

Strategy & Corporate Finance Practice

# In conversation: The COVID-Exit

Despite a resurgence of infections, confidence is rising about an end to the pandemic. Here is how to grow your way out of the crisis.



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**This episode** of the *Inside the Strategy Room* podcast examines how business leaders should plan the transition from managing operations through the crisis to establishing a foundation for growth in the post-COVID-19 era. It features two partners who are spearheading our research on these topics. Martin Hirt, the global co-leader of the Strategy and Corporate Finance Practice, is a co-author of the recent article on the COVID-19 exit and of the book *Strategy Beyond the Hockey Stick*, upon which some of the conversation is based. Anna Koivuniemi co-leads the growth service line globally and is the co-author of recent articles on through-cycle growth outperformers and lessons from growth transformations. This is an edited transcript of the discussion. For more conversations on the strategy issues that matter, subscribe to the series on Apple Podcasts or Google Play.

**Sean Brown:** Do you think the end to this crisis is in sight?

**Martin Hirt:** With vaccines being released and stock markets going through the roof, you could speculate that there is at least a line of sight toward the end of the crisis, and certainly a cause for thinking about

how to lead our enterprises toward the exit. We have seen in previous crises that it is extremely important to aim for the right exit velocity, because that can set the vector of business performance not just for the next couple of years but the next decade. So this is a pretty profound topic.

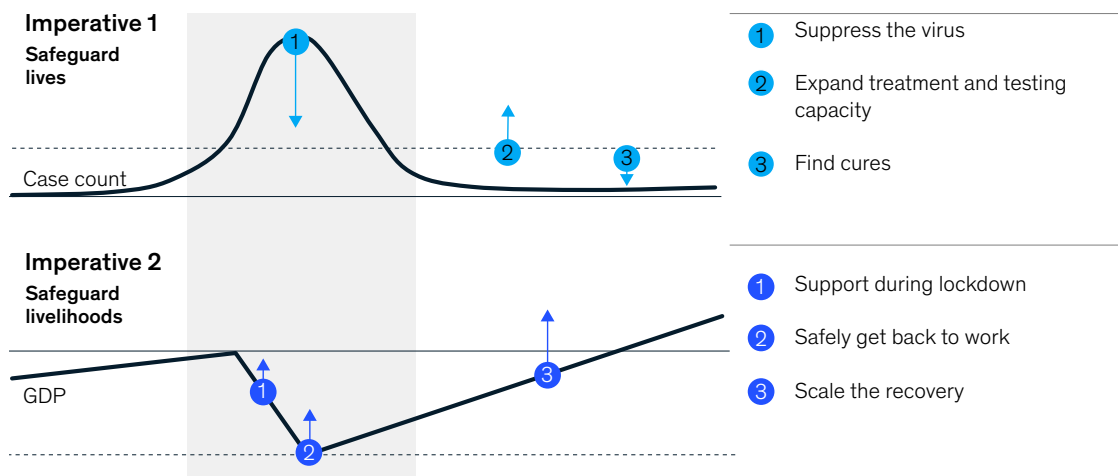
**Sean Brown:** You and our other colleagues have been tracking this pandemic from the start. Where do you feel we are on its overall trajectory?

**Martin Hirt:** The world has been processing this crisis in a couple of dimensions [Exhibit 1]. One, how to safeguard lives by getting the virus under control. We have dramatically expanded testing as well as treatment capacity and capabilities, and there may now be the first glimmer of a cure. The second equally important dimension is how to safeguard livelihoods, because we were all terribly impacted by the initial lockdowns. Many businesses are still under extreme pressure. The public-policy response to provide stimulus worked quite well in many countries, cushioning the initial shock, but some regions are still struggling to get people safely back to work and to scale the recovery.

Exhibit 1

## Safeguarding our lives and livelihoods is the imperative of our times.

### 'Timeboxing' the virus and the economic shock



Source: McKinsey analysis, in partnership with Oxford Economics

These two dimensions defined the scenarios that we have been using throughout to frame the economic impact. We have now seen a few quarters of the crisis playing out. We expect the global GDP to show a dramatic rebound in the third quarter from the unprecedented trough in the second quarter. We project a recovery of 7 percentage points in Q3, which is equally unprecedented. The big question now is, where will we go from here? Will the recovery continue on this current very steep trajectory, or will we see an additional slowdown, at least temporarily, due to new lockdowns being implemented in Europe, for example, and potentially some measures the new US administration will devise? There is still quite a bit of uncertainty but it's more narrow than before.

**Sean Brown:** On what does that uncertainty primarily center? Is it the effectiveness of pandemic containment in the coming months?

**Martin Hirt:** The virus has been the main driver of the crisis all along. Much of the economic recovery over the summer had to do with people feeling less uncertainty and more comfort spending again after mortality dropped substantially from the peaks in spring. Under most scenarios, the expectation is that 2021 will be a year of tremendous growth, at rates the world has not seen for a long time. When exactly that growth will start largely depends on how quickly we get the virus under control. Then 2022 will be the year of the actual COVID-19 exit when we return to more normal, 2019-type growth rates.

**Sean Brown:** How has the resurgence of the virus in many parts of the world affected those projections?

**Martin Hirt:** Our scenario is based on expectations of further drastic public health interventions such as lockdowns, and mortality is certainly correlated with that. If excess mortality [death rates above the norm] rises, the authorities will have little choice but to return to more stringent lockdowns. We are now more cautious in our estimates because this resurgence is actually quite steep. The good news is that the excess mortality in most geographies is within historical trend lines or slightly above. We are not seeing anything near the excess mortality in the

spring that had led to the rigorous lockdowns, with dramatic implications for the economy.

**Sean Brown:** Given this continuing uncertainty, do you think business leaders can make concrete plans?

**Martin Hirt:** We saw in previous economic crises that the main unlock for the economy is uncertainty dropping. We still have a fair amount of it but it has decreased and once the uncertainty recedes, the economic rebound will be in full swing. There seems to be more confidence now that a positive scenario will play out through better treatments and better protection of vulnerable parts of the population. We know that vaccines and glass vials are being produced at scale, we know that logistics companies have plans in place for distributing the vaccine, so those are sources of optimism. What that means for the trends your business needs to consider will be one of the most important factors in your plans for the next couple of years.

**Sean Brown:** A number of trends, especially around digital offerings, have rapidly accelerated, benefitting some industries enormously while other sectors have slumped. How should business leaders factor that into their strategies?

**Martin Hirt:** We have seen winner-take-all dynamics in many industries, especially those that are ahead of the trends. The fundamental dynamic of accelerating returns for companies with business models that others cannot compete with is a global trend. But even in the worst-performing industries there are companies that create value and in the highest-performing industries there are many that destroy value. Take, for example, the semiconductor industry: in almost every subsegment, there are only one or two companies that create enormous value and many that destroy it. So what you do matters a lot, regardless of the industry you are in.

**Sean Brown:** So what do outperforming companies do differently? Anna, this is a topic you have been studying for some time.

**‘Almost 65 percent of the outperformers pursued all growth directions whereas other companies were either unable to grow their core or were not as actively looking at adjacent markets.’**

—Anna Koivuniemi

**Anna Koivuniemi:** We looked at what industry outperformers, meaning companies that grow faster and are more profitable than their peers, did in the last crisis. We found that 8 percent of the companies grew faster than their peers throughout that crisis. They delivered a compound annual growth rate [CAGR] of 3 percent during the actual downturn and 15 percent during the recovery, which was three times higher growth than their peers.

We wanted to see what we could learn from these outperformers and we found five consistent patterns across industries. First, the companies had a through-cycle mindset. They pulled back in some areas early in the downturn but then ramped up R&D and capital investments faster than others during the recovery. One thing that helped them is that they had created optionality: before the crisis began, they had 20-percent higher excess cash, which then enabled them later to invest.

The third pattern was that the outperforming companies made bold moves around growth opportunities. They not only looked at their core businesses but at adjacencies and value chain disruptions. And they often made those moves

using M&A. They did 10 percent to 20 percent more deals during the crisis than their peers, and their deals were 1.8 times larger. Lastly, they invested in building new and enhancing existing capabilities more than the others.

What’s interesting is that during the financial crisis, these companies had two years to pull back capex and other expenses. In this crisis, they did it in two quarters and much more drastically.

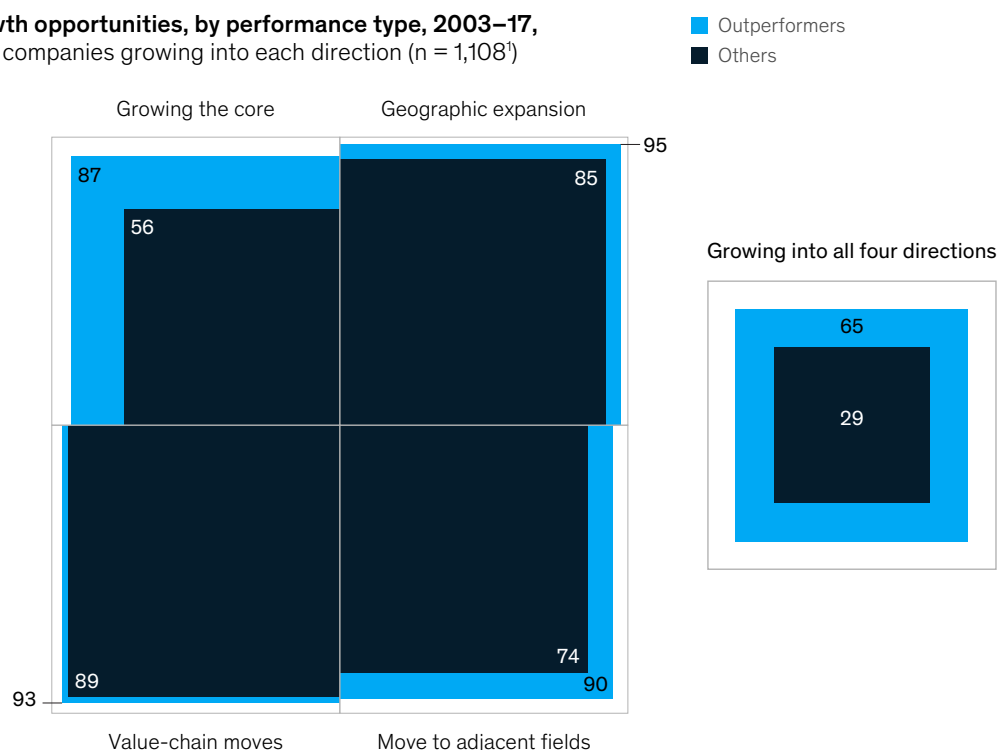
**Sean Brown:** Are there any particular directions of growth that seemed to pay off the most for these through-cycle outperformers?

**Anna Koivuniemi:** Almost 65 percent of the outperformers pursued all the growth directions whereas the other companies were either not able to grow their core or were not as actively looking at adjacent markets. We also found that over the past 15 years, geographical expansion accounted for the highest share of the growth [Exhibit 2]. Now we believe the core is the game to play, especially in the short term, but many of the companies we talk to are also looking at expansion into adjacencies.

## Exhibit 2

### Big moves: The majority of outperformers have grown into all four directions.

**Growth opportunities, by performance type, 2003–17,**  
% of companies growing into each direction (n = 1,108<sup>1</sup>)



<sup>1</sup>Companies may grow both in new geographies and into new industries or along value chains at the same time. Core growth is calculated assuming an "average" overlap.

**Sean Brown:** You mentioned M&A earlier and that outperformers did more and bigger deals during the last crisis. Have you seen these companies focus more on digital acquisitions, especially in recent years?

**Anna Koivuniemi:** Yes. In roughly the past five years, the outperformers did 85 percent more digital deals than their peers and those deals were 40 percent bigger, so there is an even larger delta between the outperformers and the others on digital deals. If you look only at 2020, which admittedly is a short time and digital M&A activity was not at normal levels, we see that delta growing further.

**Sean Brown:** Were there particular capabilities these outperformers were looking to access through mergers and acquisitions?

**Anna Koivuniemi:** In our research, we defined more than 200 capability areas and we tracked how these were changing over time. Since 2008, we have seen a correlation between personalization, multichannel, cloud, automation, agile, artificial intelligence, all these buzzwords, and the outperformers' growth rates. We saw the same on learning and collaboration, which is important especially for industries where innovation drives outperformance. Next, we wanted to see how these patterns were changing. We found that companies are still investing in personalization but e-commerce and digital sales are, not surprisingly, on more people's agendas. Some new topics are also rising because of the current circumstances: sourcing, inventory management, convenience.

# ‘Don’t overthink 2021. Next year will be difficult. Try to figure out your exit vector in 2022 and anchor those plans in your 2019 performance.’

—Martin Hirt

What’s noteworthy is that more than 50 percent of the outperformers are investing in these capability areas, while only 30 percent of their industry peers are doing likewise. The biggest differences in the investment levels are in digital, sales and marketing, and innovation and R&D.

**Sean Brown:** Thanks, Anna. With that in mind, let’s come back to plans for the COVID-19 exit. Martin, how would you advise companies to approach their strategies for the next two years and beyond?

**Martin Hirt:** There are big differences in the state of various industries but given recent news and the fact that this pandemic is better understood than it was last spring, there is a case to be made for adding a positive scenario to your 2021 planning. It might be only one of four scenarios you are looking at but make sure you have it because the absolute growth rates in 2021 are likely to be very high. In some of the more positive public health scenarios, we could break through to 2019-level performance earlier than later next year.

The second recommendation is to not overthink 2021. Next year will be difficult. Try to figure out your exit vector in 2022 and anchor those plans more in your 2019 performance than in 2020 or 2021. Then, with that exit vector, consider what transformation initiatives you need to undertake—for example, in

the directions that Anna discussed—to reposition your portfolio for that exit and make sure you hit it in stride. That will guide how you think about 2021, which becomes a transition year from where you are today and that exit point. And get those initiatives going now because every minute matters.

**Sean Brown:** As we start thinking about a recovery from this pandemic, what do you expect to happen to some of the industries that have been hit hard by the crisis? For example, do you think travel will recover?

**Martin Hirt:** Imagine that this crisis is over, people are vaccinated, we don’t have to worry about a virus anymore. Just think how big the party is going to be! People have such a desire to go out and have a normal life again, interact with each other, travel, so I think there will be tremendous joy around the world.

That said, based on my personal experience, reactivating travel is going to take some time. I was three times in quarantine last year and I can tell you, many countries that have managed to get the virus to zero or near zero are very careful not to let it back in. Airlines will need time to ramp up, rehire staff, get the planes out of the desert, and deal with other logistical issues. But I have no doubt that the demand for the services these industries provide will be very strong as soon as the pandemic subsides.

Business travel is a tougher question. The fact that we have discovered we can have highly effective and efficient meetings via videoconference will have a sustained impact. But we will see how it goes. Last fall, I spent a few months doing in-person meetings in Taiwan, where there is no virus, and I can tell you, it feels different than sitting on Zoom.

**Sean Brown:** For all the challenges we faced in 2020, many companies and individuals accomplished incredible things. How do business leaders keep that focus and ambition in their organizations when the crisis atmosphere starts to dissipate?

**Martin Hirt:** Let me give you an example of how one of my client CEOs turned it to highly motivating effect. He pulled the R&D team together in a town hall and said, “This is unbelievable. What you accomplished in this period of a few months we

previously could not have done in years.” He singled out a product that they did literally in two weeks almost from scratch. It was a healthcare product for which there was much need, so there was a clear case for being fast. But they did that unbureaucratically, putting the best people on the team, and the team experienced peak performance that was hugely motivating.

The CEO then said, “We will not go back to who we were, because we have now seen how we can work together and do amazing things in a really short time.” And he challenged the R&D organization to tell him how they wanted to reorganize to create that sort of motivating work environment. So there are many things you can do to turn this crisis into a forward-looking, motivating event that allows people to finally do things the way they always thought they should be done. There are lots of opportunities.

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