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How European businesses can position themselves for recovery

The path to the next normal is uncertain and will differ for each country, sector, and company. There are ways, however, to prepare for the transition.

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For tens of millions of Europeans, the coronavirus pandemic will be a life-changing event. Even if they are untouched by the disease itself, the upheaval caused by the virus will have a profound effect on many people's livelihoods and life circumstances. Never before, except in wartime, have whole industries shut down and consumer demand dropped so far so fast.

The economic implications are highly uncertain. In a midpoint scenario explored in previous McKinsey research, the world economy would experience a sharp downturn followed by a relatively slow recovery, as physical-distancing measures are kept in place for several months. In this scenario, the economy of Europe (defined as the EU 27 and the United Kingdom) would shrink 11 percent in 2020, and it would take until 2023 before economic activity would return to precrisis levels.

For European business, the priority is to keep their employees and customers safe, even as their companies face serious and unprecedented cash-flow, supply, and operational issues. It is also important, however, to look beyond the immediate crisis and begin to imagine paths to the next normal.

In this article, we present a number of indicators that could help European businesses anticipate the shape of recovery and help them in reformulating their strategic posture. Among them: patterns from previous recessions (part 1), changes in customer behaviour due to COVID-19 (part 2), and the effect of lockdowns on different sectors (part 3). Combined, these indicate how businesses can start to strategize about the postcrisis world (part 4)—based on how fast they are likely to recover and how much they have been changed by the crisis. Some will have to "lean in" to changes that are in the works; others will have to restructure, and some will have to swerve, reinventing themselves even as they seek to find their footing. Our conclusion is simple: those companies that focus on planning ahead across multiple time horizons are likely to emerge faster from this crisis than others, and in a more resilient state.

Part 1: Previous recessions may provide sectors with clues to the speed of recovery

Past recessions are not necessarily a predictor of future outcomes; even so, considering what happened before can be a useful point of reference. Certain patterns from previous recessions and recoveries can be informative. Two are worth highlighting—the role of consumers and exports.

Both recessions and recoveries tend to be consumer-led. As economic conditions worsen, households cut back on spending, especially on nonessential purchases that can be delayed, such as jewelry, clothes, white goods, or cars; that was the conclusion of McKinsey research after the 2008 financial crisis. Because latent demand builds up, consumers tend to come back in a rush when their outlook improves. In the last three recessions in Europe, household consumption in the first year of recovery increased by 1.0 to 2.5 percent (as a percent of GDP), contributing to a 2.2 to 4.6 percent growth in overall GDP (Exhibit 1).

While nuanced, these patterns proved surprisingly similar across the EU 27 and the United Kingdom. Of more than two dozen subsectors analyzed, the ones that most consistently rebounded first after the 2008–09 recession, regardless of country, included retail, food and drink, and insurance.

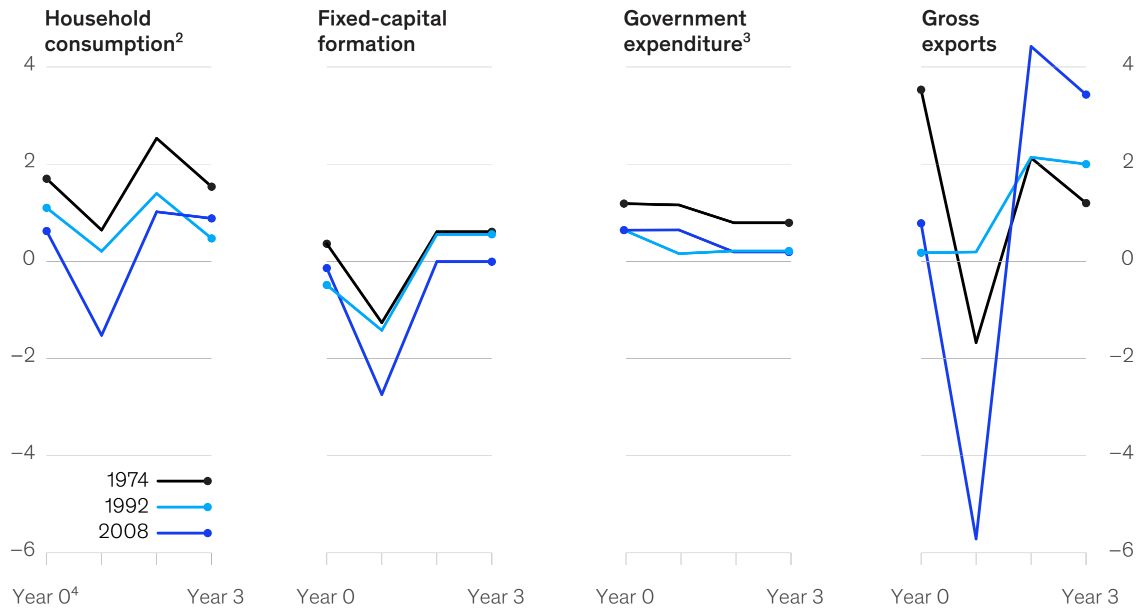
By contrast, recovery comes later for sectors producing mostly intermediary products or capital goods.[1] When a recession starts, many of these businesses are still completing customer orders and can continue operating at high levels for a while. However, as demand for consumer products and services declines, the effects start to be felt further upstream. Moreover, the uncertainty accompanying economic slowdowns often results in capital investments being put on ice. The same delayed dynamic repeats itself on the way out of recession: even after consumer demand starts growing, it takes time for demand to recover in business-to-business (B2B) sectors.

[1] Since 2010, certain intangible investments, especially in research and development, software, databases, and other forms of intellectual property have been classified as capital (rather than expenditure) in national accounts.

Exhibit 1

Consumption and exports tend to lead Europe out of recessions.

Contribution of components to annual GDP growth in Europe,[1] percentage points



[1] EU 27 + United Kingdom.
[2] Includes consumption by nonprofit institutions that serve households.
[3] Only includes final consumption by government, so excludes transfers; fiscal stimulus will primarily have been channelled via households and businesses, so would show up in household consumption or capital formation.
[4] Year 0 indicates year before each recession.

Source: The World Bank; McKinsey analysis

When these eventually emerge from the downturn, though, a quick pickup similar to that shown by consumer spending can be discerned. In B2B sectors where stocks have been depleted, an economic acceleration means that intermediaries not only need to fulfill orders but also to build up inventory. This is truer for goods than for services. Because most services cannot be stored, they do not exhibit the same stocking and restocking effects.

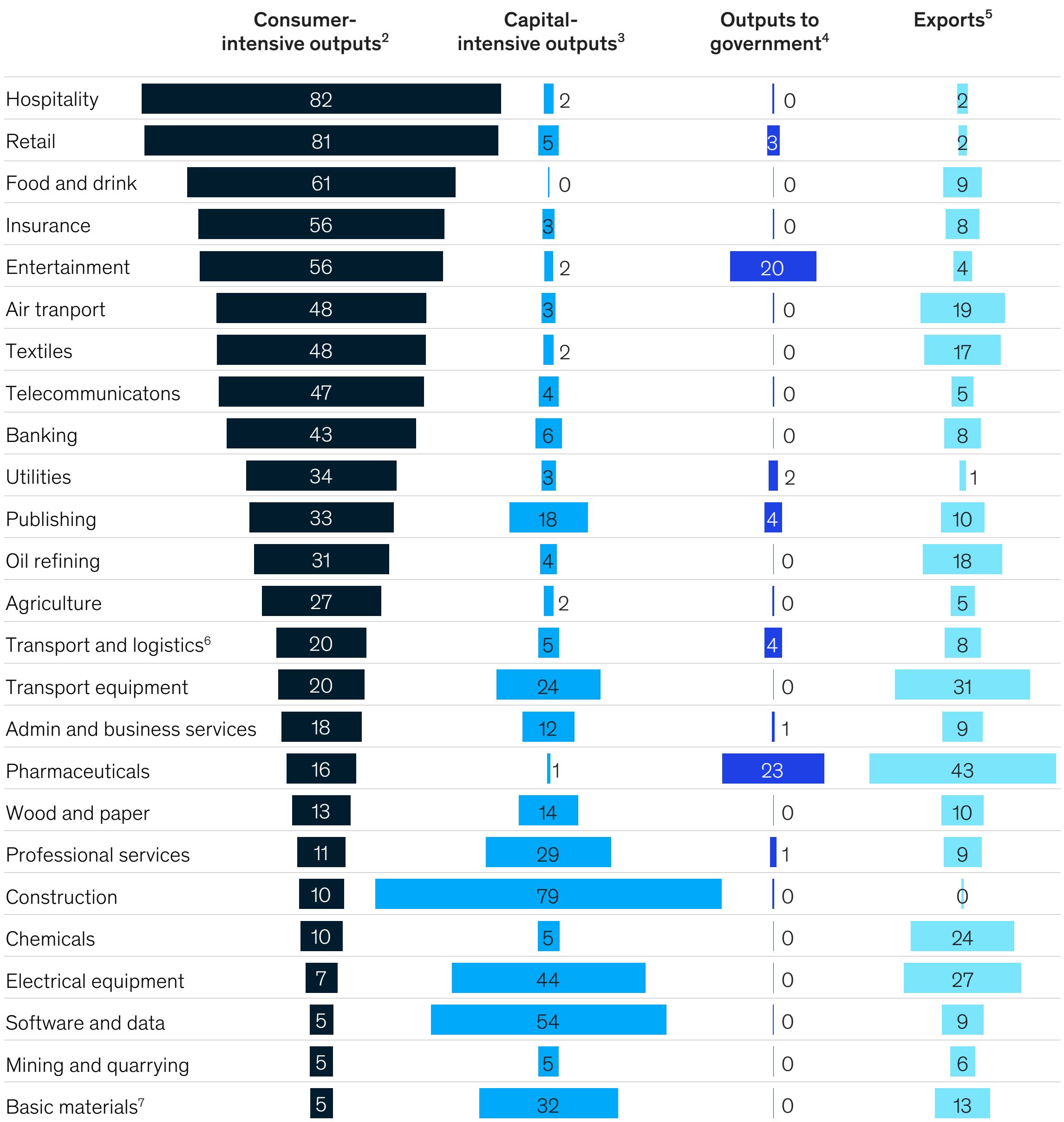
Exhibit 2 shows the proportion of each sector's output that is sensitive to household, capital investment, government expenditure, and export demand in the EU 27 and United Kingdom. If consumer and business behavior from earlier recessions repeats, sectors where a high proportion of outputs go directly to end-consumers—think of hospitality, retail, food and drink, manufacturing, insurance, and entertainment—could recover relatively swiftly once people's confidence about the future is restored.

Export-led subsectors tend to bounce back faster than nonexport led ones. Exports also played a leading role in recovery after previous recessions in the EU 27 and the United Kingdom, making up 2.1 to 4.4 percent of the total 2.2 to 4.6 percent increase in GDP in the first year post-recession (Exhibit 2). This pattern can be observed at the sectoral level, too—with two exceptions. First, despite fast overall growth in service exports, only a few subsectors, such as computer programming, experienced an immediate boost after the 2008–09 recession. For example, the GDP of the professional services

Exhibit 2

If consumer expenditure recovers quickly, the hospitality, retail, and food and drink sectors are likely to benefit most.

Composition of sector outputs in Europe,[1] 2018, % of total use



[1]EU 27 + United Kingdom. [2]Outputs going to final consumer consumption, including nonprofit institutions serving consumers, plus outputs to sectors where more than 50% goes to final consumer consumption. [3]Outputs going to capital formation plus outputs to sectors where more than 20% go to capital formation. [4]Only includes final consumption, not capital formation. [5]Total exports including within the EU. [6]Excluding air transport. [7]Basic materials includes basic metals, fabricated metal products except machinery, rubber and plastic products, and other nonmetallic mineral products.

Source: Eurostat; McKinsey analysis

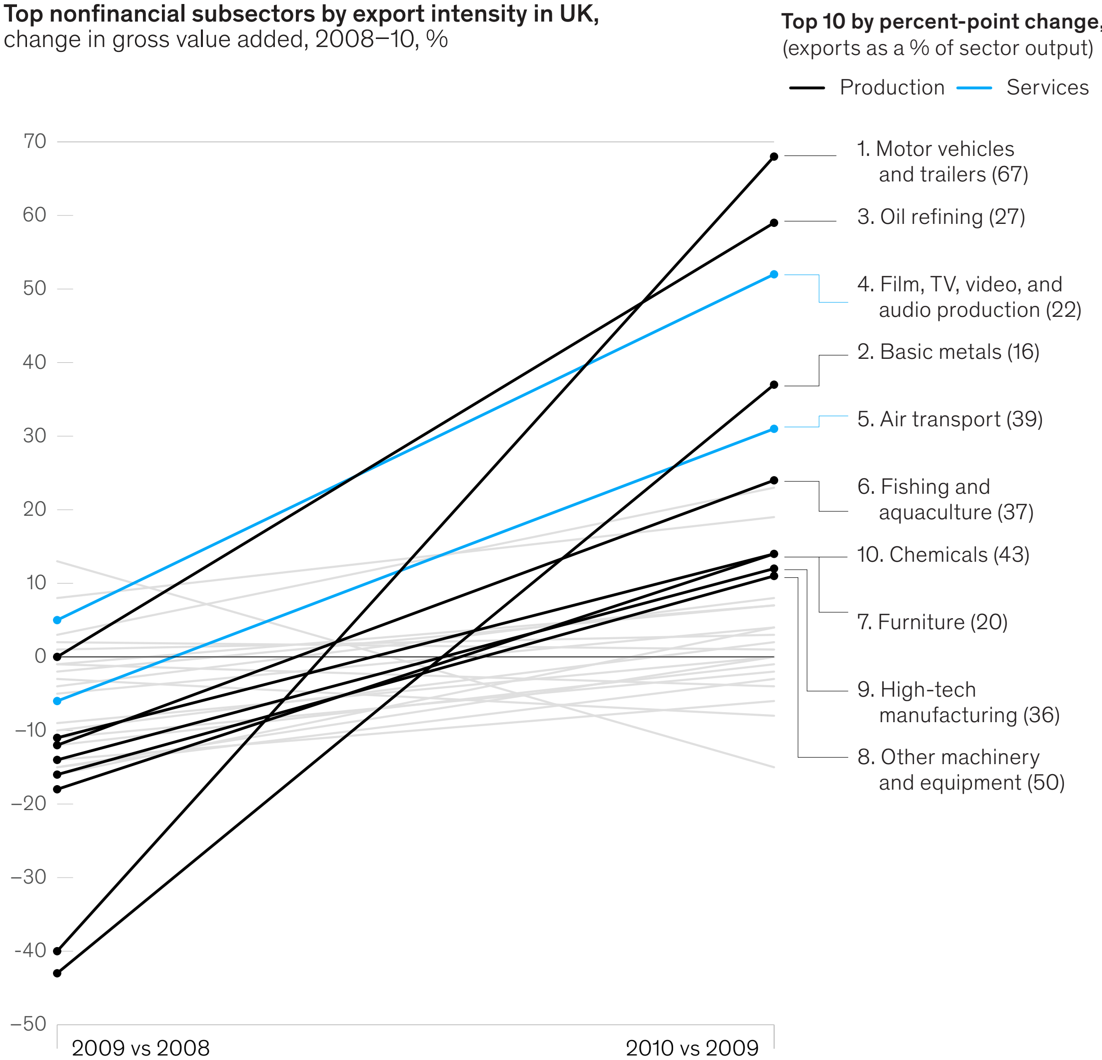
sector in the EU 27 and the United Kingdom only recovered to its prerecession level in 2013. Second, even if they are export-oriented, European sectors in structural decline, such as mining or textile manufacturing, had not fully recovered by 2018.

The story is more positive for those export-led industries where European manufacturers are positioned to take advantage of the post-recession global boost, such as vehicle and high-tech manufacturing. By way of an example, in the 2008–09 recession, British companies' output of sports goods, knitwear, and motor vehicles dropped by 56 percent, 51 percent, and 47 percent, respectively. A sharp drop in demand for export-led sectors is typical in recessions. In the following year, though, they recorded increases of 69 percent, 55 percent, and 90 percent. Of the top export subsectors in the United Kingdom, almost all grew more in 2010 than they lost in 2009, recording a weighted average growth rate of twice the rate for the economy as a whole (Exhibit 3).

Exhibit 3

In the United Kingdom's last recession, the hardest-hit and most export-oriented sectors bounced back first.

Top nonfinancial subsectors by export intensity in UK, change in gross value added, 2008–10, %



Source: UK Office for National Statistics; McKinsey analysis

The global nature of the current crisis and the timing of the different COVID-19 epidemic waves across Asia, Europe, the United States, and the rest of the world complicates matters. On the one hand, overall export demand is unlikely to pick up the pace until most of the world is on a path to both containing the virus and rebuilding their economies. In the scenario considered most likely by business executives surveyed by McKinsey, that is likely to take several months. This contrasts with the post–financial crisis recovery, in which emerging-market growth provided crucial support to export sectors in Europe. Moreover, the virus could make a resurgence, requiring an undulating pattern of stricter and less strict physical distancing measures until a vaccine is found. This would make synchronizing global value chains extremely difficult. On the other hand, there could be opportunities for European companies that can offer reliable deliveries, for example into a faster-growing Asian market.

The importance of competitive advantage for export-led recovery also means that to gain real insight, it is necessary to examine individual countries and sectors. For example, output in metals and chemicals after the 2008–09 financial crisis grew quickly in Poland, returning to prerecession levels within two years. In Germany, the same sectors didn't recover until 2014 and 2015. For the EU 27 and the United Kingdom, metals didn't get back to previous levels until 2016, and chemicals hadn't as of 2018. Historically, many of the European sectors that struggled to return from recessions were lumbered with structural issues related to productivity and cost-competitiveness. Post-COVID-19, additional sectors might now be facing structural challenges due to radically changed customer (or employee) attitudes.

Part 2: Some changes in customer behavior might outlast the crisis

The imperative to save lives in the COVID-19 crisis has resulted in rapid changes in people's behavior and perceptions. Businesses thinking about their postcrisis positioning need to observe these trends closely.[2]

Consumers are shifting to remote channels, and not just in retail. Historically, e-commerce has been adopted fastest in business-to-consumer (B2C) markets. The COVID-19 lockdowns have meant e-commerce is deepening and broadening—albeit unevenly, depending on the category and country.[3]

For example, McKinsey's sentiment surveys suggest that European consumers expect to reduce their spending in practically all product categories. At the same time, they anticipate shifting a significant proportion of their entertainment purchases, and some of their grocery purchases, online (Exhibit 4). In countries that already had a relatively high penetration of e-commerce, such as Britain, these shifts have been more dramatic. For example, according to the United Kingdom's Office for National Statistics, online sales as a proportion of all retail increased from 20 percent in February 2020 to an estimated 25 to 30 percent in the last week of March; Britain went into lockdown on March 23.

The adoption of digital and other remote channels extends far beyond household purchases. In 2018, only 12 percent of health consultations in the EU took place remotely and only 4 percent of general practitioners reported monitoring patients remotely.[4] Since coronavirus-related safety concerns and lockdown restrictions have come to the fore, a large proportion of health consultations

[2] For a broader consideration of how the post-COVID-19 world could be different, see Shubham Singhal and Kevin Sneader, "The future is not what it used to be: Thoughts on the shape of the next normal," April 2020, McKinsey.com, and Oliver Tonby and Jonathan Woetzel, "Could the next normal emerge from Asia?" April 2020, McKinsey.com.
[3] For the latest country-by-country and category-by-category consumer sentiment, see "A global view of how consumer behavior is changing amid COVID-19," April 2020, McKinsey.com.
[4] *Benchmarking deployment of eHealth among general practitioners (2018)*, BDI Research, Directorate-General for Communications Networks, Content and Technology (European Commission), Open Evidence, and RAND Europe, October 4, 2019, europea.eu.

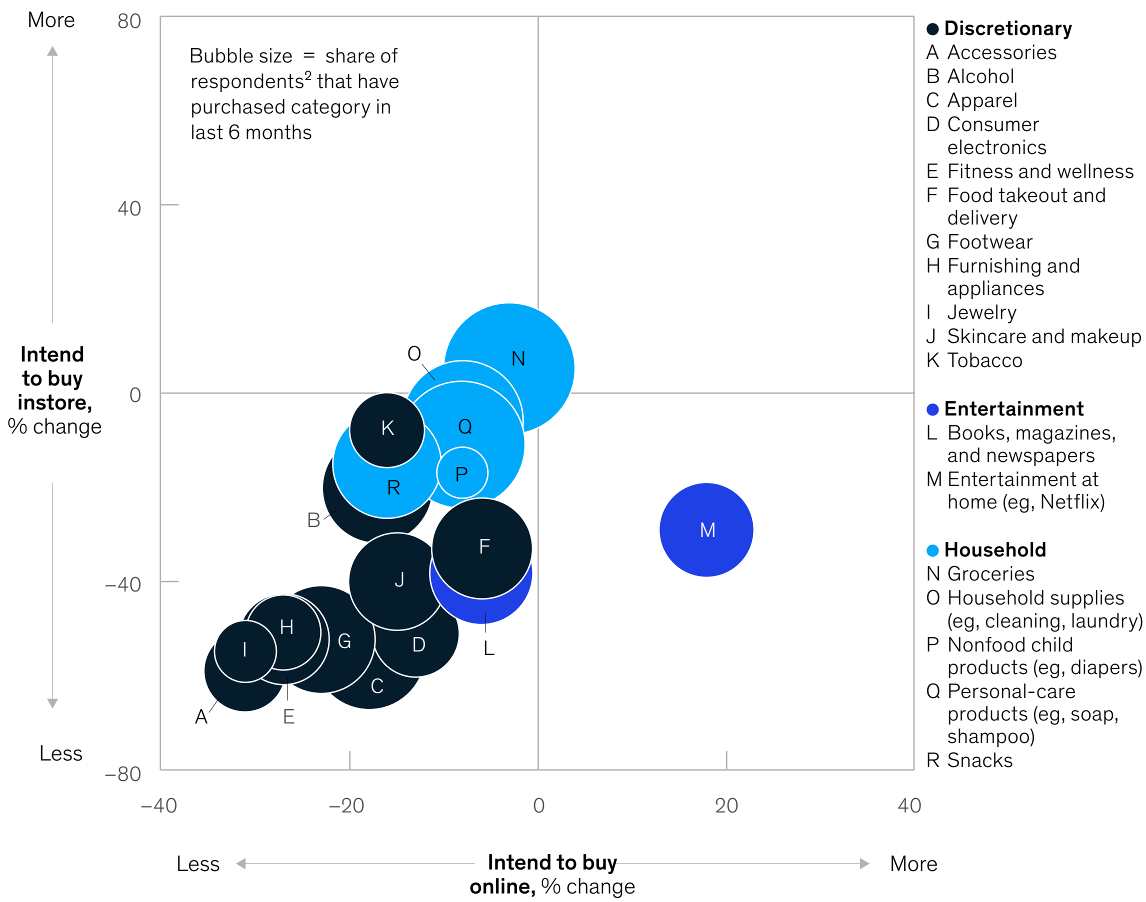
have moved to telephone or video calls. For example, in Germany, the Charité—Universitätsmedizin Berlin hospital, ramped up its online video clinic to meet a surge in demand. In countries across Europe, many of the most common ailments, such as diabetes, high blood pressure, chronic pain, depression, and anxiety are now being treated remotely.[5]

The education and entertainment sectors are also seeing innovation and rapid adoption of remote technology. In Europe, most universities and many primary and secondary schools have shifted to online teaching. Even nightclubs have reinvented themselves by hosting stay-at-home parties. Organizers in Berlin now provide a virtual club service each night, "United We Stream." After just two weeks, the site had recorded five million viewers. At the other end of the music spectrum, a performance in March of *Geister* ("Ghost") by the Berlin State Opera, attracted 160,000 people.

Exhibit 4

European consumers in lockdown expect to increase their purchases of in-store grocery items and online entertainment, but not much else.

Expected change per category over the next two weeks[1]



[1] Question: And where do you expect you'll buy these categories? Tell us if you will shop in the following places more, about the same, or less in the next 2 weeks. Please note, if you don't buy in one of these places today and won't in next 2 weeks, please select "N/A." Question was not asked for travel and multiple other categories. Countries included are France, Germany, Italy, Spain, Portugal, and UK.
[2] Net intent is calculated by subtracting the % of respondents stating they expect to buy less here from the % of respondents stating that they will buy more for each category and type of channel.

Source: McKinsey M&S COVID Europe Consumer Pulse Survey, Apr 16–Apr 19, 2020, n = 5,623; sampled and weighted to match general population aged 18+

[5] Bharadwaj V Chada, "Virtual consultations in general practice: embracing innovation, carefully," *British Journal of General Practice*, June 2017, Volume 67, nih.gov.

In many ways, the shift in delivery models in professional services is an extension of what was already happening in service exports.

Business customers for many kinds of services are accommodating remote delivery. Downloads of videoconferencing apps in European countries in March were between ten and 30 times the number at the end of 2019.[6] While many of these will have been for personal use, a large proportion of B2B interactions has also shifted to using remote technology instead of face-to-face, on-location or office-based meetings. In 2018, around 5 percent of all EU 27 and UK workers usually worked from home.[7] Amid COVID-19, we estimate that around 20 percent—especially in the information and communication, professional, and financial-services sectors—might be working remotely. In February, the Mobile World Congress in Barcelona, which normally attracts more than 100,000 visitors, was cancelled, due to the coronavirus. In May and June, however, many upcoming technology conferences—such as Apple WWDC, Dell World, Forrester CX, and many others—are expected to take place virtually.[8]

In many ways, the shift in delivery models in professional services is an extension of what was already happening in service exports. In Britain, the trade intensity (that is, total exports and imports relative to total output) of professional services has risen from 20 percent of GDP two decades ago to more than 30 percent.[9] The vast majority of these services—between 75 and 85 percent—are delivered remotely, without either the suppliers' or customers' people crossing borders. Now, given the severe restrictions on movement, similar practices have been scaled up domestically in other categories, such as information, communication, and financial services. Given the savings in time and travel costs, it is unlikely that B2B sectors will fully snap back to previous practices.

Part 3: Physical distancing is affecting sectors differently

Will business operations change permanently? Or will companies return to their former ways of working when the crisis passes? The firm answer: it depends. With some suppliers under lockdown, companies have had to revamp their procurement routes to include alternative suppliers, or have been forced to use different inputs for their production processes. To mitigate supply shortages, customers of one Italian company are using 3-D-printed valves to support the manufacture of life-saving respiration equipment.[10] In some cases, these changes will be temporary stopgaps; in others, companies will find that they have chanced upon an improved business formula and will stick to it.

For now, one aspect that is relatively easy to assess among sectors is how physical distancing has affected employees' ability to work. There are two elements to this assessment. The first is to evaluate to what degree business as usual is compatible with physical distancing. For example, in places where

[6] Lexi Sydow, "Video conferencing apps surge from coronavirus impact," App Annie, March 30, 2020, appannie.com.
[7] "How usual is it to work from home?" Eurostat, February 2, 2020, europa.eu.
[8] Bill Detwiller, "Coronavirus tech conference cancellations list: Apple WWDC, Microsoft Build and Ignite, VMworld, HPE Discover, Gartner, Dell World and more," ZDNet, April 17, 2020, zdnet.com.
[9] "Input–output supply and use tables," Office for National Statistics, October 31, 2019, ons.gov.uk.
[10] "Digital solutions in times of COVID-19," European Digital SME Alliance, digitalsme.eu.

people mostly work with machines, staying apart from others is relatively straightforward. For people working in offices, however, doing so may be more logistically difficult. And in occupations that take place in busy, crowded places, such as bars and restaurants, or that require physical contact, such as hair styling, working during the pandemic has been all but impossible. Postcrisis, there is likely to be heightened sensitivity to employee and customer safety; it is possible these concerns will change long-term working practices.

Second, in cases where remote working is necessary, some occupations and businesses can adapt readily—think of personal assistants, speech and language therapists, and software engineers. In others, the work location is more fixed; it is not feasible for a factory worker or a truck driver to work remotely. Exhibit 5 shows which sectors need to promote physical distances for safety reasons, combined with their ability to continue operating when they do so. This allows us to identify which industries have been disrupted most by employee-related challenges—namely (and not surprisingly), hospitality, construction, entertainment, retail, and personal services.

One fairly obvious implication is that businesses that have faced less operational disruption appear to be in a better position to return to normal more quickly. Perhaps more significantly, sectors with a larger gap between the ability and need to work remotely may be among the last ones to reopen, unless large-scale testing and tracing allows people to return to work. These sectors include hospitality, entertainment, construction, and retail. Regardless of when strict lockdown restrictions are lifted, different protocols will be needed—by location, sector, and employer—to minimize the spread of the virus until a vaccine is widely available. This in turn will weigh on late-to-open sectors' cash flows and profitability and is likely to augur continued uncertainty and structural change.

Part 4: Four ways to think about planning for the next normal

Two factors—the speed of recovery and the magnitude of structural change—will shape European recovery. Depending on how these play out, companies and sectors will, in broad terms, fall into four categories. No sector will fit any single archetype perfectly and every business will have its own idiosyncrasies. Nevertheless, we believe these cover most of the post-coronavirus landscape.

Bounce back. Sectors in this category have experienced limited fundamental change in the business environment and are likely to see customer demand return relatively quickly; examples could include food manufacturing, restaurants and bars, and many consumer goods, such as apparel, furniture, and cars. Companies in these sectors should focus on supporting employees' return to work, consolidating customer and supplier relationships, and improving operational efficiency.

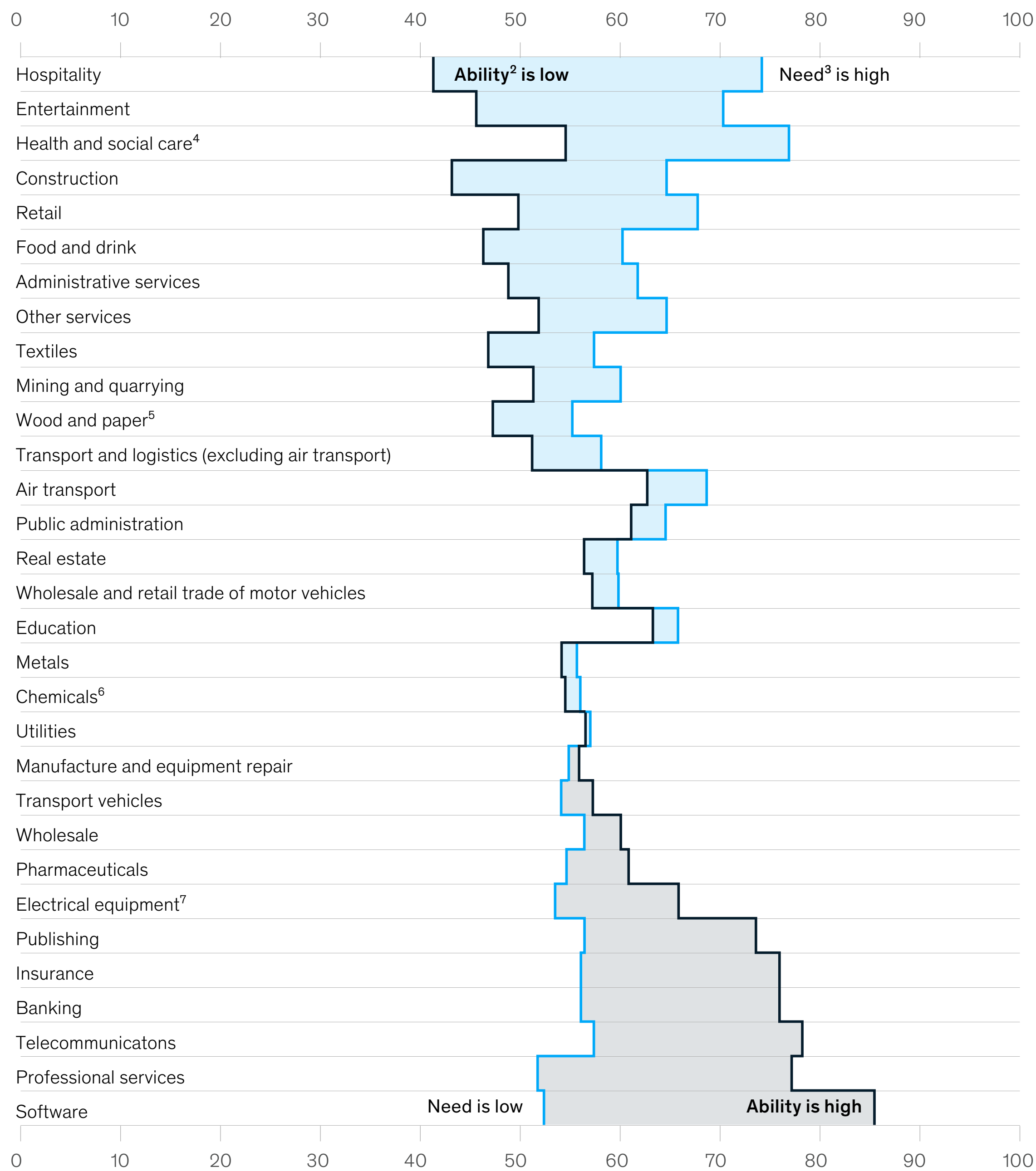
Lean in. These are sectors where demand is likely to recover relatively quickly but the lockdown period might prove to have

Two factors—the speed of recovery and the magnitude of structural change—will shape European recovery.

Exhibit 5

In cases where remote working is necessary, some occupations and businesses can adapt readily; in others, the work location is fixed and cannot adapt easily.

Difference between ability to work remotely and need to work remotely,[1] index (0 = no need or ability)



[1] Agriculture is not included. [2] Based on each occupation's level of interaction with computers. [3] Based on each occupation's level of physical proximity to other people. [4] Health and social care are special cases: work is likely to continue despite high proximity to other people. [5] Includes other manufacturing. [6] Includes oil refining. [7] Includes high-tech manufacturing.

Source: Eurostat; LabourCube; Occupational Employment Statistics, US Bureau of Labor Statistics; McKinsey Global Institute analysis permanently changed consumer behavior or ways of operating. Companies in this cluster should focus on "leaning in" to new practices, ways of working, and consumption patterns, specifically by rapidly reallocating capital and talent to support these changes. Retail, entertainment, and financial services likely fall into this category. There are also opportunities for significant transformations in health and education.

Restructure. These are sectors where the fundamentals haven't changed significantly but demand growth and the restoration of supply chains will take some time to recover. These circumstances will prompt businesses to seek new ways to improve their cost-competitiveness; there may also be market consolidation. In recent recessions, extraction, basic materials, and some manufacturing sectors have fallen into this category, as well as construction and parts of transportation and storage.

Swerve. This is the most challenging category, comprised of sectors facing a slow recovery while also having to deal with fundamental changes in delivery modes and customer behavior. Surviving and thriving will require a complete reinvention of business models for the next normal. Among those likely to be affected are parts of the transport and tourism sectors, such as airlines and hotels, as well as many building- or office-related services, if there is a significant increase in remote office work.

The viability of European companies' business models will depend on the depth and length of the disruption in their sectors, and how effectively they plan ahead. Given that the only thing business leaders know for sure is that the future is uncertain, they would do well to consider a range of scenarios. Thinking now, with imagination and an open mind, about their future strategic posture will put them in a superior position to respond.

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