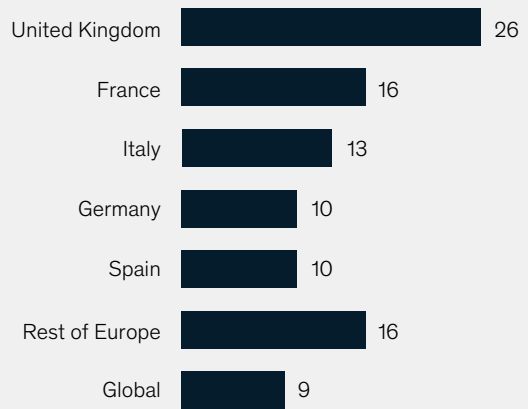
Exhibit

### Our survey involved interviewing more than 30 industry experts from leading European leasing companies.

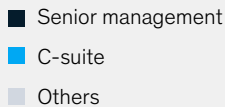
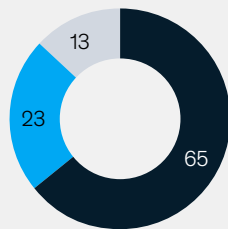
**Segment, % of respondents**



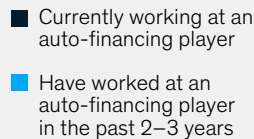
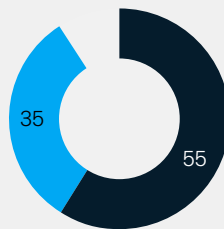
**Location, % of respondents**



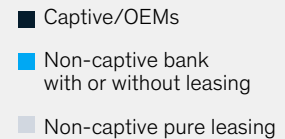
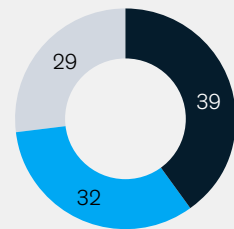
**Management level, % of respondents**



**Employment status, % of respondents**



**Company type, % of respondents**



Source: McKinsey European Auto Finance Survey 2020

## Changes within the consumer base

In past financial contractions, consumers postponed discretionary purchases and increased their savings as they braced for harder times ahead. These trends are already apparent with COVID-19, as seen with the steep decline in private-vehicle sales.

According to recent McKinsey research, discretionary consumer spending could decline by 40 to 50 percent, translating to a roughly 10 percent reduction in GDP and numerous second- and third-order effects in 2020. The continued consumer wariness will significantly decrease light vehicle sales for 2020 as a whole, and it could also prompt buyers to purchase smaller vehicles than originally planned. “Nearly new” used cars could see increased demand, since consumers may be willing to accept a car with some mileage if the price is competitive.

We believe that private-vehicle sales will soon begin to improve, although they will remain slightly below pre-crisis levels over the medium term. In the first half of 2021, consumers in most regions will continue to delay auto purchases, but China could see sales begin moving toward their pre-crisis levels. We expect a recovery in second-half 2021, driven by GDP growth resulting from government subsidies and lower interest rates. There is still much uncertainty, however, since much depends on how the pandemic will evolve and how rapidly the economy will stabilize again. We expect that light vehicle sales losses across the EU will total 5 to 10 percent in 2021 compared to pre-COVID-19.

### **A greater shift to digital and direct B2C channels**

In addition to depressing auto sales, COVID-19 is shifting consumer behaviors. Already, the pandemic has accelerated the growth of digital and online channels for business-to-consumer (B2C) purchases. In response to these trends, OEMs have begun to “virtualize” their dealerships and operate remotely. Sometimes, they offer fully contactless test drives and servicing. With sales, some representatives now completely conduct business online. Non-digital marketing activities also are decreasing as consumers migrate to online channels.

Many new fintechs in the EU market offer products through online and mobile channels, and this could give them an edge against more traditional players. McKinsey’s automotive and mobility consumer insights survey shows that at least a third of consumers across European markets already prefer digital sales channels. In-person interactions at auto dealerships, which were already in decline, could fall further as economies move into the recovery phase.

Based on their experience with retail purchases, customers now expect a seamless online experience, including hassle-free pricing and data sharing for reciprocal benefits. Other products, such as rental and shared mobility services, could become part of an integrated multimodal bundle resulting in a seamless mobility solution for all circumstances.

### **Increased customer interest in auto subscriptions and leasing**

The consumer shift toward flexibility is fueling the expansion of the subscription market, which partly explains why leasing is seeing higher growth than auto loans. Companies are primarily targeting the B2C segment with subscription offers, since they know many consumers want the greater flexibility that comes with shorter contracts and a pay-as-you-go model. Consumers may also appreciate that some subscriptions include services such as vehicle maintenance and insurance.

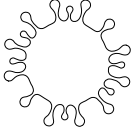
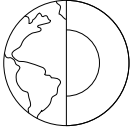

## Driving the next normal in auto financing

The auto-financing industry in Europe will change as major trends fundamentally alter how people think about and purchase mobility. To thrive in the new landscape, the following actions are critical (Exhibit 2):

1. Defend—establish post-COVID-19 resilience
2. Deliver—strengthen the core business
3. Disrupt—reinvent future offerings to meet customer needs and drive a stellar customer experience

**To thrive in the new landscape, auto-financing companies must focus on three measures.**

**Suggested actions to be taken**

<b>Defend</b>	<b>Deliver</b>	<b>Disrupt</b>
Establish post-COVID-19 resilience	Solidify the core business	Reinvent future offering
		
<p><b>1</b> Manage residual value and remarketing of leasing returns</p> <p><b>2</b> Manage collections effectively and efficiently</p> <p><b>3</b> Optimize funding and capital efficiency</p>	<p><b>4</b> Digitize core processes for cost excellence and quality</p> <p><b>5</b> Upgrade IT/tech capabilities for faster time-to-market</p> <p><b>6</b> Establish a high-performance agile organization with new skills/talent</p>	<p><b>7</b> Address and scale used-car (leasing) offerings</p> <p><b>8</b> Activate and scale B2C channel</p> <p><b>9</b> Develop products in line with customer needs, such as subscriptions</p>

**Defend—incubate against COVID-19 to establish strong resilience**

The COVID-19 crisis has exposed vulnerabilities in business models across industries. To build resilience, auto-financing and leasing companies should focus on three activities.

**Managing residual values and remarketing.**

Our executive survey suggests that many auto-financing players do not yet have optimal risk-management strategies for preserving the residual value of leased vehicles. To improve, they should embrace active inventory planning and increase their data-driven decisions. Healthy residuals, plus effective remarketing practices for off-lease cars, will give companies a powerful one-two combination on this uncertain new playing field. Companies must also improve risk-adjusted pricing to avoid unexpected losses and ensure the efficient turnover of vehicles that are returned after leasing contracts expire. This step will ultimately result in lower inventories.

**Improving collections effectiveness and efficiency.**

Financial resilience requires strong cash-

management skills, especially when it comes to reducing the volatility of cash flows. Our executive survey suggests that many auto-financing players still need to improve these capabilities. More than half the respondents stated that their collections-management capabilities were mediocre, with an average efficiency score of 2.9 on a scale of 1 to 5, suggesting that this area needs particular attention. Improving the turnover within accounts receivable will naturally translate into better collections, allowing companies to avoid a crunch at a time when cash is king.

**Optimizing funding and capital efficiency.**

Pure leasing companies that lack banking licenses have little access to deposits to refinance. In consequence, they often tap into refinancing solutions that go beyond current funding sources to ensure future portfolio growth. Many of these non-traditional solutions are already common in certain regions. For instance, US leasing companies frequently self-fund through the securitization of residual values while simultaneously using leasing rates as the basis for structured asset-backed security (ABS) transactions. In Europe, especially

Germany, players remain conservative about refinancing strategies. Our survey showed that the main funding tools in Europe involve lease ABS transactions, while few companies use residual-value-backed ABS transactions (Exhibit 3).

**Deliver—add implementation muscle to strengthen the core business**

To build post-crisis resilience and ensure long-term success, companies must strengthen their core business. Again, three activities are critical.

**Digitizing core processes to achieve cost excellence and improve quality.**

Companies need a strong technological backbone to support product development and go-to-market strategies. To reduce inefficiency and cost pressure, they should replace clunky manual processes with automation, digitization, and end-to-end solutions

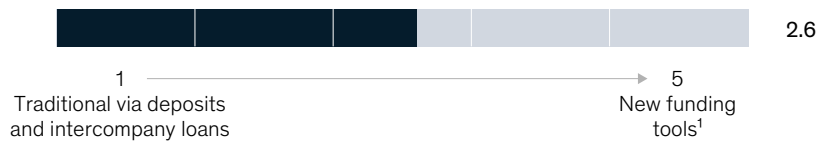
(for instance, tools and processes that help them interface with car-dealer systems). Fortunately, most auto-financing players already recognize the importance of building a solid foundation. In our survey, respondents stated that digitizing core processes was their top priority for the next one-to-two years. Building a strong technological backbone was ranked third (Exhibit 4).

When automating and optimizing processes, companies can take a multi-lever approach—digitization, robotic-process automation, simplification, business-process optimization—across operation centers or build real-time decision engines that deliver answers faster. Among other benefits, digitization and automation will help companies expand their online offerings and B2C channels, providing the high-quality customer experience that consumers increasingly expect.

Exhibit 3

**Auto-financing companies should consider nontraditional refinancing.**

**Innovation in refinancing strategies**, average respondent rating (on a scale of 1–5, with 1 = low innovation and 5 = high innovation)



**Use of current funding tools**, % of respondents



<sup>1</sup>New funding tools include residual-value-backed asset-backed-security transactions. Source: McKinsey European Auto Finance Survey 2020

Exhibit 4

## The strategic priorities of auto-financing executives are shifting.

Strategic priority shifts over next five years

■ Up    ■ Same    ■ Down

Priorities now

Priorities in the next five years



Source: McKinsey European Auto Finance Survey 2020

### Updating IT and tech capabilities to decrease time to market.

Successful auto-financing and leasing companies depend on technology. IT is the largest cost driver in transformation projects, but it enables future growth, and supports the viability of the entire business model. Our executive survey revealed that auto-financing players believe that a gap exists between the current and expected future state for their IT and technology capabilities.

Companies that want to upgrade their tech capabilities must undertake a profound transformation. Rather than viewing themselves as traditional financial-services players, they will become tech companies that offer products in the financial-services space. This new image will ensure that auto-financing and leasing companies give IT the attention it deserves. Organizations focused on the creation of a lean technology backbone will automatically question whether they should retain

legacy systems and complex architectures and processes as they transform.

### Establishing a high-performing agile organization with new skills and talents.

To create innovative products and stay ahead of the game in an increasingly competitive market, organizations must adapt. Our executive survey reveals many auto-financing players still need to become more agile and adopt new ways of working. By implementing an agile organization with low hierarchy and strong cross-functional teams, companies can co-create products with customers in quick, iterative steps. This strategy allows them to tailor products based on customer behaviors and needs while simultaneously delivering new digital solutions. The focus on aligning IT with business objectives will also help organizations build their B2C business further and achieve their priority goals for improving their online presence.



Our survey respondents said the two top skills needed for sustainable growth were digital knowledge/expertise and IT expertise (Exhibit 5). We believe that European captive-financing players particularly need data scientists. Once companies adopt new ways of working, they may attract more top talent with the digital and IT capabilities required to fuel product innovation.

If companies streamline their organizational models by reducing reporting layers and adjusting spans of control, they can reduce costs while driving agility. Likewise, a continued focus on optimizing processes and reducing complexity will allow them

to simplify the product portfolio. Together, these combined improvements will drive additional gains. For instance, a company might assign agile squads to cover certain areas of the simplified product portfolio to identify even more opportunities for cost and complexity reductions.

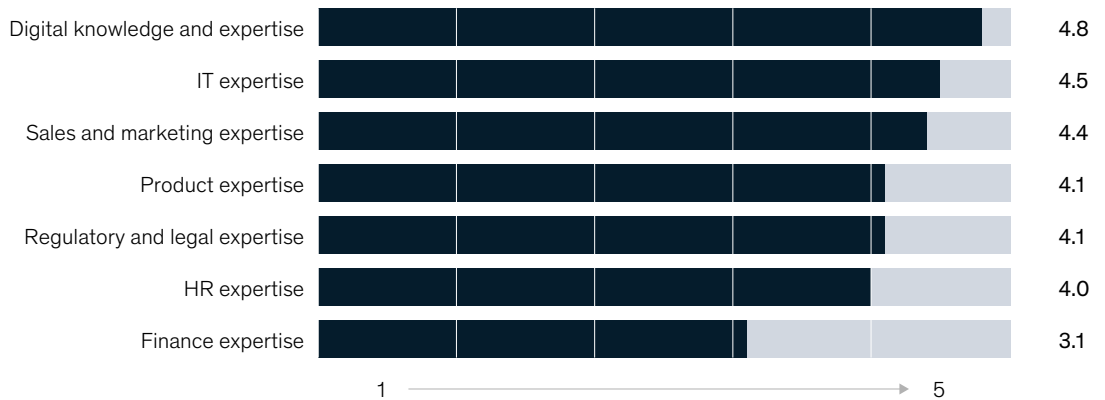
**Disrupt—change the game by reinventing future offerings**

To achieve long-term success, auto-financing players must identify growth pockets, introduce disruptions, and ideally boost coverage in these areas. The following activities will help in all respects.

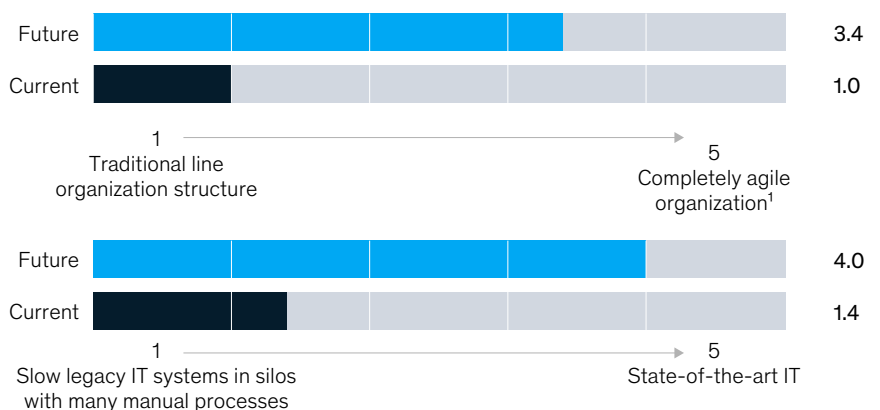
Exhibit 5

**Digital and IT expertise are in high demand, but executives recognize that they need better capabilities.**

**Capability importance for strong future growth**, average respondent rating (on a scale of 1–5, with 1 = not relevant and 5 = extremely relevant)



**Current capabilities compared to essential future capabilities**, average respondent rating (on a scale of 1–5)



<sup>1</sup>Organization with cross-functional teams and new ways of working. Source: McKinsey European Auto Finance Survey 2020

## Facts about leasing and auto loans in Europe

Here are some of the main data points we uncovered about the European market, both from research and our survey.

### The EU auto-loan market:

- Was worth about €17 billion in 2019
- Will be worth about €17 billion to €19 billion by 2025
- Is expected to have a compound annual growth rate (CAGR) of about 1 percent from 2019 through 2025

### The EU leasing market:

- Was worth about €25 billion in 2019
- Will be worth between €31 billion and €34 billion by 2025
- Is expected to have a CAGR of about 4 percent from 2019 through 2025

### Key findings from the McKinsey European Auto Financing Survey 2020 include the following:

- Respondents expect the subscription market to increase to reach a share of 20 percent of the total retail-financing market by 2025; about 25 percent of respondents even expected growth to a 25 to 35 percent share
- Respondents expect the direct B2C online channel to reach a 20 to 25 percent share of total sales
- About 95 percent of respondents rated offerings for electric vehicles as important or extremely important when ranking their strategic and financial priorities for products
- About 90 percent of respondents rated modular offerings as important or extremely important in their strategic and financial priorities for products



### Actively addressing the used car market.

Leasing companies have recently been placing more emphasis on the used-car market. They could accelerate business even further by devoting more attention to the B2C segment, which is generating more customer interest in Europe. Worldwide, several fintechs—Carvana and Vroom in the United States and HeyCar, the VW subsidiary—are already targeting the B2C used-car segment. Some players, including AutoBorse (Santander), HeyCar, JuhuAuto (BDK), Spoticar (Groupe PSA), and VivaCar (CGI) are focusing on controlling the customer front end by building their own online B2C marketplaces. Other companies that enter the B2C segment should also make this a priority. These marketplaces could even become remarketing channels, further contributing to vehicle disposal efficiency.

In another shift, companies should invest in adapting their residual-value models for used-auto leasing. This step will help increase financial stability while reducing unexpected losses.

### Activating and scaling the B2C online channel.

Organizations should activate and scale their B2C channels to reach new customers, since online and

digital options are rapidly becoming more popular. Among other benefits, online channels will give customers the flexibility they now expect while facilitating the shift toward direct-to-consumer interactions.

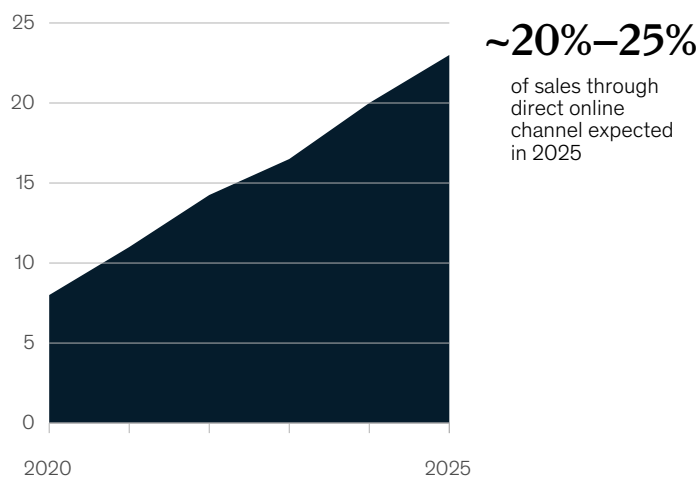
Auto-financing players are focused on digitizing core processes as quickly as possible, since this is necessary to expand B2C channels. In our survey, OEMs and captive players were especially set on this goal. Companies should also digitize their distribution channels and services by building integrated platforms that offer extras, such as remarketing, insurance, or repair services.

The industry is already experiencing high online and mobile traffic volumes, and the COVID-19 pandemic will likely accelerate growth in these channels. Our survey showed that auto-financing executives expect about 20 to 25 percent of B2C sales for auto leasing and loans to go through online channels by 2025 (Exhibit 6). Respondents from captive-financing arms were most conservative, with estimates of about 20 percent, while pure leasing players expected a share of around 30 percent.

Exhibit 6

## Auto-financing executives expect online business-to-consumer sales for auto loans and leasing to reach a market share of around 20 to 25 percent by 2025.

Expected share of online B2C sales for auto loans and leasing until 2025, % estimated by respondents



Source: McKinsey European Auto Finance Survey 2020

Like independent leading players and fintech companies that target their customers via online and mobile platforms, such as LeasePlan with CarNext, OEMs can capture growth opportunities by scaling their online channels. This step will likely require new partnerships and alliances, especially with giant non-automotive e-commerce players. By increasing their online channels, OEMs will be able to attain other strategic goals, such as the development of mobility-as-a-platform offerings that combine different modes of transportation on a single platform. These new business models will likely require heavy investment in platforms and car fleets, as well as new partnerships with private-equity funds, banks or captive-financing arms that can provide funds.

**Developing new financial products.**

As customer preferences shift from owning to using, flexibility is becoming more important. In other words, consumers know exactly what product combination they need, as well as the exact timeframe when they will use it. The growing preference for flexibility will create opportunities for incumbents to venture into new business areas, but

it will also give challengers a chance to gain market share by introducing new offerings and business models.

To succeed in the new landscape, companies should reevaluate all current products against key performance indicators (KPIs) to determine if they should be eliminated or simplified. They should then supplement their existing offerings with innovative products that will help them compete with newcomers. Modular/packaged offerings, subscription offerings, and rentals are all priorities (Exhibit 7).

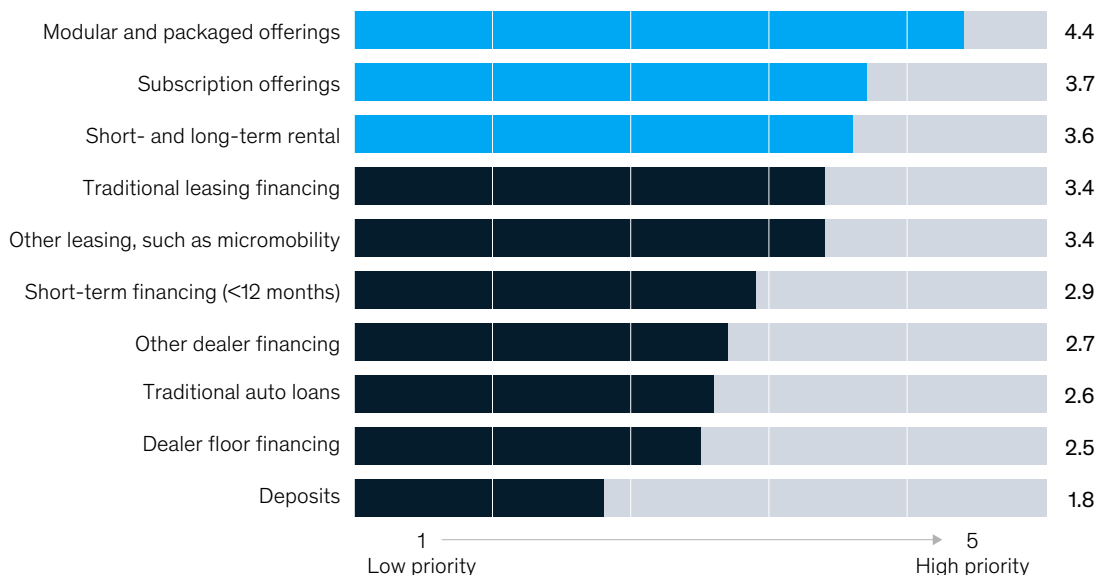
**Satisfying demand for modular or full-service offerings.**

As noted earlier, private and corporate customers increasingly want flexibility. This preference extends to product bundles, since many customers now want to choose a specific combination of products and specify the timeline for their use. New forms of shared mobility are gaining market share since they provide flexible alternatives to private-vehicle ownership. Eventually, they will reshape the private-vehicle market.

Exhibit 7

**Modular and packaged offerings are the top product priority for auto-financing players.**

**Strategic and financial priorities of product offerings, average respondent rating (on a scale of 1–5)**



Source: McKinsey European Auto Finance Survey 2020

Senior executives in the auto-financing sector could create several options to satisfy customer demand for modular and packaged offerings. For instance, companies could offer a set of modular services that complement the product portfolio, such as maintenance and repair services. Customers would have the freedom to choose among add-on modules, such as a subscription for tires, with leases and other products. They could also select or drop modules over time.

As a first step, auto-financing players must develop a technology landscape, including the right IT systems, partnerships, and distribution channels, to deliver these modular innovations, if they have not already done so. They should also redesign contracts to allow customers to terminate individual elements. Other products, such as rented and shared mobility, could become part of an integrated multi-modal bundle—for instance, a contract that offers a leased car and an option for a ride-sharing service—to allow for a seamless mobility experience, regardless of location.

#### **Increasing the focus on subscriptions.**

As more consumers seek flexibility, demand is rising for subscription offerings, where customers pay a fixed, usually monthly, fee for a vehicle. While these are still niche products, auto-financing players should launch a comprehensive subscription offering that allows customers to add or subtract modules as they desire. Our experience shows that companies can often reorient their product landscapes to focus on such products within 24 to 48 months.

Subscription-based offerings show strong promise. In our survey, senior executives expected that they will represent about 20 percent of the total market by 2025. While this estimate may seem ambitious, we do believe there will be exponential growth in this area. High demand exists for fully flexible products, such as leasing models with non-binding durations, but only a few such offerings are available.

Automotive OEMs, rental companies, and new market players already offer some subscription-based products but availability varies by region. OEMs mostly offer products, such as Audi select, Access by BMW, and Free2Move by Groupe PSA, in the United States. In Europe, fintechs dominate the market, with offerings such as Cluno and ViveLaCar, and OEMs still have limited presence. Volvo does have an offering called Care by Volvo in Europe, however, and other OEMs may find opportunities there.

Most subscription offerings include added services as part of an all-inclusive or modular add-on package. These might involve maintenance, insurance, or concierge services. Some subscriptions also allow vehicle swaps at the end of each period, or even during a running contract.

**Subscription-based offerings show strong promise. In our survey, senior executives expected that they will represent about 20 percent of the total market by 2025.**

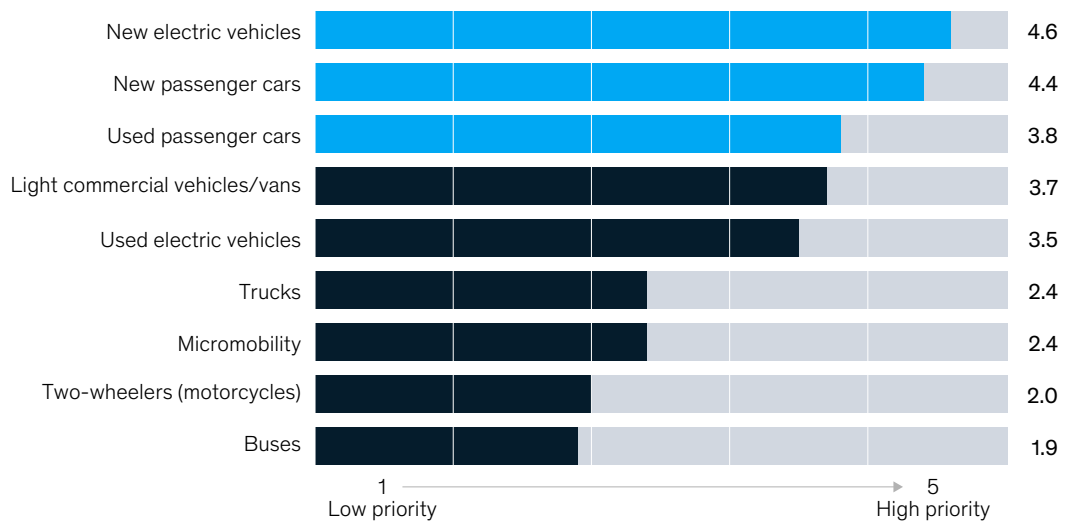
**Driving toward more sustainable mobility with EVs.** When asked about product priorities, executives in our survey ranked offerings for new EVs first (Exhibit 8). Given the growing popularity of these vehicles, auto-financing companies must develop advanced residual value models internally or jointly with partners to manage battery risk. Leasing products and services can give customers a hedge against the prevailing uncertainty about battery lifetimes and quality. Auto-financing players should also improve their prediction accuracy and residual-value models for EVs so they can offer competitive leasing rates. Players may need to review their appetite for risk regularly and understand the implications of adding risk to the balance sheet. (For information on the regulatory factors that might encourage the growth of EVs, see the sidebar titled, “The potential impact of regulations on the growth of electric vehicles.”)

Companies that provide mobility-as-a-service offerings must also develop innovative services, most of which will likely involve connectivity packages and mobility budgets that allow for integrated multi-modal bundles. There will also be a greater need for packaged offerings that allow customers to lease EV-charging infrastructure, and some companies are already moving in this direction. For instance, LeasePlan and ALD partnered with a fintech to provide EV charging infrastructure in their offering. Additionally, companies should consider creating a new product category related to the modular financing of EV batteries—both their purchase and potential servicing—or work with a partner to develop one.

Exhibit 8

**Auto-financing players state that offerings for electric vehicles are their top priority.**

**Strategic and financial priorities of product segment (offerings per vehicle type), respondent rating (on a scale of 1–5)**



Source: McKinsey European Auto Finance Survey 2020

## The potential impact of regulations on the growth of electric vehicles

Regulatory changes could also affect the types of vehicles that consumers buy or lease, as well as their mobility patterns. For instance, electric vehicles (EVs) may see increased demand within the leasing segment. While consumer interest is a factor, EVs will also benefit from regulatory tailwinds in Europe, where strict CO2 targets will most likely remain unchanged. In fact, Germany and France have already agreed to additional financial incentives to stimulate EV demand. Current indicators suggest that EV demand is stable in Europe and may even expand throughout the crisis. Volume and premium OEMs are likely to stick to their EV start-of-production dates to meet CO2 targets, since regulations established prior to the COVID-19 crisis will impose penalties for falling short of these goals in 2020 and 2021. Such penalties could run as high as several billion euros according to our internal estimates.

Many cities are also likely to implement more policies that suppress private-vehicle ownership and incentivize more sustainable modes, such as shared mobility. These policies will first roll out in large cities and reach other areas later in the decade. The pop-up bike lanes in several large European cities give some clues about what might be in store in other locations. City center bans and congestion charges to disincentivize private-vehicle ownership might also emerge. In Paris for instance, city officials have reduced parking spaces and the number of car lanes but increased support for EV car-sharing solutions. As with the growth of EVs, such changes will ultimately affect the auto-financing market.



## Getting started

In the light of recent developments, including the repercussions of COVID-19, Europe's auto-financing players need to reposition themselves for success, and the time to act is now. That means resiliently defending their chosen value, delivering needed changes to safeguard the core business, and disrupting markets to capture new sources of revenue. We believe those who fail to capitalize on current trends now will be left behind.

### Defend

Continue to build COVID-19 resilience for the short and medium term by optimizing collections, improving residual value management, and rethinking refinancing strategies. Companies should shift to more innovative funding tools, such as residual value-backed ABS. For instance, they could optimize finances and analytics by building a calculation engine for residual value, or by optimizing a sustainable refinancing strategy to encourage growth. Companies should also review best practices that other players have recently implemented to derive important lessons.

### Deliver

Build a solid foundation to launch the company forward by strengthening the core business. This will involve digitizing core processes, creating a sturdy technological backbone, and upgrading internal capabilities (for example, through process optimizations, IT diagnostics, and agile organization transformations). Now is the time to double down on digitization and enhance digital capabilities to build a foundation for growth.

### Disrupt

Develop product offerings that are more flexible, such as modular subscriptions, and activate B2C channels to reach customers more efficiently and effectively.

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The authors would like to thank Thomas Baumgartner, Alessia Cheng, Ben Ellencweig, Max Großmann, Philipp Koch, Robin Seibert, Sarah Steinbach, and Andreas Tschiesner for their contributions to this article.



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