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The great acceleration

The COVID-19 crisis has intensified existing trends, widening the gap between those at the top and bottom of the power curve of economic profit. Will your strategy keep you ahead of the accelerated pace of change?

by Chris Bradley, Martin Hirt, Sara Hudson, Nicholas Northcote, and Sven Smit

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The fault lines between industries and business models that we understood intellectually before the COVID-19 crisis have now become giant fissures, separating the old reality from the new one. Just as an earthquake produces a sudden release of pent-up force, the economic shock set off by the pandemic has accelerated and intensified trends that were already underway. The result is a dramatic widening of the gap between those at the top and the bottom of the power curve of economic profit[1]—the winners and losers in the global corporate-performance race.

Along with the accelerated pace of change, however, comes a unique opportunity to unlock big strategic moves. Our research found that companies that pursued big strategic moves persistently, through every phase of the economic cycle, increased their odds of outperforming their peers. Much of the organizational inertia that usually stands in the way of unlocking these big moves is now gone, as the crisis has rendered obsolete the budgets and personal targets that make such moves so hard to achieve.

Mind the gap

To understand how the COVID-19 crisis is shifting profit pools, we have used changes in market capitalization to calculate market-implied long-term economic profit for the largest companies globally.[2] While the question of whether share prices are a fair reflection of our new reality is open to debate, we aren't as interested in the overall market-capitalization levels as in the patterns emerging among companies and industries. And those patterns are meaningful, consistent across measurement periods and with our clients' experience, and very different from what we saw during the global financial crisis of 2008–09.

Our analysis reveals that the gap in economic profit between the top corporate performers and everyone else has widened dramatically. In effect, the crisis has accelerated a trend that was already present (Exhibit 1). Between December 2018 and May 2020, the top quintile of companies grew its total market-implied annual economic profit by $335 billion, while companies in the bottom quintile lost a staggering $303 billion. And while the specific numbers can fluctuate from day to day, the larger trend is unmistakable: a gap is opening up, and it's rapidly expanding. That's a pattern that has been evident since 2010. Now, the COVID-19 pandemic is pushing it to entirely new levels.

What's driving this widening chasm? So far, we aren't seeing a great reshuffling of industries and companies along the power curve as was the case during the global financial crisis, when companies in the electronics, energy, and financial-services sectors fell off their historical peaks. Rather, industries and companies that started at the top of the curve before this crisis are proving to be resilient, while those that were at the bottom are accruing the biggest losses.

This increased dispersion can be seen both across and within industries. Sectors that were at the top of the curve before the crisis, such as pharmaceuticals and semiconductors, seem to be pulling ahead from the less profitable industries that started at the bottom, such as banks and utilities (Exhibit 2). In fact, the six most-profitable industries have added $275 billion a year to their expected economic-profit pool, while the bottom six have lost $373 billion.

The dispersion of performance within industries is widening too. In fact, in 18 of the 23 industries we studied, companies that were in the top quintiles of

[1] See Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," *McKinsey Quarterly*, February 2018, McKinsey.com, based on *Strategy Beyond the Hockey Stick: People, Probabilities and Big Moves to Beat the Odds*, Hoboken, NJ: John Wiley & Sons, 2018.

[2] The sample consisted of the largest 2,562 listed companies in the world that had economic-profit data available in 2018, the most recent year with financial reporting available for all regions. To calculate the market-implied long-term economic profit in June 2020, we used the following variables: economic profit in 2018, change in market capitalization from December 2018 to May 2020 (monthly average), change in invested capital from 2018-reported figures to the end of May 2020 (estimate), and cost of capital. The patterns presented in this article were consistent across time periods and for different estimation methods.

Exhibit 1

The gap in corporate profits between the top performers and everyone else has widened dramatically.

Economic profit by quintile, $ billion (n = 2,562)[1]

[1]Largest companies by revenue in 2018 with data for 2003–18 available.
Source: Corporate Performance Analytics by McKinsey

their industries before the crisis are outperforming their peers that were in the bottom quintiles to an even greater extent than they had before.

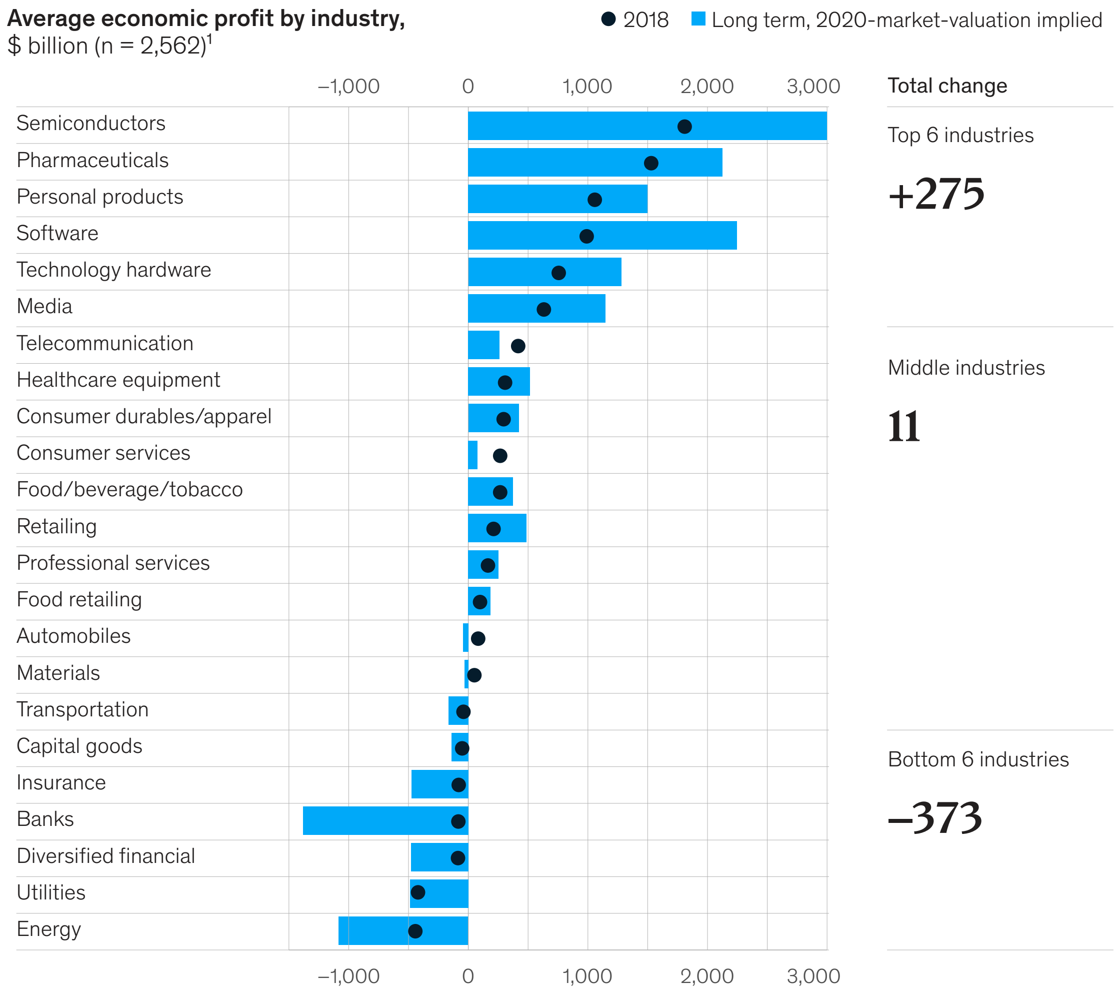
It would be easy to assume that the widening gap between those at the top and the bottom is simply because of the nature of this pandemic and the resulting demand shifts. While that has indeed played a role, it isn't the full story. What we are seeing is a *great acceleration of trends that existed* before the crisis. For example, online delivery's volume increased by the same amount in eight weeks as it had over the entire previous decade. Telemedicine experienced a tenfold growth in subscribers in just 15 days. Similar acceleration patterns can be seen in online education, near-shoring, and remote working, to name but a few areas. All these trends were clear before the crisis and have been amplified by it.

The industry data support this view (Exhibit 3). To a remarkable degree, industries that were experiencing declining economic profit before the crisis have suffered even greater declines because of it, while those that were growing their profit have seen outsize gains.

Companies with resilient, future-ready business models positioned to ride these trends have pulled further away from their industry peers, while

Exhibit 2

The best industries are getting better, and the worst are getting worse.



[1]Largest nonfinancial companies by revenue in 2018 with data for 2003–18 available.
Source: Corporate Performance Analytics by McKinsey

those with legacy business models have, for the most part, fallen further behind. For example, media companies with streaming services have outperformed their traditional satellite-based peers, and meal-kit providers have benefited from an accelerated trend toward healthy at-home cooking. Examples can be found in many other industries. During a recent quarterly earnings call, Microsoft CEO Satya Nadella said, “We’ve seen two years’ worth of digital transformation in two months.” *The quarter is the new year, and the fastest will win.*

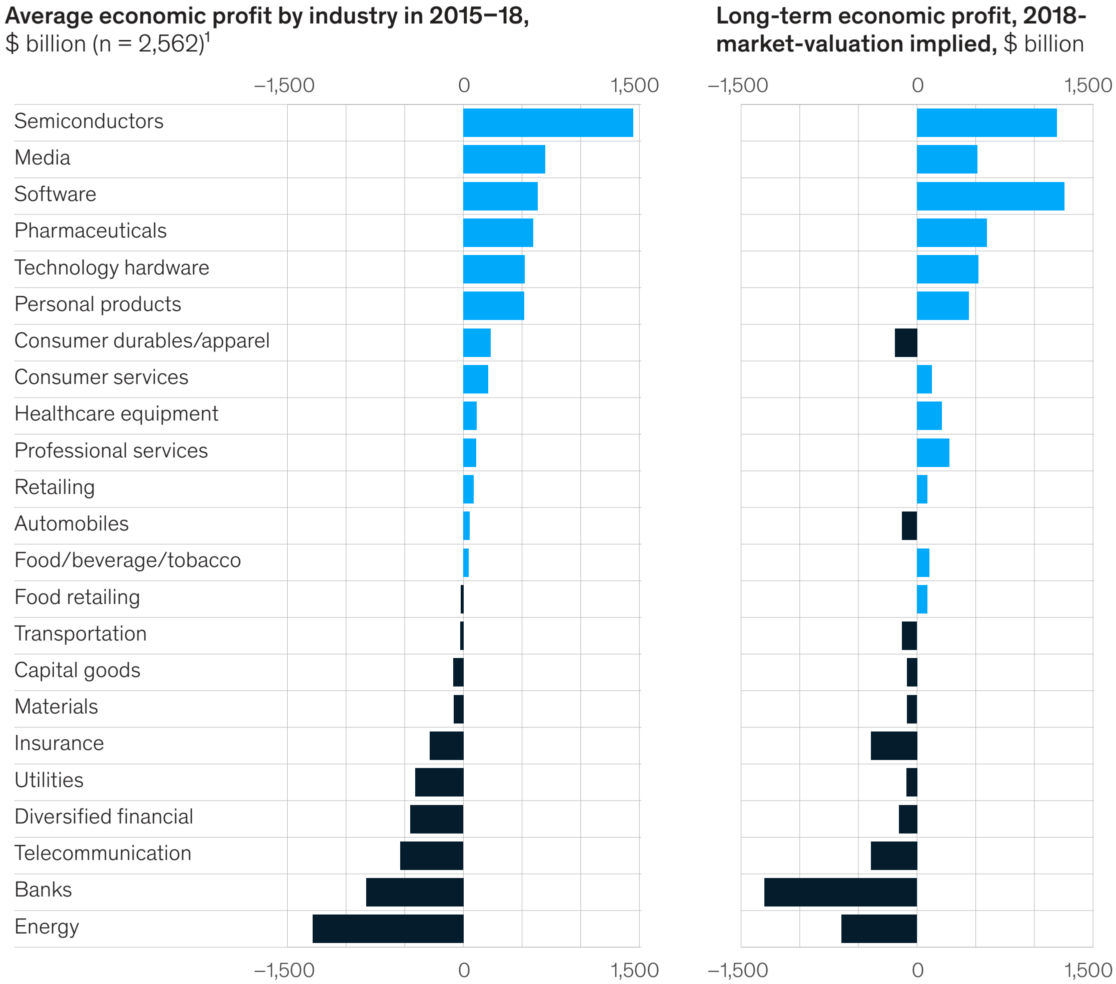
A unique window of opportunity

In many strategy rooms, the social side of strategy—misaligned interests, egos, and cognitive biases—creates inertia that gets in the way of organizations committing to big moves.[3] In times of crisis, however,

[3] Chris Bradley, Martin Hirt, and Sven Smit, “Eight shifts that will take your strategy into high gear,” *McKinsey Quarterly*, April 2018, McKinsey.com.

Exhibit 3

Industry economic-profit trends from before the COVID-19 crisis have been accelerated because of it.



[1]Largest nonfinancial companies by revenue in 2018 with data for 2003–18 available.
Source: Corporate Performance Analytics by McKinsey

the burning platform is clear, leaders are often in military-command mode, and precrisis budgets have become obsolete. Resources are easier to reallocate when no one needs to be convinced of the need for a rapid response and the individual targets set before the crisis no longer apply. Think of it as a big "unfreeze." As one CFO told us about shifting resources in recent months, "What I thought would never be possible, I can now do in two weeks."

Clearly, the crisis is affecting sectors and companies in very different ways. Some companies are achieving the best results in their corporate histories, and others are teetering on the verge of bankruptcy. Most are somewhere in between. What's the unique window of opportunity this great acceleration presents for your particular business?

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— *Top quintile.* For companies in the top quintile of economic profit and those thriving on the megatrends accelerated by the crisis, this could be the opportunity of a lifetime—and many are seizing it. Manufacturers of some hygiene-related products are aggressively expanding production capacity for the coming year. Pharmaceutical companies are reinventing their production- and regulatory-management systems to accommodate soaring demand. High-tech players are acquiring missing elements of their future ecosystems. E-commerce leaders are unleashing massive through-cycle spending on infrastructure, capacity, and even brand-portfolio expansion. If your business is in this position of strength, how do you plan to use your momentum to extend your lead?

— *Middle.* For companies with middling performance, this is a call to action. Can you use the unfreezing of your organization and its resources to leap into new trends, beating the odds to vault to the top of the power curve? We see companies in this position aggressively reallocating resources to new growth businesses. For example, some are giving the full go-ahead for the large digital- and analytics-transformation programs they had been slower to commit to under prepandemic conditions. Never let a crisis go to waste! If your business is in the middle of the performance curve, how do you avoid staying stuck there?

— *Bottom quintile.* For companies that find themselves in the bottom quintile by economic profit or in industries facing secular headwinds, it's imperative to avoid losing further ground and to start rebuilding momentum. Your starting position should encourage you to be bold. Radical portfolio or industry restructuring may be needed to enable you to close the widening gap to top performers. Even with market values down, this might be the right time to divest nonstrategic parts of the business. Companies that outperformed in the 2008–09 financial crisis divested underperforming businesses 10 percent faster than their peers did.[4] Buyers eager for a good deal are there, and if freed-up funds are used to reposition a company toward growth opportunities, the returns of such strategic moves could outweigh the lower proceeds of a divestiture. Are you realistic about the downside scenarios of this crisis and your business model's ability to compete in the next normal? Do you have a plan to avoid being drawn further into the downward spiral? How will you rebuild your momentum?

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[4] Martin Hirt, Kevin Laczkowski, and Mihir Mysore, "Bubbles pop, downturns stop," *McKinsey Quarterly*, May 2019, McKinsey.com.

Your decision making and execution are likely to be hampered by the high levels of uncertainty still present around the virus situation, but waiting for clarity may come at a high cost: our earlier research on corporate resilience clearly demonstrates that companies that move early in a crisis to get a jump on competitors often maintain that lead for years to come. As was the case in getting the virus outbreak under control, time is of the essence, requiring corporate leaders to take action now to get ahead of the great acceleration of trends already underway.

Creating a plan-ahead team can help.[5] Task this small group of high performers with shaping option-rich plans that are stress-tested against multiple scenarios. This will give you the confidence to know which moves are genuinely "no regret" and an understanding of where you need to keep your options open. Then, once you have developed a robust portfolio of moves, you can dynamically evolve your strategy as you learn more.

In many ways, we are only in the early stages of the economic fallout from the COVID-19 pandemic. Some companies may find themselves in a position of strength, while others will face challenging times. Regardless of your context, given the speed at which this crisis has been unfolding and the great acceleration of trends accompanying it, you will need to be faster, bolder, and more agile than ever before to succeed.

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[5] Yuval Atsmon, Chris Bradley, Martin Hirt, Mihir Mysore, Nicholas Northcote, Sven Smit, and Robert Uhlaner, "Getting ahead of the next stage of the coronavirus crisis," April 2020, McKinsey.com.

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