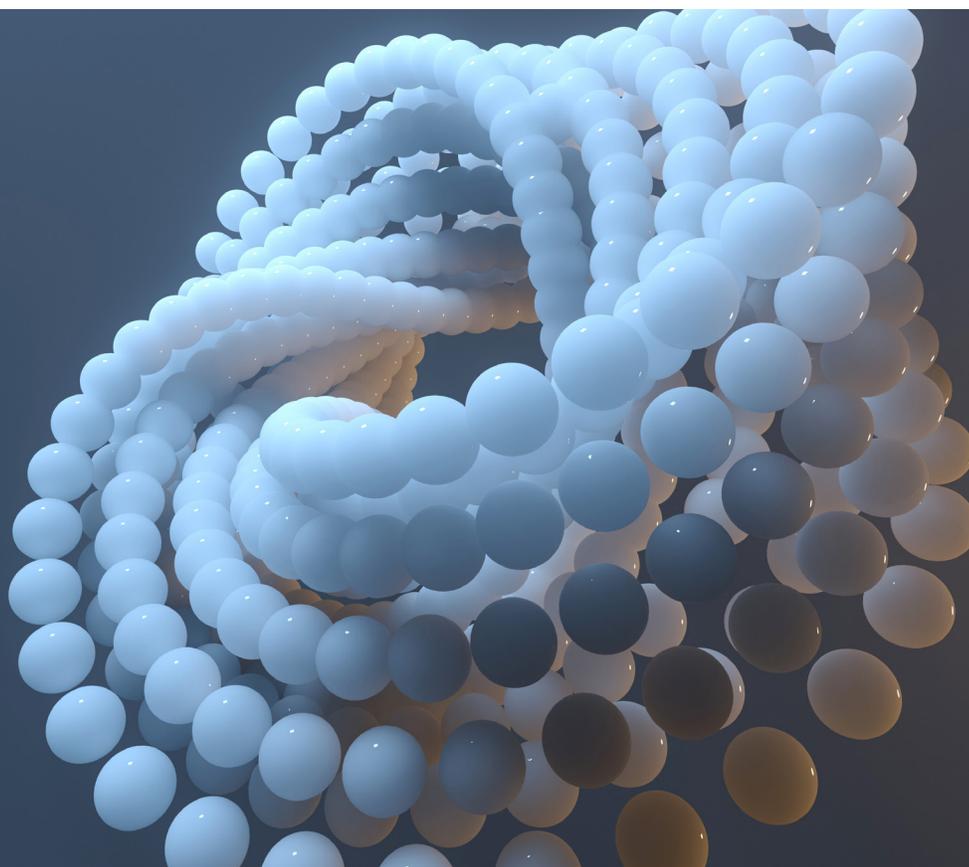


Advanced Industries Practice

The CEO agenda for companies in advanced industries

As automotive and industrial companies take tactical steps to survive the pandemic, they should seize the opportunity to embrace ten actions to sustain leadership and value creation in the coming decade.

by Thomas Baumgartner, Rajat Dhawan, and Asutosh Padhi



CEOs and corporate leaders are awash with uncertainty due to the persistent transmission of COVID-19, shifting regional dynamics, fluctuating customer demand, and transformational technology disruptions. For industrial companies—those within advanced electronics, aerospace and defense, and automotive and assembly—the decisions made today about their strategy, products and services portfolio, and sustainable performance transformations could have widespread economic repercussions. Worldwide, industrials employ almost 25 million people and generate about \$9.3 trillion in annual revenue. In the United States alone, they represented around 13 percent of the total market capitalization on US stock exchanges as of January 2020, and the sector’s combined market capitalization of about \$5 trillion was larger than that of energy, real estate, materials, utilities, and most other sectors.

We have worked closely with industrial CEOs and their leadership teams since the onset of the pandemic, focusing in large part on tactical issues to carry them through 2020 and 2021. But we believe this is an opportunity to chart a new course for the next decade—one in which industrials truly differentiate themselves from competitors, accelerate their recovery, and aggressively transform their companies to prepare for the next normal. Their leadership teams have been open to creating innovative long-term strategies, but they first wanted answers to several questions before moving forward:

- When can we expect to see recovering revenues and services growth, and when will we meet or exceed 2019 growth levels again? Can we accelerate our growth?
- What does the next frontier of margin improvement look like?
- How should we revise our strategy and organization to suit the next normal, considering the upcoming disruptions resulting from a complex interplay of new tech, digital, and heightening regulatory oversight?

With their complex supplier networks, diverse product mix, and varied customer base, global industrial companies must balance many important considerations as they answer these questions. Although each company will develop a unique approach that suits its needs, they can all benefit from ten game-changing strategies for establishing areas of competitive differentiation. If industrial leaders implement these strategies, their companies will be exceptionally well positioned for the next decade. These leading-edge activities fall into three areas: securing high-confidence growth, achieving next-generation margin and productivity transformation, and reshaping strategy and organization for the next normal (Exhibit 1). This article provides a high-level view of the ten strategies that companies could follow.

High-confidence growth

By prioritizing four competitive differentiators for growth, including expansion through M&A, industrial CEOs can increase revenues and move forward with greater confidence, despite the current uncertainty.

1. Digital and go-to-market disruption

Three trends have been fundamentally changing how buyers purchase products and services: the growth of omnichannel sales, greater use of data, and increased automation in sales processes. These forces have been growing in importance and reshaping go-to-market (GTM) models in recent years, but the pandemic has brought them to an inflection point. With sales representatives unable to meet with customers in many circumstances, digital channels are more critical than ever. Similarly, data and analytics are gaining ground as players suffering revenue losses seek new sources of growth. The third trend, automation, is accelerating as companies navigate the challenging environment and attempt to transform both back- and front-end processes.

Advanced electronics players already have significant experience with all three trends. Their complex GTM models have always involved a

Strategic actions fall into three categories.

 <p>High-confidence growth</p> <ul style="list-style-type: none"> • Digital and go-to-market disruption: transforming go-to-market from concept generation through digital-business building at scale • Revenue acceleration through digital and services: assessing company performance with digital and analytics to identify opportunities • Digital-business building: pursuing growth by building new businesses or scaling existing digital products and services • M&A strategy through integration and transformation: accelerating value capture by moving seamlessly from strategy to deal making and integration 	 <p>Next-generation margin and productivity transformation</p> <ul style="list-style-type: none"> • Margin improvement through digital operations: using digital tools along the end-to-end value chain to mitigate risks, lower costs, and achieve other benefits • Full transformation: unlocking an organization's full potential through holistic interventions in performance, capabilities, and health • Transformed global footprints and industrial supply chains: building resiliency with reimagined business models, secure control points, and efficient industrial supply chains 	 <p>Strategy and organization for the next normal</p> <ul style="list-style-type: none"> • Cloud partnerships to accelerate momentum: creating a focused cloud strategy, enhanced by sound partnerships, infrastructure, and capabilities • Redesigned organizations that are built for speed, at-scale capability building, and resizing: accelerating decision making, creating agile teams, and reimagining talent strategies • Sustainability: transitioning operations, products, and growth strategies to achieve a low-carbon, sustainable economy
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variety of players, such as distributors, agents, suppliers, and contractors, in a multilayered arrangement. What's more, advanced electronics companies have long viewed online sales as a mainstay of their GTM setup, since they prefer to serve customers via the most efficient channels. Likewise, their sales representatives are accustomed to using customer-relationship-management (CRM) systems that contain vast amounts of customer data to inform pricing, account coverage, and churn management.

Although automotive players have less experience with omnichannel management, data and analytics, and automation, the COVID-19 crisis has prompted them to take more heed of these forces as the sales landscape shifts and financial pressures mount. For instance, their customers have traditionally visited dealerships to buy a car, but a recent global survey indicated that more than 50 percent of respondents were willing to buy a car online. The numbers varied

by country, ranging from 33 percent in Japan to 68 percent in China. Such shifts, and other consequences of the pandemic, will permanently transform automotive players' GTM approach.

While industrials are well aware of recent trends, they must make greater efforts to adapt their GTM models to respond to them:

- **Omnichannel as a differentiating reality.** In the automotive sector, strong omnichannel management will be critical for OEMs and dealers, or else they might face pricing and revenue pressure as they compete for market share. In addition, consumers will increasingly expect full data access and greater contact along the decision journey as online models become more established. All industrial players, including those in advanced electronics, must ensure that their B2B online channels provide a high-quality experience. For instance, B2B

decision makers, who are critical for growth, will expect the same availability that B2C channels provide. Surveys show that the number of B2B respondents who viewed remote selling as more effective than a model focusing on in-person interactions rose from 45 percent in 2019 to 75 percent in August 2020. Overall, companies can grow their lead pipeline by 1.5 to 2.0 times through strong omnichannel-lead generation. Implementing a direct sales model could also reduce sales costs by up to ten percentage points.

- **Increased automation and at-scale digital-sales operations.** Customers increasingly prefer self-service in both digital and traditional channels, with the number of people who want this option more than doubling at some points of the customer decision journey. Companies will need to leverage automation more frequently to provide the desired self-serve solutions. Successful digitization and automation can reduce sales costs by up to 25 percent.

- **A new wave of profitable growth through better use of data.** Within marketing and sales, a comprehensive data and analytics engine will become table stakes for players who want detailed insights on all critical topics, including volume, mix, pricing, customer loyalty, and performance management. Targeted sales analytics could potentially raise conversion rates by 20 to 30 percent.

Industrial leaders must act now and embrace innovative solutions along the entire value chain to satisfy customer expectations for a seamless journey from consideration to purchase. They must also be sure to revise their GTM models at speed and scale, given how rapidly the market is changing. Exhibit 2 shows some priority actions for automotive and advanced electronics companies.

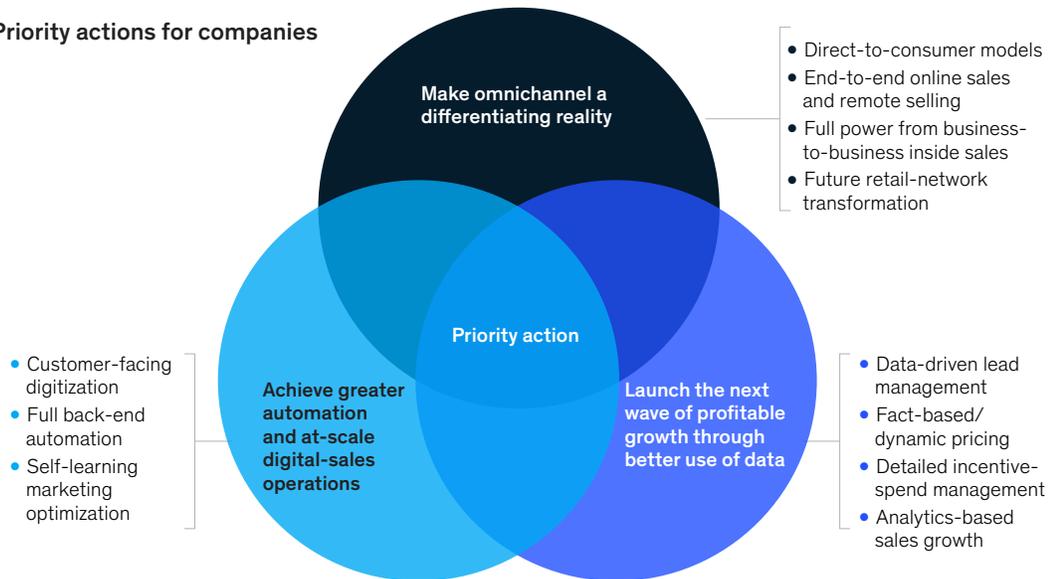
2. Revenue acceleration through digital and services

In the first days of the COVID-19 crisis, leaders of B2B companies, including industrials, took steps

Exhibit 2

Several trends, accelerated by the COVID-19 crisis, are fundamentally disrupting go-to-market models.

Priority actions for companies



to ensure workplace safety, increase liquidity, and keep supply chains moving. Those changes were absolutely necessary, but experience shows that companies are more likely to thrive if they act aggressively to capture market share during downturns rather than wait for the recovery to begin. Furthermore, the changes in the current environment, including shifting demand patterns and changes in customer buying habits, present an opportunity to revisit the commercial status quo to accelerate revenue recovery and growth.

Based on our market research and insights from McKinsey's COVID-19 B2B Decision-Maker Pulse Survey, we believe that four immediate actions are critical to accelerating revenue through digital and analytics (Exhibit 3). First, industrials must identify microsegments of growth. To do so, they must gather detailed information—for instance, sales numbers within microgeographies or zip codes. After gathering these data, industrials can create different scenarios to show how demand might evolve, looking at products, customer segments, and region.

Next, companies should accelerate e-commerce growth, which has seen a sharp rise since the onset of the COVID-19 pandemic. These changes could have huge benefits, since research shows that companies that embed digital sales into their

GTM model see five-times-faster revenue growth, compared with previous levels, as well as 30 percent higher acquisition efficiency and cost reductions of 40 to 60 percent within sales.

Finally, companies must adapt prices to suit customer needs, since many of their best accounts may be suffering financially. Their strategies should go far beyond reductions in top-line price by developing customized offers. For instance, an industrial-services provider introduced new options, smaller in scope, that could be sold at lower prices to appeal to customers.

Depending on their starting point and current channel mix, companies that develop an effective strategy for digital and services typically achieve a three- to five-percentage-point improvement in return on sales. They also achieve a 5 to 10 percent increase in revenue—above average for the mature, low-growth markets in which industrials typically operate.

3. Digital-business building

For established industrial leaders, starting up or acquiring new digital ventures to serve their core and adjacent customer ecosystems is now essential because disruptions have opened new growth opportunities. Despite the common

Exhibit 3

Four digital and analytics strategies can accelerate revenue recovery.

 <p>Identify 'hot' micro-segments of growth</p> <p>Leverage real-time, detailed insights to identify and respond quickly to demand-recovery signals</p>	 <p>Reshape the go-to-market approach</p> <p>Redesign your go-to-market strategy and understand how customers engage during their digital journeys; plan for virtual sales interactions</p>	 <p>Accelerate e-commerce growth</p> <p>Accelerate e-commerce by testing and iterating quickly to optimize the customer journey, conversion, and channel efficiency</p>	 <p>Enable dynamic pricing</p> <p>Leverage rich market data to evaluate pricing-related trade-offs and provide deal-level guidance for price to realize the best value</p>
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perception that they are at a disadvantage against start-ups, incumbents are in a good position to compete because they have the means to invest, access to customers and distribution, and a deep understanding of their industry segments.

Industrials would be wise to act now on scaling new businesses, despite the current economic slowdown. Historically, companies that have invested in innovation during down cycles have significantly outperformed their peers on total returns to shareholders in the decade after the crisis. (For information on a specific McKinsey strategy for scaling businesses, see sidebar, “The Leap approach.”)

4. M&A strategy through integration and transformation

M&A activity within industrials was near a historic high in 2019 but sharply dropped in 2020 as the pandemic spread (Exhibit 4). We believe that M&A will reemerge as a critical value-creation lever for industrials, since research indicates that winning companies—those with the best total returns to shareholders—acquire two times more than other companies during down cycles. Broad economic trends, combined with supply-chain disruptions and other repercussions of the COVID-19 crisis, will also continue to drive the need for M&A.

As industrial companies explore M&A, we expect that their strategies will focus on several themes,

The Leap approach

Through McKinsey’s tested Leap approach—one recommended strategy for business building—companies can combine the strength of an incumbent with the flexibility and speed of a start-up. The elements include a new focus on e-commerce, direct-to-customer channels, and remote operations and management (exhibit).

Many industrial companies believe the odds of failure are high, so they are reluctant to develop and scale high-growth digital businesses. But after analyzing more than 200 recently created businesses, there is substantial evidence that companies that apply the Leap business-building methodology achieve a 1.7 times average return on investment

compared with average venture-capitalist returns. Also, venture-capital-portfolio start-ups only scale in about 2 percent of the cases; with Leap, the chances increase by an average of 30-fold.

Exhibit

Three digital strategies have already created billions of dollars in value for industrials.



E-commerce acceleration

Companies can capitalize on industry shifts toward online models to drive adoption of B2B and B2C e-commerce platforms, allowing for better connectivity and efficiency



Strong direct-to-customer channels

Companies can rethink traditional supply-chain models and develop simpler, flexible, and direct paths to customers



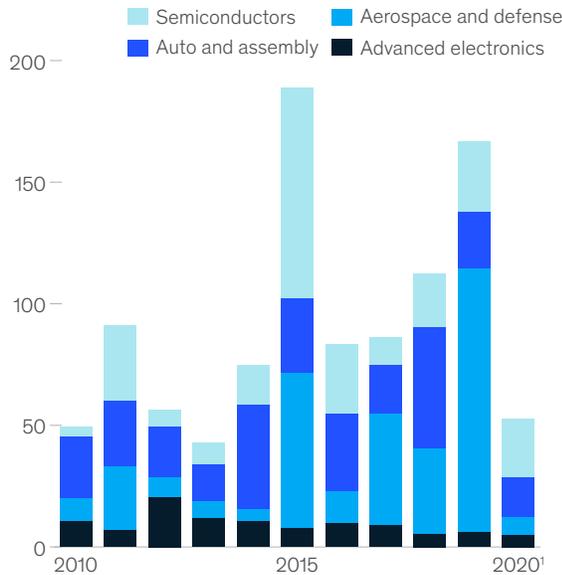
Improved remote operations and management

Companies can deploy the Internet of Things, initiate remote work, and adapt management practices to improve safety and accelerate productivity

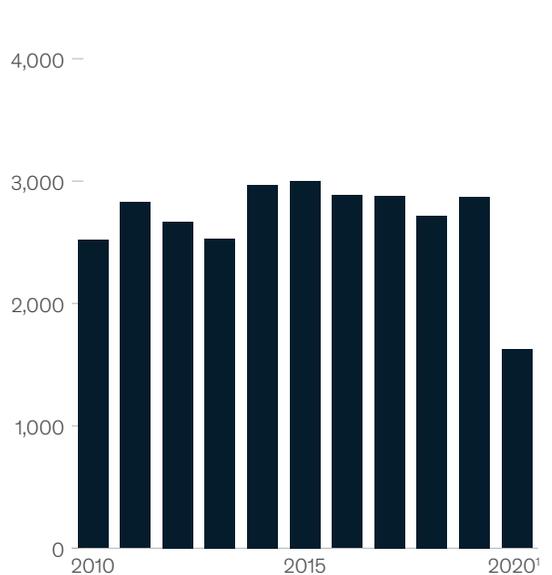
Exhibit 4

Industrial M&A activity approached record highs in 2019 but has fallen in 2020.

Deal value over time, \$ billion



Deal volume over time, thousands



¹As of Sept 20, 2020.
Source: S&P Capital IQ

some of which are evergreen moves and others that are new:

- services businesses and digital ecosystems, which will be underpinned by digital solutions, new products, and value-added services
- digitization of the product portfolio or integration of previously disconnected products (to increase “connectedness”)
- portfolio realignment or attempts to grow scale through consolidation
- transformational change, which will focus on new technologies and capabilities

Industrial CEOs should create a strong plan for improving resilience and then determine how M&A can help them achieve this goal. It is important

to have this plan in place before exploring M&A to avoid the proverbial tail wagging the dog. Most industrials, fortunately, already have such plans. A programmatic M&A strategy may help industrials get ahead of the curve, since that has been shown to increase resilience and deliver strong, long-term results. As with other competitive differentiators, speed to action is of the essence.

Next-generation margin and productivity transformation

Industry 4.0 technologies and analytical tools are gaining traction, potentially bringing a step change in productivity and margins.

5. Margin improvement through digital operations

As industrial CEOs see the growing productivity gap between traditional operations and those

powered by Industry 4.0, many are trying to use digital tools along the end-to-end value chain to drive margin improvements.

An ongoing study has validated the step-change effects of digitization in “lighthouse factories.” By scaling up multiple Industry 4.0 initiatives, both within individual factories and across the value chain, these lighthouses have achieved substantial operational and financial benefits. The benefits of digitization stem from three main elements: providing connectivity, driving better intelligence and analytics, and introducing automation technologies. Exhibit 5 shows example use cases related to these three elements, and the report identifies many more.

When the COVID-19 pandemic hit, several industrial companies focused on their core operations and halted digitization efforts. Others, however, accelerated digitization to capture value in areas such as performance visibility and management, planning and scheduling, supply-chain agility and

resiliency, and procurement optimization. In addition to improving productivity, digitization promises to enhance industrial companies’ sustainability, agility, and speed to market. Workforce development has been critical to these efforts, and the lighthouses prioritized their people through upskilling and reskilling efforts.

6. Full transformation

Transformation has become a bit of a buzzword, but real company-wide transformations are intense change journeys that transform an organization’s trajectory. They have two objectives: enhancing performance and boosting organizational health. “Go big, go broad” and “move fast” are key directives that can determine the success of these efforts. When full transformations succeed, they radically improve the important business drivers that lead to long-term success and competitive differentiation: top-line growth, capital productivity, cost efficiency, operational effectiveness, customer satisfaction, and sales excellence.

Exhibit 5

Many industrials are using digital tools to drive margin improvement.

Benefits of digital operations across value chain (sample use cases)				
	 Capital expenditures	 Procurement	 Supply chain	 Manufacturing
Connectivity	Digitized project-management systems	Aggregate demand across end-to-end supplier network	End-to-end, real-time supply-chain visibility	Augmented reality for standardized work instruction
Intelligence	Models based on advanced analytics (AA) that assess dependencies and optimize schedules	Parametric “clean-sheeting” to inform negotiations and support make-versus-buy decisions	AA-driven transportation planning and route optimization	Motion optimization using video and remote monitoring
Automation and new tech	Automated modeling of net present value to enable long-tail screening of discretionary projects	Digitized auctions with automated bid analytics	Fully automated picking and packing	3-D scanning for automated quality control

Transformations that are cross-functional—as opposed to those focused on improvements in a single function—can improve performance by more than 30 percent over the medium term. In fact, many of the first five strategic actions this article mentions could be combined into one holistic company-wide transformation if that best suits the company context.

An estimated 70 percent of large-scale transformations fail for reasons that stem from multiple sources. The fundamental lesson from our collective experience is that companies rarely have the combination of stretch aspirations, change-ready mindsets, capabilities, and ongoing commitment needed to pull off a large-scale transformation.

Real transformation happens when CEOs and their leadership teams embrace the idea of holistic change in business operations and tackle all the factors that create value for an organization. What's more, the leaders combine performance initiatives with a focus on organizational health. Top-quartile

companies have clear alignment around a common vision and strategy, emphasize line-led execution, create a structured performance infrastructure, and invest in employee capabilities.

To achieve and sustain extraordinary results, CEOs must embrace a comprehensive, highly disciplined approach. CEOs are familiar with the importance of moving the many specific transformation ideas and initiatives through three phases: an independent diagnostic, bottom-up planning, and rapid implementation. Even better, they can increase the odds of success by focusing on seven actions: setting high aspirations, attaining leadership alignment, integrating revenue growth, changing the company culture, empowering employees, creating a disciplined execution engine, and ensuring that line managers take the lead (Exhibit 6). For example, addressing—and changing, if necessary—company culture and capabilities can increase total returns to shareholders by a factor of two.

Exhibit 6

Although many transformations fail, some companies have identified a winning formula.

7 actions underpin the most successful transformations

1	Set the highest aspiration	Use fact-based, unbiased analyses and insights to assess the full potential for transformation across performance, health, and capabilities
2	Insist on leadership alignment	Ensure transformation is a top management priority, with aligned aspirations and incentives; have leaders visibly role-modeling the change
3	Integrate revenue growth	Go big and broad to deliver more impact, rather than focusing on purely bottom-line improvements
4	Integrate culture and capabilities	Improve organizational health and build talent and capabilities at scale to sustain value over time
5	Foster an owner's mindset in every employee	Encourage measured risks based on long-term value, not short-term gain
6	Empower a structure for relentless execution	Implement a disciplined approach to execution that drives rapid, real-time, and transparent performance management
7	Ensure the change is led by lines	Create conviction in line leaders to drive the change, set goals, make commitments, and execute plans

Source: McKinsey analysis of 82 public companies that undertook a full-scale transformation in the past 10 years with observable 18-month transformation track record

7. Transformed global footprints and industrial supply chains

Over the past few decades, industrial value chains have grown in length and complexity as companies expanded globally in pursuit of margin improvements. This has led to unintended risks, as the recent pandemic exposed. New research from the McKinsey Global Institute shows that companies can now expect supply-chain disruptions lasting a month or longer every 3.7 years, resulting in as much as 45 percent of one year's earnings before interest, taxes, depreciation, and amortization (EBITDA) every decade. Financial repercussions from supply-chain risk are particularly acute with industrials, which have among the most complicated supply chains.

Industrials are now exploring ways to reduce supply-chain risk without sacrificing efficiency, and their analyses may show that higher-cost production centers may, after all, not carry all the penalty they were laden with in the past. With select industries and commodities, Industry 4.0 and digital technologies alone can offset about 50 percent of the labor-cost differential between traditionally high- and low-cost production centers. When all factors are considered, rebalancing the supply chain to incorporate reshoring, nearshoring, and regionalization may open real opportunities.

Rethinking the resiliency of industrial supply chains requires end-to-end visibility and necessitates

the inclusion of digital tools to create sustained improvement, rather than a one-time response to disruption. In most cases, resiliency does not need to come at the expense of efficiency, since companies can improve both in tandem. Before attempting to improve the global footprint and supply chain, companies should stress-test their operations to identify vulnerabilities, such as those related to structure (Exhibit 7). For best results, companies will complement their supply-chain initiatives with other actions that improve resiliency, such as dual sourcing, revising inventory policies, and reducing complexity.

Strategy and organization for the next normal

The final three competitive differentiators relate to strategy and organizational themes pertinent to the coming decade, such as cloud partnerships, organizational redesign, and a greater emphasis on sustainability.

8. Cloud partnerships to accelerate momentum

The COVID-19 pandemic has intensified the need for the cloud as an enabler of critical e-commerce, remote sales, the Internet of Things, automation, data and analytics, and flexible cost structures at scale. During the recent lockdowns due to the virus, ten years of e-commerce growth took place in three months. B2B remote selling is also here to stay, since 89 percent of buyers are satisfied with it and

If industrial companies act now, they can help define the future cloud ecosystem of their industry and supply chain.

Exhibit 7

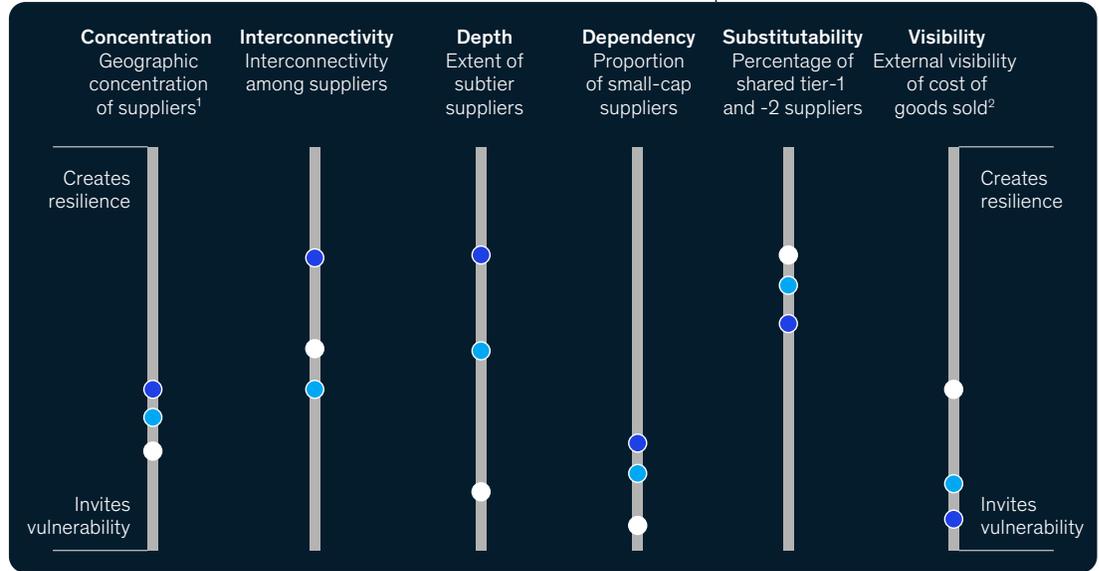
Companies are stress-testing their supply chains across seven dimensions.

7 supply-chain dimensions



Sanitized examples of structural resilience and vulnerability

● Company ● Peer 1 ● Peer 2



¹As measured by Herfindahl–Hirschman Index.
²Refers to tier-1 and tier-2 suppliers.

42 percent actually prefer it. Furthermore, the global health crisis is increasing economic uncertainty, making it more important than ever for businesses to have flexible operations and channels, as well as infinitely variable technology costs.

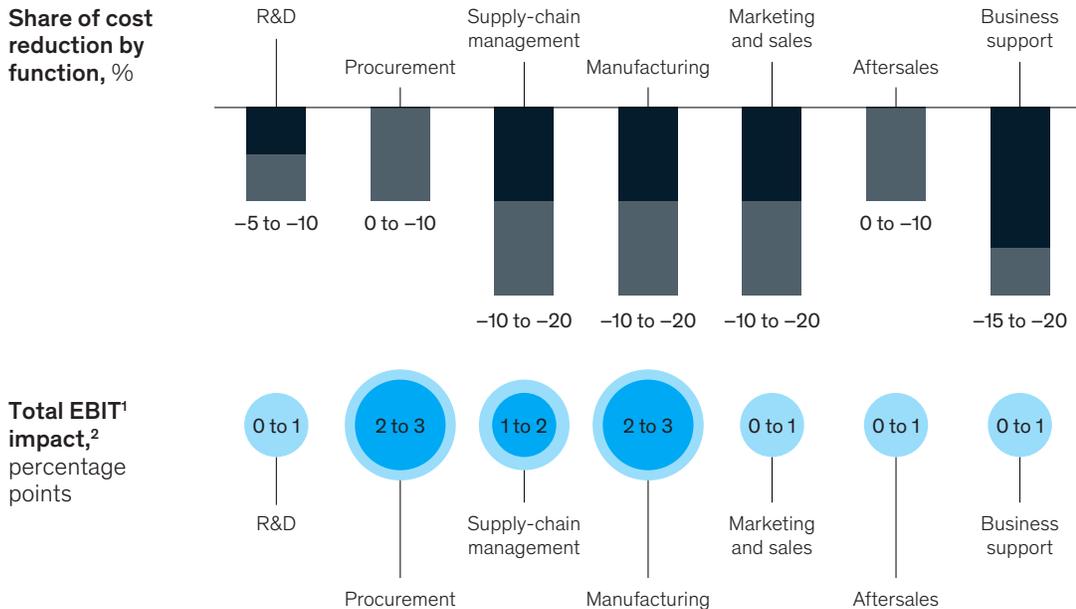
When implemented correctly, the cloud can help industrials accelerate their business transformation and respond more rapidly to the changing landscape—a benefit that might help them leapfrog competitors as they move to the next normal. A fully scaled, cloud-enabled digital-and-analytics effort may also significantly reduce

costs and add five to ten points of earnings before interest and taxes (EBIT) at a typical industrial organization (Exhibit 8).

Although almost every industrial company is exploring cloud initiatives, most have yet to achieve new capabilities or scaled business impact to achieve optimal results. Our analysis suggests that not only are the companies on average 23 percent over budget on cloud spending, but they also end up wasting 30 percent of their outlays. This waste may only grow, since companies expect to increase cloud spending by 47 percent next year.

Exhibit 8

Using the cloud can reduce costs across functions.



¹Earnings before interest and taxes.
²Based on typical industrial parts and labor.

We believe now is a good time for industrial companies to “bend the curve” to make cloud pay back on investment. If they act now, they can help define the future cloud ecosystem of their industry and supply chain. Moving ahead will require a four-pronged approach:

1. Have a clear end-state vision on which applications should migrate to the public cloud and then manage cloud consumption.
2. Change the IT operating model early to drive a step change in pace and productivity, especially in infrastructure management, and use the software-engineering paradigm to enhance the identification and development of IT talent.
3. Balance infrastructure migration against an ongoing cloud-enabled business redesign,

since the latter can start to self-fund the transformation through business-process improvements—often enabled by analytics—where investment is lower and impact is faster.

4. Embrace the flexibility of the cloud to drive ongoing business innovation in the form of a faster introduction of new products, more partnerships with external players, and new ecosystem plays.

9. Redesigned organizations that are built for speed, at-scale capability building, and resizing

In McKinsey’s recent Global Leadership Survey on organizational speed, which included more than 900 senior executives from nine industries, respondents revealed that they were already attempting to make work processes and operations more efficient to prepare for the next normal. Executives from companies in advanced industries

reported multiple improvements, including supply-chain enhancements, better technology use, streamlined processes, and more online sales and marketing. What’s more, they had established flatter hierarchies, faster decision-making processes, nimble teamwork norms, and a new approach to learning and talent development.

While these shifts are impressive, they do not guarantee long-term success. In fact, many survey respondents from advanced industrial companies doubted that they could sustain their gains. When asked about perceived obstacles to operating at greater speed, executives in advanced industries cited organizational silos, slow decision making, too much hierarchy, and a lack of strategic clarity.

To overcome these issues and increase organizational speed, especially in the wake of the COVID-19 crisis, companies must rethink ways of working, reimagine organizational structures, and reshape talent (Exhibit 9). For instance, they may need to reskill digital talent to fill new roles, invest in new technologies, and adapt to a marketplace with changing customer preferences. If companies are not quick to embrace change and respond rapidly, they may not remain competitive. To get started, organizations can pursue a two-speed approach.

They can make quick moves to lock in new changes that have generated positive outcomes while simultaneously undertaking a broader evaluation of the structural and procedural foundations upon which the organization is built.

In our experience, companies that adopt an organizational structure built for speed will see operational improvements in the range of 30 to 50 percent and an increase in customer satisfaction of ten to 30 percentage points. These improvements have benefited companies’ financial performance, with total returns to shareholders doubling.

10. Sustainability

Corporate sustainability is at a tipping point as the risks of climate change accelerate. Among other indicators, we are witnessing unprecedented wildfires from Australia to California, the most severe hurricane season on record, Mediterranean cyclones, heat waves, and greater drought frequency worldwide. Globally, anthropogenic CO₂ emissions—those originating from human sources—now total about 40 gigatons annually (Exhibit 10).

Many governments have already issued regulations to promote sustainability. In parallel, the investor

Exhibit 9

Companies must focus on ten activities to increase organizational speed in the wake of the COVID-19 crisis.

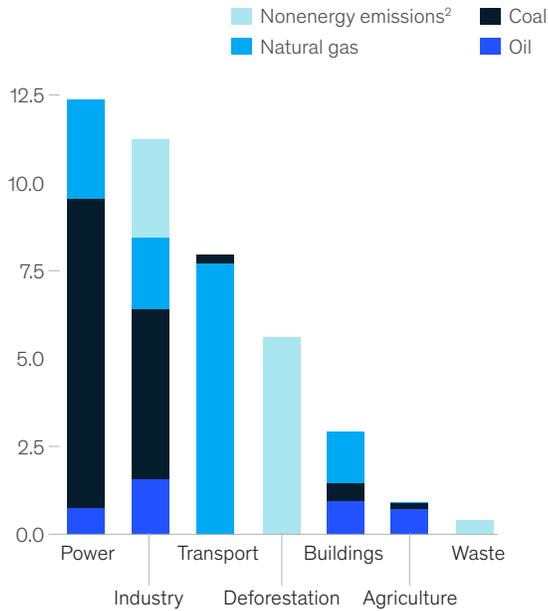
Major categories and subactivities

 <p>Rethink ways of working</p> <ul style="list-style-type: none"> • Speed up and delegate decision making • Step up execution excellence • Embrace digital in everything • Develop culture as the “secret sauce” 	 <p>Reimagine structure</p> <ul style="list-style-type: none"> • Flatten the structure • Unleash nimble, empowered teams • Make hybrid work 	 <p>Reshape talent</p> <ul style="list-style-type: none"> • Field tomorrow’s leaders today • Massively reskill your work force • Rethink the role of leaders
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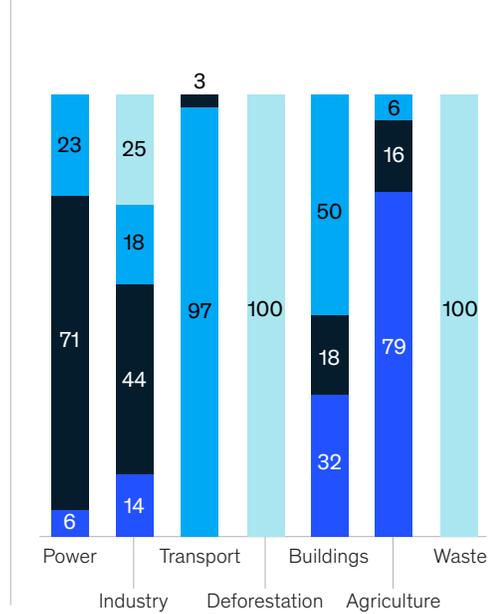
Exhibit 10

Yearly global anthropogenic CO₂ emissions total about 40 gigatons.

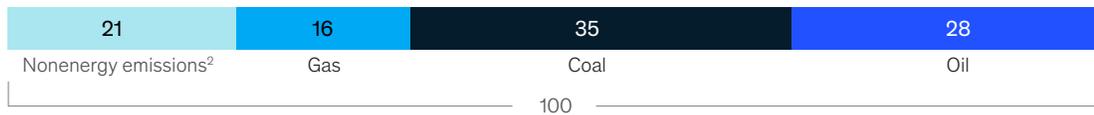
CO₂ emissions¹ in 2016 by sector, gigaton



Share of fuel within each sector, %



Total emissions per type, %



Note: Emissions numbers might not add up due to rounding.

¹Excludes non-CO₂ greenhouse-gas emissions.

²In addition to energy-related CO₂ emissions, anthropogenic emissions include industry-process emissions, deforestation, and waste.

Source: *Global Energy Perspective 2019: Reference Case*; McKinsey 1.5°C scenario analysis

community is holding companies to higher environmental, social, and governance (ESG) standards, with more than \$12 trillion in assets under management by ESG investors in the United States alone. Businesses are also increasing their focus on sustainability, as are consumers (especially millennials and those in Generation Z). For instance, surveys have shown that 58 percent of employees consider a company's social and environmental commitments when deciding where

to work, and 76 percent would boycott products or services based on the values of the companies that produce them.¹

If companies in advanced industries fail to act, they could be at risk. A survey of aerospace CEOs pegged the value at stake from emissions at an average of 30 percent of EBITDA. The risks of inaction include increases in insurance and compliance costs (related to greenhouse-gas regulations) and greater

¹ 2016 Cone Communications employee engagement study, June 2016; and 2017 Cone Communications CSR study, May 2017, Cone Communications, conecomm.com.

production costs resulting from the high costs of water, energy, and other inputs. Across advanced industries, we estimate that the EBITDA at risk ranges from 20 to 60 percent.

The decarbonization required to limit warming to 1.5 degrees Celsius would fundamentally reshape industry by 2050. For instance, 90 percent of coal would be phased out of power generation, 60 percent of flights would be on zero-carbon fuels, all road transport would be electrified, and low- and midtemperature industrial processes would be fossil free. This transition would create vast new markets and value pools for the following:

- developing and implementing circular business models
- electrifying transport, industry, and buildings
- decarbonizing the power sector by developing hydrogen and bioenergy markets
- scaling carbon capture, utilization, and storage to developing markets to achieve negative emissions

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Beyond protecting the environment, sustainability initiatives can help businesses. Nearly 60 percent of purpose-driven companies have had growth rates of more than 10 percent for the past three years. Sustainably marketed products are also growing more than five times faster than traditional products. And companies may find that sustainability helps attract talent, since 80 percent of Generation Z states that they want to work for an employer with strong corporate and social responsibility.

As industrials chart their course for the next decade, they should consider how the activities discussed in this article could benefit them, keeping in mind each strategy's potential benefits, as well as its relevance and fit. It would be daunting to undertake all ten strategic actions concurrently, thus CEOs and their companies must adopt a sequenced approach. Those companies that act now stand to transform their businesses and successfully differentiate themselves from the competition.