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Risk & Resilience Practice

Business building: The path to resilience in uncertain times

In an uncertain economy, executives' first instinct might be to cut costs and shore up established holdings. A better way is to build new businesses.

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In stable times, business building is a powerful way to extend into new and higher growth areas. In times of great disruption and uncertainty, however, building new businesses becomes a critical path to improving an organization's ability to survive and thrive.

Many leaders are bracing for a rough economic ride—they're girding their companies against a series of acute global risks. In addition to geopolitical instability, volatile commodity markets, and rising inflation, they anticipate continued waves of global health crises, more frequent and severe climate hazards, and major shifts in consumer and industrial demand. These developments, they feel, could put long-term pressure on their business models—thus heightening the need for resilience.[1]

The new reality is that crisis and disruption are here to stay, and conventional approaches won't work the way they did in the past. Business building, by contrast, is a way to diversify, shore up, protect, and expand when others are contracting. Committing resources to a new business, however, is only part of a winning strategy. Incumbents need a tool kit: a road map, a sense of urgency, and an entrepreneurial mindset, using their advantages—resources and talent—and eliminating disadvantages, such as barriers to innovation and systems that don't support new initiatives and growth.

Traditionally, resilience meant cutting costs and preserving capital. While belt-tightening shouldn't be ignored, the cost focus alone has never been sufficient—and certainly isn't in today's market. Business is not facing just a momentary inflection but a state of volatility and long-term change that is becoming the new normal. In an extended volatile environment, companies must create optionality to enhance their risk profiles—not only their exposure to markets or geographies but also their exposure to system-level changes (Exhibit 1).

50%

of all revenue during the next 5 years is expected to come from new businesses, products, and services.

New businesses can be the best way for incumbents to grow now—and in future evolutions of the world's current era of volatility. Established companies have many advantages in building new businesses: infrastructure, talent, facilities, and brand. Incumbents may, of course, face challenges with innovations, processes, and cultures that don't lend themselves to internal entrepreneurship—but these are all execution-driven challenges, and none are insurmountable.

Companies can diversify in a few ways, but building new businesses constitutes an especially powerful approach. For example, our research suggests business building helped companies weather pandemic disruptions: 34 percent of companies that prioritized business building kept their revenues from shrinking during the pandemic, compared with 26 percent of companies that prioritized other organic-growth strategies.[2] Business building provides both financial as well

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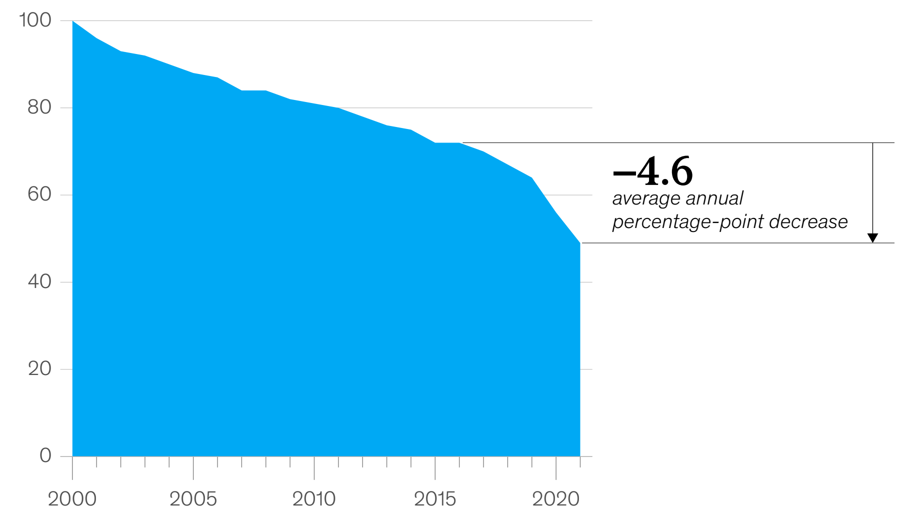
1 Børge Brende and Bob Sternfels, "Resilience for sustainable, inclusive growth," McKinsey, June 7, 2022.
2 Shaun Collins, Ralf Dreischmeier, Ari Libarikian, and Upasana Unni, "Why business building is the new priority for growth," *McKinsey Quarterly*, December 10, 2020.

Exhibit 1

Corporate longevity is declining: The share of top 500 global companies has fallen and accelerated amid disruption.

Share of global companies maintaining a top 500 position in 2000,[1] %



[1]Top 500 defined by market capitalization at the end of the calendar year.
Source: Corporate Performance Analytics by McKinsey; McKinsey analysis

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as operational diversification that is broader than typical cost-saving measures (Exhibit 2).

At a basic level, newly built businesses help established companies form new customer relationships and accelerate growth. Organic growth typically generates more value, and it spares companies from paying a take-over premium on top of the stand-alone value of the acquired business.[3] Because new businesses don't have legacy costs, they can yield higher profit margins and be less exposed to cash flow pressures. And when new businesses have offerings and operating models that differ substantially from those of existing holdings, they help insulate an organization against inflation, supply chain disruption, and economic down cycles. Achieving these benefits involves focusing on businesses that foster resilience and growth.

New businesses that build resilience

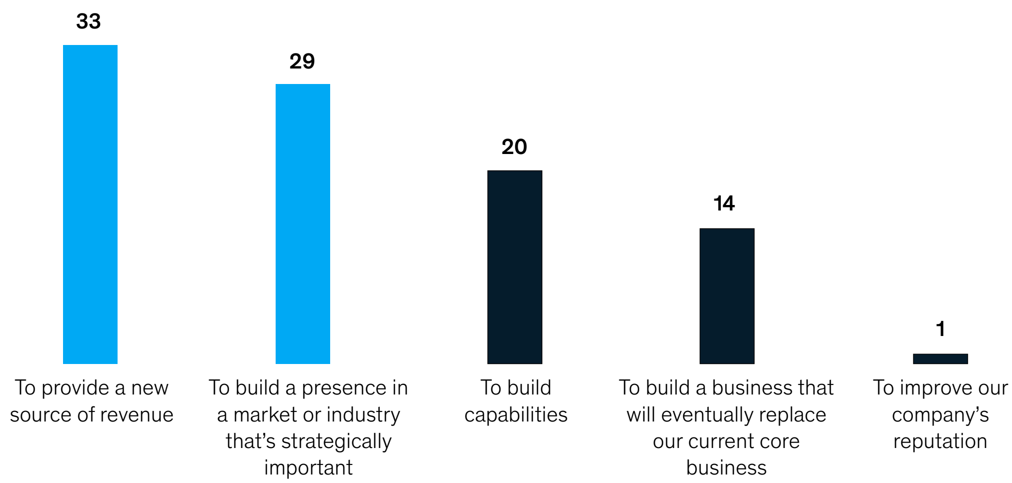
Considering the challenges facing companies today, four types of new-business builds are particularly well suited to resilience. Many of these can be started rapidly and begin generating earnings within 24 months—enabling success in early stages and beyond.

[3] Marc Goedhart and Tim Koller, "The value premium of organic growth," January 19, 2017.

Exhibit 2

Today, nearly a third of companies building new businesses are doing so to build a source of strategic diversity.

Organization's primary reason for building a new digital business,[1] % of respondents (n = 851)



[1]Question: What was your organization's primary reason for building a new digital business?
Source: McKinsey Digital Strategy Survey, 2022

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The counter-cyclical businesses

Catering to markets or customers with relatively inelastic (and growing) demand allows established companies to better counter cyclical swings. For example, data sales related to transaction processing are less directly correlated to consumer spend than swipe fees, which tend to go up and down with the economy and consumer confidence.

There are several approaches to building ventures that help organizations diversify away from exposure to inflation. For example, some service businesses generate more stable revenues than comparable product or capital-goods businesses, because they can supplement their sales of larger-ticket items such as elevators or automobiles with services that are smaller but longer touch. In such cases, companies can shift their sales model to accommodate cash-strapped customers and move from a "sell the air compressor" model to a "sell the tire refill" model. At times, even more straightforward approaches to inflation mitigation (for example, cost pass-throughs) are more palatable to customers if accompanied with updated business models (for example, where sales are linked to outcomes). In consumer products, for example, the notion of the "Lipstick Index"[4] was coined to describe how certain, more accessible products (small "affordable luxuries") can become popular during times of economic

[4] Andrea Felsted, "Our lipstick obsession says a lot about the economy," *Washington Post*, September 13, 2022.

difficulty when larger purchases need to be put on hold. Finding these pockets of growth within whatever business you're in (and even scaling to new businesses through novel delivery platforms, for instance) can be critical to survival and future growth but won't happen if an organization is narrowly focused on cost.

Resource-light businesses

When interest rates rise and cash flow dwindles, new ventures that can scale without proportional additions of equipment or workers can reinforce the bottom line of a company whose other divisions require substantial capital assets and head count. These commonly take the form of marketplace convenors. Uber and Airbnb, for example, famously created e-commerce versions of these models. More recent examples are companies that have provided platforms for services that others provide, such as Verbling, which connects language tutors to students, and Bosch-owned Azena, which created an Internet of Things ecosystem for security devices. Companies such as these, with existing relationships and access to users or providers, are in a privileged position to scale these businesses rapidly with little capital of their own at risk.

Similarly, we are seeing new businesses built by "asset owners" take on more business functions that used to be done later in the value chain. Residential real-estate companies such as RXR built businesses during the 2008–09 financial crisis that enabled them to offer new end-to-end customer experiences—for example, move-in assistance or digital concierges for housekeeping or grocery delivery. This isn't limited to residential real estate: commercial warehouse providers now offer logistical services beyond the four walls, workforce training, and more. If your organization might not be the best owner of the asset or function, it can still be the best connector of whatever the asset is to whomever needs to use it, depending on your business context.

Consolidated or robust supply-chain-driven businesses

A McKinsey survey in 2020 found that industries experienced supply chain disruptions lasting for a month or longer every 3.7 years. And this was before COVID-19 lockdowns, trade tensions, war in Ukraine, disruptive weather, and other difficulties snarled global supply chains. This year brought sharp increases in prices of commodities such as fertilizer, aluminum, coal, and steel. While supply chains and commodities tend to correct in the long term, midterm disruptions abound and highlight the comparative resilience of businesses that operate with light exposure to global logistics and overseas production.

These patterns are generating a lot of interest in circular business models,[5] which reclaim the initial product for its raw materials to be used in future production. Such models are meeting new needs from a supply chain perspective but also from an environmental standpoint. One example that is being highlighted as a success is EMMA Safety Footwear.[6] The company created the first safety shoe that had a fully circular business model back in 2017 but couldn't scale it enough to be profitable. It then engaged with industry competitors to create a bigger ecosystem that has the scale to be fully profitable and significantly less vulnerable to shocks that affect access to raw materials and overseas supply chain disruptions.

Similarly, successful businesses have been built based on providing insights that reduce input costs by increasing yield. Such businesses have thrived in disparate sectors such as semiconductor manufacturing (by increasing chip yields) and agricultural production (by increasing crop yields while reducing input costs such as fertilizer or pesticides).

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[5] Jos van Hillegersberg, Matthias Olthaar, and Dennis Vegter, "Supply chains in circular business models: Processes and performance objectives," *Resources, Conservation, and Recycling*, November 2020, Volume 162.

[6] "The circular economy: From enthusiasm to realism," *European Business Review*, November 11, 2021.

Adjacent businesses facing less (or at least different) headwinds

Often, value pools adjacent to a company's core can be unequally affected by headwinds. The adjacencies—commonly value-chain or market-segment adjacencies—can be value areas to enter, as some incumbent advantages may be transferrable. Our research suggests companies that master moving into adjacencies can deliver 3 percent more TSR over time.

News Corporation was a traditional print-media conglomerate that found itself needing to radically pivot in order to survive. Digital-heavy investment has transformed News Corporation into a market leader in the online real-estate, streaming, and information aggregation sectors. It didn't just move its news from print to online (though it did that as well). It executed M&A-led entries into digital brands such as REA in Australia and Move in the United States and built out adjacent services such as mortgage brokering through the same platforms. It also purchased complementary data businesses that could plug into existing services and aggregated intellectual property from thousands of news information sources, in different formats and languages.

This play can win across sectors. Many consumer-packaged-goods companies quickly adapted their channel mix, launched direct-to-consumer (D2C) offerings, tailored products for comfort and at-home use, and de-emphasized items like suits or corporate-office furniture and equipment. Materials companies moved downstream, often using D2C or white-label brands where their inputs could capture more value. And financial institutions, which commonly catered to business-to-business or other institutional investors, successfully entered retail banking (Exhibit 3).

Making business building part of the resilience agenda

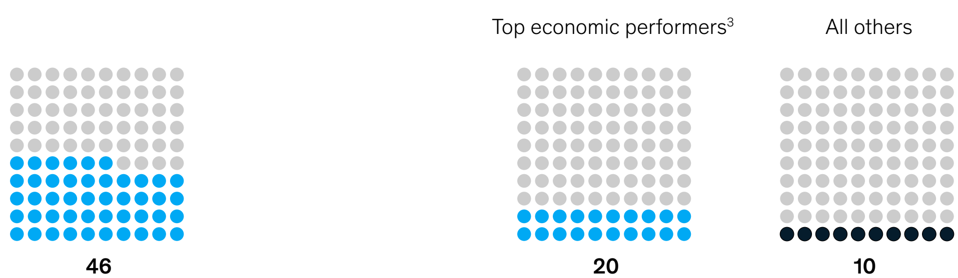
In a McKinsey survey in 2020, findings suggested that 24 percent of new businesses started by large corporations went on to become viable, large-

Exhibit 3

As uncertainty has grown over the past three years, executives have doubled down on business building at top-performing companies.

Company executives who consider business building a top 3 priority, 2022,[1]
% of respondents (n = 995)

Median share of digital-technology spending on new digital business separate from the core in next 3 years, by performance, 2022,[2] %



[1]Question: How important is building new businesses at your organization currently? Responses exclude "Don't know."
[2]Question: Over the next 2 years, how is your organization planning to allocate its digital and technology spending across the following initiatives or transformations?
[3]Companies with respondents who reported increases of ≥15% in their organizations' revenue and EBIT over the past 3 years.
Source: Leap by McKinsey Global Survey on New Business Building, 2022; McKinsey Digital Strategy Survey, 2022

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scale enterprises. In the current environment, more companies could benefit from the resilience new businesses can provide. But building new businesses is not without risk. Just 20 percent of incumbent companies created 66 percent of the viable, large-scale businesses that have been built in the past ten years.[7] While today's heightened uncertainty could make the prospect of building new businesses less attractive to executives occupied with the health of existing businesses, the risk of *not* broadening the business portfolio could be even greater. Corporate longevity has never been lower, and more than 50 percent of all revenue over the next five years is expected to come from businesses and offerings not in existence today.

Research suggests that the risks of building new businesses can be mitigated, and that incumbents possess certain advantages over start-ups.[8] Take a look at what established companies can do to boost their new businesses' odds of success.

Follow a proven playbook. Applying a rigorous business-building methodology can raise the success rate of new businesses and avoid common critical pitfalls.[9]

Make business building a habit. Our 2020 survey found that frequent business builders—those that launched four or more businesses in the past ten years—see higher returns on investment, on average, than those building fewer new businesses. These frequent business builders are 2.2 times more likely than other companies to generate returns of five or more times their original investment. The difference can be attributed, in part, to the benefits of having a portfolio of new companies and developing capabilities to build and scale these ventures.[10]

Start today. Our research suggests those that innovated and built new businesses in the last downturn outperformed by 10 percent in the crisis and 30 percent through the cycle. Market discontinuities can create opportunities—the time to start is now.

Business building is not without risk, but not taking the leap may be even riskier.

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7 "Why business building is the new priority for growth," 2020.
8 "Building new businesses: How incumbents use their advantages to accelerate growth," McKinsey, December 12, 2019.
9 "Why business building is the new priority for growth," 2020.
10 Ibid.