

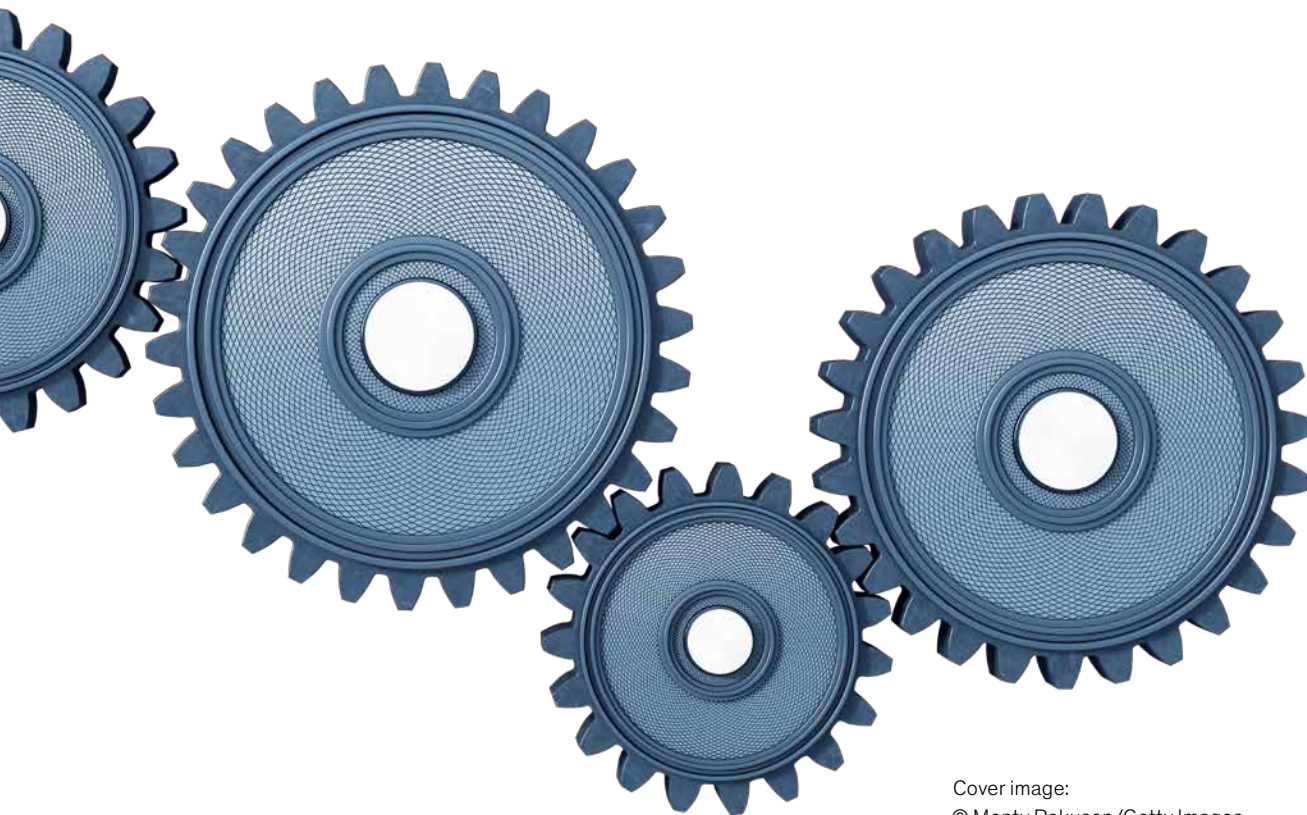
McKinsey  
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# Jumpstarting the recovery

Navigating the *return* across industries



May 2020



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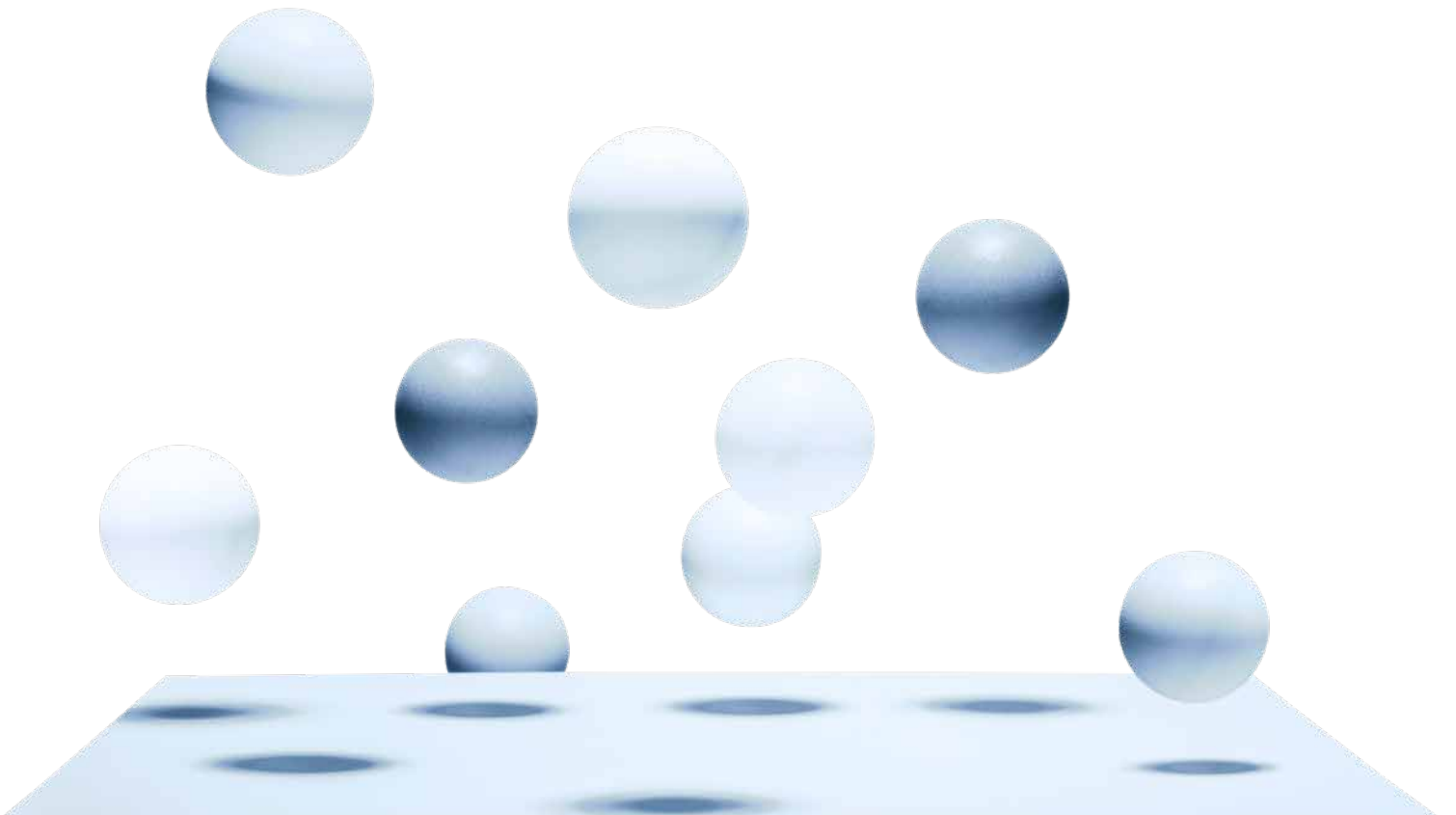
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Navigating the *return* across industries

May 2020



# Introduction

Just two months later, daily reports of outbreaks—and of waxing and waning infection and mortality rates—continue to heighten anxiety, stir grief, and cast into question the contours of our collective social and economic future. Never in modern history have countries had to ask citizens around the world to stay home, curb travel, and maintain physical distance to preserve the health of families, colleagues, neighbors, and friends. And never have we seen job loss spike so fast, nor the threat of economic distress loom so large.

In this unprecedented reality, we are also witnessing the beginnings of a dramatic restructuring of the social and economic order—the emergence of a new era that we view as the “next normal.” Dialogue and debate have only just begun on the shape this next normal will take. But since the onset of the pandemic, McKinsey has published a rapidly growing collection of insights (at least 250, at this two-month mark) on the impact of COVID-19 on the economy, the workforce, and the gamut of functions and industries, both globally and in specific regions across the world. We have collected and curated the first 100 of these articles into four compendiums, organized by the initial stages of the path we see as leading from the current crisis to the post-pandemic era—the next normal that will materialize after the battle against coronavirus has been won.

These initial stages are Resolve, Resilience, and Return; as we progress, they will be followed by Reimagination and Reform.

In this last of four compendiums, *Jumpstarting the recovery*, we curate a selection of articles related to the third stage, Return: how leaders across a range of industries can begin to navigate back to operational health. We begin with healthcare, an industry perhaps singularly vital in combating COVID-19 but also beset with broadly shared challenges, such as protecting employees’ safety and mitigating economic concerns. We discuss how governments might best support their citizens through the crisis, including managing the historic surge in unemployment in the United States. We look at retail and airlines, both embattled industries reckoning with the pandemic’s profound effects and reimagining their respective futures. And we talk about the effects of coronavirus on the financial industry—specifically, banking, insurance, and private equity.

You can download this and three other compendiums at [McKinsey.com/pathbeyondcovid-19](https://McKinsey.com/pathbeyondcovid-19), as well as find these and our entire collection of individual insights at [McKinsey.com/covid-19](https://McKinsey.com/covid-19).

We look forward to your feedback at [Crisis\\_Feedback@McKinsey.com](mailto:Crisis_Feedback@McKinsey.com).

## **Raju Narisetti**

Global Publishing Director Elect  
McKinsey Publishing

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# Moving from wartime to peacetime in health care

**6**

From “wartime” to  
“peacetime”: Five stages for  
healthcare institutions in  
the battle against COVID-19

**14**

At the heart of a crisis:  
How consumer-health  
companies can lead in the  
time of the coronavirus

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Winning against  
COVID-19: The implications  
for biopharma







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# From “wartime” to “peacetime”: Five stages for healthcare institutions in the battle against COVID-19

Healthcare has found itself tested by the pandemic. The frontlines are delivering heroically, but the next normal for healthcare will look nothing like the normal we leave behind.

*by Shubham Singh; Prashanth Reddy; Penelope Dash, MD; and Kyle Weber*



**In “Beyond Coronavirus: The Path to the Next Normal,”<sup>1</sup>** we outlined five stages that leaders must plan for: Resolve, Resilience, Return, Reimagination, and Reform. Healthcare leaders

face a multifaceted challenge: combating the healthcare crisis on the frontlines while also tackling similar issues as other industries, such as employee safety and economic challenges.

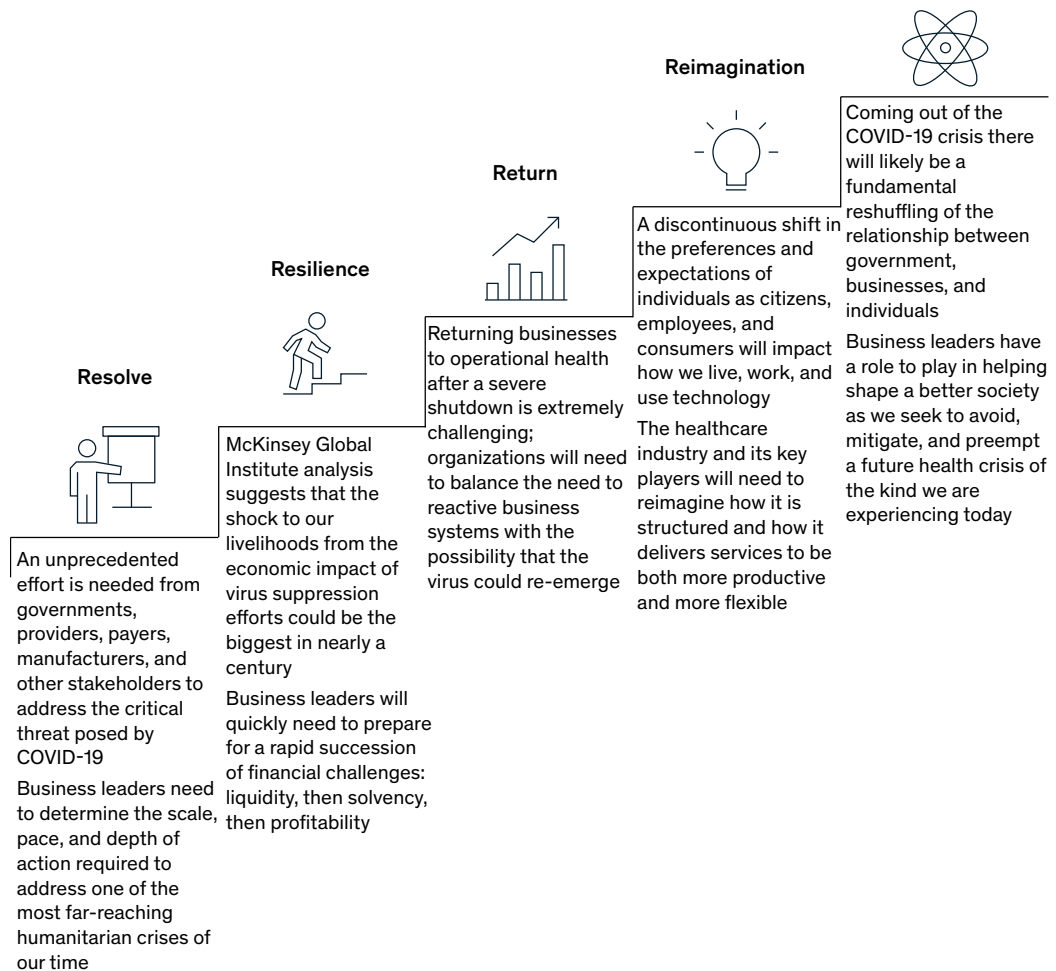
Most healthcare leaders have already assembled high-functioning teams to respond to the immediate crisis resolving to manage the immediate need to care for the surge of COVID-19 patients. They also

have demonstrated the resilience required to deal with fast-moving liquidity, solvency, and economic sustainability challenges.

Many leaders now are beginning to recognize the importance of planning for the complicated return stage. Return from the lockdowns will not be easy—particularly as we remain vigilant against virus resurgence in the absence of a vaccine or treatment.

For some leaders, it has been difficult to dedicate much time to reimagination and reform.

<sup>1</sup>Kevin Sneader and Shubham Singhal, "Beyond coronavirus: The path to the next normal," March 2020, McKinsey.com.



The pandemic is likely to result in a series of discontinuous changes that will fundamentally reshape healthcare. These changes include:

- The expectations and needs of individuals as citizens, consumers, patients, and employees
- The combination of resilience and productivity demanded by the funders of healthcare expenditure
- The need to be able to flex up and down care capacity and shift care across modalities, including virtual health platforms

- An opportunity to unlock the promise of exponential improvements<sup>2</sup> through technology and medical science

Moreover, healthcare reform often has followed major economic shocks.

While there are an extensive set of issues for healthcare leaders to consider across each stage, below are some critical items to consider.

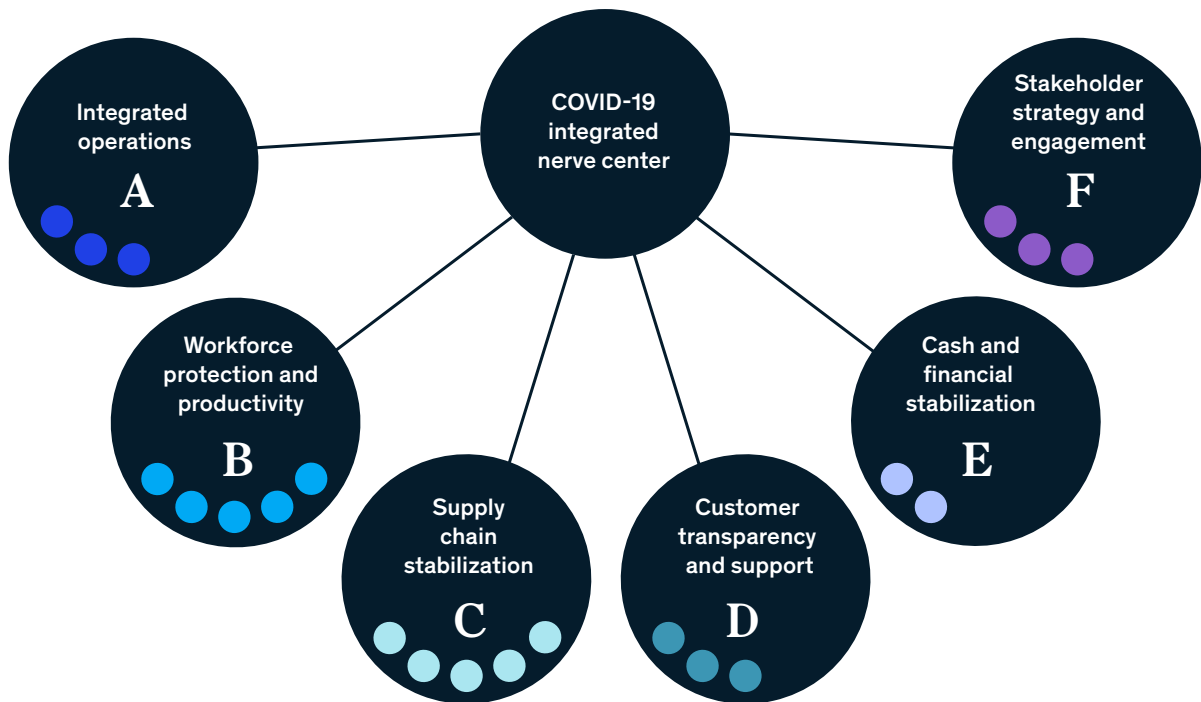
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<sup>2</sup>Shubham Singhal and Stephanie Carlton, "The era of exponential improvement in healthcare?" May 2019, McKinsey.com.

## PHASE 1: RESOLVE

### Overview of responsibilities for the minimum viable nerve center.

Based on discussions with health and risk professionals



## PHASE 1: RESOLVE cont.

### A. Integrated operations

● Issue map & management	Single source of truth for issue resolution and tapping surge resources where needed
● Portfolio of actions	Trigger-based portfolio of actions
● Leadership alignment	Align leaders on scenarios   Roundtable exercises

### B. Workforce protection and productivity

● Policy & management	Policies   Portfolio of actions including prevention   Escalation criteria and process
● Two-way communication	Multichannel communications   Confidential reporting mechanisms   Source of truth
● Personnel & contractors	Tiering (all/some/no WFH)   WFH infrastructure setup (VPN, telephony)   Contractor incentives
● Facility & onsite norms	Staggering work shifts/times   Prevention (eg, physical distancing)   Closures
● Health & govt engagement	Local and federal regulators and public health officials

### C. Supply chain stabilization

● Supplier engagement	Cross-tier risk transparency   Supplier restart   Order management   New supplier qualifications
● Inventory management	Critical part identification   Parts rationing   Location optimization
● Production & operations	Operational impact assessment   Production capacity optimization
● Demand management	S&OP SKU-level demand signal estimates by macro scenario   Production and sourcing plans
● Logistics	Ports   Logistics capacity pre-booking   Route optimization

### D. Customer transparency and support

● B2B transparency	Comms to B2B customers (eg, microsite)   Scenario-based risk comms
● Customer protection	Prevention interventions across customer journey   Customer team training   Execution monitoring
● Customer outreach	Customer comms re: COVID-practices   Fact-based reports on issues   Situation comms

### E. Cash & financial stabilization

● Scenario definition	Relevant scenarios based on latest epidemiological and economic outlooks
● Financial stress tests	Financials in different scenarios, especially working capital requirements

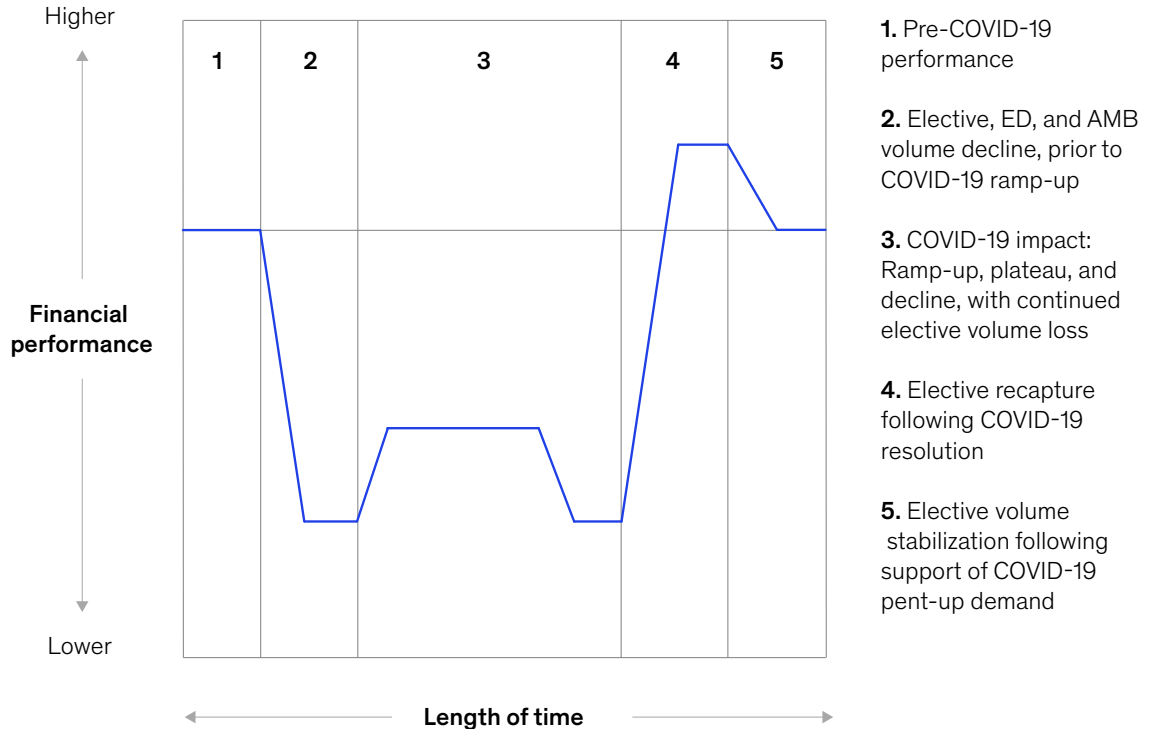
### F. Stakeholder strategy and engagement

● Member protection	Protective interventions across member journey   Execution monitoring   Access to care/testing
● Demand responsiveness	Reaction to member's demand signals   Flexible product and service forecasting
● Provider support	Comms re: COVID-practices   Fact-based reports on issues   Situation comms

PHASE 2: RESILIENCE

**Long-term impact of COVID on a typical health system's operating margin.**

**Financial performance over time** (provider example)



**Keys to resilience**

**Maintain liquidity**

- Providers face immediate threats to their cash position, being harmed from multiple, compounding angles
- Payers face a distinct but similarly challenging position to their liquidity
- Services firms will face a variety of competing forces that impact cash position

**Address solvency**

- Businesses will need to take aggressive action to remain solvent—must be careful not to over-index on debt covenants tied to liquidity, missing those tied to solvency
- For payers it is not difficult to imagine a sequence of events leading to insolvency
- Other types of healthcare organizations may face a similar set of solvency issues that result from a combination of declining asset values and increasing expenses and liabilities






**Grow for sustainability**

Organizations that survive the liquidity and solvency issues will have an opportunity to reshape the healthcare system. While strategies vary, themes emerge:

- Acquiring strategic assets, partnering to create/fortify ecosystem, responding to coverage shifts, capitalizing on moves toward digital therapies and care delivery, tightening relationships with public-sector agencies, embedding advanced analytics in operations *(In the United States, government assistance has focused on boosting providers' resiliency)*

PHASE 3: RETURN

**Providers and payers can take steps across their organization to reactivate non-COVID capacity.**

	Provider	Payer
<b>Talent</b> 	<ul style="list-style-type: none"> <li>• Establish proactive program for caregiver healing</li> <li>• Understand gaps in readiness to scale non-COVID capacity</li> </ul>	<ul style="list-style-type: none"> <li>• Engage in broad workforce renewal</li> <li>• Supplement talent in areas of emerging importance to next normal</li> </ul>
<b>Customers</b> 	<ul style="list-style-type: none"> <li>• Reestablish the health system as a safe place for patients</li> <li>• Learn patients' preferences on new forms of healthcare</li> </ul>	<ul style="list-style-type: none"> <li>• Engage at-risk members</li> <li>• Promote a differentiated telehealth program</li> </ul>
<b>Operations</b> 	<ul style="list-style-type: none"> <li>• Design operations to allow for flexible transition from/to COVID operations</li> <li>• Sequence return of non-COVID clinical volume</li> </ul>	<ul style="list-style-type: none"> <li>• Ensure appropriate payment for services offered during crisis</li> <li>• Double down on member communications, care/utilization management, and care navigation</li> </ul>
<b>Regulations</b> 	<ul style="list-style-type: none"> <li>• Engage regulators to maintain crisis-driven changes in rules where patient care was improved</li> <li>• Coordinate on widespread testing and tracking initiatives</li> </ul>	<ul style="list-style-type: none"> <li>• Engage regulators to clarify and/or codify rules established in crisis</li> <li>• Shape the narrative on how next normal may be regulated</li> </ul>
<b>Finance</b> 	<ul style="list-style-type: none"> <li>• Begin proactively utilizing new capabilities</li> <li>• Appropriately generate reserves</li> </ul>	<ul style="list-style-type: none"> <li>• Allocate capital to developing new capabilities</li> <li>• Ensure appropriate reserves</li> </ul>

**Actions now**

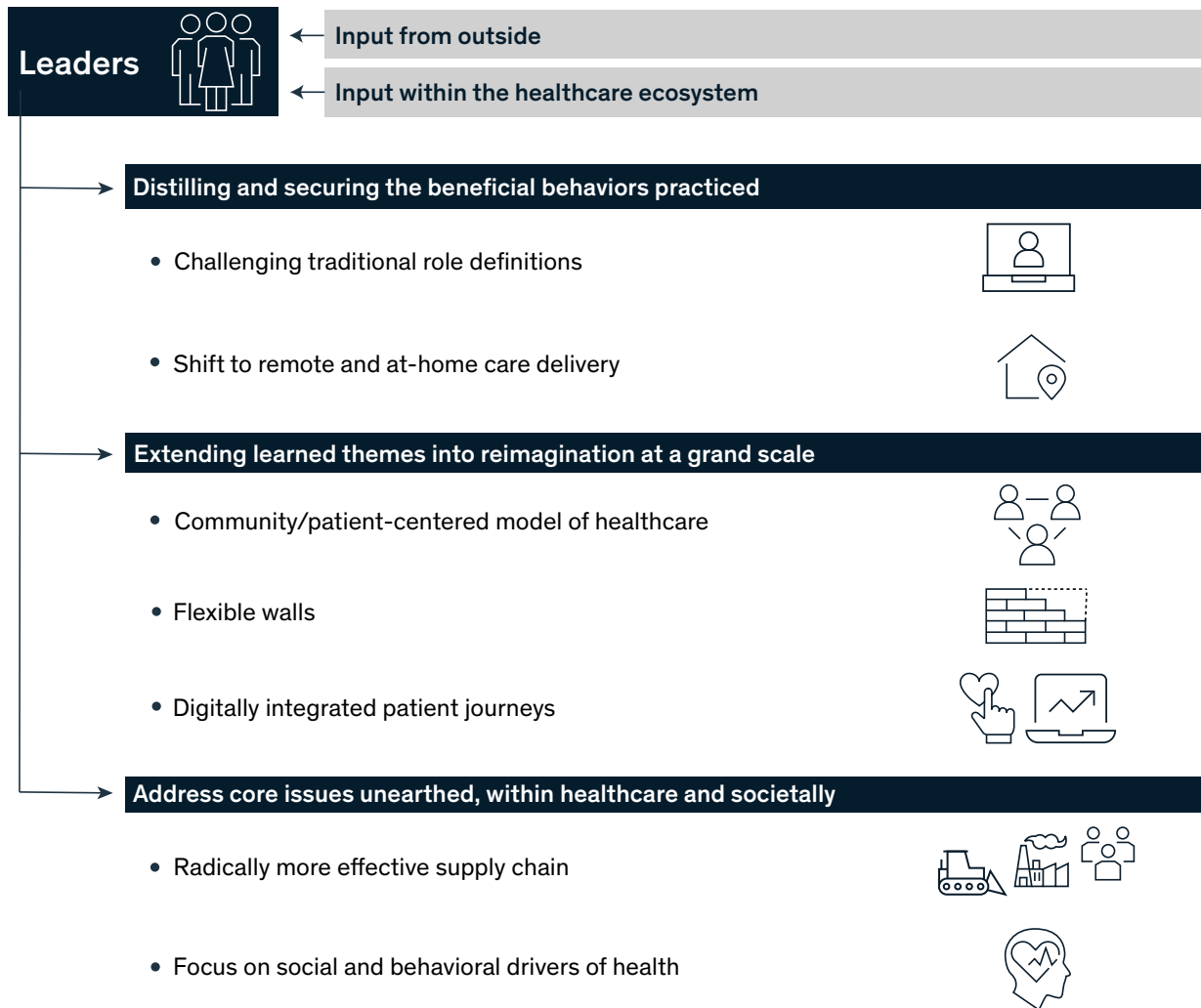
This is the time when boards and CEOs will likely have the greatest opportunity in their careers to positively impact their organizations and the communities they serve. This opportunity should not be squandered. Boards and CEOs should prioritize creating an environment where decisions are made calmly and based on facts. Second, given the high degree of continuing uncertainty, leaders should ensure they are actively tuned into the real-time information from all levels in their organization,

plus outside forces, to inform decisions. Finally, the ability to act, innovate, and execute at scale at previously unheard-of speeds likely will be critical. We have observed many examples of organizations that have accelerated projects scheduled to take months and years to a timeline of a few days and weeks.

An important aspect will be for CEOs to organize their management team to act against each of the five stages. Each organization will need to



## How can we fundamentally reinvent health services in a different way?



make this decision individually, but we see three guidelines for selecting accountable leaders. First, CEOs must be able to trust the accountable leader’s judgment within the role’s decision-making context, particularly in this speedy and uncertain climate. Second, the accountable leader should directly report to the CEO. This reporting relationship does not need to have been a preestablished one and can be created ad hoc during this crisis. Third, CEOs must ensure that accountable leaders are motivated by a deeper resolve, whether it be to address the humanitarian

crisis, or to protect the team and workers within the organization.

As we consider the scale of change that the coronavirus has engendered—and will continue to create in the weeks and months ahead—we feel compelled to reflect not just on a health crisis of immense proportion but also on an imminent restructuring of the healthcare industry in the future. The five stages described here offer

## How will the relationship between government, businesses, and individuals change?

There are several actions many governments may pursue to be prepared for a future crisis:



**A handful of reforms have already been enacted that may result in longer-term structural changes to the industry:**

- Allowing the permanent, direct hire of National Disaster Medical System healthcare
- Limiting out-of-pocket cost-sharing for COVID testing
- Adjusting CMS regulations to permit use of telehealth

healthcare leaders a path to begin navigating to the next normal—a normal that looks unlike any in the years preceding COVID-19, the pandemic that changed everything.

To read more, visit <https://www.mckinsey.com/industries/healthcare-systems-and-services/our-insights/from-wartime-to-peace-time-five-stages-for-healthcare-institutions-in-the-battle-against-covid-19>.

**Shubham Singhal**, a senior partner in McKinsey's Detroit office, is the global leader of McKinsey's Healthcare Practice. **Prashanth Reddy** is a senior partner in McKinsey's New Jersey office. **Penelope Dash, MD**, is a senior partner in the London office and leads the Healthcare Systems and Services Practice in Europe. **Kyle Weber**, is a partner in McKinsey's Chicago office.

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**The consumer-health sector is at the center of efforts to control the current COVID-19 pandemic**, which has already had sweeping effects on people and economies across the globe.<sup>1</sup> As consumer-health companies respond to the crisis, they must consider the needs and interests of their major stakeholders: consumers, customers, and employees. In the near term, consumer-health companies have critical decisions to make about each group—for example, how to communicate with and distribute products to consumers, how best to support their customers (that is, retailers and pharmacies), and how to help employees adjust to drastically different working conditions and norms.

The industry is uniquely positioned to lead in this crisis, given the trust that consumers place in its brands and their reliance on its products for self-care. While the situation continues to evolve, consumer-health companies should consider taking several steps to demonstrate clear public-health leadership during an uncertain time.

### **How consumer behavior is changing**

As the COVID-19 pandemic has progressed across and within geographies, consumer behavior has also evolved quickly. Three broad phases of consumer behavior, linked to epidemiological phases and government responses to the crisis, are playing out: escalation, accumulation, and early recovery.

Each phase involves distinct consumer-purchasing behaviors. During the escalation phase, consumers tend to “pantry load” essential goods, such as shelf-stable foods, toilet paper, and cold and pain medicines. During the run-up to Italy’s lockdown,<sup>2</sup> a McKinsey analysis shows sales of grocery food and pharmaceuticals grew by 11 percent and 20 percent, respectively, year over year. Similar purchasing patterns have played out in the United States and in other affected countries. For example, some

consumer-health companies have reported an uptick in prevention- and immunity-oriented products during this phase, including a more than 40 percent year-over-year increase in sales of multivitamins.

In the accumulation phase, consumers brace for a sustained quarantine and purchase items for self-sustainment. During this phase in Italy, consumers purchased more everyday personal-care items, such as cleaning sheets and toilet paper, and continued stocking up on essential foods. Finally, in the early recovery phase—which has started to take hold in China—consumer sentiment rebounds: for example, a recent McKinsey survey in China found that 70 percent of consumers in tier-1 and tier-2 cities intend to return to the same (or even higher) levels of spending on consumer goods after the COVID-19 crisis has been resolved.<sup>3</sup>

Consumers have also chosen to buy their products through channels different from those they used before the pandemic. In Italy, online sales of grocery items increased by 20 percent year over year from February 23 to March 11, 2020. During this period, overall e-commerce levels were up more than 80 percent, including a two- to three-times increase in click-and-collect purchases. Likewise, as customers in China’s most affected areas were forced to close or experienced a reduction of up to 70 percent in foot traffic, the country’s already high e-commerce sales have risen. For example, JD.com’s year-over-year online fresh-food sales grew by 215 percent during the ten-day period ending February 2, compared with the same period last year.<sup>4</sup> Similar channel shifts are already underway in the United States, where online traffic for certain categories, such as groceries, has increased by at least 25 percent.<sup>5</sup>

We expect the impact on consumer-health companies to vary by product type and by whether a given product could help manage milder symptoms

<sup>1</sup> Matt Craven, Linda Liu, Mihir Mysore, and Matt Wilson, “COVID-19: Implications for business,” March 2020, McKinsey.com.

<sup>2</sup> Data from February 23, 2020 (when the first coronavirus red zone was declared in Italy) to March 11, 2020, two days after the Italian government declared a country-wide lockdown.

<sup>3</sup> The survey was in the field from February 21 to February 24, 2020, and included 1,249 responses.

<sup>4</sup> “How Chinese are spending during the coronavirus outbreak,” February 8, 2020, jdcorporateblog.com.

<sup>5</sup> From February 29 to March 13, 2020.

of the virus. In the consumer-health industry, there are four key product types:

- *Treatment mainstays.* These include over-the-counter respiratory and pain-relief products. Sales will probably increase during the accumulation phase as consumers stock up on essential items, including those they need to treat mild symptoms at home instead of visiting a doctor's office or hospital. According to the World Health Organization, most cases of COVID-19, while of concern, are characterized as mild, and some 20 percent of cases around the world are classified as either severe (requiring oxygen) or critical (requiring ventilation). As the strain on hospitals intensifies, more people will opt for—or be required to—follow safety measures such as self-isolation or community quarantines.
- *Prevention arsenal.* These include vitamins and dietary supplements that may support overall immunity. While such products do not protect against the transmission of COVID-19, some believe that they support overall immune-system health; they may therefore become part of a consumer's prevention regimen.
- *Lockdown essentials.* These include gastrointestinal remedies, allergy medications, oral- and eye-care products, and other items that consumers use regularly. Although these products might not be related to COVID-19, consumers are likely to purchase more of them if they think a quarantine period is highly likely.
- *Premium discretionaries.* These include certain cosmetic products (skin care, for example) that consumers may not purchase during uncertain economic conditions.

In many markets, including the United States, where COVID-19 has spread quickly, we have already observed significant demand for treatment mainstays and prevention-arsenal products. Demand is also high for some lockdown essentials,

depending on the local severity of the coronavirus outbreak and the government's response. We have also seen a channel shift and increase in e-commerce, following trends in China and Italy.

## **How consumer-health companies can support consumers, customers, and employees in the near term**

Given the dramatic changes in consumer behavior, and more broadly, in societies and economies, it's critical that the industry moves quickly to respond to the coronavirus—and that they keep their key stakeholders in mind when making near-term business decisions. Consumer-health companies should take several actions to support consumers, customers, and employees during the pandemic.

### **Consumers**

Consumers are understandably anxious and uncertain in the current environment, given the fast-developing nature of the COVID-19 crisis.<sup>6</sup> As consumers look to known consumer-health brands and companies in times of uncertainty, these companies can do several things to help them:

- *Educate consumers.* Consumer-health companies have the credibility and reach to help consumers cut through misinformation about the coronavirus, as well as a role to play in helping to alleviate confusion among consumers. To do so, these companies can use their own communication platforms—their corporate or brand websites—to inform consumers about product usage, direct them to the relevant health agencies, and clarify fact versus fiction for certain products. To ensure that companies provide the right information, they should coordinate closely with the relevant government agencies and strongly consider coordinated industry-wide efforts to educate consumers.
- *Get products to people in new ways.* Amid social distancing, quarantines, and shrinking

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<sup>6</sup>“Survey: US consumer sentiment during the coronavirus crisis,” March 2020, McKinsey.com.



inventories, this is a unique moment for consumer-health companies to support consumers by providing access to important products—waiving fees for home delivery, for example. These companies also have opportunities to partner with public-health organizations and private-delivery services to ensure that key products (including prescriptions) get to consumers when they need them.

- *Play a visible, purpose-driven role.* Since consumers trust consumer-health companies and brands about health-related issues, these companies have an important role to play serving and supporting communities affected by COVID-19. They can do so, for example, by expediting the manufacture of critical products

and donating products to more vulnerable populations. Near-term public actions to support consumers can breed goodwill in the long term.

### Customers

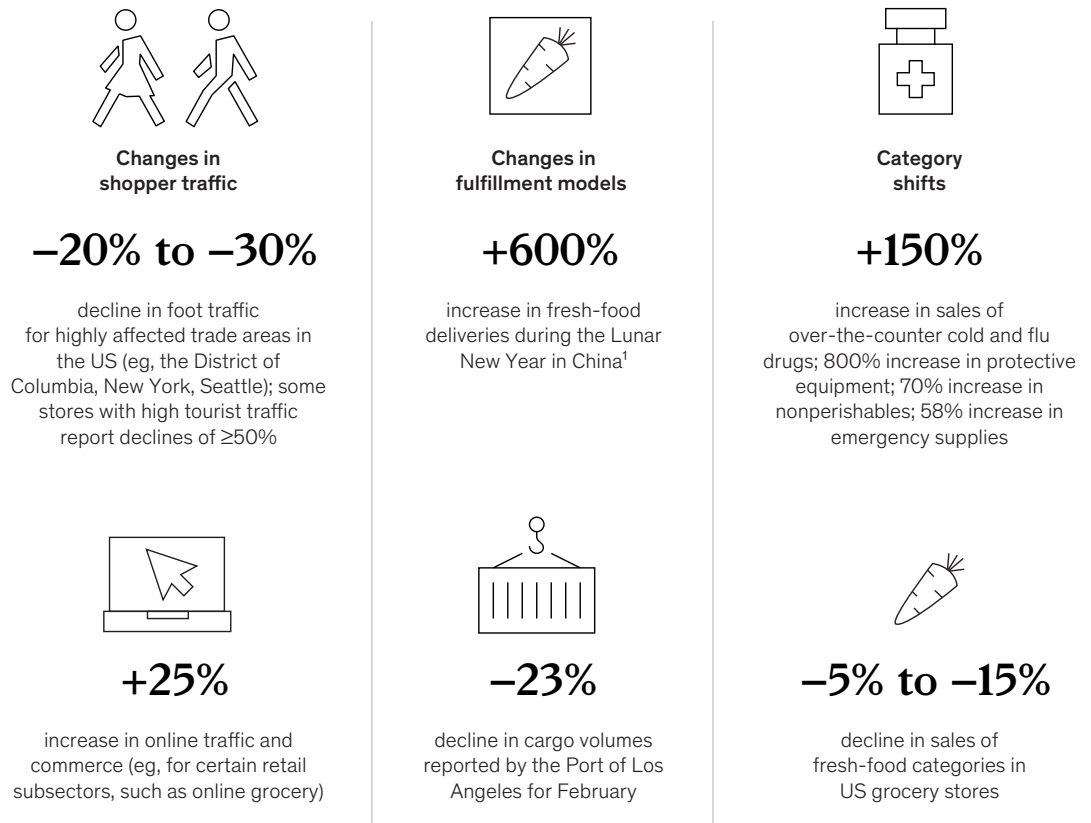
Customers are experiencing significant changes to their businesses and will continue to do so in the weeks and months ahead (Exhibit 1).

To help retailers and pharmacies manage these disruptions, consumer-health companies can take the following actions:

- *Enable flexible product flows.* As consumers stock up on treatment, prevention, and (potentially) lockdown products, consumer-

Exhibit 1

## Customers are experiencing, and will continue to experience, significant changes from COVID-19 in the weeks and months ahead.



<sup>1</sup>Reported by Carrefour.

Source: Nielsen Retail Measurement Services; RetailNext

health companies should work closely with customers to ensure that product inventories align with consumer demand. This means collaborating with customers' merchant and planning teams to reallocate or identify alternative product-flow strategies: moving more inventory to online channels, for example, and making distribution centers more flexible. Consumer-health companies should also focus more on the accuracy of their inventories and the visibility of stock across omnichannel networks, since that will help minimize supply-chain or distribution disruptions as more consumers purchase products online.

- *Bolster the online presence.* As consumers increasingly purchase consumer-health products online, consumer-health companies should be ready to help customers make similar moves and meet consumers where they are. In many cases, this will require working with customers' planning teams or with online retailers to ensure that inventory levels are accurate and supply-chain logistics can keep up with the likely increase in online sales. In some cases, companies may want to accelerate direct-to-consumer sales through their own websites, though existing online channels are probably the most expedient way to meet consumers' needs in the near term.
- *Become a trusted, transparent adviser.* Consumer-health companies should maintain close contact with their customers about the availability of products and potential disruptions, particularly of the most needed products. The sales forces of these companies could be a powerful way to advise and support customers by ensuring that their shelves are stocked or by supporting pharmacists with product and treatment information.

### **Employees**

Supporting the health and safety of employees is also vitally important—and all companies should monitor and incorporate guidance from national

health authorities, such as the Centers for Disease Control and Prevention, as the coronavirus pandemic continues to develop. Consumer-health companies should take several actions for their employees' benefit:

- *Increase communication.* In this uncertain time, it's critical that consumer-health companies communicate frequently and clearly with employees. These companies must balance the needs of the business with expectation setting and morale building, so employees know that their well-being is top of mind. Companies can do this in a more sustained way by establishing internal and external communications teams that reports directly to the C-suite and by aiming for frequent, transparent communications. The leadership teams at many companies have also been sending daily updates to help employees cut through the torrent of information on COVID-19.
- *Change working norms.* As of the time of writing, the ten largest global consumer-packaged-goods (CPG) companies had all implemented travel restrictions and advised employees in affected areas to self-quarantine. Other companies should follow suit and adjust their travel policies to permit only the most critical travel for business purposes. They should encourage remote work—universally if possible or by A/B testing remote-work-team models at all locations—and defining the labor strategy for a fully remote workforce. They should also discourage or postpone large in-person employee gatherings, such as training sessions and conferences.
- *Protect people's health.* To keep employees working safely and healthily, companies can communicate often and clearly about positive hygiene habits, applicable even if people work remotely. They should provide employees with health-related products, such as over-the-counter respiratory products and vitamins. And given the far-reaching effects of coronavirus,

they should consider amending sick-leave policies to show compassion for employees whose loved ones have been affected by the virus or have been exposed to it themselves.

are especially important for consumer-health companies to take.

First, companies should move quickly to set up COVID-19 nerve centers—a flexible organizational structure that guides their work on the pandemic—to cover critical areas of the business.<sup>7</sup> These include protecting employees, stabilizing the supply chain,<sup>8</sup> financial stress testing, monitoring inventories and levels of working capital, and managing demand during the crisis—while preparing for recovery. Cross-functional coordination is critical in the current moment of crisis response, and nerve centers, which break

## How consumer-health companies can mobilize for action

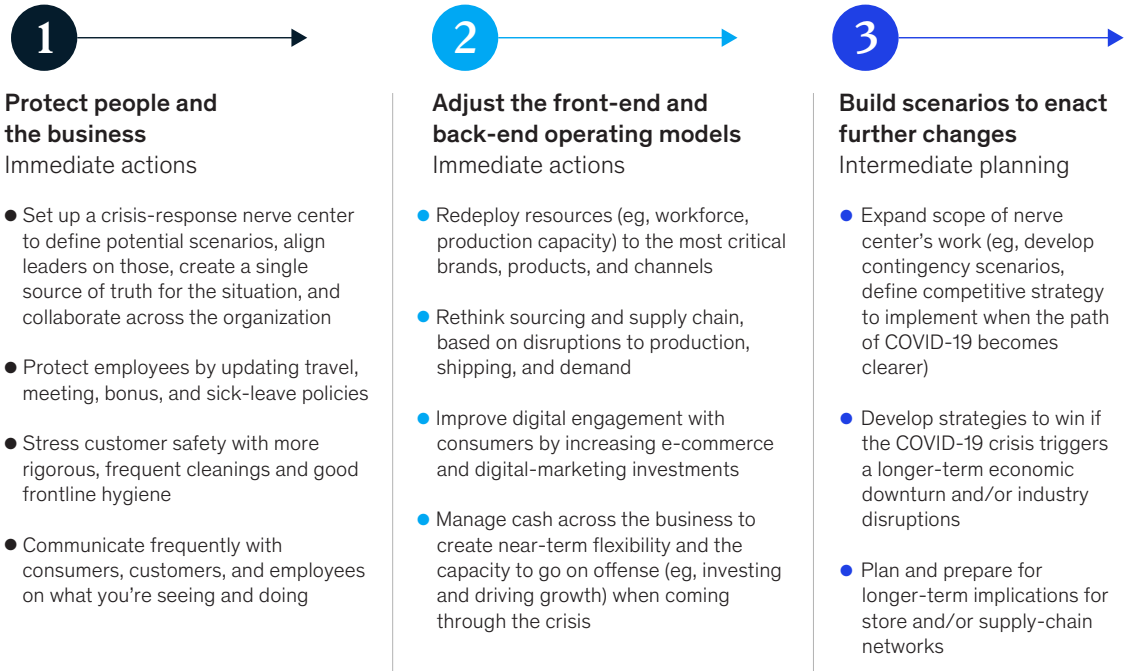
The need for consumer-health companies to respond to the coronavirus pandemic—and quickly—is clear. But they must have the right organizational capabilities and mechanisms in place to do so. All CPG companies should follow a three-part plan (Exhibit 2), and there are two specific actions that

<sup>7</sup> Mihir Mysore and Ophelia Usher, "Responding to coronavirus: The minimum viable nerve center," March 2020, McKinsey.com.

<sup>8</sup> For more on the potential impact of the coronavirus on supply chains, see Knut Alicke, Xavier Azcue, and Edward Barriball, "Supply-chain recovery in coronavirus times—plan for now and the future," March 2020, McKinsey.com.

Exhibit 2

## Consumer-health companies should consider a three-part organizational response to COVID-19.



## Long-term implications for the consumer-health industry

**Beyond the immediate impact of the COVID-19 crisis**, the global economy could be challenged for months to come. Although the outlook is uncertain, the consumer-health industry should keep certain implications in mind.

- *A constrained spending environment.* The pandemic and its economic impact could bring about lasting changes in consumer behavior—as well as a more challenging economic environment overall, once the current crisis passes. After the 2008 recession, consumers moved away from premium brands in some categories and didn't come back after positive experiences with more value-oriented brands.<sup>1</sup> One consequence of this shift was an expansion of private-label products in several markets. In the United States, spending on private-label over-the-counter products increased from 21 percent of all category sales to 30 percent between 2006 and 2012, according to Euromonitor—and these levels have stayed largely consistent since then. Coming out of the COVID-19 crisis, consumers may trade down and make more value-oriented purchases, which could mean a resurgence of consumption of private-label products in some categories.
- *A growing focus on prevention and self-care.* Consumers are increasingly focusing on preventative care to boost their health and immune systems. For example, immunity-related dietary supplements are a \$1.8 billion market in the United States, and sales grew

at close to 6 percent a year from 2013 to 2018, according to Euromonitor. Since the COVID-19 pandemic disproportionately affects people with underlying health conditions, consumers may be even more aware of their well-being and more likely to take proactive measures to maintain healthy lifestyles—a trend that may last well beyond the current crisis. Relatedly, current travel restrictions, tightening consumer spending, and growing use of online channels could accelerate the broader increase in sales of self-care products.

- *Reset in digital engagement.* Compared with other industries, consumer health—and over-the-counter (OTC) products in particular—generates a relatively low proportion of its total sales through e-commerce. According to Euromonitor, for example, only 3 percent of global OTC sales happen online. As consumers purchase more goods remotely during the pandemic, they may become accustomed to purchasing consumer-health products online, especially as delivery speeds increase. That could lead to higher levels of online sales for OTC and other consumer-health products, potentially north of 15 percent, in markets such as the United States and Europe. The current crisis may also be the first time consumers use telemedicine services, other health-related online tools, or coronavirus-related apps (for example, alerts, case trackers, and some nascent screeners or tests). If patients become more comfortable

using online tools for health-related purposes, consumer-health companies may have opportunities to partner with telemedicine services and other health-based online platforms.

- *The importance of a company's purpose.* If consumer-health companies and other private-sector businesses play a visible leadership role supporting communities during the pandemic, consumers may have greater trust and goodwill toward these organizations and brands going forward. McKinsey research indicates that younger consumers consistently prefer brands they perceive as authentic and having a strong purpose.<sup>2</sup> The coming weeks and months may therefore give consumer-health brands an opportunity to demonstrate clear public-health leadership and purpose, with potentially lasting effects.

<sup>1</sup> Betsy Bohlen, Steve Carlotti, and Liz Mihas, "How the recession has changed US consumer behavior," *McKinsey Quarterly*, December 2009, McKinsey.com.

<sup>2</sup> Bo Finneman, Julia Ivory, Sophie Marchessou, Jennifer Schmidt, and Tom Skiles, "Cracking the code of millennial consumers," March 2017, McKinsey.com.

down organizational silos, can help consumer-health companies expedite their decision making and ability to act.

Second, companies need to focus immediately on their most critical products, especially those for treatment and prevention. This requires quick resource-allocation decisions to redeploy internal resources, including production capacity and head counts, toward those items. The nerve center can support rapid reallocation by bringing together the relevant leaders across supply chain, logistics, R&D, finance, human resources, sales, legal, and marketing. Likewise, consumer-health companies should consider their assortment of products. In other sectors, such as food and beverages, companies have already significantly reduced SKU counts on the most needed items to maximize the

speed of production. Consumer-health companies should do so for their treatment mainstays.

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Consumer-health companies must prioritize the needs and interests of their consumers, customers, and employees in the near term, and follow a clear plan for responding to the human and economic challenges ahead. But it's not too early to start thinking about the longer term (see sidebar, “Long-term implications for the consumer-health industry”)—in particular, moving more business online, as both a distribution channel and a forum for interacting with consumers, potentially in new ways. They should also consider partnering with other stakeholders to find new ways to improve people's health overall and to mitigate future pandemics.

**Shaun Callaghan** is a partner in McKinsey's New Jersey office, where **Warren Teichner** is a senior partner. **Martin Lösch** is a senior partner in the Stuttgart office, and **Stefan Rickert** is a partner in the Hamburg office.

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# Winning against COVID-19: The implications for biopharma

How companies act individually and collectively in the next few weeks and months will shape the outcome of the pandemic and the reputation of the biopharma industry for decades to come.

*by Gaurav Agrawal, Hemant Ahlawat, and Martin Dewhurst*

**Pandemics, like other humanitarian crises, are times of great change and uncertainty.** The society that emerges in the wake of COVID-19 will be different. People's behavior and values will change in ways we can't predict. Health systems will be fundamentally altered. The pace of adoption of some new technologies, such as telemedicine, may step up. Patient journeys will be transformed through new settings of care. Health systems will face different priorities and pressures on funding, depending on the depth of the economic downturn and the pace of recovery.

In these unprecedented times, the world is looking to the biopharma and medical-products industry for a response. Its contribution spans testing, ventilators and other critical medical devices, repurposed and novel therapeutics, and vaccines. Beyond that, it provides the only path to whatever next normal we may find on the other side. It is the source of hope and the primary path to mitigating and, ultimately, helping resolve a potential humanitarian catastrophe.

How companies act individually and collectively in the next few weeks and months will shape the outcome of the pandemic and the reputation of the biopharma industry for decades to come.

Our thinking, like yours, is evolving from day to day. Below we share perspectives we have developed following discussions with industry leaders and stakeholders, and from what we are seeing more

broadly. We have divided them into three horizons anchored in our 5R framework (Exhibit 1):

- *Immediate crisis response* (Resolve)—where most companies are today
- *Shaping the recovery* (Resilience, Return)
- *Shaping the next normal* (Reimagination, Reform)

### Immediate crisis response

Here, our sense is that most companies have acted decisively in standing up “nerve centers” to plan for the challenges to come. We see the primary imperatives as follows:

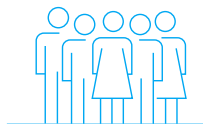
- Keeping employees safe.
- Managing the transition to effective home working, using new technologies and exploring new ways of connecting.
- Maintaining business continuity: preparing for possible site closures and distribution delays; evaluating the need for new sources of supply for raw materials, active pharmaceutical ingredients (APIs), and outsourced products; introducing new safety measures.
- Ensuring the supply of medicines to patients and physicians and ensuring treatment and support for non-COVID-19 patients, some of

Exhibit 1

## Pharmaceutical and medtech companies should plan along three horizons.

### The 3 horizons

#### 1 During the crisis



**Resolve**  
Address the immediate challenges that COVID-19 represents to institution's workforce, customers, technology, and business partners

#### 2 As healthcare systems start to recover



**Resilience**  
Address near-term cash-management challenges and broader resiliency issues during virus-related shutdowns and economic knock-on effects

#### 3 As you settle into the new normal



**Return**  
Create detailed plan to return business to scale quickly as COVID-19 situation evolves and knock-on effects become clearer



**Reimagination**  
Reimagine the next normal: what a discontinuous shift looks like and implications for how institutions should reinvent



**Reform**  
Be clear about how regulatory and competitive environments in industry may shift

whom are particularly vulnerable to the virus. Some companies in the United States have recently taken the step of extending their patient support programs with this in mind.

- Identifying immediate implications across the value chain, by market and by therapeutic area, and, where applicable, planning how to respond to huge spikes in demand that are putting pressure on supply chains.
- Mobilizing to help fight the pandemic by contributing to the supply of tests, medical equipment, and devices as well as the development of repurposed therapies and vaccines. As of early April, we tracked more than 200 vaccine and therapeutic candidates in development—an unprecedented level of mobilization within three months. Companies are also stepping in to donate funds or products—such as Novartis, Bayer, and Sanofi, who have committed to donating chloroquine, should that prove effective in addressing the virus—and adding their capabilities and expertise to national and global efforts.

## Shaping the recovery

The key is for the industry to engage proactively, and positive signs are already emerging. We urge companies to take a health systems' view and ask where we can make the biggest difference.

At a company level, we encourage you to set up a plan-ahead team<sup>1</sup> that works across all time horizons to help you to stay on top of escalating issues and make the right decisions. To navigate the huge uncertainties ahead, model a broad range of scenarios covering both the epidemiological and economic perspectives. We have developed nine macro economy-wide scenarios and explored four in greater depth (Exhibit 2). The implications for each company will of course differ.

To help shape the recovery, consider the following critical steps:

- Taking an end-to-end view across the value chain to assess the implications from the pandemic and identifying the challenges and areas where the disruptions from the pandemic may accelerate change.
- Staying close to your customers and stakeholders. In particular, what do healthcare providers need? When will they have the capacity to engage with you?
- Planning how to support patients through uncertain and anxious times, focusing on how they are experiencing the crisis and taking a granular view by therapy area and geography. Different health systems will emerge from the crisis at different rates and in different ways. There may be stark differences even within countries such as the United States and China.

Looking across your business, consider the following:

- Accelerating your transformation, especially in using digital and analytics tools and adopting digital channels to engage with healthcare professionals, such as telemedicine or remote consultation. In a recent April survey, physicians reported a sixfold spike in remote patient engagement across specialties and geographies—a trend that many of these physicians believe will endure post-crisis.<sup>2</sup> New channels may also emerge to further address patient needs during the crisis. The use of customer-facing field personnel also could be uncertain for some time to come. In China, some pharma companies have used the enforced pause to refine their go-to-market model and invest in digital capability-building for physician engagement.
- Developing contingency plans for launches over the next six to 12 months, recognizing that health systems are coming under enormous strain in many markets, with the pandemic putting frontline healthcare professionals at considerable risk and exacting a heavy personal toll.

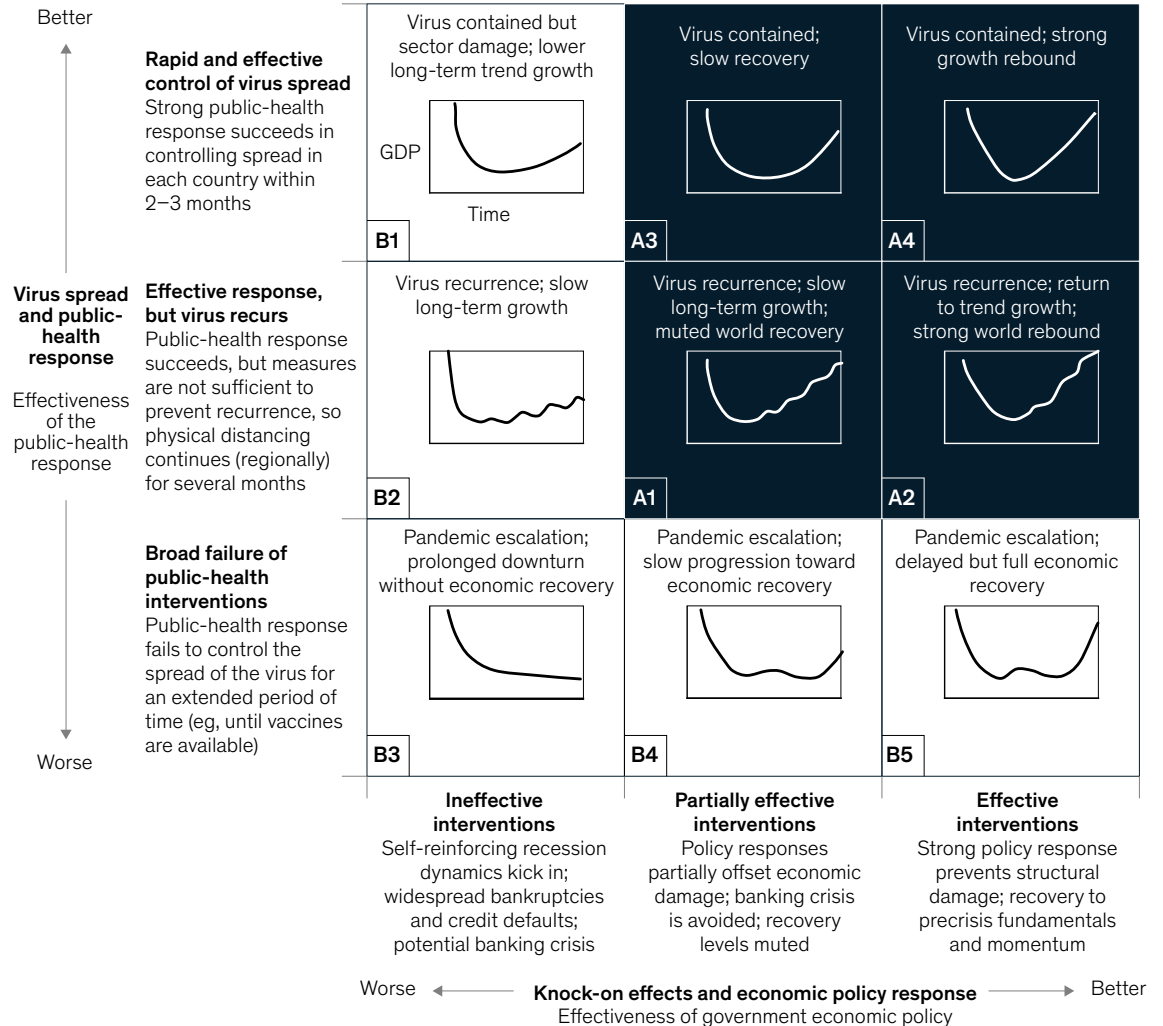
<sup>1</sup> Yuval Atsmon, Chris Bradley, Martin Hirt, Mihir Mysore, Nicholas Northcote, Sven Smit, and Robert Uhlener, "Getting ahead of the next stage of the coronavirus crisis," April 2020, McKinsey.com.

<sup>2</sup> Ortal Cohen, Brian Fox, Brent Hooper, Nicholas Mills, Rukhshana Motiwala, and Peter Wright, "COVID-19 in pharma commercial: Navigating an uneven recovery," forthcoming on McKinsey.com.

Exhibit 2

**Scenarios for the economic impact of the COVID-19 crisis.**

**GDP impact of COVID-19 spread, public-health response, and economic policies**



- Seizing opportunities presented by remote working and spare capacity among field sales representatives and other groups to accelerate capability development. Past experience indicates that the capability gap between those who successfully adapt and those who fall behind widens during crises. We are seeing companies building muscle in driving change and boosting digital and analytics skills among key cohorts.
- Taking a forensic view of your supply chain and operations to derisk key elements such as in-market supply, while also deepening your

capabilities in data availability and transparency and modelling capacity needs.

- Developing granular, data-backed plans on “when” and “how” to restart paused trials as well as ensuring existing trials can continue to retain patients using quick-win tools, such as telemedicine, sending drugs directly to patients, and travelling nurses. At an industry level, more than 2,800 trials and nearly a million trial patients—accounting for more than 80 percent of multisite trials sponsored by pharma companies—are at sites that are in locations that are now partly or fully locked

due to COVID-19. In addition, starting new trials and sites in this environment is challenging; a recent survey showed that over 75 pharma and biotech companies are facing significant disruption in their clinical trials.<sup>3</sup> One especially urgent task is to identify and decide how to address those trials for which data may already be compromised.

- Accelerating productivity improvements to create head room to respond to the pricing and access challenges that major economic shocks could bring, and taking a forward-looking view on how to increase the agility of operating models for countries and therapeutic areas to handle demand shocks better.
- Evaluating bold moves, such as undertaking M&A in adjacent segments or deepening integration between digital and health tech.

At an industry level, we see many signs that companies are coming together in exciting new ways.<sup>4</sup> We believe now is the time for a critical shift from a competitive to a collaborative mindset based on shared humanitarian goals. By pooling capabilities, pharma companies could unleash a huge wave of innovation. Positive steps to consider include the following:

- Continuing to deepen your collaborations in R&D, including supporting biotechs by providing them with access to your capabilities and capacity, and sharing data, assets (such as compound libraries) and platforms to accelerate the approval of vaccines and therapeutics.
- Working with industry peers to shape new modes of engagement with regulatory bodies and establishing trial infrastructure and regulations that are better equipped to withstand future disruptions with more robust data management, remote trial capabilities, and real-world-evidence-based regulatory processes.
- Deepening collaboration in manufacturing, taking advantage of collective capacity and

capabilities to rapidly scale up vaccines and therapeutics, particularly from biotechs. An encouraging collaboration model is the recent announcement by several plasma manufacturers to work collectively to produce a single unbranded product.

- Continuing to commit resources to support the needs of health systems. For example, Pfizer and Merck are enabling employees who are licensed medical professionals to volunteer on the frontlines providing services such as public-health support, diagnostic testing and treatments, and patient services. Eli Lilly has medical professionals staffing a free drive-through COVID-19 testing facility at its corporate headquarters in Indianapolis as a service to the community.<sup>5</sup>
- Engaging in transparent, responsible behavior, as exemplified in AbbVie's decision to give up its intellectual-property protection on Kaletra. Proactive engagement with external stakeholders—regulators, global agencies, health systems—will help the whole healthcare ecosystem navigate the fast-evolving crisis.

## Shaping the next normal

This is the right moment to start shaping how you want to be operating two years from now and reflect on the choices that you will have to make as a biopharma leader. At a company level, you will need to navigate numerous uncertainties, including the level of economic disruption caused by the pandemic, and the nature of the response from governments, regulators, and health systems. This will be a marathon, not a sprint. We propose taking a dynamic view of emerging scenarios, identifying no-regrets moves and looking for ways to emerge stronger from the crisis. Shaping the next normal could involve the following:

- Committing to pushing the boundaries on digital, data and analytics, and customer-centricity—for both patients and healthcare professionals.

<sup>3</sup>Selina Koch, "Survey says: Companies seek regulatory flexibility as COVID-19 makes clinical disruptions the new norm," *Biocentury*, March 25, 2020, [biocentury.com](https://www.biocentury.com).

<sup>4</sup>C. Simone Fishburn, "Pharmas on one page with action plan to solve COVID-19 together," *Biocentury*, March 25, 2020, [biocentury.com](https://www.biocentury.com).

<sup>5</sup>"Medical professionals across Merck & Co., Inc., Pfizer Inc., and Eli Lilly and Company activate to support health systems, first responders and patients amid COVID-19 pandemic," *Pfizer*, April 1, 2020, [pfizer.com](https://www.pfizer.com).

- Evolving your perspective across the value chain and ecosystem, including the greater use of shared platforms in research.
- Embracing both patient- and principal investigator–centricity to drive trial design and conduct: including protocols that reduce patient burden and, as one of many tools toward that goal, deploying digital and remote engagement platforms, such as remote assessment of vitals and end-points, to increase virtualization of trials. Among major pharma companies, 60 percent are already using telemedicine for trial visits in response to the COVID-19<sup>6</sup> crisis and more seem likely to follow.
- Looking across the value chain to identify how to build more resilience in the network and finding the right trade-off between global efficiency and local resilience. Implementing operations and supply chain 4.0, with greater site automation and more flexible manufacturing platforms, could speed up supply–demand response rates. With an “Amazonification” of the pharmacy value chain on the horizon, companies also need to prepare to service new direct-to-patient channels.
- Considering bold moves in areas such as productivity improvements and cost reductions, M&A, new ecosystems of collaborations, and increased use of health tech to improve patient outcomes.

capacity, and product security. Indeed, governments may see health through a similar lens to that of defense—one of national security requiring controls.

- Collaborating with relevant stakeholders to shape an economic model that makes it compelling for the industry to invest in preventing pandemics and working on areas subject to market failures, such as anti-infectives and antimicrobial resistance. How can the industry ensure lessons are learned from the crisis so that nothing on this scale can ever happen again?
- Planning for other possible “black swan” events, such as biosecurity hazards and cybersecurity threats.
- Building closer industry-wide collaboration in R&D and manufacturing, with fewer silos and faster joint innovation, and cultivating a new mindset of collaboration both across the industry and between biotech and universities.
- Considering the potential for a more fundamental shift to prevention (which typically accounts for just 4 to 6 percent of today’s healthcare spending), giving greater prominence to considerations for the health of the broader population and raising questions on how the industry should participate in this broader dialogue.
- Developing new contracts and nurturing closer relationships with health systems, payers, healthcare professionals, and patients.

Across the industry, we believe companies need to work together not only to shape both a positive outcome for the pandemic but to safeguard their broad license to operate in the decades ahead. There is a real imperative for change to get to a better next normal. Here are our suggestions:

- Deepening engagement with governments, bearing in mind the potential implications of more locally driven agendas over the next few years, with respect to local manufacturing

This is a historic moment of danger and opportunity—or, in Mandarin, 危机, the two characters that make up the word “crisis.” It is no exaggeration to say the industry holds our future in its hands.

<sup>6</sup>McKinsey Clinical Operations Roundtable Survey, April 2019.

**Gaurav Agrawal** is a partner in McKinsey’s New York office, **Hemant Ahlawat** is a senior partner in the Brussels office, and **Martin Dewhurst** is a senior partner in the London office.

# Navigating the government response

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# Crisis nerve centers: Supporting governments' responses to coronavirus

A centralized response system can help set up government leaders for success in managing a crisis.

*by Adi Kumar, Leah Pollack, Navjot Singh, and Catharina Wrede Braden*

**Subnational (provincial, state, and municipal) governments** are on the front lines in responding to the spread of COVID-19. The magnitude of the pandemic poses daunting challenges: officials must coordinate fast-moving and interconnected work streams across the private and social sectors while communicating vital information to residents, stakeholders, and the media—all in a clear and consistent way.

Our experience suggests that a crisis nerve center—a highly agile, coordinated body that brings together crucial organizational skills and capabilities—can provide senior government leaders with the structure and clarity to mount an effective response and mobilize every part of society.

This nerve center shouldn't supersede existing crisis-management structures. Rather, it is an additional executive-support structure for senior leaders that works closely with all existing emergency-management channels. By using this approach, governments can be better positioned to manage a crisis.

### Crafting a rapid response

Nerve centers are particularly appropriate under three conditions:

- Significant disruption to regular activities that threatens to overwhelm existing resources
- Highly unfamiliar, highly novel situations that are unlike anything the organization has faced before, impeding rapid pattern recognition
- High-velocity disruptions, in which organizations do not have enough time to truly understand and interpret threats using traditional means

In these situations, nerve centers provide several integrated benefits that improve leaders' overall decision-making speed and quality:

- *They increase response efficacy* by coordinating and adjusting activities around real capabilities—instead of just formal roles and responsibilities—and providing a mechanism to balance what's important and what's urgent.

- *They increase the quality of information flow* by connecting and coordinating disparate efforts through a central source of data collection and analysis.
- *They improve response agility* by allowing for rapid assembly of cross-functional teams in response to changing needs.

### Structuring the COVID-19 crisis nerve center

Each nerve center should be designed to reflect local context, capabilities, personalities, and needs. A typical structure includes the following:

- *A strong, trusted leader with the capabilities and operating rhythm to manage fast-moving, disparate teams.* The overall response leader, often a senior official in government, oversees the operational leads. Selecting a person with the right skills is critical to the success of the crisis response. In our experience, the response leader should be decisive, have the authority to act, and possess the judgment, maturity, stamina, and communications skills to project a consistent, calming presence.
- *A set of agency or cross-functional teams representing the areas of work that are the highest priority.* Each team should have a dedicated project manager and core team personnel in addition to a leader. These can be existing or new teams but should reflect actual, on-the-ground needs, not historical organizational divisions. See the exhibit for examples of what this could look like for a COVID-19 nerve center.
- *Representatives of legal, regulatory, and other critical bodies.* These representatives should be available to provide on-the-spot guidance and advice.
- *Data and analytics team.* In recent years, governments have made strides in building their analytics and data-sharing capabilities. An effective crisis response requires operations to have the latest data available—and in formats that can be shared and understood—to aid

planning and the allocation of resources and equipment. It is essential that the government have access to a “single version of truth” (as far as that is known) and that the crisis nerve center be accepted by all parties as the owner of that truth, rather than having competing voices across the agencies.

- **Links to stakeholder groups that require regular communications.** In the case of a COVID-19 nerve center, these connections could include citizens, legislatures, the business community,

social-sector organizations, and educational institutions.

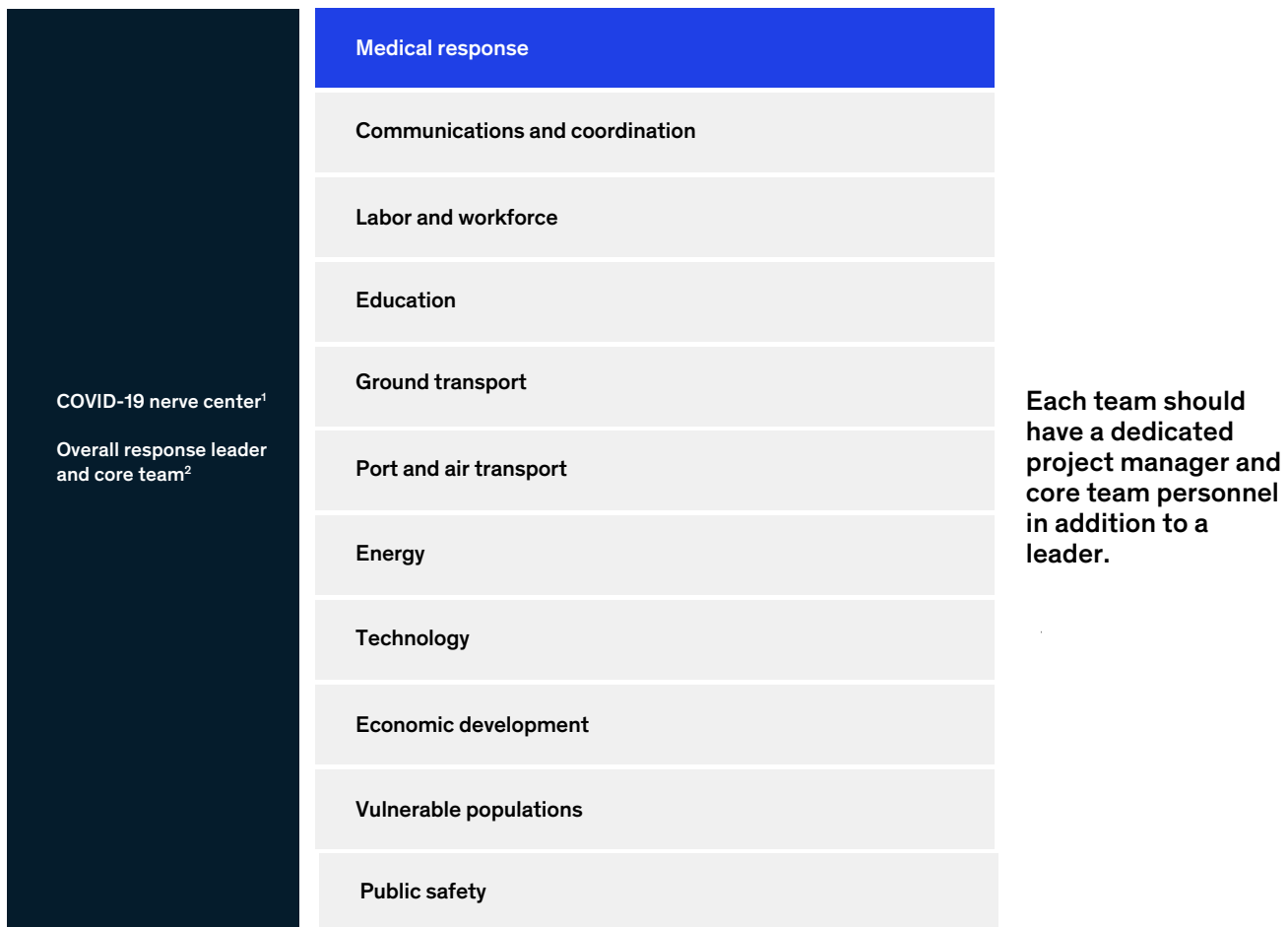
- **Links to other major external partners.** In the case of local government, these links could include federal or national partners.

The center is tasked with developing a unified approach to short-term response and long-term stabilization. The primary objectives are to coordinate efforts across multiple operations to serve a focused mission: bring together the

Exhibit

**Nerve centers coordinate activities across areas of responsibility.**

■ Integrated nerve center ■ Health component ■ Departments and cross-functional teams



Note: Content draws upon best practices from other scenarios and ideas for setup rather than advice and counsel.

¹A nerve center can focus on all or some of the activities.

²Each team can either represent a distinct state or a local-level department or cross-functional team.

disparate sources of information required for decision making, set and act on priorities for the short and long term, craft solutions with all the relevant voices, and execute.

In the initial stages of the response, COVID-19 nerve centers have often focused on the key medical lines of effort:

- **Testing.** In many countries, a lack of test kits has been a major obstacle. The crisis nerve center team could work with multiple suppliers, the healthcare system, and the national government to secure the needed capacity; identify any requirements, laws, or regulations that may prevent rapid test acquisition; facilitate the collection and analysis of critical testing data (including collecting not just positive but also negative testing data); and work with partners to develop creative alternatives.
- **Personal protective equipment (PPE).** Procuring and distributing PPE to healthcare workers requires governments to identify and overcome supply bottlenecks. These efforts are crucial, since the pandemic will quickly overwhelm healthcare systems crippled by infected workers. Nerve-center teams often work with state emergency-management agencies and others to secure supplies, organize and track donations, project future PPE needs and shortages, and support the issuance of guidance to affected stakeholders.
- **Critical care.** Governments must determine the capacity of healthcare infrastructure such as hospital beds, ventilators, and healthcare

workers. They need to find quick ways of bridging the gaps, including by leaning on private- and social-sector infrastructure, medical students, and retired medical staff; easing procurement rules; and even asking for help from other governments. In addition to other tasks, teams often track, coordinate, and help procure beds of all types; develop additional capacity for a range of discharge needs; and identify and project staffing shortages.

- **Telemedicine.** Governments can help hospitals and healthcare facilities focus on the most severe cases by making certain that they are fully equipped to provide care and advice. Key tasks include ensuring active call centers, low wait times, and ample capacity—perhaps by tapping more trained personnel, such as nurses.
- **Quarantine logistics.** The general population and businesses that are essential to remain open (such as grocery stores and pharmacies) will need advance notice to prepare for large-scale quarantines and stay-at-home orders. Governments must clearly communicate restrictions and timelines, model the appropriate quarantine response, and take necessary enforcement actions.

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The COVID-19 pandemic has forced all organizations, especially governments, to dramatically elevate their response strategies. The crisis nerve center provides governments with the structure and agility to mobilize resources quickly, execute, and shift gears as conditions change.

**Adi Kumar, Leah Pollack, and Catharina Wrede Braden** are partners in McKinsey's Washington, DC, office, and **Navjot Singh** is a senior partner in the Boston office.

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# US coronavirus relief funds: A guide for state and local governments

State and local governments need to mobilize quickly to capture the full humanitarian and fiscal benefits of the roughly \$2 trillion federal relief package.

*by Trey Childress, Stuart Skeates, and Todd Wintner*

**The ratification** of the historic Coronavirus Aid, Relief, and Economic Security (CARES) Act floated a life raft of \$2 trillion to \$2.2 trillion<sup>1</sup> to many US businesses, families, and local governments reeling from the economic shutdown (exhibit).

Some of these benefits, including \$300 billion in direct payments to households, are expected to hit the economy as soon as mid-April. Others may take a month or longer before agency rulemaking, allocations, and recipient certifications allow funds to reach the hands of end beneficiaries.

McKinsey's preliminary analysis of the CARES Act estimates that nearly half of all appropriations in the legislation will be distributed through state and local governments. These funds will primarily cover spikes in demand for state and local services—for example, the more than 6.6 million Americans who filed for unemployment in the last week of March alone<sup>2</sup>—but also help state agencies and local organizations recoup lost revenue, as with transportation grants to help the nation's airports stay afloat amid a drop in passenger demand. CARES Act provisions directed at federal agencies, such as the expansion of subsidized loan programs from the Small Business Administration, are also of great interest to state and local governments because they directly benefit vulnerable constituents and present opportunities for complementary relief measures.

If the American Recovery and Reinvestment Act of 2009 taught us anything, it is that time matters. State and local governments must act swiftly to get money into the hands of beneficiaries. This urgency is one of humanitarian necessity: similar to the previous relief packages, most of the CARES Act programs provide immediate health-related response measures (for example, enhancing hospital capacity). Disbursing money quickly is also an economic imperative: 50 percent of Americans work for or own a small business and, on average, these businesses have only 27 days of cash flow.<sup>3</sup> In the aftermath of the Great Recession, states accumulated a total of \$500 billion in budget

shortfalls, state tax revenue fell 17 percent below the previous year's levels, and personal income taxes dropped 27 percent<sup>4</sup>—despite federal transfers that helped soften the blow.

In this article, we discuss the steps state and local governments can consider to maximize the impact of the CARES Act. These actions include assigning leaders to spur accountability, establishing mechanisms to coordinate with federal counterparts, planning for financial inflows, providing appropriate resources for agencies to handle the influx of demand, and overcommunicating with the individuals, businesses, and organizations that might benefit.

### **Distribution complexity will vary by benefit and program**

Given the multiple types of distribution mechanisms—each with its own complexities—and the volume of funds to be distributed, state and local governments must prepare for a likely capacity challenge.

One bucket of support, which we estimate to be less than 10 percent of the money allocated to state and local governments, augments existing benefit programs that require minimal additional capacity to distribute. An example would be increasing the Federal Matching Assistance Percentage, which determines the degree to which the federal government finances states' Medicaid programs. Increasing the matching rate for state funds would allow the federal government to provide states with much-needed relief from entitlement obligations.

A second bucket of support will require a moderate increase in capacity to get money out the door. We estimate this approach to include 65 to 75 percent of funds allocated to state and local governments. This funding often requires state or local governments to derive or amend their own allocation and allotment processes for third-party beneficiaries (for example, hospitals and nonprofits) that will deliver direct services. Sometimes the state's own capacity, such as eligibility verification for new unemployment benefits, will need to be augmented.

<sup>1</sup> Total is an estimated range as some programs are based on volumes and therefore there are not defined amounts allocated in the bill.

<sup>2</sup> "COVID-19 impact," U.S. Department of Labor, April 2, 2020, [dol.gov](https://www.dol.gov).

<sup>3</sup> Ross Baird, Colin Higgins, and Bruce Katz, "Rethinking disaster relief for small businesses," *New Localism*, March 18, 2020, [thenewlocalism.com](https://thenewlocalism.com).

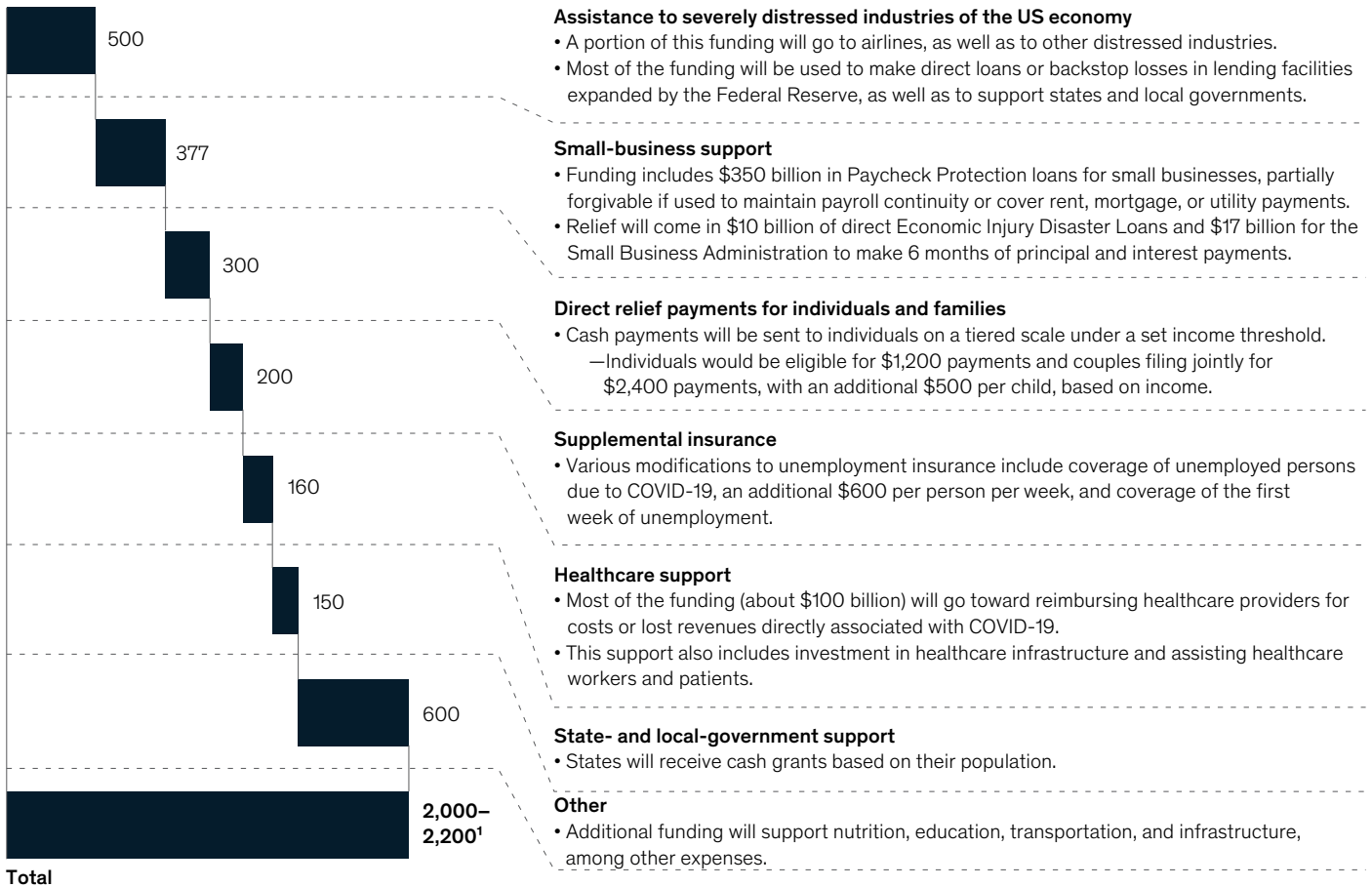
<sup>4</sup> Tracy Gordon, "State and local budgets and the Great Recession," Brookings Institution, December 31, 2012, [brookings.edu](https://www.brookings.edu).



## The CARES Act will provide economic support across six core areas.

Breakdown, \$, billions

Areas of focus in the bill:



- Assistance to severely distressed industries of the US economy**
  - A portion of this funding will go to airlines, as well as to other distressed industries.
  - Most of the funding will be used to make direct loans or backstop losses in lending facilities expanded by the Federal Reserve, as well as to support states and local governments.
- Small-business support**
  - Funding includes \$350 billion in Paycheck Protection loans for small businesses, partially forgivable if used to maintain payroll continuity or cover rent, mortgage, or utility payments.
  - Relief will come in \$10 billion of direct Economic Injury Disaster Loans and \$17 billion for the Small Business Administration to make 6 months of principal and interest payments.
- Direct relief payments for individuals and families**
  - Cash payments will be sent to individuals on a tiered scale under a set income threshold.
    - Individuals would be eligible for \$1,200 payments and couples filing jointly for \$2,400 payments, with an additional \$500 per child, based on income.
- Supplemental insurance**
  - Various modifications to unemployment insurance include coverage of unemployed persons due to COVID-19, an additional \$600 per person per week, and coverage of the first week of unemployment.
- Healthcare support**
  - Most of the funding (about \$100 billion) will go toward reimbursing healthcare providers for costs or lost revenues directly associated with COVID-19.
  - This support also includes investment in healthcare infrastructure and assisting healthcare workers and patients.
- State- and local-government support**
  - States will receive cash grants based on their population.
- Other**
  - Additional funding will support nutrition, education, transportation, and infrastructure, among other expenses.

Note: Numbers may not sum, because of rounding.

<sup>1</sup> Total is an estimated range because some programs are based on volumes and therefore there are not defined amounts allocated in the bill.

Source: Advisory Board; CNN; Holland & Knight; *National Review*; *Politico*; *Wall Street Journal*

A final bucket of support—which we estimate may near 25 percent of these funds—will likely require significant investment in new capabilities (and perhaps innovation) to reach beneficiaries. One example is the expansion of funding for food purchases and demonstration projects to increase

flexibility for schools to provide free meals. School districts around the country have scrambled to build creative solutions for distributing these meals during a time of physical distancing and widespread school closures.<sup>5</sup>

<sup>5</sup> Anya Kamenetz and Cory Turner, "Schools race to feed students amid coronavirus closures," NPR, March 20, 2020, npr.org.

# States can continue to rely on tools such as the Federal Funds Information for States that provide leaders with real-time information on disbursements and restrictions.

## State and local governments can consider steps to maximize the impact of the legislation

All levels of government are fully immersed in responding to the most immediate humanitarian needs, so leaders can consider several steps now to ensure maximum impact from additional funds. Many of these actions are based on the experience of state and local governments' responses to the American Recovery and Reinvestment Act as well as the early experience of states in developing their COVID-19 crisis nerve center.<sup>6</sup>

### Assign leaders to spur accountability and improve transparency

- *Appoint a relief and recovery lead* to coordinate across state and local agency officials. This appointee should be senior enough to convene principal-level leaders in each responsible agency. This appointee is often a deputy chief of staff or chief operating officer.
- *Establish a response lead in each agency* to manage the response (including

federal-agency interaction) for the department. This leader is often a deputy commissioner or secretary.

### Establish mechanisms to coordinate with federal agencies

- *Track agency-level rulemaking and appropriations.* States can continue to rely on tools such as the Federal Funds Information for States that provide leaders with real-time information on disbursements and restrictions.
- *Reach out to federal agencies early.* Contact US government leaders in national, regional, and state offices as appropriate; in doing so, establish a protocol to maintain open lines of communication as resources go online.
- *Centrally track applications and deadlines required by various federal agencies.* Doing so will allow states to recoup qualified expenditures or receive up-front payments.

### Plan for financial inflows

- *Track already-authorized emergency costs* to both ensure full understanding of

<sup>6</sup> For more on crisis nerve centers, see Adi Kumar, Leah Pollack, Navjot Singh, and Catharina Wrede Braden, "Crisis nerve centers: Supporting governments' responses to coronavirus," March 2020, on McKinsey.com.

expenditures related to COVID-19 and receive reimbursement from relief packages where applicable.

- *Project benefit demand* to evaluate financial impact as well as operational considerations.
- *Identify sources of working capital* (for example, emergency reserve appropriations and interfund borrowing) at the agency level to finance spending surges before federal money becomes available, particularly in the case of reimbursement programs.
- *Begin the allocation process* by cataloging existing programs, municipalities, and nongovernmental agencies that will be the ultimate recipients of many funding streams. Also, start discussions on distribution criteria and application processes before funds are available.
- *Weigh appropriate fraud, waste, and abuse controls*, particularly for programs with new eligibility requirements, such as unemployment benefits.

**Provide appropriate resources for agencies to handle the influx of demand**

- *Redeploy staff* to areas of higher demand to alleviate bottlenecks in relief fund distribution; state and local governments might even

consider augmenting full-time employees with recently furloughed or unemployed private-sector workers as a means of further economic stimulus.

- *Test all aspects of systems*, such as IT infrastructure and administration capacity, that are likely to experience record levels of use in services—for example, from applications for unemployment insurance and aid through the Supplemental Nutrition Assistance Program.
- *Evaluate and upgrade IT infrastructure*, including fast-tracking procurement for third-party vendors where needed to accelerate capabilities.

**Communicate, communicate, communicate**

- *Build a simple, one-stop web portal* with clear, up-to-date links to state and federal resources (overseen by the relief and recovery lead mentioned above) for individuals, businesses, and community organizations seeking information.
- *Establish a hotline* to support agencies in addressing questions related to relief funds.
- *Require agencies to submit citizen outreach strategies* to reach relevant segments such as loan recipients eligible for relief. Agencies can also go beyond explanations of benefits

**Begin the allocation process by cataloging existing programs, municipalities, and nongovernmental agencies that will be the ultimate recipients of many funding streams.**

to connect vulnerable institutions and firms to service providers (for example, identifying local lenders certified by the Small Business Administration).

to monitor developments and share additional guidance as the landscape changes.

Establishing these basic organizational structures and operating processes will leave governments better able to respond to a prolonged economic shutdown. It is ultimately in the hands of state and local leaders to put relief legislation to work to get the money flowing.

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Based on what we see today, state and local governments are likely to see revenue shocks as severe, or worse, than those experienced during the Great Recession. We have heard from many local government leaders who hope the next wave of relief will focus on longer-term economic stimulus to the same degree that the CARES Act provides near-term relief. We will continue

**Trey Childress** is a consultant in McKinsey's Chicago office; **Stuart Skeates** is a consultant in the Washington, DC, office, where **Todd Wintner** is a partner.

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# COVID-19: How American states can manage the surge in unemployment services

State government leaders can proactively streamline service delivery to the public amid a quickly evolving situation—and maintain the improvements.

*by Ramsey Fahs, Nehal Mehta, Jim Pallotta, Rachel Riley, Sarah Tucker-Ray, Hrishika Vuppala, and Rob Whiteman*

**In a matter** of weeks, a single confirmed case of COVID-19 in the United States has exploded into a human tragedy that has affected hundreds of thousands of people in the country. The pandemic has also created an economic crisis that is stretching state governments' ability to deliver support services.

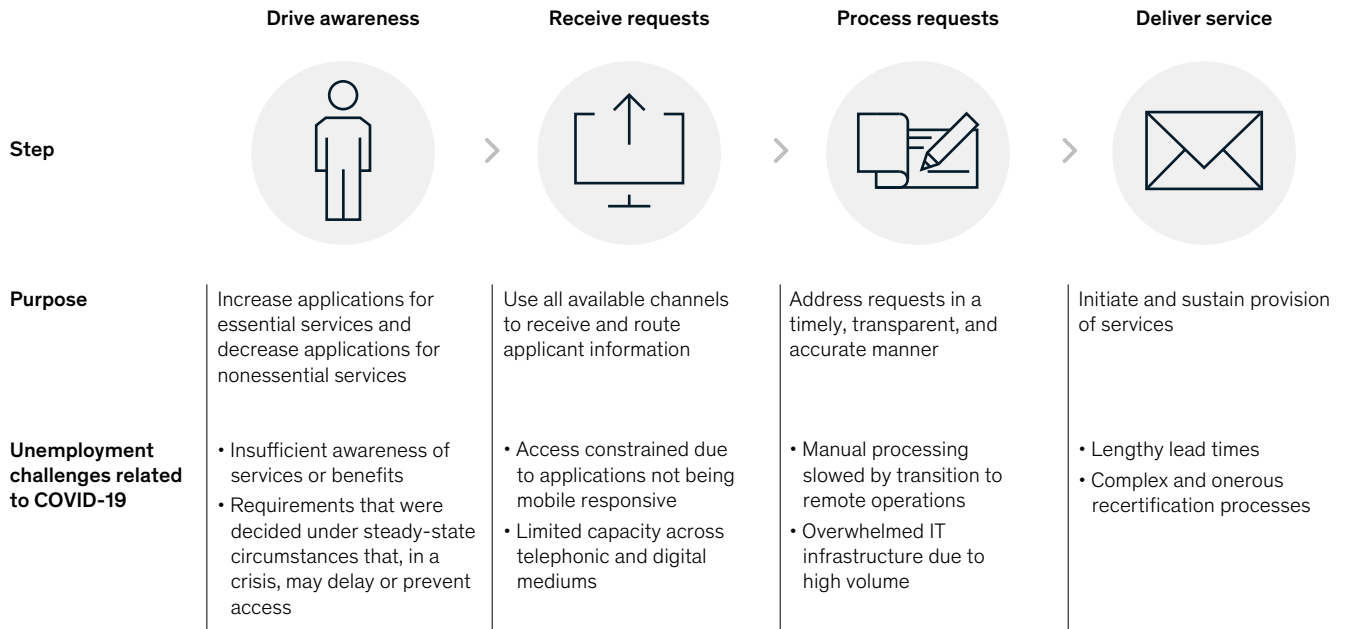
As businesses lay off workers in the face of an abrupt economic slowdown, a spike in unemployment has tested state governments' capacity. Almost 3.3 million people filed initial claims for unemployment benefits between March 15 and March 21, 2020, the highest on record for the country.<sup>1</sup> Unemployment programs are under-equipped to meet this level of need: programs themselves are understaffed for a crisis, processes easily overwhelm legacy IT systems, and in-person appearances aren't feasible during a pandemic.

At the moment, claimants are facing obstacles at every step of the process to obtain unemployment benefits (Exhibit 1):

1. **Insufficient awareness of services and benefits.** Many residents who have lost their jobs don't know which benefits they are eligible for or where and how to access them. And those who do find an entry point can struggle with navigation, bouncing between websites and call centers to resolve issues—without the option of going to a field office for guidance. Additionally, employers in many states are unaware that they can submit batch applications on behalf of their employees. Employer-submitted batch applications can significantly reduce strain on systems while meaningfully decreasing the number of days it takes for claimants to receive their benefits.<sup>2</sup>
2. **Complex and difficult-to-access systems when requesting services.** Application forms for unemployment benefits are long, complicated, and sometimes entirely analog. Unemployment websites often interface and rely on legacy systems that are not designed to handle the

Exhibit 1

### COVID-19 complicates each step of state governments' efforts to provide critical services to residents.



<sup>1</sup> "COVID-19 impact," U.S. Department of Labor, March 26, 2020, dol.gov.

<sup>2</sup> Taylor Gantt, "What You Need To Know: Help With Unemployment Benefits," *Georgia Public Broadcasting*, March 24, 2020, gbdnews.org.

current volume of requests. In addition, some states lack mobile-responsive websites, which constrains low-income residents who don't own computers and cannot access desktop computers in locked-down public spaces such as libraries.

3. **Inefficient request processing.** Back-end processing is often manual, labor intensive, and fraught with bottlenecks. For example, many states still use mailers to verify loss of employment, delaying processing by at least a few days. In addition, most states' aggressive antifraud stance means that even simple inconsistencies in an application—writing “Street” instead of “St.,” for instance—can trigger enhanced validations and delay cases.
4. **Lengthy and opaque service-delivery timelines.** Largely because of process traps, claimants can wait for weeks or even months to receive their benefit checks. During this period, their application status is often unclear or

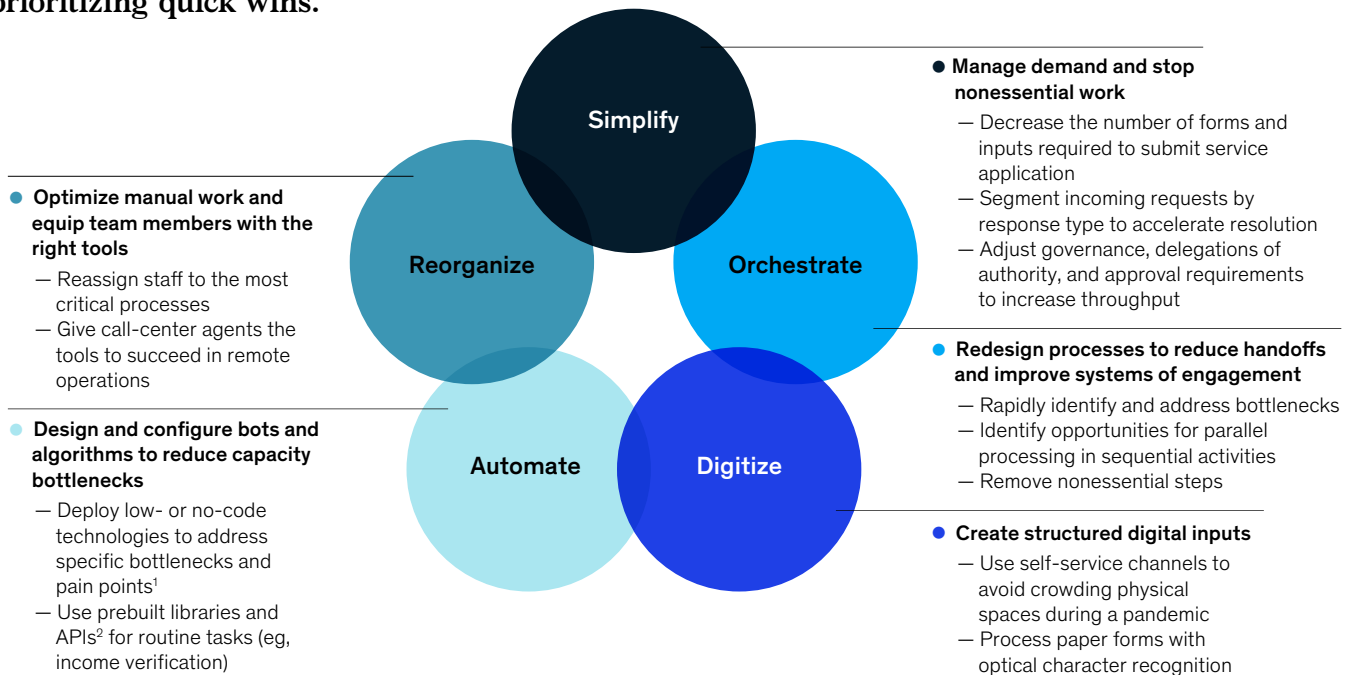
unavailable. Indeed, a claimant might not know that an application is incomplete or erroneous—and therefore not progressing.

Yet the public is depending on unemployment programs to meet the challenge. Unemployment assistance is one of the few immediately available financial lifelines, not only for residents in need but also—in a massive economic event such as the COVID-19 pandemic—for local economies. For a local economy, unemployment insurance has the potential to inject far greater stimulus than the individual assistance in the federal relief package given the level of support per person. In the face of these challenges, states could consider five levers to identify and address bottlenecks and rapidly deliver benefits to residents (Exhibit 2).

Critically, each of these levers can have a tangible impact within days or weeks, enabling states to weather surging demand (to see what states could accomplish immediately, see sidebar, “Easing service backlogs within 24 hours”). Taken together,

Exhibit 2

**To address these challenges, governments can use five mutually reinforcing levers while prioritizing quick wins.**



<sup>1</sup>Low- and no-code technologies include robotic process automation, robotic desktop automation, business process management, and automated machine learning.  
<sup>2</sup>Application programming interface.



## Easing service backlogs within 24 hours

**Some states** might not have time and resources to implement all recommendations (exhibit).

However, every state can accomplish the following tasks, which will more easily match residents to unemployment benefits:

- Adapt eligibility guidelines to reflect new federal and state permissions.
- Encourage employers to submit batch applications on behalf of their employees if the system allows it.
- Smooth demand with tactics such as assigning different times of day for different groups to apply.
- Prominently display links to file claims on web pages.
- Reallocate capacity from other departments to unemployment benefit-related tasks.
- Sort and assign cases based on complexity to maximize processing speed.

Exhibit

### An array of immediate, short-term, and medium-term actions can help states ensure services reach their most vulnerable residents.

	S Simplify	O Orchestrate	D Digitize	A Automate	R Reorganize
Time to impact	Drive awareness	Receive requests	Process requests	Deliver service	
<b>Immediate</b> (<24 hours)	<ul style="list-style-type: none"> <li><b>S</b> Adapt eligibility guidelines to reflect new federal and state permissions</li> <li><b>O</b> Update online FAQs to reflect eligibility changes</li> </ul>	<ul style="list-style-type: none"> <li><b>O</b> Implement measures to smooth demands (eg, assigning daily time slots for different groups to file)</li> <li><b>O</b> Redesign website landing pages to front-load links for filing claims</li> <li><b>R</b> Plan and launch rapid hiring event</li> <li><b>A</b> Communicate anticipated wait times to applicants</li> </ul>	<ul style="list-style-type: none"> <li><b>R</b> Redeploy capacity from other departments to process claims</li> <li><b>O</b> Implement rapid triage protocols to sort and assign cases based on complexity</li> </ul>	<ul style="list-style-type: none"> <li><b>D</b> Transition in-person touchpoints with applicants to the web or phone</li> </ul>	
<b>Short term</b> (1–2 weeks)	<ul style="list-style-type: none"> <li><b>O</b> Integrate information on services in communications related to COVID-19</li> <li><b>O</b> Integrate communications to make residents aware of all available state services</li> </ul>	<ul style="list-style-type: none"> <li><b>R</b> Establish digital continuity team to respond to crash events</li> <li><b>O</b> Pilot process to batch requests to smooth demand on servers</li> <li><b>R</b> Work with vendors to maximize surge capacity</li> <li><b>R</b> Maximize remote working in call centers to support physical distancing</li> </ul>	<ul style="list-style-type: none"> <li><b>O</b> Move toward automatic conditional approval to process initial claims and implement ex post fraud prevention</li> </ul>	<ul style="list-style-type: none"> <li><b>A</b> Build conversational chatbot to handle most common servicing requests (eg, change of address, status checks)</li> <li><b>R</b> Partner with local firms to support delivery of benefits</li> </ul>	
<b>Medium term</b> (3–4 weeks)	<ul style="list-style-type: none"> <li><b>S</b> Determine steady-state eligibility rules for duration of COVID-19 pandemic</li> <li><b>D</b> Optimize web traffic for services to ensure proper routing</li> </ul>	<ul style="list-style-type: none"> <li><b>D</b> Build surge capacity into network and other tech systems for the long term</li> <li><b>D</b> Develop aspirational plans for full digital journey transformation</li> <li><b>O</b> Add triaging functionality to call-centers' interactive voice response systems to reduce unnecessary call volumes</li> </ul>	<ul style="list-style-type: none"> <li><b>A</b> Automatically triage requests</li> <li><b>O</b> Recalibrate fraud detection mechanisms to improve throughput</li> </ul>	<ul style="list-style-type: none"> <li><b>D</b> Lay groundwork to fully digitize service provision (eg, providing funds electronically rather than with physical card)</li> </ul>	

these levers help set the stage for fundamental process redesigns—rather than mere incremental improvements.

**Simplify** centers on managing demand and stopping nonessential work. This could be as simple as taking a few hours to execute a governance change that decreases bottlenecks during processing. For instance, several states have revised their eligibility requirements to increase throughput of applications. In addition, states could fast-track claimants who are most likely to qualify for benefits and consider relaxing requirements that might not be worth the incremental complexity. These decisions require careful cost–benefit analysis but could be quite impactful.

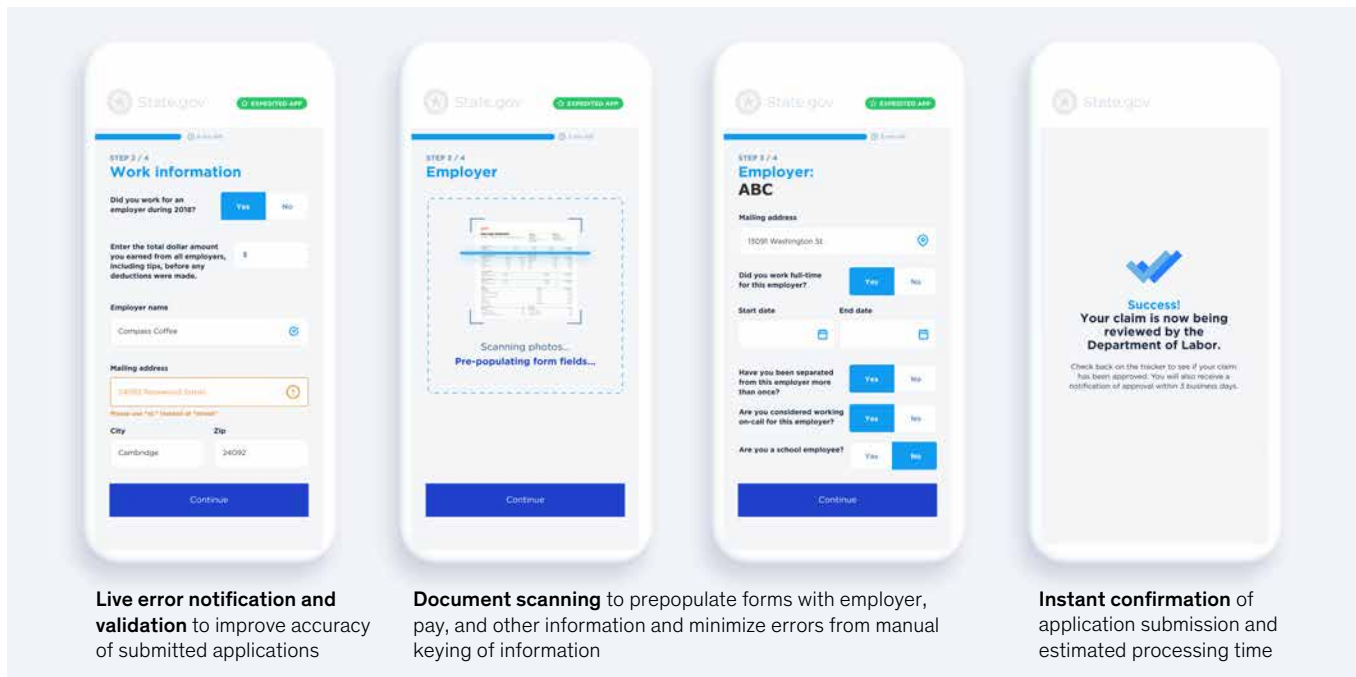
**Orchestrate** refers to redesigning processes to reduce handoffs and bypass bottlenecks. Some shifts could be simple—for instance, expediting straightforward claims in batches. Others could

require more legwork, such as moving toward automatic approval for initial claims that meet certain conditions. States can significantly shorten processing time by making end-to-end processes leaner; a virtual “process war room” can help rapidly identify and act on opportunities for improvement. Indeed, multiple states are already expediting claims by waiving requirements such as seven-day waiting periods and employment-search verifications.

**Digitize** enables states to make significant front- and back-end changes to improve user interaction, enhance data clarity, and streamline workflows—ushering in a completely reinvented process, which is especially relevant given the implications of physical distancing during a pandemic. At the same time, a cloud-hosted model increases the ability to handle surge volumes more easily, web pages updated with simple directions and FAQs improve application quality, optical character recognition scans forms rapidly and automatically, and

Exhibit 3

### The ideal user interface should be intuitive, mobile-optimized, simple, and clear.



Note: This is an illustrative example, not reflective of a current offering.

dashboards track productivity in real time (Exhibit 3). State unemployment program leaders will need to work closely with state or department chief information officers to incorporate considerations such as security and coordinate on procurements, but this lever has significant potential to support physical-distancing efforts by enabling both residents and state employees to avoid physical locations.

**Automate** refers to techniques such as targeted deployment of low- and no-code technologies (for example, robotic process automation, robotic desktop automation, and chatbots) to rapidly address holdups (such as common errors in forms) and updates for residents on the status of their applications by text or phone. Although these investments can take longer to implement, they can significantly decrease backlog as well as the burden on state staff while efficiently administering services. With staff already overwhelmed, gathering their input to automate processes will require creativity. Work sprints that minimize time commitment from staff and tap former department employees who are not actively responding to the crisis can generate useful input without burdening staff.

**Reorganize** focuses on people—deploying and upskilling workers to efficiently work through the

backlog. In the short term, supporting employees and making sure they can effectively work from home can improve output. Over time, reallocating capacity to the area of greatest need, training agents in customer service, and ensuring consistency can sustainably increase productivity. For example, a midwestern state has redeployed staff from less-utilized services to meet demand at its unemployment call center.

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While state unemployment systems have never seen such a surge in volume, our experiences with governments in crisis situations suggest that states can use these tactics to overcome the present challenge. After all, one federal agency achieved a tenfold increase in claims throughput after a natural disaster.

Unemployment benefits is the first of many services to see a spike in demand. States can invest in interventions that will remove process bottlenecks today, increase readiness for the surge that is likely to come, and lay the foundation for broader, longer-term transformational change. States that transform the way they deliver services can improve the likelihood that critical resources reach their most vulnerable residents.

**Ramsey Fahs, Nehal Mehta, and Rachel Riley** are consultants in McKinsey's Washington, DC, office, where **Sarah Tucker-Ray** is a partner; **Jim Pallotta** is a consultant in the Atlanta office; **Hrishika Vuppala** is a partner in the San Francisco office; and **Rob Whiteman** is a partner in the Chicago office.

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# Reimagining retail

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# Reimagining stores for retail's next normal

At some point, retail stores will reopen—but unless apparel and specialty retailers redefine the role of the store and revamp store operations, they will be ill prepared for the post-COVID-19 future.

*by Praveen Adhi, Andrew Davis, Jai Jayakumar, and Sarah Touse*



**As the COVID-19 pandemic erupted**, hundreds of thousands of stores across the United States shut their doors, unsure as to when they would reopen. Retail workers have been furloughed or laid off en masse, causing widespread economic pain and deepening the devastation of an unprecedented public-health crisis.

At some point, stores will reopen and people will return to work, as evidenced in countries like China where the pandemic has passed its peak. The timing is uncertain and will differ across US markets, but what's certain is that stores can't simply pick up where they left off. COVID-19 has changed consumer behavior, perhaps permanently, and retail stores will need to take these new behaviors into account.

To maximize their potential when they emerge from the crisis, retailers must factor in the realities of the post-coronavirus world. In this article, we share a perspective on the trends that will affect US apparel and specialty retail stores postcrisis and the strategic imperatives that will enable them to thrive in the "next normal."<sup>1</sup>

## **How the crisis has changed consumer behavior**

Consumers have altered their shopping and buying behavior during the pandemic. For one, loss of income and declining consumer confidence have driven decreases in discretionary spending. In an April 6–12 survey of US consumers, 67 percent of respondents said they expect to spend less on apparel in the near future than they typically do.

A potentially longer-lasting behavioral change is the accelerated adoption of e-commerce. Even before the pandemic, consumers were increasingly browsing and buying online. In the recovery period, retailers could see spikes in online shopping even in categories that in the past were primarily store-based (such as makeup). It's also possible that

e-commerce will attract consumer segments that previously preferred to shop offline, such as baby boomers and Gen Zers. Post-pandemic, apparel executives expect up to a 13 percent increase in online penetration, according to a survey we conducted in early April. Indeed, retailers in Asia—where precrisis online penetration was much higher than in the United States—are expecting a "sticky" increase in online penetration of three to six percentage points as they reopen stores.

These trends will shape the industry's next normal and could have profound implications on a retailer's P&L. Store sales could plummet, fiercer competition and increased operational complexity due to workforce disruptions could contribute to margin compression, and the migration of sales from stores to e-commerce (typically a lower-margin channel for retailers) could further hurt profitability. To illustrate: if online penetration increases by ten percentage points and gross margin falls by one percentage point, driven by increased pricing pressure, retailers could expect store profitability to decline by up to five percentage points (exhibit). A hit to profitability of this magnitude could push a significant number of brick-and-mortar stores into loss-making territory.

In short, the coronavirus crisis has escalated the case for change for retail stores into a proverbial "burning platform." We urge retailers to prepare for the next normal by taking decisive action now. Forward-thinking retailers will redefine the role of their stores, streamline store operations, and reevaluate their store networks.

## **Strategic imperatives to prepare for the next normal**

To survive and thrive in the post-coronavirus world, apparel and specialty stores must fundamentally change how they operate on both sides of the P&L. We see three strategic imperatives for simultaneously improving the top line and the bottom line:

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<sup>1</sup>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.



Exhibit

## If online penetration increases by ten percentage points, many stores could become unprofitable.

Post-COVID-19 store profitability,<sup>1</sup> % of revenue, illustrative



<sup>1</sup> Illustrates impact of a ten-percentage-point increase in online penetration.

### Radically accelerate in-store omnichannel integration

Unless stores offer consumers a compelling value proposition, store traffic—which was already thinning in pre-coronavirus times—will slow to a trickle. Consumers are now accustomed to staying home for weeks at a time and buying a wide range of products online. In the future, they won't visit stores unless retailers give them good reason to.

Retailers must therefore gain a deep and up-to-date understanding of customer preferences, envision a new role for their stores in light of these preferences, and execute surgical changes to store formats and in-store customer experience.

During the crisis, physical distancing and stay-at-home mandates compelled retailers large and small to launch omnichannel initiatives, with even mom-and-pop stores offering contactless curbside

pickup. In-store omnichannel integration will become "table stakes" in the next normal. In our survey of US apparel executives, 76 percent said they plan to improve omnichannel integration in stores.

To jump-start this integration, retailers could consider the following actions:

- **Redefine the role of the store.** More than ever, stores need to offer unique customer experiences instead of simply serving as transactional venues. To better cater to changing customer preferences in the next normal, stores should seek to deliver a superior product-discovery experience and provide access to exclusive merchandise (for example, through "in store only" and "in store first" product launches).

# When stores reopen, retailers can't expect a seamless return to pre-coronavirus norms. They will need to reset stores' cost structures and prepare their workforce for the next normal.

- **Offer omnichannel fulfillment basics.** To meet rising customer demand for contactless fulfillment options, retailers should introduce curbside pickup and “buy online, pick up in store” (BOPIS) features and continuously improve the execution of these services.
  - **Build an omnichannel staff.** Retailers should invest in training and equipping store associates to engage with customers online, so that store staff can guide customers at the start of the product-discovery journey and interact with them postpurchase. Retailers with a truly omnichannel mindset could also reward store associates for influencing online sales in local zip codes.
  - **Enable personalization of in-store touchpoints.** If store associates have access to customer data generated both offline and online (for example, data on loyalty and purchase behavior across channels), they can tailor their customer interactions accordingly. Even customers that start and end their journeys online can then receive personalized attention in stores.
- 1. **Reset store cost structure**

Retailers may find that they need to deliver 20 to 30 percent improvement in store productivity to compensate for the channel shift away from physical stores. To achieve this, they will need to relentlessly simplify store operations and rebalance the allocation of store costs to support the increasing volume of in-store omnichannel activities.
  - **Shift complexity upstream.** To support stores with reduced postcrisis staffing levels, store-operations leaders should collaborate with the merchandising function to reset store-replenishment frequency and minimum stock levels to reflect postcrisis sales and traffic in stores. In addition, distribution and sourcing teams can potentially find ways to shift certain tasks (such as price tagging and labeling) away from stores and to distribution centers or, where possible, vendor locations.
  - **Rapidly digitize and automate non-value-added work.** Retailers should digitize and automate in-store activities, where possible, to free up associates for higher-value work. This includes automating labor scheduling, expanding the use of self-checkout and mobile checkout, and providing remote-management tools for store and field managers.

## Reimagine store operations to reflect the new reality

When stores reopen, retailers can't expect a seamless return to pre-coronavirus store-operations norms. They will need to reset stores' cost structures and prepare their workforce for the next normal.

- **Improve omnichannel touchpoints.** Retailers might consider, among other options, dedicating staffing for ship from store, redesigning BOPIS processes, improving inventory management, and working with the supply-chain function to reduce the end-to-end cost of fulfilling orders.
- **Introduce contactless self-serve features for omnichannel transactions.** Over the past few weeks, consumers have increased their adoption of contactless services in retail sectors such as grocery. There's a good chance they will continue to demand similar experiences in other brick-and-mortar settings even after the pandemic. Retailers should consider providing contactless self-serve options for online order pickups, price checks, and returns management. (We've found, for example, that 60 to 70 percent of the typical retailer's returns process can be digitized.)
- **Improve training and onboarding.** Digital learning tools can help facilitate training outside the traditional store or classroom settings. Microtrainings—which consist of a series of short, focused learning modules often delivered through rich media formats—can serve as an effective training approach to accelerate onboarding and improve retention. Store processes, including sales effectiveness, visual merchandising, and price and promotion management, could be ideal candidates for microtraining initiatives.
- **When rebuilding store teams, rethink workforce composition.** The lasting effects of the crisis call for a reevaluation of store-associate roles, expected skills, minimum staffing levels, and other aspects of team composition. Retailers may need to upskill store associates to achieve the required digital fluency and cross-train employees to optimize the number of distinctive store roles.

## 2. Prepare the workforce for the next normal

The pandemic has caused dramatic disruption in the retail frontline workforce. In our survey of apparel and specialty-retail executives, 75 percent indicated that their companies have either furloughed or laid off store associates since the crisis began. During the recovery, retailers should shape their future workforce to support the evolving role of the store and should improve workforce flexibility to prepare for potential recurring virus-related disruptions.

- **Retain pre-COVID-19 talent.** Given the scale of furloughs and layoffs (some retailers have furloughed all store associates), retailers risk losing some of their high-performing associates for good. One way to minimize this risk would be to stay in touch with furloughed store associates and provide regular updates on store reopening plans and timelines. Retailers can use a variety of digital tools to conduct online huddles and one-on-one check-ins or to issue periodic newsletters. They might also consider redeploying store associates to fill omnichannel roles as they wait for stores to reopen.

- **Improve workforce flexibility.** Retailers should increase the agility of their workforce models to manage any potential future virus-related disruptions and to better respond to changes in store traffic. This could include enabling employee mobility across stores and incorporating “gig” workers into the store workforce.

### Optimize the store network based on omnichannel performance

Retailers had been rightsizing their store network even before the COVID-19 crisis—but the pandemic has heightened the urgency for them to have a clear vision of their future-state network. In our survey, 53 percent of respondents said they expect to close underperforming stores in the aftermath of COVID-19.

Retailers should incorporate their future-state vision into their store reopening plans. To do this right, they must make network decisions based on an omnichannel perspective of long-term store

performance. The traditional way of looking only at “four-wall economics” is outdated because it doesn’t account for the role that a store might play in generating e-commerce sales. To better understand a store’s true economic value, a retailer should modify the store P&L to include its e-commerce halo—for example, by ensuring that the store “gets credit” for e-commerce sales in the local zip code. A forward-looking omnichannel view of each store’s performance should incorporate postcrisis traffic projections and the retailer’s envisioned role for the store.

A retailer can then develop a future-state vision for its store network. Outcomes from this exercise might include accelerating store-closure plans, particularly for stores with a pending exit opportunity; choosing not to reopen stores with expected low productivity;

accelerating rent negotiations and footprint rationalization for stores that are essential but underperforming; and adding network nodes (either stores or distribution centers) in areas where the retailer lacks omnichannel coverage.

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Apparel and specialty retailers should be prepared to open their stores as soon as regulatory restrictions are lifted. Of course, employee and customer safety will continue to be the top priority. At the same time, retailers can lay the foundation to thrive in the next normal—and once again become a source of livelihood for millions—by proactively planning the comeback using a P&L lens, paying close attention to both sales and profitability.

**Praveen Adhi** and **Andrew Davis** are both partners in McKinsey’s Chicago office, where **Jai Jayakumar** is a consultant; **Sarah Touse** is an associate partner in the Atlanta office.

The authors wish to thank Colleen Baum and Althea Peng for their contributions to this article.

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# What food retailers should do during the coronavirus crisis

The food-retail industry plays a critical role in these uncertain times. Here are six actions food retailers should take to help their communities, their employees, and their business.

*by Bill Aull, Dymfke Kuijpers, Alex Sawaya, and Rickard Vallöf*



**As of this writing (March 19, 2020),** the epidemiological numbers of COVID-19, caused by the coronavirus, are becoming outdated by the hour. While events are rapidly evolving, a few things are becoming clear:

- The disease is less fatal than SARS, but the transmission rate is one and a half to two times higher than the flu's, with various factors driving the ultimate local fatality rates.
- The virus is located in five major transmission complexes that are in different stages of maturity—with “community spread” getting worse in several of them.
- The impact is very different for every retailer, depending on country, category, and customer mix.

According to McKinsey's March 16 briefing note, two scenarios are most likely: a delayed recovery or a prolonged contraction. Regardless of which scenario plays out, food retailers will need to think ahead and be prepared to act quickly. We are continuously updating our views and keeping a close eye on what retailers are doing, and we plan to share our insights regularly. Clearly, the top priority is saving lives; managing the business is a distant second.

This article recommends six actions that food retailers can take to continue doing what they do best—serve as reliable sources of food and essential items for people across communities worldwide—while also staying calm and executing rigorously in these uncertain times. The first four actions are urgent; the last two are more focused on the long term and thus will likely require the attention of a distinct set of leaders with a different mandate to ensure sufficient focus.

## **1. Protect your employees and customers**

For headquarters staff, the challenges presented by this crisis—working remotely, defining contingency

plans, and maintaining morale—are difficult but manageable, given ample technological solutions. The real heroes are in the field: the cashiers, the shelf stockers, the drivers, the warehouse workers. Food retailers must step up frontline hygiene and limit human contact as much as possible, using as much technology as possible. Several retailers are encouraging self-checkout, minimizing cash payments, stocking shelves only before or after store hours, and having drivers drop off deliveries at doorsteps rather than handing them to customers or going inside homes. Some franchisees have taken extra precautions, such as putting plastic tents around cashiers.

Beyond workplace and store safety, it is crucial to create an environment that fosters social distancing or isolation to protect the vulnerable. We have seen retailers implement paid sick leave for affected employees, free testing, and stay-at-home policies for employees who have colds or are feeling ill. Food retailers must also prepare for worst-case scenarios by, for instance, proactively creating backup plans for the most crucial staff, working in A/B teams, and moving quickly to hire additional flexible capacity. We've seen that the latter often comes at a premium (for example, Amazon is raising wages for hourly workers).

Several retailers have shown positive examples of employee and customer care. Chinese e-commerce giant Alibaba is sending coronavirus-testing kits and protective equipment to other countries. Grocery chains, including Ahold Delhaize and Lidl, are setting aside certain store hours to serve the elderly exclusively (to lessen elderly customers' risk of infection). Other retailers are donating food and essential items to the needy in their communities or offering free meals to healthcare workers and first responders.

## **2. Secure business continuity**

Food retailers must keep the lights on: stores and distribution centers must stay open, employees must continue to work, home deliveries must be made, and customers must be served. This has



proven challenging, especially when schools and childcare facilities are closed. Equally challenging is meeting the enormous (700 percent or more) spikes in demand on e-commerce sites—with the associated struggles of getting enough delivery drivers, giving customers accurate delivery time slots, and keeping the IT systems running.

Food retailers must take the time to listen to customers' most acute needs, and then use those insights to both jury-rig solutions and define new ways to serve customers for the short and medium terms. For example, some retailers have had to flex space allocation radically to accommodate surges in demand (such as dedicating more store space to toilet paper and hand sanitizer); others have switched selected stores entirely to click-and-collect formats to protect both customers and employees. Companies must work with local governments, suppliers, employees, and service providers to develop a set of minimum norms for operating during the crisis. Several retailers have collaborated with local authorities to keep daycare centers open for "essential workers," which food-supply-chain employees certainly are.

### **3. Get a granular view of the local reality**

The pace of recovery from COVID-19—and, consequently, the patterns in consumer demand—vary across countries and categories. Some retailers are facing spikes in demand of up to 800 percent

in over-the-counter cold and flu medicines and between 25 and 50 percent in food items. Within food categories, we've seen consumers in some areas buying fruit over beer—but, after a few days, returning to beer and snacks as they find themselves having to stay home for extended periods of time. Certain store formats—convenience stores, for example—are seeing steep declines in sales, while others (such as the aforementioned e-commerce players experiencing a 700 percent increase in demand) are unable to fulfill customer orders.

Continually staying abreast of what is happening at a detailed, local level will enable food retailers to act appropriately and act fast. Many retailers are setting up some form of a virtual nerve center to control, plan, stabilize stakeholder management, address primary threats rapidly, and mitigate threats' root causes. Financial stress testing and a cash control tower are critical in any crisis.

As food retailers, you are the backbone of the food supply chain, and most of your companies are cash rich—which means that spotting up-front cash issues outside your own company is crucial. Your ability to operate is determined by the weakest link in your supply chain. Some retailers are offering shorter payment terms to keep their suppliers afloat. Meanwhile, other retailers—such as convenience-store chains, apparel retailers, and specialty retailers experiencing forced store closures—are trying to delay payments to manage their own cash. Granularity matters.

**As food retailers, you are the backbone of the food supply chain, and most of your companies are cash rich—which means that spotting up-front cash issues outside your own company is crucial.**

#### 4. Simultaneously manage demand and supply

The crisis has changed what an average grocery basket looks like: the exhibit shows the shifts in demand patterns in Italy. The supply chain is struggling to keep up. To restore the balance, we believe food retailers must simultaneously manage their commercial calendars and supply chains.

To be clear, this is not just a matter of paying close attention to critical steps in the supply chain—such as providing supplier credits, finding alternative sources of supply, pulling in extra shifts, and safeguarding in-store replenishment, warehouses, truck drivers, and last-mile delivery. It is not just a matter of paying extra wages to secure flexible capacity to cover the peaks. These actions are, of course, important to ensure that retailers can fulfill peak demand. But it's just as important to manage consumer demand proactively.

On this front, we have seen both positive actions (CEOs and governments advising consumers to avoid panic buying and hoarding) and abhorrent behavior (online sellers charging exorbitant prices for hand sanitizer and thermometers). We suggest taking a “cleansheet” look at your marketing and promotional calendar and making adjustments, such as reducing promotion intensity in select categories, to smooth out unexpected peaks in the supply chain—not just today but also as a regular practice going forward.

#### 5. Transform your business model to ensure that it is tech enabled and future proof

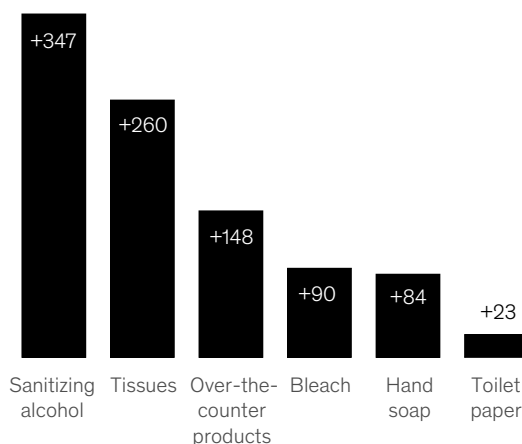
The crisis has accelerated many societal trends that were already under way: remote working, online shopping, tech-enabled retail, and localized supply chains. Even as food retailers address today's short-term challenges, they should

Exhibit

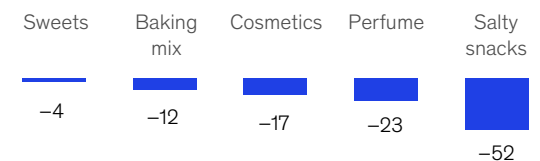
### In Italy, demand patterns shifted dramatically in the period before lockdown.

Shift in purchasing behavior in Italy,<sup>1</sup> % change

#### Cleaning and safety products



#### Discretionary products



#### Raw materials and long-shelf-life products



<sup>1</sup>Data from day of 1st "red zone" declaration (Feb 23, 2020) to day before full lockdown (Mar 11, 2020) compared with data from same period in 2019.

Source: GfK survey, March 2020, gfk.com

take the time to rethink their business models to become more efficient—and, therefore, less exposed to shocks:

- **Stores.** Can you make your store model cashless or virtually cashless? Can you replace the cashier-based model with a seamless no-checkout model? Are you using data to measure on-shelf availability in real time? Are you automating replenishment?
- **Supply chain.** Are you embracing technology sufficiently in warehousing and transportation to reduce the burden on labor? Have you adopted machine learning in your forecasting so that you can spot abnormalities fast and adjust immediately?
- **Merchandising.** Are your merchants equipped with the technological tools to run their categories “customer back” and remotely? Have you diversified sourcing sufficiently to derisk future shocks? Are there reasons for you to pursue more vertical integration or more strategic partnerships? In light of the latest consumer trends, are you striking the right balance between local and international partnerships? Should you expand your position in private labels in the face of potential GDP adversity and customers’ quest for value? Or, put another way, should you introduce more private labels with a diversified but primarily local supplier mix?
- **E-commerce.** Can you accelerate investments in a seamless online-to-offline experience and proactively shift spending to your online channel, in a model that serves the customer better and is sustainable over the long term? Do you have a scalable technological backbone and delivery network to flex up and down as needed?
- **Head office.** Can you transform your head office into a flexible, remote-working team supported by tech and data? Are your systems

able to handle the increased load and cybersecurity issues that come with distributed remote work?

## 6. Boldly reshape your ecosystem, including through M&A

Experience teaches us that crises typically trigger new avenues for growth and M&A. What moves can you make now to serve your customers, your employees, and your stakeholders better for the longer term? Which growth avenues could you pursue?

As highlighted by the more than 150 profit warnings in recent days, many companies are struggling. Very few of them are food retailers. Are there companies you could potentially partner with to keep them afloat while providing yourself with an opportunity to grow into adjacencies (such as food service)? Is there room to expand your footprint and find new franchise models in the aftermath of the crisis? Are there moves along the value chain and ecosystem, such as vertical integration, services, or payments, that have become more attractive? What partnerships or acquisitions, such as tech companies and tech talent, could you pursue now that were perhaps more difficult before? The answers will be specific to your country, your categories, and your customer positioning—but the opportunity to reset the strategic game board is substantial, particularly for companies that are cash rich and growth poor.

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We have full confidence in food retailers’ ability to handle this crisis. In every country, you—as leaders in the food industry—are crucial to the health and well-being of the population, both today and in the future. The actions we’ve outlined here can help you and the other leaders in your organization navigate this current crisis, as well as build and strengthen your business for the longer term.

**Bill Aull** is a partner in McKinsey’s Charlotte office, **Dymfke Kuijpers** is a senior partner in the Singapore office, **Alex Sawaya** is a partner in the Hong Kong office, and **Rickard Vallöf** is a partner in the Oslo office.

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# Delivering when it matters: Quick-service restaurants in coronavirus times

The pandemic has hit many quick-service restaurants hard. Here's how they can respond to the crisis and prepare for what comes next.

*by Sabine Becker, Stacey Haas, Eric Kuehl, Ignacio Marcos, and Kumar Venkataraman*

**With much of the world's population** being asked or required to stay home and follow physical-distancing guidelines, once-bustling restaurants and cafés now sit empty. Although a few quick-service restaurants (QSRs) are seeing heightened demand in takeout and delivery—several US pizza chains, for instance, are hiring thousands of workers as orders spike—most other QSRs have experienced dramatic sales declines. Some have closed their doors for good.

The coronavirus pandemic is a humanitarian crisis whose economic impact will almost certainly be severe as well. As our colleagues wrote in a recent article, “The required ‘lockdowns’ of the population and other efforts to control the virus are likely to lead to the largest quarterly decline in economic activity since 1933.” They expect an unprecedented 40 to 50 percent decline in discretionary spending—a roughly 10 percent reduction in GDP.<sup>1</sup> (See [McKinsey.com/coronavirus](https://www.mckinsey.com/coronavirus) for our most up-to-date insights.)

The QSR industry has been hit particularly hard. A few restaurants have already declared bankruptcy; others report that they soon won't be able to cover their rent and personnel costs. In the United States alone, up to seven million restaurant workers could lose their jobs by June, according to the National Restaurant Association.

Undeniably, QSRs face tough decisions in the coming weeks and months. But some QSRs will fare better than others, depending on their starting point and the actions their leadership teams take. This article lays out a series of practices—critical for “navigating the now,” planning the comeback, and shaping the future—that can help QSRs not just survive the current crisis but also position themselves to succeed in the “next normal.”<sup>2</sup>

## COVID-19's impact on consumer behavior

In many countries, QSRs are either closed entirely or operating on a limited basis, offering only

takeout, pickup, delivery, drive-through, or some combination of those options. Even among QSRs that remain open, the drop-off in business has been steep. Consumer-sentiment surveys that McKinsey conducted in late March across Europe and the United States indicate that during the crisis, most consumers expect to reduce their spending on all restaurant food—takeout and delivery, QSRs, and other types of restaurants.

Meanwhile, in China, where physical-distancing restrictions have already been loosened, consumer-sentiment surveys reveal the following three trends (exhibit) that could play out in other geographies as well:

- Postcrisis spending on in-restaurant dining is expected to be lower than precrisis levels, largely because consumers will still be wary of being in densely populated public spaces.
- Demand for takeout is expected to return to precrisis levels fairly quickly.
- After the pandemic, consumers will likely spend more on food delivery, prepared foods, and groceries than they did before the pandemic. Again, because of financial strains and lingering concerns about eating in crowded places, consumers will likely continue to prefer eating at home, at least for a time.

The specific challenges each QSR faces during this crisis are unique, depending on the company's financial and market position and the pandemic's timing and progression in local markets. But every company can take inspiration from what some of its counterparts around the world are doing.

## Actions to consider, both for now and for later

Drawing on lessons from the past several weeks, we have identified a set of actions for QSR executives to consider during these challenging times.

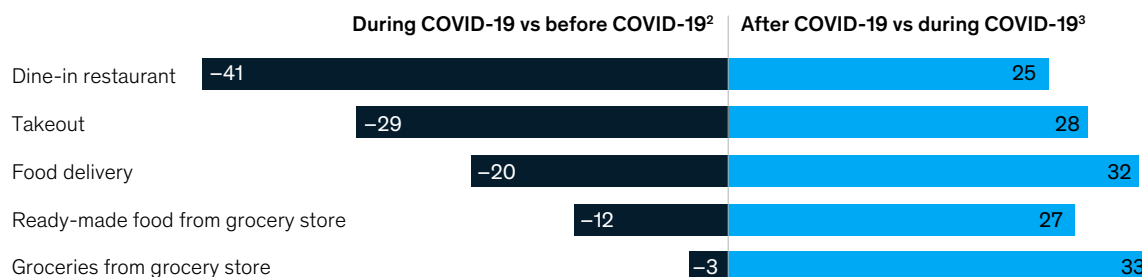
<sup>1</sup> Kevin Buehler, Arvind Govindarajan, Ezra Greenberg, Martin Hirt, Susan Lund, and Sven Smit, “Safeguarding our lives and our livelihoods: The imperative of our time,” March 2020, [McKinsey.com](https://www.mckinsey.com).

<sup>2</sup> Shubham Singhal and Kevin Sneader, “Beyond coronavirus: The path to the next normal,” March 2020, [McKinsey.com](https://www.mckinsey.com).

Exhibit

## The accelerated shift to grocery and food delivery could persist after the COVID-19 crisis.

Change in spending preference, China, net intent<sup>1</sup>



<sup>1</sup> Net intent is calculated by subtracting the % of respondents stating they expect to decrease spend from the % of respondents stating they expect to increase spend (total respondents, n = 611; sampled and balanced to match China general population aged 18–65 years).

<sup>2</sup> Question: How has your spending per month changed during the COVID-19 outbreak compared with before the COVID-19 outbreak?

<sup>3</sup> Question: How do you expect your spending per month to change after the COVID-19 outbreak compared with now (during the COVID-19 outbreak)?

Source: McKinsey COVID-19 Survey (mobile), Mar 21–23, 2020

### ‘Navigate the now’: Short-term priorities

While QSRs should stay abreast of how the situation evolves, they should take immediate action in certain critical areas. Short-term priorities for QSRs during the crisis include the following:

#### Protecting employees and customers

By now, most QSR players have established new health and safety processes and policies to protect employees and customers. Some of the practices QSRs have implemented include adjusting travel policies to permit only the most critical business travel, encouraging or requiring remote working for corporate staff, and amending sick-leave policies for employees affected by COVID-19. QSRs have also adjusted their onsite offerings to follow local and national guidelines—for example, by shutting down self-serve prepared-food counters, suspending all customer events, and switching to a delivery-only model.

With regard to hygiene and safety, QSRs have instituted strict protocols, such as providing hand sanitizer and thermometers and training employees

to minimize human contact. In addition, most QSRs have increased the frequency and rigor of in-store cleanings, making sure to sanitize high-touch areas (such as counters, self-checkout screens, and door handles on coolers and freezers).

#### Safeguarding the top line

Despite physical-distancing regulations, restaurants can continue to generate sales. In localities that prohibit on-premise dining, QSRs have ramped up their takeout and delivery capabilities and adopted new marketing tactics to reach consumers who may not actively be searching for these services.

- **Doubling down on the online channel.** Many QSRs that built their own online-ordering mechanisms on their websites or mobile apps are working to make sure these can handle an increase in demand. Meanwhile, companies that don’t have their own online capabilities are partnering with call centers, delivery aggregators, and other third-party providers—though serving customers through



# A return to previous demand levels won't happen right away, so QSRs will need to take a phased approach to bringing back labor, dine-in operations, and supply-chain support.

such partnerships yields significantly lower margins (because aggregators, for instance, typically take 25 to 30 percent of the value of each transaction). In either case, restaurants are finding that they need to expand their delivery fleets. Some are reassigning in-store employees to assist with delivery operations.

- ***Simplifying kitchen operations while meeting customers' changing needs.*** During this crisis, consumers have become more willing to have a broad array of food products delivered to their homes. For example, beverages, bread, and fruit—products that consumers have historically preferred to consume in restaurants or buy in grocery stores—now increasingly appear in restaurant-delivery orders. Some restaurants are therefore expanding their delivery menus, giving customers more choices in both fresh and prepared foods and even, in some cases, offering meal kits that customers can put together at home. However, QSRs recognize the need to simplify their operations to avoid putting further stress on an already-strained workforce. They are therefore striving to meet new consumer needs without making kitchen operations more complex.
- ***Sending targeted customer communications.*** Communicating with customers is especially important for QSRs during this time, as restaurants face increased competition from

home cooking. With people spending almost all their time at home, QSRs are shifting their marketing spend to home-based channels, such as TV or online, and from sports channels to news outlets. They are also securing preferred placement in food-delivery apps. In addition, some QSRs are engaging with trade associations and industry experts to ensure the appropriateness and accuracy of their marketing messages (for instance, in ads emphasizing safety of food delivery or takeout).

## **Stabilizing the supply chain**

Restaurants need a reliable supply chain—not just for food ingredients but also for essential supplies to keep the business running: disposable paper goods (such as napkins and food cartons), cleaning products, spare parts for the vans and motorbikes used for food deliveries, and so forth. To minimize the risk of disruption in the supply chain, QSRs are taking a range of actions, such as limiting menus to match what they can predictably source, substituting frozen products for fresh products when necessary, revising purchase orders to align with demand, identifying alternate suppliers, and collaborating with manufacturers to create contingency plans. To support small and midsize suppliers that might be struggling during the crisis, some cash-rich QSRs are adjusting payment terms or offering temporary loan options. A handful of forward-thinking QSRs are also taking advantage of historically low commodity prices (of oil and chicken,

for instance) by purchasing ahead where possible or by pre-booking freight capacity.

### Managing cash

Most QSRs can expect to generate only a small fraction of their normal revenues for the foreseeable future, so cash management is a clear priority. Some QSRs have established a “cash lab”—a central team with full visibility into cash forecasting and optimization. The cash lab stays on top of regulatory developments in each market so that, where appropriate, the company can receive government aid, benefit from tax deferrals or credits, or apply for federal loans as quickly as possible.

To conserve cash, QSR leaders are postponing or renegotiating rent payments, deferring noncritical indirect spend and capital expenditures, and reducing personnel costs through hiring freezes and efforts to take advantage of government-funded programs, such as Germany’s *Kurzarbeit*, or “short-time work” wage subsidy. In addition, they are preparing clear and detailed messages for investors about their plans for generating cash and the timing of those initiatives.<sup>3</sup>

### Modeling a range of scenarios

When will people start eating in restaurants again? The answer will be different everywhere—but we expect the mandated closures to extend beyond the dates originally announced, at least in Europe and the United States. And we expect that, for health and safety reasons, restaurant dining rooms will be among the last businesses that will be allowed to reopen. The timing of recovery will also vary by country. We see China recovering ahead of many western countries including Italy and the United States.

For QSR players with locations in multiple markets, one crucial exercise is to model three-month, six-month, and 12-month scenarios for each market and to develop concrete action plans for every scenario. If, for instance, restaurants remain shut in six

months’ time, QSRs may need to reduce fixed costs drastically by renegotiating leases and credit terms or by selling real estate. If restaurant closures last even longer than six months, some companies may need to seek new lines of credit, divest business units, or even put themselves up for sale.

Ideally, this kind of scenario modeling and contingency planning will be among the responsibilities of a COVID-19 nerve center—a cross-functional team that has access to real-time data on how the situation is evolving. This team helps ensure that company leaders are aligned on the scenarios as well as on the portfolio of actions for each scenario.<sup>4</sup>

### Plan the comeback: Medium-term actions

As stay-at-home mandates begin to lift and restaurants reopen, QSRs will need to have plans in place to capture returning demand. A return to previous demand levels won’t happen right away, so QSRs will need to take a phased approach to bringing back labor, dine-in operations, and supply-chain support.

In the immediate postcrisis period, we see QSR companies choosing between two sets of strategic actions, depending largely on each QSR’s financial and competitive position. Companies with low liquidity and weak competitive differentiators would need to pursue “preserve and grow” actions. On the other hand, companies with strong financial fundamentals and competitive advantages can aggressively build on their strengths. QSR companies that entered the crisis from a position of strength will, of course, have more options and greater flexibility in preparing for the recovery.

#### ‘Preserve and grow’

Some QSRs entered the crisis in an already precarious cash position. Broadly speaking, these players tend to have a few attributes in common: a heavy reliance on their brick-and-mortar restaurants, a minimal presence in digital and delivery channels, menus that aren’t sufficiently

<sup>3</sup>Tom Kolaja and Tim Koller, “When investors call: How your business should talk about coronavirus,” March 2020, McKinsey.com.

<sup>4</sup>Mihir Mysore and Ophelia Usher, “Responding to coronavirus: The minimum viable nerve center,” March 2020, McKinsey.com.

differentiated from those of competitors, and limited loyalty programs. They also tend to be more prone to supply-chain instability because of a small and dispersed supplier base.

During the crisis, these companies will be focused on avoiding bankruptcy; they need to find ways of adapting their offerings while conserving cash. But even during the recovery period, cash-poor restaurants will need to keep instilling a cash-conscious culture at all levels of the organization. They'll need to remain vigilant with their spending, in part as a cautionary measure in the event of a resurgence of the coronavirus. For these companies, continuing to create weekly cash-flow projections and to conduct financial-health evaluations regularly across the network will be important. They also should consider renegotiating contracts to increase flexibility—for example, by tying rent to revenue.

At the same time, cash-constrained QSRs should constantly communicate with their customers, particularly their most loyal ones, who will be their best lever for increasing demand once restaurants reopen. To make sure that brand communications are consistently sensitive and will resonate with the customer base, QSRs should run frequent “pulse checks” on consumer sentiment.

And of course, an important “preserve and grow” action for QSRs will be to continue to prioritize hygiene and safety while controlling costs. Companies will need to establish stringent labor processes and schedules in their restaurants; some might consider simplifying menus to further reduce complexity in kitchen operations.

#### **‘Build on strengths’**

Other QSRs, by contrast, entered the crisis with strong liquidity positions. These financially stable companies tend to have well-established digital and delivery channels and strong loyalty programs. Most have invested in the supply chain by building up a stable supplier base and developing contingency plans to minimize supply-chain disruptions in times of crisis.

During the recovery, these companies can accelerate growth by increasing their investments in mobile and delivery solutions, offering value-meal and family-meal promotions, and focusing on occasions that saw the biggest declines during the crisis (such as breakfast on the way to work). They can entice customers to return to on-premise dining with attractive promotions and new menu offerings. They might also consider launching task forces to conduct competitive scans: in some markets, competitors may either be struggling or have closed locations. QSRs could step up their marketing efforts in those areas to capture market share.

Stronger companies can also leverage their cash positions for disruptive moves: they might, for instance, make anticyclical investments, purchase real estate, or acquire distressed competitors, business units, or brands. As QSR companies seek to form partnerships or make acquisitions, they should consider not just economic rationales but social rationales as well—for example, could a particular M&A deal keep another company afloat, save jobs in a struggling community, or strengthen the restaurant industry for the longer term?

#### **Shape the next normal: Long-term considerations**

As the crisis subsides, all QSRs must prepare for the coming shifts, in consumer mindsets and behavior, that will shape the industry’s next normal. The following are some of the changes we believe are possible:

- ***Greater concern about hygiene and safety.***  
Consumers will demand much more information about what ingredients are in restaurant food, where it comes from, how it’s prepared, and by whom. Sanitization will become a significant focus for restaurants; day-to-day operating costs will increase as a result. Food-packaging costs may also rise. Contactless delivery and pickup may become the norm.
- ***Stronger demand for digital and delivery.***  
The competitive landscape in food delivery

will be transformed as QSR players build internal capabilities, invest in next-generation technology (such as delivery drones), or join forces with third-party providers. Loyalty programs will become more robust as QSRs look to increase “stickiness” among customers. Some QSRs may also reformat their locations—for instance, by shrinking seating areas and increasing drive-through capacity.

- ***Shift in spending from QSRs to grocery stores.*** Early signs indicate that some of the shift from spending in restaurants to spending in grocery stores will persist in a post-coronavirus world. To supplement these losses, QSRs can look for additional revenue streams; more QSR players may, for example, consider launching grocery product lines or expanding into new channels, such as B2B catering. In response to lower sales levels, some QSRs may also consider reevaluating their corporate costs, restaurant networks, and franchisee base.
- ***Increased focus on supply-chain management.*** The COVID-19 crisis is exposing weaknesses in many QSR supply chains and highlighting

the importance of flexibility and adaptability. This challenge will galvanize QSRs to invest in supply-chain technology and capacity so that they can better—and more rapidly—align supply with demand. Many QSRs also experienced supply-chain disruptions as a result of labor shortages during the crisis, and that may lead them to accelerate their investments in supply-chain automation.

QSRs need an operating model that can accommodate the extreme level of uncertainty facing the industry. Two practical steps they can take to guide their decision making are to launch a “plan-ahead team” and to direct that team to work across multiple time horizons.<sup>5</sup>

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The QSR business, by definition, is about serving customers at speed. We believe that if QSRs act quickly in this crisis to meet the changing needs of consumers while prioritizing people’s health and well-being, QSRs can not only withstand these difficult times but also build valuable capabilities for resilience and success in the future.

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<sup>5</sup>Yuval Atsmon, Chris Bradley, Martin Hirt, Mihir Mysore, Nicholas Northcote, Sven Smit, and Robert Uhlener, “Getting ahead of the next stage of the coronavirus crisis,” April 2020, McKinsey.com.

**Sabine Becker** is a consultant in McKinsey’s Zurich office; **Stacey Haas** is a partner in the Detroit office; **Eric Kuehl** is a consultant in the Chicago office, where **Kumar Venkataraman** is a partner; and **Ignacio Marcos** is a partner in the Madrid office.

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# Reimagining food retail in Asia after COVID-19

New survey results suggest where, and how, food retailers in Asia might rethink their businesses in the wake of COVID-19.

*by Dymfke Kuijpers, Simon Wintels, and Naomi Yamakawa*

**As the coronavirus pandemic spreads** across the globe, threatening lives as well as livelihoods, it has clarified the vital role that grocery retailers play in society. Consumers expect these businesses to keep them fed and healthy, and groceries remain essential retailers in an uncertain situation that continues to evolve day by day.<sup>1</sup> The short-term priorities for food retailers are clear. They should safeguard the health of employees and customers, maintain business continuity, set up nerve centers to manage their organizations' work on the COVID-19 crisis,<sup>2</sup> and manage demand to align with supply-chain capacity—for example, by reducing the assortment of offerings, rethinking promotions, or introducing new products.<sup>3</sup>

To better understand how COVID-19 is affecting people's behaviors, spending, and expectations, we conducted research with more than 5,000 consumers in Asia, across seven countries.<sup>4</sup> Nearly 70 percent of Thai respondents and 53 percent of Indonesian respondents are very worried about their ability to make ends meet because of the coronavirus. In Australia, China, and South Korea, the figures are lower (between 30 and 41 percent) but still significant.<sup>5</sup>

These countries are in different stages of the epidemic's progression, and their governments have taken different actions to address it. Regardless, the surveys point to signs that some shifts in consumer behavior are similar and could be lasting. These shifts require food retailers to act—and in some cases, accelerate the changes they have already made in response to the crisis—in four areas:

- ***Reimagine safety, health, and the scope of supply chains.*** While there are local differences, consumers across countries appear to care about in-store safety and prefer offerings that are healthy and locally sourced more than they did before COVID-19.

- When shopping, consumers are worried about their personal safety: one in five Australians and more than half of all Thais are afraid to go outside to shop for groceries. What's more, hygiene and cleanliness consistently feature among the top three reasons for positive shopping experiences. Consumers say these same factors will remain important in the next four weeks, as they consider which grocers to go to.
- Consumers report an increased focus on health and well-being in light of COVID-19. In all countries except China and Japan, more than three out of four consumers say they are focusing on boosting their immunity through more exercise and healthy eating. In most countries, we also see an increase in consumption of products that are perceived to be healthy (for example, fresh foods, eggs, dairy, and bottled water) and a drop in purchases of alcoholic beverages and snacks.
- In most countries, consumers also express strong preferences for local brands over international ones, across all categories. For instance, in Australia more than 80 percent say their preference for local brands has increased since before the outbreak began, while in China—a country where foreign brands have had a historically strong reputation—only 43 percent say they have a greater preference to buy from these brands.

To address these consumer shifts, retailers have a clear role to play. They should rethink their offerings and provide healthier, more locally sourced products (including ready-to-eat and ready-to-cook items) with a smaller environmental footprint. To meet rising customer expectations, these companies should also rethink the safety of the customer

<sup>1</sup> Bill Aull, Dymfke Kuijpers, Alex Sawaya, and Rickard Vallöf, "What food retailers should do during the coronavirus crisis," March 2020, McKinsey.com.

<sup>2</sup> For more on nerve centers and crisis response, see Mihir Mysore and Ophelia Usher, "Responding to coronavirus: The minimum viable nerve center," March 2020, McKinsey.com.

<sup>3</sup> For more on the potential impact of the coronavirus on supply chains, see Knut Alicke, Xavier Azcue, and Edward Barriball, "Supply-chain recovery in coronavirus times—plan for now and the future," March 2020, McKinsey.com.

<sup>4</sup> Australia, China, India, Indonesia, Japan, South Korea, and Thailand.

<sup>5</sup> Includes respondents who said "strongly agree" and "agree."



# Consumers appear to care about in-store safety and prefer offerings that are healthy and locally sourced more than they did before COVID-19.

journey, whether it's in-store or via delivery. For example, they can use technologies such as self-checkout and cash-free transactions to reduce risks.

- **Reimagine how technology can enable delivery and the value chain.** The results show that consumers are shifting their food spending online and have yet to return to their normal spending levels for food service. Responses also suggest an opportunity for grocers to digitize their stores.
- Across channels of food purchasing, respondents in most countries report a 30 to 70 percent drop in their preference for dine-in spending<sup>6</sup> and an increase in grocery shopping and purchases of ready-made food in grocery stores, which consumers tend to prefer more than meal delivery from restaurants.
- Across countries, we see the frequency and share of online spending on food increasing by between 16 and 70 percent—and consumers indicate they intend to continue shopping online at this new pace. The only exceptions are in Australia, where online delivery was halted at the country's two largest grocery retailers, and in Japan, where behavior had hardly changed at the time the survey was in the field.<sup>7</sup>

- In all countries, consumers express a preference for self-checkout rather than assistance from cashiers during the coronavirus pandemic. Even in countries like Indonesia, 40 percent claim they will use more self-checkouts in the future.

To respond to the current crisis and meet future ones, food retailers need to use technology in new and different ways to scale up their e-commerce channels and their capacity for home delivery. They can do so by partnering with last-mile players and cold-storage warehouses, which will help them expand home-delivery capacity. Other options are expanding shifts in existing warehouses, using hybrid picking models, and converting a few retail locations into dark stores. Retailers can also use technology to enable their business and support consumers, not only by increasing their self-checkouts but also by looking end to end and considering how technology can make things safer for customers. Both e-commerce improvements and tech enablement will require new capabilities and talent—possibly from other industries—or an investment in reskilling current employees.

- **Reimagine the meaning of value for money.** In past crises, there have been surges in purchases of private-label and value brands. After the 2008 financial crisis, 60 percent of US

<sup>6</sup>The one exception is in India, where consumers reported a 2 percent decline in their preference for dine-in spending.

<sup>7</sup>The survey was in the field from March 23 to 24, 2020, and included responses from 500 participants from 18 to 65 years old.

consumers were more interested in reasonably priced products with core features than in higher-priced, cutting-edge products.<sup>8</sup> Now, the consumers we surveyed expect times will only get tougher.

- As mentioned earlier, people are worried about the pandemic's impact on their personal incomes. In most countries, between 30 and 40 percent of consumers are worried about being able to make ends meet; in Thailand, 70 percent of consumers say so.
- What's more, consumers are willing to forgo future spending. Up to 50 percent of Chinese consumers surveyed say they were planning to give up a future purchase because of uncertainty related to COVID-19.

To address these shifts, food retailers should rethink their promotional calendars to safeguard their marketing spending to use only when it's needed to stimulate demand, either for discretionary products or for postcrisis essentials to meet people's desire for value.

- **Reimagine loyalty.** During the COVID-19 crisis, consumers have been loyal to those retailers and brands who offered essential products in their assortments.
  - Location and availability of goods (often, fresh products) are the primary reasons why consumers have changed stores. In most countries, promotions or pricing has not emerged as a top three reason for switching to different stores.

- Except for in Japan and in South Korea, between 30 percent and 50 percent of customers have shifted from their primary stores, largely based on the availability of fresh food and the location. Depending on the country, up to almost 50 percent (reported by consumers in China) say they have not switched back.
- Except for in Japan and in South Korea, between 30 percent and 70 percent of customers have tried a new brand. Those in China are the most likely across countries to say they have not shifted back to old brands, which 20 percent of consumers there report.

To address this "loyalty shock," retailers should determine which stores are being affected disproportionately by customers shifting to other primary stores. Targeted marketing may help bring these customers back, as would retailers finding a way to better communicate the efforts they are taking to support customers and their societies more broadly, so consumers will be likelier to give them a bit more leeway.

Once food retailers have reimaged their businesses in these four ways, they will be better equipped to provide employment opportunities to people who are currently out of work, reshape their industry ecosystem, and work closely with business partners on how to operate in a new normal. Their mission is broader than meeting consumer demands—it involves supporting the well-being and livelihoods for millions of people.

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<sup>8</sup>Betsy Bohlen, Steve Carlotti, and Liz Mihas, "How the recession has changed US consumer behavior," *McKinsey Quarterly*, December 2009, McKinsey.com.

**Dymfke Kuijpers** is a senior partner in McKinsey's Singapore office, where **Simon Wintels** is a partner. **Naomi Yamakawa** is a partner in the Tokyo office.

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# It's time to rewire the fashion system: State of Fashion coronavirus update

Fashion executives are focusing on crisis management now but eventually must shift to reimagining the industry. How will changes to the global economy and consumers' behavior affect fashion in the postcoronavirus world?

*by Imran Amed, Anita Balchandani, Achim Berg, Saskia Hedrich, Jakob Ekeløf Jensen, and Felix Rölkens*

**Even before the coronavirus** disrupted financial markets, upended supply chains, and crushed consumer demand across the global economy, fashion-industry leaders were not optimistic about 2020. The industry was already on high alert, and executives expressed pessimism across all geographies and price points in our annual report, *The State of Fashion 2020*, released late last year. But fast-forward a few months, and fashion's outlook has gotten dramatically and suddenly bleaker. The industry is now on red alert.

This unforeseeable humanitarian and financial crisis has rendered previously planned strategies for 2020 redundant, leaving fashion businesses exposed or rudderless as their leaders confront a disorienting future and vulnerable workers face hardship and destitution. With this special coronavirus update to *The State of Fashion 2020*, we have taken a stance on what our new normal will look like in the aftermath of this "black swan" event to provide insights (from analyzing surveys, data, and expert interviews) for fashion professionals as they embark on the 12- to 18-month period after the dust settles.

## **The black swan and fashion**

COVID-19 could spur the biggest economic contraction since World War II, hitting every sector from finance to hospitality.<sup>1</sup> Yet fashion, because of its discretionary nature, is particularly vulnerable. The average market capitalization of apparel, fashion, and luxury players dropped almost 40 percent between the start of January and March 24, 2020<sup>2</sup>—a much steeper decline than that of the overall stock market.

Humanitarian repercussions are expected to outlast the pandemic itself. Dire consequences for fashion, one of the biggest industries in the world, generating \$2.5 trillion in global annual revenues before the pandemic,<sup>3</sup> entails joblessness or financial hardship for people across the value chain.

We estimate that revenues for the global fashion industry (apparel and footwear sectors) will contract by –27 to –30 percent in 2020 year-on-year, although the industry could regain positive growth of 2 to 4 percent in 2021 (compared with the 2019 baseline figure). For the personal luxury goods industry (luxury fashion, luxury accessories, luxury watches, luxury jewelry, and high-end beauty), we estimate a global revenue contraction of –35 to –39 percent in 2020 year-on-year, but positive growth of 1 to 4 percent in 2021 (compared with the 2019 baseline figure). If stores remain closed for two months, McKinsey analysis approximates that 80 percent of publicly listed fashion companies in Europe and North America will be in financial distress. Combined with the McKinsey Global Fashion Index (MGFI) analysis, which found that 56 percent of global fashion companies were not earning their cost of capital in 2018, we expect a large number of global fashion companies to go bankrupt in the next 12 to 18 months.

The interconnectedness of the industry is making it harder for businesses to plan ahead. Just as China inched through recovery, outbreaks worsened in Europe and the United States. But it is in the developing world, where healthcare systems are often inadequate and poverty is rife, that people will be hit the hardest. For workers in low-cost sourcing and fashion-manufacturing hubs, such as Bangladesh, Cambodia, Ethiopia, Honduras, and India, extended periods of unemployment will mean hunger and disease.

The crisis is affecting daily lives, instilling anxiety and uncertainty in the minds of almost everyone. Indeed, consumer pessimism about the economy is widespread, with 75 percent of shoppers in Europe and the United States believing that their financial situation will be affected negatively for more than two months.<sup>4</sup>

<sup>1</sup> "UN chief says coronavirus worst global crisis since World War II," France 24, April 1, 2020, france24.com.

<sup>2</sup> McKinsey analysis, based on data from S&P Capital IQ.

<sup>3</sup> McKinsey analysis, 2019.

<sup>4</sup> McKinsey COVID-19 Consumer Pulse Survey: for Europe, held March 20–26, 2020, with 5,614 respondents (France, Germany, Italy, Portugal, Spain, and the United Kingdom); for United States, held March 23–29, 2020, with 1,119 respondents.

Although the duration and ultimate severity of the pandemic remains unknown, it is apparent that the fashion industry is just at the beginning of its struggle. By causing blow after blow to both supply and demand, the pandemic has brewed a perfect storm for the industry: a highly integrated global supply chain means that companies have been under immense strain as they have tried to manage crises on multiple fronts as lockdowns were imposed in rapid succession, halting manufacturing in China first, then Italy, followed by countries elsewhere around the world.

A freeze on spending is aggravating the supply-side crisis. Widespread store closures for an industry reliant on offline channels, coupled with consumer

instinct to prioritize necessary over discretionary goods, hit brands' bottom lines and depleted cash reserves. Even online sales have declined 15 to 25 percent in China, 5 to 20 percent across Europe, and 30 to 40 percent in the United States.<sup>5</sup>


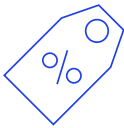

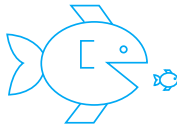

### Once the dust settles

Once the dust settles on the immediate crisis, fashion will face a recessionary market and an industry landscape still undergoing dramatic transformation. The exhibit unpacks five areas that could see significant changes; the full report explores these areas in greater depth. We expect a period of recovery to be characterized by a continued lull in spending and a decrease in

<sup>5</sup>McKinsey analysis, based on data from Amazon and Stackline.

Exhibit

## Five areas of the fashion industry could be particularly affected by the coronavirus outbreak.

Global economy	Consumer shifts		Fashion system	
Survival instincts	Discount mindset	Digital escalation	Darwinian shakeout	Innovation imperative
				
Recovery from the pandemic will coincide with a recessionary market, compelling players to ramp up resilience planning and adapt operating models. Companies surviving the crisis will have made bold, rapid interventions to stabilize their core businesses before seeking new markets, strategic opportunities, and pockets of growth.	As deep discounting plagues retailers for the remainder of 2020, a decade-long buildup of bargain-shopping culture will be exacerbated by a rise in anticonsumerism and cash-strapped consumers looking to trade down or turn to off-price channels. Clearance of overstock will be a priority as brands find ways to regain value and rethink their business missions.	Physical distancing has highlighted the importance of digital channels more than ever, and lockdowns have elevated digital as an urgent priority across the entire value chain, but unless companies scale up and strengthen their digital capabilities in the recovery phase of the crisis, they will suffer in the longer term.	The crisis will shake out the weak, embolden the strong, and accelerate the decline of companies that were already struggling before the pandemic, leading to massive waves of consolidation, M&A activity, and insolvency.	To cope with restrictions, mitigate the damaging impact of the pandemic, and adapt to economic and consumer shifts, companies must introduce new tools and strategies across the value chain to improve operational agility, boost productivity, and future-proof business models.

demand across channels. As noted in our previous articles on “getting woke,” radical transparency, and sustainability first, the consumer mindset was already showing signs of shifting in certain directions before the pandemic.

Now, the resulting “quarantine of consumption”<sup>6</sup> could accelerate some of these consumer shifts, such as a growing antipathy toward waste-producing business models and heightened expectations for purpose-driven, sustainable action. Meanwhile, some of the shifts we will witness in the fashion system, such as the digital step change, in-season retail, seasonless design, and the decline of wholesale, are mostly an acceleration of the inevitable—things that would have happened further down the road if the pandemic had not helped them gain speed and urgency now.

The coronavirus also presents the fashion industry with a chance to reset and reshape the industry’s value chain completely—and an opportunity to reassess the values by which it measures actions. We expect that themes of digital acceleration, discounting, industry consolidation, and corporate innovation will be prioritized once the immediate crisis subsides. Even after witnessing waves of insolvencies, industry leaders will need to get comfortable with uncertainty and ramp up

future-proofing efforts as the potential for further outbreaks and lockdowns loom.

This will also be a time for collaboration within the industry—even among competing organizations. No company will get through the pandemic alone, and fashion players need to share data, strategies, and insights on how to navigate the storm. Brands, suppliers, contractors, and property owners should also find ways to share the burden.

This joint report by the Business of Fashion and McKinsey is an effort to advance the discussion beyond crisis management and immediate contingency planning by outlining the areas in which the fashion industry must focus once the dust settles on the current crisis. Exactly when this will happen is impossible to know for sure, except that it will, in all likelihood, be linked to the discovery of a workable antiviral treatment and delivery of a proven vaccine, which some experts say is at least 12 to 18 months away.

Navigating this uncertainty will not be easy for fashion leaders. Players need to be decisive and start putting recovery strategies into motion to emerge with renewed energy. The crisis is a catalyst that will shock the industry into change—now is the time to get ready for a postcoronavirus world.

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<sup>6</sup>Marcus Fairs, “Coronavirus offers ‘a blank page for a new beginning’ says Li Edelkoort,” *Dezeen*, March 9, 2020, [dezeen.com](https://www.dezeen.com).

**Imran Amed**, the founder, editor-in-chief, and CEO of the Business of Fashion, is an alumnus of McKinsey’s London office, where **Anita Balchandani** is a partner and **Jakob Ekeløf Jensen** is a consultant; **Achim Berg** is a senior partner in the Frankfurt office; **Saskia Hedrich** is a senior expert in the Munich office; and **Felix Rölkens** is an associate partner in the Berlin office.

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# Perspectives for North America's fashion industry in a time of crisis

Apparel retailers, department-store chains, and cosmetics stores employ millions of people. Industry leaders must take quick action while also planning for postcrisis realities.

*by Colleen Baum, Pamela Brown, Emily Gerstell, and Althea Peng*

**As business leaders worldwide grapple** with the COVID-19 pandemic, the health and well-being of their employees and customers must be the top priority. Already, apparel and fashion companies have put their assets to good use in the crisis, be it by turning over their factories to make face masks or hand sanitizer, donating products and services to healthcare workers, or helping employees find temporary roles with companies that are hiring. Ensuring that the business can survive and thrive after this unprecedented shock is crucial as well, as our colleagues emphasize in a recently published article, “Safeguarding our lives and our livelihoods: The imperative of our time,” on McKinsey.com. (For the latest insights on the pandemic, see McKinsey.com/coronavirus.)

In North America, the apparel, fashion, and beauty industry generates approximately \$600 billion in annual revenue and employs more than four million people. Apparel and fashion companies must act quickly to secure business continuity, minimize downside for the latter half of 2020, and get ahead of business-model changes that may be necessary coming out of this disruption.

This article has four objectives. First, we examine COVID-19’s impact on North America’s apparel and fashion sector—and the near-term outlook in light of consumer sentiment and lessons from other regions. Second, we recommend a set of urgent actions to secure business continuity. Then, we look at medium-term actions to take during the recovery to minimize the downside for the latter half of 2020. Finally, we explore longer-term actions to position companies to succeed in the postvirus business environment.

### **COVID-19’s impact: A fundamental reset or a painful but short blip?**

While the apparel and fashion industry, particularly in the US market, has faced challenges in the past decade (because of a combination of recession aftershocks, increased promotional intensity, channel shifts, and an excess of real estate), it has been on a path of steady if slow growth over the past three years, with value and off-price formats being rare bright spots.

Today, the situation is dire. Based on current positions for earnings before interest, taxes, depreciation, and amortization (EBITDA), 75 percent of publicly listed apparel and fashion companies in North America could find themselves with negative EBITDA or untenable net debt-to-EBITDA ratios after three-month store closures. Depending on their cash positions, these companies will be in deep financial distress unless they take urgent action (Exhibit 1).

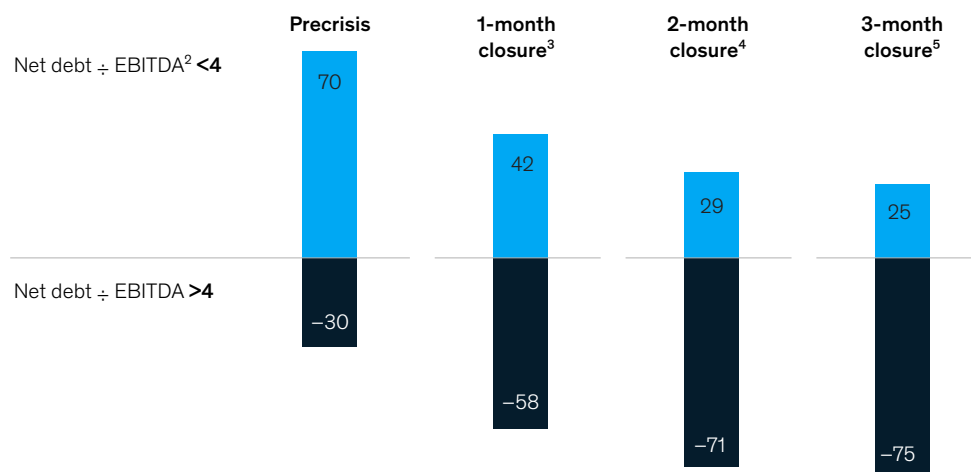
While it’s too early to quantify COVID-19’s toll on the fashion sector, the pandemic has certainly shaken some of the industry’s foundations:

- *Offline retail had already seen massive declines in sales and traffic at the start of the crisis—and now both have gone to zero.* Across North America, retailers are shuttering their doors for consumer and worker safety or in compliance with government orders. Recent announcements suggest no assumptions of normalcy until the end of April 2020 at the earliest. For many brands, the store closures are coming on the heels of disappointing sales in the fourth quarter of 2019 as well as traffic declines in February 2020. Compounding the problem is the fact that North America is “overstored”: the United States has almost 24 retail square feet per person, whereas Germany, for instance, has just slightly more than two. Most concerning of all is the plight of retail workers, many of whom (as of this writing) have been promised at least two weeks’ compensation for scheduled shifts—but stores are unlikely to reopen within that time frame. Some retailers are exploring furloughs rather than layoffs; we are also seeing retailers furlough or reduce pay for corporate employees, as a way of showing solidarity with field workers and as a cash-saving measure. In the meantime, the number of Americans seeking unemployment benefits is expected to increase precipitously in the coming weeks.
- *Online retail is not keeping pace.* While consumer engagement with apparel and fashion brands may be up at this time—as more consumers find themselves at home, idly scrolling through social media—that traffic is

Exhibit 1

**Depending on the duration of store closures, 75 percent of apparel and fashion companies could face challenges managing debt levels.**

**Share of companies with high debt burdens, by duration of lockdown, %<sup>1</sup>**



<sup>1</sup> Analysis of 77 listed apparel and fashion companies in North America. Net debt defined as total debt minus cash and cash equivalents.

<sup>2</sup> Earnings before interest, taxes, depreciation, and amortization.

<sup>3</sup> 1-month store closure and 1-month lost sales in ramp down and ramp up: equivalent to 17% FY-revenue and cost-of-goods-sold (COGS) decline.

<sup>4</sup> 2-month store closure and 2-month lost sales in ramp down and ramp up: equivalent to 33% FY-revenue and COGS decline.

<sup>5</sup> 3-month store closure and 3-month lost sales in ramp down and ramp up: equivalent to 42% FY-revenue and COGS decline.

not translating to conversion. Even retailers with higher online penetration, such as direct-to-consumer specialty-apparel players, face challenges as consumers pull back on discretionary spending. Many retailers report that e-commerce sales two weeks ago were flat compared with the same period last year and down 20 percent last week. They anticipate further declines of 30 percent or more this week. These numbers track with what apparel retailers elsewhere in the world have experienced. Retailers with a heavier concentration of in-store sales (such as fast-fashion retailers and midtier department stores) face even greater pressure to drive consumers online and rapidly scale e-commerce operations. Furthermore, the fulfillment of online orders risks disruption,

whether through reduced staffing because of illness, physical distancing, site cleaning, or even distribution-center closures under state decree.

- **Promotion is a potential 'needle mover,' but it is nearing its limits.** Unsurprisingly, retailers are heavily discounting spring and summer 2020 inventory. The specialty-apparel and department-store channels have already reached peak promotional frequency online, so it will be difficult for brands to break through with clear, differentiated offers that stand out to consumers. Messages about flash sales, savings of 50 percent off, and buy-one-get-one deals will be lost among a sea of similar emails and digital ads, which can drive conversion but will become unmanageably expensive for retailers,

given the surge in online traffic. In such an environment, brands must continually evaluate the effectiveness of different promotional offers, as there is risk of giving away margin, resetting customers' value expectations, and adversely affecting brand perception.

- **Consumer spending will continue to decline and may take time to recover.** Sales data from Amazon show that growth in apparel sales fell by an average of 40 percentage points between mid-February and mid-March (Exhibit 2). “Indoor” fashion categories, such as pajamas and activewear, fared a little better—but they are highly fragmented and lower margin, with limited differentiation across brands. In a March 20–22 survey of US consumers, 63 percent of respondents said that they expect to spend less on apparel than they usually do. If the shape of the recovery in

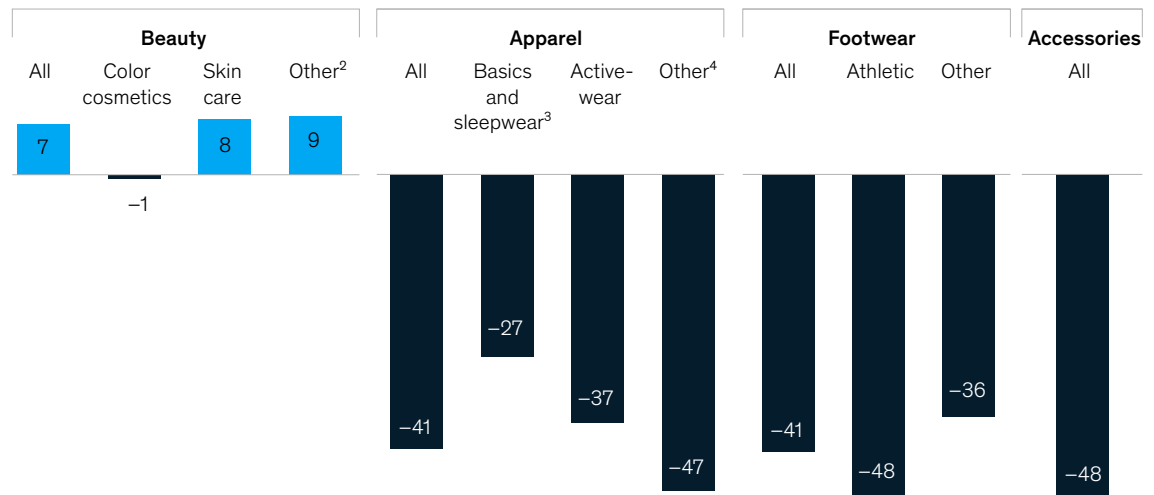
North America mirrors that of China, it could be midsummer before spending and shopping behaviors begin to return to “normal.”

The apparel industry has repeatedly proven its ability to reinvent itself and adjust to where, what, and how consumers buy. We believe in the North American fashion sector’s long-term potential. That said, sector averages cannot predict the destiny of an individual company. In the remainder of this article, we recommend actions for apparel and fashion companies to take. Some of these actions will mitigate risks across the industry, particularly for those retailers and brands that entered this crisis with lower levels of cash on hand. Other actions will help leaders pull further ahead. A company’s ability to execute both types of actions, in a bold and timely manner, will determine whether it will emerge stronger from the crisis.

Exhibit 2

### Sales data from Amazon reflect changes in buying behavior, with slower declines in ‘indoor’ categories focused on comfort and self-care.

Change in year-over-year sales growth, percentage-point change between Feb 15 and Mar 14<sup>1</sup>



<sup>1</sup> Change between 4 weeks ending Feb 15, 2020, and 4 weeks ending Mar 14, 2020.

<sup>2</sup> Includes soap, other body-care products, and hair-care products.

<sup>3</sup> Includes lingerie.

<sup>4</sup> Includes tops, bottoms, outerwear, dresses, suits, swim wear, and bridal wear.

Source: Stackline

# The apparel industry has repeatedly proven its ability to reinvent itself and adjust to where, what, and how consumers buy.

## **Navigate the now: Immediate priorities**

While CEOs should stay abreast of how the situation evolves, there is a clear set of actions—ideally, coordinated by a COVID-19 nerve center<sup>1</sup>—that companies should implement now, without hesitation.

### **Lead with compassion and protect your people**

Communicate frequently and clearly with employees. Set expectations about the new working norms, safety precautions being taken, and cadence of communication; build morale by creating informal opportunities for connectivity and by being open about challenges (including personal ones); and, when possible, make empathetic offers of assistance or time off to support employees' well-being. The health and safety of employees—at headquarters and in the field—is the absolute priority, requiring solutions that can be technological (such as remote working) or practical (such as staggered shifts). Protecting customers, another top priority, involves introducing new processes and policies, such as strict hygiene practices in stores and new safety procedures for handling and delivering online orders.

### **Manage for cash**

Set up a “cash control tower,” with representation from both the procurement and sales teams, to examine spend and identify potential reductions in cash outflow. Work closely with authorities to find ways to alleviate cash strains via public measures, potentially on a state-by-state basis.

## **Review your in-year inventory position and assess the supply chain**

Quickly review your full-year 2020 buys, category by category, making decisions based on “fashionability” (basics or evergreen products versus on-trend products), depth of buy, and confidence in style. Beginning with the spring and summer inventories, determine which products could be delayed for late summer and fall or 2021, even if in an outlet channel. Some products might also be sold in flash sales during the holiday period, depending on availability of storage space. Clear all other spring and summer products as quickly as possible to improve cash position (Exhibit 3). Managers will need to adjust buy quantities for the fall and holiday seasons, accounting for first-half carry-over and any expected category shifts.

As your company and other retailers reset inventory positions, you should be cognizant of the knock-on effects on brands and upstream manufacturers that are already under pressure because of decreasing unit volume in some channels and categories. Be transparent in your communications about payment terms. Support your long-term partners by consolidating volume and engaging in joint planning.

### **Amplify digital**

Accelerate investments to enhance your digital presence and shift media spending to the online channel. These efforts should primarily apply to your own websites but may also pertain to partnerships

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<sup>1</sup> Mihir Mysore and Ophelia Usher, “Responding to coronavirus: The minimum viable nerve center,” March 2020, McKinsey.com.

with e-retailers or with wholesale partners that have stronger e-commerce businesses. Revisit the logic of your marketing investment: shift from brand building to customer activation, focusing on conversion, basket building, and repurchase triggers. Digital marketing will play a fundamental role in not only maintaining engagement and boosting online sales, but also enticing customers to visit stores in those geographic markets when stores reopen.

**Maintain connections with consumers**

Just as consumers continue to seek connections with one another during this crisis, apparel and fashion companies must continue to engage consumers as well, even if those consumers are not spending. This must happen in a way that is authentic to the brand and resonates with its consumer base. For some companies, that may mean communicating to consumers why it is

still safe to shop online and how the company is ensuring that warehouse workers stay healthy. For others, it may mean sparking candid conversations about how something as seemingly frivolous as a new pair of shoes or a new tube of lipstick can bring comfort and joy in a time of chaos. This is a time to use your brand voice to speak to consumers and forge community around your brand.

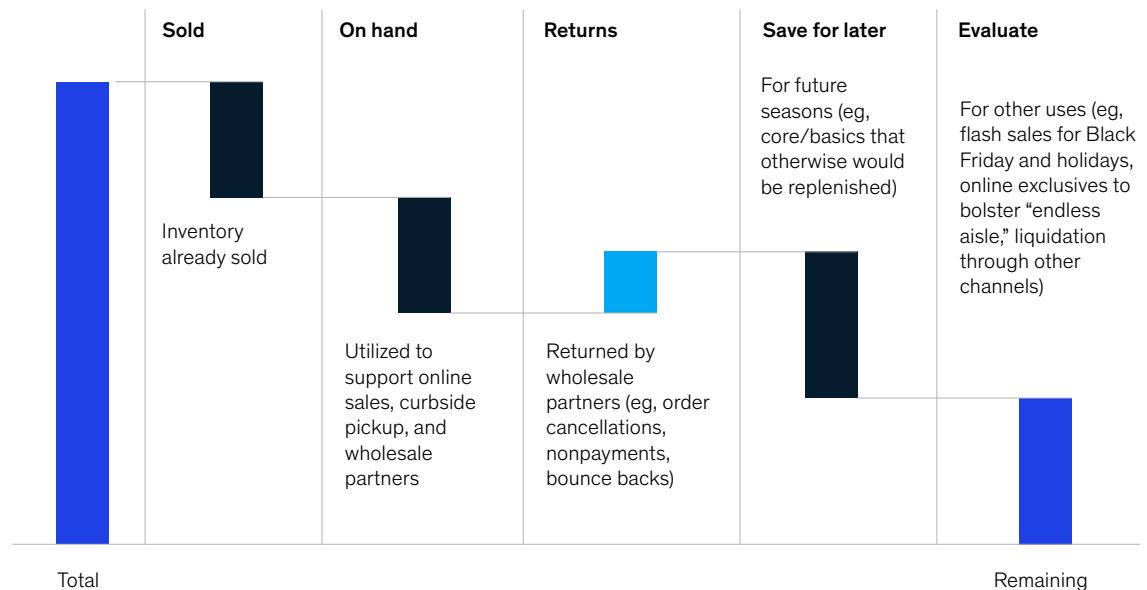
**Plan the comeback: Medium-term actions for 2020**

Beyond the immediate “must-dos,” certain actions can help companies minimize the downside and maximize opportunities in the latter half of the year. The following steps apply to most enterprises, with variance dictated largely by the size of the store network.

Exhibit 3

**By reassessing inventory and segmenting stock in each category, a retailer can maximize gross margin and free up working capital.**

**Illustrative spring 2020 inventory segmentation**





### **Prepare to reopen stores and drive traffic**

Make thoughtful, store-by-store decisions as you reopen the store network, not only to safeguard the health and trust of employees and consumers, but also because most enterprises will be operationally constrained. You might decide that certain stores should reopen in a very different capacity—for example, serving a more value-oriented consumer segment and helping to clear excess product—or shouldn't reopen at all.

We expect that most retailers will pursue a region-by-region approach to reopening stores: a gradual ramp up in staff (particularly if rehiring is necessary after an extended closure), digital engagement with loyal customers to invite them back to stores, testing of localized promotions, and compliance with local requirements (with regard to cleaning practices and store density, for example). Consumer behavior and preferences may have changed during the crisis, so forward-thinking retailers will reopen with a new operating model centered around customer engagement and styling (for example, floor-space resets to facilitate seamless in-store pickup of online orders, and scannable products that connect shoppers to online product reviews).

### **Reassess merchandising plans for fall 2020 and spring 2021**

Weeks of shutdowns will almost certainly alter the shape of the recovery for the apparel industry. We expect continued telecommuting, reduced travel, and cancellation or postponement of special events (such as weddings and music festivals). We also expect upstream impact, with significant changes in sourcing and production. Garment manufacturers in Bangladesh, for instance, have already seen \$1.5 billion in canceled orders from Europe and North America.

Brands should monitor sales data and exchange insights with their vendors and suppliers, then review their merchandising plans for the fall and holiday 2020 and spring 2021 seasons. Consumers have been trying new brands and new categories during

this crisis, so—for brands and retailers with resources to invest and the willingness to take risks—there could be opportunity to acquire new consumers.

### **Connect with brand loyalists**

Look to your most loyal consumers first to jump-start growth. It's not uncommon for 10 percent of a brand's consumer base to drive 60 percent of its sales, making activating these VIPs a must-do. These consumers will likely be inundated with other brands' offers, so you will need to set the bar high to stand out; personalization will be the best way to do that. Tailored promotions, early access to new-product drops or limited editions, and invitations to VIP-only experiences can be effective levers. At the same time, many consumers might be in a different financial position than they were before the crisis. Detailed consumer segmentation and personalized promotions (not just discounts, but offers that deliver meaningful value) will be crucial for retaining your loyalists.

### **Shape the 'next normal': Longer-term strategic actions**

CEOs should look beyond epidemiology and sales data to formulate a view on how the COVID-19 pandemic will reshape their ecosystems and how their companies might capture new opportunities. The following longer-term actions deserve management consideration.

#### **Map a strategic journey to financial resilience**

Crises can create new avenues for growth. Companies will have entered the crisis from various positions of strength, so go-forward opportunities will be, to some extent, bound by starting positions. But all companies would do well to take a hard look at the portfolio: Are you playing in the most attractive spaces and channels? Are you set up to execute effectively to capture demand? Is there an opportunity to consolidate or acquire brands, assets, or capabilities at attractive multiples that would allow you to better serve your core customer? There will be important choices about what brands, partnerships,

and organizational changes to pursue—but also about what *not* to pursue. The crisis is poised to precipitate a massive shakeout, and the players that ask and answer the tough questions will be better positioned to revive their business.

### **Build your operating model around digital and become truly omnichannel**

While, in the short term, a demand shock has driven a decline in online conversion and sales, we believe that in the longer run there could be permanent shifts in consumer shopping behavior that push more traffic and categories online. For example, in China, new customer segments and markets have gravitated toward e-commerce; the same could happen in North America. Retailers could see a broader adoption of e-commerce among previously underpenetrated categories (such as lingerie) and consumer segments (such as baby boomers and even Generation Zers who, according to recent McKinsey research, are more likely than millennials to go to malls).<sup>2</sup>

Take this opportunity to leapfrog into the digital arena by making it the center of your operating model. Start by revising channel-mix targets and investment allocation to give a greater share to online channels. Accelerate personalization in digital marketing so that you can deliver the same quality of interactions online that consumers are accustomed to in stores. Explore new ways of partnering with e-retailers to gain growth momentum through their channels while protecting your brand equity.

### **Anticipate shifts in consumer sentiment and behavior**

While no one can predict what the next normal will be like, we expect a strong desire on the part of

consumers to resume their precrisis habits once conditions allow. Some themes that have begun to surface in our consumer research and in discussions with CEOs include the following:

- *All casual, all the time.* Many people will return to a fundamentally different work environment—one in which telecommuting, flexible hours, and an emphasis on work–life balance are new norms. Comfort could become a top consideration in apparel purchases. The trend toward “casualization,” which was already strong prior to the crisis, could further accelerate.
- *A focus on flexible supply chains, centered on ‘made in America.’* Many apparel and fashion companies will look to onshoring or nearshoring, as they begin to value a flexible supply chain over a low-cost one.
- *An evolution in clean beauty.* There could be a shift in what “clean” means in beauty and personal-care products, as consumers increasingly emphasize product safety and quality over organic or all-natural ingredients.

It will be critical to keep a close eye on how your consumer base is changing and determine what that means for your brand.

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There’s no denying that the COVID-19 pandemic will make for a difficult 2020. For some companies, even survival will be a struggle. If, however, apparel and fashion companies lead with compassion and undertake bold actions, they can position themselves not only to weather the crisis but to emerge from it even stronger.

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<sup>2</sup>Shruti Bhargava, Bo Finneman, Jennifer Schmidt, and Emma Spagnuolo, “The young and the restless: Generation Z in America,” March 2020, McKinsey.com.

**Colleen Baum** is a partner in McKinsey’s New York office, **Pamela Brown** and **Emily Gerstell** are both associate partners in the New Jersey office, and **Althea Peng** is a partner in the San Francisco office.

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# A perspective for the luxury-goods industry during—and after—coronavirus

In these uncertain times, luxury-goods companies must take action to “navigate the now,” plan for the recovery, and shape the future.

*by Antonio Achille and Daniel Zipser*

**Amid the coronavirus pandemic**, every company's first priority is, of course, to protect the health and safety of employees, consumers, and business partners. Indeed, luxury companies have pivoted to address urgent public-health needs: factories that produced scarves and perfume now manufacture face masks and hand sanitizer, and many luxury groups have made monetary donations to hospitals and other not-for-profit organizations. At the same time, with millions of people relying on the luxury-goods industry to make a living—from factory workers and retail-store employees to small-town artisans and craftsmen—industry leaders are planning ahead and wrestling with longer-term strategic questions to ensure the survival of their businesses.

In this article, we discuss the impact of the crisis on the luxury-goods sector. We then recommend two sets of priorities for industry executives: short-term actions for “navigating the now” and longer-term considerations for shaping the future.

### **A hard reset or a short-term blip?**

While it's too early to quantify COVID-19's total financial toll on the sector, the pandemic has certainly shaken some of the foundational aspects of the luxury industry—and some of these changes could be permanent.

**Wholesale Darwinism.** Even before the pandemic struck, independent luxury-goods wholesalers in Europe (many of which are small, family-owned boutiques) and some of the large North American luxury department stores were already struggling—in part because of luxury brands moving to vertical integration over the past 20 years and, more recently, the growth of e-commerce. This pandemic might force some of them out of business. The damage could extend to brands that have not yet fully transitioned to a vertically integrated distribution model, as well as to upstart brands that need wholesale channels to reach new customers and to finance the development of their full collections. To

survive, wholesalers are likely to adopt aggressive commercial and discount policies—which, at least in the medium term, could hurt the luxury positioning of brands that don't have a concession model.

**From global traveler to local shopper.** The luxury sector appeals to a global consumer: 20 to 30 percent of industry revenues are generated by consumers making luxury purchases outside their home countries. In 2018, Chinese consumers took more than 150 million trips abroad; we estimate that purchases outside the mainland accounted for more than half of China's luxury spending that year.<sup>1</sup> Asian shoppers buy luxury goods outside their home countries not only to benefit from lower prices in Europe, but also because shopping has become an integral part of the travel experience: buying a brand in its country of origin comes with a sense of authenticity and excitement. With the recent travel restrictions, an important driver of luxury spending has come to a halt, and we anticipate only a gradual ramp-up in international travel, even after the restrictions are lifted. That said, Chinese consumers remain the biggest growth opportunity for the luxury sector. Brands, clearly, will need a new approach to attracting luxury shoppers. To reactivate Asian luxury consumers in their home countries, brands can focus on creating tailored local experiences, strengthening their digital and omnichannel offerings, and engaging more deeply with consumers in tier-two and -three cities. The latter will be challenging, given the limitations in both retail infrastructure and customer-service capabilities in those cities.

**Shows without live audiences.** Fashion weeks and trade shows have been essential ways that brands have maintained vibrant relationships with consumers and trade partners. While we expect some return to normalcy on this front, we also believe that the luxury industry—in close collaboration with fashion-week organizers and trade associations—should explore alternative ways to deliver the same kind of magic that these events offer when there are restrictions

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<sup>1</sup> Aimee Kim, Lan Luan, and Daniel Zipser, “How young Chinese consumers are reshaping global luxury,” April 2019, McKinsey.com.

on international travel and large gatherings. Industry players might also consider pushing for a coordinated revamping of the fashion calendar, with brands simplifying and streamlining their presentation calendars.

***From ownership to experience, and back again.***

“Experiential luxury”—think high-end hotels, resorts, cruises, and restaurants—has been one of the most dynamic and fast-growing components of the luxury sector. Millennials (those born 1980–95) opted more for experiences and “Instagrammable moments” rather than luxury items. Baby boomers (born 1946–64), too, were moving in this direction, having already accumulated luxury products over the years. While we expect the positive momentum of experiential luxury to persist, it will slow down in the short term as consumers temporarily revert to buying goods over experiences.

***Hyperpolarization in performance.*** Even before the crisis, it made little sense to talk about the sector in terms of averages because growth rates and profit margins were so widely spread out. Even within the same segment and price point, luxury brands’ growth varied from 40 percent to negative percentages, and earnings from 50 percent to single-digit percentages. We expect further polarization based on three fundamentals: the health of a brand’s balance sheet prior to the crisis, the resilience of its operating model (including its digital capacity, the agility of its supply chain, and its dependence on wholesale channels), and its response to COVID-19.

***Another chance for ‘rare gems.’*** Over the past decade, European luxury conglomerates, private-equity firms, and, more recently, US fashion groups and Middle Eastern investors eagerly snapped up attractive acquisition targets. As a result of the current crisis, some of these acquirers—particularly those that aren’t luxury companies themselves—could find that they have neither the core competencies nor the patience to nurture these high-potential brands, and thus might be willing to put them back on the market. Acquisitions that were once forbiddingly expensive could become viable in the postcrisis period. Such developments could result in further industry consolidation or even the formation of new luxury conglomerates.

Time and again, the luxury industry has proved capable of reinvention. We are confident about the sector’s long-term potential. But some brands will emerge from the crisis stronger, while others will struggle to preserve the integrity of their business. Much will depend on their ability to respond to the short-term urgencies related to COVID-19 while simultaneously planning and executing for the future.

**‘Navigating the now’: Immediate priorities**

Many luxury executives have demonstrated caring leadership during this crisis. They are prioritizing the safety of employees and customers and proactively communicating with all stakeholders about their new health and safety protocols, crisis-response activities, and the steps they’re taking to keep operations running. At the same time, they must

**More than 40 percent of global luxury-goods production happens in Italy—and all the Italian factories, including small, family-based *façonnières*, have temporarily shut down.**

take quick action to ensure that their businesses weather the crisis. Here are short-term actions that company leaders should consider taking.

**Review 2020 inventory and rethink 2021 collections.** Sales for this year's spring season are as much as 70 percent lower than last year—not surprising, considering that consumers had little opportunity to explore the spring and summer collections in stores. Decide how to phase in the 2020 fall and winter collections and develop a plan for dealing with unprecedented levels of unsold 2020 inventory—without resorting to steep discounts, which jeopardize brand equity. Stay informed about wholesalers' and e-retailers' plans to clear extra inventory. In some cases, inventory swaps might be preferable to aggressive promotions and discounting. One way to use extra inventory could be to reward loyal customers with gifts or other types of giveaways to surprise and delight them, while also whetting their appetite to shop across collections or categories.

**Enhance digital engagement.** As stores remain closed in many parts of the world, e-commerce is a crucial channel for keeping sales up, communicating with customers, and forging a sense of community around a brand. Accelerate your digital investments and shift media spending to online channels, with a focus on customer activation rather than brand building. Aside from enhancing your own websites, also consider partnerships with reputable e-retailers. Digital marketing could help not only boost online sales but also entice consumers to visit stores once they reopen.

**Manage for cash.** Set up a cash-control team, with representation from the procurement and sales teams, to examine spending and identify responsible reductions in cash outflow. Review lease contracts and all operating expenses, including marketing spending and events. At the same time, prepare to selectively support wholesalers and department stores by extending accounts-receivable terms and arranging inventory swaps. Work closely with government authorities on a country-by-country basis to find ways to alleviate cash strains with public measures.

**Take a 'cleansheet' view of demand planning.** Review your 2020 budget and inventory plans, assessing COVID-19's impact on each region and business unit. Adjust revenue and profit forecasts and create incentives for business-unit heads to set new targets. Resist the temptation to push sales at the expense of margins, as a sales-focused approach will likely yield inaccurate demand projections and, consequently, large amounts of unsold inventory.

**Assess the strength of your supply chain.** More than 40 percent of global luxury-goods production happens in Italy—and all the Italian factories, including small, family-based *façonnières* (a French term that loosely translates to “contract manufacturers”), have temporarily shut down. Luxury companies should assess, category by category and product by product, where the impact is likely to be felt most acutely. Potential short-term actions include moving inventory across regions and channels, privileging geographic markets that are less affected, and making sure to fulfill online orders. In the medium term, luxury companies should help production partners recover by making prompt payments and restoring production as quickly as possible. If Italy's *façonnières* do not survive, a signature element of the luxury ecosystem—the craftsmanship that is the result of excellence and skill passed down through generations, and the source of the “Made in Italy” aura—could be lost forever.

**Adjust merchandising plans.** As consumers' social routines adapt to lockdowns and physical-distancing restrictions, we are starting to see changes in buying behavior. For example, some luxury players report that, in terms of price points, high-end and low-end luxury items are proving more resilient than those in the middle of the range, perhaps due to a combination of “revenge spending” (a phrase that refers to pent-up demand for luxury items during or after crises) and a desire to maximize value for money by purchasing functional items. They're also seeing handbags and small leather goods selling better than ready-to-wear apparel during the crisis. Children's wear seems to be doing particularly well. Millennials haven't reduced their spending as much as other adult



segments have. These are the observations of a few luxury players, but clearly there is no one-size-fits-all merchandising plan. Brands should carefully analyze sales data and embed consumer insights into their merchandising plans.

### Shape the next normal: Longer-term considerations

Stabilizing the business during the crisis is crucial—but management must not lose sight of the longer term. Here are strategic actions to consider taking during the recovery.

#### *Put digital at the center of your operating model.*

For many companies, this crisis has been a catalyst for developing and executing an online and omnichannel strategy. In China, e-commerce has attracted new customer segments and markets (exhibit); we can expect a similar pattern to play out

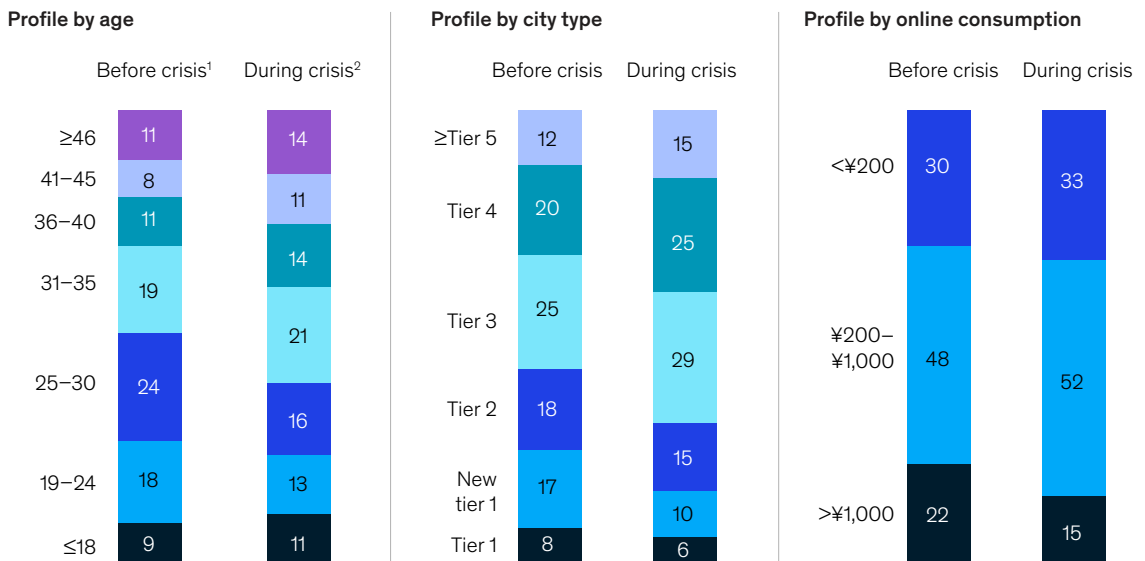
in other geographies. Start by allocating a greater share of investment to the online channel. Explore new ways of partnering with established e-retailers. Step up your personalization efforts in digital marketing. Luxury consumers are accustomed to a high standard of service in stores; the emphasis, then, should be on creating a personalized digital experience of the same quality.

**Build competencies related to resilience and transformation.** For the past 30 years, the luxury sector has created value, thanks to its creativity and innovation. In addition to supporting core competencies such as design, marketing, and merchandising, luxury businesses now need to build the managerial talent to support the CEO in resilience and transformation. One possibility is to create a new C-suite position, the chief transformation officer, to emphasize the importance of these competencies.<sup>2</sup>

Exhibit

## In China, e-commerce user profiles shifted during the coronavirus outbreak.

E-commerce user profiles before and during COVID-19 crisis in China, %



<sup>1</sup> Data from Jan 14, 2020, to Jan 31, 2020.

<sup>2</sup> Data from Feb 3, 2020, to Feb 16, 2020.

Source: QuestMobile

<sup>2</sup> Olivier Gorter, Richard Hudson, and Jesse Scott, "The role of the chief transformation officer," November 2016, McKinsey.com.

***Boldly reshape the ecosystem, including through M&A.*** Crises can create new avenues for growth. Companies should ask themselves questions such as: “Are there companies we could potentially partner with, both to keep them in business and to allow us to expand into adjacent markets or product categories? Are there moves along the value chain (such as vertical integration) that have become more attractive? What partnerships or acquisitions—perhaps in the technology arena—could we pursue now that were less viable before? What brands could we acquire to complement our portfolio or to initiate our journey toward becoming a larger luxury group?” As companies seek to form partnerships or make acquisitions, it will be important to consider not just economic rationales but social rationales as well: For example, could an M&A deal help a supplier in distress, save jobs in a struggling community, or strengthen the luxury sector for the longer term?

***Anticipate shifts in consumer sentiment and behavior.*** Consumers are the ultimate shareholders of the luxury sector. We expect that, once conditions allow, consumers will want to resume their normal lives. However, the next normal might look quite different; luxury companies must try to anticipate and respond to whatever that next normal will be. For example, in our recent conversations with CEOs, one trend that is likely to intensify postcrisis is the trend toward sustainability and the desire for more-responsible consumption—reinforcing the need for companies to provide clear, detailed information

about their processes and products. Experience also suggests that, after a large-scale crisis with a heavy emotional toll, consumer preferences could shift, at least for a time, toward “silent luxury”—paying more attention to classic elements, such as craftsmanship and heritage, and less to conspicuousness and “bling.”

***Digitize the end-to-end supply chain.*** Technology—from remote-working platforms to virtual showrooms—can help luxury companies maintain productivity during the crisis and, perhaps, even improve productivity for good. In addition, the commercial elements (such as virtual showrooms and digital prototyping and sampling) will be valuable in maintaining strong relationships with buyers, even during times when travel restrictions are in place. Digitizing the supply chain from end to end will, of course, require investment in innovative, leading-edge technologies.

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While the COVID-19 pandemic has made for a challenging 2020, we are confident that, with careful planning and deft execution, the luxury-goods sector can successfully weather the crisis and emerge even stronger. The actions we’ve outlined here can help you and the other leaders in your organization navigate the challenges of today while building and strengthening your business for the longer term.

**Antonio Achille** is a senior partner in McKinsey’s Milan office, and **Daniel Zipser** is a senior partner in the Shenzhen office.

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# Reviving consumer and packaging

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# How consumer-goods companies can prepare for the next normal

Consumer-packaged-goods manufacturers must anticipate changes in consumer behavior and set up plan-ahead teams to guide and accelerate decision making.

*by Raphael Buck, Tracy Francis, Eldon Little, Jessica Moulton, and Samantha Phillips*

As the coronavirus pandemic spreads across the globe, threatening both lives and livelihoods, consumer-packaged-goods (CPG) manufacturers continue to play an important role: producing essential items we all rely on for our health and well-being. CPG leaders have focused on meeting this demand while guarding the safety of employees and customers.

At the same time, forward-thinking CPG companies have begun to think about the “next normal”—what the world may look like after strong virus-control measures are lifted. The measures in place are expected to lead to the largest quarterly decline in economic activity since World War II. An unprecedented 40 to 50 percent decline in discretionary spending will translate to a roughly 8 to 13 percent drop in GDP. (For our macroeconomic scenarios and latest insights, see [McKinsey.com /coronavirus](https://www.mckinsey.com/coronavirus).) While many CPG companies have withstood the initial economic shock, all will need to prepare for the longer-lasting effects, including an erosion in consumer confidence that will drive recessionary behavior.

In this article, we describe five trends in the consumer and retail landscape that have emerged during the crisis and, we believe, will persist in the aftermath. We then recommend the creation of a plan-ahead team to equip CPG companies for whatever the next normal may turn out to be.

## Consumer trends and channel shifts

We map four horizons of the crisis and beyond (Exhibit 1). At the time of this writing, most countries around the world—with notable exceptions in Asia—are still navigating the crisis. The questions many are now grappling with include: What will the next normal look like? And how long will the intervening period of partial restrictions last?

It’s increasingly clear that the intervening period will be lengthy. Consumers and retailers will need

to adjust to ongoing physical distancing and travel restrictions. Outlets and venues where physical distancing cannot be achieved will be among the last to reopen.

Current sentiment, the trends we are seeing in Asia, and lessons from the last recession lead us to anticipate at least five behaviors to “stick” through the prolonged recovery and the next normal: increased price sensitivity, higher digital engagement, rise in attention to wellness and hygiene, “nesting” at home, and a redefinition of brand purpose. We also expect to see important channel shifts: a smaller food-service sector, retailer consolidation, the rise of value retailers, and Amazon’s growth in grocery (a sector in which the e-commerce giant has historically had lower share).

### **Economic insecurity, leading to price sensitivity**

Already, two-thirds of consumers are pessimistic or unsure about the pandemic’s lasting effect (Exhibit 2). Despite their comparative optimism for economic recovery, 46 percent of US consumers and 28 percent of Chinese consumers said they plan to reduce spending in the coming weeks.<sup>1</sup> (For our latest surveys, see “Global surveys of consumer sentiment during the coronavirus crisis,” on [McKinsey.com](https://www.mckinsey.com).)

The 2008 recession is an imperfect analog to the COVID-19 crisis—which is more of a shock, with many governments introducing bold, unprecedented fiscal measures—but we believe it offers valuable lessons about how consumers behave under financial stress. That recession had a lasting effect on consumer confidence, which didn’t return to prerecession levels until 2011 in Germany, 2014 in the United Kingdom and the United States, and 2017 in China.<sup>2</sup> Consumers reduced their spending in several ways:

- **Refocusing on home occasions.** Many consumers spent less outside the home; 55 percent of Germans and 63 percent of Americans said they ate out less.<sup>3</sup>

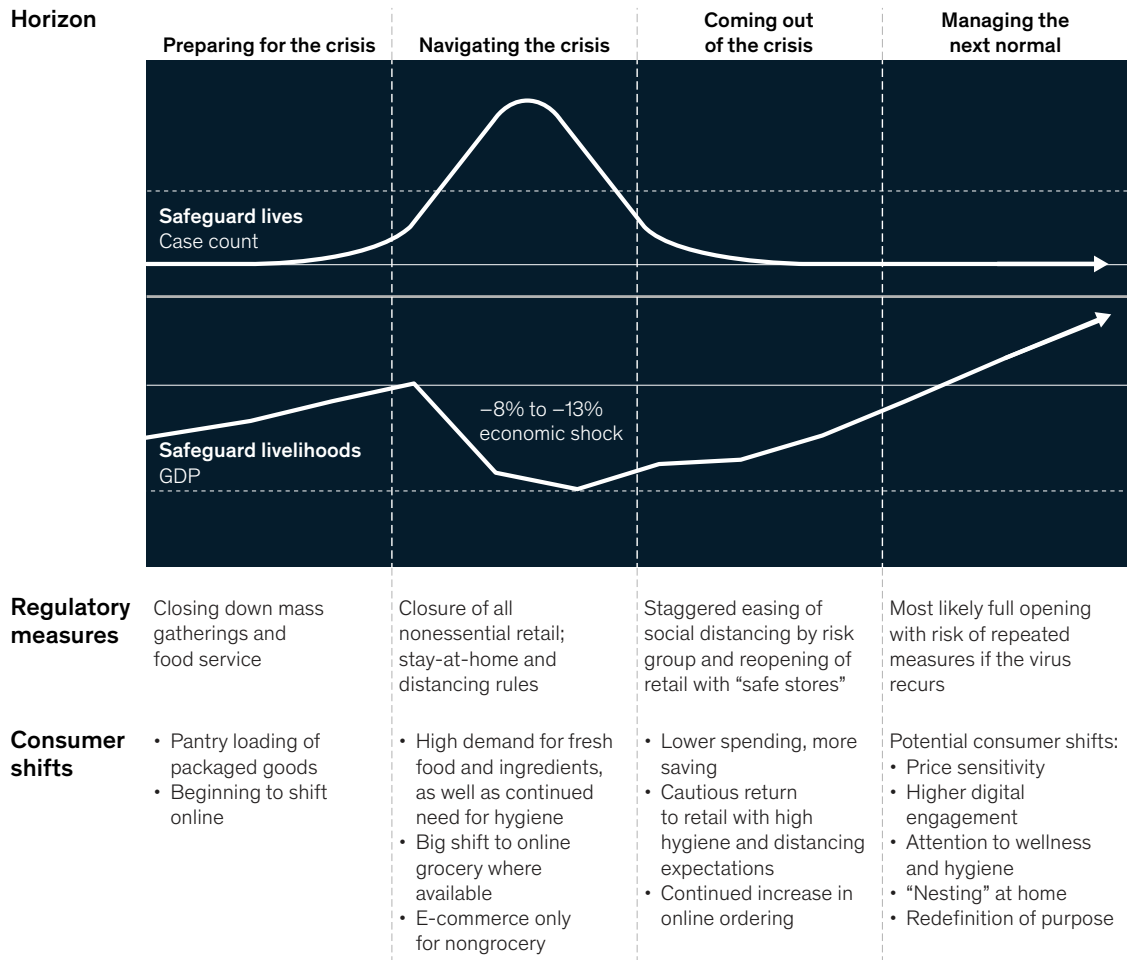
<sup>1</sup> McKinsey Consumer Sentiment Survey in China and United States, March 30 to April 6, 2020.

<sup>2</sup> Consumer Confidence Index, OECD, [oecd-ilibrary.org](https://www.oecd-ilibrary.org).

<sup>3</sup> McKinsey US Consumer Sentiment Survey, February 2009; McKinsey Global Institute Europe Consumer Insights Survey, December 2008.



**Most markets—with exceptions in Asia—are navigating the crisis.**



Source: McKinsey analysis, in partnership with Oxford Economics

- **Cutting back on nonessentials.** Two-thirds of US shoppers said they cut back on high-end luxury goods; one-third cut back on cosmetics.<sup>4</sup>
- **Deal seeking.** Shoppers became increasingly promotion conscious. In the United Kingdom, the percentage of products sold on discount climbed from 26 percent in 2002–06 to 36 percent in 2011.<sup>5</sup>
- **Trading down.** Consumers switched to cheaper brands or private labels. UK private-label sales

increased by 10 percentage points from 2008 to 2010.<sup>6</sup>

- **Shifting channels.** Many consumers began shopping at value retailers. Discounters now account for 10 percent of grocery sales in the UK market, up from 3 percent in 2006.<sup>7</sup>

**A seismic shift in digital engagement**

Physical-distancing rules have increased consumption of online media and significantly accelerated e-commerce, particularly in markets

<sup>4</sup>McKinsey US Consumer Sentiment Survey, February 2009.

<sup>5</sup>State of the nation 2012: A review of UK consumers and the grocery industry in 2011, Nielsen, 2012; National Consumer Panel data on total purchasing.

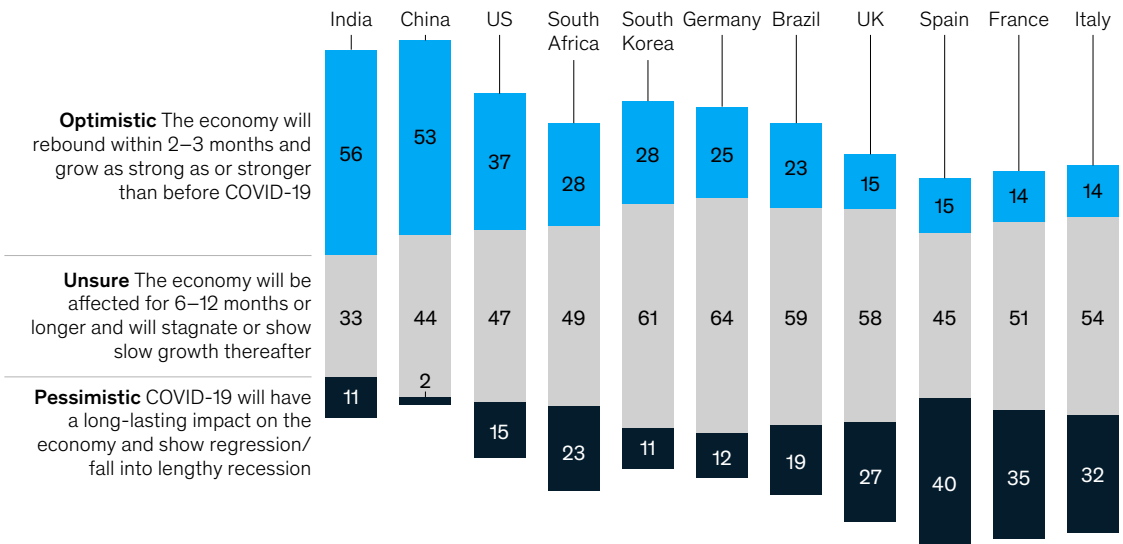
<sup>6</sup>Euromonitor International data from 2008 to 2010.

<sup>7</sup>Euromonitor International data from 2006 to 2018.

Exhibit 2

**In most markets navigating the crisis, the majority of consumers are pessimistic or unsure about the economic recovery.**

**Confidence in own country's recovery in after-COVID-19 economy,<sup>1</sup> % of respondents**



Note: Figures may not sum to 100%, because of rounding.

<sup>1</sup>Question: How is your overall confidence level on economic conditions after the COVID-19 situation?

Source: McKinsey COVID-19 Consumer Pulse Survey, 2020; Brazil (March 28–30) n = 1,311; China (April 1–4) n = 1,048 including Hubei province; France (April 2–5) n = 1,003; Germany (April 2–5) n = 1,002; India (April 3–6) n = 582; Italy (April 2–5) n = 1,005; South Africa (March 24–26) n = 535; South Korea (April 3–6) n = 600; Spain (April 2–5) n = 1,003; UK (April 2–5) n = 1,000; US (March 30–April 5) n = 1,119

that already had a head start. In the United Kingdom, for example, where online's share of grocery shopping was 7 percent before the crisis, grocers are furiously increasing capacity to meet demand: the three largest grocers have added more than 500,000 new delivery slots—an increase of more than 30 percent.<sup>8</sup> For many discretionary categories, e-commerce has become *the* channel as stores have closed.

We expect this channel shift to endure to some extent, especially in countries where retailers had enough preexisting capability to offer a positive online experience. Early lessons from China suggest that three to six percentage points of online market share will be “sticky,”<sup>9</sup> driven by older generations newly comfortable with digital channels and by new consumer segments who have overcome barriers

to trial (such as account setup). Also, in the medium term, we expect shoppers to prefer the “safe” experience of shopping online to the prospect of shopping in crowded stores.

Amazon is likely to build momentum in fresh food and packaged goods, especially in markets where the major grocers lack e-commerce “legs.” In the month leading up to March 14—even before governments issued shelter-in-place guidance—Amazon US saw year-on-year growth of 41 percent in household goods, 25 percent in health products, and 23 percent in groceries.<sup>10</sup>

**Rise in attention to wellness and hygiene**

The wellness trend has endured—and even gained strength—during the outbreak. “Healthy eating” has remained the highest priority of food shoppers

<sup>8</sup>Globaldata 2019 Food & Grocery; press searches.

<sup>9</sup>McKinsey Consumer Sentiment Survey in China (mobile), February 2020.

<sup>10</sup>Stackline data from February 15 to March 14, 2020.

across Europe: net sentiment (positive responses less negative) was 55 percent, rising to 82 percent in Italy.<sup>11</sup> Consumers are also investing in at-home exercise: in Germany and the United Kingdom, Amazon's fitness-equipment sales spiked by approximately 60 percent each week in March.<sup>12</sup>

We expect this upward trajectory to continue into the next normal. Hygiene will become a core element of wellness. The speed of the virus's spread has highlighted the level of connectedness in society—and the associated risk. Brands should consider the implications for their strategy and communications (for instance, reassessing manufacturing processes and packaging, as well as emphasizing health and cleanliness in marketing messages). The battle to eradicate COVID-19 will be a long one, and CPG manufacturers will need to prove their safety and trust credentials.

### **Nesting at home**

Staying in is the new going out. Once restrictions are lifted, we expect consumers to continue spending more time at home, driven by a desire to save money, persistent safety concerns, and a newfound pleasure in nesting. Through the crisis period, many have invested in upgrading their homes and gardens or bought equipment for new hobbies and routines. Next to groceries, the category that saw the highest growth in US e-commerce in recent weeks has been breadmakers (652 percent growth). Other nonessentials, such as weight-training gear (307 percent), computer monitors (179 percent), and craft kits (117 percent) also made the top-100 list.<sup>13</sup>

### **Redefinition of purpose**

Large CPG companies have prioritized crisis-related communications (such as announcements of new safety protocols and charitable donations). Digital-native brands have nimbly connected with their social-media communities about how they're helping people affected by COVID-19. Consumers may expect companies to continue this heightened

emphasis on social responsibility after the crisis ends. In the previous recession, more than 75 percent of consumers agreed that "corporations should operate in a way that aligns with society's interests, even if that means sacrificing shareholder value."<sup>14</sup> That said, brands must be careful to strike the right tone. During this pandemic, 77 percent of consumers said they appreciate CPG companies communicating how their brands can be helpful in daily life, but an almost equal percentage said brands shouldn't "exploit" COVID-19 as a commercial opportunity.<sup>15</sup>

It will be essential for companies to balance existing focus areas with emerging consumer concerns. Sustainability, for instance, continues to be important to consumers in many markets (60 percent of UK consumers cited it as a top consideration when food shopping).<sup>16</sup> Yet consumers who have become more price sensitive or more concerned about hygiene may favor single-use packaging.<sup>17</sup>

CPG companies should examine the potential impact of these trends on the categories in which they play. Besides these, we are also monitoring two other trends, whose longevity is less clear: deurbanization and big-brand growth. With cities becoming COVID-19 epicenters, urbanites may move to the suburbs, or cities could see a significant reduction in traffic as people stay local. Big brands may benefit over the longer term, as retailers' current focus on high-volume SKUs will change the consumer decision set. (In the United States, for instance, large and midsize brands captured 60 percent of recent growth, compared with only 20 percent in previous years).

### **Channel shifts**

These consumer trends will have channel implications, each of which will have varying impact on different countries and categories.

<sup>11</sup> McKinsey Consumer Sentiment Survey in France, Germany, Italy, Spain, and United Kingdom, March 27 to March 29, 2020.

<sup>12</sup> Stackline data for month leading up to March 28, 2020.

<sup>13</sup> Stackline data on United States for March 2020 versus March 2019.

<sup>14</sup> 2011 Edelman Trust Barometer, Daniel J. Edelman Holdings, August 30, 2011, edelman.com.

<sup>15</sup> "Brands in a pandemic world: Insights from Kantar's COVID-19 Barometer," WARC, March 27, 2020, warc.com.

<sup>16</sup> McKinsey UK Consumer Survey 2020 (part of *The Rise of Conscious Eating*, forthcoming summer 2020).

<sup>17</sup> Nielsen and McKinsey analysis of the last three weeks of March 2020 versus 2015–18.

Most significantly, food-service operators—particularly independents—will experience substantial contraction and consolidation as a result of physical-distancing restrictions and the recessionary environment. Food-service closures have accounted for 10 to 20 percent grocery growth in Western markets; when the food-service sector reopens, we expect a few percentage points to remain in grocery.

We also expect to see significant retailer consolidation, especially in sectors that were less well capitalized and struggling before the outbreak, such as small US quick-service restaurants. Some distributors will go out of business, creating route-to-market challenges for some CPG players, especially in the fragmented trade.

Amazon and other e-marketplaces were already growing by 25 percent a year from 2013 to 2018<sup>18</sup> but had previously struggled with the supply-chain complexity of fresh food and the economics of delivering CPG products. During the crisis, however, these players are likely to capture an outsize share of core grocery.

In offline grocery, discounters and other value retailers will benefit from the downturn, as they did in 2009. Major grocers will rationalize their assortments based on learnings during the crisis. They will also likely invest more in neighborhood proximity formats: in China, for instance, convenience-store sales were 8 percent higher in March than in January.<sup>19</sup> And grocers will ask CPG companies for support in making the economics of e-commerce work.

## Getting ahead of the next phase

By now, most CPG companies have well-established crisis-response teams monitoring the situation and reacting accordingly. Preparing for the next normal, however, calls for a distinct working group:

a plan-ahead team tasked with planning across multiple time horizons. As our colleagues explain in a recent article, “Getting ahead of the next stage of the coronavirus crisis,” the plan-ahead team should work through five frames: a realistic starting position, scenarios, a broad direction of travel, strategic moves, and trigger points.<sup>20</sup> In the remainder of this article, we discuss CPG-specific considerations for each of these frames.

### 1. Gain a realistic view of your starting position

The plan-ahead team should review the company’s financial assumptions, ongoing initiatives, and strategic choices, and sort them into three buckets: “still about right,” “wrong,” and “unsure.” CPG companies should reevaluate their 2020 growth expectations and key drivers, including the markets, categories, and customers that will deliver growth; the role of planned product launches and campaigns in light of store closures and recessionary pressure; and the allocation of resources, including talent. This exercise will clarify your starting point and provide a clear picture of the challenges you need to address.

### 2. Develop scenarios for multiple versions of your future

Scenario planning for the next normal is a daunting task, with many macroeconomic possibilities, vast differences in markets (and even regions or cities), and only an early view of the consumption implications. “Bound the uncertainty” by considering at least four discrete scenarios—each covering country, category, and channel outcomes—underpinned by clearly stated assumptions about containment measures and financial aid.

### 3. Establish your posture and broad direction of travel

After a detailed scenario-planning exercise, it may seem odd to make macro choices—but they help to align companies on the direction of travel. CPG companies might consider their stances on the following:

<sup>18</sup> Data for 2013 to 2018 from analyst reports, Euromonitor International, Kantar, Planet Retail, and S&P Capital IQ.

<sup>19</sup> MIYA payment data for the four weeks after March 8, 2020, versus the four weeks before January 29, 2020.

<sup>20</sup> Yuval Atsmon, Chris Bradley, Martin Hirt, Mihir Mysore, Nicholas Northcote, Sven Smit, and Robert Uhlener, “Getting ahead of the next stage of the coronavirus crisis,” April 2020, McKinsey.com.

# With customer decision journeys encompassing more digital touchpoints and increasing in complexity, shoppers will expect CPG companies to have a consistent presence online and offline.

- **Global business.** Will you focus on your previous priority growth markets or review your segmentation based on new behaviors and economic outlook?
- **Portfolio.** Will you continue to prioritize at-home essentials or invest in rebuilding demand for products that consumers largely held off buying?
- **Value proposition.** Will you reposition premium offerings or prioritize cheaper brands?
- **Discretionary categories.** Is your primary aim to restart operations and manage your bottom line, or will you invest—for example, in marketing or direct to consumer (DTC)—to capture share?
- **Essential categories.** Will you focus on traditional retail partners or on growth channels, such as e-marketplaces?
- **Challenger brands.** Will you wait to bounce back or create a marketing and promotional growth plan?

Think about how to align your operating model with these stances and about which new “muscles” you might have to build. Establishing your posture and broad direction of travel will help you decide on strategic moves.

#### **4. Determine actions and strategic moves that are robust across scenarios**

The plan-ahead team can then draft and pressure-

test action plans for each scenario. CPG players have a range of commercial, operational, and strategic areas to cover.

#### **Accelerate e-commerce and digital marketing**

The specific actions will depend partly on your posture and business model, but all CPG companies should deepen their relationships with third-party e-commerce partners and work with them in new ways, such as category captaincy, deeper data exchange, or shared warehousing. At the same time, avoid overreliance on the e-marketplace giants—strengthen your relationships with second-tier e-tailers and owned e-commerce (such as DTC websites, owned marketplaces or ecosystems, or partnerships in which you control your brand presence and own the consumer relationships and data.)

With customer decision journeys encompassing more digital touchpoints and increasing in complexity, shoppers will expect CPG companies to have a consistent presence online and offline. Capturing and managing data will be essential and can help deliver precision marketing at lower cost. Finally, despite the uncertainty, consider actively recruiting otherwise hard-to-come-by digital talent.

#### **Revisit your channel strategy and customer segmentation**

In light of the aforementioned retail dynamics, reset your channel strategy around both the enduring global trends and smaller, local shifts. This will in turn require a review of your customer-segmentation strategy and growth targets, and an understanding of the capabilities you may need for new partnerships.

Rebase overall investment across tiers as needed and build up new priority customers with stronger ways-of-working agreements. Decide how you'll manage the trade spend you'd previously allocated to now-lower-priority customers, while maintaining those relationships and your fair share of sales. Also, decide how you'll support the return of food service, if it's important to your mix—especially in the difficult period immediately after lockdowns are lifted.

#### **Revise assortment and pricing**

After the crisis, retailers are likely to want to reevaluate their category vision and assortment, which could be good news for CPG companies that play in multiple categories and price tiers. To prepare action plans, know your category consumer better than anyone else: test ranging and new promotional mechanics, revisit insights from the previous recession, and, later, supplement in-store learnings with primary consumer and shopper research to understand postcrisis perspectives.

Reprioritize your portfolio based on shifts in consumer and customer needs and on changes in sourcing and the supply chain. And get granular: one size will not fit all. Build shopper-, occasion-, channel-, and customer-specific plans.

#### **Strengthen your purpose orientation**

A company's actions during times of crisis are written into its history and make a lasting impression on consumers. To lead with purpose, understand your stakeholders' needs and review the trade-offs in addressing them. Think about how to bring your greatest strength or "superpower" to bear, perhaps more creatively than before.

Communicate frequently and clearly, but you don't need to have all the answers—you can crowdsource ideas and involve your employees.

Your jointly created purpose can then be a source of energy and renewal. Finally, use purpose as a filter for your action plans. If they don't stack up against your values, identity, and legacy, look for alternatives.

#### **Build a resilient supply chain**

While the immediate need during this crisis is an operational supply chain, the next focus will be to build a smarter, more flexible, and, especially, more resilient one. Heads of operations and CIOs should review the strategy, footprint, assets, processes, and tools along the entire supply chain. They will have to decide whether efficiency and centralized footprints remain the answer to manage future risk. They will also need to determine whether legacy infrastructure and systems should be upgraded to autonomous end-to-end planning systems or to a combination of advanced analytics and end-to-end visualization solutions, for better complexity management.

Embed new ways of working based on lessons from the crisis. Complement monthly sales and operations planning (S&OP) cycles with weekly control towers, which help balance service, cost, and cash (that is, inventory). Last year's sales and traditional forecasts will be less valuable, so dial up planning across sales and operations and jointly make decisions about demand—for example, is a huge order a true uptick in demand, a one-time effect of new ranging, or the same demand pulled forward a week? For priority customers, short-term solutions (such as connected inventory or simplified routes from factory to store) could be leveraged on a more regular basis to manage new demand levels.

#### **Define the next level of productivity**

Any short- to medium-term falloff in spending

**A company's actions during times of crisis are written into its history and make a lasting impression on consumers.**



(resulting, for example, from store closures and travel restrictions) should be swept into updated budgets. Rigorously allocate all remaining funds toward the highest-ROI activities. Steer demand to customers and brands with excess supply, and functional capacity to more urgent needs.

Given COVID-19's immediate impact, planning for the next normal can feel like a real-time zero-based-budgeting effort. Analyze performance at the lower spend levels and then build back investment in priority categories, brands, and channels, with monthly monitoring of triggers to start "investment spend" as you emerge from the crisis. In the 2008 downturn, the top 20 percent of performers reduced costs more quickly and were faster to invest as the economy recovered.<sup>21</sup>

Accelerate the role of digitization and automation in supply chain, back-office functions, procurement, and even route to market. Done right, automation transformations can have an impact on both the top and bottom lines in as little as three months.

#### Stay abreast of regulatory changes

Pay close attention to government mandates and regulatory actions, which may become more interventionist in areas such as consumer health, control over national or local food ecosystems, and employee safety. If you lack an experienced public-affairs department, consider temporarily devoting resources to government relations and making it part of the crisis-response team's remit.

#### Scan for small-brand M&A

Consider updating your M&A strategy in the context

of your posture—for example, buying rather than building new capabilities or reframing priorities (for example, resilience over pure efficiency). If you decide to look for complementary assets, focus on strategic acquisitions: brands that expand your portfolio, challengers within your major categories, or resilient adjacent players.

While industry players are balancing many challenges, private-equity firms are single-mindedly focused on preparing for transactions. Make sure that any asset-valuation work is risk-managed and rooted in your scenarios. Also, consider divestments of your own underperforming or less-strategic assets to free up cash and ensure longer-term resilience.

#### 5. Set trigger points that drive your organization to act at the right time

Finally, time is of the essence. Lay out key indicators and set clear trigger points for each scenario; ensure that your teams have the data and processes to identify these trigger points as soon as possible. It's then up to the top team to give the go-ahead to execute the plans.

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The consumer trends that are crystallizing during the crisis and will most likely persist—recessionary behavior, greater digital engagement, attention to wellness and hygiene, nesting, and heightened expectations of corporate purpose—will affect every CPG category. By establishing plan-ahead teams and acting on the five frames, CPG companies can emerge stronger from the crisis and be well positioned to succeed in the next normal.

**Raphael Buck** is a senior partner in McKinsey's Zurich office; **Tracy Francis** is a senior partner in the São Paulo office; **Eldon Little** is a senior partner in the Dallas office; and **Jessica Moulton** is a senior partner in the London office, where **Samantha Phillips** is an associate partner.

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<sup>21</sup> S&P Capital IQ and Corporate Performance Analytics by McKinsey data; performers defined as those in top quintile based on total returns to shareholders from 2007 to 2011.



# How China's consumer companies managed through the COVID-19 crisis: A virtual roundtable

*Xin Huang, Alex Sawaya, Daniel Zipser*

## About the participants



**Jan Craps**

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Jan Craps is Zone President for Asia Pacific, AB InBev, and Chief Executive Officer & Co-Chair at Budweiser Brewing Company APAC. AB InBev is a leading premium brewer in the China beer market, and is expanding across the region after Budweiser APAC listed in Hong Kong in September 2019. After joining AB InBev in 2002, Jan relocated to Canada to lead the Quebec Sales Region, and was then appointed Head of Sales for Canada, before becoming Business Unit President in 2014. He later moved to APAC, where he served as Zone President Asia Pacific South, Member of the Executive Board of Management of AB InBev. Prior to joining AB InBev, he was a consultant in McKinsey's Brussels office.

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**Motonobu Miyake**

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Motonobu Miyake is CEO of Japanese convenience store operator Lawsons (China) Holdings, where he oversees more than 2,000 stores, and is driving an expansion to 3,000 outlets this year.

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**Jean-Michel Moutin**

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Jean-Michel Moutin is Chief Operating Officer of luxury brand LVMH Perfumes for Greater China and North Asia. He has spent the past seven years in China, moving from Shanghai to Hong Kong, overseeing LVMH Perfumes & Cosmetics' business in the region from a strategic, operational, and financial perspective. Previously, he was CFO of Parfums Christian Dior, LVMH's biggest cosmetic brand. He has worked for LVMH for 25 years across Asia and Europe at corporate, regional, and local level.

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**Feng Hua Song**

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Feng Hua Song is Vice President of Erdos Group. Erdos is the world's largest manufacturer and retailer of cashmere apparel, with five brands: 1436, Erdos, 1980, Blue ERDOS and ERDOS Kids. Erdos markets its apparel through over 500 direct stores and over 1000 franchise stores. Feng Hua Song oversees Erdos' operations including merchandising, customer relationship management, manufacturing, and supply chain operations.

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**Belinda Wong**

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Belinda Wong is Chairman and Chief Executive Officer of Starbucks China, where she oversees the company's overall business on the Chinese mainland, including driving Retail business growth through leading and strengthening the store experience, and pioneering the next wave of digital innovations for the Digital Ventures business. Wong is also a member of Starbucks global executive leadership team, contributing 20 years of experience building the Starbucks brand across China and the Asia Pacific region to the company's global strategic decision making.

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**Dr. Wenzhong Zhang**

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Dr. Wenzhong Zhang is Chairman of Beijing-based Wumart and Founder of Dmall. Wumart operates more than 1,800 fresh grocery hypermarkets and supermarkets, convenience stores, department stores, and home improvement stores in China with annual sales over 50 billion RMB. Dmall is an ecommerce and online-to-offline retail specialist that partners more than 100 large retailers and 10,000 brick-and-mortar stores in China, and counts more than 80 million registered users and over 18 million monthly active users on its mobile app.

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On March 19, China reported no new locally transmitted cases of COVID-19 for the first day since the outbreak of the virus in the Hubei province capital of Wuhan. Extraordinary containment measures limiting the movement of millions, coupled with rapid medical response, appear to have proved effective in preventing new infections.

As a result, China's economy is resuming activity after a near total shutdown. Factories are restarting production, offices are reopening, and consumers are tentatively venturing outdoors and returning to stores. As China lifts its lockdown, Europe and North America are entering their own period of uncertainty, with governments closing borders, issuing self-containment advisories, and banning public gatherings.

In this unprecedented period of transition, McKinsey's Greater China Consumer and Retail Practice conducted a virtual roundtable discussion with China-based executives at leading consumer-facing companies about their experience managing operations under lockdown. They spoke with Jan Craps, Chief Executive Officer & Co-Chair at Budweiser Brewing Company APAC; Motonobu Miyake, CEO of Lawsons (China) Holdings; Jean-Michel Moutin, Asia COO at LVMH Perfumes and Cosmetics; Feng Hua Song, Vice President of Erdos Group and GM of Erdos 1436 Brand; Belinda Wong, Chairman and CEO of Starbucks China; and Dr. Wenzhong Zhang, Chairman of Wumart and Founder of Dmall.

They offer perspectives on the chief difficulties they faced, the measures that proved most successful in mitigating the human and business impacts of the virus, and how their operational emphasis shifted through the epidemic.

They agreed that creating, communicating, and delivering new business plans in an uncertain environment was among the most difficult challenges they have ever faced. Acting fast to provide protective gear and sanitizer, additional insurance, and other health-related benefits, emerged as the most effective strategic response, as this was crucial for maintaining morale.

As the crisis deepened, digital communication with employees, both of safety measures and operational changes, and messages of support to customers, became vital in keeping strategic responses on track. With stores closed, businesses doubled-down on digital initiatives, including contextualized WeChat campaigns, online-to-offline and omnichannel sales, community commerce, and pure ecommerce. When stores reopened, contactless in-store ordering systems helped customers and employees feel safe.

The respondents also said planning to immediately reopen offline stores was critical to maintaining company spirit during the crisis. Many also suggested the experience has brought their companies closer together, while accelerating transitions to digital as they bring operations back to normal.

Below is a collection of reflections about their experience working under lockdown conditions, collated in the hope that executives in other markets can better adjust to similarly testing circumstances.

### ***McKinsey: What was the most difficult challenge you faced during the COVID-19 outbreak?***

**Motonobu Miyake:** The biggest challenge was maintaining operations while keeping employees safe when it was unclear whether customers were infected. We hand-carried medical goggles and protective clothing from Japan as it was difficult to source these and other in-store consumables like disinfectant, masks, and non-contact temperature checking devices. Store opening conditions were also tough to coordinate as they differed by region, and according to rules imposed by the buildings in which they are housed, both of which changed frequently. We made sure staff were aware that if they acted to comply with local regulations without consulting supervisors, they would not be penalized, and that clear and

open communication about their situation was paramount. It was also a challenge to keep headquarter operations running as a result of restrictions on office working.

**Belinda Wong:** There was no playbook. The situation was evolving rapidly amid huge uncertainty, so we had to decide how to lead. We pivoted from opening stores – in normal business a new Starbucks store opens roughly every 15 hours in China – to proactively closing most of our 4,300 stores, and taking measures to protect our 58,000 partners (employees). That meant unwinding everything I had learned over 30 years in retail. I had to completely reset my thinking, concentrating on protecting the safety of Starbucks partners and customers.

**Jean-Michel Moutin:** The speed and severity of the crisis required daily immediate action either for the safety of our people, or for the continuity of our business. Fast decision making was required in a multi-brand and progressively multi-market environment, as well as crisis management for a type of crisis that was not specifically on our radar.

**Jan Craps:** Nightlife venue and restaurant closures cut off our usual points of contact with consumers, so the challenge was to shift resources to in-home occasions via ecommerce and omnichannel; online to offline, and community commerce. This involved realigning cross-category promotions, and launching new in-home consumer experiences like weekly DJ livestreams, and e-gaming events, while digital influencers conduct online sales. We also customized marketing around home-delivery, and linked this with our loyalty program to drive repeat purchases through the lockdown period. For social commerce, we piloted having select consumers and employees act as brand representatives and group-buying coordinators for different compounds and residential developments. Putting all this together in double-quick time under lockdown conditions was hugely challenging for all involved.

***McKinsey: In hindsight, what were the most impactful actions you took at the onset of the outbreak?***

**Belinda Wong:** We were among the first major brands to proactively close most of our stores, to protect our partners, customers, and society, though this quickly shifted to reactive closures. At the peak of the crisis, 80 percent of our stores were closed. For stores that remained open, protecting our partners and ensuring they felt safe drove our early decisions. Apart from securing supplies of masks and sanitizing agents, we drew up elevated store operation standards, establishing a ‘safety station’ at entrances to check customers’ temperatures, and ensure they wear masks before entering. All partners are required to undergo daily temperature checks, and wear masks at all times, while washing their hands and sanitizing surfaces at regular intervals. We also introduced the ‘Contactless Starbucks Experience’ – digital ordering via mobile that minimizes human contact, and reduces the time customers have to stay in-store. Some stores continued to offer limited lobby service, with reduced seats to maintain a safe distance between individual customers.

**Dr. Wenzhong Zhang:** We convened our leadership every morning and evening to review procedures and progress, and published nine versions of guidelines to counter virus transmission with the result that among our 100,000 staff there have been zero infections so far. Our team traveled to South Korea to purchase facial masks, which enabled us to have the first batch delivered to Beijing on January 29, and ensure the capital did not run out of stock, despite sales of 18 million units in the first month of the outbreak. At the onset of the crisis, we supplied up to 90 percent of the masks sold in Beijing, in the process helping minimize virus transmission in the city. We also tripled supplies of fresh vegetables and meat to Beijing to make sure the city did not run out, and donated food and other supplies to hospitals and communities in Wuhan.

**Jan Craps:** Leveraging our global procurement network to source protective gear and masks for all our 26,000 employees. We launched digital employee health tracking and support, complemented by hygiene and health training, and measures to disinfect breweries and offices. We offered cashflow

support to our wholesalers, and provided retailers with toolkits including masks, gloves, and sanitizers so they could reopen. We also defined seven-day, 30-day, and 100-day action plans, starting with a war room focused on employee welfare and social responsibility, including donations of protective gear. The 30-day plan aimed to reshape the business and resume operations, while the 100-day plan seeks to grow the China business post-crisis. Big data allowed us to differentiate the speed and level of our investment by channel and region, while monitoring progress on a city by city basis.

**Jean-Michel Moutin:** Protecting the safety of our staff was paramount. We defined safety measures, and in less than 10 days put in place a full supply chain to source and dispatch hundreds of thousands of masks to our staff all over Asia, in the field and at the office. That required an unprecedented degree of coordination between human resources and logistics staff. We then acted to preserve the business by focusing on ecommerce while managing a supporting supply chain, and organizing new ways for our office staff to work from home.

**Feng Hua Song:** Responding quickly and maintaining a strong relationship with customers and staff. We rapidly distributed masks to employees, and 500 VIP customers, along with a goodwill message. This might seem like a small gesture, but it helped instill confidence in our organizational stability, and was deeply appreciated by customers. Fast and effective communication was essential, so we prioritized sending a letter to all our staff emphasizing that the company would be there to support them. Once we had dealt with the fundamentals, we formed a dedicated team to accelerate development of our online business, as we knew offline would be hit hard. We used WeChat to ensure our customers and staff, which was larger than usual because of Chinese New Year sales, were kept up to date. Later, we successfully launched a Valentine's Day WeChat campaign with the "love is the cure" slogan that helped drive online sales of new apparel lines.

On January 26, Erdos also restarted our cashmere coat factory, purchased materials from around the country, and converted production to manufacture protective masks and clothing. We also instituted professional disinfection and sterilization procedures that helped bring the epidemic under control in Inner Mongolia. On the same day, the Chairman of the Board of Directors of the Group personally called the President of Mitsui Corporation in Japan, drawing on a partnership built up over several years, and asked for help with the purchase of professional protective materials from around the world. From February 5, materials worth over 20 million RMB flowed into the country and onto the front lines of the fight against the epidemic. On February 9, we donated 8 million RMB to the Song Qingling Foundation to establish the "Erdos Warmth Fund" to care for and support frontline medical staff and their families.

**McKinsey: *Is there any major difference in your actions and focus in the first two-three weeks of the outbreak compared with more recently as things have started to stabilize/recover?***

**Jean-Michel Moutin:** Our first weeks focused on immediate decision making to preserve employees' safety, and the continuity of our retail business and supply chain. Now, we are working on managing the recovery in China, with progressive reopening of our retail network, and preparing for the rebound. We are also analyzing the medium-term consequences of a worldwide outbreak, with an economic and financial crisis following in its wake. This will likely be combined with accelerated changes in our Chinese consumers' habits, like moving even faster than expected to digital and ecommerce, while reducing their travel abroad for at least a few months. Focusing on crisis management does not mean that you have to give up long-term perspective and strategic capability building, especially in a market as important as China. Finally, in the last week, we have leveraged our China supply chain to secure orders for 40 million surgical masks, with the intention of distributing these to the French national health service.

**Belinda Wong:** Early on, we committed to paying partners even when our stores were closed, stepped up insurance benefits in the event that partners or their family members contracted the virus, and launched a Partner Assistance Program (PAP) to give counseling to partners and their families, with costs



borne by the company. As the situation evolved, we shifted focus to reopening, which was critical not just for the business but also for company spirit. We started planning to reopen while store closures were still growing, prioritizing our partners to ensure they were safe and confident in their working environment. Now, over 90 percent of our stores have reopened.

**Dr. Wenzhong Zhang:** In the early days of the crisis, we concentrated on meeting demand for fresh and staple foods, as well as protective gear. There was enormous demand for home delivery, and contactless pick-up. We set up about 3,000 online-to-offline community pick-up stations, which covered more than half the 4,000 communities in Beijing. These played a significant role in keeping the city supplied as it was going under quarantine, and attracted strong mobile orders in the first 10 days. We expect this model to continue growing strongly even now that the virus situation has come under control.

**Motonobu Miyake:** In early January, we did not yet feel a sense of crisis, and it was only on January 20 that travel to Wuhan was restricted. After the city was blockaded, we web-conferenced a leadership meeting involving Chinese management who had experienced the Severe Acute Respiratory Syndrome (SARS) epidemic. They drafted advice on what the likely government regulatory response would be, and we delivered this across the regions, while adjusting opening procedures to keep employees safe. We also procured extra store consumables – particularly masks and cup noodles. As the crisis evolved, the government or host building instructed us to close stores to prevent new infections. We then reviewed our manufacturing processes and made volume adjustments based on the principle of safety first; we were concerned that factories facing staff shortages, and under pressure to meet emergency orders, might take shortcuts on hygiene, and so reduced our orders in line. We also looked into emergency financing in case we had funding difficulties. Right now, store supplies of consumables are almost back to normal, with relatively few shortages, and we aim to normalize headquarters and store operations. Our biggest task is to rescue the franchisee stores who have suffered economic distress.

**Feng Hua Song:** The biggest difference is in the mentality of the organization, which shifted from being unsettled to one of confidence after our response became clear, and people came to terms with ex-office work routines. Once the situation was under control, we shifted to strategic planning; looking at ordering remotely for the next season. We also began to work on revised three-year plans that included much more aggressive omnichannel targets, transforming our supply chain to be more agile, and other strategic moves to grow the business.

**Jan Craps:** In the first few weeks, our focus was employee safety and preparing to resume commercial and supply chain operations. More recently, we have returned to growth mode; developing new consumer trends, and accelerating existing trends like premiumization, and digital trade.

**McKinsey: *If you had one piece of advice for companies around the world battling COVID-19 under lockdown conditions, what would it be?***

**Jean-Michel Moutin:** Dare and care. Dare to take quick decisions through a crisis management team properly empowered to preserve business continuity. Care about your team, always putting people first in terms of health and financial security both on the frontline and in the back-office to guarantee service continuity. It is important to make sure your teams feel supported by management. A combination of managerial courage, teamwork, and strong resilience is required. As Nelson Mandela said: “May your choices reflect your hopes, not your fears”.

**Dr. Wenzhong Zhang:** We believe the coronavirus crisis has brought forward the timeline for adoption of omnichannel grocery services, such as remote ordering and pick-up, by at least one year. Keeping track of how online ordering preferences change under lockdown is also essential; customers sought to vary their diet across a balance of ready meals and home-cooking, and there were significant shifts among top-selling brands.

**Motonobu Miyake:** Assuming a prolonged lockdown, the first step is to keep employees safe, and prepare for reopening. A company cannot survive if it is closed forever, and there is tremendous value in empowering staff with the message that their work is essential to life returning to normal. Those in a position to do so should offer support to medical institutions.

**Jan Craps:** Empower regional teams to deliver within guardrails based on best practice and non-negotiables like safety, quality, and business protection. Give more flexibility and autonomy to frontline teams to react rapidly, given the situation can be very different city-by-city and channel-by-channel. Crisis-hit consumers are shifting towards more home-cooking and looking for innovative forms of in-home entertainment, while demonstrating increased preparedness to trade up, opening opportunity for agile businesses to meet evolving consumer demands.

**Feng Hua Song:** Though in physical lockdown, it is important not to panic, and focus on organizing a response. In the digital age, a strong organization should always be connected, and we have realized that many roles do not require face-to-face interactions. The leadership group must act calmly to maintain the confidence of employees, as this is key to holding the company together. If all goes well, a more tightly knit organization will emerge from the crisis.

**Belinda Wong:** I remembered how Howard Schultz (Starbucks founder and chairman emeritus) used to say that not every decision is an economic one. That has stuck with me, and in the current crisis, it helped me understand what I needed to do. I fell back on the fundamental principle - what is the right thing to do for our partners, customers, and the country? In times of extreme ambiguity, our values can provide much-needed clarity and guidance.

**Xin Huang** is a partner in McKinsey & Company's Shanghai office; **Alex Sawaya** is a partner in the Hong Kong office; **Daniel Zipser** is a senior partner in Shenzhen.

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# How the packaging industry can navigate the coronavirus pandemic

The industry is a key player as consumers and other sectors adapt to the COVID-19 outbreak. Here is a three-step plan that can help packaging companies through the crisis.

*by David Feber, Oskar Lingqvist, and Daniel Nordigården*

**As the coronavirus outbreak** has spread and its humanitarian impact has grown, industries that help provide for essential needs, such as getting food and required supplies safely to consumers, are increasingly affected. With food packaging being the packaging industry's largest area of activity, the \$900 billion per year worldwide industry is on the front lines. The coronavirus crisis has already led to some of the sharpest declines in recent times in demand for certain types of packaging while accelerating growth for others—such as packaging for e-commerce shipments that are emerging as lifelines in this new world. Such changes are presenting many packaging companies with a new set of challenges. In this article, we present a three-step plan to help them navigate through the crisis.

### Packaging demand is expected to move through three phases during the outbreak

We expect that the impact of the coronavirus crisis on the packaging industry will be mixed—and this pattern has already been playing out in countries such as China and South Korea, which have been the first to confront the pandemic. Demand will rise sharply for packaging for groceries, healthcare products, and e-commerce transportation. At the same time, demand for industrial, luxury, and some B2B-transport packaging could decline. The impact on packaging players will depend on their portfolios and exposures to different regions, end uses for packaging, and substrates (Exhibit 1). As the pandemic tightens its grip on other regions,

Exhibit 1

## The COVID-19 impact on packaging players will likely be mixed, depending on converters' portfolio position.

Change in expected US consumer spend per category, not exhaustive, net intent<sup>1</sup>

■ Increase    
 ■ Stay the same    
 ■ Decrease

		Impact on packaging substrate, not exhaustive
Groceries	+14	● Flexible, rigid plastics and corrugated grocery packaging
At-home entertainment	+3	● Corrugated and protective packaging
Household supplies	+1	● Plastic bottles and metal aerosols
Snacks	-7	● Flexible films (eg, oriented polypropylene)
Personal-care products	-11	● Tubes, bottles, jars, and caps/closures
Takeout/delivery	-22	● Food-service packaging (eg, plastic, paper)
Alcohol	-23	● Metal and glass bottles
Consumer electronics	-36	● Corrugated and protective packaging
Skin care and makeup	-38	● Plastics, tubes, glass, and jars
Footwear	-47	● Corrugated and microflute packaging and cartons
Apparel	-50	● Corrugated and microflute packaging and cartons
Jewelry	-53	● Folding cartons and paper boxes
Out-of-home entertainment	-63	● Food-service packaging

<sup>1</sup>Net intent calculated by subtracting the % of respondents stating they expect to decrease spending from the % of respondents stating they expect to increase spending; n=1,402, sampled and weighted to match US general population aged ≥18 years. Question: Over the next 2 weeks, do you expect that you will spend more, about the same, or less money on these categories than usual?

Source: McKinsey M&S COVID-19 US Consumer Pulse Survey, Mar 16–17, 2020

packaging demand in those regions is likely to move through three phases.

Phase one is the period of initial shock, which typically lasts at least four weeks but can extend for much longer. Changing consumer sentiment<sup>1</sup> translates to cutbacks in a number of categories, reducing demand for certain types of packaging. The immediate demand shocks to the packaging industry are less drastic than for sectors such as travel and hospitality, but they could be substantial in several areas:

- **Industrial, bulk, and transportation packaging.** Demand for this type of packaging is closely linked to the trend in GDP and the level of industrial activity, so the sharp decline related to COVID-19 leads to a reduction in packaging demand. However, some of this is being offset by industrial customers stockpiling purchases of intermediate bulk containers and drums, which causes a temporary spike in demand. At the same time, several segments—such as packaging for the food and pharmaceutical industries—continue to see robust demand. High growth in demand for corrugated packaging for e-commerce and grocery deliveries is also offsetting some demand lost elsewhere with industrial customers.
- **Consumer packaging.** Demand is likely to shift drastically in the food area as the pandemic shuts down restaurants and food-service outlets. Consumers will thus continue to move to grocery purchases, for which packaging demand will rise. Consumers' wishes to stockpile and their panic purchases of food, beverages, and home-care necessities have accentuated this trend. But demand for nonfood and premium-good packaging is being hit as stores are required to close and as consumers start to cut back on their spending.
- **Healthcare packaging.** Demand will rise across different healthcare-packaging types and related substrates, including flexible blister foils, pumps, closures, and rigid plastics. Similarly,

demand will rise for packaging used in dietary supplements, such as vitamins, and for essential supplies, such as allergy medication, that consumers will need in a lockdown situation.

The packaging industry also needs to be ready for second-order effects triggered by the COVID-19 crisis. As crude-oil prices have fallen (partly because of the pandemic's effect on demand), the cost of oil-based raw materials, such as plastic resins for the packaging industry, is likely to fall. The strengthening of the US dollar has improved the relative competitiveness of packaging-raw-material makers based elsewhere. At the same time, border closures are leading to challenges for companies with extended supply chains and those that rely on teams to be able to move internationally to overhaul equipment. These developments spell a period of high uncertainty for many areas of packaging demand and different packaging substrates. The unpredictability of how government actions to mitigate the adverse economic effects of the pandemic might play out further clouds the outlook.

Phase two covers the period when countries and regions bring the pandemic under control. The length of this period is, of course, uncertain, and it is realistic to consider a number of scenarios for its duration, from a few quarters to longer than one year.<sup>2</sup> Reduced household disposable income and weakened corporate balance sheets are expected to lower demand across most end-use segments for packaging, with the exception of healthcare and certain food categories.

During this phase, we expect certain consumer behaviors, such as stockpiling, will slow while others, such as grocery purchases via e-commerce, will accelerate. Key implications for packaging include nongrocery retail likely coming to a near halt, demand for low-cost private-label goods likely increasing, and demand for high-end packaging likely declining. The fight to defeat COVID-19 could also start to affect packaging choices, favoring packaging designs and substrates that demonstrably address hygiene and consumer-safety concerns—for example, those that minimize

<sup>1</sup>“Survey: US consumer sentiment during the coronavirus crisis,” April 2020, McKinsey.com.

<sup>2</sup>Kevin Buehler, Arvind Govindarajan, Ezra Greenberg, Martin Hirt, Susan Lund, and Sven Smit, “Safeguarding our lives and our livelihoods: The imperative of our time,” March 2020, McKinsey.com.

the possibility of the virus's survival on the packaging surface.

Packaging players also need to ready themselves for other developments. Depending on the severity and duration of the crisis, lower household disposable income and weakened corporate balance sheets at the companies that are the customers of the packaging industry could result in significant pressure to reduce selling prices and costs along the whole packaging-industry value chain. Companies need to prepare for scenarios under which small and medium-size enterprises and heavily indebted companies could end up bankrupt—events that could sweep away customers, subsuppliers, and printers. In our view, the severity and duration of phase two will be highly dependent on governments' actions to mitigate adverse economic effects.

Phase three is the rebound, in which we expect to see packaging demand gradually return. Some sectors, such as packaging for food service, should see a rapid rebound of demand. For others, the rebound is likely to be slower, as consumers are likely to be more hesitant to return to luxury products, travel, and the hospitality industry. Consumers' purchasing behavior could stay soft as businesses emerge only weakly from the crisis and employment levels suffer.<sup>3</sup> The speed of packaging players' recovery will be differentiated largely by segment, depending on the degree of disruption among the segment's customers and challenge to different players' supply chains.

### **How will COVID-19 affect the industry's megatrend drivers?**

The COVID-19 crisis is likely to alter some of the megatrends at work in packaging<sup>4</sup> (Exhibit 2). Consumers across the globe are going to be increasingly inclined to buy their

products through different channels from those they used before the pandemic, leading to a strong acceleration of e-commerce shipments and other home-delivery services. US consumers are changing their behavior in the light of the crisis: research suggests they intend to double their spend at online-only grocery stores.<sup>5</sup> A similar pattern has been seen in China: online sales of fresh food by a large online retailer grew more than 200 percent during a ten-day period in late January 2020 compared with the same period in 2019, with sales of meat and vegetables increasing more than 400 percent.<sup>6</sup> Cost pressures on the packaging industry are also expected to increase, with its customers under strong pressure, consumers becoming even more price sensitive, and packaging converters needing to win a sufficient volume of orders to keep their plants well utilized.

How will the sustainability agenda that has become an important issue for the packaging industry be affected by COVID-19? It seems likely that concerns about hygiene and food safety in the context of the pandemic might become a higher priority while the sustainability performance of different packaging substrates could become a lower priority—at least for the short term. Because of the pandemic, there is a new appreciation by consumers and industries of the hygiene advantages plastic packaging can offer that seems to be outweighing concerns about recyclability and plastic-waste leakage into the environment.<sup>7</sup> For example, a global coffeehouse chain is temporarily banning reusable cups amid the outbreak. At the same time, in the current state of emergency and concerns about virus-contaminated surfaces, numerous cities and retailers around the world are putting off the introduction of bring-your-own-bag measures and suspending recycling services for both residential and commercial customers. Some recycling contractors have also suspended services because of inadequate staffing.<sup>8</sup>

<sup>3</sup> See Matt Craven, Linda Liu, Mihir Mysore, Shubham Singhal, Sven Smit, and Matt Wilson, "COVID-19: Implications for business," March 2020, McKinsey.com.

<sup>4</sup> Including sustainability, cost pressure, e-commerce, digitization in general, and shifting consumer preferences. For more, see David Feber, Daniel Nordigården, and Shekhar Varanasi, "Winning with new models in packaging," May 2019, McKinsey.com.

<sup>5</sup> McKinsey Marketing & Sales COVID-19 US Pulse Survey, conducted March 19 to March 22, 2020, of 1,502 respondents, sampled and balanced to match US general population aged 18 years and older.

<sup>6</sup> *JD.com corporate blog*, "How Chinese are spending during the coronavirus outbreak," blog entry by Yuchuan Wang, February 8, 2020, [jdcorporateblog.com](https://jdcorporateblog.com).

<sup>7</sup> Peter Berg, David Feber, Anna Granskog, Daniel Nordigården, and Suku Ponskhe, "The drive toward sustainability in packaging—beyond the quick wins," January 2020, McKinsey.com.

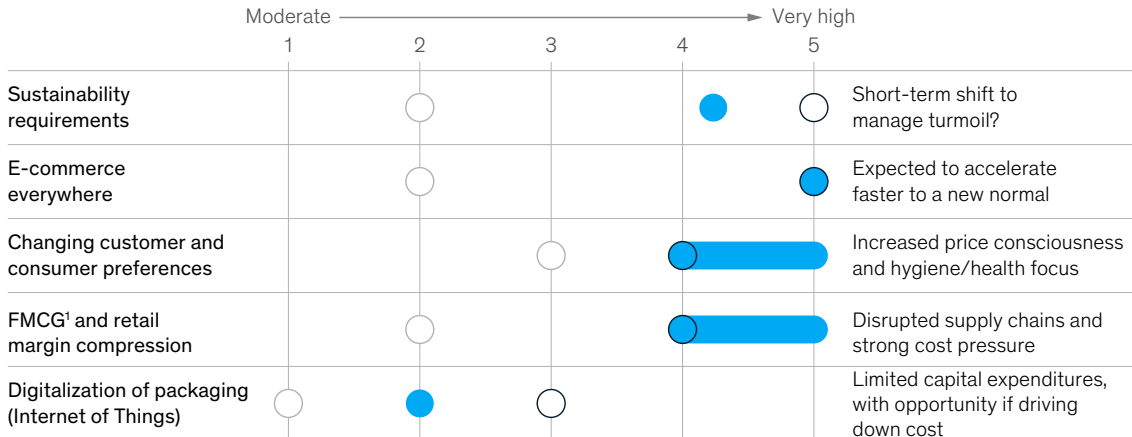
<sup>8</sup> Leslie Kaufman, "Plastics had been falling out of favor. Then came the virus," Bloomberg, March 15, 2020, [bloomberg.com](https://www.bloomberg.com).

Exhibit 2

**Packaging megatrends are changing with the COVID-19 crisis.**

**Observed and expected impact of trends on packaging industry, scale 1–5**

○ Past 5 years ○ Next 10 years ● Current COVID-19 impact



¹Fast-moving consumer goods.

The open question is, whether this reevaluation by consumers of the trade-offs between hygiene, safety, and sustainability performance marks a permanent shift, or whether sustainability performance could reemerge as a source of competitive advantage that could help some packaging players as they come out of the crisis—particularly if they take such trade-offs into account? A resourceful packaging company might be able to help both customers and consumers if it found a cost-effective and sustainable substrate on which the novel coronavirus has minimal viability. There is plenty of room for improvement: a recent study showed that the virus’s survival rates varied from 24 to 72 hours on different packaging substrates, with the longest being on plastic and stainless steel.<sup>9</sup> Packaging players could also consider using temporary spare capacity in plants to scale their pipelines of new, more sustainable packaging materials for end-use segments in which demand is still high.

**Actions for packaging companies to consider**

Leaders of packaging companies could consider a three-part response to the crisis.

**Part one: Navigate the now**

As a first action, a packaging player can create a crisis-response nerve center that can steer the organization and serve as the core information source.<sup>10</sup> The center can manage risks and responses and align all stakeholders. A key priority should be to support and protect employees’ health. Besides that being arguably a moral responsibility of an employer, it is also a pragmatic first line of response to maintain an enterprise’s ability to function at all.

Acting on this top priority can happen in several areas. The company can monitor health risks and communicate about them through updates on its intranet, postings at the entrance to its sites, and regular conduct training on how to handle them. It can also provide personal protective equipment, including masks, gloves, and hand sanitizers, and can regularly clean its buildings. It can also implement targeted processes and policies that include checklists, new travel and meeting guidelines, and the splitting of teams into shifts when operationally possible.

The company can also review its production footprint and what it will need to ensure that it can

<sup>9</sup>“New coronavirus stable for hours on surfaces,” National Institutes of Health, March 17, 2020, nih.gov.

<sup>10</sup>Mihir Mysore and Ophelia Usher, “Responding to the coronavirus: The minimum viable nerve center,” March 2020, McKinsey.com.



keep running by creating country-specific plans and clear checklists for plants. Related to this is the need to screen the supply chain to understand the risk of disruptions—such as dependence on a single supplier source for raw materials or on printers that might close—and then take actions to address anticipated disruptions and shortages.

Once the top priorities to maintain health and operations have been dealt with, a leadership team can set about understanding how consumer sentiment may be evolving—for example, to an acceleration in e-commerce shopping and higher-than-previous demand for grocery packaging—and how that could make some shifts necessary in its portfolio of packaging offerings. Based on that assessment, a leadership team can review its operating model to evaluate its packaging-production flexibility. For example, it can take steps to understand where demand will be temporarily high and assess its ability to shift production appropriately to fulfill new demand patterns. At the same time, the leadership team can evaluate what it needs to do to ensure the company's financial health by identifying and mitigating risks of declining demand from certain segments and by monitoring raw-material-pricing indexes closely to protect its margins.

#### **Part two: Plan for the comeback**

Leadership teams in packaging companies should build a recovery strategy that will include a mix of financial resilience, operational plans (such as restarting operations at packaging plants that it might have had to temporarily close and assessing future market-demand potential), and strategic customer-focused moves (such as understanding the impact of COVID-19 on particular customers' packaging-substrate choices).

Companies can take steps to identify packaging categories that are likely to return to strong levels of demand. They can also consider the supply-chain

requirements and production planning—including addressing the footprint and rebalancing supply—that they will need to cope with that return. They can also look out for new pockets of growth potential with different packaging end uses and different substrates. Last, companies can review the packaging product designs and associated capabilities that they would need to manage new trends in consumer sentiment and requirements, such as safety, health concerns, and more e-commerce.

Based on those assessments, leadership teams can sharpen their companies' value propositions to deliver on the next normal in demand. Such propositions could include the ability to adapt packaging designs best to the needs of e-commerce while simultaneously adhering to consumer preferences and, at the same time, always delivering greater cost efficiency.

#### **Part three: Shape the next normal**

Packaging-company leadership teams should assess which shifts are getting under way in customer and consumer sentiment and which behaviors may stick after the crisis—for example, hygiene requirements, e-commerce, and resurgent concerns about sustainability. They can also consider rethinking their business portfolios so that they can ensure the stable cash flows and healthy balance sheets that can protect their companies.

Steps that packaging companies can take to this end can include narrowing the range of substrates they currently use. They can also extend to evaluating acquisition opportunities of assets in the market that could strengthen their business. And finally, companies need to make a regular practice of the kind of vigilance that served them well at the start of the crisis: thinking through the network implications for their plants and supply chains and the potential risks related to single sources of raw materials and packaging components.

**David Feber** is a partner in McKinsey's Detroit office, where **Daniel Nordigården** is an associate partner; **Oskar Lingqvist** is a senior partner in the Stockholm office.

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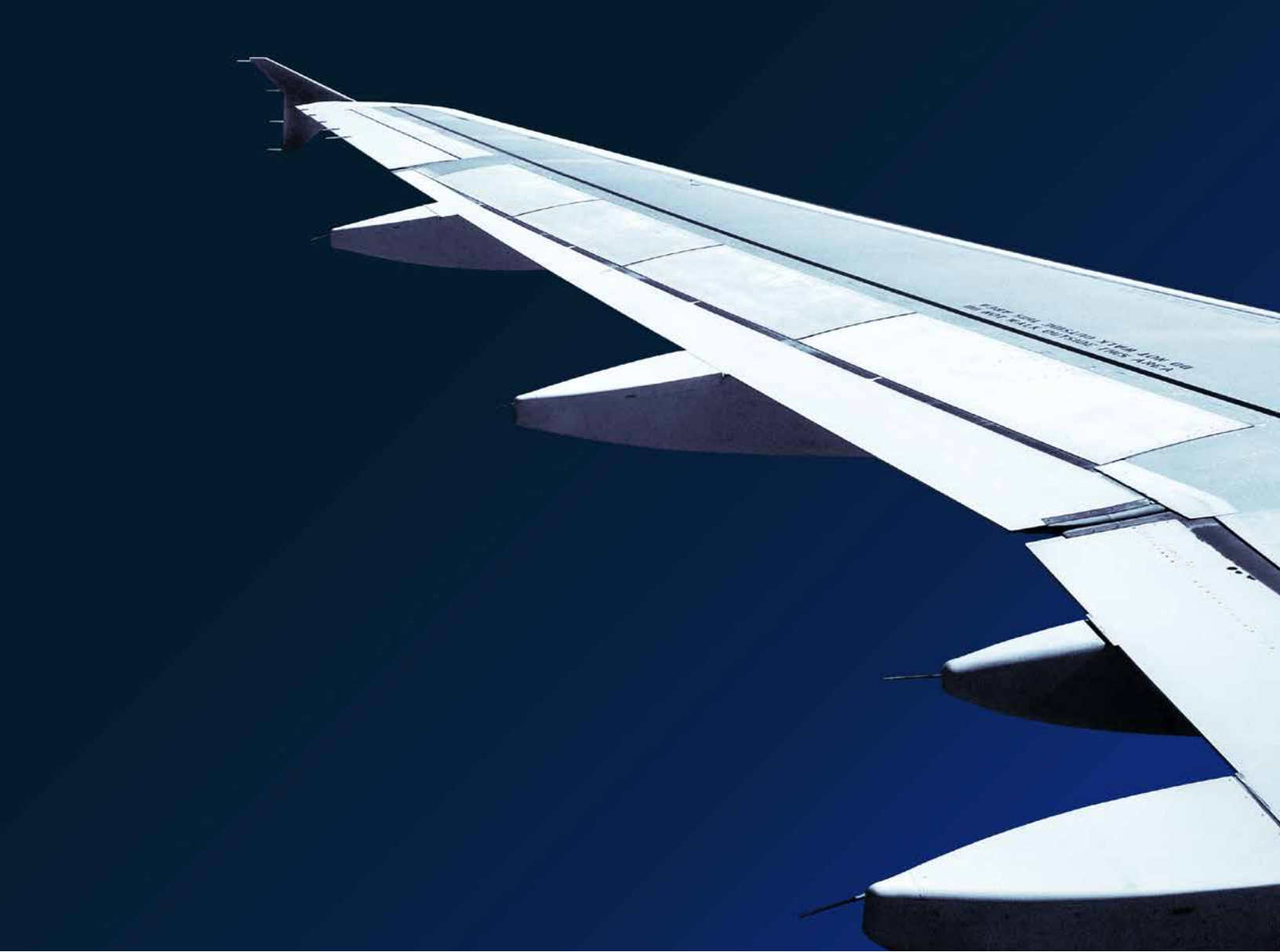
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# Coronavirus: Airlines brace for severe turbulence

COVID-19 has brought travel to a sudden halt. Airlines need strategies for navigating the crisis and returning to the skies.

*by Andrew Curley, Alex Dichter, Vik Krishnan, Robin Riedel, and Steve Saxon*

**Only four months after** the first case of COVID-19 was reported in China, the disease has spread worldwide and afflicted well over two million people. To curb the spread of coronavirus, many countries have taken extreme measures, including quarantines and border closures. As of early April, 2020, 91 percent of the world's population lived in countries that limited or forbid the entry of noncitizens and nonresidents.<sup>1</sup>

In addition to the human toll, COVID-19 is devastating the global economy. Although almost every sector feels some repercussions, few have been as hard hit as the airline and travel sector. The sudden, sharp decrease in travel demand is much worse than that seen after September 11, 2001, and the 2008 financial crisis, combined. Airlines had more robust balance sheets when COVID-19 emerged, compared with previous crises, but a slowdown of this magnitude leaves even the strongest players vulnerable.

Most airlines have sufficient short-term liquidity to survive the next three to six months, despite the sudden plunge in revenue. Some airlines have declared bankruptcy, but governments are also stepping up and providing financial support to ensure that airlines remain solvent. But the long-term picture raises concerns. Airlines will not return to normal operations and demand levels until 2022 at the earliest—and when they do, it will be in a world forever altered by COVID-19. That means 2020 will be a balancing act, as airlines simultaneously attempt to stabilize their business while preparing for demand recovery, all while operating in an uncertain landscape where the usual assumptions about traveler behavior may no longer apply.

### **The end of normal: Current airline demand**

With the closure of international borders and imposition of stay-at-home directives, travel demand is almost nonexistent. In the United States

alone, travel spending for 2020 is expected to decrease by around \$400 billion, translating into a loss of about \$900 billion in economic output.<sup>2</sup> These numbers mean that COVID-19 would have more than seven times the impact of September 11, 2001, on travel-sector revenues.

Worldwide, airline capacity is down 70 to 80 percent in April 2020, compared to April 2019, and multiple large airlines have temporarily ceased operations. Overall, almost 60 percent of the global fleet was grounded in early April 2020.<sup>3</sup> Again, a comparison with previous crises provides some perspective. US airline capacity was down more than 70 percent in early April 2020, compared with April 2019 (Exhibit 1). Those drops far surpass the year-on-year declines of 19 percent after September 11 and 11 percent after the global financial crisis of 2008. Likewise, we estimate US airline load factor is now down about 70 percentage points, well above the drops seen with prior crises.

With fleets grounded or most passenger flights cancelled, airlines are directing their energies to assisting with coronavirus-relief efforts. Many planes that typically fly people now transport cargo, including medical supplies used to fight COVID-19. Some airlines are also providing medical workers with free round-trip flights to New York City and other hard-hit areas, while others are helping by seconding staff into areas that need extra hands, such as medical facilities and grocery stores. These steps are a natural and much-needed first response to the crisis.

### **Looking ahead: How airline demand might evolve**

Of course, everyone hopes that the coronavirus is quickly contained and that a vaccine or effective cure becomes available, but it is also necessary to consider alternatives. Another McKinsey article, "Safeguarding our lives and our livelihoods: The imperative of our time," presents nine scenarios

<sup>1</sup> Phillip Connor, "More than nine-in-ten people worldwide live in countries with travel restrictions amid COVID-19," Factank, Pew Research Center, April 1, 2020, [pewresearch.org](http://pewresearch.org).

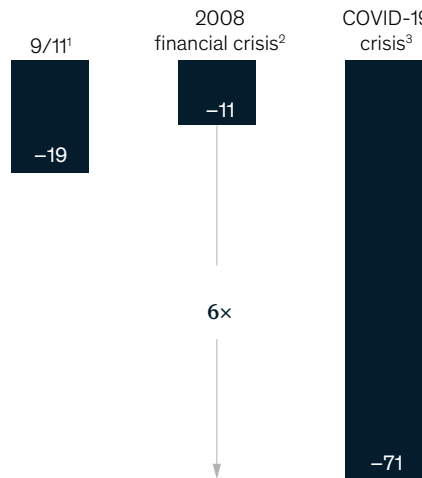
<sup>2</sup> *The economic impact of the coronavirus due to travel losses*, Oxford Economics, March 2020, [ustravel.org](http://ustravel.org).

<sup>3</sup> Andrew Doyle, "Tracking the in-storage fleet and utilization in a time of uncertainty," Cirium, April 2020, [cirium.com](http://cirium.com).

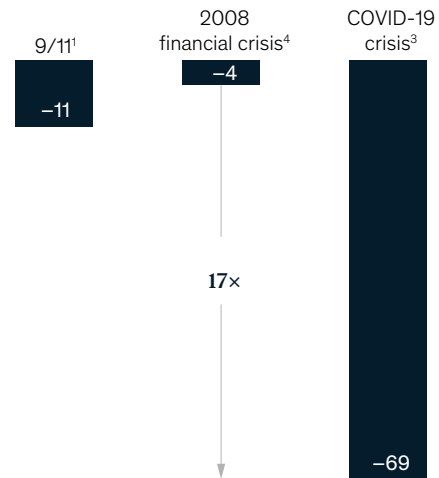
Exhibit 1

**COVID-19 has created an unprecedented crisis for airlines.**

**US airline available seat miles, year-over-year % change**



**US airline load factor, year-over-year percentage point change**



<sup>1</sup>Year-over-year change Sept 2000 vs Sept 2001. <sup>2</sup>Year-over-year change Feb 2008 vs Feb 2009. <sup>3</sup>Year-over-year change April 2019 vs April 2020. <sup>4</sup>Year-over-year change Mar 2008 vs Mar 2009.

Source: A4A; USDOT T100; press search

that illustrate how the COVID-19 crisis might evolve, depending on the success of containment efforts, government policy, and other factors. When examining how global travel demand might recover, we focused on two of these scenarios: one in which the pandemic resolves relatively quickly and one that takes a more pessimistic view. These divergent scenarios allowed us to envision and plan for two very different outcomes at a time when uncertainty reigns.

Even in the more optimistic scenario, in which the spread of coronavirus is rapidly and effectively controlled, air travel still drops by almost 50 percent in 2020. But, in this scenario, governments create strong economic interventions, travel bans start lifting as COVID-19 cases drop, and the global economy begins recovering in early May. Simultaneously, airlines successfully stimulate demand by lowering ticket prices. People resume

their normal behavior, with no lasting differences, and airlines ramp up operations. Global travel returns to pre-crisis levels by 2021 and exceeds them in the following years.

In the more pessimistic scenario, a coronavirus resurgence requires long-term mobility restrictions, economic interventions are weaker, and governments maintain travel bans for longer. As in the more optimistic scenario, airlines cut prices to stimulate demand but see limited gains. For leisure travelers, the combination of economic uncertainty and fear of infection results in low demand. On the business side, some work trips are replaced with the videoconferences that have become the norm during the pandemic. Air travel demand drops by about 60 to 70 percent in 2020 and does not recover to pre-crisis levels until 2023 or even later.

# Airlines must ensure that they have sufficient cash on hand to fund their short-term operations.

## **In a holding pattern: Immediate actions required to maintain operations**

With revenues plummeting, airlines must ensure that they have sufficient cash on hand to fund their short-term operations. Although many large airlines have enough cash to cover more than six months of zero-capacity operations, others have had to draw on available credit lines that they established pre-crisis. While some are also investigating new loans, for which they would use aircraft, real estate, and other unencumbered assets as collateral, they may have difficulty securing the funding. After all, the value of their assets has dropped sharply as demand contracts. Smaller, regional airlines are especially vulnerable to financial pressures. Widespread ratings agency downgrades could trigger breaches of covenants on debt agreements and increased holdbacks by credit-card issuers, cutting into airline working capital at a critical juncture.

Governments have already stepped in to help airlines sustain liquidity, and several are considering various financial-aid packages for them, including the following:

- Direct subsidies, designed to supplement company cash flow, which are generally distributed evenly to all industry participants; these may come with certain conditions, such as the need to maintain employment levels.

- Direct financial aid, such as government loans, or guarantees to ensure debt provision from financial institutions; these can have various structures and covenants, such as requirements to have an oversight board, time restrictions, or other limits on corporate governance.
- A reduction in, or waivers of, government-controlled taxes or regulations, such as landing fees; these incentives encourage airlines to keep operating, since they cannot collect benefits unless they are active.

The United States has already answered a call for relief from airlines through the Coronavirus Aid, Relief, and Economic Security Act (CARES) stimulus package, which earmarks \$50 billion in loans and salary support for passenger airlines. Other countries, including Finland and Norway, have started to extend loans to airlines.

With government support varying by country, some airlines may receive a competitive advantage and emerge from the crisis stronger than they were in the past, relative to their competitors. For others, of course, the opposite may be true.

## **Preparing for take off: Next steps for airlines**

After airlines have addressed their immediate liquidity issues, they require a plan that guides



them through the ongoing coronavirus pandemic and its aftermath. They may find a path forward by following a framework that McKinsey created to assist companies on their journey to the next normal. It guides companies through five phases: Resolve, Resilience, Return, Reimagine, and Reform. We have identified the questions and issues that companies must consider along this journey, with some being relevant during multiple phases (Exhibit 2).

**Resolve and Resilience: Surviving through the crisis**

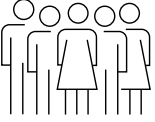
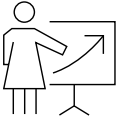
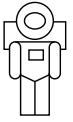
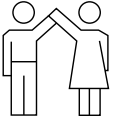
Most airlines are now focused on staying in business and keeping the lights on. But they will benefit their customers and employees much more if they also think strategically during this difficult time and consider challenging questions. Take liquidity issues. Will airlines need to adhere to certain operational requirements, such as continuing certain flight

routes, if they accept government assistance? And if they use assets as collateral to improve liquidity now, will that restrict their use in the future? If airlines fail to address such questions until late in the crisis, they might not recognize the long-term consequences until it is too late to reverse course.

With travel at record lows, airlines will also benefit from developing new strategies to connect with customers, who probably are not flying, and employees, who may not be working. And looking ahead to the day when travel restrictions lift, airlines might want to begin thinking about adjusting their health and safety operations now. Passengers may be hesitant to travel even after the coronavirus is contained, believing that airports and planes might expose them to infection, and employees might have similar concerns when returning to work. Many airlines have already adopted new safety

Exhibit 2

**The questions airlines must address will evolve as they navigate the crisis.**

 <p><b>Resolve</b></p>	 <p><b>Resilience</b></p>	 <p><b>Return</b></p>	 <p><b>Reimagination</b></p>	 <p><b>Reform</b></p>
<ul style="list-style-type: none"> <li>● As the <b>immediate liquidity situation</b> becomes more clear, what are the second order implications for the industry (eg, operating model changes, government conditions)?</li> <li>● For <b>safety of customers and employees</b>—what more can we do? What role does the industry have in shaping this? (vs governments)</li> <li>● How can we continue to <b>build engagement</b> with employees (who may not be working) and customers (who may not be traveling)?</li> <li>● How can we help <b>fight the coronavirus</b> (for instance through emergency cargo flights)?</li> </ul>	<ul style="list-style-type: none"> <li>● What are the characteristics of <b>early demand</b> (eg, segments, geographies), and what signals should we be watching?</li> <li>● What will it take for people to <b>feel comfortable traveling</b> again? Can travel be stimulated?</li> <li>● How can we ensure we capture (at least) our fair share of <b>nascent demand</b>?</li> <li>● How do we prime our <b>operations and commercial functions</b> to scale appropriately?</li> </ul>	<ul style="list-style-type: none"> <li>● How will the <b>characteristics of demand or supply</b> change (eg, who will travel, where, why, how)? What do we already know? How much "smaller" will the industry be in 2021, 2022, or later?</li> <li>● How will <b>end-to-end customer journeys</b> change (eg, expectations, behaviors, innovations)?</li> <li>● How will the <b>travel value chain</b> change (eg, who will emerge stronger, weaker, different)?</li> </ul>		

protocols, and others are now developing them. Some of the strategies that Chinese airlines have enacted—requiring passengers to wear masks and taking their temperatures pre-flight or asking for registration of previous and planned travel—might be replicated elsewhere.

### **Return: Ramping up operations**

Airlines will experience a gradual and uneven return to operations that requires an unprecedented logistical effort. Done poorly, their strategy may be as costly as the crisis itself. What's more, airlines must ramp up operations alongside ever-changing health mandates and government guidelines to which they must adhere.

While demand is currently low, airlines can gain an advantage by planning their return to large-scale operations now. It may be difficult to predict when that will occur, so they should carefully monitor early indicators for demand, such as flight-search activity, and examine data to identify customer segment and geographies that may represent new growth pockets.

Consider the Chinese market as an example. Some signs hint at possible demand growth, such as the reopening of many tourist attractions, greater hotel occupancy, and an uptick in public-transport use. A look at ticket sales is concerning, however, since purchases have plateaued after recovering slightly from their nadir. And a close examination of passenger demographics suggests that the current customer base may be very different, with young people and budget travelers predominating. Customer behavior has also changed, with short booking windows—often a week or two—now common as fewer travelers make plans far in advance. Passengers are also mostly booking domestic flights, and international travel is still waiting for its return.

Since travel may take years to reach pre-COVID-19 levels, airlines may have questions about whether they can truly stimulate demand. Although we do not know what new regulations may emerge to govern travel, there could be some time-consuming

additional checks or requirements that discourage business or short-term leisure travelers from taking trips. Regulatory differences between regions may also drive costly complexity in operations and create confusion for customers. Airlines will need to work proactively with one another, regulators, and others in the ecosystem to ensure a smooth and consistent customer experience while ensuring safety.

In this environment, airlines should carefully consider whether any specific incentives or discounts will produce the desired results or simply eat into their financials. While marketing efforts will be essential, as always, their content will change to reflect new customer preferences and concerns.

Again looking ahead, airlines may gain an advantage by thinking about the actions that their competitors are likely to take as travel increases and by determining how they will respond. Taking this step now will help them capture their fair market share—always an important goal, even if demand remains low. Airlines can also prepare by considering which people, processes, and systems must be available when operations begin to ramp up, so they can move quickly.

### **Reimagine and Reform: Becoming stronger than ever**

During these stages, airlines must acknowledge that once dependable patterns may disappear and that the traditional methods for determining prices, flight routes, and passenger incentives may no longer be valid because passenger preferences, demographics, and behavior have shifted. For example, segments that in the past might have been easily lured onto flights with cheap fares and deals might be less responsive to such actions if they still have health concerns. Some governments might also complicate the picture by making unexpected policy changes that restrict travel to or from their countries, even after the pandemic abates. As airlines gather information on these changes, they may need to update their pricing and revenue-management systems because they typically rely on past observations to create forecasts.

In addition to revising their planning processes, airlines may need to adjust the end-to-end customer journey since passengers may have new expectations and behaviors once they begin to travel again. Businesses may be reluctant to have their employees travel, especially internationally, and this may continue for some time. With such changes occurring, airlines may need to update their products, networks, and operations.

Finally, the airline industry itself will be different once the pandemic subsides. Some airlines will be stronger while others will be in a more difficult position than they were previously, or even sidelined altogether. Further consolidation is also likely in the new landscape, as are major strategic changes. With so many changes happening so quickly, and in a time of such disruption, airlines might want to reassess the competitive landscape and abandon any prior assumptions about their rivals before making major decisions.

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Almost overnight, airlines saw travel demand evaporate and busy fleets grounded. With revenues plummeting and continued uncertainty about the pandemic's course, airline leaders may have difficulty looking beyond the next few months. But those that think strategically about managing their return to large-scale operations, reimagining their business, and reforming their organizations to suit the next normal will help both their employees and their customers. Collaboration could be increasingly important to their success in the new world. For instance, airlines could form marketing partnerships with hotels, tourism agencies, and others within the travel ecosystem to increase demand, or assist governments and regulators in creating worldwide or regional standards for hygiene or operations. Such collaborations, as well as other strategic moves, will help airlines resume their primary goal of connecting our world.

**Andrew Curley** is a partner in McKinsey's Chicago office, **Alex Dichter** is a senior partner in the London office, **Vik Krishnan** and **Robin Riedel** are partners in the San Francisco office, and **Steve Saxon** is a partner in the Shenzhen office.

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# Coronavirus: Five strategies for industrial and automotive companies

To rebound from the coronavirus pandemic, industrials must undertake a journey that begins with resolve and ends with fundamental reform.

*by Joe Dertouzos, Heike Freund, Michael Mischkot, Asutosh Padhi, and Andreas Tschiesner*

**We are still in the early stages** of a global health crisis resulting from the coronavirus pandemic. Protecting lives is the first priority, but we must also protect our livelihoods. For automotive and industrial companies, surviving and emerging stronger at the far end of this crisis will require thinking beyond the next fiscal quarter. Success in the long run will require a journey across five stages: Resolve, Resilience, Return, Reimagination, and Reform (exhibit).

- screening and safeguarding the supply chain by understanding risks and taking action to address disruption
- adapting marketing and sales by identifying and mitigating the risks of declining sales while meeting critical customer needs
- maintaining financial health by improving liquidity, reducing costs, and establishing a spend control tower

## Resolve

The first stage, Resolve, involves determining the scale, pace, and depth of action required. To do so, companies in advanced industries must take the following steps:

- establishing a nerve center to steer the organization, serve as the information hub, manage risk and responses, and align all stakeholders
- protecting employees by making their health the paramount concern and adjusting production as needed

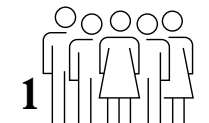
During the Resolve phase, companies must also make difficult choices, such as suspending production facilities, suspending discretionary spending, and furloughing workers. These decisions will require a comprehensive understanding of the situation, including data-driven scenarios for market evolution.

Consider the automotive industry. It is difficult to predict how the pandemic will affect sales in the European Union and the United States, two regions where coronavirus penetration is still emerging. We draw insights about potential developments by looking at the evolution of auto sales in China over

Exhibit

## Companies in advanced industries need to think and act across five horizons.

Here's how it applies to automotive and industrial companies



### 1 Resolve

Address the immediate challenges that COVID-19 represents to institution's workforce, customers, and business partners



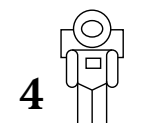
### 2 Resilience

Address near-term cash-management challenges and broader resiliency issues during virus-related shutdowns and economic knock-on effects



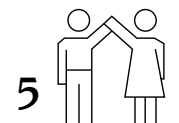
### 3 Return

Create detailed plan to return business to scale quickly, as COVID-19 situation evolves and knock-on effects become clearer



### 4 Reimagination

Reimagine the next normal: what a discontinuous shift looks like and implications for how institutions should reinvent



### 5 Reform

Be clear about how regulatory and competitive environments in industry may shift

the first quarter, since this country has already “bent the curve” and begun to recover from the coronavirus.

To translate the Chinese case study into scenarios for the European Union and the United States, we examined regional differences in viral spread, economic policy, and auto-specific supply and demand drivers. The latter includes OEM plant shutdowns, government restrictions on travel, consumer confidence, and overall loss of economic wealth. One scenario, which can help automotive companies move forward with greater resolve, is shown below as an example.

#### **Scenario: Virus contained; slow recovery**

In a scenario with containment of the coronavirus but a slow recovery, a strong public-health response succeeds in controlling the spread of the coronavirus within two to three months. Policy responses partially offset economic damage, a banking crisis is avoided, and recovery levels are muted.

In the European Union, 2020 real GDP contracts 4.4 percent, much more than the 0.4 percent in China. Temporary automotive plant closures are more extensive than those in China, leading to an estimated 8 percent reduction in production capacity. The strongest constraint, however, relates to consumer demand. Government lockdowns reduce auto sales to 10 percent of the pre-crisis forecast for April. Sales do not recover to 90 percent of the pre-crisis forecast until September, since consumer sentiment is less volatile in the European Union than it is in China. Over the course of 2020, more than five million unit sales, representing 25 to 30 percent of the pre-crisis forecast, are lost.

In the United States, 2020 real GDP contracts 2.4 percent. Similar to the European Union, government lockdowns force April and May auto sales to only 15 to 20 percent of the pre-crisis forecast. Consumer confidence then becomes the limiting factor. Experience from the recession of 2007 to 2009 suggests a slow, U-shaped recovery of consumer confidence. As a result, more than 5 million unit sales are lost in 2020, representing 30 to 35 percent of the pre-crisis forecast.

Globally, the automotive market could go down by as much as 20 to 25 in this scenario. The worldwide numbers are slightly better than those for the European Union and the United States because China is now recovering.

## **Resilience**

As industrials experience virus-related shutdowns and economic pressures, they should move quickly to address near-term cash management challenges and broader resiliency issues.

To understand what makes companies resilient, past downturns provide helpful insight. Some companies also flourish during those hard times—typically those that took significant action at the outset. Our experience shows that resilient companies, defined as those in the top quintile of total revenue share within their sectors, took several key steps:

1. They sustained organic revenue growth throughout the recession and out-performed on earnings and on revenue in recovery.
2. They moved faster and harder on productivity, which preserved growth capacity.
3. They divested 1.5 times more during the downturn and acquired 1.2 times more in the recovery.
4. They maintain clean balance sheets long before a downturn starts.

Compared with non-resilient companies, resilient businesses increased revenues by 30 percent and reduced operating costs three-fold.

The most resilient companies also created end-to-end plans to guide their recovery. They first identified key risks, both internal and external, and then developed a range of scenarios to predict future outcomes. Other important activities included stress-testing the P&L, balance sheet, and cash flows, and then establishing a portfolio of interventions. Resilient companies also set up “cash

war rooms” to improve transparency and implement tighter controls. Finally, the best companies built resiliency dashboards of leading indicators that could be easily monitored and updated.

## Return

Restarting production facilities can be more challenging than shutting them down. It requires a thoughtful approach to revive the supply chain, match volume to actual demand, and, most importantly, protect the workforce.

For worker safety, we can again learn from what is already happening in China. Factories there have taken special steps to resume operations. First, they restarted capacity gradually. For example, 20 percent of workers return every two weeks. Second, factories monitor the health of workers continuously. For example, employees get daily body-temperature checks upon entering to screen for potential infection quickly. Third, workspaces are redesigned with modifications that include deactivating elevators, increasing ventilation, and ensuring that workers are well spaced and not stationed to face each other. Lastly, to guard against a single-point failure, workers of the same type are separated into multiple groups.

Given the complexity of global supply chains, ramping up factories in a coordinated way will be mission critical. This will include four important phases:

1. Preparation. Companies reach full transparency about systems, networks, and workforce, including the parts and people available.
2. System filling. Leaders monitor their global supplier networks to ensure readiness.
3. Stabilization. Employees become familiar with the new normal and prepare for volume increase.
4. Ramping up. Companies produce the full product portfolio, matching supply and demand.

## Reimagination

The coronavirus pandemic could fundamentally shift how people live, work, and use technology. Advanced industries will likely see a shift in preferences as the expectations of workers and leaders begin to change. The organizations that reinvent themselves will emerge much stronger than those that simply work to reclaim their pre-COVID-19 position.

For industrial companies, this global health crisis may lead to a reimagination of the following:

- *the go-to market approach*, as businesses shift to e-commerce and companies digitize their sales experiences or place greater emphasis on new business models, such as rentals and leasing, to overcome consumer reluctance about purchases that involve a greater commitment

**Given the complexity of global supply chains, ramping up factories in a coordinated way will be mission critical.**



- *cooperation and alliances*, as “frenemies” work together to promote technology innovation while reducing the funding burden
- *M&A opportunities*, as companies increasingly seek deals when market capitalization approaches historic lows
- *workers’ roles*, as businesses further automate warehouses, plants, and facilities
- *geographic footprint*, as global supply chains increase the exposure to health impacts, disruptive trade dynamics, and an uneven global recovery
- *sourcing*, as the incremental costs of redundant sourcing outweigh the hazards of sole sourcing
- *costs*, as a shift from fixed to variable cost enables a lower breakeven volume in times of high volatility

## Reform

In addition to dealing with the significant societal changes coming in the next few months, industrial companies may want to consider strategies for addressing some of the persistent issues affecting the sector to avoid the next crisis. For example, they may want to minimize supply-chain risks by increasing local production or dividing production among more sites. Other imperatives include sustainability, workforce flexibility, and adaptability to accommodate changing tariffs. Above all, companies need early-warning systems to detect risks such as the coronavirus and get a head start on preparation.

We see two notable examples of reform emerging in the industrial sector. First, the spread of COVID-19

has already led to greater workforce flexibility, with teams adapting to remote or virtual ways of working. Additionally, companies have added flexible work hours, so that workers can care for children and elder family members during the crisis. In the next normal, we expect to see enterprise-wide flexible employment contracts at scale and more opportunities for remote working, which will allow better leverage of the global talent pool.

In another shift, industrials are likely to make fundamental changes to supply chains to improve their resilience. The current pandemic has revealed the global dependencies of most supply chains, and many industrial companies have shown a lack of contingency planning. With the high level of uncertainty arising from the pandemic, supply-chain leaders are placing more emphasis on forecasting efforts to help them determine global ramp-ups and improve reaction times. Going forward, we expect that local-to-local supply chains will provide more flexibility and that vendors will be more accommodating. We also expect that companies will increasingly adopt digital and analytical tools as they recognize the real value of predictive monitoring and supply/demand matching.

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For more than 200 years, the advanced industries sector has underpinned economic and societal progress that has dramatically improved lives. Its technologies have had a flywheel effect, enabling other sectors of the economy and increasing productivity, and its future success will be critical to the world economy and the advance of technology. The new five-step approach can help automotive and industrial companies weather this pandemic and rebound quickly when it abates.

**Joe Dertouzos** is a partner in McKinsey’s Detroit office; **Heike Freund** is a partner in the Munich office, where **Andreas Tschiesner** is a senior partner; **Michael Mischkot** is a consultant in the Vienna office; and **Asutosh Padhi** is a senior partner in the Chicago office.

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# Coronavirus: A response framework for advanced industries companies

As the coronavirus causes worldwide challenges for healthcare systems and economies, advanced industries companies are looking for strategies to navigate the difficult, evolving situation.

*by Thomas Baumgartner, Bernd Heid, Jakob Fleischmann, Heike Freund, and Dominik Luczak*

**Note: This article focuses on companies in advanced industries and reflects our thinking as of March 20, 2020. We are regularly updating our global perspective on the business implications of COVID-19.**

**COVID-19 continues to spread rapidly** around the world, straining healthcare systems and creating a humanitarian tragedy. The number of new cases caused by the coronavirus (SARS-CoV-2), appears to have crested in China, where the disease originated, but other countries are now reporting increases. The situation changes daily, prompting governments to announce quarantines, travel restrictions, and other measures to minimize risk.

Although patient health is the paramount concern, corporate leaders are also evaluating the business implications of COVID-19, including the disruptions resulting from factory shutdowns, lost wages, and product shortages. For companies in advanced industries, including electronics, automotive, and aerospace, such economic repercussions

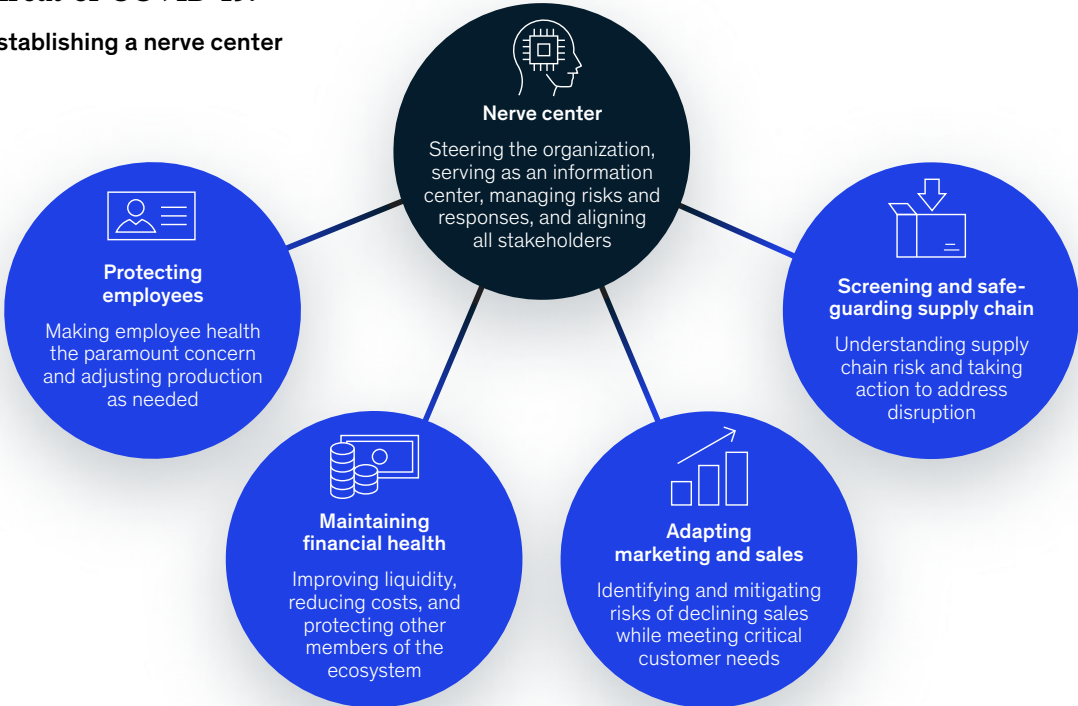
could be particularly severe, given the extent of their global footprints and the complexity of their deeply multitiered supply chains (see sidebar, “Why COVID-19 could be especially challenging for companies in advanced industries”). Some companies in advanced industries also follow a sales model that requires human contact (for example, at automotive dealerships), intensifying the impact of low foot traffic.

Companies in advanced industries understand the seriousness of the situation and have already begun implementing changes to sustain their operations as COVID-19 continues its inevitable spread. Our recommendations for immediate and midterm actions focus on five areas (Exhibit 1). These recommendations will help companies plan ahead, set priorities, and accelerate their response during supply chain disruptions or lowered production capacity. We offer these recommendations to assist advanced industries companies with their long-term planning and recovery efforts.

Exhibit 1

**Companies in advanced industries must respond quickly and decisively to the threat of COVID-19.**

**Establishing a nerve center**



## Establishing a nerve center as the central crisis steering organization

Companies in advanced industries need a nerve center—a dedicated team in a central location—to coordinate their response to COVID-19 across locations and business units. Staffed with a cross-functional team that has decision-making power about important issues, a nerve center could focus on the following deliverables:

- *Creating a threat-map dashboard.* Working with IT, nerve-center leaders will use digital tools to create threat maps with real-time data imported from internal and public sources. For instance, a threat map may document disease spread in critical export markets, employee-absentee rates by location, dealerships' foot traffic, and supply chain disruptions.
- *Establishing a risk log.* While a threat map will make many risks visible, it will not capture every important development. If teams or functions become aware of any additional threats, they can immediately log the information in a database accessible to all critical employees, allowing the nerve center to respond quickly with interventions.
- *Developing an integrated plan.* A nerve center will get updates from all affected regions and functions—ideally, at least twice a week. Its leaders can then integrate these reports into a plan to ensure that all groups coordinate their efforts and follow best practices.

A nerve center typically has a simple meeting cadence and follows agile principles to eliminate bureaucracy in decision making. It also encourages transparency, providing employees, suppliers, customers, and shareholders with frequent updates about the potential risks of COVID-19 and the company's response. From inception, a nerve center can serve as the main source of information and single source of truth, with its leaders creating communication plans and aligning on key messages.

## Protecting employees

Companies are acting to protect employee health and quickly relay information about potential threats

throughout their organizations. The advanced industries sector is no exception, with businesses taking measures that include splitting shifts to minimize employee contact, distributing protective gear, curtailing travel, providing on-site health monitoring, and increasing on-site sanitization. The specific measures will vary by role, location, and company. Some measures that may be universally valuable include the following:

- developing contingency plans that describe actions to take in different scenarios, such as how leaders will respond if their team members become infected
- enabling employees to work from home using remote-collaboration tools
- updating operational procedures—from safety protocols to operating hours to ramp-up processes—if companies deviate from standard processes

Since employee safety comes first, some plants will function under capacity or find that their suppliers may not meet delivery dates. Their response to such challenges is critical and will help set the stage for a quick recovery. For instance, companies could set new production priorities if their capacity falls, looking at factors such as the strategic importance of each customer, the potential for product shortages, and possible revenue decreases. Leaders from the production, supply chain, and marketing and sales functions will likely collaborate on these decisions.

## Screening and safeguarding the supply chain

Advanced industries companies have large and complex supply chains that stretch across continents and include hundreds or thousands of vendors. Beyond their direct suppliers, company leaders may have little insight about supply issues. But with COVID-19 disrupting production globally, more transparency is essential. For example, automotive OEMs cannot simply determine if their weather-stripping suppliers are functioning; they also need information about disruptions at the companies that provide rubber to the weather-stripping suppliers.

Companies do not have time to build all the capabilities that they would want to have, but they can still take some important steps. First, they could work closely with their direct suppliers to gain greater insights about their production capacity and possible issues. It is critical to get this information now. Given the length of supply chains, the impact of disruptions beginning in January 2020 may not be felt for several months. Ideally, companies and their direct suppliers might create a joint agreement to monitor lead times and identify potential problems.

If companies anticipate shortages from their preferred vendors, they can consider other options that they have previously vetted or seek new suppliers from lower-risk areas. When onboarding new suppliers, companies could expedite the qualification process for parts and evaluate how future shifts in suppliers might affect negotiating dynamics.

Other actions that companies could take to alleviate shortages include prebooking freight capacity, stocking up on critical parts, purchasing components that their direct vendors might need, and making plans to leverage existing aftermarket inventory.

If critical suppliers shut down operations, companies could establish recovery plans that describe how they will deal with shortages, support their vendors, and promote recovery. Leaders could also work with individual business units to determine how supply chain disruptions could affect production.

Companies that depend on Chinese suppliers have not yet experienced the full impact of the shutdown, but they will likely do so in the coming weeks as their direct suppliers cannot get the parts or materials needed for production. Some Chinese suppliers have begun to recover, and companies can monitor these developments closely.

When possible, companies might want to build stock, either of components or finished products, so that they can continue to meet customer needs for as long as possible.

## **Adapting marketing and sales to suit new consumer behaviors**

In-person contact is essential to many purchases, especially those within the automotive sector, where customers traditionally have extensive interactions with salespeople at dealerships as they seek product information, consider their options, and evaluate available models. COVID-19 has changed this dynamic in hard-hit areas, since many people are staying at home, either voluntarily or because of quarantines and travel restrictions. To serve these regions, automotive OEMs can strengthen their online marketing and sales channels, such as by allowing customers and dealers to make offers and purchases through their computers.

For many customers, online information cannot substitute for a test drive. In these cases, OEMs could consider supporting dealerships in providing at-home demonstrations and test drives for customers. Such strategies limit personal contact while also giving customers the on-road experience they need.

## **Why COVID-19 could be especially challenging for companies in advanced industries**

**COVID-19 will affect all sectors**, but the following factors may exacerbate problems for companies in advanced industries:

- a lack of transparency into the supply chain, beyond direct vendors, making it hard to anticipate potential disruptions
- complex global footprints that make it difficult to develop a coordinated response
- an automotive-sales model that involves dealership visits and test drives—something that may be challenging or impossible if customers cannot leave the house or voluntarily stay at home

Finally, automotive OEMs could consider how COVID-19 will affect their product mix on a monthly basis, then adjust their incentives and promotions accordingly. If they are going to have a shortage of certain models or parts, then planned promotions or upselling may no longer be appropriate.

China provides a good example of these strategies in action, since many automotive OEMs have made some critical changes to ensure that they can still satisfy critical customer needs for transportation (Exhibit 2).

### Maintaining financial health during disruption

COVID-19 will affect profits and liquidity by increasing procurement expenses and capital costs while simultaneously forcing customers to defer purchases. In some cases, these consequences are already apparent. To protect their business and rebound as quickly as possible, companies will benefit from financial stress tests

in which they examine their current cash flows and balance sheets. They can then determine how company finances might evolve if any of the scenarios defined by their nerve centers materialize.

Given the challenges ahead, companies will likely improve liquidity whenever possible, including by renegotiating agreements with suppliers, giving customers an incentive to make advance payments, and asking banks for extended payment terms. Cost control will be particularly important, and companies can establish spend-control towers to increase transparency. Ideally, functional leaders will review spending plans every few weeks and make changes, such as decreasing billboard spending in quarantined areas with little road traffic (Exhibit 3). Functional leaders can also review new spending requests in daily or weekly meetings, always considering whether COVID-19 will influence their returns on investment. With so much concern about profitability, leaders will likely be cautious about approving any new expenditures.

Exhibit 2

## Companies in advanced industries must adapt their marketing and sales approach because of COVID-19.

### China example: COVID-19 changes customer journey for traditional, offline car purchases

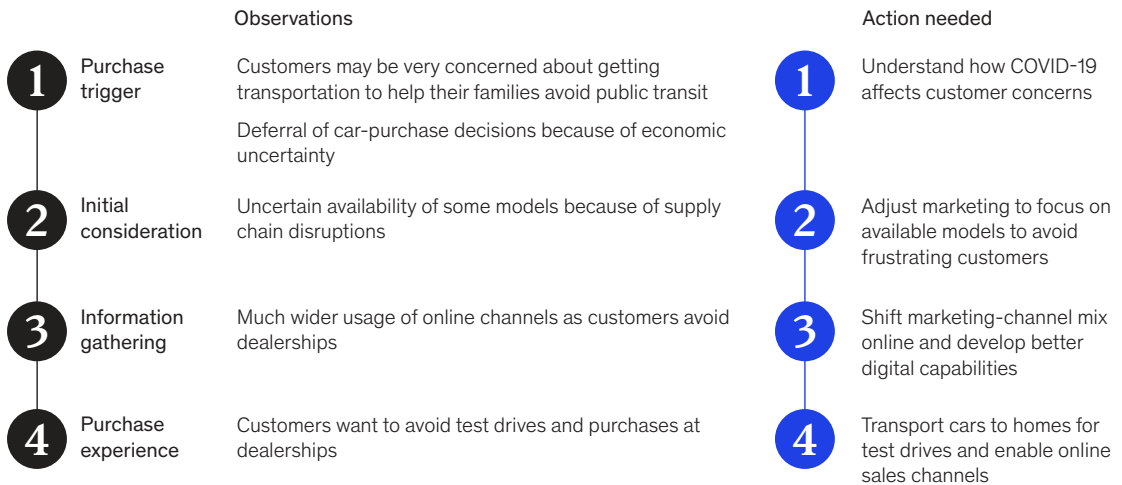
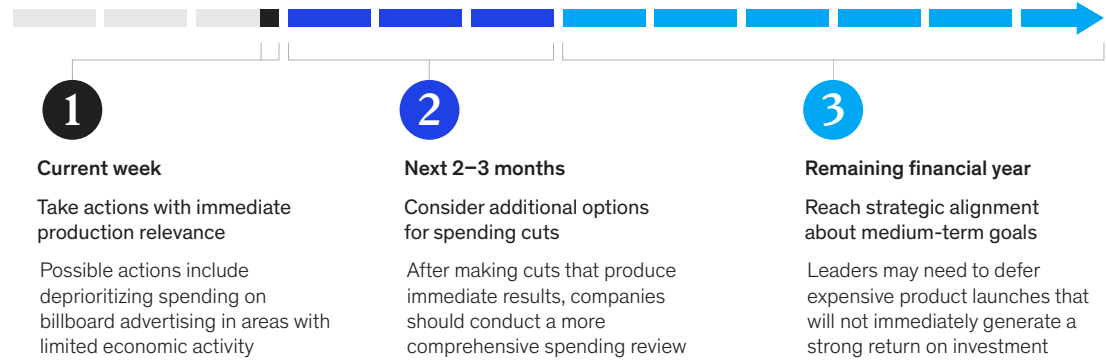




Exhibit 3

**Companies in advanced industries must set new spending priorities, considering different time horizons.**

**A timeline of priorities**



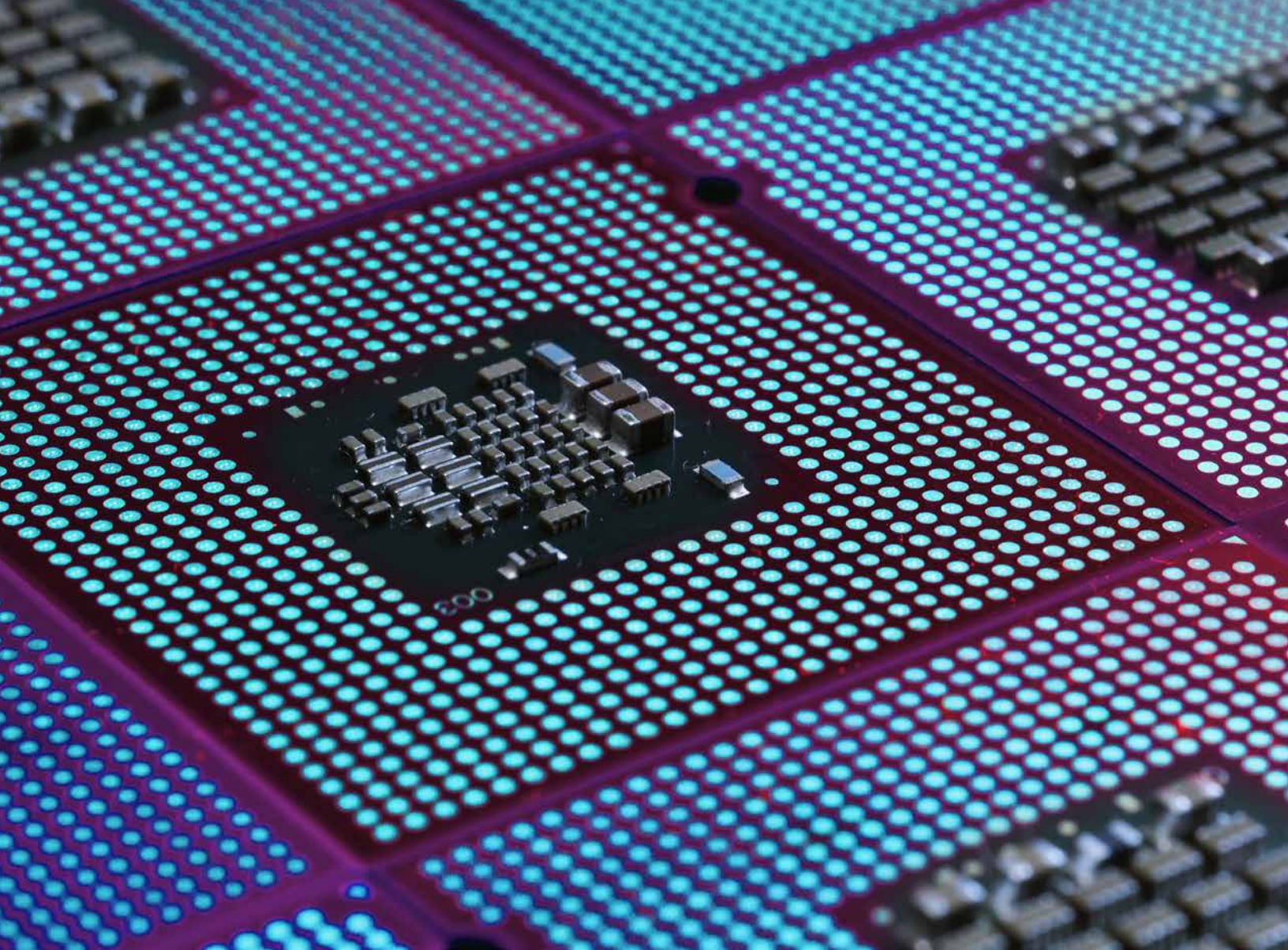
Over the longer term, leaders can look for \_\_\_\_\_ they help suppliers remain in business by allowing other opportunities to reduce costs and review them to increase their prices. strategic goals. For instance, they might want to postpone costly product launches that would not increase profits during the upcoming fiscal year.

To protect their ecosystem, companies in \_\_\_\_\_ The impact of COVID-19 will continue to be felt for months to come, but advanced industries companies can move quickly to protect their employees, walls. As one example, automotive OEMs could \_\_\_\_\_ customers, and other members of their ecosystems. help dealerships maintain their financial health The recommendations in this article represent an important first step—one that could minimize damage.

**Thomas Baumgartner** is a senior partner in McKinsey’s Vienna office; **Bernd Heid** is a senior partner in the Cologne office; **Jakob Fleischmann** is a consultant in the Munich office, where **Heike Freund** is a partner; and **Dominik Luczak** is a partner in the Tokyo office.

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# Coronavirus: Implications for the semiconductor industry

The coronavirus is shifting demand patterns for major semiconductor end markets. How will these changes ultimately affect the semiconductor industry, and how can leaders respond?

*by Harald Bauer, Ondrej Burkacky, Peter Kenevan, Abhijit Mahindroo, and Mark Patel*

**Despite ongoing quarantines,** shelter-in-place orders, and other stringent measures, COVID-19 has continued to spread. As deaths climb and the human toll mounts, leaders are focused on containing the virus and saving lives. In parallel, efforts are under way to mitigate the devastating economic consequences of COVID-19, which include business shutdowns, record unemployment, and unprecedented drops in gross domestic product (GDP) across many countries.

The semiconductor industry, which has historically been a major source of high-tech jobs, is among the many sectors that have had to adjust their production planning and operations as COVID-19 shifts demand for major semiconductor end applications. In addition to exploring the impact of such changes on semiconductor demand, this article provides insights about the industry's evolution post-crisis and outlines how semiconductor leaders should prepare themselves for the next normal.

## **Impact of COVID-19 on global semiconductor demand**

The COVID-19 crisis is unprecedented in our time. While the recession during the financial crisis from 2007 to 2008 was driven by stagnating consumer demand, the COVID-19 situation induced a shock to both global demand and supply, creating a dual challenge. This unique phenomenon makes it difficult to extrapolate from past crises to make predictions.

Nevertheless, this article aims to provide guidance on how semiconductor demand will shift in the short- and mid-term—taking into account extensive surveys, research on the recovering Chinese market, and global GDP projections. Our GDP projections in this article are based on two of the nine scenarios that McKinsey developed for global GDP recovery, both of which assume that the spread of coronavirus is eventually controlled and catastrophic economic damage is avoided. In the first scenario, global

GDP recovers in the fourth quarter of 2020; in the second, recovery is delayed until late 2022.<sup>1</sup> All demand forecasts are shown as a percentage of 2019 market sizes.

Based on the two scenarios we evaluated, we expect demand to decline by 5 to 15 percent for the semiconductor industry as a whole this year compared to 2019 (Exhibit 1). Breaking down this projection by major end markets—PC or server, wireless communication, wired communication, consumer electronics, automotive, and industrial applications—shows that demand shifts vary greatly, with steep declines anticipated for some markets and gains expected in others. These differences can be explained by the diversity of underlying trends that affect demand for semiconductors, and the varying impact of macroeconomic forces on each end market. (See sidebar, “Demand drivers of semiconductor end-applications.”)

### **PC or server**

We expect chip demand for the PC and server end market to drop by 1 to 7 percent this year, with results varying by product.

Demand for PC semiconductors will decline by an estimated 3 to 9 percent in 2020, mostly because companies will delay planned hardware upgrades and other long-term migration projects. Stable laptop and tablet demand will partly offset this drop, since many consumers will upgrade their private IT infrastructure to support their work or homeschooling activities, even if they are cutting back in other areas. These one-time IT equipment upgrades will not be repeated to the same extent in later years if the downturn persists and consumers cut back spending even further. This fact, combined with enterprises decreasing computer replacements to manage their liquidity, could further erode semiconductor sales after 2020 if the crisis persists.

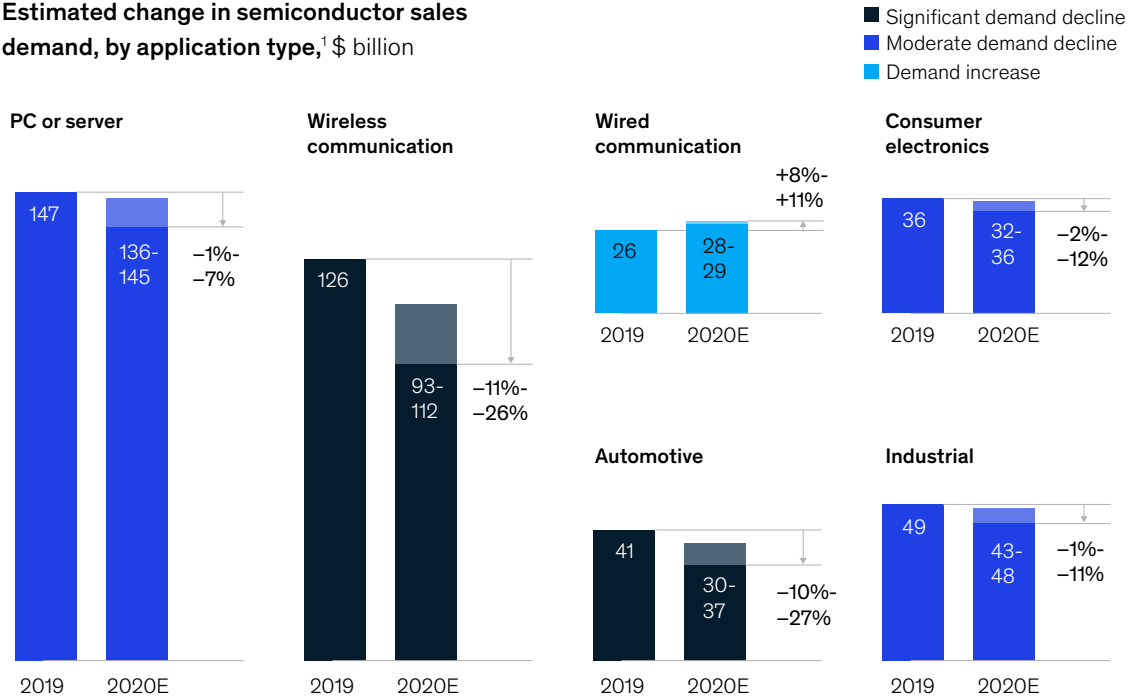
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<sup>1</sup> See Sven Smit, Martin Hirt, Kevin Buehler, Susan Lund, Ezra Greenberg, and Arvind Govindarajan, “Safeguarding our lives and our livelihoods: The imperative of our time,” March 2020, McKinsey.com. In this article, the two scenarios on which we focused are labeled A1 and A3.

Exhibit 1

**The semiconductor market as a whole will decline by 5 to 15 percent in 2020.**

**Estimated change in semiconductor sales demand, by application type,<sup>1</sup> \$ billion**



<sup>1</sup> Products include memory, microcomponents, logic, analog, discrete, optoelectronic, and sensors/actuators. The estimates for 2020 were calculated using a 2019 baseline and percentages have been rounded.

Source: IHS; McKinsey analysis

Through late 2020, the semiconductor market for servers could increase by 1 to 7 percent, driven by a strong uptick in video streaming and conferencing as more people work from home. Demand for enterprise IT and enterprise cloud solutions is expected to remain stable or show a minor decline as some companies cut IT budgets while others accelerate their cloud-migration plans. Increased server demand may not persist past 2020, however. If the global economy continues to struggle after the fourth quarter of 2020, more companies will cut IT budgets—a trend that will outweigh any additional increases in video streaming.

**Wireless communication**

Demand for semiconductors used in wireless communication applications will see one of the sharpest drops in 2020, with an expected decrease of 11 to 26 percent. The level of mobile-phone sales, the primary demand driver in this category, has historically been well correlated with GDP and thus is expected to drop significantly over the coming months. (Sharp decreases have already been documented in areas where COVID-19 is prevalent, especially China). We also expect consumer preferences to shift to less expensive phones, which will also negatively affect demand

## Demand drivers of semiconductor end-applications

This chart shows the main end-user applications that incorporate semiconductors, as well as the primary factors that drive semiconductor demand in each category.

Exhibit

### The demand drivers for semiconductors vary by end-user application.

#### Demand drivers of semiconductor end-applications

PC or server	Wireless communication	Wired communication	Consumer electronics	Automotive	Industrial
<b>Server</b> <ul style="list-style-type: none"> <li>● Cloud investments (by enterprise and hyperscalers)</li> <li>● Artificial-intelligence expenditures</li> <li>● Video-streaming levels</li> </ul> <b>PC</b> <ul style="list-style-type: none"> <li>● PC operating system/software upgrades</li> <li>● Purchases of laptops to support new ways of working</li> <li>● Purchases of tablets to support new ways of working</li> </ul>	<ul style="list-style-type: none"> <li>● Number of mobile phones sold</li> <li>● Mobile-phone average selling price</li> </ul>	<ul style="list-style-type: none"> <li>● Investment in security infrastructure</li> <li>● Cable/DSL/FTTH consumption</li> <li>● Purchases of switches/routers</li> <li>● Purchases of optical network infrastructure</li> <li>● Investment in streaming infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>● Purchases of video games</li> <li>● Purchases of audio equipment</li> <li>● Purchases of appliances</li> <li>● Purchases of TVs</li> <li>● Purchases of watches and other wearables</li> </ul>	<ul style="list-style-type: none"> <li>● Car-sales volume</li> <li>● Level of vehicle digitization</li> <li>● Level of vehicle electrification</li> </ul>	<ul style="list-style-type: none"> <li>● Investment in medical electronics</li> <li>● Investment in aerospace and defense</li> <li>● Investment in power and energy</li> <li>● Upgrade rate for lighting solutions</li> </ul>

for semiconductors. The recovery of mobile-phone sales will vary by geography, with China likely to see an uptick before Europe and the United States, since its economy is closer to recovery.

For wireless communication infrastructure—5G in particular—we expect to see two different demand patterns. In areas that have not launched 5G networks, telecom providers will likely postpone investments and instead focus on improving their existing networks to accommodate rising data traffic. By contrast, some telecom providers in areas that already have 5G will double down on their investments, especially if governments provide subsidies in an attempt to stimulate the local GDP.

#### Wired communication

Demand for semiconductors used in wired communication applications will increase by 8 to 11 percent in 2020 because of several pandemic-related factors, including:

- more security upgrades for existing enterprise infrastructures as more employees work from home
- a more than 50 percent increase in fixed broadband usage in some countries, leading to more purchases of cable/DSL and wireless routers as workers upgrade internet connections in private home offices



- higher internet traffic, which will spur demand for switches and routers
- greater demand for cloud services and associated computing nodes, which will increase the need for optoelectronics in data center fiber connections
- a more than 40 percent increase in video streaming across many networks

Even if the economic downturn persists after 2020, demand for semiconductors used in wired communication will still grow. Annual growth may not remain as high as the 8 to 11 percent seen in 2020, however, since many of the mentioned investments are one-time purchases that will reduce future replacement needs.

#### **Consumer electronics**

Semiconductor companies provide components for many consumer-electronics products, including video games, televisions, and watches. Consumers use discretionary funds to purchase most products in this category, so demand is highly correlated with local GDP. We expect demand for consumer-electronics semiconductors to drop by 2 to 12 percent in 2020. While significant, this decrease is lower than the drop seen within wireless communication—another area where end-market sales are closely tied to local GDP.

Consumer electronics are faring better than wireless communication because of a recent rise in demand for gaming devices, audio equipment, and some kitchen appliances—a trend likely occurring because people are spending more time at home. Although this increase has partly offset the significant declines reported for other consumer-electronics products, it likely stems from one-off purchases and thus will not persist over time. In consequence, the decreased demand for consumer-electronic semiconductors will extend beyond 2020.

#### **Automotive**

Sales of semiconductors for automotive applications primarily depend on car sales volume and the level of vehicle digitization and electrification. Since global automotive demand has already fallen sharply this year and will likely decline further over coming months, the automotive semiconductor market is expected to decrease by 10 to 27 percent in 2020. Semiconductor companies will likely not feel any effect until late in the second quarter, however, due to long lead times of automotive semiconductors.

In terms of semiconductor demand, hybrid electric vehicles (HEV) and electric vehicles (EV) are particularly important, since they contain more semiconductors than combustion-engine vehicles. Currently, we expect that the decline in demand for HEVs and EVs will be similar to that for other

**Some shifts in work processes and consumer behavior that arose during the pandemic might also persist, and these could open both new markets and routes to market.**

vehicles, leaving their market share constant. That said, semiconductor companies should watch out for certain developments that might increase or decrease the share of HEVs and EVs in the market. For instance, increased government subsidies may spur additional demand for HEVs and EVs, while less stringent emissions regulations or continued low oil prices might push sales down.

**Industrial applications**

Within industrial applications, the major demand drivers for semiconductors include investments in medical electronics, aerospace equipment, power and energy products, as well as upgrades to lighting solutions. Demand is expected to decline for all of these end markets through 2020 as companies postpone infrastructure investments, reduce manufacturing activities, or decrease operations. Overall, semiconductor demand for industrial applications is expected to fall 1 to 11 percent this year.

For medical electronics, demand in certain medical-device categories that are directly related to the management of COVID-19, including ventilators, X-ray machines, and diagnostic tools, has sharply increased since the start of the outbreak. However, there will be even steeper demand declines in other areas that will offset such extreme demand spikes for

critical treatment products because many hospitals are postponing purchases to improve liquidity.

**Strategies for semiconductor companies**

Like all business leaders, semiconductor executives are wondering how they can adapt to sudden changes in demand, as well as other uncertainties associated with COVID-19. They may find a path forward by following a framework that McKinsey created to assist companies on their journey to the next normal. It includes five stages: resolve, resilience, return, reimagine, and reform (Exhibit 2).

Most semiconductor companies have already passed through the first two phases or are currently addressing challenges related to reduced workforce availability and near-term cash-management. Experience has also shown, however, that companies should do far more than handling operational challenges during economic downturns if they want to emerge stronger post-crisis. Despite focusing on operational issues that require immediate attention, semiconductor leaders would also benefit by thinking ahead—and that will involve progressing through the return, reimagine, and reform phases as quickly as possible.

Exhibit 2

**Semiconductor companies must embark on a journey that includes 5 phases.**

**Here’s how they should proceed**

<b>Resolve</b>	<b>Resilience</b>	<b>Return</b>	<b>Reimagination</b>	<b>Reform</b>
Address the immediate challenges that COVID-19 represents to semiconductor workforce, customers, and business partners	Address near-term cash-management challenges and broader resiliency issues during virus-related shutdowns and economic pressures	Create a detailed plan to return the business back to scale quickly, with a focus on adapting your demand planning, product pricing, and sourcing strategy, as well as ensuring a smooth ramp-up of production	Reimagine the “next normal”—understand how macroeconomic developments will impact semiconductor- industry dynamics and understand how your institution should reinvent itself to adapt	Closely monitor regulatory and competitive developments

## Return

When planning for the return to the next normal, semiconductor leaders should determine if they need to revise any critical business activities in response to the changed demand dynamics. As they set their course, they may benefit by focusing on the following tasks:

- **Adjusting demand planning.** How long will it take until an increase or decrease in customer demand affects orders for semiconductors and how steep will the decline be?
- **Revising production planning.** Can the business adjust its production plans and make costs more variable to reflect changing customer demand and/or labor shortages?
- **Revisiting sourcing strategy.** How does the closure of country borders and the potential financial distress of suppliers affect sourcing operations?
- **Revising product pricing.** Will the company's product-pricing strategy be affected by changing logistics costs and/or our customers' willingness to pay?
- **Revising previous business practices.** Based on the company's experience with remote work during the pandemic, do any business practices need to be revised, or even removed?

## Reimagine

As semiconductor companies start to reimagine a new normal for their industry, they should create dedicated working teams that follow-up closely on the following topics.

**Changing industry dynamics.** New technologies that helped in the fight against COVID-19 could permanently change how companies work. Some shifts in work processes and consumer behavior that arose during the pandemic might also persist,

and these could open both new markets and routes to market. Semiconductor players might place more emphasis on digital marketing, for instance.

**Growth stimulation.** Governments may soon provide subsidies, such as incentives for further 5G roll outs, to stimulate the economy in multiple industries. Other government subsidies might encourage local production or investments in healthcare. Such changes could lead to faster technology adoption, and semiconductor companies might need to re-evaluate their product road maps.

**Sourcing shifts.** Companies along the value chain are likely to revise their sourcing strategies. For semiconductor players, this might involve further leveraging foundries and decreasing their reliance on critical suppliers.

## Reform

Throughout the reform phase, semiconductor companies should monitor changes in the following areas.

**Regulatory environment.** Trade tensions are unlikely to increase significantly over the short term, since economies are still highly interlinked and governments will likely be cautious about causing additional stress in industries that are still striving to recover. If governments decide to subsidize local sourcing and manufacturing activities, however, opportunities could open for fast movers.

**Competitive environment.** As the crisis drains liquidity from companies, and valuations take a significant hit (with high variance, depending on semiconductor end market exposure), we are likely to observe increased M&A activities. The companies involved should monitor potential regulatory constraints on foreign purchases.

## Strategic next steps

As companies proceed through the five phases that will take them to the next normal, they could



strengthen their muscles by evaluating and capturing strategic opportunities at a fast pace.

After the financial crisis of 2007 to 2008, the semiconductor companies that emerged strongest were those that implemented bold moves and thus contributed to reforming the industry. They maintained relatively higher capital expenditures and R&D spending compared to their competitors and were more active in pursuing M&As. Current leaders might want to consider similar options.

Before making such moves, semiconductor companies might want to reassess their baseline position, since the coronavirus pandemic may have altered it considerably, and then look at both potential opportunities and business threats that

may arise over multiple time horizons. Companies must quickly move from strategic plans to action, however, since many opportunities may open up quickly and only be available for a limited time. Some leaders might want to define specific trigger points—events that will move them to act—as they create their plans.

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Market dynamics in the semiconductor industry are rapidly changing. Demand is moving in different directions, and to different extents, depending on the application segment involved. As semiconductor players adapt to these changes and journey toward the next normal via bold and timely moves, they can help their businesses thrive.

**Harald Bauer** is a senior partner in McKinsey's Frankfurt office, **Ondrej Burkacky** is a partner in the Munich office, **Peter Kenevan** is a senior partner in the Tokyo office, **Abhijit Mahindroo** is a partner in the Southern California office, and **Mark Patel** is a senior partner in the San Francisco office.

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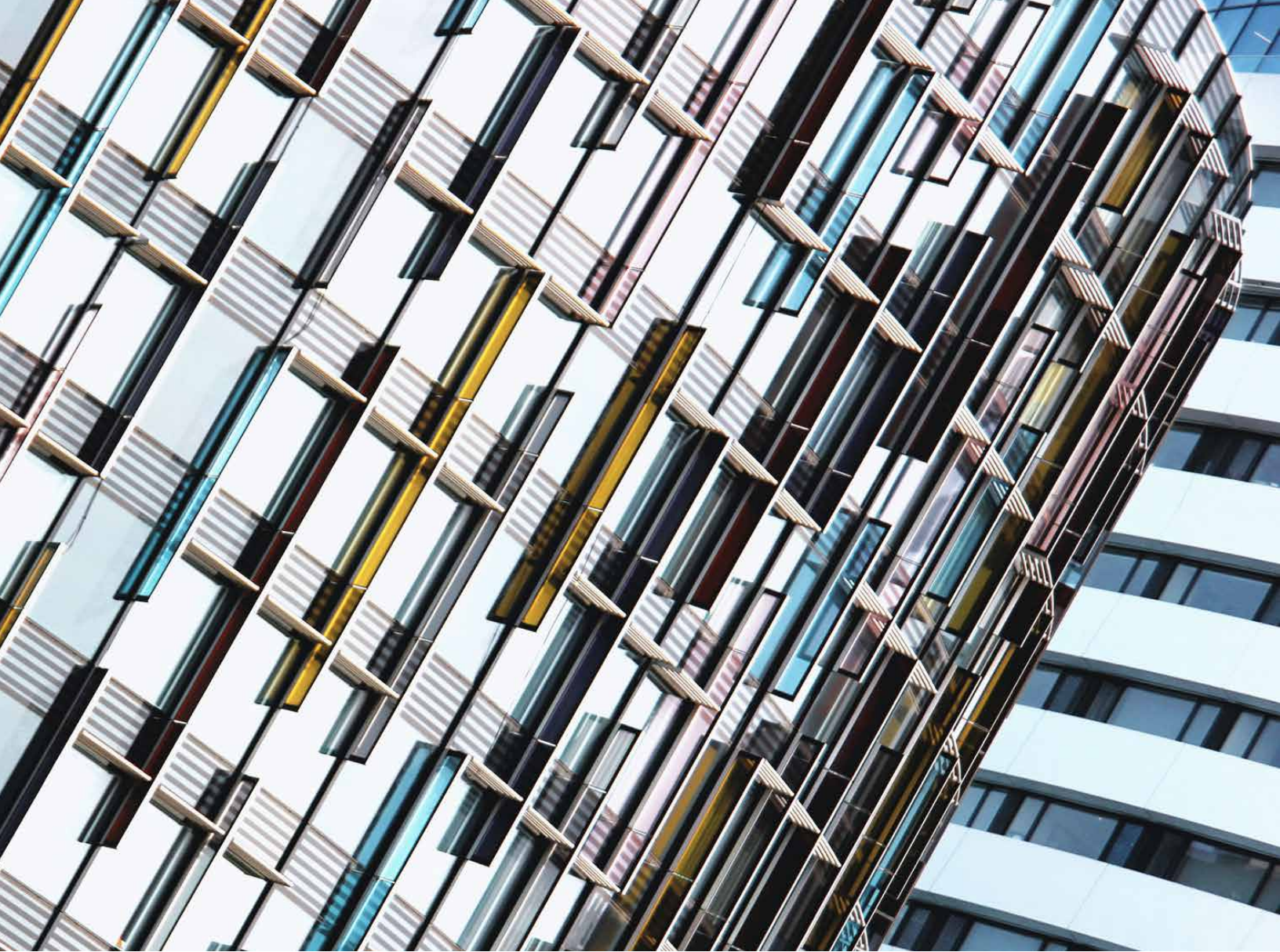
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# Leadership in the time of the coronavirus: COVID-19 response and implications for banks

As the effects of the COVID-19 pandemic continue to reverberate, banks have a role to play as systemic stabilizers.

*by Kevin Buehler, Olivia Conjeaud, Vito Giudici, Hamid Samandari, Lorenzo Serino, Marco Vettori, Laura Webanck, and Olivia White*

**The profound humanitarian fallout** of the COVID-19 crisis carries with it the potential equally disruptive economic fallout. The path ahead is hence a precarious one, driven by epidemiological uncertainty, the unique blend of resulting shocks to both supply and demand, and “preexisting conditions” in the global macroeconomy.

At this writing, Europe has become the prime epicenter of the crisis, with nearly 75 percent of new cases reported globally on March 18. In Italy, years of low growth and high government debt are colliding with the rapid spread of the disease in an elderly population. Spain and France, face similar prospects, as do many countries in Asia. Thailand, for example, is similarly reliant on exports and tourism receipts and already has one of the highest debt burdens in the region at around 75 percent GDP. The particular characteristics of the US economy may make it susceptible to the impacts of COVID-19, despite its general strength before the virus’ arrival. A high number of households and businesses are vulnerable to the impact of disease-containment measures, because of their high-debt burden.

At the same time, yield chasing over the past several years may exacerbate the potential for market illiquidity. The Fed and the European Central Bank (ECB) have already cut rates to zero; historically low rates limit the tool kit of other central banks, and several global regions are probably already in recession as many economists and the latest data from China suggests. Addressing the situation will require further global action and public–private coordination. Banks around the globe will play a critical role in this as systemic stabilizers for their customers, their employees, and for their economies at large. Cash and deposit services, credit extension, payment facilitation, and market making are all essential services.

This memo lays out our initial recommendations for actions that banks should take now, beyond what common business continuity plans or crisis response checklists suggest. In their immediate response, we believe institutions should plan for

an acute period of multiple months, spanning their entire footprint, and with a view of all stakeholders—not the more constrained circumstances that business continuity plans typically address. At the same time, banks may begin to stress test their capabilities and financials, laying the groundwork for identifying long-term strategic implications and ensuring a smooth bridge between the present and future.

## **Immediate response**

Banks have already taken a series of actions in reaction to the spread of COVID-19. Common steps we’ve seen include establishing a central task force, curtailing travel, suspending large-scale gatherings, segregating teams, making arrangements for teleworking, and refreshing external-vendor-interaction policies.

Beyond these immediate and basic actions, banks should prioritize three measures tailored to the particular combination of biological and market stresses and how they affect the market. These points draw on the experience of China, Italy, and several other countries, acknowledging that differences exist in economic and political structures, healthcare systems, and social and cultural norms among these countries.

### **1. Normalize workforce measures for multimonth sustainability**

As a top priority, nearly all firms have already taken proactive measures to protect their people and to contain the spread of COVID-19 (Exhibit 1). These include restricting travel and taking other prevention-oriented policies, emphasizing workplace hygiene, offering alternative ways of working, and initiating proactive communication.

However, health measures to contain propagation may take months, not days or weeks, as we’ve seen in China. Therefore, banks will need to make sure the measures they have put in place are sustainable—and designed to get the best out of their people, while preserving their mental



Exhibit 1

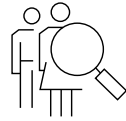
**For banks that choose to maintain branches, certain tangible actions can help manage operations while monitoring risks.**

**Checklist for banks that maintain branches**



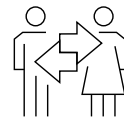
**Clean**

Ensure cleanliness and deep clean all branches and customer-interaction locations to give employees and customers comfort



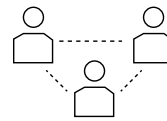
**Identify**

Heighten monitoring of physical channels to quickly identify the ones affected (confirmed and potential) and develop a playbook for addressing contamination



**Alter processes**

Identify and alter physical process requirements—to ensure continuity on main services even with branch closure or staff reduction<sup>1</sup>



**Control**

Ensure appropriate controls in altered workplace setting and that trade-offs between contingency measures and risk appetite are well-considered



**Monitor**

Monitor customer-service capacity against need and reduce operations if customer need is not evident

<sup>1</sup>For example, review ATM and branch limits on receipts and payments; identify alternatives to in-person sign-offs; leverage branches with remote advisory installed capabilities).

and financial well-being over such a period. Further, specific consideration will be required for contingent and contract workers, who might be most immediately impacted.

Because banks are providers of essential services to customers and communities, and the markets more broadly, they will need to adopt a carefully segmented approach to workforce management, informed by service criticality and exposure risk (Exhibit 2). Particularly careful attention is required for those in the workforce who provide critical services that are either customer facing or that require infrastructure only available at work premises. These include, for example, branch employees, some call-center support, sales and trading personnel, employees in the Treasury function, as well as some facilities and custodial staff. Korea's Shinhan bank directed 150 of its call-center staff to work remotely, to handle activities that do not require access to customer information, such as queries on financial products. More detailed requests they forward to colleagues who continued working in the office.

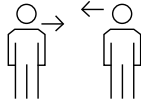
One case in point: trading activities are central for market functioning but cannot easily be executed remotely because of technology and compliance requirements. Most banks have already taken a number of actions including segregating team members and activating business continuity plan (BCP) sites for parts of the sales team. Furthermore, BCP sites may have insufficient capacity to support a split-team model, requiring banks to consider alternatives in the event of a prolonged crisis. Since the virus reaches across all major financial centers, the potential for simultaneous infection across sites rises as the disease spreads. Institutions should maintain and test backup plans in case this occurs and establish clear triggers for putting such plans in place, such as a case of infection at or in the vicinity of one site. Backup plans might include the potential to move immediately to a work-from-home model, for which regulatory clearance and robust technical testing should occur preemptively.

For those segments of employees for whom remote work is possible (a group that may well have to be larger than initially envisaged), banks should

Exhibit 2

## As COVID-19 cases grow, there is a range of actions emerging across banks to protect and communicate with clients.

### Checklist for client engagement



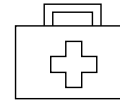
#### Engage clients

Proactively reach out to clients encouraging proactive exchange on upcoming financial challenges and offer advice on how to weather negative impact. This will require training bankers to engage clients and coach them through the crises



#### Identify risk

Review and sharpen risk identification, monitoring and measurement to identify clients with higher vulnerability to primary and secondary effects of the outbreak, and anticipate, as much as possible, detection of creditworthiness deterioration



#### Support vulnerable clients

At a high level, clients that may need more support will be small businesses within affected sectors, individuals who are self-employed or working in affected industries, especially those with higher debt levels. On the other hand, larger companies may be less affected, along with those at the forefront of the humanitarian response



#### Mitigate risk

Adjust potential credit-risk-mitigating actions for pre-delinquency, early delinquency, and nonperforming exposures, in light of specific implications of COVID-19 on clients, eg, temporary vs long-term nature of business disruption, value-chain considerations

review policies, practices, and controls and tailor them to the new working environment. “Work-at-home” organizations and routines, output-based performance management, and technological capabilities should be a particular focus. In parallel, banks should make sure both employee relations and internal technical support are sufficiently staffed and trained to accommodate potentially new and elevated levels of requests. Critically, institutions will need to ensure that appropriate controls are in place in all altered workplace settings and that trade-offs between contingency measures and risk appetite are well-considered. Key considerations include data security, fraud, cybersecurity, and privacy, especially safeguarding personally identifiable information. Bank managers should also pressure test and update business-continuity and disaster-recovery plans as needed for these new working conditions.

### 2. Provide essential banking services to retail consumers

People will continue to need essential banking services through these trying times. Banks

should continue branch and ATM operations with the appropriate safeguards, while encouraging widespread use of remote services. This approach will account for needs and preferences across all consumer segments, including the older part of the population that is both more vulnerable to COVID-19 and less likely to adopt digital channels.

Institutions can continually monitor and assess consumer demand for in-person services to adjust capacity and minimize risks. For example, in some areas of China, banks observed limited demand for services other than ATM access and so were able to close most of their branch locations without disrupting customer service. Banks in several regions, including Hong Kong, Italy, and Germany, have also closed (some) branches or moved to restrict staffing and hours when the risk to the public and employees was deemed to outweigh the need to maintain the branch. In Korea, which has adopted aggressive virus testing, branches have tended to remain open unless active cases are detected.



Physical locations that adopt rigorous yet consumer friendly approaches to disease containment both safeguard health and inspire confidence in the system. Examples borne from experience include evident deep cleaning of all branches and ATMs, alternatives to in-person sign-offs, and further leveraging branches with remote advisory capabilities.

At the same time, banks should encourage and support customers to use digital and other virtual channels, wherever possible. To encourage customers to use remote channels and digital products, institutions can launch positive and safety-oriented messaging aimed at reducing reliance on branches for services that are digitally available—while also providing tutorials online and by phone and increasing remote support options. Banks can also enhance their current digital offerings, identifying key functionalities that can be improved quickly; for example, they can increase the limit for online activities, and they can simplify the procedure to reset passwords. Institutions in both Italy and China have found that many people readily used remote channels and digital offerings (see sidebar “Digital shift in China: Digital offerings can provide necessary services while supporting employee and community safety”).

Regrettably, increased fraud and information security risk are likely. Opportunists and threat

actors may exploit confusion and vulnerabilities stemming from changes in ways of working and serving customers. Banks should include risk professionals on agile-product-development teams and run controls tests in parallel. However, they may also need adjust their risk appetite upward and should make this explicit. Recent regulatory communications seem to indicate that such an adjustment, if well-examined and well-communicated, would be positively received.

### **3. Fulfill social mission to support households and businesses with credit**

A majority of households and businesses will be negatively affected by the unprecedented nature and extent of the current health and safety measures. For example, in the United States, 74 percent of workers say they are living from paycheck to paycheck, while 58 percent are paid by the hour. For them, financial impact of quarantine measures and lack of employment—due to reduced sector activity, such as travel—will be particularly difficult. The stress will be especially acute for those who are already in debt. These individuals will likely need further support from banks to support day-to-day liquidity needs through credit. Even in places where household savings rates are high, such as in some Asian countries, a greater connection to global markets means more households and businesses are likely to be affected.

## **Digital shift in China: Digital offerings can provide necessary services while supporting employee and community safety.**

**On average, the Chinese population** spent around seven hours per day on their phones before the virus struck, mainly on entertainment, social media, and gaming as well as ordering food and essential products for delivery.

Banks that were integrated into this ecosystem or were able to roll out new solutions to interact with new behavior (for example, with the ability to make payments online or by having credit solutions online) were the most successful in driving

customers to digital channels—and to ones that protect the customer as well as the employee. The increased use of digital alternatives during the crisis has changed company expectations for future digital offerings.

Among businesses, the impact will vary significantly by sector and by company. It seems quite likely at this point that travel and tourism, entertainment, automotive, oil and gas, and healthcare industries will be most affected due to disruptions in supply and demand. Within these sectors, smaller businesses, such as those that cannot shift to remote work and online delivery and those catering to the most vulnerable segments, are likely to be more affected.

From a credit perspective, banks should rapidly identify most affected sectors and customers to understand how they can be most supportive to their clients and community. Some are already considering relaxed payment schedules and availability of credit, and the media is already monitoring hardship requests. In doing so, banks might draw on lessons learned in Italy and elsewhere (see sidebar “Client response in Italy: Segmenting the client base can maximize the effectiveness of bank support.”). This will include proactively engaging with clients to understand their situation, segmenting portfolios based on expected needs, developing an internal view of where support measures will be the most effective, and adjusting risk-mitigation actions for early delinquencies and for nonperforming exposures. While banks have taken some of these relief measures as part of natural-disaster response in the past, this situation will require a much broader geographical scope. Supporting clients in these critical times will deepen customer relationships and reaffirm the role of banks as key enablers of the economy.

Regulators around the globe understand the challenge and are already relaxing rules for banks. For example, the ECB announced on March 12 that banks can fully use their capital and liquidity buffers. Banks will be allowed to operate temporarily below the level of capital defined by the Pillar 2 Guidance, the capital conservation buffer, and the liquidity coverage ratio. The ECB also suggested that national authorities relax their required countercyclical capital buffers. In Asia, the Bank of Japan has loosened the monetary policy through conducting various operations including purchases of Japanese government bonds, US dollar funds-

supplying operations, exchange-traded funds, and real estate investment trusts. In the United States, regulators have expressed support for firms that choose to use their capital and liquidity buffers to lend and undertake other supportive actions in a safe and sound manner, saying that these buffers were designed to support the economy in an adverse situation; this will also allow banks to continue to serve households and businesses.

From a liquidity perspective, the simultaneous supply and demand shock has stressed companies across industries, pushing them to draw on credit lines to support working capital and stockpile cash. Additional drawdowns in commercial as well as retail lines of credit are also to be expected, in combination with a “flight to quality” toward deposits of certain customer segments, such as wealth-management clients. Strong internal liquidity-management practices will be required for banks to be maximally effective in supporting market liquidity and changing customer borrowing needs. The severity of the crisis is likely to lead to larger-than-expected drawings on credit lines. High market volatility will also elevate margin calls for derivatives. The liquidity coverage ratio as a measure of outflows over a one-month period may not be enough to capture all the risks to liquidity from a longer period contagion. Banks will need to upgrade their risk models and mobilize collateral for refinancing at central banks.

Banks should remain vigilant about liquidity measures to support their customers and confirm that telling indicators, such as corporate-deposit rates and interbank lending, are monitored with the right level of attention and escalation. Select leaders should ensure proactive communication and clear, deliberate signaling. It is even possible that US banks may be faced with the question of whether to pass on negative interest rates as banks have done in many European countries in recent years.

## **Stress testing financials to plan for the future**

We anticipate that financial-institution performance will be hit across all dimensions—fees, interest revenue, losses, and expenses. However, variances

## Client response in Italy: Segmenting the client base can maximize the effectiveness of bank support.

In addition to the government-mandated payment holiday on mortgages, some Italian banks are developing frameworks to assess which proactive actions may have the more effective outcome on clients, including considerations such as the following:

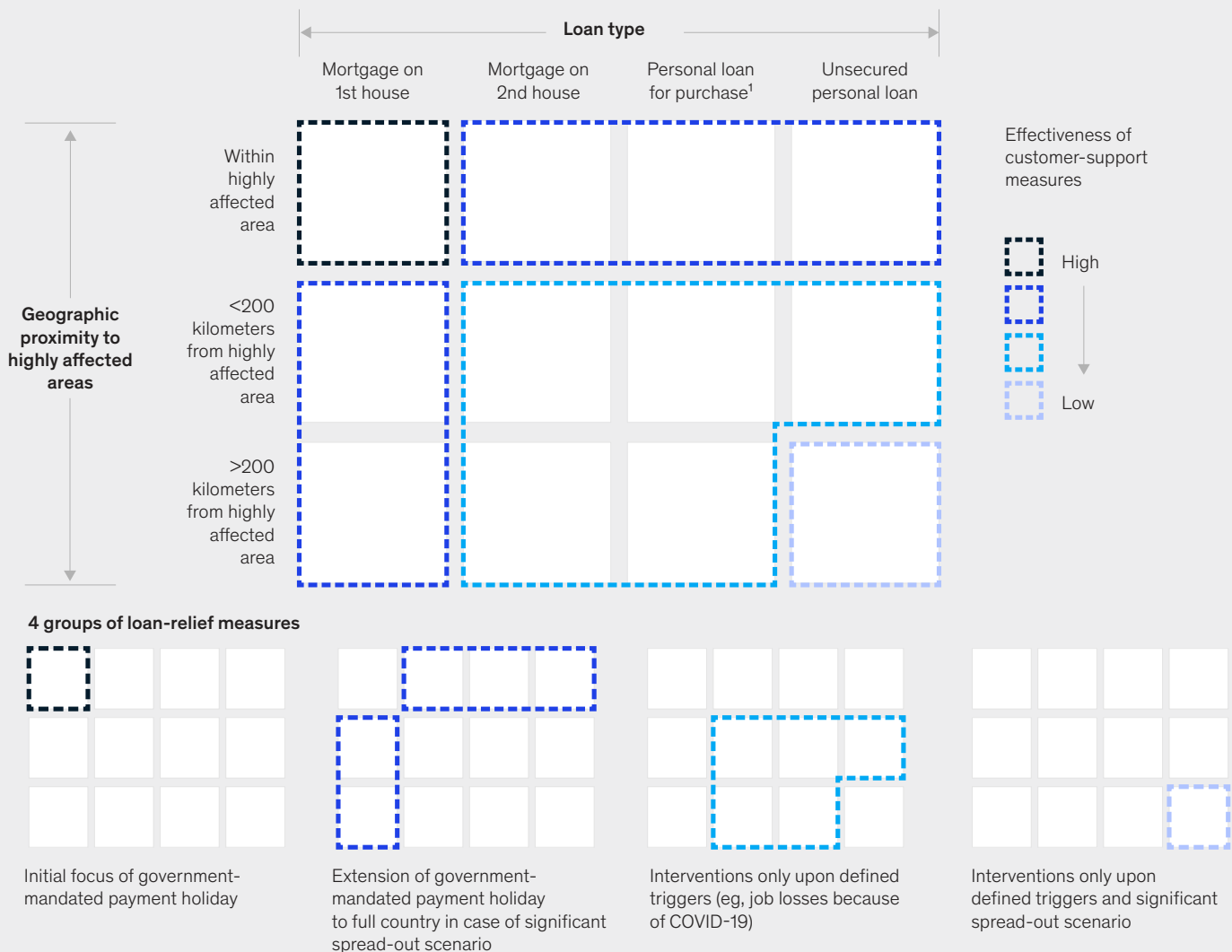
- *level of COVID-19 impact*, for example, geographical areas most affected by the virus
- *type of loan*, for example, primary-home mortgages, secondary-home mortgages, unsecured personal loan
- *client delinquency stage*

This segmentation allows the effective prioritization of cases based on their criticality. For example, clients that are most affected by COVID-19 and have a primary-house mortgage will be supported with the highest priority in case of need (exhibit).

Exhibit

### Some Italian banks are prioritizing support for customers, based on proximity to the outbreak and type of loan.

Effectiveness of loan-relief measures, including impact on P&L and capital



<sup>1</sup>Such as for a car or home renovation.

will be substantial by sector and customer segment, with details depending significantly on the scenario that ultimately unfolds. While the exact financial impact of the COVID-19 crisis remains highly uncertain and will be bank dependent, we anticipate the following:

- **Fee income likely will fall**, driven by lower consumer spending in retail businesses, decreased assets under management in asset-management divisions, as well as slowdown in investment-banking activity. Some sales and trading businesses may be an exception: fixed-income flow volumes may increase, and high volatility will translate to elevated bid–ask spreads and potential mark-to-market gains.
- **Net interest margins will remain compressed**, as rates remain low or fall slightly further. Any increase in borrowing volumes, for example, from drawdowns on lines of credit, may be offset by losses in credit portfolios.
- **Credit losses will be elevated across most sectors**, across small businesses and in certain retail segments (for example, self-employed workers, hourly-wage earners, uncollateralized products). Within commercial banking, travel, tourism, and entertainment segments will be the hardest hit. Oil and gas lending may also be challenged, with ultimate outcomes depending heavily on geopolitical factors affecting oil production and price. Across all industries, smaller and less efficient businesses will be hit disproportionately.
- **Remote work may increase costs** for setup, and may cascade to lost wages normally paid to hourly workers and contingent staff. Operational losses due to fraud are also likely to increase.

To understand the impact on their own portfolio under rapidly evolving scenarios, banks need to apply testing tools, complemented by close continued monitoring. To do so, they can leverage their existing stress testing frameworks, such as the capital adequacy infrastructure developed as part of Comprehensive Capital Analysis and Review

(CCAR) in the United States. To maintain safety and soundness and limit impact on financials, banks should maintain an up-to-date and scenario-based view of expected financial impact across businesses. In doing so, however, we believe five key imperatives should be borne in mind:

1. **Prioritize and iterate.** Unlike regulatory stress testing, this is not a hypothetical exercise. Stress-test results have direct implications for decisions banks are making in real time. Banks will need to identify which industries and segments are in most imminent danger and quickly analyze and monitor data for early warning signals. That base will allow them to build a fuller view of the economic landscape iteratively, as the pandemic evolves.
2. **Reverse stress test to identify worst-impact scenarios.** Regulatory stress testing, as well as most banks' supplemental stress testing, lay out specific hypothetical scenarios to assess their potential impact. In today's world, banks should look immediately to understand the outer limits of possible actions to support borrowers and markets during the trough.
3. **Build scenarios based around potential virus spread and human reaction.** Building mere macroeconomic scenarios will not be helpful as these would be divorced from the underlying drivers of the crisis. Instead, scenarios should be built around the spread of the virus. This will require developing a range of expectations for the progression of the disease, government response, and supply and demand shifts, and only then looking at macroeconomic changes. Analyzing the interaction between supply and demand and associated impact on macroeconomic factors will be particularly complex, as there is no direct historical precedent. Historically linked variables, such as income and employment, may decouple. Typically decoupled variables may become more correlated, such as when multiple business-continuity-plan scenarios occur simultaneously across the globe. Also consider "knock-on" operational risk-like scenarios, for example, the impacts of food shortages.

4. *Examine performance assumptions built into existing models.* Because the situation is unprecedented, assumptions built into models may not hold. For example, assumptions common in some treasury models have already been broken in this past week's US Treasury price movements. As another example, collections-efficiency assumptions are unlikely to hold because of situation-dependent decisions on when and whether to collect at all.
5. *Incorporate implications of near-term actions, including on expenses.* Most institutions have appropriately acted quickly to try and contain virus spread and protect their employees' and customers' health. If these measures remain in place for several months—consistent with China's experience—their implications may be nontrivial and will need to be better understood.

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As deposit gatherers, credit grantors, and payment facilitators, banks play a vital role in the functioning of the economy. They are not simply commercial enterprises but provide important services to individuals and communities. Their health, and that of their workforce, the continuity of their operations, and their safety and soundness are therefore critical. The last financial crisis led to much emphasis on

the systemic risks posed by banks; the current one, which has entirely originated from outside the banking system, provides the opportunity for banks to prove their role as systemic stabilizers, delivering services at least in part for social good. Needless to say, this will require very careful thinking and trade-offs among various short- and medium-term options.

In doing so, bank leaders should bear in mind that this crisis is likely to reinforce, in direct proportion to its extent and duration and maybe even more, a number of existing trends. Workplace dynamics and talent management, already evolving in a digitizing world, may be durably changed after an extended period of remote working. As they settle into their new routines over the next weeks or months, banks should consider this as a testing ground for what does and does not work and draw implications for their HR, organizational, governance and culture transformations. Likewise, customer routines and expectations may also shift further in meaningful proportions, both in terms of digital adaptation and the expectation for proactive communication and care. Operational resiliency is also bound to remain critical with mounting risks of pandemics, societal and geopolitical tensions, and climate change. Banks should carefully draw on the lessons that the current situation offers and use them to inform their digital transformation, while building a much higher degree of both operational and financial resiliency.

**Kevin Buehler** and **Hamid Samandari** are senior partners in McKinsey's New York office, where **Olivia Conjeaud** and **Laura Webanck** are associate partners, and **Lorenzo Serino** is a partner. **Vito Giudici** is a senior partner in the Hong Kong office. **Marco Vettori** is a partner in the Milan office. **Olivia White** is a partner in the San Francisco office.

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# Lessons from Asian banks on their coronavirus response

Financial institutions in countries initially affected by the pandemic moved quickly to safeguard their employees, transform their operations, and serve customers in new ways.

*by Jacob Dahl, Vito Giudici, Sameer Kumar, Vishal Patwari, and Gabriele Vigo*



**As the COVID-19 outbreak** continues to spread around the world, the humanitarian crisis has been accompanied by immense social and economic disruption. Almost overnight, whole countries have had to accept a new reality: everything has changed, and daily life may never be the same.

Asian banks have already had to grapple with all of these factors, taking actions to maintain operations, protect their workforce, and keep customers informed. Their actions could offer a valuable template for banks around the world that are still amid the crisis and experimenting with initiatives. By focusing on three imperatives—ensuring business survival, fulfilling social responsibilities, and adapting to the new normal—banks can minimize disruption and continue to provide vital services to their customers.

### **Ensure business survival**

In response to the pandemic, Asian banks moved quickly to shore up their operations and implement new approaches to mitigate operational disruptions. They prioritized several areas to identify issues or obstacles to business continuity and then experimented with new solutions and ways of working.

#### **Confirm resilience of internal operations**

To guide the pandemic response, many financial institutions formed a response-management unit composed of executive-level, cross-functional teams. These teams were empowered to make key decisions as well as communicate COVID-19 responses quickly and effectively across the organization.<sup>1</sup>

Asian banks also had to shift to remote working for most employees, a move that required IT to ensure the organization's infrastructure and systems could support such a shift. In defining remote and work-from-home setups, bank executives considered both the level of human interaction required for certain tasks and the degree to which work can be segmented and individualized (exhibit).

For example, contact-center staff don't require a high level of interaction with coworkers, but banks often lack the level of technology needed to make working from home feasible. On the other side of the spectrum, digitally enabled product-development teams are better equipped to work from home compared with traditional teams (see sidebar, "Suitability of working from home by bank department").

Solutions had to balance the elements of people, processes, structure, and technology. At one Southeast Asian bank, for example, a 125-member product development team moved its work setup completely off-site over the course of two weeks. The team first implemented no-regrets moves, such as reinforcing best practices in handling data, and then defined a clear set of actions across key operating models to enable fully remote work. The actions were shaped by various business-continuity planning scenarios, ensuring operational continuity while supporting similar levels of productivity.

#### **De-risk traditional distribution channels**

In the weeks after the outbreak, Asian banks quickly took action to ensure that normal bank operations didn't contribute to the spread of the virus among customers and employees. As the primary setting for face-to-face interaction, branches were a top priority.

Within branches, hygienic and cleaning protocols in commercial and ATM areas were stepped up, and bank notes were regularly disinfected and quarantined for two weeks to reduce risk of transmission through cash. Temperature screening was implemented for all customers, staff, and visitors entering bank premises and branches. In addition, institutions began providing aid kits (for example, thermometers, hand sanitizer, masks, and general medicines). Tellers were instructed to wear masks and wash their hands frequently.

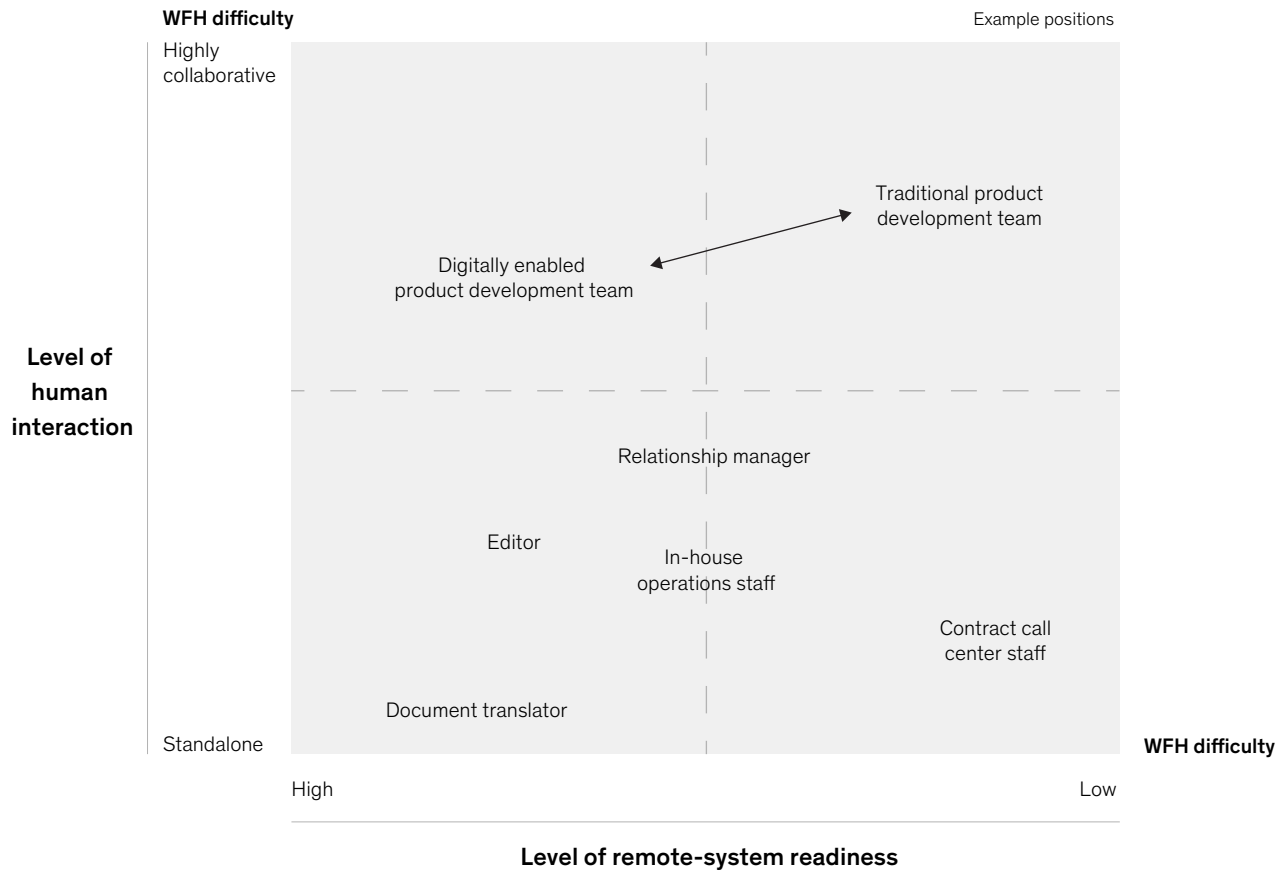
The way that branches were operated and staffed also changed. For example, bank hours were shortened, the number of staff was reduced where

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<sup>1</sup> Mihir Mysore and Ophelia Usher, "Responding to coronavirus: The minimum viable nerve center," March 2020, McKinsey.com.

Exhibit

**Bank executives defined a work-from-home (WFH) framework dependent on staff needs and requirements.**



possible, and a portion of the workforce was relocated to other offices. Other steps included proactively limiting the number of customers inside a branch at a given time and encouraging physical distancing. Some banks also halted high-risk activities—for instance, limiting transmission through foreign notes by closing currency-exchange booths nationwide and discontinuing all in-branch transactions that involved foreign currencies.

These measures extended to parts of the operational areas with high concentrations of workers at a given location, such as call centers.

One South Korean bank instituted a platoon system for its nearly 450 call-center employees, allowing 150 staff members to work from home at a time. Voice over internet protocols and laptops equipped with company software were installed in these employees' homes. Employees working from home handled only new customer inquiries and generic queries to avoid compromising sensitive customer information. Calls that required access to customer information were forwarded to on-premise call centers, where workspaces were altered and partition walls were heightened to increase space between employees.

## Suitability of working from home by bank department

To gauge which positions might be the best candidates for remote working, banks should assess roles on several criteria

(exhibit). Positions that handle sensitive customer information or depend on engagement with other teams, for example,

typically require specific remote-working tools to facilitate collaboration and mitigate risks from data security and system access.

Exhibit

**A work-from-home (WFH) model is possible if remote-working tools are provided to facilitate collaboration and mitigate risks from data security and system access.**

Bank departments	Human interaction			System readiness			Overall	Implications
	Need for creative collaboration	Structured work	Client facing	Data confidentiality	Remote system accessibility	Home office		
Branches								Require on-site customer engagement
Sales force								Can be enabled for remote work through tools and mechanisms
Central business units								Well positioned for WFH where collaboration tools are in place
Product development								Require range of collaboration tools to enable remote work
Technology								Can enable remote working if necessary tools are provided
Operations								Generally difficult to enable remote work due to high confidentiality of data and system access requirements; mitigations are possible
Contact center (customer service)								

### Shift to digital

To some degree, the pandemic forced banks to significantly accelerate their shift to digital channels. Asian banks not only leaned more heavily on existing digital channels to enable contactless customer engagement but also accelerated the path to digitized core-banking processes such as electronic know your customer (eKYC), digital signature collection, and online document submission.

Many institutions offered customers an expanded range of online services to reduce the need for in-person banking. Ping An Bank, as part of its anti-coronavirus initiative, introduced the Do It At Home campaign to offer contactless and smart services. Customers could complete a variety of financial services on the Ping An Pocket Bank app, relating to basic banking transactions, wealth management, insurance, foreign exchange, private bank or family

trust, investor education, and more. Artificial intelligence–powered customer service was rolled out to offer around-the-clock consultation when call centers were closed and face-to-face communication wasn't possible. In just two weeks, more than three million customers had made 11.67 million transactions, and 475,000 customers had viewed online lectures on mutual funds, PE investment, and financial laws and taxation.<sup>2</sup>

In response to the spread of COVID-19, DBS Singapore introduced several support measures on February 17. It offered financial assistance to affected customers in the form of complimentary insurance coverage and home-loan-payment relief for employees in affected industries. Small and medium-size enterprises were provided a package of support measures; these included a six-month property-loan principal deferral, temporary loan bridging for affected businesses, extension of import facilities up to 60 days, digital account opening, and next-day, collateral-free business loans. The bank also launched health- and education-related tools, such as online doctor consultation, online video-based lessons for kids, and taxi street-hail contact tracing. These services were tremendously popular: DBS Singapore's free COVID-19 hospital cash insurance policy, for example, recorded more than 52,000 sign-ups a day at its peak.<sup>3</sup>

### **Strengthen liquidity position**

Asian banks also had to prepare for potential changing customer borrowing needs and withdrawals. Executives assessed their institution's position to ensure sufficient liquidity. This process involved identifying key risks to liquidity from both supply and demand perspectives, such as additional drawdowns in commercial and retail businesses and large withdrawals. Some fast-acting banks developed a short-term liquidity plan and updated contingency plan, created full transparency on liquidity positions (such as through an intra-day dashboard), identified major accounts by materiality, and started negotiations with customers early. Depending on the severity of the situation,

some other actions may have included canceling transactions, settling early, and trade compression if required; mobilizing trading and nontrading assets to be used as collateral; and utilizing support from government programs. Over the medium term, banks should review their liquidity models to incorporate a variety of financial scenarios.

### **Fulfill social responsibilities**

Banks and other large institutions have a social obligation to customers and the economy at large. Asian banks took this obligation seriously with concrete actions to support their customers and government efforts to cushion the economic impact of the pandemic.

#### **Protect customers**

Banks are in a unique position to enhance customer confidence, ease concerns about financial commitments at a time of disruption, and take proactive measures to help the most vulnerable customers. Retailers, small and medium-size enterprises, and corporate customers are all developing strategies to weather the economic disruption and maintain the viability of their businesses.

Asian banks have assisted vulnerable customers with immediate financial relief. Measures included interest rate discounts on new and existing loans for customers in affected economic sectors, payment moratoriums and late-payment fee waivers, extensions of working capital facilities and loans, and collateral-free emergency funding. Some institutions have offered additional products and value-added services, such as COVID-19 insurance and an epidemic and medical information portal.

China Merchants Bank, for example, enhanced its app to become a one-stop shop for life and financial services. Users could access various daily services for stay-at-home employees (such as food delivery, recipes, and online courses) and those returning to work (ridesharing services). These services were located in the same window as traditional financial

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<sup>2</sup> Public information drawn from press search.

<sup>3</sup> "DBS extends enrollment deadline for COVID-19 relief insurance," *Singapore Business Review*, March 17, 2020, sbr.com.sg.

services such as lending, wealth management, credit-card repayment, and fund transfer. A special zone on the app provided real-time pandemic data, online counseling, and a designated hospital search through partnerships with various third-party suppliers. In just one month, the special zone had more than 100 million visits, with 1.6 million visitors receiving counseling from around 50,000 doctors.<sup>4</sup>

### **Engage regulators, governments, and society**

Banks have a wealth of resources, from financial models to data analysis, that can inform public policy and shape the economic response to the pandemic. In the first months of the outbreak, Asian banks lead the dialogue among regulators and government officials aimed at supporting customers and mitigating risk.

State Bank of India research has been working to analyze COVID-19's economic impact and propose a set of interventions to stabilize the economy. In monetary policy, SBI recommended a rate cut to accommodate the expected surge in liquidity demand and shock-related price increases. Stakeholders also considered a degree of prudential forbearance for most-affected sectors such as hotels, aviation, transport, metal, auto components, and textiles. The effort also recommended using the excise duty saving from lower crude-oil prices to provide relief to people who are lower on the socioeconomic ladder.

### **Adapt to the new normal**

The scale and duration of economic disruption remain uncertain, but the immediate effects have increased risk and rendered many existing strategies obsolete. Once banks have taken action to ride out the initial waves of the pandemic, they must turn their attention to functioning in a post-COVID-19 world.

### **Mitigate financial impact**

The pandemic's immediate aftermath reduced margins and volumes as well as disrupted physical channels and operations. In response, Asian banks

need to model possible scenarios on the impact to profits and capital and refresh their business plans accordingly. Where necessary, additional contingency measures should be added. Banks can also create a structured approach to review their loan book and take action to mitigate risk.

Asian financial institutions also designed specific interventions to manage end-to-end credit risk. Updated credit underwriting strategies may include, for example, a request for a COVID-19 contingency plan from corporate clients at origination. Similarly, sharper risk identification, monitoring, and measurement approaches can identify clients with higher vulnerability to primary and secondary effects of the COVID-19 outbreak and anticipate deteriorating creditworthiness. In client engagement, banks have adjusted potential credit risk mitigation actions and approaches to safeguard relationships and future business opportunities.

To manage scenarios that include a prolonged spread of the coronavirus, Asian banks have explored options to quickly reorient resources from underwriting to monitoring and collection, including dedicated training sessions and outsourcing. Data-and-analytics methodologies have helped banks neutralize the impact of COVID-19 on capital (as much as possible), provisioning (such as through IFRS 9), and stress-testing models.

### **Revisit strategy**

Banks must develop new strategies that consider a range of external and internal factors. Emerging consumer trends include greater receptiveness to digital channels—particularly among digital-averse segments such as elderly or rural populations. After the crisis, employees may be more inclined toward remote-working arrangements, which will have repercussions on everything from real-estate costs and planning to IT spending. Meanwhile, banks could face a prolonged period of lower profits and tighter balance sheets, reduced interest rates due to regulatory pressure, and increased operational costs due to new safety measures.

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<sup>4</sup> Public information drawn from press search.

These combined factors can reshuffle priorities and point the way toward new ways of serving customers. In the wake of COVID-19, Asian banks sped up the launch of digital platforms and services while expanding digital banking services to emerging ecosystems. To effectively manage the future downside risk on revenue, banks should target becoming lower-cost franchisees by considering strategic cost programs that draw on multiple cost-saving strategies, including remote working. Institutions with healthy balance sheets could consider M&A possibilities. Last, an increase in IT spending could enhance internal resiliency to

future disruptions and provide more flexibility in maintaining operations.

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Asian banks had no choice but to respond to the coronavirus outbreak quickly and decisively. Their rapid action lessened the impact on their organizations and customers. Following in their footsteps could help financial institutions in countries facing the next wave of the pandemic increase their own resilience.

**Jacob Dahl** and **Vito Giudici** are senior partners in McKinsey's Hong Kong office; **Sameer Kumar** is a partner in the Kuala Lumpur office, where **Gabriele Vigo** is a senior partner; and **Vishal Patwari** is a senior expert in the Singapore office.

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# Leading a consumer bank through the coronavirus pandemic

The implications of the COVID-19 crisis are profound for consumer and small-business banks, and the steps they take now will shape operations long into the future. Here is where to start.

*by Ashwin Adarkar, Paul Hyde, Marukel Nunez Maxwell, and Abhilash Sridharan*

### **How consumer and small-business banks**

respond to the coronavirus pandemic will have an impact on customers, employees, and, indeed, the economy at large. As deposit gatherers, credit guarantors, and payment facilitators, these banks are among the financial institutions most personally connected to the public.

While the near-term humanitarian challenge looms large, the situation is also likely to accelerate fundamental changes to customer behavior. As we shelter in place, we are all rapidly accelerating our adoption of digital technologies, whether they be videoconferencing, peer-to-peer payments, or online banking. This increasing comfort with digital technologies and decreased reliance on physical branches could accelerate the transformation of the banking landscape, advantaging the banks with stronger digital capabilities. In China and Italy, for example, four weeks after the coronavirus began to spread, the estimated increase in customers' digital engagement is 10 to 20 percent. If these customers have a positive experience, it could shift behavior for the longer term.

Based on our conversations with consumer- and small-business-banking leaders from across the world, there are several top-of-mind questions: How do we get the best out of our operating model as the situation evolves? How do we serve our customers and differentiate ourselves? And how should we both accelerate out of the downturn and redefine? Each of these are momentous challenges in their own right. In this article, we share our perspectives on these issues, along with suggestions for how leaders of consumer and small-business banks can respond to them.

### **Implementing a dynamic and flexible operating model**

Banks across the world are rapidly flexing their operating models to ensure business continuity. While it is clear that all banks will have to adapt capacity as the model adjusts, at least in the

interim, the most thoughtful institutions are doing it strategically. As we discuss potential solutions with banking leaders, the initiatives they are most commonly adopting are taking proactive steps to protect the health and boost the morale of their employees, establishing an interim operational model for branches, and developing a support model for remote working.

### **Implement preventive measures to protect employee health**

Consumer and small-business banks in most places are already undertaking the most basic steps to protect employee health. They are reinforcing hygiene and cleaning protocols inside branches, for example, both in commercial areas and around ATMs, which act as transmission vectors. And they are providing to branches care packages that include thermometers, hand sanitizer, and other personal protective equipment. Some are also issuing guidelines to keep branch personnel physically separate, with employees from each shift working in exclusive, delimited areas or at work stations separated by at least five to six feet.

The banks might want to go further, conducting emergency training to prevent coronavirus contamination. All branch personnel should participate in measures to minimize their own, their families', and their customers' health. Although additional actions may go beyond the steps recommended by official agencies, they might include instituting routine temperature checks at the beginning of each shift, assigning a dedicated employee to control facility access, and even wearing gloves and face masks. Chinese banks have gone so far as to disinfect paper currency to avoid infection, a practice followed by a few South Korean banks.

### **Establish an interim operational model for branches**

Banks are monitoring the situation on a day-by-day-basis, dynamically modifying branch hours of operation and closures. For example, in the United States, JPMorgan Chase has temporarily closed

about 20 percent of its branches and reduced staffing in the remaining ones. Banks elsewhere are operating branches only in the morning. Canada's Big Six banks<sup>1</sup> have announced that they will be working together to limit operating hours temporarily while maintaining critical services for customers. Banks should be strategic and proactive to protect their employee capacity to support a remote-working network versus losing employees to potential infection and sickness.

The coronavirus pandemic is also requiring changes to employees' ways of working, and the model will need to evolve as the facts on the ground do. Such changes could include steps that reduce the number of employees in branches at any given time. For example, a bank might staff only half of its usual number of employees per shift or develop a rotation schedule, with a third of its employees absent, a third at branches, and a third working from secure sites or home offices.

Finally, banks are also proactively limiting client flow inside their branches. Measures that banks are taking include requiring client visits by appointment when possible and keeping doors closed to restrict the number of clients inside to no greater than the number of employees. They are also promoting safe spacing by allowing only one customer per a predetermined number of square feet or by marking the floors to delimit positioning in lines to keep clients at a safe distance from each other inside the branch. Many are also moving to protect customers outside the branches, setting up mechanisms to ensure appropriate distancing and hygiene in case lines develop outside the entrances.

Branch facilities are also setting aside dedicated service hours to customers in high-risk groups. For example, Britain's Nationwide Building Society (the world's largest building society, with more than 15 million members) will open around 100 branches an hour early so that elderly and vulnerable customers can be served in a safer environment, compliant with physical-distancing guidance, after facilities have received deep cleaning. Retailers in the United

States, including Target Brands and Whole Foods Market, are taking similar steps.

Other banks are providing options for walk-in customers to contact relationship managers, service managers, and tellers remotely—through a phone booth, for example, or videoconference. To do this effectively, banks will want to identify which mass processes can be performed digitally and offer video access to all relevant employees.

### **Develop a support model for remote employees**

Consumer and small-business banks are managing several challenges related to the coronavirus. Customer queries and concerns are surging, without a commensurate increase in staff to handle them. A significant portion of the employees are working from home—where they continue to face operational challenges, such as internet-bandwidth issues, technology glitches, and childcare priorities. Several best practices, such as the following, could help these banks implement a more efficient distributed-work environment over the coming weeks:

- *Get creative in cross-training and repurposing employees.* Demand surges are likely in the next few weeks, especially in service-related calls pertaining to repayment schedules, flexibility via payment holidays, and an increase in fraud-related activity. A surge in demand for mortgage-refinance applications, which began before the US Federal Reserve Board's rate cut on March 15, is likely to continue (Exhibit 1). To manage the surge in mortgage-refinancing applications, leaders like JPMorgan Chase and Quicken have cross-trained and reallocated employees from other products within the bank. Similarly, branch tellers who might be temporarily free because of branch closures could shift to handle demand in other parts of the business.
- *Conduct targeted analytics to address changes in call demand and agent supply.* Banks may want to consider rebuilding demand forecasting and capacity models not only to respond to the present

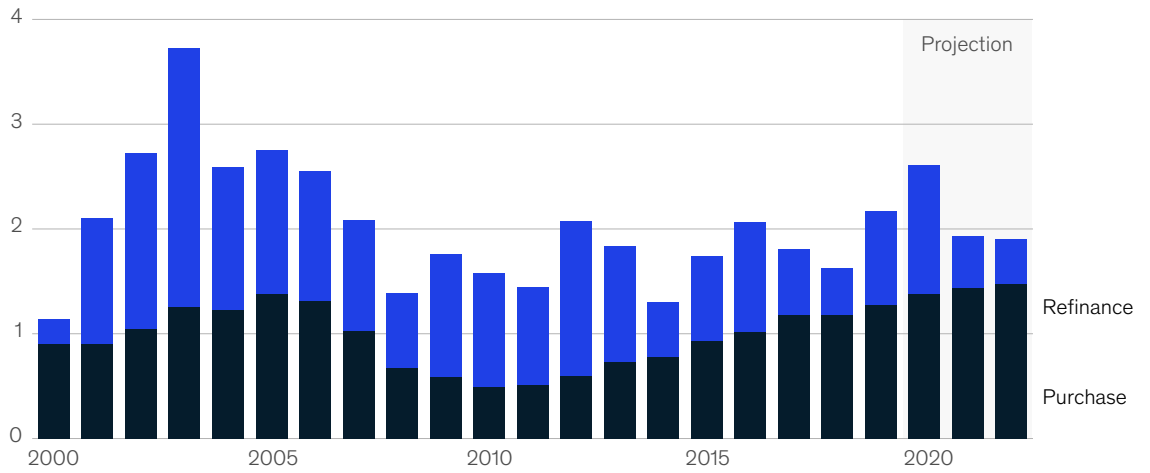
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<sup>1</sup>Bank of Montreal, CIBC, National Bank of Canada, Royal Bank of Canada, Scotiabank, and Toronto-Dominion Bank.

Exhibit 1

**Low rates are leading to another spike in refinancing volume.**

**Annual mortgage-origination volume by purchase/refinance split, \$ trillion**



Source: March 6, 2020, forecasts, Mortgage Bankers Association

circumstances but also to develop resiliency in the face of future demand shocks. Better data can improve a bank's workforce flexibility, allowing it to focus cross-training into roles dealing with increasing demand, away from roles dealing with declining demand. It could also identify call types that could benefit from better segmentation or routing. For example, there may be queues for which banks could suspend live call support or reduce the average handling time.

- *Enable technology setup and infrastructure for remote work.* Supporting remote-work technology and infrastructure can include assisting employees with home-office setup, ensuring adequate VPN bandwidth, and providing remote application access. It can also include adopting a suite of digital tools that facilitate effective cocreation, communication, and decision making, such as videoconferencing, file sharing, real-time communication, coediting, and task management. Extending work-at-home functionalities to more of the workforce also requires setting clear policies and communicating expectations to all employees.

It is critical to ensure that agents have the necessary tools and resources to handle calls from home while maintaining customer-data-confidentiality standards.

**Nurture the culture to maintain employee morale**

In such challenging times, it is natural for employees to feel frustrated, given the uncertainty around their jobs and the fear of recession. It is important for bank leaders to set the tone and direction. At a minimum, this requires managers to set clear directions for remote teams that are pursuing common goals and to increase the frequency of check-ins to reinforce goal setting. We recommend daily check-ins. Managers should also take the opportunity to delegate and empower their employees for decision making. Both intrinsic and extrinsic motivation through rewards, clear spans of control, and meaningful appreciation can go a long way in supporting employee morale.

In addition to developing tools and practices that help teams work together effectively, managers should also double down on social activities that

build a one-team culture, identity, and feeling without compromising physical-distancing protocols. The social aspects of co-located teams often get lost in distributed teams. Helpful activities might include virtual catch-up meetings and happy hours—any virtual event in which employees can share best practices, success stories, and challenging experiences to create a sense of community.

### **Serving customers in challenging times**

Delivering on customer expectations while adapting the operating model to the reality of the current pandemic will be an unprecedented challenge for banks. In our view, it is highly important for banks to make their genuine concern for their customers clear and to make customer interactions with the bank as easy as possible.

#### **Show customers that you care for them**

In contrast with 2008, when people widely considered banks to be the source of the financial crisis, banks around the world are today seeking to be part of the solution—and redefining what it means to support their customers. They are taking measures to minimize negative financial effects on customers, provide broader counseling, and lead community-support efforts. The following are some of the actions that leading banks can take to show their concern for customers:

- *Offer payment holidays and temporary relief.* Bank customers are facing extraordinary financial stress. In response, most banks are starting to waive interest charges and suspend late-account fees for customers who request such changes for coronavirus-related relief. For example, Goldman Sachs is allowing Apple Card users to skip March payments.<sup>2</sup> Ally Financial is allowing automobile-loan and mortgage customers to delay payments by 90 to 120 days. We expect to see more of these actions across the industry in the coming days and weeks.
- *Provide financial-fitness tools and help lines.* In the face of so much uncertainty, bank customers will have financial questions

or simply need reassurance. Banks should anticipate these and embed more financial-fitness tools and dialogue in their client interactions. They should, in particular, direct individuals to their online financial-fitness tools and make those tools available on their website landing pages—and promote personal engagement and program chatbots accordingly. We believe that banks should start reaching out to clients proactively to discuss financial-fitness tools, starting with the customers most at risk in the current environment. Additionally, bank managers should create opportunities for human interactions for distraught customers who just want to talk through their concerns and establish help lines for customers who need support during remote (mobile or internet) transactions.

- *Serve in unexpected ways.* Especially during a crisis, customers don't always know what they will need until that need is pressing. Finding that their bank is prepared to help in unexpected ways will go a long way toward reassuring them. Financial institutions could take inspiration from the actions a few banks in China have taken (Exhibit 2). There, many banks went above and beyond their financial commitments to cater to their customers' growing medical needs during the epidemic. For example, China Construction Bank partnered with China's Department of Civil Affairs to launch a digital platform to help local community managers monitor the number of people affected by coronavirus in their specific geographies. The platform also helps residents and employees input basic personal information to apply for return to work. Additionally, it allows them to stay connected with other open-banking platforms, such as those for the rural population, medical services, education, and eldercare.

#### **Enable seamless customer service and support new ways of working**

The coronavirus pandemic is already leading to abrupt changes in how customers manage their finances. Customers already under health and




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<sup>2</sup>Olivia Rockeman, "Goldman Sachs to let customers defer Apple Card, Marcus payments," Bloomberg, March 16, 2020, bloomberg.com.

Exhibit 2

## Chinese banks took proactive digital measures in response to COVID-19.

### Response measures

Category	Bank	Response	Launch date	Initial impact
No-contact banking 	Ping An Bank	Based on Ping An of China's well-established ecosystem, Ping An Bank launched Do It At Home service through which customers can complete series of financial and nonfinancial services on Ping An Pocket Bank app	Feb 3	<ul style="list-style-type: none"> <li>&gt;8 million page views</li> <li>116.7 million transactions from 3.05 million customers</li> </ul>
Live-streaming marketing 	Bank of China (BOC)	BOC's Wealth Management (WM) subsidiary set up 3 online live shows, conducted by its leading investment managers, about impact of coronavirus outbreak on capital market and newly issued WM products	Feb 11	<ul style="list-style-type: none"> <li>&gt;26,000 viewers for first online live show</li> <li>&gt;44,000 total viewers for 3 online live shows</li> </ul>
Ecosystem building 	China Construction Bank (CCB)	CCB launched smart community platform	Feb 14	<ul style="list-style-type: none"> <li>Platform covers 738,500 communities, 404,000 companies, 1,337 schools, and 60 senior centers</li> <li>101,600 total users in 1 week</li> </ul>
	China Merchants Bank (CMB)	CMB launched antiepidemic zone on its app, with real-time epidemic data, online counseling, and designated-hospital searching, by partnering with various third-party suppliers  App users can find daily stay-at-home and return-to-work services (eg, food delivery, online videos, shared rides, online courses) and online financial services (eg, lending, WM)	Feb 11	<ul style="list-style-type: none"> <li>~100 million visits to antiepidemic zone</li> <li>Offered &gt;1.6 million online counseling sessions with &gt;50,000 doctors</li> </ul>

Source: Press search; McKinsey analysis

financial stresses will need ready access to bank products and services. It is all the more important, then, to reach customers through digital channels, stay connected through innovative communication channels, meet the needs of vulnerable populations, and stabilize critical infrastructure:

- *Encouraging digital migration.* Banks should encourage more customers to use existing remote channels and digital products whenever possible. To do so, institutions can launch positive and safety-oriented messaging aimed at reducing reliance on branches for services that are digitally available while also offering

discounts, providing online and call-based tutorials, and increasing remote support options. Banks can also enhance their current digital offerings, identifying key functionalities that can be improved quickly—for example, speeding up the procedure to increase limits on online transactions and simplifying password reset.

- *Keeping clients engaged via SMS, mobile apps, and digital media.* Early and proactive communication can help minimize unpleasant surprises to customers (such as potential branch lockdowns), encourage fraud-prevention measures, clarify the availability

of solutions on digital channels, and define preventive measures to ensure the health and safety of clients and employees in branches. Banks in China, for example, have built information on branch status and lockdown zones into their mobile apps. Some have instituted frequent nudging mechanisms to notify clients of bill payments, deposits, and spending activity. Such efforts both engage clients and promote their financial fitness.

- *Serving vulnerable populations.* Many of the bank customers considered vulnerable to the coronavirus, especially the elderly, may not have been active online users. Banks can get creative with short-term solutions, such as remote access and delivery of paper communications to customers' doorsteps. Germany's Sparkasse set up mailboxes for direct account transfers with no human interaction.
- *Stabilizing critical infrastructure, systems, and processes.* The current situation is likely to expose technology glitches. Some financial institutions will need to address such technology gaps in order to offer a seamless digital customer experience. This will require planning ahead by scaling infrastructure capacity and network bandwidth, stress testing and scenario planning, managing near-term patches, and identifying urgent weaknesses in architecture.

We have developed a checklist of key tasks for banks in the areas of customer engagement, infrastructure setup, and digital engagement (Exhibit 3).

### **Accelerating out of the downturn: Redefining consumer and small- business banking**

As the human cost of the coronavirus pandemic unfolds, we are only just beginning to come to grips with its impact on the economy and on the banking landscape. It seems likely that the forced abrupt shift to remote working will have profound long-term implications on key banking operating-model

dimensions, such as location strategy, outsourcing, offshoring, and employee value proposition—for example, flexible hours, job sharing, and accessing new talent pools.

While keeping the needs and well-being of both customers and employees at the forefront, banks can use this moment to experiment with radical redesigns of their operating models to achieve better efficiency. Although the timing and shape of recovery is still unclear, we expect far-sighted organizations to begin both taking actions to mitigate the impact of the situation and positioning themselves to build momentum rapidly in the postrecovery phase. Such actions include the following:

- *Increasing the use of digital abilities to boost customer engagement.* We believe the pandemic will be a catalyst for the use of digital banking tools and will also change the way customers interact with their banks. For example, China's Ping An Bank launched the Do It At Home service as part of an initiative to help customers during the pandemic. The Ping An Pocket Bank App enables customers to complete a variety of financial-service transactions across basic banking services, insurance, foreign exchange, and wealth investment. Banks that encourage and support customers now will be well positioned to increase the use of digital channels in the future. Banks should continue to invest in boosting digital engagement and sales. Additionally, as branches perform fewer service transactions, banks may need to migrate paper documents and marketing materials to digital channels aggressively, with in-branch coaching to support the customer shift. This will pave the way for banks to reorient branches away from services and toward relationship management and business development.
- *Promoting capabilities for supporting financial advice.* The current environment will increase the pressure on banks to grow. Banks will need to think through how to differentiate themselves in delivering value to clients. This might include, for example, the emergence of bankers who can



Exhibit 3

**Banking leaders should develop a checklist of key tasks around customer engagement, infrastructure reinforcement, and digital engagement.**

**Customer engagement**

<p><b>Educate on bank capabilities</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Digital content development</li> <li><input type="checkbox"/> Targeted digital education across all channels</li> <li><input type="checkbox"/> Social-media activation and constant communication</li> <li><input type="checkbox"/> Call-center messages</li> <li><input type="checkbox"/> Migration to alternative channels</li> <li><input type="checkbox"/> In-branch hygiene standards</li> </ul>	<p><b>Respond to government measures</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Crisis center</li> <li><input type="checkbox"/> Expert-panel response team</li> <li><input type="checkbox"/> Marketing response team</li> <li><input type="checkbox"/> Corporate-social-responsibility campaigns</li> </ul>	<p><b>Disseminate postlockdown awareness</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Fraud-prevention webinars</li> <li><input type="checkbox"/> Wealth-planning webinars</li> <li><input type="checkbox"/> Cash-and-liquidity webinars</li> <li><input type="checkbox"/> Financial-literacy webinars</li> </ul>	<p><b>Create specialized offerings</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Credit availability</li> <li><input type="checkbox"/> Debt-relief plan/flexible payments</li> <li><input type="checkbox"/> Credit-limit review</li> <li><input type="checkbox"/> Terms-and-conditions review</li> </ul>
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**Infrastructure reinforcement**

<p><b>Ensure bankability</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Virtual/digital and physical cards for everyone</li> <li><input type="checkbox"/> Limited adjustment</li> <li><input type="checkbox"/> Mass online/mobile-activation capability</li> <li><input type="checkbox"/> Specialized services for high-risk segments</li> <li><input type="checkbox"/> Point-of-sale and e-commerce expansion</li> </ul>	<p><b>Enable infrastructure</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Channel-capacity-change plan</li> <li><input type="checkbox"/> Cash availability</li> <li><input type="checkbox"/> Mobile-infrastructure-system stability</li> <li><input type="checkbox"/> Hygiene standards in branches</li> <li><input type="checkbox"/> Call-center-capacity increase</li> <li><input type="checkbox"/> Decentralized call center</li> <li><input type="checkbox"/> ATM reallocation</li> </ul>	<p><b>Develop fast enhancements/work-arounds</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Work-arounds/fast enhancements for ATMs/CDMs</li> <li><input type="checkbox"/> Work-arounds/fast enhancements for online/mobile functionalities</li> <li><input type="checkbox"/> Technology integration</li> </ul>	<p><b>Operationalize remote services</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Remote infrastructure</li> <li><input type="checkbox"/> Remote tools</li> <li><input type="checkbox"/> Remote standards</li> <li><input type="checkbox"/> Employee equipment for remote work</li> <li><input type="checkbox"/> Network reorganization</li> </ul>
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**Digital engagement**

<p><b>Motivate customers to use remote and digital services</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Fee waivers</li> <li><input type="checkbox"/> Tutorials and how-to sessions</li> <li><input type="checkbox"/> Transaction rationalization</li> <li><input type="checkbox"/> Call-center support</li> <li><input type="checkbox"/> Mass activation of debit/credit cards</li> <li><input type="checkbox"/> Direct sales-force and telecom sales</li> <li><input type="checkbox"/> Targeted migration campaign</li> <li><input type="checkbox"/> Revised staff incentives</li> </ul>	<p><b>Reinforce remote advisory capabilities</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Evaluation of excess capacity</li> <li><input type="checkbox"/> Redeployment of excess branch capacity into virtual units</li> <li><input type="checkbox"/> Scripts and guidelines</li> <li><input type="checkbox"/> Employee training</li> </ul>	<p><b>Support new/enhanced digital capabilities</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Dedicated digital squads</li> <li><input type="checkbox"/> Prioritized list of functionalities</li> <li><input type="checkbox"/> Search-engine optimization</li> <li><input type="checkbox"/> Budget reallocation toward digital</li> <li><input type="checkbox"/> Digital marketing platforms</li> </ul>	<p><b>Recalibrate capacity across channels</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Capacity-need adjustment</li> <li><input type="checkbox"/> Reskilling</li> <li><input type="checkbox"/> Special incentives/motivation</li> <li><input type="checkbox"/> Idle-capacity rationalization</li> </ul>
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cover both investments and banking; delivery of advice to clients in a cost-effective way, via financial-fitness tools and remote advice; and enhancing solutions as ecosystems with other services, such as accounting and tax services.

- *Encouraging relationship-based banking.* We are a long way from understanding the full financial impact of the coronavirus pandemic—and some banks will fare better than others. But overall, we anticipate that consumer-banking economics will likely be depressed as a result of net-interest-margin compression and decreased fee income. In the event of a flight to quality deposits, traditional banks can deploy relationship rewards and relationship pricing to encourage customers who have shifted to non-FDIC vehicles to come back. They can emphasize their broader suites of products and the value of relationships to underscore their value proposition to these customers.
- *Rethinking the portfolio strategy for small business.* Small-business-banking leaders may consider reevaluating their portfolio and credit strategies to develop industry-segment-specific insights. This will allow them to focus on core sectors and clients—which is not only the right thing to do during such a situation but also will cement long-lasting client relationships. Banks may also need to implement new programs to disburse funding to the most hard-hit industries and segments, such as the US Small Business Administration

has done with its lending package for small businesses affected by COVID-19. Banks will need to scale the capability building of bankers and underwriters to deliver these loans to clients in their time of need.

- *Setting up capabilities for supporting clients in a postpandemic environment.* Banks can invest now to build client-support and workout capabilities, such as improving sensitivity to early-warning systems, developing short-term forbearance solutions and loan modifications, and providing guidance on alternative products. If call-center employees are severely affected, banks can also build contingency strategies to run collection programs through digital channels.

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Prior to the advent of the coronavirus pandemic, consumer and small-business banking was facing a difficult array of challenges: the threat from new digital-attacker models, changing customer expectations, low customer affinity, and depressed economics. Today, workplace dynamics, talent management, governance, bank culture, and customer routines and expectations are all in flux, and the consumer and small-business bank of tomorrow is likely to look very different than it did yesterday. To make the transition successfully, banks can begin by rearticulating the benefits of relationship banking and shifting to a more efficient and customer-centric multichannel engagement model.

**Ashwin Adarkar** is a senior partner in McKinsey's Southern California office; **Paul Hyde** is a senior partner in the New York office, where **Marukel Nunez Maxwell** is a partner and **Abhilash Sridharan** is an associate partner.

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# Remaking banking customer experience in response to coronavirus

In the context of COVID-19, banks can better serve customers in distress by enhancing support in the use of digital tools and new products and services.

*by Eleanor Bensley, Shital Chheda, Robert Schiff, Daniel Stephens, and Nicole Zhou*

**The last time there was a global crisis**, banks were widely perceived to be a big part of the problem. This time around, banks are central to the solution.

Banks can play an immediate role in slowing the spread of COVID-19 by helping customers make better use of existing digital and remote channels. And banks can help limit the impact of the likely downturn by building new experiences to help their customers manage debt, adjust budgets, and make full use of new government programs.

In normal times, customer experience in banking is about making customers happy—with the result that they are more loyal, use products more, and cost less to serve. In the context of COVID-19, superior customer experience means clarity and transparency, support for digital tools with which many customers are still unfamiliar, and new products and services for customers in distress.

### A first-cut action plan

In response to the crisis, most banks need to meaningfully reset their customer agenda to meet

urgent needs—and to do so for the uncertain period likely to continue for some time.

### 1. Help customers go digital and remote right now

In the current crisis, there are immediate actions banks can take to help retail and small-business customers; in particular, they can support the use of digital channels so that customers can bank from home, and they can provide extra support to borrowers in distress.

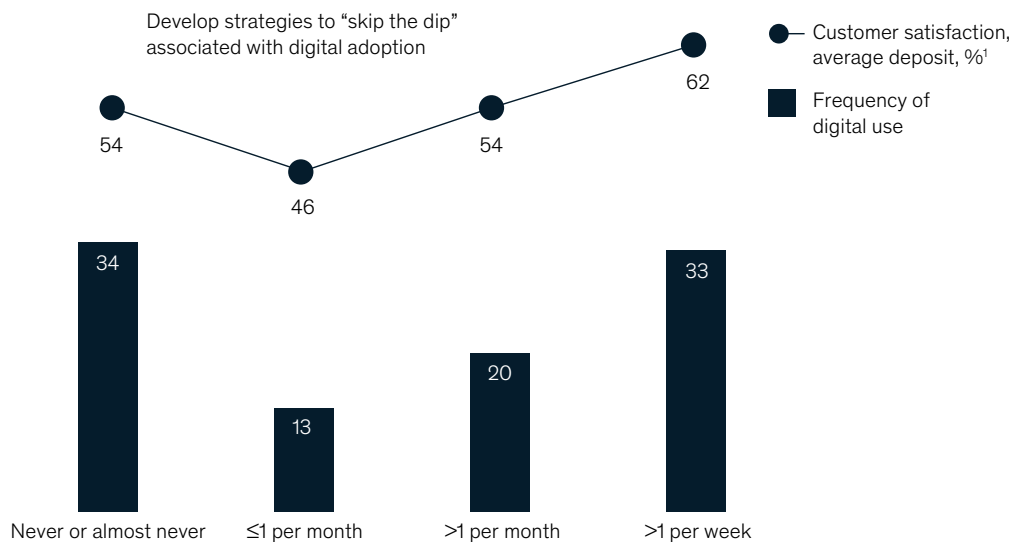
Many banks struggle to increase digital adoption among their customers. In the United States, for example, nearly half of banking customers either never use their mobile app or do so infrequently (Exhibit 1).

In normal times, many customers struggle with the transition to digital. For instance, in the United States, while the most satisfied customers use digital multiple times per week, the second most satisfied customers *do not use digital at all*. The least satisfied banking customers are those who use digital tools infrequently, less than once per month. This is because customers go through a learning curve as they adopt digital tools, and

Exhibit 1

## Half of US banking customers engage digitally infrequently or not at all and need extra support to make the transition.

Frequency of mobile-app usage for deposit products in 2019, %



<sup>1</sup>Percentage of respondents that selected a 9 or 10 on a 10-point overall customer-satisfaction scale.

Source: McKinsey Banking Journey Pulse Benchmark

# Banks can play an immediate role in slowing the spread of COVID-19 by helping customers make better use of existing digital and remote channels.

most banks under-support their customers in the adoption journey. In the current environment, banks should redouble their efforts to smooth customers' transition to digital.

Effective approaches will include easy-to-find and clear communication, segment-specific campaigns, remote coaching and advice, and coherent experiences across each journey (for example, written and video explanations for how to accomplish specific digital tasks, along with ways to try them out, rather than a one-size-fits-all tutorial disconnected from the tools themselves).

For instance, in China, leading banks set up new online portals to explain available services and the actions they were taking in the context of the coronavirus. These portals provided video servicing and sales capabilities, as well as educational videos for investors who were worried about the impact on their portfolios.

One leading Chinese bank launched an integrated digital coronavirus program: banking services, wealth-management services, tutorials, and timely advisory content, as well as non-banking-related services ranging from help with online shopping to doctor appointments to the delivery of disinfectant. Another launched a digital site that combined information on how to use online tools to bank remotely with information on public-health awareness and a way to support the local Red Cross Society.

For services that require branch interaction, digital tools can still play an important role—they can

provide information on adjusted hours, essential services, reduced staff numbers, heightened safety precautions, social-distancing measures, and digitally enabled queuing.

For more on what actions banks can take to drive digital adoption and engagement, see “Leading a consumer bank through the coronavirus pandemic” on McKinsey.com.

## **2. Introduce new experiences for distressed customers**

In times of crisis, customers' priorities change. Banks can play a significant role in easing financial distress, so that customers can spend more energy on their families' and their own health and well-being.

In the United States, COVID-19 has made half of banking customers concerned or somewhat concerned about their job security.<sup>1</sup> For customers who were already in a financially vulnerable state before the pandemic, these new concerns are alarming. And there are many people in this situation. For example, in 2018, 39 percent of US households said they do not have the resources to cover an unplanned \$400 expense.<sup>2</sup> And 2016 research found that the average US small business only had enough cash to cover 27 days of operation.<sup>3</sup>

Preexisting financial vulnerability plus new stresses from COVID-19 will make it harder for banking customers to navigate complexity or make the best financial decisions. For example, research suggests that financial scarcity takes a significant

<sup>1</sup> McKinsey Financial Decision-maker Consumer Pulse Survey, March 2020.

<sup>2</sup> *Report on the economic well-being of U.S. households in 2018 - May 2019*, Board of Governors of the Federal Reserve System, May 2019, [federalreserve.gov](https://www.federalreserve.gov).

<sup>3</sup> *Cash is king: Flows, balances, and buffer days*, JPMorgan Chase Institute, September 2016, [jpmorganchase.com](https://www.jpmorganchase.com).

<sup>4</sup> Sendhil Mullainathan and Eldar Shafir, *Scarcity: Why Having Too Little Means So Much*, New York: Times Books, 2013.

psychological toll and leads to more myopic decision making.<sup>4</sup>

The challenge is that even in normal times banks are not well-equipped to help customers discover and apply for new products and services. Our 2020 Banking Journey Pulse Benchmarking, fielded prior to COVID-19, found that “shopping” is the single least satisfying banking journey across products (such as deposits, credit cards, and mortgages), with the application process itself being not far behind (Exhibit 2).

The key design principles for serving distressed customers are awareness, simplicity, transparency, clear expectations, and frequent status updates. Services and experiences that are likely to be increasingly important to consumers in distress include pausing loan payments; enabling customers to restructure existing loans; refinancing home-equity loans to provide near-term liquidity; resetting budgets to reduce spending; providing relocation services associated with new job opportunities; and, for small

businesses, taking advantage of new government programs that have been introduced around the world to increase access to capital (many are likely to be intermediated by banks).

One leading Singaporean bank rapidly introduced a comprehensive solution for small and medium-size enterprises (SMEs), including six-month property-loan principal deferments, temporary bridging loans, fee rebates, new digital account-opening services, and next-day and collateral-free business loans. The bank complemented these initiatives with an online “SME Academy” to help business owners navigate the new context. In China, one leading corporate bank quickly introduced a new online-only short-term corporate loan with a simple application, fast approval time, flexible payment options, and near-instant fulfillment.

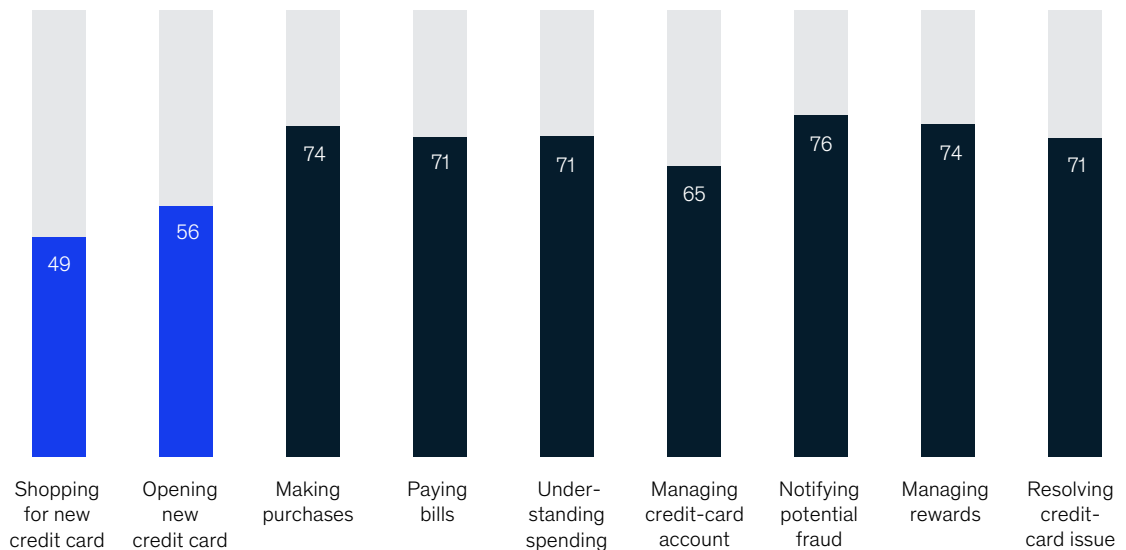
**3. Improve experience in ways that also address efficiency**

The economic consequences of coronavirus will increase the need for banks to improve efficiency and the customer experience. They can do so by

Exhibit 2

**Shopping for new products and account openings are normally the least satisfying retail-banking journeys.**

Average journey satisfaction, credit-card customers,<sup>1</sup>%



<sup>1</sup> Percentage of respondents that selected a 9 or 10 on a 10-point overall customer-satisfaction scale.

Source: McKinsey Banking Journey Pulse Benchmark

enhancing digital self-service as well as by making operational trade-offs.

Digital servicing and sales are less expensive than branch- and phone-based approaches. The problem for many banks is that too few customers use digital offerings because they find them unfamiliar and intimidating. To address this, banks can, for instance, reframe calls to the contact center to teach customers how to use digital channels in addition to addressing the reason, or pain point, for the call.

Understanding what leads to a superior customer experience also enables banks to make thoughtful and efficient trade-offs. For example, if positive experience for a bank's customers is grounded in trust, they might double-down on clear communications, achievable timelines, and status updates—and reduce investments in speedy service.

To improve experience and efficiency at the same time, many banks will need to reset their customer-experience priorities in general, and their approach to customer-experience measurement in particular.

Some banks do not know which parts of their digital experience work well or not, have little sense of which actions help customers learn how to use digital tools, or do not know where the opportunities for operational trade-offs are. In other words, they lack an interpretation of what matters to their customers and what drives behavior.

Too often banks track interactions rather than journeys—and thus are unable to make the connection between a single bad interaction and a customer's future behavior. In addition, they rely on surveys few customers fill out, and they therefore take a one-size-fits-all approach to customer feedback rather than responding to specific customers and business objectives.

To achieve simultaneous improvements in experience and efficiency, banks can use the following feedback and measurement approaches:

- Structure customer-experience measurement around journeys, not single-point interactions.

- Ask questions relevant to specific business objectives, such as digital self-service.
- Link measurement results directly to the potential impact on efficiency.
- Introduce predictive analytics to determine how to be successful with the vast majority of customers who do not fill out surveys.
- Set goals based on how experience and efficiency move together.

#### **4. Reframe employee experience around mutual commitment, especially reskilling**

Employee experience shapes customer experience. That is even more true in a crisis. In their efforts to provide a meaningful employee experience in the midst of the coronavirus pandemic, banks need to acknowledge and reflect on the sacrifices and struggles their employees face as they juggle their immediate job responsibilities with the concerns they have, that all of us have, about the health of their family and economy.

In normal times, employee experience may be a better predictor of customer experience than more commonly used indicators, such as the ratings of a bank's mobile app. For example, an analysis of 13 US banks with iOS App Store scores of 4.8 and higher, on a 5-star scale, found that their customer-satisfaction ratings ranged from an average of 47 percent for the bottom three banks, to an average of 69 percent for the top five; in other words, even if a bank has a great app, it does not seem to be determinant of overall customer experience. In comparison, employee experience tracked differences in overall customer experience well (Exhibit 3).

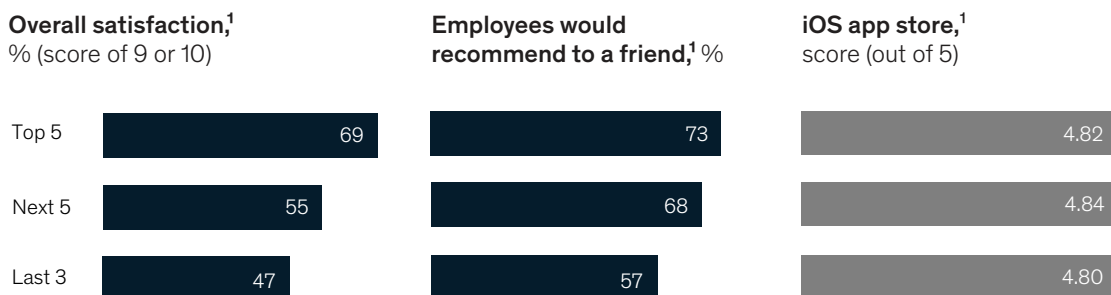
In the near term, banks will need tremendous effort from their employees to navigate the crisis, they must engage with customers empathetically, and they should adjust operations. In this context, banks need to make a credible commitment to their employees and acknowledge the contributions they are making, using both words and policy (for instance, flexible sick leave and compensation).

Greater emphasis on teaching customers how to use existing digital services will also require current staff to engage with customers in new



Exhibit 3

**Strong digital offerings are necessary but not sufficient: Employee experience is a key differentiator.**



<sup>1</sup>13 US banks with iOS mobile-app scores of 4.8 or higher.

Source: McKinsey Banking Journey Pulse Benchmark; Apple iOS app store; Glassdoor employee reviews

ways and learn new skills. Banks can use this moment to significantly improve the quality and availability of reskilling programs, including introducing externally meaningful credentialing so that the new skills are portable. This will equip employees with the skills they need to support new digital experiences. And in many markets, it will not be appropriate for banks to reduce staff at a time of crisis, making reskilling the only sustainable way to fill existing gaps.

When done well, such reskilling programs are a powerful signal of banks' positive role in society and commitment to their people.

**5. Make doing the right thing a competitive advantage**

For banks, investing in customer experience was an imperative before the current crisis, both from a "good business" perspective and a "good bank" perspective. Now, these factors are even more relevant.

Doing right by customers creates long-term shareholder value. Our analysis of 23 publicly traded US banks found that the half with a high customer-satisfaction score delivered 55 percent higher returns to shareholders from 2009 to 2019.

In addition, for banks, downturns are when market positions shift. For example, at the end of 2007, the most valuable of the US universal banks had a market capitalization that was 23 percent greater than the next bank. By 2012, their positions had reversed, and the new leader was 34 percent more valuable. By 2019, the difference in value had hardly moved.

Delivering on customer experience will be an integral part of how banks reassert their positive role in society during the coronavirus crisis. By addressing new customer needs and concerns while improving their own efficiency and effectiveness, banks will be a stabilizing force in a very uncertain environment.

**Eleanor Bensley** is an associate partner in McKinsey's Sydney office; **Shital Chheda** is a partner in the Chicago office; **Robert Schiff** is a senior partner in the San Francisco office; **Daniel Stephens** is a senior partner in the Washington, DC, office; and **Nicole Zhou** is a partner in the Shenzhen office.

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# Addressing the coronavirus impact on customer delinquency

As banks respond to disruptions in their operations, they can plan their collections strategies around three customer-centric best practices.

*by Ademar Bandeira, Bruno Batista, Adelman Felipe, Matt Higginson, Frédéric Jacques, Frederico Sant'Anna, and Alexandre Sawaya*

**People across the globe** are feeling the effects of the ever-evolving coronavirus crisis. Indeed, as of March 19, the World Health Organization has reported more than 200,000 confirmed cases, with more than 9,000 cases in the Americas. By most forecasts, the Americas are only beginning to see of the spread of the virus, and businesses are already scrambling to best support both their customers and employees. Banks' functions appear vulnerable to disruption, with many institutions starting to shutter major operations centers and implement remote-working practices and partial staff furloughs.

One aspect of bank operations seems especially vulnerable: retail collections. A sharp economic slowdown and an equally sudden interruption to core banking functions, including call centers, pose a double threat to effective retail collections operations. The inability to effectively help delinquent customers and service debt poses real operational and economic risks.

In this article we describe three steps lenders can take to best assist customers during this humanitarian crisis and attendant economic hardship. We also discuss ways to modify current collections strategies and adjust staff working practices to a new normal following the pandemic outbreak. Our perspectives are based on our experience supporting executives over recent weeks, including in infection hotspots across Asia and Italy, as well as managing collections during previous crises.

## **Help your customers**

Customers will experience the impact of COVID-19 on multiple levels. In the short term, a significant percentage of people will likely be directly affected by the virus, either through their own health or that of a loved one. Even for those who are not infected by the virus, widespread lockdowns and other social curbs may already be preventing them from earning their regular income and curtailing physical interaction with their bank through an abundance of caution.

In the medium to longer term, employees of industries hardest hit by the pandemic—such

as oil, retail, and travel—may face prolonged unemployment and economic hardship. Several highly populated US states are already reporting more unemployment applications in the first two days after the crisis intensified on March 16 than they would expect in a typical month, and US Secretary of the Treasury Steven Mnuchin warned the unemployment rate could spike to up to 20.0 percent from its current level of 3.5 percent. Meanwhile, the US Travel Association forecasts nearly five million travel jobs will be lost in 2020, which alone would nearly double the US unemployment rate. Although countries in Central and South America have lower exposure to Asian supply chains than the United States, they are facing substantial capital market uncertainty due to oil demand shocks, financial market volatility, and possibly decreasing business investments. University and think tank FGV estimates at least 100,000 people in Brazil will be newly unemployed at current GDP projections.

At such times, it is critical for banks to prioritize the welfare of their customers. For those in debt or facing delinquency on their borrowing, it is the lender's responsibility to provide short-term relief from debt payments for those in need while making payments as simple and frictionless as possible for those who can afford them. We have already seen retail banks and several Latin American and US auto lenders offer borrowers temporary suspension of payment obligations ("payment holidays") while suspending repossessions, interest and late fees, and offsets.

We recommend that lenders provide a range of both short- and long-term, socially responsible solutions to customers in debt or facing hardship. Lenders should activate programs for deferring payments, interest relief, and automated restructuring plans while also communicating details of organizations offering consumer guidance and debt relief. In recent times we have seen lenders launch programs for customers affected by natural disasters—such as fire, flooding, or hurricanes—including at the postal-code level for especially vulnerable communities. While every US state and most Latin American countries have reported cases of COVID-19 infection, certain states and metropolitan areas

have been and will be hit harder economically (for example, cities that are heavily dependent on the oil industry, such as Houston, or major airline hubs such as Atlanta, Chicago, Rio de Janeiro, and São Paulo).

In addition, early signs from China suggest the novel coronavirus may be catalyzing a predictable yet widespread shift away from brick-and-mortar banking to digital channels. Lenders must follow this trend for customers in debt, rapidly activating digital channels for communication, self-service, and debt payment. Now is an opportune time to mimic—and arguably improve upon—the customer experience received through interactions with a call-center employee via online channels, multiple payment options and debt-relief solutions, and customer education on financial well-being.

Above all, lenders must prioritize outreach and communication with concerned customers. Offering empathy and genuine caring not only strengthens the customer relationship but also demonstrates a commitment to customers' long-term well-being. Customers will welcome such a commitment as reassuring and potentially even refreshing at a time of extreme uncertainty.

## Care for your employees

We have already seen many financial institutions quickly introduce remote-working arrangements and establish the underlying infrastructure for beyond the short term. The high transmissivity of the open, high-density environment of call centers, such as those required for effective collections, poses a particular challenge because supporting effective remote operations requires wholesale changes to working practices. Supporting staff welfare, such as by communicating well with and reassuring staff while encouraging real-time connectivity, is especially important.

For many employees, remote working requires little more than a laptop, adequate bandwidth, and robust authentication methods. But for collections call centers, lenders face the additional challenges of providing coordinated telephony (dialer) services, secure access to account information, and the protection of sensitive and confidential customer information such as payment details. Supporting remote work may require banks to migrate from a physical to a virtual dialer and provide additional physical devices such as imaged laptops, monitors, and headsets. Banks may also have to offer training

## Take urgent action to demonstrate commitment to helping customers

### Actively overcommunicate

- Communicate frequently and clearly with customers, demonstrating empathy and a shared sense of impact and response to the evolving crisis
- Set expectations for service-provision levels, assistance with debt, and likely outcomes
- Acknowledge the personal and economic hardship caused by the pandemic, and reassure customers of the commitment to finding sustainable solutions

### Provide immediate debt relief

- Offer short-term payment relief via additional payment channels
- Activate socially responsible collections programs (such as deferred or restructured payments, or interest relief)
- Provide tailored customer solutions at city, state, or postal-code level
- Activate digital channels for customer communications and self-service
- Prioritize proactive outreach, with public advisory and welfare messaging

## Safeguard employees' safety

### Humanize work relations

- Communicate frequently and clearly with employees, set expectations, and be sincere in recognizing concerns and supporting their well-being
- Promote and encourage remote work versus face-to-face meetings, especially for any high-risk groups; eliminate large in-person employee meetings (such as conferences or events)
- Consider changing sick- or personal-leave policies, offering flexibility for employees to care for ill or vulnerable friends and relatives, or organizing child-care services

### Ensure a safe workplace

- If employees cannot work remotely, reinforce principles of social distancing, promote heightened cleanliness, and ensure availability of hygiene products in the workplace
- Involve the health insurance provider in planning and implementing different prevention or containment scenarios (such as primary care and testing at home, instead of hospitals)
- Continuously review and update policies to prevent further spread of COVID-19 infections (via home offices or travel restrictions), prioritizing employee welfare over financial considerations

on compliant handling of personally identifiable information and maintaining strict information security while working remotely.

For staff, remote working also presents challenges to regular communication, team coordination, and management. It is especially important for managers to schedule regular touchpoints with their team members, such as video conferences (“virtual huddles”) at the start and end of each day, and experiment with ways of providing remote coaching and feedback (for example, through call listening, video feedback, and instant-messaging channels). Staff are likely to be nervous, unaccustomed to working alone, and unsure about how long the arrangements will continue. Therefore, clear and regular communications with all staff are critical. To the extent possible, current performance-management programs (such as scorecards and feedback) should be maintained to demonstrate the ongoing commitment to excellent standards of customer service, though targets may potentially be modified to reflect the changed working conditions.

Where remote working is not an option, or employees voluntarily choose to work on-site,

employers should practice responsible social distancing and take care to reduce the density of workspaces, deliberately increasing the physical space between employees to at least six feet (two meters). Having on-site staff may require regularly cleaning an office space; however, this may cause workflow interruptions and result in a shifting call-center contact strategy—for example, to limit the number of employees available at any one time to help customers. Equally, this change in availability will require refreshed customer segmentation to ensure that help is prioritized for those who need it most. Above all, it should be impressed on employees that their safety is of primary concern, any working arrangements are entirely voluntary and, to the extent possible, their job security does not depend on such choices.

### Modify your strategy

Our experience in times of financial stress suggests that lenders should rapidly modify their credit strategy, both to manage exposure and maintain the effectiveness of collections operations. In the face of economic uncertainty, many lenders are already undertaking active portfolio and balance-sheet management, selling underperforming assets, and

## Develop strategies to manage credit-risk exposure

### Safeguard for crisis escalation

- Increase sensitivity to early warning systems to trigger active credit-line management
- Offer short-term forbearance solutions and other loan modifications, guidance on alternative products, and broader financial education
- Build and pilot a contingency strategy based on digital or automated channels to run collections in case call center capacity is depleted by more than 50 percent

### Design and deploy strategies

- Initiate implementation road map for contingency strategies with activation triggers and measurable performance indicators
- Build renegotiation products with deferred payments and fee waivers, targeting specific high-risk customers
- Design contingency plans that consider substituting agents with robocalls, interactive voice response systems, and digital-first contact channels managed by geographically separate teams

reducing their portfolio-risk exposure. Furthermore, many lenders have been reviewing and updating their downturn-readiness playbooks and are well positioned to act now.

Healthy credit-line management is important at times of economic stress, not only to reduce banks' risk exposure but also to signal the need for responsible budget management to customers. An effective early warning system (EWS) will detect customers showing signs of distress—for example, rapid increases in revolving balances, reduced monthly payments, unusual spending behavior, and sudden deterioration of credit score. Effective EWS signals can trigger policies to limit credit lines and thereby exposure. But lenders may want to become more proactive, too, anticipating instances in which increasing or decreasing lines can help customers and initiating outreach campaigns that can demonstrate genuine concern for their financial well-being. Similarly, offering short-term forbearance solutions and other loan modifications, guidance on more appropriate or advantageous products (such as consolidation loans), and effective budgeting tools can lead to better customer outcomes and faster recovery.

Collections strategy will also need to change at an operational level. As centralized collections operations shutter, automated nonhuman messaging (for example, voicemails and digital messaging) can be introduced in place of human outbound calling to limit interruption of day-to-day customer contact. Effective account analytics and segmentation will be essential to tailor the contact strategy to customer preferences and identify opportunities to accelerate assistance for distressed customers. For example, predicting the behavior of customers falling delinquent for the first time can be especially challenging. In many instances such models have not been tested under such difficult conditions and may need to be adapted to new and evolving circumstances.

Historically, as credit losses rise, there has often been a scramble to increase servicing capacity, both in-house and through third-party agencies. However, third parties are facing similar capacity challenges during the spread of COVID-19, and of hiring and training employees during a pandemic would be especially difficult. Instead, to ensure that customers in need are receiving maximum assistance, some banks might choose to retrain

## Take preventative steps to minimize operational disruption

### Social distancing

- Educate agents to greet without touching
- Intensify good hygiene during shift changes
- Increase the number of cleaning teams by at least 30 percent
- Deep clean work stations between shifts
- Ensure each operator has a unique headset
- Install hand sanitizer dispensers

### Workforce preservation

- Eliminate overlapping shifts in call centers
- Check employees' health on each shift
- Stagger work breaks in waves of fewer than ten people
- Accelerate establishing home-office solutions
- Immediately report any new COVID-19 exposure
- Cancel all in-person training and onboarding

### Workplace continuity

- Test contingency plans of all third parties
- Guarantee suppliers have alternative sites
- Set up contracts for using a nonhuman contact channel
- Ensure call centers have spare robocall and interactive voice response licenses

staff (for example, offering digital training for early-stage collectors) or redeploy employees from other roles at the call center or branches.

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Lenders typically struggle in recessions to balance the need to limit credit risk while providing sufficient credit to customers to survive personal financial hardship. In the case of the spread of COVID-19, the challenge is especially acute due to the physical constraints banks face when serving customers in need.

Choosing the right path for both the short and long term can be tough. In this instance, the guiding principle is clear: banks should care for customers and employees in a sustainable way first and foremost. By immediately offering short-term hardship arrangements and activating remote-working models with necessary precautions, banks can limit their risk exposure. Whether the economic impact of COVID-19 is a short, sharp shock to people's everyday lives or leads to longer-term stress on the financial system, how individual banks react and care for customers and staff will be remembered for years to come.

**Ademar Bandeira** and **Adelmo Felipe** are associate partners in McKinsey's São Paulo office, where **Bruno Batista** is a partner, **Frederico Sant'Anna** is a consultant, and **Alexandre Sawaya** is a senior partner. **Matt Higginson** is a partner in the Boston office, and **Frédéric Jacques** is a partner in the Montréal office.

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# How payments can adjust to the coronavirus pandemic—and help the world adapt

The challenges are immediate, with long-term implications for global, regional, and local economies—and for the payments industry itself. Here's what to expect.

*by Philip Bruno, Reet Chaudhuri, Olivier Denecker, Tobias Lundberg, and Marc Niederkorn*

**As the catastrophic human costs of the coronavirus come into clearer focus**, so too do the consequences for people's well-being beyond the immediate imperative to safeguard lives. Taking care of our families and friends, our neighbors and communities, our employees and coworkers comes first. For that reason, companies across industries and geographies have scrambled to establish remote-working conditions—and continue to improve them as the health crisis continues. Those that can, including most banks and financial-services companies, have taken swift action to protect both their customers and their employees.

The next focus of all the professionals involved with the transactions infrastructure must be the stability of systems, for both payments and securities. At this writing, despite the scale of the emergency measures underway, no major outages of core infrastructure have been reported. Payments systems have proved resilient and reliable, as they have in earlier crises. Payments systems and providers, which enable companies and their customers to transfer funds in return for goods and services, continue to enjoy a high level of trust from the general public.

At the same time, we all realize that the economic disruption will be profound and the short-term drop in activity for economies under lockdown will be severe. Quarterly GDP in the second quarter of 2020 could decline by as much as 35 to 40 percent—and the payments industry's financial outlook reflects that uncertainty in the short term. But the industry's stability will play an invaluable role in rebooting the global economy, and the potential for innovation can support functioning economies as a "new normal" emerges. Below, we observe how the payments industry can adapt now—and suggest ten

fundamental changes to the payments ecosystem that will help all of us find a new normal.

### **How will the coronavirus crisis affect payments economics?**

There is no definitive answer. Much depends on the complex interplay between economic activity, the interest-rate landscape and associated liquidity patterns, and the evolution of individual and collective behavior. Taking these factors into account, we expect revenue growth in global payments to turn negative. Instead of growing by 6 percent, as projected by our 2019 global payments report,<sup>1</sup> activity could drop by as much as 8 to 10 percent of total revenues, or a reduction of \$165 billion to \$210 billion—comparable to the 10 to 11 percent revenue reduction in the wake of the global financial crisis in 2008–09 (Exhibit 1). Expecting a decline in revenues, investors have already driven the share prices of payments companies into a steep decline, substantially beyond the actual profit impact expected.

Of course, any projection of industry performance rests on assumptions about overall economic activity. The outlook largely depends on the spread of the virus, the public-health response, and the effectiveness of the fiscal, monetary, and broader public response.<sup>2</sup> A relatively optimistic scenario, taking into account these variables, assumes that the virus will be contained after an economic lockdown of two to three months in Europe and the United States.<sup>3</sup> Under this scenario, global GDP would decline in 2020 by 1.5 percent, which we estimate would result in, at most, a decline in payments revenues of around \$165 billion, some 8 percent lower than they were in 2019—instead of the 6 percent increase against the base of \$1.9 trillion

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<sup>1</sup> Sukriti Bansal, Philip Bruno, Olivier Denecker, and Marc Niederkorn, "Tracking the sources of robust payments growth: McKinsey Global Payments Report," September 2019, McKinsey.com.

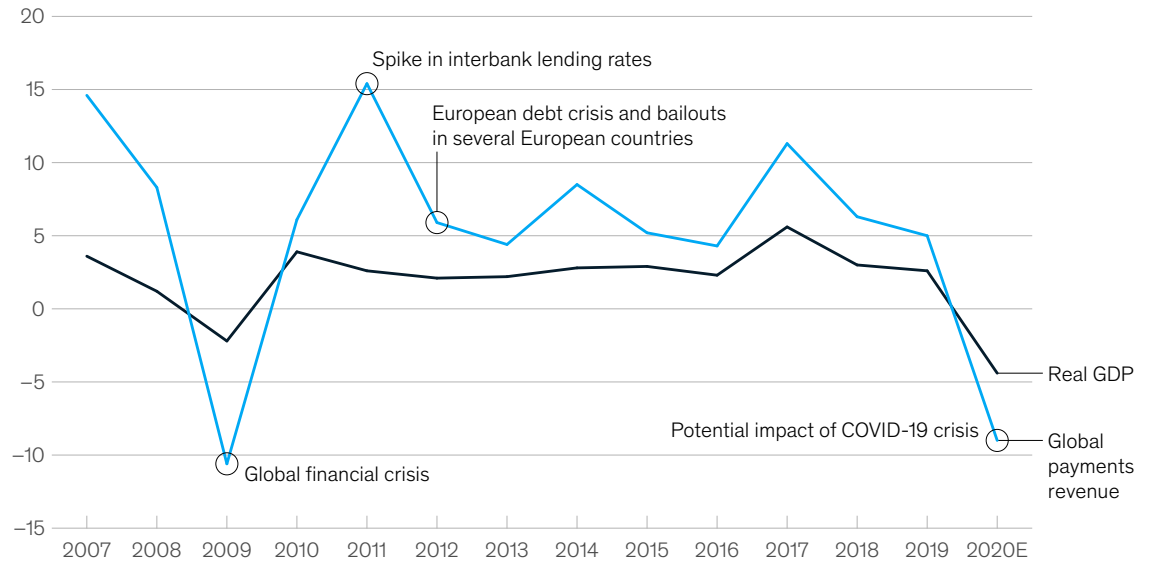
<sup>2</sup> Kevin Buehler, Ezra Greenberg, Arvind Govindarajan, Martin Hirt, Susan Lund, and Sven Smit, "Safeguarding our lives and our livelihoods: The imperative of our time," March 2020, McKinsey.com.

<sup>3</sup> Assumptions in the virus-contained scenario: there are declines of 1.5 percent in 2020 global GDP, 4.4 percent in eurozone GDP, 2.4 percent in US GDP, 8.8 percent in transaction revenue, and 7 percent in current account balances; retail current-account balances stay flat; the effects of credit-card interest income are primarily in China and the United States; the cross-border-revenue impact is based on the correlation between GDP and trade flows; and nontrade flow impact is based on trade flow and impact on nontrade during the 2008 financial crisis.

Exhibit 1

**The economic impact of COVID-19 is comparable to that of the 2008 financial crisis.**

**Year-over-year growth, %**



Source: Global Payments Map, Panorama by McKinsey

we projected before the crisis (Exhibit 2). A second, more pessimistic, scenario<sup>4</sup> contemplates a muted recovery, with resurgence of the virus in China and continued spread in the United States and Europe, leading to a continued drop in global trade levels and a sustained contraction of major economies. Under this scenario, global GDP would contract by 4.7 percent in 2020, which could lead to a decline in global payments revenues in excess of \$210 billion, around 10 to 12 percent of precrisis levels.

On closer examination, McKinsey’s Global Payments Map<sup>5</sup> simulations suggest that the net interest-margin component, the source of about 60 percent of overall payments revenues, explains only about 20 percent of the decline. The transaction component, the source of around 40 percent of revenues and the driver of the growth of payments

revenues over the past few years, would be responsible for about 80 percent of the decline. The experience of past crises, adjusted for the current mix in geographies and means of payments, suggests that an economic contraction of 1.5 percent would lead to a disproportionate 8 percent reduction in payments volumes. The more severe scenario could lead to a drop in transaction volumes of up to 12 percent.

Although much data are still unavailable, and what we have is still noisy, such projections suggest different underlying realities for different segments of the payments arena (Exhibit 3).

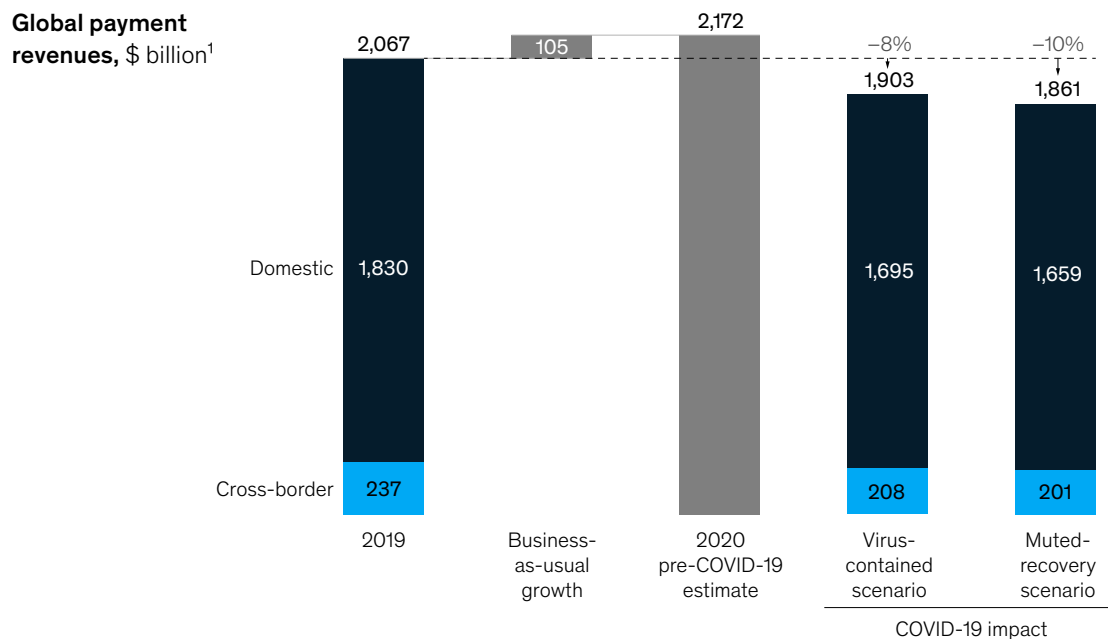
- Cross-border *consumer-to-business transactions* are likely to drop. One-quarter of the total decline in revenues in our analysis

<sup>4</sup> Assumptions in the muted-recovery scenario: there are declines of 4.7 percent in global GDP, 9.7 percent in eurozone GDP, 8.4 percent in US GDP, 11.8 percent in transaction revenue, and 10 percent in current-account balances; retail current-account balances stay flat; the effects of credit-card interest income are mainly in China and the United States; interbank rates decline 50 basis points (bps) in the United States, 10 bps in China, and 20 bps across Africa, the rest of Asia, and Latin America; the cross-border-revenue impact is based on the correlation between GDP and trade flows; and nontrade-flows impact is based on trade flow and impact on nontrade during the 2008 financial crisis.

<sup>5</sup> Global Payments Map, Panorama by McKinsey.

Exhibit 2

**Slowing global payment-revenue growth is expected to cost the payment industry \$165 billion to \$210 billion in 2020 revenue.**



Note: Figures may not sum to listed totals, because of rounding.  
<sup>1</sup>Domestic payments include revenues from credit, charge, debit, and prepaid cards; bank transfers; direct debits; current accounts; and overdrafts. Cross-border payments include revenues from trade, nontrade, in-person spend, e-commerce, C2B cross-border payments, and B2C payouts.

Source: Eurostat; Federal Reserve Board; Worldometer; Global Payments Map, Panorama by McKinsey; McKinsey analysis

is driven by cross-border payments, led by a 25 to 30 percent decline in cross-border C2B transactions. This would be explained mostly by the disruption of travel and tourism, but also by increasingly localized commerce ecosystems, such as those promoted through buy-local campaigns. Examples of highly vulnerable markets would be Saudi Arabia, with 40 percent of online payments related to travel and entertainment, and Thailand, a major destination of international travelers. Major expat markets, such as the United Arab Emirates, could also see a substantial share of their revenues disappear.

- Cross-border *business-to-business transactions* have also been affected. Container freight is down since January, considerably lower than its level in the comparable period of 2019.<sup>6</sup> However, supply chains will be

disrupted over the longer term because different geographies will emerge from the crisis at different times. Chinese manufacturers, for example, won't be able to sell engine parts to US automakers until US car production resumes.

- Payments related to *securities transactions* are at record highs, reflecting the market's instability and volatility. This volatility is creating a higher degree of risk for international securities-clearing transactions.
- Retail payments and merchant-services businesses will be severely affected. Classic point-of-sale (POS) payments volumes could drop by as much as 30 to 40 percent in the short term, though online sales will be less affected. Data for retail<sup>7</sup> show that as of March 18, foot traffic was down, compared with the

<sup>6</sup>Steven Bernard, John Burn-Murdoch, Keith Fray, Alan Smith, and Cale Tilford, "Coronavirus economic tracker: Latest global fallout," March 30, 2020, ft.com.

Exhibit 3

**Ripple effects throughout the payment industry are likely.**

**Demand and supply-chain disruption by industry, nonexhaustive**



	Demand	Supply chain	Key drivers of disruption
Advanced industry and automotive	High	High	Acute decline in global demand; existing vulnerabilities and trade tensions amplified; supply chain and production disrupted
Electronics and consumer durables	High	High	Manufacturers facing significant labor shortages; delivery bottlenecks in complex global supply chains
Hospitality and tourism	High	High	Tourism at standstill; hotel occupancy down year on year; peak travel periods affected
Luxury retail	High	Medium	Eroding demand from China, which led 65% of 2018 growth; Italy is home to a number of premium brands
Airlines	High	Low	>200,000 flights canceled; Asia-Pacific (APAC) with 95% of industry global revenue lost; APAC full-year passenger demand down 13%
Events	Medium	Medium	Sporting, cultural, and political events canceled or postponed
Hotels, restaurants, and catering	Medium	Medium	Online food-delivery spike; dine-in restaurants and cafés adversely affected
E-commerce (nontravel related)	Low	Medium	Cross-border e-commerce stalled; surge in online shopping

**Impact on payments**

Maximum payment-volume decline in airlines; hospitality and tourism; electronics and consumer durables; luxury retail; hotels, restaurants, and catering; and events	Refund transactions expected to increase in airlines and in hospitality and tourism	Triple-digit growth in nontravel e-commerce, remote ordering, and low-value contactless payments	Supply-side uncertainty, factory closures, and trade barriers affect B2B cross-border flows
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same period in 2019, by around 20 percent in the United Kingdom and by more than 70 percent in Italy and the United States. Sales at restaurants<sup>8</sup> and hotels and for recreation, culture,<sup>9</sup> and travel<sup>10</sup> have virtually collapsed. In 2018, these categories represented over 30 percent of EU household expenditures<sup>11</sup> and an even higher percentage of POS transactions.

— The gig economy—and fintech wallets based on it—is also suffering. Our industry observations suggest that flows are down by 20 to 30 percent for some leading wallets in Asia, despite a growing number of users. Offline merchant payments and ride hailing are most affected, while online payments and food delivery are holding up.

<sup>7</sup>Per Springboard data, there has been a rapid deterioration in retail foot traffic in all major geographies since the first week of February 2020.

<sup>8</sup>Per OpenTable booking data, global bookings for seated dinners are almost 100 percent down, year on year, with rare exceptions.

<sup>9</sup>Per Box Office Mojo, movie-theater audiences vanish as COVID-19 takes hold: for the first week of March 2020, year-on-year data available for Hong Kong, Malaysia, the Philippines, South Korea, and Thailand show that audiences dropped around 100 percent. The European Union and the United States will rapidly see a similar evolution because of lockdowns.

<sup>10</sup>Per Flightradar24, the global number of flights per day has dropped by more than 25 percent since March 9, 2020. Passenger flights have been affected disproportionately.

<sup>11</sup>Eurostat, ec.europa.eu.

Some payment methods are also likely to suffer more than others. Despite attempts to sterilize cash (using ultraviolet rays, ozone, or heat treatments, for example), the use of cash and other paper payment methods is declining. We understand from most of our discussions that cash withdrawals at ATMs are down dramatically—by more than 50 percent—in many European countries. Contactless payments, on the other hand, are rising strongly, despite the overall contraction, as the perceived hygienic security is higher than it is for normal POS payments.

## Rebooting the global economy

As important as the management of the ongoing health crisis might be, getting economies up and running again as we emerge from lockdowns will help mitigate the long-term impact on people's livelihoods. Payments operators can help business activity to resume in the shortest term while they realign their efforts to ensure an accelerated return to full activity. First and foremost, this means supporting customers. But a profound schism like this one will also require adjusting your portfolio of services, adapting your operating model, and even reviewing the industry structure with an eye to acquisitions and divestitures that would support a reshaped economy.

### Supporting your customers

To ensure recovery in the most affected sectors, payments operators should reflect on how to help their customers—both to maintain essential liquidity through the crisis and to accelerate the restart of business.

- Chinese banks have quickly set up simple e-commerce platforms for their small-merchant client base to remain alive and to restart in a more remote-commerce environment. This approach combines easy-to-use payments options and website displays, possibly connected with delivery contracts. Banks have been launching similar initiatives in other countries in long lockdowns, such as Italy.
- Italian entrepreneurs have leveraged their loyalty and couponing apps to order services—such as a dinner or a beauty treatment— at a

discount today, to be provided after the COVID-19 lockdown ends. This will make it possible to secure business upon reopening while providing some (though limited) cash flows ahead of the lockdown's end.

- In corporate payments, companies are likely to continue replacing complex global supply chains with local alternatives. Local B2B players can help by deploying their merchant networks to create simplified local and regional trade mechanisms.
- To provide some relief to vulnerable businesses, many transaction banks are temporarily waiving transaction fees and tenor-of-trade finance facilities. Similar measures for fees can be taken in retail payments as well. In Ghana, mobile money providers have been directed to waive fees on transactions below about \$18. On the other hand, Ghana's monetary body eased know-your-customer requirements and put restrictions on transactions to withdraw cash, to ensure growing access to digital payments.

Money remitters can launch alternatives to traditional cash payouts for receiving funds, especially as remittance counters are likely to remain closed in the early stages of the economic reboot. This could, for example, entail a new use for the remitters' increasingly underutilized ATM networks.

### Adjusting your portfolio

Customer needs and the volumes that go with economic intensity are not likely to shift rapidly. But customers with new priorities will probably desire payments companies to offer solutions as those new priorities emerge. Payments companies may, for example:

- *Support the mass distribution of government relief payments.* Payments companies can help governments and aid organizations to reach citizens and enterprises, particularly small and midsize enterprises, with a wide variety of support payments (such as childcare vouchers, emergency relief, or loan support) by using various digital payments methods.

Especially in traditionally unbanked customer segments—including, for example, more than 80 percent of Pakistan’s and about 70 percent of Egypt’s population—traditional account numbers may be unavailable. For these aid recipients, it may be necessary to use alternative unique identifiers, such as mobile-phone numbers, email addresses, or citizen identification numbers.

- *Ensure an easy online offer.* Companies with the greatest online presence seem likely to suffer less from the anticipated downturn. It is no longer a real option only to provide merchants with POS offers. Players with a limited online offering may need to consider partnering with specialists, at least in the short term, to ensure an automatic online restart for customers.
- *Add identity and health to mobile-wallet functionalities.* Such solutions can be used to monitor and guide usage, including enabling checkouts only for elderly customers at certain times, boosting tap-and-go checkout functions in supermarkets, or facilitating restricted shopping times to limit crowds. For retailers with the necessary setup, these wallets can also be a means of payment in stores, to avoid contact.
- *Repurpose your ATM network.* Customers are increasingly skeptical of traditional paper currency as a result of the health risk it carries, and its use may not rebound when lockdowns end. With ATM use down significantly in many markets, providers can reconsider how machines are utilized instead of just discarding them. Underutilized ones might be repurposed for tasks (such as opening accounts, verifying identification, or delivering public documents) that would normally require face-to-face contact.
- *Simplify the B2B supply chain.* An increased need for companies to share credit risk with suppliers will require a boost to products such as supply-chain financing (where buyer’s credit risk is assessed) relative to factoring or invoice discounting (where supplier’s credit risk is

assessed). Payments companies could support the process by, for example, using sourcing platforms that bring dynamic discounting and factoring to a larger set of clients or by enabling the accelerated onboarding of smaller suppliers to large network supply-chain platforms.

- *Provide easy access to analytics-based cash-flow forecasting.* Access to liquidity is essential for the survival of companies large and small. Helping CFOs to get a clear picture at the global, regional, and local level of funding is essential for them in this context. Using payments data to give them an up-to-date and comprehensive sense of the money needed and available would help all.

### **Adapting your operating models and habits**

A rebooting economy may need to deal with social distancing, increased sensitivity to security, and accrued risk awareness for quite some time. Even after the end of enforced health-safety measures, companies will want to consider long-term adjustments to their operating models, such as the following:

- Much of the economy will have learned to work effectively without physical meetings. Remote sales and virtual interactions will be the new normal, substantially reducing the importance of business travel, food, and beverages as a source of revenues and costs. Remote sales skills and channels will be paramount, as will digital solutions for things like document signing and notarization.
- Widely distributed operating models and value chains will also be challenged. The asymmetric responses of governments and regulators, local shutdowns, workforce requisitions, and the lack of a coordinated regional or global political response will lead to the local relocation and reintegration of some or all critical functions.
- With the increase of local operations, standard planning will shift from the short-term issues that threatened distributed operations for a period of days or weeks to long-term crisis-



# A rebooting economy may need to deal with social distancing, increased sensitivity to security, and accrued risk awareness for quite some time.

resistance scenarios. In particular, agile ways of working in remote or work-from-home setups will become standard. The increased use of digital tools will accelerate the adoption of future-of-work models.

## Finding the next normal

As the crisis plays out, we will get more clarity about the depth and duration of the pain. One thing is clear now: there will be no return to the norms of 2019; the impact on the behavior and expectations of customers and businesses—indeed the entire fabric of the economy—will be profound. So it is critical not only for the payments ecosystem but also for the economy as a whole to develop, today, the payments solutions that will allow economies to emerge from the current crisis efficiently and define the post-COVID-19 future.

Here we highlight ten fundamental changes that require us all to be prepared. These are not only things we believe the industry should predict or anticipate but also things that we should all ensure will happen for the effective and lasting relaunch of our economies.

1. *Rationalize cash.* Physical means of payments, such as cash and checks, have been actively discouraged through the crisis for their potential of carrying the virus. Banks have closed branches for security reasons, and clients and staffs have readjusted to changed interaction models, either over the phone or by appointment only. Some branches will never open again. Now is the time to promote and design digitization programs for commerce and the economy.
2. *Ensure universal access.* The current crisis is highlighting the fact that not everyone has the same level of access to the necessary new technologies and digital tools. Moving away from cash affects unbanked citizens disproportionately. Merchants without access to digital payments lose out more as remote buying increases. Now is the time to design setups where all merchants and all consumers, irrespective of finances and education, will have access to the tools of the future. Limits in the payments infrastructure or prices should not be used as an excuse.
3. *Stabilize digital currencies.* With values collapsing and trust eroding, digital currencies have proved incapable of delivering on their promise of a universal payments solution in a time of need. The crisis is reinforcing the importance of governments in maintaining the global financial system. Consider, for example, the momentous currency swap lines of credit made available by the US Federal Reserve to global central banks.
4. *Make the leap to omnichannel payments solutions to support omnichannel commerce.* The growth of online commerce has accelerated and will continue to do so, especially as markets, such as those in Southern Europe, close the gap with more advanced Northern European or Anglo-Saxon economies and China. Some smaller retailers forced to close in the crisis may not reopen physically but seek a digital future instead. The rapid build-out of omnichannel capabilities—which will bridge payments in any environment, physical or digital—will become an

essential requirement for all payments players in most geographies.

5. *Make all payments touchless.* The fear of contact with contaminated surfaces has given a real boost to the use of contactless payments, card and wallet based. Cashiers are being trained not to take cards from customers and to promote the insertion of cards into readers by customers. The educational impact of, say, local shopkeepers who actively encourage customers to use contactless payments and refuse to take cash will convert some of the more reluctant users. As this habit becomes further engrained, it will become the key to removing barriers to further growth.
6. *Expand digital-wallet solutions beyond payments.* Payments using digital devices—phones or wearables—had already started to emerge before COVID-19 struck. Enabling other features, such as digital IDs and transaction monitoring and reporting, to the wallet features will promote even more growth. Your phone could tell you when it is too crowded to go shopping or alert you when your goods are ready to pick up when you arrive. Such capabilities will make a difference to the reopening of some stores. Companies that provide viable options for integrated and contactless payments, to both customers and merchants, will probably have a distinctive edge over competitors.
7. *Deploy data as a protection against fraud.* The COVID-19 crisis has opened new avenues to use data. In China, phone data were used to help people understand “safe corridors” for movement and to track contagion cases rapidly. Even in Europe, consumers are more open to the use of data for their own benefit. The protections against fraud that can be developed should benefit users, not providers, in the weeks when activity resumes. Benefits delivered then will carry the mindset change forward. Fraud prevention is likely, more than ever, to be the priority here.
8. *Promote a new era of cooperative competition.* The universal disruption of our societies is triggering a new wave of innovation, with a cooperative mindset not common in past crises. The liquidity and profitability crunch provoked by the crisis will lead to a shakeout in the fintech industry, eliminating initiatives that lack clear long-term economic viability. We believe this development will lead to a new fintech landscape, geared more to marketwide cooperation and win–wins and less to challenging the incumbents. Given the change in valuations and market expectations, market consolidation and the development of local and regional champions may continue. In that context, companies will also be reviewing their prospects for growth, as well as considering partnership models and organic and M&A growth, to support their strategies.
9. *Transform bank-payments operating models.* Banks will also have to readjust to the new normal. Payments today are a major cost burden for many banks, and most spending maintains existing systems instead of creating change. In the postcrisis world, banks will need to reflect on how to organize themselves for change, possibly by running some of their payments businesses in a completely different way. They could, for example, consider structural moves on the use of onshoring versus outsourcing, cloud-based infrastructure, automation, and analysis-driven decisions to reimagine scale or the realignment of products. Payments-as-a-service business models, in their infancy before the crisis, are likely to get a boost, particularly where they can provide relief for reduced IT budgets.
10. *Redesign the regulatory model.* In a time of change, we must move to setups that solve real-world problems—guaranteed by regulators but not imposed. This will require a new model of collaboration between the payments sector and regulators—a model focused on innovation in payments, adapted to the new economic reality in a sustainable and resilient fashion.

Early indications are hopeful: for example, the US Federal Reserve, the FDIC, and the OCC announced, on March 27, that they will allow companies to delay the adoption of current-expected-credit-loss (CECL) standards on regulatory capital for two years. This will support lending activity in the wake of COVID-19 while maintaining the quality of regulatory capital.<sup>12</sup>

Managing the immediate threat to people's health and well-being is currently the highest priority, so not all these reforms can be achieved immediately. But we do believe it is imperative to balance short-term crisis management today with thinking ahead to the restart of the economy and preparing for the new normal. Keeping one eye on the road ahead could allow us to exit the crisis with a more customer-focused, efficient, and resilient payments industry.

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<sup>12</sup> Paul Davis and John Reosti, "CECL impact delayed two years," *American Banker*, March 27, 2020, [americanbanker.com](http://americanbanker.com).

**Philip Bruno** is a partner in McKinsey's New York office; **Reet Chaudhuri** is an expert associate partner in the Singapore office; **Olivier Denecker** is a partner in the Brussels office; **Tobias Lundberg** is a partner in the Stockholm office; and **Marc Niederkorn** is a partner in the Luxembourg office.

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# US insurance market trends during the pandemic

Policygenius CEO Jennifer Fitzgerald shares insights on how the industry is managing risk and safeguarding consumers in the midst of the COVID-19 crisis.

**In normal times**, consumers might not think much about their insurance products. But the COVID-19 pandemic has caused pervasive uncertainty and shifted consumer focus with unmatched speed and magnitude. Individuals are now seeking to understand their coverage, free up money, and address risks. Meanwhile, insurance companies have been scrambling to adapt their operations, expand digital channels, and meet the needs of their customers.

Jennifer Fitzgerald, CEO of online insurance broker Policygenius, has a distinctive vantage point on how the pandemic has affected the insurance industry. She sat down with Alex D'Amico to discuss evolving consumer trends, how carriers have responded, and the innovations that could endure beyond the current crisis.

**McKinsey:** *What patterns have emerged during the crisis?*

**Jennifer Fitzgerald:** We track Google search trends as a leading indicator of consumer interest, and we have seen the highest levels of consumer search traffic ever for life insurance specifically. Compared with the past several years, volumes in the first few months of 2020 are 25 to 50 percent higher. Conversion rates remain strong too. Whenever the top of the funnel increases, you are obviously going to get a lot of folks who are earlier in their journey and lower intent, but we are seeing a strong pull-through throughout the funnel.

While the biggest surge we've seen has been for term life insurance, this pattern has extended to other product lines. Demand for disability insurance has increased. On the P&C side, interest in homeowners insurance has surged more than we've seen in the past few years. For the P&C products, I think the spike in volume might be from people looking to shop around or save money on their insurance premiums.

**McKinsey:** *What changes are carriers making to their new-business and underwriting processes?*

**Jennifer Fitzgerald:** One of the things that we've had to work through with our life insurance carrier partners is availability and consumer sentiment regarding life insurance medical exams. There was some ambiguity with the initial shelter-in-place orders about whether life insurance medical exams qualified as essential businesses. The answer was yes, so exams are still taking place. However, some consumers don't want the examiner in their house.

This issue is completely new for the life insurance industry, but we've seen a lot of flexibility from carriers. For example, some carriers have moved much more quickly on the electronic medical-record side. We've also seen carriers increase the face amount that they're willing to underwrite using data instead of the medical exam. Insurers already have data, including prescription drug history, so options such as a self-testing kit—where consumers could do their own blood testing—are being considered. Overall, I think this has pushed the industry to adopt some changes much more quickly than it otherwise would have, and I think some of those changes are going to stick.

**McKinsey:** *How are carriers handling the risk of adverse selection?*

**Jennifer Fitzgerald:** We are seeing life insurance carriers tighten up their underwriting in response to the COVID-19 risk. Some carriers have temporarily stopped accepting applications from people older than age 70 and postponed applications for anybody who has recently traveled internationally or plans to do so. Others are now requiring the consumer to complete a statement of good health before final policy delivery, attesting that nothing has changed in their health status since submitting the initial application. That statement would give the carriers grounds for contestability in the event of a coronavirus-related death within the first two years of the policy.

**McKinsey:** *Are you seeing products being removed or repriced? Any new products coming to market?*



## Jennifer Fitzgerald

### **Education**

Graduated with a BA in internal affairs and political science from Florida State University and earned a JD from Columbia Law School.

### **Career highlights**

**Policygenius**  
(2013–present)  
CEO and cofounder

**McKinsey & Company**  
(2008–13)  
Associate principal, financial services

**World Bank**  
(2003–05)  
Junior professional associate

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**Jennifer Fitzgerald:** Life insurers are repricing across the board, but they reprice pretty frequently anyway. At least one, if not a couple of carriers, have actually pulled back on longer-duration term policies—temporarily pulling 30-year term policies because of the interest-rate environment, for example. We aren't seeing net new products come to market yet.

**McKinsey:** *As a fintech entrepreneur, how have you changed as a leader? What have you had to do to keep Policygenius moving forward?*

**Jennifer Fitzgerald:** We formed a COVID task force that is responsible for daily communications to employees. We use it to share information with employees on not just their working situation but also what it means for the company. We have a lot of employees who are reading the news, hearing from friends who have been laid off, so we've had to get in front of that and be thoughtful about the communications that we deliver to the company.

We had already developed contingency plans that took into account business resiliency and revenues. But we've been spending a lot of time reassessing all of those plans.

The first couple weeks of March were kind of a whirlwind. We were able to move more than 300 employees to fully remote work, including a high-volume customer-operations group. I was in close contact with a lot of other founders and CEOs in New York, and our venture-capital firms were good about doing calls with all the CEOs in their portfolio companies so we could pressure test how we were thinking about the situation.

And thankfully, we're in a pretty shielded part of the economy. But we've also been very, very responsive to all of our carriers, working with them to make rapid changes in new-business operations and how they are approaching this environment. So kudos to all of our life carriers; they've been really great partners during this time.

**Jennifer Fitzgerald** is CEO of Policygenius. The interview was conducted by **Alex D'Amico**, a senior partner in McKinsey's New York office.

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# Private equity and the new reality of coronavirus

Sponsors and their portfolio companies need to adjust quickly to the COVID-19 outbreak. Here's the new playbook.

*by Alejandro Beltran de Miguel, Jeremiah Connolly, Alexander Edlich, Ari Oxman, Vivek Pandit, Laurens Seghers, and Elizabeth Skovira*



**COVID-19 is an enormous global humanitarian challenge.** Millions of health professionals are battling the disease, caused by the coronavirus (SARS-CoV-2), and putting their own lives at risk. Governments and industries around the world are working together to understand and address the challenge, support victims and their families and communities, and search for treatments and a vaccine.

The economic damage is becoming palpable. Every business, large and small, is coming to grips with the unfolding crisis (see McKinsey's global perspective on the implications for business on McKinsey.com). Private equity (PE) firms and their portfolio companies come into the crisis riding a decade-long wave of growing transaction volumes, valuations, and fundraising. That position of strength may prove a bulwark in the months ahead, especially for firms that have exercised prudence recently. But there are also fault lines in private markets: deal leverage recently reached a new high, and multiples paid in recent months reached a multiyear high.

Every industry needs to respond to the crisis—including private equity. This article provides an outline of the emerging playbooks for both PE firms and their portfolio companies.

## **Firm actions and priorities**

For many experienced investors, a crisis is not uncharted territory. But the COVID-19 outbreak is fundamentally unique in its disruption of core working processes. Every sponsor needs to make five kinds of adjustments; some leading firms are already taking several of these steps.

### **Take care of employees**

PE firms need to make sure that colleagues can prioritize their own and their families' health, energy, and stress levels, in line with guidelines from the relevant public-health organizations. Many firms are already investing heavily in the blocking-and-tackling needed to expand remote technology and back-office infrastructure (for example, by adding VPN access and extending help-desk hours). We have seen others planning to enhance virtual training (to

come back from the crisis with a better-skilled team) and adding benefits such as telehealth services.

Many of the tools, even if they have been in use for a while, will be unfamiliar to colleagues. Firms need to provide appropriate training for all employees to get comfortable with this new operating model and to make sure they can do their jobs remotely.

Firm leaders need to role-model the emerging best practices and ensure their presence (through videoconferences or more frequent informal calls) to maintain both organizational connectedness and ongoing critical activities.

### **Ensure continuity of critical processes**

PE firms need to keep crucial machinery running; they should continue to assess the investment pipeline, conduct investment-committee discussions, and manage all other essential processes through videoconferencing. Similarly, they can continue regularly interacting with portfolio-company leaders through videoconferencing and shift to conducting board and review meetings virtually.

Firms might consider increasing the frequency of interactions, thus reducing lead time on agreed actions. This would allow maximum flexibility and agility for responding to fast-emerging challenges and making quick, risk-mitigating decisions (such as halting an exit).

### **Prioritize the portfolio**

Sponsors are looking for clarity on the areas in which portfolio companies urgently need support and, when appropriate, course correction. Of course, the industry sector in which a portfolio company operates will be a strong determinant of how it will be affected. Some portfolio companies in healthcare or retail are part of the front-line response or provide critical products and services; ensuring that their supply chains are operating at peak performance is essential. Others (such as travel and hospitality companies) are experiencing immediate and unthinkable drops in consumer demand. Since most sponsors have limited resources to share with their owned companies (such as liquidity, operating

executives to provide leadership and execution support, and critical relationships with other organizations), they will need to decide where best to allocate time and resources.

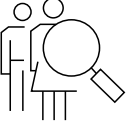
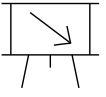




A handy way to prioritize is to consider six indicators of disproportionate risk or impact (Exhibit 1). These aren't exhaustive, and they may change as the crisis unfolds. But these are the six that sponsors are currently using successfully. These six dimensions can quickly identify portfolio companies that require more support. For example, some sponsors whose portfolio companies are dependent on international supply chains have rapidly identified a need to develop regional alternatives for critical parts to maintain operations.

While some portfolio companies require support to address risks, others may be experiencing countercyclical support. Some might be able to make incredible differences to society—say, through supply-chain improvements. And some may have opportunities to restructure their balance sheets in fluctuating financial markets. For example, some manufacturing companies have found ways to shift production toward critical necessities or medical products that are in short supply, while some retailers are finding innovative ways to meet unprecedented consumer demand in an orderly manner. For example, a field-services company is retraining its maintenance workers to handle break/fix calls to keep critical retailing infrastructure up and running.

Exhibit 1

## Six indicators can prioritize support to portfolio companies.

### Checklist of questions

					
<p><b>Risks to employees' and customers' health, safety, and productivity</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Does the portfolio company have policies and procedures to minimize risk of infection? Is it in compliance?</li> <li><input type="checkbox"/> Are there confirmed or suspected COVID-19 cases among employees?</li> <li><input type="checkbox"/> Are there barriers to successful remote working? Potential to help customers or others?</li> </ul>	<p><b>Financial/liquidity risk or customers seeking financing</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Is leverage (eg, near-term debt repayments, high-interest payments, tight covenants) high?</li> <li><input type="checkbox"/> Are counter-parties exerting pressure to extend accounts-receivable terms? Do customers have liquidity constraints?</li> <li><input type="checkbox"/> Have there recently been any abnormally high expenses?</li> </ul>	<p><b>Geographic considerations</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Are operations, customers, or suppliers based in today's riskiest areas? What about tomorrow's?</li> </ul>	<p><b>Short-term revenue and delivery risks</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Is revenue dependent on travel, foot traffic, events, and so on?</li> <li><input type="checkbox"/> Is revenue affected by social distancing or disease prevalence?</li> <li><input type="checkbox"/> Is the supply chain (in particular, raw materials) susceptible to disruption?</li> </ul>	<p><b>Longer-term risks and opportunities</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Will shifts in government policy present risks? Opportunities?</li> <li><input type="checkbox"/> Will changes in patterns of global trade, travel, and logistics offer opportunities? Risks?</li> <li><input type="checkbox"/> Will customer preferences change permanently?</li> </ul>	<p><b>Less tangible risks and opportunities</b></p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Is the company or its business model susceptible to reputational or cultural risk?</li> <li><input type="checkbox"/> Does the company have sufficient redundancy in its critical functions? Can it provide capacity to others?</li> </ul>

# Now is the time to consider investment and portfolio actions in the context of the unfolding humanitarian crisis.

Finally, sponsors can use this prioritization exercise to bolster the confidence of their management teams, reassuring them that support will be provided where necessary.

## **Assess investment strategy, asset allocation, and financing**

The current financial-market displacement and equity valuations have undoubtedly created potential investments for sponsors with dry powder. It is difficult to determine which of these will be actionable, not least because obtaining debt finance for buyouts could be challenging. In some cases, sponsors may move ahead, even with limited information. But many sponsors are preparing for a broader range of investments. These can include debt or other rescue financing for companies suffering the brunt of the crisis and other situations that are outside the norm for control-equity investors. Either strategy will require an agile investment process in order to move quickly when potential investments arise.

One final note on investment strategy: COVID-19 has proved again that black swans exist. Investors would do well to consider a wider range of disruptive scenarios when considering new investments.

## **Support your limited partners and consider your stakeholders**

Limited partners crave insights from their investment managers during crises. Some sponsors are supplementing market updates with

communication on additional topics relevant to their board and public stakeholders, reinforcing the value and credibility of in-place risk-management and preparedness practices.

Now is also the time to consider investment and portfolio actions in the context of the unfolding humanitarian crisis. At a time when public expectations of business's role in society are shifting rapidly, firms should consider doubling-down on their commitments to environmental, social, and governance (ESG)-related investing and evaluate their actions through a lens of social citizenship, taking a long view as they plot their course.

## **Portfolio-company actions and priorities**

Many portfolio companies are engaging in some or all of five priorities: workforce protection and productivity, managing financial and liquidity risk, stabilizing operations, engaging with customers, and preparing for recovery and growth. Workforce protection is a must for every company; the others will vary by sector (medical companies and hospitals may focus their resources on supply chain and operations; travel and leisure companies, as well as oil and gas companies, on liquidity risk; tech companies on supply chain; and critical-goods retailers on customers and growth).

These five priorities are typically coordinated by a central team (Exhibit 2).

## A coronavirus playbook is emerging for the portfolio company.

### Portfolio-company COVID-19 response playbook<sup>1</sup>

<b>A Establish central executive/team to coordinate</b>	
Issue map and management	● Provide single source of truth for issue resolution; tap surge resources where needed
Portfolio of actions	● Develop trigger-based portfolio of actions across all work streams
Leadership and alignment	● Align leaders and sponsors on scenarios; conduct "tabletop" exercises; delegate authority for agile decision making
Risk assessment	● Identify and review business-continuity risks and single points of failure; develop backup plans for critical functions
Local guidelines	● Understand local government guidelines; ensure compliance as situation evolves
<b>B Ensure safety and productivity of workforce</b>	
Workforce policies	● Develop policy 2-pagers, escalation criteria, and call trees; build portfolio of preventative actions
2-way outreach	● Ensure multichannel communications and confidential-feedback/reporting channels
Contractor management	● Align contractor policies and incentives for real-estate contractors
Work-from-home infrastructure	● Create 3 tiers (all, some, or none); ensure adequate training, VPN, telephony, and broadband
On-site-work norms	● Stagger work shifts and times; promulgate social-distancing norms; run health checks; collect productivity ideas
Issue management	● Create single-source-of-truth "issues map," with clear resolution owners and deadlines
Stakeholder engagement	● Collaborate with local and federal regulators and public-health officials
<b>C Stress-test liquidity and bolster balance sheets</b>	
Scenario definition	● Define relevant scenarios based on latest epidemiological and economic outlooks
Liquidity stress tests	● Assess financial and liquidity outlooks under various scenarios
Adequate-liquidity assessment	● Develop and implement appropriate cash-management strategy, given stress-test outcomes; stand up "cash war room"
Customer-risk assessment	● Review client segments for liquidity and repayment risk
<b>D Stabilize operations</b>	
Supply-chain transparency	● Ensure cross-tier transparency into suppliers' risks; identify critical parts; find alternative sources
Available-inventory analysis	● Estimate inventory along supply chain, including spares and remanufactured goods
Production and distribution optimization	● Optimize limited production capacity for critical parts
Logistics	● Estimate and accelerate logistics capacity; consider new modes of transport and routes
Customer-demand estimate	● Estimate true customer demand, using direct customer communication and external market insights
Manufacturing throughput	● Safeguard employees and facilities; assess and mitigate potential disruptions to proficiency
Mix management	● Consider shifting mix to higher throughput items (reducing changeovers), especially for critical items

Exhibit 2 continued

## E Engage customers

B2B transparency	● Engage B2B customers (eg, through a microsite); use scenario-based risk communications
Customer protection	● Protect customers at every touchpoint, with team training and execution monitoring
Customer outreach	● Talk to customers about recommended practices related to COVID-19, using fact-based reports and situational communications
Brand	● Anticipate potential challenges, take actions necessary to protect brand

## F Prepare for recovery and future growth

Overall strategy	● Consider whether adjustments to overall strategy are necessary
Budget	● Adjust budgets and goals for current environment; review and prioritize capital investments
M&A strategy	● Develop and execute add-on strategy; consider divestiture of noncore assets
Growth investment	● Judiciously invest to gain market share; prepare for long-term growth (as permitted by liquidity constraints)
Exit preparation	● Build postrecovery exit narrative (for companies closer to end of natural holding period)

<sup>1</sup>Based on discussions with risk/health professionals and >200 companies across sectors and on insights from public and private corporations that successfully navigated the 2008–09 recession. Not exhaustive or applicable for every portfolio company; requires tailoring for specific circumstances.

In the following sections, we outline how portfolio companies are approaching some of these priorities.

### Set up a ‘cash war room’ to manage financial and liquidity risk

Consolidation can only be successful with a deliberate approach.

Companies in sectors with especially tight liquidity or hugely reduced customer demand may benefit from standing up a dedicated “cash war room.” This team typically focuses on three tasks:

- **Rapid assessment of risk and potential cash savings.** This assessment, based on internal data and some publicly available sources, includes modeling cash flow to view balances under different scenarios (Exhibit 3).
- **Identification of cash levers.** This step includes a review of the balance sheet and proposing cash-generation levers for major asset and liability categories. Many portfolio companies are exploring ways to restructure or refinance

while debt is available and comparatively cheap. Simultaneously, a working-capital diagnostic can highlight potential short-term cash releases.

- **Collaboration with business leaders and outside experts.** This step allows companies to address urgent issues related to liquidity and crisis management.

The war room can work entirely remotely yet in constant cooperation with the portfolio company’s CFO, treasurer, and executive team. A dashboard of balance-sheet and cash-flow diagnostics, shared virtually over any confidential platform, can help maintain oversight and keep focus on the most important levers.

### Stabilize operations

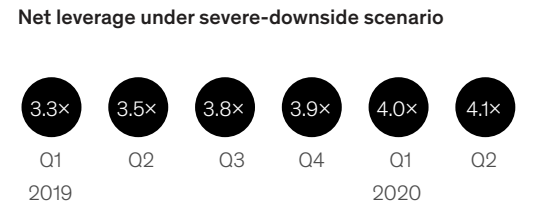
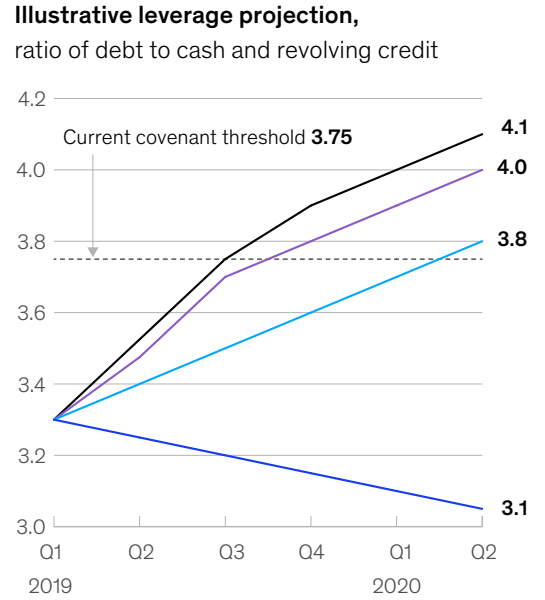
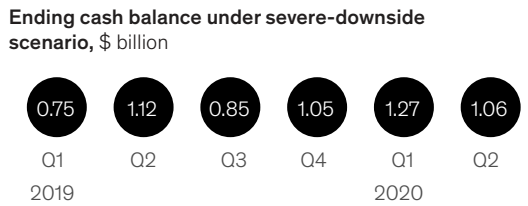
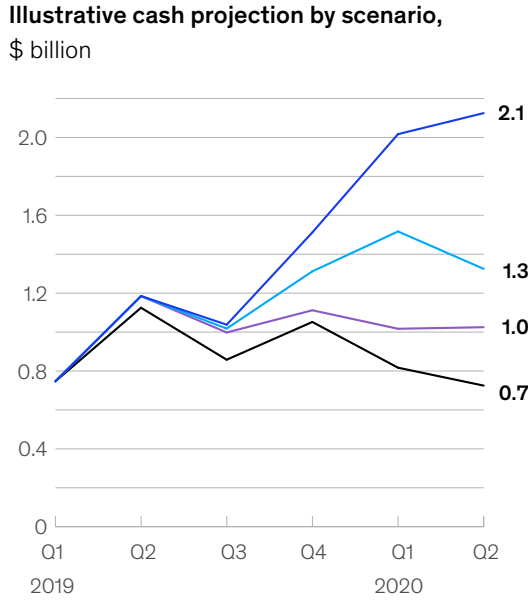
Portfolio companies should move to assess operational risk rapidly and, when necessary, stabilize their operations. This will vary widely by sector. For example, many manufacturing companies are moving swiftly to create visibility into their supply chains, even in advance of potential issues,



Exhibit 3

**Portfolio companies must stress-test their financials against a variety of scenarios.**

— Original projection — Effect of market risk — Effect of refinancing risk — Severe-downside scenario



given the rapid shifts in customer demand. This can include analyzing available inventory (some is often hidden along the chain), comparing it with demand forecasts (which can be refined through direct customer communications and external market insights), and identifying alternative supply sources for critical parts. For example, some portfolio companies may look to source parts from vendors in regions with slower demand to supply more active factories. Manufacturers might also consider how to optimize production, distribution, and logistics. New production methods, vendors, and routes may be necessary to avoid supply disruptions.

For service-oriented businesses, capacity planning and demand management are important levers to consider to maintain effective operations. For example, for one communications-services business, maintaining call-center capacity was the most urgent operations concern.

It's also important to consider risks to critical counterparties, such as suppliers and customers. Portfolio companies may need to work closely with and even support counterparties, especially small- and medium-size businesses, to maintain stability. Several public companies have been noteworthy leaders in this regard.

### Prepare for recovery and growth

After taking initial actions to recover and stabilize, portfolio companies can prepare for growth. In the last downturn, many portfolio companies had success by investing at greater rates than their competitors. In the United Kingdom, for example, one prominent study found that PE-backed portfolio companies cut investment by five to six percentage points fewer than their public-company peers did (in other words, they invested more), contributing to an average six to eight percentage points faster growth than their underlying markets.<sup>1</sup>

Commercially, portfolio companies could consider tailoring product or service offerings to help customers weather the downturn. An equipment business, say, could offer leases to lower customers' upfront investment costs (these may be especially germane in businesses in which leasing economics enhance the lifetime value of customers, irrespective of the macroclimate). Businesses might also reconsider contract structures and identify ways to increase customer "stickiness." For example, a rental and services business is offering near-term commercial concessions in exchange for increasing

the minimum duration of the contract and tightening break requirements.

Portfolio companies should also prepare for M&A. McKinsey research shows that public companies that outperformed coming out of the last recession divested underperforming businesses faster than others did and made acquisitions earlier in the recovery phase.<sup>2</sup> Portfolio companies can utilize a similar strategy by planning and executing a through-cycle strategy for M&A and divestitures and by building a pipeline of potential strategic targets. Finally, as strategy and goals evolve, companies will need to reset budgets and management incentives for the new environment.

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The scale of human catastrophe from COVID-19 is yet to be seen. The economic damage is likewise uncertain. Given the range of potential outcomes, sponsors are right to move quickly and decisively on new-playbook initiatives, internally and with their portfolio companies, to help weather this storm and position themselves for the eventual recovery.

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<sup>1</sup>Shai Bernstein, Josh Lerner, and Filippo Mezzanotti, "Private equity and financial fragility during the crisis," *Review of Financial Studies*, April 2019, Volume 32, Number 4, pp. 1309–73, [academicoup.com](http://academicoup.com).

<sup>2</sup>Martin Hirt, Kevin Laczkowski, and Mihir Mysore, "Bubbles pop, downturns stop," *McKinsey Quarterly*, May 2019, [McKinsey.com](http://McKinsey.com).

**Alejandro Beltran de Miguel** is a senior partner in McKinsey's Madrid office; **Jeremiah Connolly** is a partner in the New York office, where **Alexander Edlich** is a senior partner, **Ari Oxman** is an associate partner, and **Laurens Seghers** is a partner; **Vivek Pandit** is a senior partner in the Mumbai office; and **Elizabeth Skovira** is an associate partner in the Boston office.



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# Lessons for private equity from the last downturn

Adding value to portfolio companies and buying cheap still matter.

*by Jeremiah Connolly, Bryce Klempner, Paul Maia, and Tucker Ward*

**One phrase heard often** these days in (video) conversation with private equity professionals is, “We have been expecting a downturn for a long time—just not this one.”

Of course, the havoc that COVID-19 has wrought on lives and livelihoods the world over is much more than a downturn; it is a global crisis whose human toll is yet to be understood, much less accounted. But it is also an economic downturn. This raises the question: To what extent are the lessons of previous downturns relevant?

The private equity (PE) industry is still fairly young, though old enough to remember 2008. We looked briefly at two aspects of how the industry confronted the last economic downturn for hints on what may drive value in this one. In brief: operating groups appear to matter; and “buying low” is great, if you can.

## PE firms with portfolio value-creation teams outperformed in the last crisis

We analyzed 120 of the largest PE firms, which included many with specialist teams focused on driving value creation in portfolio-company operations, and many without such teams. We compared their investment returns and their fundraising over 2004–18, looking at five-year periods before, including, and after the global financial crisis that started in 2008 (Exhibit 1).

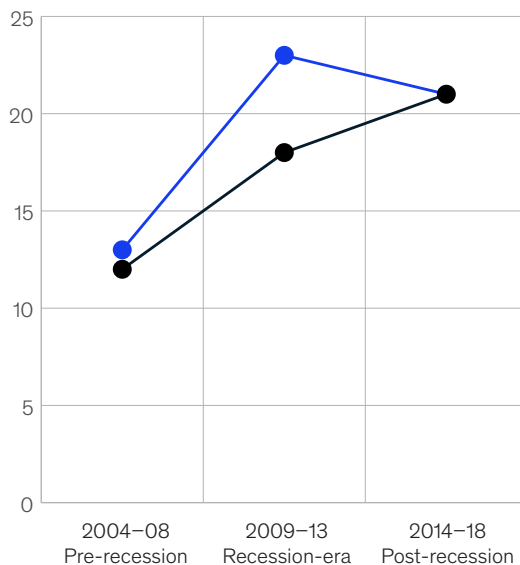
Before and after the crisis, both groups of firms performed comparably (about 13 percent net internal rate of return (IRR) for vintages 2004–08 and about 21 percent for vintages 2014–18). But during the crisis years, firms with value-creation teams meaningfully outpaced the others, achieving about five full percentage points more in IRR (23 percent) than firms without portfolio-operating groups (18 percent).

Exhibit 1

## General partners with value-creation teams produced higher returns during the last recession, and raised more capital afterwards.

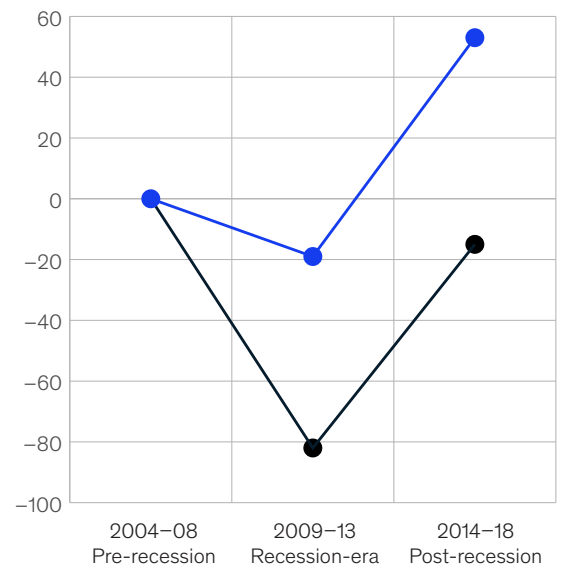
**Average internal rate of return across funds, %**

● With value-creation team ● Without value-creation team



Data source: Preqin

**Average fund size (indexed), % change (2004–08 = 0)**



# In brief: operating groups appear to matter; and ‘buying low’ is great, if you can.

Firms with value-creation teams also saw less disruption in fundraising in the crisis period, with their fund size falling 19 percent on average versus 82 percent for general partners (GPs) without an operating team. This fundraising advantage proved durable, as firms with value-creation teams saw fund size rise by 53 percent in the post-crisis years, while those without experienced 15 percent further declines in fund size.

The lesson for GPs today is self-evident—albeit hard to put into practice once already under duress. While correlation is not causation, there appears to be a strong relationship between having a portfolio value-creation team and outperforming in tough times. PE firms without such a team will likely find that assembling, let alone deploying, a high-caliber group in the midst of a global crisis may not be possible. As firms consider their options, they should note that a big team is not necessarily needed: a separate McKinsey research effort has found that the size of the operating group is not clearly correlated to fund performance or fund size. Larger firms tend to have slightly bigger teams, but there is no hard and fast rule.

Other options for GPs without these internal capabilities are to redirect dealmakers with operational bona fides toward the portfolio, or seek to bolster portfolio companies with strong operators to meet pressing needs. (Many firms also maintain strong links to trusted third-party advisers, who can play a part.)

Meanwhile, GPs that have an operating team can take some comfort in their prescience. The data suggest that firms’ substantial investments in these groups have paid off. This analysis also validates the decision making of limited partners (LPs), who have voted with their feet in the same direction.

## **It is easier to sell high when you’ve bought low**

There are many ways to lose out in a crisis. Common ones include deploying too much capital at the peak; selling too much in a panic at or near the bottom; and, often as bad or worse, sitting nervously on the sidelines as prices resume their climb. During the GFC, many investors made all of these mistakes, paying multiple times for what in hindsight is dubbed a “lack of discipline.” Thus chastened, GPs and LPs alike have pledged over the last decade to “maintain pricing discipline” and “avoid vintage risk” and “stick to pacing plans.”

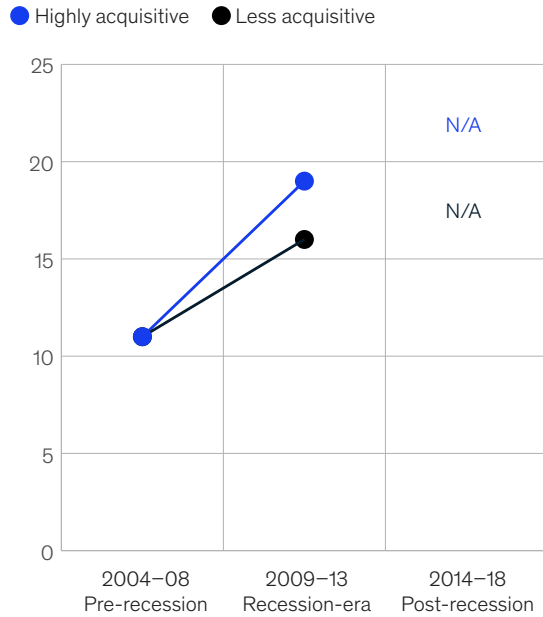
This logic appears to be borne out by the data. Our analysis of 500 PE firms confirms that those which maintained their capital-deployment rate tended to outperform (Exhibit 2).

It is hard to be entirely wrong when arguing that investors should seek to buy low and sell high. Yet it is, of course, not quite that simple. Today’s “low” may turn out to be tomorrow’s “not yet that low.” The cheap debt financing that was so plentiful a few months ago is suddenly scarce. Many sellers are less excited to exit at current prices.

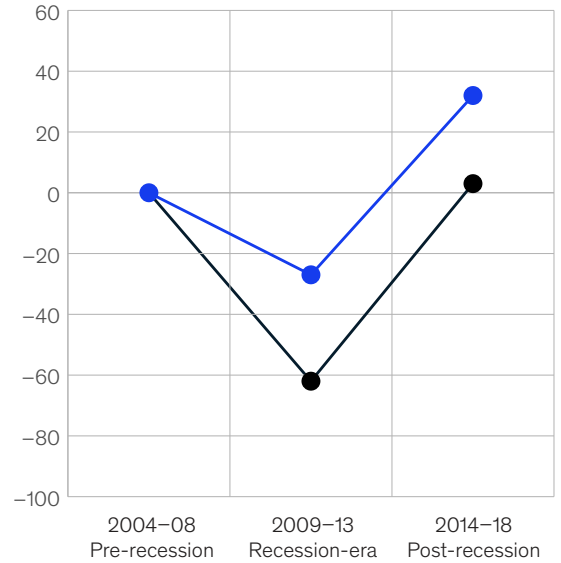
Exhibit 2

**General partners that were more acquisitive during the recession performed better and raised more capital.**

**Average internal rate of return across funds, %**



**Average fund size (indexed), % change (2004-08 = 0)**



Data source: Preqin

At the same time, it is a fact that public-market comparables are lower than they have been in several years. It is a fact that the PE industry has a historically large stockpile of dry powder. And it increasingly appears that for every newly unmotivated seller, there may be one or two others

that find themselves with previously unexpected financing needs. So, notwithstanding the recent slowdown in deal activity, it is reasonable to imagine that many PE firms will seek to continue deploying capital despite the current tumult and uncertainty.

**Jeremiah Connolly** is a partner in McKinsey's New York office. **Bryce Klempner** is a partner in the Boston office. **Paul Maia** is an associate partner in the New Jersey office. **Tucker Ward** is a consultant in the Washington, DC, office.

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# How private equity operating groups are taking on the challenge of the coronavirus

Value-creation teams are grappling with the COVID-19 pandemic and its implications for their portfolio companies. Our interviews reveal the steps they're taking.

*by Ivo Naumann and Jason Phillips*



**The COVID-19 crisis has** caused epochal disruptions to social and economic systems, posing a threat to lives as well as livelihoods. For business leaders, the required management decisions range from significant to staggering. That's twice as true for private equity (PE) firms, which often own businesses in many industries and in countries around the world. To better understand how PE firms are addressing these complex choices, we interviewed 12 operating-group heads at leading PE firms and large institutional investors in Asia, Europe, and North America. The firms range from midmarket specialists to global buyout behemoths and cover the spectrum of investment strategies.

Our interviewees were unanimous about the pandemic's "black swan" nature and the need to react quickly. In this article, we'll review the actions taken by Asian firms—the first into the fray—and then look at how leading firms in other geographies have followed suit. Several of these practices and behaviors are already fairly common across private investing; others are just catching on; some are entirely new. As operating groups work to support their portfolio companies through this crisis and position them for future success, many leaders also have their eye on a less tangible prize: they are highly conscious that their actions now will set the tone for the next several years, so they are determined to make the right decisions for their people, their customers, and their companies.

### **Asia: On the leading edge**

The outbreak first emerged in Asia, and firms in the region had a two-month head start to address the issues. Of course, private investing and the broader business context in Asia are quite different from those in other parts of the world, and the public-health response in much of Asia has been more assertive than elsewhere. Nonetheless, much of what Asian operators have done is relevant to firms in Europe and North America.

The initial priority for all respondents was to ensure the safety of their own employees and those of their

portfolio companies. Next, respondents ensured that basic operations could continue—for example, by setting up remote-working processes and protocols. Several leaders agreed that a crucial next step was to rethink the playbook for the downturn, using dramatically different assumptions. Many firms have downturn scenarios for their investments. These scenarios were developed through collaboration between executives of portfolio companies and deal teams. However, the firms realized quickly that even their worst-case scenarios were too optimistic. Revenue declines of 50 percent or more and temporary closures of entire industries, such as movie theaters, were not included in any firm's playbook. For many regions, McKinsey research suggests, the pandemic might produce the biggest downdraft since the Second World War.

Reassessments of downturn scenarios typically span revenues, the stability of the supply chain, general operations, and liquidity needs. Realistic assumptions now, according to our interviewees, involve a downside two or three times worse than previously assumed; for example, if the old playbook projected a downside scenario with revenues falling by 15 percent, multiply that by three to envision a 45 percent decline. Beyond survival, the core challenge facing all firms is how best to ensure that portfolio companies are positioned and prepared to benefit from a recovery. The revenues of a portfolio company in China, for example, had fallen by more than 70 percent, but it has already recovered most of that through a concentrated effort, with a war-room setup.

Deal teams and operating teams are also reviewing asset-management plans (such as investment theses and plans for exit), revising them for the new reality and establishing milestones for the next three, six, and 12 months. This has significantly changed plans for many assets. The guiding principle, in all cases, has been not just to survive the crisis but also to use it to strengthen the competitive positioning of portfolio companies. Some firms are moving hard to lift the productivity

# Teams are revising asset-management plans for the new reality. The guiding principle has been not just to survive the crisis but also to use it to strengthen the competitive positioning of portfolio companies.

of their companies as a way to preserve growth capacity. Other firms are cautiously continuing conversations with targets they had identified before the crisis.

A common thread among Asian business leaders was that macroeconomic forecasts proved relatively ineffective for their decision making, perhaps because in the earliest days of the crisis, forecasts were inevitably well behind the curve. Operating teams have expanded their base for decision making to include a variety of new (and often more operational) data sources, such as production benchmarks and real-time metrics on road congestion, air pollution, and people returning to work. In the future, these teams plan to devote more energy to developing such information sources to gain improved visibility into the potential trajectories of their businesses.

Liquidity, of course, is paramount in a crisis. Asian execs told us that they placed a justifiably strong focus on cash. As one operating-team executive wrote to all portfolio-company CEOs, “priorities one, two, and three are safety and cash.” Company execs communicated extensively with lenders and were reassured that no financial-system crisis is emerging, and access to funding will not be a problem in the short term. Their responses to this guidance were varied and nuanced. Certain firms encouraged all portfolio companies to draw down revolvers and other financing to provide financial

flexibility and ensure liquidity. Others advised companies to take more measured actions based on their relative exposure. All firms were consciously managing their responsibilities not only to their portfolio companies and investors but also to a broader universe of stakeholders, with an eye to the future implications of their actions.

Asian firms are applying learnings from the 2008–09 global financial crisis to align with portfolio-management teams on strategic priorities, including the need to generate funding for growth initiatives and to accelerate digital-transformation efforts. Leaders also stressed the importance of a strong bias to action.

In parallel, firms in Asia are rapidly reassessing their mode of interaction with, and governance model for, their portfolio companies. Multiple respondents felt this had previously been unclearly defined, which led to some inefficiencies and trust issues at the beginning of the crisis.

## **Europe and North America: Fast followers**

The first order of business for firms in North America and Europe has been to establish a crisis-response team, or nerve center, to assess the risk each portfolio company faces and to partner with management teams to protect the health and well-being of their employees. Leaders we interviewed

agreed on the twofold nature of the challenge: saving lives and protecting livelihoods. Ensuring the safety of essential employees who remain working on site has been the first consideration, followed closely by support for employees working from home—a new consideration that few firms ever anticipated requiring at scale.

To focus limited support resources on the most vulnerable businesses, many operating groups have adopted the traditional “red–yellow–green” traffic-light system to indicate the level of engagement and support each business will need. Acknowledging the primacy of cash in sustaining businesses, firms have requested 13- to 26-week cash forecasts from portfolio companies to better manage liquidity. Companies were also asked to identify ways to lift earnings and stabilize balance sheets.

Many Western firms put more stock in macro-economic factors than their Asian peers do. Few, however, choose to impose a single scenario across their portfolio companies, preferring instead to develop industry-specific scenarios. Yet many agree that their companies’ initial projections often underestimated the downside. At some US firms, subsequent revisions led to downside scenarios that ranged from a fairly rapid recovery to a longer decline and more gradual recovery beginning in Q3 to a grim scenario with doors closed through the end of 2020. Firms with more experienced operating groups often asked executives to incorporate triggers into their scenarios so that certain financial outcomes would require leaders to take specific actions to improve their cash positions.

Another common refrain in our interviews: communication between PE firms and their portfolio companies is on the rise. Monthly or quarterly check-ins have quickly shifted to weekly—even daily—ones, and the data discussed have been more granular and standardized. Firms with an integrated, automated financial-reporting infrastructure across their portfolios have been able to monitor critical performance metrics daily, with minimal disruption

to the finance teams of portfolio companies, and to engage executives immediately to determine appropriate responses to problems.

Across the board, firms report that they are drowning in information. Many are using their crisis-response teams to validate, curate, and manage the flow of information to portfolio-company leaders. These teams also are tasked with assessing the quality of recommendations offered by advisers and analysts. Several operating groups report that they are making a point of tracking all the government funding now coming onstream and helping portfolio companies to manage their responses. As government moves vary significantly—sending aid to consumers, small businesses, and large companies, depending on the country—this service is especially useful. So is sharing the firms’ informed perspectives on how government responses to previous crises have worked out.

Another service that firms are providing to their companies is facilitating the peer-to-peer sharing of ideas and best practices across the portfolio. More established companies and more seasoned executives are sharing strategies for modifying operating budgets, managing remote workforces, marketing through downturns, and many other things. Operating groups with cross-portfolio councils of CFOs, CIOs, CHROs, and other functional leaders are using the standing calls of these groups to disseminate critical communications and convene collaborative problem-solving sessions quickly. Leadership is needed from every role (see sidebar, “Leadership everywhere” for more). Some firms are also putting in motion long-held visions of central knowledge repositories.

PE firms say that their stance is neither entirely reactive nor entirely defensive. Many recognize that systemic shocks can and do create opportunities. While marquee assets are not frequently available for acquisition during downturns, smaller businesses with wobbly balance sheets may

## Leadership everywhere

### **It's clear that operating groups**

everywhere are fully engaged alongside their portfolio companies in a battle to survive today and to position those companies for strength in tomorrow's new reality. For leaders of private equity firms and portfolio companies alike, here are six behaviors proving essential for navigating through the crisis.

### ***Lead with empathy and engage holistically.***

COVID-19 is a uniquely difficult challenge for humanity, threatening both lives and livelihoods. Humans are social creatures, and our ways of working have evolved accordingly. The actions needed to slow the spread of the coronavirus are thwarting these well-established patterns. Employees working from home and those required to remain on-site are working and managing through a unique set of unfamiliar challenges, often with minimal support. Their fears of sickness and death are nearly matched by concerns about maintaining their economic well-being. Leaders must be sensitive to the singular nature of this crisis and must engage employees with caring authenticity and empathy.

***Think 'right to left.'*** Leaders should consider the implications of their actions in the crisis in a postcrisis world. Many executives are now being particularly thoughtful about the treatment of employees, determining how to balance their pain with the necessity of maintaining solvency. These executives are thinking about creative ways to keep employees and maintain their income rather

than releasing them with hopes of rehiring in the future. The same is true for suppliers and customers: executives are asking how they can approach difficult conversations and decisions in mutually beneficial ways to earn goodwill. Executives realize that employees, customers, and suppliers will remember how they have been treated during this crisis—and are acting accordingly.

***Communicate, communicate, communicate.*** During a crisis, no news is not good news; in fact, it's the opposite. Effective leaders are maintaining frequent—weekly, if not daily—virtual get-togethers with employees, customers, suppliers, lenders, sponsors, and board members. Today's unprecedented access to data and information means that stakeholders put a high premium on the ability to separate signal from noise; these audiences are looking to leaders for guidance. At the same time, leaders should seek, and be receptive to, ideas and insights from these stakeholders. Solutions can be crowdsourced.

***Embrace agile as the new normal.*** That should be particularly important with reduced staff onsite and a distributed workforce sheltering in place. The number of decisions, and the speed with which they need to be made in this environment, are stressing command-and-control organizational models. Creating cross-functional agile teams and training and empowering them to solve problems and act accordingly will accelerate responsiveness to rapidly changing market dynamics.

***Evaluate other needed shifts.*** Companies are right that this is a “black swan” event. But it may be more than that; it may be a recurring one. Reducing the costs associated with delivering each incremental dollar of revenue can protect the business during times of increased volatility. As one leader told us, “this is like the biggest zero-based budgeting exercise ever—we're thinking about what's essential and nonessential and making rapid, decisive decisions.” Similarly, accelerating the transition to digital can create efficiencies that provide invaluable resilience in a downturn. And the massive switch to working from home could prove permanent. One leader told us, “I'm convinced that the number of remote employees will be substantially the same after the recovery. At some point, people aren't going to want to pay top dollar for a fancy, large headquarters.”

***Resist the temptation to simply 'hunker down.'*** There's real value in complementing defense with offense. Market shocks create conditions for significant shifts in share. If companies haven't done so already, they should develop an informed perspective on “where the puck is going and when it's going to get there,” so they can make decisive, preemptive strategic moves to be positioned advantageously for recovery. Companies likewise should think about accommodations they can make today to generate goodwill and loyalty among customers, employees, and suppliers, both current and future.

see being acquired as a compelling alternative to other paths. Our respondents suggest that companies with well-developed M&A pipelines and relationships with potential targets may be able to act quickly, with the support of sponsors likewise familiar with specific targets. Operators with portfolio companies in sectors (such as grocery, personal protective equipment, and cleaning products and services) that are now seeing a spike in demand recognize the need to act rapidly and decisively to expand capacity quickly and increase their marketing efforts to make the most of the unexpected tailwind.

Respondents at firms with credit or distressed-investment strategies say they are seeing new opportunities to provide struggling companies with relief and to save them from insolvency. In each case, operating teams are taking a comprehensive view of the evolving economic environment to help their firms make quick yet well-informed decisions that can have a dramatic impact on how their portfolios emerge in the recovery—when it arrives.

**Ivo Naumann** is a partner in McKinsey's Shanghai office, and **Jason Phillips** is a partner in the San Francisco office.

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# Commercial real estate must do more than merely adapt to coronavirus

COVID-19 is a humanitarian challenge that will have lasting effects on how people live, work, and play. By acting today, real estate leaders can best serve end users and ensure their own viability.

*by Vaibhav Gujral, Robert Palter, Aditya Sanghvi, and Brian Vickery*

**In a matter of weeks**, the lives of so many have changed in ways they had never imagined. People can no longer meet, work, eat, shop, and socialize as they used to. The working world moved rapidly from business as usual to cautious travel, office closures, and work-from-home mandates. Instead of traveling and going out to eat at restaurants, consumers across the world are tightening their purse strings to spend only on essentials—primarily food, medicine, and home supplies—and getting these delivered much more often.

Physical distancing has directly changed the way people inhabit and interact with physical space, and the knock-on effects of the virus outbreak have made the demand for many types of space go down, perhaps for the first time in modern memory. This has created an unprecedented crisis for the real estate industry. Beyond the immediate challenge, the longer this crisis persists, the more likely we are to see transformative and lasting changes in behavior.

To respond to the current and urgent threat of COVID-19, and to lay the groundwork to deal with what may be permanent changes for the industry after the crisis, real estate leaders must take action now. Many will centralize cash management to focus on efficiency and change how they make portfolio and capital expenditure decisions. Some players will feel an even greater sense of urgency than before to digitize and provide a better—and more distinctive—tenant and customer experience. And, as the crisis affects commercial tenants' ability to make lease payments, many operators will need to make thousands of decisions for specific situations rather than making just a few, broad-based portfolio-wide decisions.

Most real estate players have been smart to begin with decisions that protect the safety and health of all employees, tenants, and other end users of space. The smartest will now also think about how the real estate landscape may be permanently changed in the future, and will alter their strategy. Those that succeed in strengthening their position through this crisis will

go beyond just adapting: they will have taken bold actions that deepen relationships with their employees, investors, end users, and other stakeholders.

## **The immediate challenge**

Over the past several years, real estate investments have generated steady cash flow and returns significantly above traditional sources of yield—such as corporate debt—with only slightly more risk. Since the virus outbreak, however, this reality has changed, and real estate players have been hit hard across the value chain. Service providers are struggling to mitigate health risks for their employees and customers. Many developers can't obtain permits and they face construction delays, stoppages, and potentially shrinking rates of return. Meanwhile, many asset owners and operators face drastically reduced operating income, and almost all are nervous about how many tenants will struggle to make their lease payments. “Concession” and “abatement” are the words of the day, and players are working rapidly to figure out for whom they apply and how much.

Not all real estate assets are performing the same way during the crisis. The market seems to have pivoted mostly on the inherent degree of physical proximity among an asset class's users—even more so than on its lease length. Assets that have greater human density seem to have been the hardest hit: healthcare facilities, regional malls, lodging, and student housing have sold off considerably. By contrast, self-storage facilities, industrial facilities, and data centers have faced less-significant declines. As of April 3, by one estimate, the unlevered enterprise value of real estate assets had fallen 25 percent or more in most sectors and as much as 37 percent for lodging (the most extreme example).<sup>1</sup> It's no surprise that—when shoppers avoid crowds, universities send students home, and retailers, restaurants, and hotels close their doors—owning and operating those properties is a less valuable proposition. As such, liquidity and balance-sheet resilience have become paramount.

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<sup>1</sup> REITs amid a pandemic, Green Street Advisors, April 3, 2020, [greenstreetadvisors.com](https://www.greenstreetadvisors.com).



## **Behavioral changes that may outlive the crisis**

Real estate owners and operators across almost every asset class are considering several potential longer-term effects of the coronavirus outbreak and the required changes that these shifts are likely to bring.

For example, within commercial office space, the multiyear trend toward densification and open-plan layouts may reverse sharply. Public-health officials may increasingly amend building codes to limit the risk of future pandemics, potentially affecting standards for HVAC, square footage per person, and amount of enclosed space. At the same time, just as baby boomers age into the sweet spot for independent and assisted living, fear of viral outbreaks like COVID-19 may prompt them to stay in their current homes longer. It is possible that demand for senior living assets could dampen, or the product could change altogether to meet new preferences for more physical space and more-intensive operational requirements. It is also possible that senior-living facilities could prove they are best able to handle viral outbreaks, accelerating demand.

The COVID-19 experience could also permanently change habits that may affect demand for other real estate assets, such as hospitality properties and short-term leases. Even a short moratorium on business travel could have lasting impact when alternatives such as video conferences prove sufficient or even preferable. Near-shoring of supply chains may further reduce demand for cross-border business travel, and consumers who are afraid of traveling overseas may shift leisure travel to local destinations.

Consumers forced to shop online because of closed malls and shopping centers may permanently adjust their buying habits for certain categories toward e-commerce. Before the pandemic, consumers were already shifting their spending away from physical stores. This long-term trend may accelerate even faster after the crisis—especially as many previously struggling brands are tipped over the

edge into bankruptcy or forced to radically reduce their footprint. Early evidence from China shows some staying power in the coronavirus-driven shift to e-commerce. Within certain product categories where supermarkets or mainstream retailers competed with online retailers, substantial market share could transfer to online players.

The shift to e-commerce may also further boost already high demands for industrial space. Relatively niche asset classes (such as self-storage and cloud kitchens) could see an improvement in their unit economics, as demand density goes up when more people work from home, while other asset classes (such as coliving) may suffer. And universities forced to educate remotely for entire semesters could convince students and other stakeholders that existing tools are sufficient to provide a high-quality education at a lower cost, and a new type of hybrid (online–offline) education could become even more widely embraced.

The depth and breadth of economic impact on the real estate sector is uncertain, just as the scale of human catastrophe from the pandemic is yet to be seen. However, behavioral changes that will lead to significant space becoming obsolete in a post-coronavirus environment seem imminent. Given the potential for transformative changes, real estate players will be well served to take immediate action to improve their businesses but also keep one eye on a future that could be meaningfully different.

## **How leading real estate owners and operators are navigating the crisis**

While the longer-term consequences are difficult to predict, the immediate market consequences of the coronavirus crisis have been made clear—the public market sell-off in certain real estate types has been nothing short of dramatic. All companies, public and private, are working hard to navigate the immediate crisis with respect to staff, tenants, and end users of space, while also facing tough business trade-offs. Most industry leaders seek to strike the right balance between capital preservation and further strengthening their competitive differentiation.

Over the past several years, industry leaders have been diversifying sources of revenue, pursuing digital strategies, and focusing on tenant experience. The COVID-19 crisis has accelerated the need for those strategic changes—and highlighted that those that haven't yet made such investments will probably need to catch up quickly. For example, while relatively few real estate companies were actively developing or pursuing digital and advanced analytics strategies before the pandemic, such strategies can help with tenant attraction and churn, commercial lease negotiations, asset valuation, and improved tenant experience and operations. Other direct results of the outbreak include the need to meaningfully engage with customers and employees on health and safety in physical spaces.

In the wake of the coronavirus outbreak, real estate industry leaders are taking on a set of common imperatives.

#### **Earning the respect, trust, and loyalty of customers and employees**

Above all, owners and operators have an obligation to protect the safety and health of people by all reasonable means. For leading operators, the need to overcommunicate—to both make sure they fully understand tenants' needs in this moment and help protect everyone in their ecosystem—is leading to some changes in behavior. This may make the practice of communicating as a company-level brand (rather than property-level brand) more common, speeding up an existing market trend. In B2B environments, such as offices and retail stores, CEOs and management teams may join asset managers and property managers and engage directly with tenants. They should follow up quickly on the actions they have discussed with tenants. Not only are such changes the right thing to do—they're also good business: tenants and users of space will remember the effort, and the trust built throughout the crisis will go a long way toward protecting relationships and value.

#### **Centralizing cash management**

Real estate has always been highly decentralized: many important decisions that impact cash flow have been made at the property level. But given the uncertainty around the duration and depth of this crisis, top management is now providing more centralized direction on property-level cash management in addition to company-level balance-sheet decisions and credit lines. All levels of management—including those at the property level and company level—are beginning to identify efficiency levers and when to pull them based on the underlying performance of properties and the business as a whole. In the past, few properties and companies took a lean-enterprise mentality toward capital and operating expenses. Those that do adopt lean practices and eliminate inefficiencies, however, can buy themselves a little more time to work through uncertainty. But creativity can also be employed more often, as not all cash-creating activities need to involve cutting costs. For example, some developers engaged in residential sales are looking into innovative ways to liquidate new inventory, such as lease-to-own programs and financing partnerships.

#### **Making tailored, informed decisions—particularly in commercial lease concessions**

While it may be tempting to make reductive assumptions about the coronavirus outbreak's economic impact, the corresponding policy responses at city, state, and federal levels will not be uniform across real estate portfolios. Even within a single asset, needs will vary among tenants. Thanks to the richness of available behavioral data, select real estate leaders will use analytics to generate fact-based insights on local epidemiological and economic scenarios, what is happening to competitive assets around a property, and the impact of the crisis on individual tenants. These perspectives can inform highly targeted decisions, rather than a one-action-fits-all-tenants approach.

Nearly every landlord is preparing for the effects of the downturn, when scores of tenants across asset

classes will ask for lease concessions or abatement. While a single policy across all tenants and properties may be easier to implement, decisions must be made for each situation, starting with a consideration of tenants' safety and well-being. In the office sector, factors such as price point in the market, tenant-renewal probability, tenant-default probability, local regulations, building appearance due to vacant spaces, and potential reputational risks should inform individual decisions. Few real estate players have information about these on hand, and even fewer have the right tools, processes, and governance to make decisions. For instance, they rarely have detailed protocols in place for what can be decided at a property level versus what should be decided centrally, as well as what tools can be used for leasing or which asset-management professionals must make these tough decisions daily. Properly implemented, a set of clear protocols along with structured, fact-based decisioning will ensure fairness and procedural justice for tenants and help operators communicate their actions with key stakeholders, including tenants, investors, and lenders.

### **Taking the digital leap**

Before the crisis, the real estate industry had been moving toward digitizing processes and creating digitally enabled services for tenants and users. Practically overnight, physical distancing and the lockdown of physical spaces have magnified the importance of digitization, particularly by measures such as tenant and customer experience. Within residential real estate, players that have invested in digital sales and leasing processes—using virtual open houses and showings; augmented and virtual reality; and omnichannel, targeted, and personalized sales—will more quickly allow their residents to find the right space for themselves.

When an operator may have to keep its amenity spaces closed for months, creating a differentiated experience will necessarily involve a suite of digital-first products and experiences: telehealth, on-demand delivery and concierge services, virtual communities, contactless access for residents,

guests, and maintenance staff, and much more. As more users adopt these digital-first products and services, users' expectations will be raised, and players that provide a differentiated post-crisis experience will stay ahead of the curve. These digital offerings will pay dividends in the form of superior loyalty and the ability to create brand new revenue streams while better meeting the needs of tenants and end-users.

### **Acquiring operating companies, not just single assets**

In the context of a post-coronavirus world, most investors and operators are reconsidering all capital decisions. Extreme uncertainty surrounding the duration of cash-flow depression and exit capitalization rates make it exceedingly challenging to underwrite acquisitions and discretionary capital expenditure with confidence. And private market players that are *not* facing near-term financial distress intend to hold assets through the downturn—some view the current environment as a valuation issue, not a value issue. Still, record-high dry powder is influencing investor attitudes. Many have already shifted their mindsets toward finding single assets at bargain prices, though the current difficulty in accessing capital markets has delayed action, and supply may remain constrained as potential sellers wait for valuations to return. These combined complications have caused many real estate leaders to focus on acquisitions of operating companies, large asset portfolios, and public real estate investment trusts.

### **Rethinking the future of real estate, now**

Some landlords are now starting the process of thinking ahead to when the crisis is over. Strategic review processes aim to understand how real estate usage might change going forward. However, rather than relying on traditional economic or customer-survey-driven approaches, real estate leaders are looking to psychologists, sociologists, futurists, and technologists for answers. Will employees demand larger and more enclosed workspaces? Will people decide not to live in condominiums for fear of having

to ride elevators? While uncertainty currently reigns, by employing a range of creative personnel and using new methodologies—such as deep design interviews—business leaders may find new and more predictive insights.



As during the period following the global financial crisis of 2008, while some real estate players go beyond just adapting and flourishing, others fade. Individual firms' abilities to weather the storm will depend on how they respond to immediate

challenges to the industry—particularly the current declines in short-term cash flow and demand for space, as well as the uncertainty surrounding commercial tenants' ability to pay their bills. In the medium to long term, the changed behaviors forced upon the industry will have likely altered the way consumers and businesses use and interact with real estate. The critical question is which of these changes will stick. Throughout, acting quickly and smartly will help determine the fate of players not only in these challenging times but also as the industry emerges from the current crisis and inevitably reinvents itself.

**Vaibhav Gujral** is a partner in McKinsey's New York office, where **Aditya Sanghvi** is a senior partner, **Robert Palter** is a senior partner in the Toronto office, and **Brian Vickery** is an associate partner in the Boston office.

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